Information Duties

Japanese and German Private Law

Edited by

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Preface

In 2016, the Journal of Japanese Law celebrated its 20th anniversary. The Journal is jointly published by the Max Planck Institute for Comparative and International Private Law (MPI) and the German-Japanese Association of Jurists (DJJV) and aims to serve the needs of scholars, judges and legal practitioners who are interested in Japanese law. Its goal is to make all areas of the Japanese legal system accessible in a comprehensive and methodologically structured manner. At present the Journal is the world's only western-language publication which offers a regular and timely documentation and analysis of the myriad lines of development in Japanese law.

On the occasion of the 20th anniversary of the founding of the Journal, the MPI and the DJJV initiated two academic conferences aimed at an up-to-date comparison of German and Japanese law in selected areas of law which are of special comparative interest. The first was convened in Japan and the second in Germany. The Japanese conference focused on "Information Duties under Japanese and German Private Law". It was jointly organized by the DJJV, the MPI, the Chūō University in Tōkyō, and the Tōkyō office of the German Academic Exchange Service (DAAD) and took place on 23 September 2016 in Tōkyō at the German Cultural Centre. This Special Edition of the Journal presents the contributions to this symposium in an updated and edited version for an international readership.[1]

The conference brought together leading private and commercial law scholars from Japan and Germany to present a comprehensive analysis of the existence and functions of information duties in various areas of private law. Information duties in various forms have significantly increased over the last thirty years in Japan as well as in Germany. While the basic concept of information duties can be described as legal duties to provide, share, or make available certain information, the terms actually used in the various fields of law are inconsistent. In addition to information duties one can also find the terms disclosure duties, transparency obligations, and some others. Legal literature often points out the similarities among those types of duties, but it also engages in a search for functional criteria that allow for differentiating them from each other. While doing so, it has become apparent that these terms describe no clearly distinguishable legal concepts.

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1 The second conference on "Self-regulation in Private Law in Japan and Germany" was convened in Hamburg at the premises of the MPI on 4–5 November 2016. The contributions to that symposium are published in Special Issue No. 10 of the Journal.

The contributions to this volume aim first at classifying the various types of information duties and shedding light on their differences and similarities. Second, they compare the extent of the information's use, its specific contents, and the involved functions that can be observed in Japan and Germany, respectively. In so doing, this volume considers all forms of existing legal duties that involve the provision, the sharing, or the making available of information, regardless of the technical terms that are actually used, and also regardless of the involved subjects and forms of information.

Correspondingly, we see a varying range of requirements with respect to form and content. Some information duties require a provision in a specified form, e.g., in writing or as an entry in a specific register. In some cases, the content of the information is formalized by law, whereas in other cases the information to be provided has to be adjusted in scope and content to the individual circumstances of the addressee. Furthermore, the information duty may be stipulated for the benefit of an individual person, a particular group of people, or for the sake of the common good.

Information duties can be found in almost all fields of law: general civil law, consumer law, trade law, company law, insurance law, capital market law, insolvency law, and others. Certainly, there is already rich literature in Japan and Germany dealing with specific types of information duties from a stand-alone perspective limited to one field of law. But only a few analyses attempt to consider the abundance of information duties in their entity, to compare them, and to distinguish them from each other with respect to their specific functions. The same is true for a comparison of law. Until now there are only very few academic studies exploring information duties in Japan and Germany in a comparative context, and these are usually focused on one selected kind of information duty. To allow for general observations and analyses of the operation of private law system in both countries it is, however, indispensable to take into consideration numerous fields of law at the same time. This is what this volume attempts to achieve.

The volume opens with an analysis of information and disclosure duties from a law-and-economics perspective, provided by Prof. Dr. *Ulrich Schmolke* (University of Erlangen-Nuremberg), as a general introduction into the topic. The rest of the volume is divided in four parts. Section I deals with information duties in civil law. Prof. Dr. *Hisanori Nemoto* (Hokkaidō University) explores the concept of information duties in the field of property law in Japan. This involved a reflection on whether disclosure in public registers with regard to the ownership and transfer of property rights, which has been a common conventional element of property law in Japan and Germany for more than a hundred years, can be classified as a type of information duty. Thereafter, Dr. *Marc Dernauer* (Chūō University, Tōkyō) and Prof. Dr. *Carsten Herresthal* (University of Regensburg) examine in-

formation duties in the field of general contract law and consumer contract law in Japan and Germany respectively. The necessity of information duties is well acknowledged in both countries whenever there is an information disparity in a specific case or a structural information asymmetry between the contracting parties. As a further sub-field of civil law, information duties with regard to the founding and administration of non-profit legal entities are analyzed. Prof. Dr. *Makoto Arai* (Chūō University, Tōkyō) reports on the Japanese law while Prof. Dr. *Moritz Bälz* (Goethe University, Frankfurt) takes the part on Germany.

Section II deals with trade law and company law. Here, various forms of information duties with different functions could be taken into account: e.g., duties to inform specific entities, duties to inform a broader audience, and registers for the recording of specific information. Prof. *Masao Yanaga* (University of Tsukuba) reports on information duties in Japan with respect to individual and collective information as well as reporting. Three material weaknesses in the Japanese system are identified. Prof. Dr. *Ingo Saenger* (University of Muenster) distinguishes between information duties provided for in German trade law and information rights supplied by company law in Germany (the latter being duties to only a lesser extent traditionally) while acknowledging the ever extending mandatory duties to inform in the field of stock corporation law.

The subject of Section III is capital market law. Prof. *Gen Goto* (The University of Tōkyō) and Prof. Dr. *Harald Baum* (Max Planck Institute and University of Hamburg) explore the complex matrix of varying information duties in this field of law for their respective legal orders and supply a thorough overview on the surprisingly different regulatory architectures under both legal regimes. Special attention is paid to the challenges presently facing the "information model" that thus far has been regarded as the key regulatory concept of capital markets law.

Section IV, the final section, deals with insurance law, a field of contract law that features specific characteristics and an area in which information duties take on a particular relevance and assume specific functions. The Japanese insurance law is analyzed by Prof. *Yuji Ito* (Sophia University, Tōkyō), the German insurance law by Prof. Dr. *Gisela Rühl* (Friedrich-Schiller-University, Jena). Both contributions distinguish between the varying (pre-contractual) information duties of the insurers on the one hand and those of the policy-holders on the other.

This comparative analysis of information duties under Japanese and German law hopes to encourage legal academics and legislators on both sides to further reflect and (re)consider the necessity and scope of their existing information regimes especially in areas where the analyses re-

vealed that certain information duties exist only in one of the two countries or have a considerably different scope.

The organizers of the conference "Information Duties under Japanese and German Private Law" and the editors of this volume would like to express their gratitude for the generous financial support provided by the *Tokyo Club* and the *Egusa Foundation for International Cooperation in the Social Sciences*, which was essential for realizing this project. The editors would like to extend their thanks to *Janina Jentz* as well as to *Anna Katharina Suzuki-Klasen*, *Michael Friedman* and *Jocasta Godlieb* for their skillful and diligent support in editing this book.

Marc Dernauer	*Harald Baum*	*Moritz Bälz*
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March 2018

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Economic Foundations

Information and Disclosure Duties from a Law-and-Economics Perspective

A Primer

Klaus Ulrich Schmolke[*]

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I. INTRODUCTION

Information and disclosure duties are a means for overcoming information asymmetries between a party who holds a certain piece of private information and one who does not. The imposition of such information duties or, in short, "mandated disclosure" has been one of the favorite regulatory tools of social planners in the western world. Some authors even speak of mandated disclosure as being "ubiquitous" by now.[1] Indeed, for a long time information and disclosure duties appeared to be the proverbial "silver

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1 O. BEN-SHAHAR/C.E. SCHNEIDER, The Failure of Mandated Disclosure, in: University of Pennsylvania Law Review 159 (2011) 647, 650.

bullet" in the arsenal of lawmakers and regulators.[2] However, nowadays legal scholars and regulators have come to realize that ever more information does not necessarily lead to ever better decision making. In contrast, constantly growing evidence provided by behavioral economists and cognitive psychologists shows that human actors often struggle with the correct absorption and processing of relevant information due to their limited cognitive capacities. Even worse, more information may sometimes do more harm than good.[3] Thus, today the traditional regulatory technique of mandated disclosure is experiencing a crisis. Many scholars suggest major modifications of the current disclosure regimes.[4] Some even think of mandated disclosure as a complete failure.[5]

Against this background, lawyers and legal scholars are confronted with a crucial question: When is the imposition of information and disclosure duties warranted and when do such duties do more harm than good? In economics, the (overlapping) subdisciplines of contract theory, game theory and information economics deal with this very question when analyzing how information (and the lack of it) affects economic decisions. Those strands of economic research provide certain general concepts and insights which are applicable to diverse scenarios such as consumer contracts or capital market and securities transactions.[6] These concepts and insights can also help lawyers who tackle the question whether information duties are or should be mandated by the law in a specific context.[7] Drawing on the economic logic of a legal arrangement is a "functional" approach to law which is independent of the idiosyncrasies and path dependencies of a specific

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2 See, again, BEN-SHAHAR/SCHNEIDER, *supra* note 1, with numerous references and examples; as to the "disclosure paradigm" in EU private and business law, see W. SCHÖN, Zwingendes Recht oder informierte Entscheidung – zu einer (neuen) Grundlage unserer Zivilrechtsordnung [Mandatory Law and Informed Decision], in: Heldrich/Grigoleit et al. (eds.), Festschrift für Claus-Wilhelm Canaris [Liber Amicorum Claus-Wilhelm Canaris] (Munich 2007) 1191, 1194, with further references.

3 For further details, see *infra* sub V.

4 See, e.g., BEN-SHAHAR/SCHNEIDER, *supra* note 1, 742–749; O. BAR-GILL/O. BOARD, Product-Use Information and the Limits of Voluntary Dislcosure, in: American Law and Economics Review, 14 (2012) 235; from the German literature, e.g., SCHÖN, *supra* note 2, 1211; K.U. SCHMOLKE, Grenzen der Selbstbindung im Privatrecht [The Limits of Self-Commitment in Private Law] (Tübingen 2014) 849–856, 904–905.

5 BEN-SHAHAR/SCHNEIDER, *supra* note 1, passim.

6 Cf. P. MILGROM, What the Seller Won't Tell You: Persuasion and Disclosure in Markets, Journal of Economic Perspectives 22 (2008) 115.

7 For an introduction to contract theory especially for lawyers cf., e.g., K.U. SCHMOLKE, Contract theory and the economics of contract law, in: Towfigh/Petersen et al., Economic Methods for Lawyers (Cheltenham 2015) 96.

jurisdiction. Rather, law and economics provides an analytical toolbox that can be applied universally across jurisdictions. It can, therefore, be most fruitfully combined with a functional comparative analysis of the laws of different jurisdictions.[8] Having said that, the following analysis intends to point out and highlight that the issues relating to information duties which will be dealt with in the subsequent articles of this anniversary issue of the Journal of Japanese Law are functionally identical even where German and Japanese law come up with different solutions.

From an economic perspective the fundamental questions at issue are the following: (1) Do information asymmetries cause a welfare loss? (2) If so, can this loss be mitigated by imposing disclosure duties? (3) Are there other remedies besides information duties which are preferable from an efficiency perspective, whether because they are more effective or because they come at lower costs? This article addresses these questions by showing why and when information asymmetries lead to welfare losses (II.). Subsequently, it will be pointed out under which circumstances information duties may mitigate this problem and produce welfare gains (III.). However, information duties also come at a cost which may sometimes be higher than the gains to be had from mandatory disclosure (IV.). Furthermore, mandated disclosure has its limits where the disclosee is not capable of (correctly) absorbing and processing the disclosed information (V.). Against the background of the lessons learned, the article ends with a conclusion (VI.).

II. Imperfect Information as a Source of Welfare Loss

In order to illustrate the (potentially) harmful effects of information asymmetries from an efficiency perspective, the following analysis begins by showing that the well-known Coase theorem predicting allocative efficiency as a result of market transactions rests on the assumption of complete information (1.). In a second step, the harmful effects of information asymmetries on social welfare will be described (2.).

1. The Coase Theorem, Allocative Efficiency and the Assumption of Complete Information

As is well known, the Coase theorem presented by RONALD COASE in his seminal article "The Problem of Social Cost"[9] comprises two hypotheses,

8 For an outstanding example of such a combination see R. KRAAKMAN et al., The Anatomy of Corporate Law (Oxford et al., 2nd ed. 2009); from German literature cf. the groundbreaking reference work on information asymmetries in contract law H. FLEISCHER, Informationsasymmetrie im Vertragsrecht [Information Asymmetry in Contract Law] (Munich 2001).

one of which is the so-called *efficiency hypothesis*. This hypothesis has been formulated by GUIDO CALABRESI as follows: "If people are rational, bargains are costless, and there are no legal impediments to bargains, transactions will […] occur to the point, in short, of optimal resource allocation."[10] However, this ideal "Coasean world" bringing forth allocative efficiency and, thereby, welfare maximization, rests on the assumption that the transactions taking place are Pareto-efficient for the parties involved. This assumption, in turn, is only warranted where the parties to the transaction act voluntarily and are *both fully informed*.[11] Thus, where information is imperfect because one or all of the (potential) parties are not fully informed with regard to the relevant characteristics and specifications of the respective transaction, Pareto-efficient bargains are not warranted. This leaves room for state intervention, most notably the imposition of information and disclosure duties.[12]

2. *Information Asymmetries as a Source of Welfare Loss*

a) *The problem of adverse selection*

To show the detrimental effects information asymmetries may have on welfare, economists typically point to the problem of adverse selection. In his seminal article on the market for "lemons", GEORGE A. AKERLOF illustrated this deleterious dynamic by referring to the market for used cars:[13] Assume that there are only two types of used cars on the market, namely cars of good quality and cars of bad quality (so-called "lemons"). The sellers know the type of the cars they offer for sale, but the buyers do not. The buyers only know that there are good and bad cars on the market. Since they do not know more, they attach a probability of 0.5 to the car at hand being a good car and – correspondingly – an equal probability of 0.5 to the

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9 R. H. COASE, The Problem of Social Cost, in: Journal of Law & Economics 3 (1969) 1.

10 G. CALABRESI, Transaction Costs, Resource Allocation, and Liability Rules: A Comment, in: Journal of Law & Economics 11 (1968) 67, 68. The second hypothesis (so-called *invariance hypothesis*) states that this optimal resource allocation is independent of the initial allocation of legal entitlements.

11 See M. TREBILCOCK, The Limits of Freedom of Contract (Cambridge 1993) 102, referred to by M. EISENBERG, Disclosure in Contract Law, in: California Law Review 91 (2003) 1645, 1654.

12 However, there are further conditions to be met to make an argument in favor of information duties for reasons of efficiency (see *infra* sub III.–V.).

13 G. A. AKERLOF, The Market for 'Lemons': Quality Uncertainty and the Market Mechanism, in: Quarterly Journal of Economics 84 (1970) 488; the following summary of AKERLOF'S statements and conclusions has already been presented in SCHMOLKE, *supra* note 7, 101–102.

car being a bad one.[14] If we now assume that the good cars are worth ¥ 600,000 whereas the bad ones have a value of only ¥ 300,000, the expected value of each car being sold is ¥ 450,000.[15] In this scenario, the potential buyer is not willing to pay more than ¥ 450,000 for a used car. The seller of good cars is, however, not willing to sell for less than ¥ 600,000. As a consequence, the sellers of good cars are driven out of the market and only sellers of bad cars remain. Thus, even though there is a demand for good cars their supply dries up.

It only needs a slight change in our assumptions to show that this result is only the beginning of a deleterious "race to the bottom": Suppose that the cars remaining in the market are not of a single bad quality, but that their quality is equally distributed within a range of ¥ 200,000 (worst cars) to ¥ 400,000 (best of the bad cars). To put it differently, not the *actual,* but the *expected* value of the remaining cars is ¥ 300,000. After the good cars being worth more than ¥ 400,000 have dropped out of the market, the potential buyers adjust their expectations with regard to the value of the remaining cars for sale, accordingly. Since the potential buyers are, therefore, not willing to pay more than ¥ 300,000 for a car, also sellers of cars worth less than ¥ 400,000 but more than ¥ 300,000 drop out of the market. This game will repeat itself until there are only cars of the worst quality left for sale.

The bottom line of this "finger exercise"[16] is that the welfare-maximizing sale of used cars does not take place because the crucial information of the used cars' quality stays hidden from the potential buyers.[17] However, the dynamic of adverse selection is not an inevitable consequence whenever information asymmetries arise. It only occurs if certain conditions are met which go beyond the mere fact that information is distributed asymmetrically. We will come back to that when addressing the question of under which conditions there may be a case for imposing information duties on the knowing party.[18]

b) Wasteful costs of searching for information

In the market-for-lemons scenario we assumed that the potential buyers were not able to overcome their ignorance as to the quality of the used cars

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14 The latter follows from $pb = 1 - pg$, where pb is the probability of the car being a bad one and pg is the probability of the car being a good one.

15 0.5 x ¥ 600,000 + 0.5 x ¥ 300,000 = ¥ 450,000.

16 That is how AKERLOF himself characterized the example just given, see AKERLOF, *supra* note 13, 489.

17 Cf. already SCHMOLKE, *supra* note 7, 102.

18 See *infra* III.1.a)aa).

offered for sale.[19] But even if they (1) can overcome their ignorance and (2) have sufficient incentives to invest in the acquisition of the necessary information, a welfare loss in terms of wasteful transaction costs may occur.[20] With regard to our used-car scenario one might think of a "succession of prospective buyers hiring mechanics to inspect cars before purchase or, in the event of purchase in the absence of accurate information, further transactions that might be entailed in moving the goods to their socially most valuable uses, given the now fully revealed condition of the goods."[21]

III. WELFARE GAINS BY INFORMATION DUTIES

We have seen that imperfect information, in particular asymmetrically distributed information, can result in welfare losses. Thus, the imposition of information and disclosure duties that intends to supply the ignorant actor(s) with the lacking information promises to result in corresponding welfare gains. However, this kind of intervention is only warranted where the parties themselves ("the market") do not come up with a solution that is more favorable.[22]

1. Addressing the Problem of Adverse Selection

It, therefore, goes without saying that the problem of adverse selection illustrated above[23] does not justify mandated disclosure wherever information asymmetries occur. AKERLOF himself pointed to possible market solutions for this problem.[24]

a) Voluntary information

Information and disclosure duties do not lead to a welfare gain and are, therefore, at best unnecessary where the informed party has sufficient incentives to voluntarily reveal his or her private information to the uninformed party and is able to do so credibly.

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19 See *supra* sub 2.a).

20 Cf. EISENBERG, *supra* note 11, 1654, citing TREBILCOCK, *supra* note 11, 108.

21 TREBILCOCK, *supra* note 11, 108, quoted by EISENBERG, *supra* note 11, 1654.

22 This is, however, only a necessary but not a sufficient condition for state/legal intervention. Intervention by law or otherwise also requires that the costs of intervention do not wholly consume (or even exceed) the welfare gain accomplished by the intervention; cf. already SCHMOLKE, *supra* note 7, 99, and *infra* sub IV.

23 See *supra* II.2.a).

24 Cf. AKERLOF, *supra* note 13, 499.

aa) Signaling and the "unraveling" of information asymmetries through competition

The problem of adverse selection will not occur where (1) the informed party has sufficient incentives to reveal his or her private information and (2) the information is *verifiable,* i.e. can be easily checked once it is revealed,[25] by the addressees of the information.[26] If these conditions are met, the person holding the private information will reveal it. This results in a positive dynamic known as *unraveling,* which leads to the same results as mandatory disclosure.[27] A standard illustration of this principle is as follows:[28] Imagine there is a seller with a box of apples that can hold as many as 100 apples. The seller knows how many apples are inside the box, the buyer does not. What the buyer knows, however, is that the seller knows the number of the apples inside the box. After the sale the buyer can open the box and count the apples. If the seller lied about the number of apples, the buyer can claim damages. However, if the seller remained silent, the buyer has no remedy against him or her, regardless of the number of apples in the crate. Under these assumptions all sellers will voluntarily and truthfully disclose the number of apples in their crates. Why is that? Because the sellers having 100 apples in their crates want the buyers to know this fact in order to be able to charge an adequate price for 100 apples. Since the sellers of crates holding 100 apples have disclosed this information, sellers of crates containing only 99 apples are forced to do the same. Were they to remain silent, the buyers would share the belief that their crates contain 99 apples or less, since the sellers with 100 apples per crate have disclosed this information. Thus, also the seller offering crates which hold 99 apples disclose this information in order to be able to charge the best price. The same mechanism applies to sellers of crates holding 98 apples and so on. As a result, all sellers disclose their private information *(unraveling result).*

Let us come back to our used-car scenario described above:[29] The sellers of high quality cars have the same incentives to reveal their private information

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25 "Verifiability" of information can, however, not only stem from the fact that "buyers can directly check its accuracy", but may also be achieved by putting "institutions in place that effectively deter false claims by sellers"; see MILGROM, *supra* note 6, 116.

26 See D.G. BAIRD/R.H. GERTNER/R.C. PICKER, Game Theory and the Law (Cambridge/London 1994, 4th printing 2000) 89; also MILGROM, *supra* note 6, 121.

27 Cf. U. SCHWEIZER, Incentives to Acquire Information under Mandatory versus Voluntary Disclosure, in: Journal of Law, Economics, and Organization 33 (2017) 173, 174 in n. 1: "Unraveling means that voluntary disclosure will lead to the same result as mandatory disclosure."

28 See BAIRD et al., *supra* note 26, 89–90 for the following; also EISENBERG, *supra* note 11, 1678, refers to this example.

about the quality of their cars as the sellers of crates holding 100 apples. However, at least on the retail market the seller of used cars has a much harder time directly disclosing to the potential buyers her private information regarding the cars' quality in a credible way. In other words, the quality of the used cars is not as readily verifiable for potential buyers as the number of apples in the crate. Sellers may, though, get around this problem by otherwise *signaling* the quality of their cars. By applying such a strategy the holder of private information sends a signal which credibly reveals the quality of her product put up for sale so that the potential buyers, after the revelation, are capable of determining whether the product is of a good or bad quality. With regard to the used-car scenario the issuance of a warranty would be a signal with such properties. Since such a warranty is evidently much cheaper for sellers of good cars than for those selling bad cars because of the much lower probability of a defect occurring, the sellers of good cars can afford to send this signal, while it may be too expensive for sellers of bad cars.[30]

However, such a signal also comes at a cost for sellers of good cars. If the costs of viable signals are considerably high or, even worse, too high to be worth the effort, the imposition of disclosure duties enforced by sanctions may be a cheaper alternative to achieve (more) efficient results.

bb) Limits of information competition and selective disclosure

The (efficient) unraveling result[31] will not be achieved when the potential buyer is uncertain whether the seller actually possesses verifiable information or is at least able to produce such information by which she can distinguish herself from sellers of low-quality goods. Thus, the seller's silence does not necessarily mean that her goods are of low-quality but may instead only show that the seller does not possess the relevant information.[32] Knowing that the buyers cannot infer bad quality from silence, sellers "always withhold […] very bad news and report […] only relatively good news."[33] Even worse, this selective disclosure may lead to welfare losses due to exces-

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29 See *supra* II.2.a).

30 Cf. already SCHMOLKE, *supra* note 7, 102. AKERLOF, *supra* note 13, 499, himself pointed to this solution: "Numerous institutions arise to counteract the effects of quality uncertainty. One obvious institution is guarantees. Most consumer durables carry guarantees to ensure the buyer of some normal expected quality."

31 See *supra* sub I.1.a).

32 MILGROM, *supra* note 6, 121–123, who also points out the ensuing welfare loss; EISENBERG, *supra* note 11, 1678. One reason for the seller not possessing the relevant information about the quality of the good may be that testing is too costly to be worthwhile, cf. MILGROM, *supra* note 6, 117. As to the design of disclosure duties addressing the problem, see *infra* sub I.2.

33 MILGROM, *supra* note 6, 121, who also presents a model which captures this scenario.

sive quality testing by sellers.[34] The welfare losses ensuing from selective disclosure leave room for potentially welfare increasing state intervention aiming at the improvement of buyers' decisions.[35]

Information competition among sellers or, more generally, informed offerors of goods or services may also fail due to an even more fundamental and bothersome problem: The uninformed buyer (or offeree) may not know which characteristics of the offered object are of relevance or how to interpret information reported by the seller because he lacks the product-specific knowledge or general understanding. In this case the seller's voluntary revelation of private information comes to nothing.[36]

b) Disclosure duties

When analyzing disclosure duties from an efficiency perspective the question immediately arises whether these problems of selective disclosure and lack of understanding[37] can be solved by imposing disclosure duties on the seller/offeror. The answer is mixed. Let us first turn to the problem of selective disclosure. A seller's/offeror's duty to disclose what he or she *actually knows* does not solve this problem as long as the buyer or the courts are not able to verify ex post whether the seller has revealed all material information about the object sold which he knew about at the time of sale. Furthermore, even if the information is verifiable such a rule may provide the wrong incentives insofar as the seller may refrain from investigating the details of potentially negative events in order not to become cognizant of them.[38] These problems can be remedied by a rule that holds the seller liable for any undisclosed information he or she *should have known*.[39] Func-

34 For details, see MILGROM, *supra* note 6, 123–126; cf. also S. SHAVELL, Acquisition and disclosure of information prior to sale, in: RAND Journal of Economics 25 (1994) 20, 25, 28: "amount spent by sellers acquiring information is socially excessive". We will come back to this issue *infra* sub IV.1.c).

35 MILGROM, *supra* note 6, 122.

36 MILGROM, *supra* note 6, 126. The described lack of understanding may not only frustrate the goals of voluntary disclosure, but also of conventional mandatory disclosure rules. For further details, see *infra* sub 1.b and V.

37 See *supra* I.1.b.

38 MILGROM, *supra* note 6, 117 who refers to the example of a firm publicly offering its stock which is aware of disgruntled employees who could file an employment discrimination lawsuit. Cf. also EISENBERG, *supra* note 11, 1679: "A duty to disclose usually applies only to facts that an actor knows, and therefore does not provide the actor with an incentive to investigate."

39 MILGROM, *supra* note 6, 118, 127. As MILGROM himself points out, such a rule, however, only works properly if it is possible to establish ex post what the seller should have known and when. Cf. also SHAVELL, *supra* note 34, 35: "Enforcement

tionally, such a rule resembles a warranty.[40] From an efficiency perspective the seller should know all the relevant information which adds value that is greater than the costs of acquiring the information (search costs).[41] A prominent example for such a rule is the duty to draw up a prospectus when securities are offered to the public or admitted to trading and the attached liability of the persons responsible for the prospectus. Art. 6 of the new EU prospectus regulation[42] states, for example, that a prospectus "shall contain the necessary information which is material to an investor for making an informed assessment of: […] the assets and liabilities, profits and losses, financial position, and prospects of the issuer […]". And the German statutory basis for a liability claim (Sec. 21 et seqq. Securities Prospectus Act[43]) does not require actual knowledge of the incorrectness or incompleteness of the information given in the prospectus, instead considering it to be sufficient if the responsible person is ignorant thereof due to gross negligence.[44]

With regard to the lack-of-understanding problem, i.e. where the ignorant party does not even know which product specifications or other pieces of information are relevant in the case at hand, mandated disclosure may help. The problem may, for example, be mitigated where lawmakers or a regulator with sufficient sophistication specifies the relevant pieces of information to be disclosed.[45] Lawmakers may, however, content themselves with simply mandating the disclosure of "all material information". The aforementioned Art. 6 of the new EU prospectus directive is a mixture of both regulatory strategies. The problem with demanding the disclosure of "all necessary information" or "all material information" is that such rules may lead to the reporting of too much information and, thus, lead to information overload.[46] As a consequence, the unsophisticated addressee who

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requires discovery of concealment of information, and one suspects that our ability to uncover instances of this behavior is not great."

40 Cf. EISENBERG, *supra* note 11, 1679.

41 Cf. MILGROM, *supra* note 6, 124.

42 Regulation (EU) 2017/1129 of 14 June 2017, OJ L 168, 30.6.2017, p. 12.

43 *Wertpapierprospektgesetz (WpPG).*

44 Sec. 23 para. 1 German Securities Prospectus Act.

45 Cf. MILGROM, *supra* note 6, 118, 127: "The second problem, in which consumers don't know enough about the relevant product even to ask the most relevant questions, has different potential remedies. The simplest solution, in principle, is for an industry regulator who is an expert in the subject matter to mandate the relevant material disclosures. […] These kinds of required testing will also be complemented by various kinds of after-the-sale regulation, like laws against fraud, and implied warranties of merchantability or product fitness, all of which can sometimes mitigate problems in reporting and adverse selection issues more generally."

46 For further details on the problem of information overload, see *infra* sub V.1.

searches for the most important pieces of information may feel like he or she is looking for the proverbial needle in the haystack.[47]

2. *Beyond Adverse Selection: Disclosure Duties as a Means to Protect the Naïve*

The dynamic of adverse selection assumes skepticism of potential buyers that, in turn, is a consequence of the assumption of full rationality and high sophistication.[48] If we relax the assumption of rationality and sophistication and, therefore, assume less skepticism in potential buyers, sellers may strike deals with such buyers at a price that is not warranted by the information actually available to the buyer.[49] Under such assumptions, which are not unrealistic in the context of consumer decisions, mandated disclosure may reveal information to the potential buyer which helps him to make decisions which are closer to his actual preferences. This, again, leads to better results in terms of allocative efficiency.[50] This is what BEN-SHAHAR and SCHNEIDER allude to when they state that "[m]andated disclosure aspires to improve decisions people make in their economic and social relationships and particularly to protect the naïve from the sophisticated."[51] However, this result rests, again, on the crucial assumption that the addressee of the disclosed information really benefits from the disclosure because he is capable of absorbing and (correctly) assessing the information.[52]

3. *Saving Wasteful Costs of Searching for Information*

Disclosure duties may also help to save wasteful costs of searching for information. Recall the used-car example given above.[53] Whereas the seller who holds the private information regarding the car's quality can reveal this piece of information to the potential buyers at negligible cost, each and every potential buyer would have to incur search costs, e.g. by hiring a mechanic to inspect the car, in order to get the desired information about the car's quality. A duty to disclose the car's quality imposed on the seller would save the potential buyers the effort.[54]

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47 Cf. MILGROM, *supra* note 6, 118, 128.

48 Cf. MILGROM, *supra* note 6, 116 et passim: "[S]ophisticated buyers are consistently skeptical."

49 With regard to the used-car scenario (*supra* II.2.a) one might think of buyers purchasing a used car for ¥ 550,000.

50 Cf. *supra* sub II.1; and, e.g., TREBILCOCK, *supra* note 11, 112.

51 BEN-SHAHAR/SCHNEIDER, *supra* note 1, 649.

52 This point will be elaborated on *infra* sub V.

53 See *supra* sub II.2.b.

IV. THE COSTS OF INFORMATION AND DISCLOSURE DUTIES

Information and disclosure duties may not only produce welfare gains, but may also involve considerable costs. From an efficiency perspective, the imposition of such duties is, therefore, only warranted where these costs are lower than the welfare gains achieved.[55]

1. Curbing Incentives for the Production of Socially Useful Information

Firstly, mandatory disclosure may distort the incentives to acquire socially useful information. An actor has an incentive to search for such valuable information if she can expect to use this information to her advantage and the expected advantage exceeds the (expected) costs of searching. However, if the actor knows that the acquired information has to be disclosed before it can be used to reap a profit, she will not exert the effort in the first place because it is not worth the while. This problem can be illustrated by presenting the (simplified) facts of the famous US insider trading case *SEC v. Texas Gulf Sulphur Co.*:[56] Texas Gulf Sulphur (TGS), a mining company, conducts aerial geophysical surveys on over more than 15,000 square miles on the Canadian Shield in Eastern Canada in order to discover new mining grounds. These operations reveal numerous promising anomalies on certain segments of land, one of which is located near Timmins, Ontario. On this particular piece of land TGS conducts, in the next stage of its exploratory activities, a ground geophysical survey which confirms the anomaly. Subsequently, TGS carries out a diamond core drilling for further evaluation. The final findings are exceptionally promising. Therefore, TGS wants to purchase the land from the farmer owning it. Should TGS be compelled to disclose its findings on the mineral deposits under the farmer's land before the purchase is concluded?[57] If so, the farmer would adjust the price for his land accordingly. TGS would lose the possibility to reap a profitable return

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54 TREBILCOCK, *supra* note 11, 108, 112; EISENBERG, *supra* note 11, 1654, who gives another example in n. 10.

55 See already *supra* note 22.

56 401 F.2d 833 (2d Cir. 1968) *en banc*; for the popularity of this case as an example to illustrate the effects of mandated disclosure on the socially beneficial search for (and use of) information, cf. EISENBERG, *supra* note 11, 1652–1653, 1684–1685; also TREBILCOCK, *supra* note 11, 108–109, 112–113 ("the prospector case"); as to the latter, see, for further detail, *infra* sub 2.

57 According to TREBILCOCK, *supra* note 11, 117–118, one might perceive the knowing, but silent buyer (here: TGS) as perpetrating a "deliberate exploitation" of the ignorant seller who makes a less than fully autonomous choice since he is not fully informed.

on its considerable investment in acquiring the information.[58] In the end, this may prompt TGS to stop conducting this kind of costly exploration altogether.[59] In that case, mandated disclosure would leave "the farmer no better off, and the prospector and society at large worse off".[60]

a) *Adventitiously acquired information*

Against this background, economists as well as legal scholars distinguish between information that has been acquired adventitiously or otherwise effortlessly and information that has been acquired intentionally and by exerting costly effort.[61] As SHAVELL points out:

> "[I]nformation may come to a party by accident (as I pass by a secondhand bookstore, for example, and notice a rare book worth thousands of dollars marked for $5) or as a concomitant of ownership (by virtue of living in my house, I learn whether the basement leaks after a heavy rain). To the degree that this is the case, the issue of incentives to acquire information is moot; thus the freedom to keep information secret is not needed to spur its acquisition, and mandatory disclosure becomes attractive."[62]

The duty to disclose adventitiously or otherwise effortlessly acquired information may, in turn, strengthen the *incentives of third parties* to invest in the production of socially beneficial information. Take, for example, the issuer's duty to publicly disclose inside information which directly concerns the issuer as laid down in Art. 17 of the EU Market Abuse Regulation (MAR).[63] This provision is deemed to have a twofold purpose, one of which is the prevention of insider trading.[64] Insider trading is, in turn, prohibited in order to protect information traders' incentives to produce socially useful information.[65]

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58 EISENBERG, *supra* note 11, 1655, rightly points out that, while the mining company may reap a huge return on its investment in land with extensive deposits of minerals, the return is much more modest if one takes into account all the investments undertaken where the exploration activities did not reveal exploitable mineral deposits.

59 EISENBERG, *supra* note 11, 1655, but also 1690–1691.

60 TREBILCOCK, *supra* note 11, 112.

61 SHAVELL, *supra* note 34, 35; R.B. COOTER/T. ULEN, Law and Economics (Harlow, 6th ed. 2014) 349–350; A.T. KRONMAN, Mistake, Disclosure, Information, and the Law of Contracts, in: Journal of Legal Studies 7 (1978) 1, 9, 13 et passim; EISENBERG, *supra* note 11, 1656 ff., 1661 ff.

62 SHAVELL, *supra* note 34, 35 referring to KRONMAN, *supra* note 61. However, the freedom to keep information secret may be efficient on other grounds, cf. *infra* sub 2.

63 Regulation (EU) No. 596/2014 of 16 April 2014 on market abuse (market abuse regulation), OJ L 173, 12.6.2014, p. 1.

64 See, e.g., N. MOLONEY, EU Securities and Financial Markets Regulation (3rd ed., Oxford 2014) 730–731, with further references.

b) *Intentionally acquired information: Productive vs. redistributive information*

In contrast to adventitiously acquired information,[66] the protection of incentives to acquire information is a real issue with regard to intentionally acquired information, i.e. information that is acquired by a deliberate investment. However, from a social welfare perspective such incentives are only worth protecting where the acquired information adds value. COOTER and ULEN call this kind of information *productive information*. They contrast it with *redistributive information* that creates a bargaining advantage which can be used by the informed party to merely redistribute wealth in its favor without creating additional wealth.[67] Mere *foreknowledge,* i.e. information that will, in due time, be evident to all, is solely distributive in nature.[68] A famous example is the following case devised by CICERO: A seller ships crops from Alexandria to Rhodes, where the people are suffering from a famine. The seller knows that other ships loaded with crops are under way, while the suffering Rhodians – for the time being – do not.[69]

The freedom to keep merely distributive information secret provides misguided incentives to invest in the acquisition of such information. Since they produce no welfare gains, such investments are socially wasteful.[70] Even worse, further resources may be wasted by defensive measures taken to prevent losing wealth to a better-informed actor.[71] Therefore, economists widely agree that investment in the acquisition of redistributive information should be discouraged by mandated disclosure.[72]

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65 Cf., e.g., Z. GOSHEN/G. PARCHOMOVSKY, The Essential Role of Securities Regulation, in: Duke Law Journal 55 (2006) 711, 781: "The ban on insider trading shields information traders from competition by insiders and hence allows them to recoup their investment in information. Mandatory disclosure rules reduce information gathering costs."

66 See *supra* sub 1.1.

67 COOTER/ULEN, *supra* note 61, 349–350.

68 Cf. J. HIRSHLEIFER, The Private and Social Value of Information and the Reward to Inventive Activity, in: American Economic Review 61 (1971) 561, 562, who coined the term "foreknowledge" and contrasted it with "discovery", which is the "correct recognition of something that possibly already exists, though hidden from view."

69 M.T. CICERO, De officiis, Liber tertius, section 50 (English translation CICERO, On Duties, ed. by M. T. Griffin/E. M. Atkins (Cambridge 1991) 118–119). In the context at hand, the example is referred to by SCHWEIZER, *supra* note 27, 173, 188. Another example, given by COOTER/ULEN, *supra* note 61, 349, would be knowing before anyone else where the state will locate a new highway, which amounts to a crucial bargaining advantage in real-estate markets.

70 COOTER/ULEN, *supra* note 61, 349; SHAVELL, *supra* note 34, 21.

71 COOTER/ULEN, *supra* note 61, 349.

c) *Sellers' incentives to acquire information and mandatory disclosure*

The TGS case illustrates why the incentives of potential buyers' to acquire productive information should be protected.[73] But what about the sellers? As has already been mentioned with regard to the problem of selective disclosure,[74] sellers have excessive incentives to acquire information in the absence of a disclosure obligation because they can profit from revealing favorable information whereas they can keep silent about unfavorable information.[75] Mandated disclosure discourages such wasteful investments in the acquisition of information. At the same time, mandated disclosure leaves intact the sellers' incentives to acquire socially valuable information. That is at least true as long as the sellers are able to capture the value added by the information, e.g., to get a higher price for a product of better quality.[76]

Further considerations have been put forth to take a comparatively tougher stance on sellers than on buyers regarding the duty to disclose private information.[77] One argument in favor of buyers' freedom to keep information secret is to preserve their incentives to utilize this information.[78] Furthermore, it is suggested that the utility loss suffered by the seller due to forgone profits when compelled to disclose is smaller than the utility loss suffered by the buyer due to real out-of-pocket losses when left ignorant.[79]

2. *Curbing Incentives for the Efficient Utilization of Information*

Where the information is gained adventitiously, "the issue of incentives to acquire information is moot".[80] Does this mean that adventitiously acquired

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72 SHAVELL, *supra* note 34, 21; COOTER/ULEN, *supra* note 61, 349–350 who present a matrix with the two dimensions "Method by Which the Information Was Acquired" (= adventitiously vs. intentionally) and "Nature of Information" (= productive vs. distributive). Cf. also EISENBERG, *supra* note 11, 1666. CICERO, De officiis, Liber tertius, section 57, also claims with regard to his Rhodes hypothetical that the crop seller has a duty to disclose the fact that more ships are coming to Rhodes.

73 See *supra* sub 1.

74 See already *supra* sub III.1.a)bb) with n. 34.

75 SHAVELL, *supra* note 34, 21.

76 SHAVELL, *supra* note 34, 21; see also EISENBERG, *supra* note 11, 1674.

77 Cf., e.g., EISENBERG, *supra* note 11, 1674: "Given [the…] characteristics [of sellers as a class], a seller should always be required to disclose material facts concerning the property that she is selling."

78 TREBILCOCK, *supra* note 11, 113–114; see, for further detail, *infra* sub 2.

79 TREBILCOCK, *supra* note 11, 114; EISENBERG, *supra* note 11, 1674. This argument alludes to the so-called "endowment effect" and to "loss aversion"; for further details, see D. KAHNEMAN/J. L. KNETSCH/R. H. THALER, Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias, in: Journal of Economic Perspectives 5 (1991) 193.

information should always be disclosed?[81] TREBILCOCK answers this question in the negative and points to the discouraging effect of mandated disclosure on the efficient *utilization* of information.[82] TREBILCOCK'S argument can be illustrated by referring to SHAVELL'S example of the rare book offered in a second hand bookstore for a mere $5.[83] If the potential buyer of the book has to disclose the fact that the book in question is rare and valuable, the bookseller will adjust the price. As a consequence, the purchase of the book ceases to be a real bargain for the potential buyer. This would naturally dampen her incentive to buy the book, i.e. to utilize the information. Thus, a disclosure duty would make it much more likely that the book would stay in the store, its value unknown to a later buyer who might use the book as a paperweight. To put it in more general terms: In the event of mandated disclosure "the movement of resources from lower-valued to higher-valued uses" would be retarded.[84]

This consideration seems to work against mandated disclosure. However, EISENBERG regards TREBILCOCK'S argument as flawed. He himself claims that even under a duty of disclosure, the potential buyer would be allowed to sell the information to the bookseller.[85] Thus, incentives to utilize the socially valuable information remain under a mandate disclosure regime.

3. *Further Costs of Mandatory Disclosure*

The social planner who considers imposing duties of disclosure has to take into account further costs of this regulatory strategy. One cost factor which should not be underestimated is the implementation and administration of the disclosure requirements by the discloser.[86] That these costs can be considerable reveals itself when looking at the manifold disclosure obligations issuers of securities are under.[87] As BEN-SHAHAR and SCHNEIDER point out,

80 SHAVELL, *supra* note 34, 35.

81 This seems to be the position of COOTER/ULEN, *supra* note 61, 350–351.

82 As to the following see TREBILCOCK, *supra* note 11, 113–114.

83 See *supra* sub 1.1. This is, actually, what TREBILCOCK does when referring to his *The Wealth of Nations* hypothetical, cf. TREBILCOCK, *supra* note 11, 113–114.

84 TREBILCOCK, *supra* note 11, 113.

85 EISENBERG, *supra* note 11, 1660: "Even if A was under a duty to either disclose her information to B or abstain from contracting with B to purchase *The Wealth of Nations,* A would be free to sell the information to B, by making the following offer: 'You own something whose value is much greater than you realize. I will tell you what it is, if you agree to split the profit with me.'"

86 This point is stressed by BEN-SHAHAR/SCHNEIDER, *supra* note 1, 735–737.

87 Cf., e.g., MOLONEY, *supra* note 64, 736. The EU legislature acknowledged that these costs are a considerable burden for issuers. The new Prospectus Regulation, *supra* note 42, therefore, aims at a "reduction of administrative burdens" for issuers,

extensive disclosure duties carrying considerable implementation and administration costs also have anti-competitive effects insofar as they make it more costly for new market entrants to join the fray. This is, of course, just an exemplary, non-exhaustive enumeration of cost factors. More kinds of (unintended) costs can be thought of that move the scales towards abstaining from mandated disclosure.[88]

V. The Limits of Information and Disclosure Duties

Information and disclosure duties rest on the assumption that the information thereby revealed to the until then ignorant party adds to a more informed decision of that party which is, as a consequence, more in line with her actual preferences. This, in turn, leads to better results in terms of allocative efficiency.[89] In a world where this assumption is invariably correct, every piece of information is absorbed by the parties and correctly assessed with a view to its impact on the utility calculus of the decision at hand. The more information, the better the decisions that are made.[90]

1. Bounded Rationality and Information Overload

Unfortunately, this world is not ours. Rather, it is well-established knowledge that human actors only have a limited capacity to search for, absorb, and compute information. According to this insight, man is not an "optimizer" or "maximizer", but rather a "satisficer" who does not aim for the optimal choice, since it takes too much effort, but instead contents himself with a satisfactory option.[91] The severe limits of the human cognitive apparatus are illustrated by the fact that the item capacity limit of the human working memory is as low as seven information chunks (plus or minus two).[92] Due to the considerable limits on absorbing and computing information, the assumption that more information is better does not hold true. Rather, information quantity and complexity may be "too much" in the sense that it exceeds the processing capacity of the decision-maker. As a consequence of

especially SMEs, who seek access to financing on capital markets in the EU (cf. Recital 6 and 51 of the Regulation).

88 See, e.g., BEN-SHAHAR/SCHNEIDER, *supra* note 1, 737–742.

89 Cf. *supra* sub III.2.

90 Cf. also BEN-SHAHAR/SCHNEIDER, *supra* note 1, 650.

91 The concept of satisficing was invented by HERBERT SIMON; see, e.g. H. SIMON, Theories of Decision-Making in Economics and Behavioral Science, in: American Economic Review 49 (1959) 253, 262–264.

92 See G. A. MILLER, The Magical Number Seven, plus or minus Two: Some Limits on our Capacity for Processing Information, in: Psychological Review 63 (1956) 81.

such an *information overload,* decision quality will deteriorate.[93] Or to put it differently: From a certain point on the marginal utility of an additional piece of information becomes negative.[94] This may, for example, be due to the simple fact that the scarce attention of the recipient is diverted from the most relevant information to rather minor and ancillary pieces of information.[95]

2. *Lack of Understanding due to Deficient Prior Knowledge*

Furthermore, some information that is material to the contract requires a certain level of prior knowledge to be understood properly. If, for example, the bank communicates the annual percentage rate of charge attaching to a loan offered to a credit seeking consumer, this is meaningful information for the consumer only insofar as she has an idea of what the annual percentage rate of charge is. Numerous surveys show, however, that especially consumers often lack the knowledge and (basic) skills to make financial decisions that are in accord with their own preferences.[96] As a consequence of this *financial illiteracy,* the disclosure of certain features of a financial product may fall short of its aim.[97] To put it in the words of the business economists REISCH and OEHLER: "'If 50% do not know what 50% is,' then a lot of the established disclosure and information tools aimed at helping consumers are inadequate for a large part of the intended addressees."[98]

3. *Critique of the Conventional Disclosure Strategy and the Legislatures' Response*

The aforementioned findings lead many economists and legal scholars alike to the conclusion that it is not sufficient to exclusively rely on the (regulatory) strategy of providing especially consumers with ever more and better

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93 Cf., e.g., J. JACOBY/D. E. SPELLER/C. A.KOHN, Brand Choice Behavior as a Function of Information Load, in: Journal of Marketing Research, 11 (1974) 63; for a detailed account, BEN-SHAHAR/SCHNEIDER, *supra* note 1, 720–723.

94 For a summary in the context of credit agreements for consumers SCHMOLKE, *supra* note 4, 813–815 with further references.

95 See, e.g., MILGROM, *supra* note 6, 128: "Reporting too much information in this situation leads to information overload, in which the buyer may fail to notice the most relevant information."

96 For an overview, see, e.g. O. BAR-GILL AND E. WARREN, Making Credit Safer, University of Pennsylvania Law Review, 157 (2008) 1, 26–56.

97 See, e.g., BEN-SHAHAR/SCHNEIDER, *supra* note 1, 711–716.

98 A. OEHLER/L. A. REISCH, *Behavioral Economics: Eine Grundlage für die Verbraucherpolitik?, Vierteljahreshefte der Wirtschaftsforschung* [Behavioral Economics: A Basis for Consumer Policy?], 78 (2009) 30, 35: "Wenn aber 'fünfzig Prozent nicht wissen, was fünfzig Prozent sind', dann sind viele der bislang entwickelten Informationsangebote für Verbraucher für einen großen Teil der Zielgruppe nicht geeignet."

information.[99] Against this background, the "baroque abundance" of disclosure duties has been heavily criticized.[100] Some have even proclaimed "the failure of mandated disclosure".[101]

Despite this fundamental criticism, no one makes a case for discarding mandated disclosure as a regulatory strategy. Rather, economists and lawyers push for information disclosure that is "*very* brief, simple, and easy" to understand. They emphasize, furthermore, the importance of the format the information is presented in.[102] However, even such an improved disclosure regime has its limits. Therefore, modern economists and lawyers alike are convinced that additional regulatory measures are necessary to cope with the deficiencies of human decision makers. They propose, for example, the implementation of "sticky" default rules or point to expert advice.[103]

Modern legislatures have begun to react to the criticism of conventional disclosure rules and the suggested alternatives and are trying to take account of the (rather) new insights provided by behavioral economics. The EU legislature, for example, is trying to improve the digestibility and comparability of information by providing for relatively short documents that supply the disclosees (consumers, retail investors) with the core characteristics of a contract in a standardized form.[104] Furthermore, Art. 6 of the EU

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99 OEHLER/REISCH, *supra* note 98, 34: "Eine der wichtigsten Lehren aus der Behavioral Economics ist, dass der informationsökonomische Ansatz – man biete den Konsumenten mehr und bessere Information an – keineswegs ausreichend ist."; for further discussion, compare e.g., BEN-SHAHAR/SCHNEIDER, *supra* note 1, 742 ff.

100 See, for example, J. SCHÜRNBRAND, *Die Richtlinie über Wohnimmobilienkreditverträge für Verbraucher* [The Credit Mortage Directive], Journal of Banking Law and Banking, 26 (2014) 168, 170–171 ("barocke Fülle"), with regard to the creditor's duties of disclosure and transparency laid down in the EU Consumer Credit Directive, Directive 2008/48/EC of 23 April 2008, OJ L 133, 22.5.2008, p. 66, as amended by Regulation (EU) No. 2016/1011 of 8 June 2016, L 171, 29.6.2016, p. 1; more generally and with a view to mandated disclosure in the U.S., BEN-SHAHAR/SCHNEIDER, *supra* note 1, 686–687 et passim: "quantity problem".

101 BEN-SHAHAR/SCHNEIDER, *supra* note 1; see also BEN-SHAHAR/SCHNEIDER, More Than You Wanted to Know: The Failure of Mandated Disclosure (Princeton 2014).

102 BEN-SHAHAR/SCHEIDER, *supra* note 1, 743–745; OECD, Consumer Policy Toolkit (Paris 2010) 87–88; on the disclosure regime of the EU Consumer Credit Directive see also SCHMOLKE, *supra* note 4, 845–855.

103 See, e.g., BEN-SHAHAR/SCHEIDER, *supra* note 1, 746–749 with further references; for an evaluation of such (debiasing) strategies in the consumer credit context, see SCHMOLKE, *supra* note 4, 856–870.

104 For example, Art. 78 ff. of the UCITS Directive, Directive 2009/65/EC, OJ L 302, 17.11.2009, p. 32, as amended by Directive 2014/91/EU of 23 July 2014, OJ L 257, 28.8.2014, p. 186, provides for a Key Investor Information Document (KIID); similarly; Art. 14 with Annex II to the EU Mortgage Credit Directive, Directive 2014/17/EU of 4 February 2014, OJ L 60, 28.2.2014, p. 34, as amended by Regula-

Credit Mortgage Directive requires the member states to promote measures that support the financial education of consumers. And the new EU Prospectus Regulation[105] stresses that a "prospectus should not contain information which is not material or specific to the issuer and the securities concerned, as that could obscure the information relevant to the investment decision and thus undermine investor protection."[106] Furthermore, Recital 28 of the new regulation refers to the summary of the prospectus as

> "a useful source of information for investors, in particular retail investors", that should "focus on key information that investors need in order to be able to decide which offers […] they want to study further by reviewing the prospectus as a whole to take their decision".[107]

However, the attempts of lawmakers and regulators to reduce the load of information to be disclosed quite often appear rather half-hearted.[108] Many scholars suggest a more radical approach.[109]

VI. Conclusion

Information and disclosure duties are a powerful tool for overcoming information asymmetries and, as a consequence, improving efficiency. Some legal scholars even advocate a presumption in favor of disclosure.[110] How-

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tion (EU) No. 2016/1011 of 8 June 2016, L 171, 29.6.2016, p. 1, provides for a European Standardised Information Sheet (ESIS). As to the reduction of reading costs by the standardization of (form) contracts, see A.L. Wickelgren, Standardization as a Solution to the Reading Costs of Form Contracts, Journal of Institutional and Theoretical Economics, 167 (2011) 30.

105 See *supra* note 42.

106 See Recital 27 of the Regulation. In this context, cf. also Milgrom, *supra* note 6, 128, who refers to a securities prospectus to illustrate the problem of information overload: "One example [for the problem of information overload] is an initial public offering in which the investor receives a long prospectus listing so many possible risks […] that the most important risks fall out of focus."

107 As to the prospectus summary, cf., e.g., P. Schamo, EU Prospectus Law: New perspectives on regulatory competition in securities markets (Cambridge 2011) 94.

108 Cf. the critique of the disclosure rules of the EU Mortgage Credit Directive, *supra* note 104, by Schürnbrand, *supra* note 100, 174–175; Schmolke, Neue Informations- und Beratungspflichten (einschließlich Kreditwürdigkeitsprüfung) durch das Wohnimmobilienkreditrichtlinie-Umsetzungsgesetz, in: Groß et al. (eds.) Bankrechtstag 2016 (Berlin/Boston 2016) 51–52.

109 Cf., e.g., Ben-Shahar/Schneider, *supra* note 1, 743; as the disclosure regime of the EU Consumer Credit Directive see also Schmolke, *supra* note 4, 851–853 (suggesting a "price tag" for credit contracts).

110 Eisenberg, *supra* note 11, 1655 et passim, who calls this "type of presumption" the "Disclosure Principle". As to the question whether such a presumption is warranted see Trebilcock, *supra* note 11, 112.

ever, mandated disclosure is not warranted where the market participants have the incentives and the means to voluntarily disclose the material information to the intended disclosee.[111] Furthermore, mandated disclosure comes at a cost. When this cost exceeds the benefit in terms of social welfare, abstention from mandated disclosure is the superior choice. The freedom not do disclose may, for example, be indicated to protect incentives for the production of socially valuable information.[112]

Even where mandated disclosure is the efficient regulatory strategy under the assumption of full rationality, the effectiveness of disclosure duties is constrained by the bounded and sometimes deficient rationality of human decision makers. Perhaps the most important insight of behavioral economics for lawyers is that more information does not necessarily improve the decisions of the disclosees, but may rather have the opposite effect.[113] Legislatures around the world are trying to take account of the cognitive limits of humans not only by modifying existing disclosure rules so as to reduce and standardize the information load, but also by turning towards additional regulatory tools. These other tools include rather intrusive measures intended to insulate the addressees from the harmful consequences of their (possibly) deficient choices.[114] Art. 18(5) of the EU Credit Mortgage Directive[115] provides, for example, that the Member States shall ensure that "the creditor only makes the credit available to the consumer where the result of the creditworthiness assessment indicates that the obligation resulting from the credit agreement are likely to be met in the manner required under that agreement."[116] Similarly, the German financial supervisory authority (BaFin) recently made first use of a new product intervention option by restricting trading on contracts for difference (CFDs), justifying the restriction as a "necessary step to protect retail investors" given the risks associated with such financial products.[117]

Despite these developments, information and disclosure duties remain a valuable regulatory tool. Mandated disclosure has an advantage over more invasive alternatives insofar as it leaves freedom of contract to a large ex-

111 As to the "unraveling result" see *supra* sub III.1.a)aa).

112 See *supra* sub IV.1.

113 See *supra* sub V.1.

114 As to this development from a regulatory paradigm of "informed freedom of contract" to a more intrusive approach intended to prohibit or correct "wrong" contractual decisions, see SCHÖN, *supra* note 2.

115 Directive 2014/17/EU, *supra* note 104.

116 As to this paternalist provision, see SCHMOLKE, *supra* note 7, 109–110.

117 BaFin, Press release: BaFin restricts CFD trading, 8 May 2017, online available under: *https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Pressemitteilung/2017/pm_170508_cfd_en.html.*

tent unscathed. Against this background, it falls on the community of legal scholars to suggest mandated disclosure formats that limited rationality disclosees will find more understandable and readily digestible, this with the aim of rendering more intrusive measures dispensable. It can be hoped that the contributions to this issue of the Journal of Japanese Law will help to further this aim.

I. Civil Law

Information Duties in Relation to the Ownership and Transfer of Rights to Objects and Other Assets under Japanese Civil Law

Hisanori Nemoto[*]

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I. Introduction

The aim of this paper is to reveal a real function of information duties in relation to the ownership and transfer of rights to objects and other assets under Japanese civil law.

The information duty is an obligation of a party to a contract or a person who is negotiating a contract to provide the other party certain information in a proper way.[1]

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1 Information duty in this sense is usually called *"jōhō teikyō gimu"* or *"setsumei gimu"* in Japanese. See for example H. NAKATA, *Saiken sōron* [Law of Obligations

Traditionally, it has been thought that in Japan no such information duty exists from one person to another because the principle of private autonomy requires that one should, first, gather all the necessary information by oneself before deciding to enter into a contract and, second, evaluate the meaning and importance of the information at one's own risk.[2] Therefore, there are no regulations regarding information duties in the Japanese Civil Code (hereafter: Civil Code).[3] Furthermore, even today, this traditional view forms the fundamental principles underlying information duties in Japan.[4]

On the other hand, some scholars, referring to the German theory of *culpa in contrahendo,* began to suggest in the 1960s that a party negotiating a contract should compensate for loss incurred by the other party, under certain circumstances, as a result of his or her improper provision of information.[5] Based on this discussion and the so-called good faith principle set forth in Article 1, Paragraph 2 of the Civil Code,[6] the judiciary also gradually recognized such liability.[7] Currently, there is no objection either theo-

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(General Part)] (3rd ed., Tōkyō 2013) 124. Recently the former has been used more often. *"Jōhō teikyō gimu"* is presumably a translation of a French word "obligation de renseignement", while *"setsumei gimu"* comes from the German word "Aufklärungspflicht" (Y. HIRAI, *Saiken kakuron I jō, Keiyaku sōron* [Law of Obligations (Particular Part I a), Contract Law (General Part)] (Tōkyō 2008) 132). Meanings of the two Japanese terms are nowadays understood almost equally.

2 K. YAMAMOTO, *Keiyaku-hō no gendai-ka I* [Modernization of the Contract Law I] (Tōkyō 2016) 64 and 81. See also NAKATA, *supra* note 1, 124.

3 *Minpō,* Law No. 89/1896 and No. 9/1898, as amended by Law No. 71/2016; English translation: EIBUN HŌREI-SHA (ed.), EHS Law Bulletin Series (loose leaf, Tōkyō) Vol. II, FA-FAA, No. 2100-2101 (as of 2016).

4 The amendment of the law of obligations was concluded in 2017 and the new rules will come into force on the 1 April 2020 (this paper is based on the current version of the Civil Code): At the beginning of the deliberation for the amendment the possibility of introducing a new article that stipulates general information duties between two parties in the pre-contractual period was considered. However, the new article was in the end abandoned mainly due to the difficulty in precisely describing the necessary conditions for the duty.

5 See for example Z. KITAGAWA, *Keiyaku sekinin no kenkyū* [A Research of Contractual Liabilities] (Tōkyō 1963) 343–344, 356.

6 Article 1, Paragraph 2 of the Civil Code: "The exercise of rights and performance of duties must be done in good faith".

7 The discussion among scholars in 1990s was strongly influenced by French theories of "obligation de renseignement". Representative papers which analyse the French theories as a model for Japanese civil law are M. GOTŌ, *Furansu keiyaku-hō ni okeru sagi, sakugo to jōhō teikyō gimu (1)-(3)* [Fraud, Mistake and Information Duties in the French Contract Law], Minshō-hō Zasshi 102-2 (1990) 180, 102-3 (1990) 314, 102-4 (1990) 442, H. MORITA, *"Gōi no kashi" no kōzō to sono kakuchō riron (2)* [Structure of a "Defective Agreement" and Theories for Its Expansion (2)], NBL 483 (1991) 58-

retically or practically to the idea that one who is in the process of entering into a contract has an information duty to the other party and should take responsibility for a breach of the duty. Courts have already expressed their opinions in many concrete cases, addressing issues such as when a person should be burdened with the duty and what types of remedies are available to the other party for the breach of such duty.

As explained above, the theory behind the information duty under general civil law has developed in Japan through academic study, on the one hand, and through the judiciary on the other. Therefore, we must examine both in order to understand the real function of the duty.

II. General Theory behind the Information Duty

First, we should overview the general theory behind the information duty in Japan. This overview should at the same time serve as preparation for the subsequent analysis of judgments.

1. Information Duty for the Security of Self-determination

According to the prevailing opinion,[8] information duties are imposed on one party so as to eliminate any disparities in the quality and quantity of information and in the negotiating power between the two parties that might make self-determination difficult. The purpose of the duty is, therefore, to secure the freedom of self-determination of people who are in a more vulnerable position regarding the gathering of information and negotiating with others. This type of duty is usually called an "information duty for the security of self-determination".

As for the effects of a breach of the information duty, two possibilities are considered. One is the unwinding or annulment of the contract through cancellation, fraud, or mistake. The other is compensation for damages under tort law.

Regarding compensation, two different things can be regarded as constituting the substance of loss or the legally protected interest set forth in Article 709 of the Civil Code.[9] First, the right to self-determination can be

61 and M. YOKOYAMA, *Keiyaku teiketsu katei ni okeru jōhō teikyō gimu* [Information Duties in the Process of Concluding a Contract], Jurisuto 1094 (1996) 128–136.

8 Y. SHIOMI, *Saiken sōron I* [Law of Obligations (General Part) I] (2nd ed., Tōkyō 2003) 578.

9 Article 709 of the Civil Code: "A person who has intentionally or negligently infringed any right of others, or legally protected interest of others, shall be liable to compensate any damages resulting in consequence".

infringed when information is not provided or provided inappropriately.[10] In this case, the infringement results in mental suffering which should be compensated through a solatium.[11] Second, money that would not have been spent had the information been properly provided, e.g. the price actually paid for property, can also be considered a loss.[12] In this case the difference between the price and the real value of the property must be compensated. These two grounds are compatible with each other.

2. *Information Duty for the Achievement of the Contractual Purpose*

Many scholars[13] point out that in addition to "the information duty for the security of self-determination" there is another type of information duty. It is what is known as the "information duty for the achievement of the contractual purpose".[14] We find this type of duty where a person would have entered into a contract whether or not the information had been appropriately provided. For example, a food seller fails to tell the buyer how to keep the food fresh and as a result the food spoils. In this case, presumably, the buyer would have bought the food even if he or she were informed of the proper way to keep the food fresh. In other words, the self-determination of the buyer was not infringed by the improper provision (in this case, no provision) of information. However, because of the improper behaviour of the seller, the buyer did not receive the benefit that he or she intended to receive through the contract. Therefore, in this case, the inappropriate provision of information hinders the achievement of the buyer's contractual

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10 S. NISHIGORI, *Torihikiteki fuhō kōi ni okeru jiko kettei-ken shingai* [Infringement of the Right to Self-determination through Torts in Business Transactions], Jurisuto 1086 (1996) 86.

11 For instance, A. KUBOTA, *Torihiki kankei ni okeru fuhō kōi* [Torts in Business Transactions], Hōritsu Jihō 972 (2006) 72 indicates the possibility of such a compensation with a solatium.

In Japan, a person whose rights or legally protected interests were infringed can claim in general a solatium against the infringer. See Article 710 of the Civil Code: "Persons liable for damages under the provisions of the preceding Article must also compensate for damages other than those to property, regardless of whether the body, liberty or reputation of others have been infringed, or property rights of others have been infringed."

12 Y. HASHIMOTO, *Torihiki-teki fuhō kōi ni okeru kashitsu sōsai* [Comparative Negligence in Cases of Torts in Business Transactions], Jurisuto 1094 (1996) 153 and Y. HASHIMOTO, *Fuhō kōi hō ni okeru sōtai zaisan no hogo* [Economic Losses and Japanese Tort Law], Hōgaku Ronsō 164-1=6 (2009) 408–410.

13 For example, SHIOMI, *supra* note 8, 582–583, HIRAI, *supra* note 1, 134, and NAKATA, *supra* note 1, 128.

14 YOKOYAMA, *supra* note 7, 130–131, insisted on, based on a French theory, the existence of this type of information duty in Japan for the first time.

purpose. Putting it the other way around, the information duty of the seller is not to secure the self-determination of the buyer but to ensure the fulfilment of his or her purpose. So, we should understand this duty as based on the contract itself; consequently, whether or when one party owes this duty to the other depends on the nature of each contract.[15]

As for a breach of the information duty for the achievement of the contractual purpose, only compensation for damages will be taken into consideration.[16] In contrast to a breach of the information duty for the security of self-determination, the unwinding of the contract is, namely, not allowed because, as explained above, the buyer here would have concluded the contract with the seller regardless of the latter's improper provision of the information, and thus the right to self-determination of the buyer about entering into the contract was not infringed through the act of the seller. Therefore, in this case it is not necessary to reject the validity of the contract itself.

III. Analysis of Cases Regarding the Information Duty in Relation to the Ownership and Transfer of Rights to Objects and Other Assets

In this section, we will analyze cases concerning the information duty in relation to the ownership and transfer of rights and other assets. However, before we begin the analysis, its subjects and method (e.g. the nature and limitations of the cases) must be discussed. In addition, one general rule about the information duty which can apply to all the cases should also be clarified in advance.

1. Subjects and Method of Analysis

As for the subjects and method of the analysis, first, the analysis is based on 62 Japanese court judgments (two from the Supreme Court, 60 from lower courts) that have been published in law reports.[17] Naturally, they do not encompass all the cases that address the information duty we are now examining. However, this number seems to be sufficient to investigate practice trends and that is precisely what the following analysis attempts to do.

Second, the cases are categorized according to the nature of the conflict into five different types because it is presumed that the necessary condi-

15 See SHIOMI, *supra* note 8, 583.

16 YOKOYAMA, *supra* note 7, 130.

17 The list of the judgments (as of 31 March 2017) can be found at the end of this article. In the following analysis each judgment will be specified by its number on the list.

tions for the duty and the effects of its breach will reflect the particular character of each conflict and therefore will be different.

Third, most of the cases involve conflicts relating to the transfer of the ownership of immovable properties. From the extent of my research, there are almost no cases that specifically address an information duty regarding the transfer of ownership of movable properties. The probable reason for this will be discussed at the end of this article. Cases regarding the trade of stocks, securities, and insurance were excluded from the analysis because there will be a separate paper on these types of properties.

Fourth, there are two categories of transactions depending on the parties concerned. The first situation involves a real estate buyer and seller. The second involves a real estate buyer and a real estate broker retained by the seller. In this second category, there is no contractual relationship between the broker and the buyer. In Japan, real estate brokers must be licensed and have to follow the regulations set forth in the Real Estate Brokerage Act.[18] According to the Act, a broker retained by a seller must, at the same time and to a certain degree, also respect the rights of the buyer.

Finally, it has to be noted that there are several cases that do not fit within a specific type of conflict.

2. The Limit of "Information" that Should Be Provided – A General Rule

In the trade of immovable properties, not every item of information and every detail about a property have to be provided by its seller or the real estate broker retained by the seller. To put it in another way, the information which a seller or a real estate broker is obliged to tell his or her buyer is limited. Regarding the criterion for the limit, one judgment[19] suggests that only information which is considered as a significant and influential factor for deciding whether to purchase a property must be disclosed, and whether the information is "significant and influential" should be evaluated not from the subjective view of the real buyer but from the perspective of an "ordinary person" based on the standard of the "socially accepted idea". Therefore, under this criterion it will not be regarded as a breach of the information duty that a seller did not, for instance, disclose a fact which cannot, as considered from the above-mentioned perspective, be viewed as "significant and influential" for making the decision. Presumably, many courts follow such a criterion tacitly. In fact, all the information in the cases which we are going to analyze below seems to satisfy this criterion.

18 *Takuchi tatemono torihiki gyō-hō,* Law No. 176/1952, as amended by Law No. 56/2016.

19 Judgment No. 23.

3. *Analysis of the Five Types of Conflict*

In the following section, we will examine each type of conflict, focusing on the necessary conditions for the information duty.

a) *Conflict over the current state of the property*

The first type of conflict is over the current state of the property. The meaning of "state" is here understood broadly. In addition to the physical state of a piece of land or a building, things such as the actual value of a property in the market or an original poor view from a single room in a large apartment building[20] or the fact that a former resident of the house committed a suicide there also belong to the "state" of the property.

According to the judgments,[21] when the exact state of a piece of real estate at the moment of the agreement was not explained by the seller or the real estate broker retained by the seller and the buyer finds out later that it is not suitable for his or her contractual purpose, the buyer can bring suit for damages against the seller or the real estate broker who knew of the fact at the time of concluding the contract by alleging a breach of the information duty. An example is as follows: where a real estate broker retained by the seller realizes that the ground on a parcel of residential land is so weak that the ground might sink in the future, the broker must disclose this fact to the buyer. In the event the ground actually does sink after executing the contract and the broker neglected to disclose the fact in advance, the seller must assume responsibility.[22]

Furthermore, professional sellers should be burdened vis-à-vis buyers with a duty to investigate the actual state of a property to a certain degree and to explain it to buyers correctly.[23] Therefore, professional sellers are liable to buyers when they have negligently failed to recognize the current

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20 A case in which a view that was originally good at the time of concluding a contract got worse afterwards because of an environmental change to the building is classified under the third type of conflict (conflict over future environmental changes to the property).

21 Judgments Nos. 16, 18, 19, 26, 29, 31, 32, 35, 36, 38, 39, 40, 41, 42, 43, 44, 46, 47, 49, 51, 52, 54, 55, 56, 58 and 59. Judgments Nos. 60, 61 and 62 can also be understood as judgments that denied any knowledge on the part of each seller regarding the current state (weakness) of the property.

22 This is the conclusion of Judgment No. 31.

23 Judgments Nos. 35, 39 and 54. Conversely, Judgment No. 32 clearly denies such a responsibility. However, an anonymous comment on this judgment (Hanrei Taimuzu 1115 (2003) 186) thinks the decision is questionable and suggests that a real estate broker retained by the seller who could have recognized a defect of the property and indicated it to the buyer should be liable.

state of the property (and could not consequently inform the buyers appropriately). This type of information duty (a duty of investigation) owed by professional sellers can be justified with Article 35 of the Real Estate Brokerage Act.[24] Pursuant to Article 35, a professional seller has an obligation to explain to buyers, before entering into a contract, actual states of the property that are generally regarded as important matters for buyers who are making a decision to (or not to) purchase the property. Naturally, for a proper explanation, the sellers must investigate the state beforehand. The Tōkyō High Court stated in a judgment in 1977,[25] as a general principle, that the obligation of professional sellers under Article 35 of the Real Estate Brokerage Act is a duty that they owe to buyers under private law.[26]

On the other hand, it is not easy to say whether courts think that a real estate broker retained by the seller is also obliged to buyers to investigate the current state of a property. One judgment[27] affirms such a duty in general, while another two judgments[28] reject it.

Moreover, several courts[29] seem to have held that a non-professional seller basically has no such duty of investigation.

In addition to liability due to the infringement of the information duty, in this type of conflict a buyer can also pursue the liability of his or her seller based on the warranty against defects set forth in Article 570 of the Civil Code.[30] In fact, in two cases[31] the liability of the seller is approved primarily on the grounds of the warranty.

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24 Judgment No. 54.

25 Judgment No. 4.

26 See also HIRAI, *supra* note 1, 133–134.

27 Judgment No. 54. As the concrete conclusion to the case, the judgment denied a breach of the investigating duty of the broker retained by the seller about the state of the property (here, a suicide of its former resident).

28 Judgments Nos. 58 and 59 (The latter is an appeal court judgment of the case which the former judgment judged as a first instance). Both judgments said, however, that a real estate broker retained by the seller who knew a fact (here, also a suicide of a former resident of the property) by accident must notify the buyer of the fact.

29 Judgments Nos. 42, 44, 46, 47, 49 and 51. See also Judgment No. 52.

30 Article 570 of the Civil Code: "If there is any latent defect in the subject matter of a sale, the provisions of Article 566 shall apply mutatis mutandis; provided, however, that this shall not apply in cases of compulsory auction." Article 566, Paragraph 1 of the Civil Code: "In cases where the subject matter of the sale is encumbered with for the purpose of a superficies, an emphyteusis, an easement, a right of retention or a pledge, if the buyer does not know the same and cannot achieve the purpose of the contract on account thereof, the buyer may cancel the contract. In such cases, if the contract cannot be cancelled, the buyer may only demand compensation for damages."

31 Judgments Nos. 31 and 39.

b) Conflict over administrative regulations

The second type of conflict involves administrative regulations. A typical example of such a regulation is Article 56 of the Building Standards Act,[32] which provides different height limits for buildings in various urban areas.

In this type of conflict courts[33] presumably apply a similar rule about information duties as the one applying to the first type of conflict.

First, professionals who regularly sell immovable properties for business must investigate and explain relevant regulations[34] to buyers. Although all the judgments concern themselves with cases in which a professional seller did not explain to a buyer the existence of an administrative regulation that the seller had knowledge of, it is nevertheless assumed that these judgments have no intention to affirm the responsibility of professional sellers only for these cases. Furthermore, the ruling about the investigating duty of professional sellers – based on Article 35 of the Real Estate Brokerage Act – in relation to the first type of conflict can apply also to administrative regulations because Article 35, Item 2 of the Real Estate Brokerage Act imposes a duty on professional sellers to inform buyers of administrative regulations that govern the contractual object. Therefore, when a professional seller does not identify and explain a relevant regulation to a buyer, either intentionally or negligently, the seller or broker will be held liable for the buyer's loss. For example, in a case where a buyer has purchased a piece of land from a professional seller in order to build a house upon it but the buyer cannot build the house as tall as he or she originally intended because of Article 56 of the Building Standards Act, the seller should assume responsibility if he or she did not investigate or explain to the buyer that the grounds come under the regulation.

Second, real estate brokers retained by the seller, who like professional sellers similarly have to explain to the buyers the existence of relevant administrative regulations on a property based on Article 35, Item 2 of the Real Estate Brokerage Act, are equally burdened with the duty to investigate the relevant[35] regulations in advance.[36] This duty of the broker is an important difference between this type of conflict and the first type.

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32 *Kenchiku kijun-hō,* Law No. 201/1950, as amended by Law No. 72 /2016.

33 Judgments Nos. 5, 7, 8, 9, 12, 13, 14, 15, 17, 27, 48, 53 and 57.

34 On the meaning of the "relevant" regulations, see the following footnote.

35 Not all administrative regulations are regarded as the "relevant" regulations here. Judgment No. 14 held, for example, that a real estate broker retained by the seller had no obligation to the buyer to investigate whether a property fell under the regulatory scope of Article 93 Paragraph 1 (former Article 57-2) of the Cultural Properties Protection Act (*Bunka-zai hogo-hō,* Law 214/1950, as amended by Law 2014) governing unexcavated cultural properties.

Third, the liability of a non-professional seller depends on whether he or she knows of the existence of the administrative regulation at the time of entering into a contract; when the seller knows of it, he or she should disclose this fact to his or her buyer.[37] However, according to several judgments,[38] a non-professional seller has no general obligation to investigate what kind of administrative regulations exist on his or her immovable property. Therefore, the seller will not be held responsible for loss of the buyer, even if it turns out afterwards that the buyer cannot use the property as he or she first hoped to due to an administrative regulation which the seller was not aware of.

c) *Conflict over future environmental changes to the property*

The third type of conflict involves future environmental changes to the property. A classic example of this type of conflict is a case in which shortly after the sale of a single room in a large apartment building, a high building is built, blocking the south side of the apartment. The buyer, who did not expect the construction of a new building, can no longer enjoy the benefit of sunlight or the view because of the obstruction. The buyer brings suit against the seller or the real estate broker retained by the seller for the compensation of damages. In such a conflict, the most important issue becomes whether or under what circumstances, at the time of making the agreement, the seller or the broker has an information duty regarding future, potential environmental changes near the property.

Courts have held on this issue that the seller – regardless of whether he or she is a professional – and the broker typically have no obligation to investigate the possibility that the environment may change in the future;[39] consequently, there is no duty to provide such general information. However, when an environmental change is already planned and the seller or the broker knows of this fact, then he or she must advise the buyer.[40] Therefore, in the above-referenced case, if the seller or broker had already known of the plan for the construction of a new building next to the apartment at the moment of concluding the contract and nonetheless did not disclose this fact, he or she would be liable due to the breach of the information duty.[41]

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36 Judgment No. 14.

37 Judgment No. 15.

38 Judgments Nos. 7 and 17.

39 Judgments Nos. 3, 10, 11, 21, 22, 24, 25, 28, 33, 45 and 50.

40 However, a single judgment, No. 6, runs counter to this ruling. It says that a seller who knows of a concrete plan to change the environment does not necessarily have to inform his or her buyer of the plan. This relatively old judgment can be regarded today as an insignificant deviation from the current standard of the judgments.

d) Conflict over a lower price in the future for property of equal value

The fourth type of conflict involves a conflict over a potentially lower price in the future for property of equal value.

This type of conflict typically occurs between a seller of many single rooms in one large apartment building and a buyer of a single room in that building. Does the seller have to explain to the buyer at the time of entering into a contract that he or she might sell a similar room at a reduced price in the future? Should the seller be liable for the loss incurred by the buyer based on a breach of the information duty when he or she was not informed of such a possibility and where such information would have prevented the buyer from purchasing the single room as he or she would have waited for the price reduction had he or she known of it? Such conflicts were common in Japan during the severe economic depression of the 1990s as the value of most immovable properties dropped radically.

Courts have ruled on this fourth type of conflict similarly to their rulings on the third type.[42] Namely, sellers have in principle no duty to explain the general possibility of a price reduction that may happen in the future. However, according to the Supreme Court,[43] when the seller knows that the present price of the single room is so high that he or she cannot obtain the same price for a similar unit in the near future – meaning he or she needs to reduce the price radically at other sales – and when the seller does not explain this fact to the buyer, thereby severely violating the good faith principle (Article 1, Paragraph 2 of the Civil Code), then the seller will assume responsibility.

The case on which the judgment of the Supreme Court was based is as follows. A public corporation (Y) which owned a housing complex had decided to rebuild the complex and told X and others who had rented residential units in the complex that Y would provide them with the opportunity to preferentially purchase residential units of the new housing complex prior to public subscription, but only if X and others entered into new sales contracts with Y beforehand and evacuated their current units by a certain date. X and others thought that this offer of Y was aimed at enabling them to secure residential units in the new housing complex without taking part in a lottery, on the premise that Y would offer the remaining unsold residential units for public subscription immediately after the preferential offer to X and others and that the price offered for the public subscription would be at least the same as that offered to them. On the other hand, Y knew at the time of concluding the sales contracts with X and others that the price offered to them was too high

41 This was in fact the conclusion of judgment No. 24.

42 Judgments Nos. 1, 20, 30, 34 and 37.

43 Judgment No. 2. Judgments Nos. 34 and 37 that were issued by the initial court and by the appeal court on the case also reflect the same view.

to solicit purchasers though public subscription, and thus Y actually had at that time no intention of offering the remaining units for public subscription soon after the offering to X and others. However, Y did not explain these facts to X and others at all. It was not until three years after the sales contracts with X that Y offered the remaining unsold residential units for public subscription at a lower price than that offered to X and others. The average rate of the price reduction was about 25% (stated in figures, the amount of reductions was roughly 8,500 million yen on average).

Based on these circumstances, the Supreme Court stated that Y's failure to notify X and others of its lacking an intention to offer the remaining unsold residential units for public subscription immediately after making the offer to them deprived X and others of the opportunity to assess the appropriateness of the offer price sufficiently before deciding whether or not to conclude the sales contracts with Y. Moreover, Y's behavior in this manner can be regarded as a severe violation of the good faith principle set forth in Article 1, Paragraph 2 of the Civil Code. Therefore, Y infringed the information duty toward X and others illegally and hence should be held responsible for their losses.

Scholars, without exception, support these rulings by the Supreme Court. It can be said that in this case X and others in fact lost the freedom of self-determination, believing that they had had to enter sales contracts immediately with Y at the price offered by Y in order to keep residential units in the new housing complex because most of the residential units would be bought at the same price by third persons at the public subscription that would have taken place shortly after the offering to X and others. This misunderstanding of X and others was mainly caused by Y's having demanded the conclusion of "preferential" contracts with Y, which, as a professional seller, had much more information about the current situation in the immovable properties market than X and others, and which did know at that time that such a future purchase of the remaining unsold residential units would not – more accurately stated, objectively could not – occur. Under these circumstances Y's intentional silence as to the facts can be considered "almost as fraudulent".[44]

At the same time, however, it should be noted that the judgment of the Supreme Court affirming the liability of a seller for breach of an information duty in the fourth type of conflict is very exceptional. The Supreme Court itself indicates this by requiring that the conduct of a seller must violate the good faith principle "severely". Principally it is buyers who

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44 This is stated by T. KOGAYU, *Torihiki ni okeru setsumei gimu (1)* [Information Duties in Trade (1)], in: Hirose/Kawakami (eds.), *Shōhi-sha-hō hanrei hyakusen* [Selection of 100 Important Cases for Consumer Law] (Tōkyō 2010) 35.

have to assume the risk that the price of a property identical or similar to the one he or she purchases might drop in the future.[45]

e) Conflict over how to properly use the property

Lastly, the Supreme Court held in a 2005 judgment[46] that there is a breach of the information duty of a seller when he or she did not explain to the buyer how to properly use the property. In this case, upon delivery to the buyer, the company which sold a condominium did not explain where the buyer could find the switch or how to operate the switch to open a fire door located in the condominium. When a fire later broke out, there was increased loss to the buyer's condominium because he was unable to open the fire door. According to the judgment, the seller had a duty to instruct the buyer on the details of the switch as a contractual duty ancillary to the main duty to deliver; therefore, the seller had to compensate for the increased loss.

This duty should not be regarded as "the information duty for the security of self-determination" because the buyer would have bought the condominium even if the seller had told him how to turn on the switch. As many scholars[47] point out, the information duty that the Supreme Court approved in this judgment is the "information duty for the achievement of the contractual purpose".

The purpose of the buyer in purchasing a condominium equipped with a fire door[48] is undoubtedly to protect his property, including the condominium itself – and furthermore, the lives of himself and his family – in the event of a fire. For the fulfilment of this purpose, it is crucial that the buyer is informed of where he can find the switch and how to turn on it. On the

45 Y. SHIOMI, *Sōba no hendō to keiyaku* [Fluctuation of Market Price and Contract], Hōgaku Kyōshitsu 222 (1999) 47, 49, 51.

46 Judgment No. 2. M. DERNAUER, Civil Law – Tort Law/Contract Law – Liability for a Breach of Pre-contractual, Contractual and Non-contractual Information Duties – Liability of Experts – Claim for Damages, in: Bälz/Dernauer et al. (eds.) Business Law in Japan – Cases and Comments (Alphen aan den Rijn 2012) includes details on the facts and findings of this judgment in English.

47 See for example, T. KOGAYU, *Manshon no hanbai o itaku sareta takken gyōsha no setsumei gimu-to* [Information Duty of a Real Estate Broker Who Was Consigned by a Seller to Sell a Condominium, etc.], Minshō-hō Zasshi 134-2 (2006) 278-279, Y. YAMAMOTO, *Keiyaku junbi, kōshō katei ni kakawaru hōri (1)* [Legal Principles of Pre-contractual Negotiation I], Hōgaku Kyōshitsu 334 (2008) 72–73, S. OJIMA, *Keiyaku teiketsu ni saishite no setsumei gimu* [Information Duty in the Process of Negotiating a Contract], in: Nakata/Shiomi et al. (eds.), *Minpō hanrei hyakusen II* [Selection of 100 Important Cases for Civil Law II] (6th ed., Tōkyō 2009) 11.

48 The buyer knew of course that the fire door was located in the condominium. He was simply not told where the switch was.

other hand, the company which sold the condominium to the buyer itself obviously recognized the purpose of the buyer at the time of making the contract. Therefore, it is possible to conclude that the seller has the duty to provide the buyer enough information about the switch for the realization of the purpose of purchasing the condominium as an obligation based on the contract itself, where the buyer did not know about the switch. This duty of the seller is ancillary to his or her main duty to deliver the condominium. However, this sub- or co-duty, namely the "information duty for the achievement of the contractual purpose", plays a significant role in the process of executing the sale contract exactly to guarantee the buyer the fulfilment of his purpose of buying and receiving the condominium.

In the light of such a function of the "information duty for the achievement of the contractual purpose", it can be said that, for example in the above-referenced case, the seller had to explain the switch to the buyer not necessarily at the time of the agreement but at least by the delivery of the condominium (at the latest before the buyer has begun to live in the condominium). This as well is an important difference between this duty and "the information duty for the security of self-determination", which must be fundamentally performed before concluding a contract.

IV. Analysis of Real Functions of the Information Duty in Relation to the Ownership and transfer of Rights to Objects and Other Assets

We have just analyzed judgments about five different types of conflicts that address the information duty in relation to the ownership and transfer of rights to objects and other assets. Based on the results of the analysis, we should now determine the real function of the duty as a whole.

1. *The Reason for No Information Duty Relating to the Existence of Rights to the Property*

First, based on my research, there are no judgments that addressed the information duty as it relates to the existence of rights to a property, such as mortgages. The reason is presumably that people who want to buy immovable property can easily examine, for instance, whether a mortgage exists on the property by reviewing the register by themselves. In addition, according to Article 35, Item 1 of the Real Estate Brokerage Act, this type of information must be explained to the buyer by the professional seller or real estate broker before making a contract. Therefore, it can be said that any disparities regarding the existence of rights have been eliminated by these legal mechanisms.

2. The Reason for the Liability of Non-professional Sellers

Second, in the first, second and third types of conflict, courts are of the view that sellers should tell their buyers certain information about the state of the property, administrative regulations affecting the property and future environmental changes regarding the property which they actually know, even if the sellers are not professionals. It can be asked whether transactions between non-professional sellers and non-professional buyers entail disparities in the quality and quantity of information and in the negotiating power – the basis of the information duty for the security of self-determination – because such disparities are found typically between a professional seller and a (non-professional) buyer. Why are buyers not required to examine the information by themselves here and are instead allowed to trust that sellers will disclose this information to them as far as the sellers have it?

One possible answer to this question is that sellers generally have more opportunities to gain such information than buyers. For instance, it is presumably not difficult for a seller who lives in a room of a large apartment building to realize that another large apartment building will be built near his or her building and that the present good view from the room will be lost soon. On the other hand, buyers, especially those who still live in other places, are not always able to find out these facts easily. In this sense, it can be said that sellers – although they are not professionals – are basically in a closer position to the properties and thus have superior power for gathering information (and hence for negotiating) as compared to buyers in relation to the state of their property, the existence of administrative regulations on them and future environmental changes affecting them. In other words, here as well the information duty imposed on a non-professional seller works to eliminate such a disparity in the quality and quantity of information and in the negotiating power between the seller and the buyer.

3. The Reason for the Difference in the Liability of Real Estate Brokers Retained by the Seller

Third, according to the judgments we have analyzed, real estate brokers retained by the seller basically owe a duty of investigation as to the existence of relevant administrative regulations on the contractual objects. On the other hand, courts seem to be less positive about imposing such a duty on brokers in relation to the state of the properties. As we have already seen, there are two judgments[49] which clearly reject this kind of investigating duty.

Real estate brokers are licensed by the state to run agency services for the trade of immovable properties as a business. They are supposed to have

49 Judgments Nos. 58 and 59.

certain legal knowledge and be able to gather correct legal information which is important for commercial trade, if necessary. Needless to say, the existence of administrative regulations impacting immovable property is a typical example of such information. However, it would be inappropriate to expect that real estate brokers have in general special knowledge or a better ability than others to investigate and discover, for example, a physical defect in the basement of a building.[50] From this point of view, the (presumed) rationale of the courts rulings about the investigating duty of real estate brokers retained by the seller can be justified and, moreover, in itself seems to be reasonable (the conclusion reached by two judgments to reject a duty to investigate the state of the property should be supported).

4. The Reason for the Difference in the Liability of Professional Sellers

Regarding the necessary conditions for imposing an information duty on professional sellers, there is a significant difference between, on the one hand, the information duty relating to the current state of the property (in the first type of conflict) and administrative regulations (in the second type of conflict), and, on the other, the duty relating to future environmental changes near the property (in the third type of conflict). As we discussed earlier, in relation to the second type of conflict for instance, courts have held that professional sellers have a duty to investigate and advise a buyer of certain administrative regulations. In contrast to this ruling, in the third type of conflict professional sellers generally do not have to examine the possibility of future environmental changes near the property.

The first reason for this difference can be found, once again, in Article 35, Item 2 of the Real Estate Brokerage Act, because here only the existence and the content of administrative regulations are listed as important matters that sellers must explain to their buyers. However, it is thought that the range of information that must be provided to the buyers by the sellers is not limited to the matters stipulated in Article 35 of the Real Estate Brokerage Act. Instead, it must be decided on a case-by-case basis. The second reason why the information duty relating to future environmental changes near the property is generally denied is presumably the difficulty to investigate, to recognize, or to foresee such changes. It is quite easy, especially for professional sellers, to know how the present state of the property is or if administrative regulations exist in regard to the property and if the regulations apply to buyers. On the other hand, it is difficult for them to say if, how, and when the current environment might change. The third reason is that the object of a sales contract is the property and not its environment,

50 Judgment No. 14 makes a similar statement.

which the sellers do not regulate and therefore cannot control. For these reasons, we must go back to the foundation of the information duty in the third type of conflict. Each buyer must gather and examine all of the information regarding possible changes to the environment surrounding the property at his or her own risk. Only when a professional seller already has specific information regarding a change is he or she required to provide such information to the buyer.

5. The Rationality of the Judgments Regarding the Fourth Type of Conflict

From the above-mentioned perspective, it is understandable and justifiable that a rational judge would see the necessary conditions for the information duty in the fourth type of conflict in a similar manner as those conditions present in the third type, namely, the sellers must provide information only in exceptional circumstances. These conditions can be grounded on the nature of the information as well, which is similar to that of the conditions for the third type of conflict. The economic situation and the price of similar properties in the neighborhood determine how high the price of an immovable property should be, and this price is therefore not necessarily a matter that sellers are able to control on their own.

6. The Scope of the Information Duty

Regarding the scope of the duty, that is to say, the range of information which sellers and real estate brokers employed by the seller must provide, it is notable that duties are – under specific necessary conditions – imposed on sellers and brokers to provide information not only about the nature of the property itself (its current state as well as certain administrative regulations upon on it) but also about the surrounding environment and future prices. One reason for this is the purpose of the contracts typically involved in the third and fourth types of conflict. Most buyers in these cases purchase immovable properties as a place to live. Therefore, it is very important for them that the property is in and remains in a comfortable environment. The price of the property is also a great concern for the buyers. When a radical price reduction in the near future has already been planned, a buyer has an interest in buying the property at a later date at the lower price. This interest should be legally protected to a certain degree.

Another reason is that courts tend to narrowly construe the meaning of a "latent defect in the subject matter of a sale" as set forth in Article 570 of the Civil Code.[51] Pursuant to the article, if a property has a defect that its

51 On Article 570 of the Civil Code, see *supra* note 30.

buyer cannot easily discover at the point of entering into the contract, the buyer can make a claim against the seller after the sale for loss caused by the defect. Some scholars[52] insist that the meaning of "defect" should be broadly construed so that, for instance, an unexpected environmental change near the property could be treated as a "defect". However, it seems that courts interpret the meaning rather narrowly and believe that an environmental change that was not foreseen should not be considered a "latent defect" in the property.[53] It is thus necessary to use the theory of the information duty in order to resolve conflicts between parties over this issue. From this point of view, it can be said that the information duty plays the role of a functional substitute for the warranty against defects.

This explanation helps us understand why only immovable rather than movable properties are addressed in these cases. When a movable property has a "latent defect", the buyer can bring a lawsuit against the seller for liability under the warranty stipulated in Article 570 of the Civil Code. There is no need for the information duty. Additionally, movable properties have no surrounding environment to speak of.

7. *Effects of a Breach of the Information Duty*

a) *Information duty for the security of self-determination*

As for the effect of a breach of the "information duty for the security of self-determination", courts consider cancellation of the contract, compensation for damages or both remedies.[54]

In some lower court cases[55] (six out of 60), cancellation of the contract based on a breach of the information duty was approved. Three of the cases[56] involve the second type of conflict. It seems that in these three cases, each buyer was not able to realize the purpose of his or her contract due to the existence of certain administrative regulations. Therefore, these judgments approving cancellation are understandable, but at the same time, it must be pointed out that it is not easy to justify these conclusions theoretically. Article 541 of the Civil Code says that a party can cancel a contract in cases where the other party does not perform his or her contractual obliga-

52 See for instance S. SHITAMORI, *Manshon no urinushi wa sono bunjō ni saishi kainushi ni rinchi no riyō keikaku ni tuite chōsa kokuchi suru gimu o shingi-soku jō futan shite iru ka* [Do sellers of rooms in a large apartment building have a duty towards buyers to investigate how the neighborhood will be used in the future based on the good faith principle?], Hanrei Taimuzu 311 (1976) 89.

53 For example, see the ruling of Judgment No. 33.

54 As a single exception, Judgment No. 5 found fraud of the seller through silence.

55 Judgments Nos. 4, 9, 12, 15, 26 and 40.

56 Judgments Nos. 9, 12 and 15.

tions. However, in most cases the breach of the information duty occurs before the parties enter into the contract. So it is difficult to logically grasp this duty as a duty based on the contract. In 2011, the Japanese Supreme Court actually stated as much in a judgment.[57] Although the immediate issue in this judgment concerned the availability of contractual damages, rather than cancellation, for breach of information duties, one might be sceptical that the cancellation of a contract due to the breach of "the information duty for the security of self-determination" will, in practice, be approved in the future.

Considering the functions of the "information duty for the security of self-determination", the best remedy for buyers is cancellation of the sale, as they would not have made a purchase if the information had been properly provided. However, as we have just seen, it is theoretically difficult to approve cancellation based on a breach of the information duty under Japanese civil law. Because of such a difficulty, buyers and courts presumably attempt to achieve the same economic result through compensation as if the contract had been cancelled.

The first type of attempt can be seen in the number of courts that order the seller to compensate for the difference between the price actually paid by the buyer and the actual value of the property.[58] Buyers who recover damages can then return to their original economic state, namely, the state they were in before the contract was signed, by reselling the property at the actual value. Therefore, this type of compensation can work as an economic substitute for cancellation.

Second, in several cases,[59] buyers demand that sellers pay an amount equal to the amount they paid as earnest money. This type of compensation is chosen when the sales contract has already been made but the property has not yet been delivered. Here, the buyer claims a breach of the information duty by the seller and rejects acceptance of the property. In such cases, buyers return to their original economic state when they receive restitution for the amount they paid to the sellers as earnest money. Thus, it can be said that compensation in these cases also functions as an economic substitute for cancellation.

In addition to these two types of compensation, there are many other cases where courts have approved claims of solatium because of an infringement of self-determination that has occurred through an improper provision of information.[60]

57 Supreme Court, 22 April 2011, Minshū 65, 1405.

58 Judgments Nos. 7, 19, 38, 48 and 58. See also Judgment No. 43.

59 Judgments Nos. 4, 9, 13, 25 and 26.

60 Judgments Nos. 1, 16, 17, 21, 24, 26, 29, 31, 43, 53, 55, 56 and 59.

b) Information duty for the achievement of the contractual purpose

The judgment of the Supreme Courts affirming the existence of the "information duty for the achievement of the contractual purpose"[61] allows the buyer to pursue compensation for damages resulting from a breach of the duty by the seller. As we have already examined, this conclusion is suitable for the nature and function of this kind of information duty. In other words, for the breach of the "information duty for the achievement of the contractual purpose", the unwinding of the contract itself through cancellation is for both buyers and sellers not a proper remedy.

V. SUMMARY

The conclusion of this paper's analysis can be summarized as follows.

There are two types of information duties in relation to the ownership and transfer of rights to objects and other assets under Japanese civil law.

The first is an "information duty for the security of self-determination". Its substance is, first, a duty imposed on a seller, both professional and non-professional, and also a real estate broker retained by the seller who actually know of certain important facts about an immovable property to inform the buyer of the facts. Second, it is a duty imposed on a professional seller of immovable property to investigate and to provide information correctly regarding the state of the property and the existence of relevant administrative regulations. Third, it is a duty imposed on a real estate broker retained by the seller to investigate and to provide information regarding the existence of relevant administrative regulations on the property. In certain circumstances professional sellers and real estate brokers retained by the seller must also notify the buyers of future changes in the environment or price. These duties function to remove disparities in the quality and quantity of information about immovable properties and in the negotiating power between sellers and buyers. Concerning the effects of the breach of the duty, this type of information duty can and does function as a type of economic substitute for the cancellation of a contract.

The second duty is "the information duty for the achievement of the contractual purpose", which is based on the contract itself. This type of the duty is imposed on sellers not in order to secure self-determination of buyers but to guarantee the fulfilment of the buyer's contractual purpose; put alternatively, it is a duty ensuring that each buyer can actually receive the benefit he or she intended to receive upon entering into the contract.

61 Judgment No. 3.

The Judgments Analyzed for this Paper Are as Follows:

1) Supreme Court, 18 November 2004, Minshū 58, 2225
2) Supreme Court, 16 September 2005, Hanrei Jihō 1912 (2006) 8
3) Tōkyō District Court, 25 January 1974, Hanrei Jihō 746 (1974) 52
4) Tōkyō High Court, 31 March 1977, Hanrei Jihō 858 (1977) 69
5) Tōkyō District Court, 16 October 1978, Hanrei Jihō 937 (1979) 51
6) Tōkyō High Court, 11 December 1978, Hanrei Jihō 921 (1979) 24
7) Tōkyō District Court (Hachiōji Branch), 26 July 1979, Hanrei Jihō 947 (1980) 74
8) Tōkyō High Court, 28 April 1982, Hanrei Taimuzu 476 (1982) 98
9) Ōsaka High Court, 19 July 1983, Hanrei Jihō 1099 (1986) 59
10) Tōkyō District Court, 27 December 1983, Hanrei Jihō 1124 (1986) 191
11) Sapporo District Court, 28 June 1988, Hanrei Jihō 1294 (1989) 110
12) Tōkyō High Court, 25 January 1990, Kinyū Shōji Hanrei 845 (1990) 19
13) Tōkyō District Court, 28 February 1991, Hanrei Jihō 1405 (1992) 60
14) Ōsaka High Court, 21 November 1995, Hanrei Taimuzu 915 (1996) 118
15) Tōkyō District Court, 28 January 1997, Hanrei Jihō 1619 (1998) 93
16) Yokohama District Court, 23 April 1997, Hanrei Jihō 1629 (1998) 103
17) Yokohama District Court, 26 May 1997, Hanrei Taimuzu 958 (1998) 189
18) Urawa District Court (Kawagoe Branch), 25 September 1997 Hanrei Jihō 1643 (1998) 170
19) Tōkyō District Court, 23 January 1998, Hanrei Taimuzu 991 (1999) 206
20) Ōsaka District Court, 19 March 1998, Hanrei Jihō 1657 (1999) 85
21) Matsuyama District Court, 11 May 1998, Hanrei Taimuzu 994 (1999) 187
22) Tōkyō District Court, 25 January 1999, Hanrei Jihō 1675 (1999) 103
23) Ōsaka District Court, 9 February 1999, Hanrei Taimuzu 1002 (1999) 198
24) Tōkyō District Court, 25 February 1999, Hanrei Jihō 1676 (1999) 71
25) Tōkyō High Court, 8 September 1999, Hanrei Jihō 1710 (2000) 110
26) Ōsaka High Court, 17 September 1999, Hanrei Taimuzu 1051 (2001) 286
27) Ōsaka High Court, 30 September 1999, Hanrei Jihō 1724 (2000) 60
28) Ōsaka District Court, 13 December 1999, Hanrei Jihō 1719 (2000) 101
29) Kyōto District Court, 24 March 2000, Hanrei Taimuzu 1098 (2002) 184
30) Tōkyō District Court, 30 August 2000, Hanrei Jihō 1721 (2000) 92
31) Tōkyō District Court, 27 June 2001, Hanrei Jihō 1779 (2002) 44
32) Tōkyō High Court, 16 December 2001, Hanrei Taimuzu 1115 (2003) 185
33) Chiba District Court, 10 January 2002, Hanrei Jihō 1807 (2003) 92
34) Tōkyō District Court, 3 February 2003, Minshū 58, 2233
35) Tōkyō High Court, 25 September 2003, Hanrei Taimuzu 1153 (2004) 167
36) Ōsaka District Court, 15 October 2003, Kinyū Shōji Hanrei 1223 (2005) 24
37) Tōkyō High Court, 18 December 2003, Minshū 58, 2286
38) Ōsaka High Court, 2 December 2004, Hanrei Jihō 1898 (2005) 64
39) Tōkyō District Court, 20 January 2006, Hanrei Jihō 1957 (2007) 67
40) Fukuoka District Court, 2 February 2006, Hanrei Taimuzu 1224 (2007) 255
41) Tōkyō District Court, 5 September 2006, Hanrei Jihō 1973 (2007) 84
42) Tōkyō District Court, 25 December 2007, Hanrei Jihō 2033 (2009) 18
43) Tōkyō District Court, 28 April 2008, Hanrei Taimuzu 1275 (2008) 329
44) Tōkyō High Court, 29 May 2008, Hanrei Jihō 2033 (2009) 15
45) Ōsaka District Court, 25 June 2008, Hanrei Jihō 2024 (2009) 48

46) Tōkyō District Court, 19 November 2008, Hanrei Taimuzu 1296 (2009) 217
47) Fukuoka District Court (Kokura Branch), 14 July 2009, Hanrei Taimuzu 1322 (2010) 188
48) Chiba District Court, 17 February 2011, Hanrei Jihō 2121 (2011) 110
49) Utsunomiya District Court, 8 February 2012, Shōmu Geppō 59-1470
50) Ōsaka District Court, 27 March 2012, Hanrei Jihō 2159 (2012) 88
51) Tōkyō High Court, 13 June 2012, Shōmu Geppō 59-1455
52) Tōkyō District Court, 16 November 2012, Hanrei Jihō 2182 (2013) 99
53) Kōbe District Court, 6 June 2013, Hanrei Jihō 2261 (2015) 153
54) Tōkyō District Court, 3 July 2013, Hanrei Jihō 2213 (2014) 59
55) Ōsaka High Court, 12 July 2013, Hanrei Jihō 2200 (2013) 70
56) Matsuyama District Court, 7 November 2013, Hanrei Jihō 2236 (2014) 105
57) Ōsaka High Court, 23 January 2014, Hanrei Jihō 2261 (2015) 148
58) Tsu District Court, 6 March 2014, Hanrei Jihō 2229 (2014) 50
59) Takamatsu High Court, 19 June 2014, Hanrei Jihō 2236 (2014) 101
60) Tōkyō District Court, 8 October 2014, Hanrei Jihō 2247 (2015) 44
61) Tōkyō District Court, 31 October 2014, Hanrei Jihō 2247 (2015) 44
62) Tōkyō District Court, 25 December 2015, Hanrei Taimuzu 1428 (2016) 237

Information Duties under Japanese General Contract Law and Japanese Law of Consumer Contracts

Marc Dernauer[*]

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I. INTRODUCTION

Contract law is a set of rules for contracts that may also stipulate legal duties to provide information between (and among) contract parties and, although rare, to third parties. One can distinguish information duties before or upon the formation of a contract (pre-contractual information duties), information duties that result from the conclusion of a contract (contractual information duties), and information duties that survive the termination of a contract (post-contractual information duties).

This paper aims to identify and explain important information duties under Japanese contract law (in Japanese generally called "説明義務, *setsumei gimu*" or "情報提供義務, *jōhō teikyō gimu*"[1]) as well as their functions.

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1 Both terms are equally used for "information duties" in Japan. Although, the former term would be literally translated mean "duty to explain", the latter "duty to provide information", this shall mean no difference. The degree of required information, e.g. only a formal provision of information or a more thorough explanation, depends on

Moreover, it will explain how Japanese law safeguards compliance with such information duties. The analysis will focus on general contract law and consumer contract law, but in some places also refer to information duties in regard to commercial contracts. As one particular example, it will explore information duties with relevance for financial transactions, such as the sale of financial products. The paper will not only address private law information duties, but also duties based on public law. Administrative law and criminal law duties feature quite frequently in Japanese law and must therefore also be addressed.

Before analyzing the specific information duties under Japanese contract law, however, in order to facilitate the understanding of the legal framework, the basic structures of private and "public" contract law in Japan shall be briefly explained.

II. Basic Structures of Japanese Contract Law

In Japan, the core contract law rules can be found in the Japanese Civil Code (民法, *Minpō*)[2] and the Japanese Commercial Code (商法, *Shōhō*).[3] The Japanese Civil Code came into force in 1898, the Commercial Code in 1899. Both acts were significantly influenced by the German law of that time. Despite several reforms during the more than a hundred years that followed their enactment until today, except for changes to details, the basic structure of contract law laid down in these acts remained almost unaltered.[4] As a result, Japanese contract law today is still influenced to a remarkable extent by German contract law.

1. The Japanese Civil Code (CC)

The Japanese Civil Code consists of five major parts that are called "books" and which were systematically arranged in a pandect manner as in the German Civil Code, the "*Bürgerliches Gesetzbuch* (BGB)" of 1900.

the specific case, not the used word. There are also many special types of information duties with particular designations and meaning, for example "written formal information duty (書面交付義務, *shomen kōfu gimu*)", "prohibition to provide false information (不実告知の禁止, *fujitsu kokuchi no kinshi*)" or "prohibition to provide a determinative opinion (断定的判断の禁止, *dantei-teki handan no kinshi*)". The extent and details of the duties depend on the respective case.

2 Law No. 89/1896.

3 Law No. 48/1899.

4 For instance the reforms after the World War II ("democratization") and the reform of 2004 ("modernization of the language and reform of surety law"). See H. Nakata, *Keiyaku-hō* [Contract Law] (Tōkyō 2017) 3–4.

The first (1887) and second draft (1895) of the BGB served as a model for content structure, which for their part followed the suggestion of proponents of the German Historical School of Jurisprudence such as *Bernhard Windscheid*. They had developed their concept of a complete body of civil law based on ancient Roman law, in particular based on the *Digesta* (also known as the *Pandects*). This compendium of juristic writings on Roman law became the second part of the *Corpus Iuris Civilis* compiled on order of the Eastern Roman Emperor Iustinian I around 530. One difference between the ordering of the BGB and the Japanese Civil Code is that the order of Book Two on property law and Book Three on the law of obligations is reversed. Thus, the five books in the Japanese Civil Code are as follows: General Provisions (Book One), Property Rights (Book Two), Obligations (Book Three), Kinship (Book Four), and Succession (Book Five). The rules on contract law are laid down mostly in the first and third book.

In terms of content, the Japanese Civil Code was influenced by the two drafts of the BGB, particularly the first and third book that include the rules on contracts, but also by the French civil code and about thirty other foreign civil codes of the time.[5] At the time of enactment, books four and five, which deal with family (kinship) law and inheritance (succession) law, were initially based to a broad extent on traditional Japanese concepts. Two professors of the University of Tōkyō, *Yatsuka Hozumi* and *Masaaki Tomii,*[6] as members of the drafting commission, were especially responsible for the significant orientation toward German law in view of the structure and other important parts of the content. A preliminary draft, which had been announced in 1890, was very similar to the French civil code at that time and thus primarily influenced by French civil law. This preliminary draft was heavily disputed in public, and in the end dismissed.[7]

In June 2017, the Japanese legislator enacted a law for the reform of the law of obligations, which will amend Books One and Three of the Civil Code on a large scale, particularly the provisions regarding contracts and the general law of obligations.[8] This reform act will enter into force on 1 April 2020. Although it is a reform on a large scale, many amendments concern only details. In many cases, the enactments featured settled case law of the Supreme Court, with only a few cases involving fundamental reforms. The structure and basic principles of contract law will remain unchanged.

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5 G. RAHN, Rechtsdenken und Rechtsauffassung in Japan (Munich 1990) 110, citing N. HOZUMI, The New Japanese Civil Code as Material for the Study of Comparative Jurisprudence (Tōkyō 1912) 21.

6 RAHN, *supra* note 5, 111–112.

7 See also e.g. NAKATA, *supra* note 4, 1–2, with further references.

8 *Minpō no ichibu wo kaisei suru hōritsu,* Law No. 44/2017.

a) Basic principles and rules of contract law

Japanese Contract Law is based on the principle of contractual freedom (契約の自由, *keiyaku no jiyū*) as a manifestation of the more general concept of private autonomy (私的自治, *shiteki jichi*) in Japanese civil law.[9] The principle of contractual freedom is not explicitly defined or mentioned in the Civil Code, but clearly acknowledged by the Supreme Court and in legal theory as the fundament of Japanese contract law guaranteed by the Japanese Constitution.[10] As a result of the upcoming reform of the law of obligations, the principle of contractual freedom will be explicitly referred to and acknowledged by provisions newly added to the Civil Code (new Sections 521, 522(2) CC).[11] Contractual freedom, however, can be restricted by law, and in fact has been subject to broad restrictions in Japan.[12]

The requirements for the conclusion of a specific contract are also not clearly defined. However, there is a common understanding in Japan that a contract is a juristic act requiring congruent declarations of intent (consent) from the parties to enter into a contract with specific content. One declaration is technically called the "offer", the other the "acceptance".[13] Contracts involving three or more parties require numerous acceptances (or offers).[14] After the act reforming the law of obligations comes into force, a corresponding definition will be provided in the new Section 522(1) CC. Further additional rules for a conclusion of a contract are stipulated in Sections 521 to 528 CC, primarily in regard to the exchange of declarations between parties who reside at different locations.

Some general principles of civil law that also apply to contractual relations are laid down in Section 1 CC. These are the principle of loyalty and good faith (principle of *bona fide,* 信義誠実の原則, *shingi seijitsu no gensoku*), the principle that prohibits the abuse of any kind of rights (権利濫用の禁止, *kenri ran-yō no kinshi*), and the principle that all private rights are respected by law only if they are not contrary to the common good.

9 NAKATA, *supra* note 4, 23–25, 29–32; K. YAMAMOTO, *Minpō kōgi I: sōsoku* [Lecture on Civil Law I: General Provisions] (3rd ed., Tōkyō 2012) 107–115.

10 Supreme Court, 12 December 1973, Minshū 27, 1536 (Mitsubishi Jūshi).

11 The new Sections 521, 522(2) CC expressly mention the most important aspects of contractual freedom: The freedom to enter into a contract or not, the freedom to determine the content of a contract, and the freedom to conclude a contract without adhering to a specific form.

12 NAKATA, *supra* note 4, 25–29; YAMAMOTO, *supra* note 9, 112–115.

13 NAKATA, *supra* note 4, 20–21, 77.

14 For general explanations, however, in the following the concept of a contract between two parties will be taken as a basis.

b) *Legal capacity, juristic acts, and declarations of intent*

Many general rules stipulated in Book One, which can also be called the "general part" of the Civil Code, are also applicable in regard to contracts.

Sections 3 et seq. CC, for instance, generally define the entities under private law that are capable of holding private rights and of owing duties (legal capacity). This includes the assumption of relative rights such as obligations (or receivables) deriving from the conclusion of a contract (contractual obligations) – as creditor and debtor, respectively. These entities are divided into natural persons and legal persons (legal entities). Natural persons older than twenty usually have the (full) capacity to act and to deliver a declaration of intent, and thus can enter into a contract, or undertake other juristic acts, whose formation always requires the delivery of specific declarations of intent by the involved parties. Legal persons act through their representative organs. Most forms of legal entities are regulated in detail by special laws.[15]

Since a contract is a specific juristic act, Sections 90 et seq. CC on juristic acts and declarations of intent also apply to contracts. Contracts, as other juristic acts, are (fully or partly) void if they contravene public order or policy (Section 90 CC). Parties may, in particular, not agree on contractual terms that deviate from mandatory provisions, which usually express public order or policy in a particular context (Sections 91, 92 CC).

Section 95 CC stipulates that declarations of intent are void in case of an error of the declaring party. Section 96 CC provides that declarations of intent can be avoided in case of fraudulent misrepresentation (詐欺, *sagi*) or duress. Both provisions also apply to declarations of intent to enter into a contract. The rules on representation (or agency) in Sections 99 et seq. CC allow an agent with the necessary power of agency to conclude a contract or undertake other forms of juristic acts with effect for and on behalf of another person, the principal, by delivering the required declaration of intent, unless this is specifically excluded by law.

c) *Performance of obligations and remedies for non-performance*

The various grounds for discharge of obligations (Sections 474 to 520 CC), such as, for example, performance of an obligation, also apply to contractual obligations.

The same applies for the ordinary provisions on the liability of the debtor for non-performance of an obligation (Sections 412, 414 to 422 CC); they are supplemented by Sections 540 et seq. CC, which only apply to

15 For instance, companies are regulated by the Company Act (会社法, *Kaisha-hō*), Law No. 86/2005.

contracts. Sections 415, 540 et seq. CC in particular stipulate the requirements and legal consequences of (negligent) non-performance of a contractual obligation. Where the debtor is liable for non-performance, the creditor may claim compensation for damages and, in some cases, also rescind the contract. In particular, this liability for non-performance (債務不履行責任, *saimu fu-rikō sekinin*) may include the non-performance of information duties as an element of a duty of performance of a contractual obligation, be it a main duty or an accessory duty.

In case of reciprocal agreements, Sections 534 to 536 CC (new Section 536 CC) also need to be generally considered. They determine the party that has to bear the risk of counter-performance if one party, without negligence, cannot (fully) perform its contractual obligation. The impossibility of performing an information duty, however, is usually not the contentious issue in legal disputes.

d) Regulated types of contracts

Further rules on specific types of contracts are stipulated in Sections 549 to 696 CC. They refer to various frequently used types of contracts, such as for example, purchase contracts, lease contracts and loan contracts. With a few prominent exceptions, these provisions are non-mandatory provisions that only apply if there is no deviating agreement between the parties.

e) Tort law

General tort law (不法行為法, *fuhō kōi-hō*) in Japan is stipulated in Sections 709 to 724 of the Civil Code. Tort law, originally, was not particularly created to solve contract law issues. Due to the general and flexible constituent elements stipulated as requirements for a tort liability, and the resulting broad scope of application of tort law in Japan, however, tort law also applies as a basis for legal liability in cases of a breach of certain precontractual and contractual duties, including a breach of information duties, as will be demonstrated below.

2. Special Private Law and Public Law Regulation

In Japan, specific contracts are additionally regulated by countless special acts of a private law and/or public law nature, with the latter mainly represented by business laws that regulate specific business sectors or specific trading platforms, such as stock markets. One objective of these special laws is often the protection of consumers – in a broad sense – or of customers of financial service providers, who may or may not also be consumers. The regulation can refer to the formation of a contract, the content of a contract

and/or the performance of a contract. This often includes stipulations regarding pre-contractual and contractual information duties, as well as their performance and special remedies for non-performance (or non-fulfillment).

Business laws of a public law nature primarily belong to the field of economic administrative law. At the same time, they are part of contract law if they regulate contracts, forming a "public contract law" so to speak. While in theory, private contracts can be regulated by administrative law (alongside private law), from the viewpoint of European and German legal tradition, this is rather unusual. In Japan, on the other hand, this is quite common. If one further looks at other countries in Asia, where a regulation of contracts by public law is also evident, it no longer appears to be such an unusual pattern of law. Such regulation also includes legal provisions that stipulate public law information duties, which can be further subdivided into administrative law information duties and criminal law information duties.

III. Pre-contractual Information Duties

Pre-contractual information duties can be divided into *"positive information duties"* and *"negative information duties"*. Whereas positive information duties refer to duties to actively provide certain information, negative information duties are understood as prohibitions against providing false and misleading information.

In Japan, such pre-contractual information duties can be relevant between the parties about to enter into a contract who have therefore started contract negotiations. Pre-contractual information duties in this respect usually ensure that both parties enter into a contract with sufficient information about the main subject matter of the contract, the further terms and conditions of the contract and/or important surrounding circumstances. A breach of either form of pre-contractual duties – positive or negative information duties – can bring about the same undesired result, that is, one party may not be fully and correctly informed about these matters when deciding whether to enter into the contract or not. Pre-contractual information duties may also be imposed on third parties involved in the formation of the contract.

Below, explicit and implicit pre-contractual information duties of all kinds shall be explored, covering an analysis of the Civil Code, of special private law regulations and of public law regulations.

1. *Private Law Information Duties*

a) *The Civil Code*

In the Japanese Civil Code, however, one can only find very few pre-contractual information duties. When the Civil Code was originally enacted

More than hundred years ago, the Japanese legislators saw no specific need to stipulate such duties. Their concept was based on the general assumption that contract parties shall be treated as equal and therefore shall gather the information they need themselves.[16] A possible disparity of information among contract parties was generally treated as legally irrelevant. Subsequent amendments of the Civil Code so far have not brought a fundamental change of this concept.

aa) The concept of fraudulent misrepresentation

One exception to this is the already mentioned rule on fraudulent misrepresentation (Section 96 CC, 詐欺 *sagi*), similar to the German rule on *"arglistige Täuschung"* (Section 123 BGB). Generally, this rule could be treated as a specific *negative information duty* not to mislead a person into rendering a declaration of intent to enter into the contract based on the misinformation. This misinformation may involve facts about the main subject matter of the contract, the further terms and conditions of the contract or important surrounding circumstances. Misleading may also take the form of omitting to inform another party about certain facts, if the circumstances require the information of the party, such as in cases of a significant information disparity or for other reasons.[17] The provision thus also encompasses a *positive information duty*.

According to the general perception in legal theory and practice, Section 96 CC is only applicable when it is intentional, and if the conduct can be regarded as illegal. While the latter requirement would not pose any particularly high obstacle for applying the provision, the former requirement of "intent" significantly limits its scope of application. Moreover, it appears difficult to apply this provision in cases of a mere exaggeration, and in particular if it refers not to verifiable facts, but only estimations, evaluations, or assumptions regarding future developments, such as for instance future market prices or future decisions and possible acts of third parties. Whether Section 96 CC, however, really sets these requirements of "intent" or misleading statements about "facts" is at least disputable. Neither "intent" nor misleading statements about "facts" is expressly mentioned as requirements in the text of the provision.

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16 K. YAMAMOTO, Vertragsrecht, in: Baum/Bälz (eds.), Handbuch Japanisches Handels- und Wirtschaftsrecht (Cologne 2011) 461 ff., 474; NAKATA, *supra* note 4, 129; M. KONDA, *Setsumei gimu joron* [Introduction (regarding) Information Duties], in: Konda (ed.), *Setsumei gimu no riron to jissai* [The Theory of Information Duties and the Reality] (Tōkyō 2017) 3.

17 YAMAMOTO, *supra* note 9, 228–232.

Nonetheless, because of the generally perceived restrictive requirements in Section 96 CC, it is particularly difficult to apply this provision to cases of a sale of investment products such as stocks, bonds or derivatives and potentially insufficient or misleading information about the prospects of return and the financial risks involved. In fact, the provision is generally rarely applied in practice.[18] If the requirements were met however, the deceived contract party would be allowed to avoid its declaration of intent and could therefore nullify the contract. If the deceived contract party was not deceived by the other party, but by a third party, avoidance of the declaration of intent would be only possible if the other contract party was aware of the deceit, or – after the coming into effect of the reform of the law of obligations – if the other party could have known of the deceit (new Section 96 CC). The courts in Japan so far have not recognized any attributing responsibility of the other contract party for a deceit committed by some special kinds of third parties who could be classified as standing essentially on side of the other contract party, such as agents (with power of attorney) or other kind of assistants or commissioners (including experts and specialists) assigned by the other contract party to help in soliciting and concluding the contract.[19]

Related to Section 96 CC, but applying to sales contracts only, there is a more specific provision in Section 572 CC, which provides that if a seller fraudulently, that is intentionally, concealed a defect of the object of purchase, this inevitably would lead to a warranty responsibility under statutory law (Section 572 CC) for such defect, even if the seller and buyer have excluded this statutory warranty by agreement. Similar provisions can be found with regard to several other specific contracts, such for instance contracts to produce a work (Section 634 CC), donations (Section 551 CC), and loan contracts (Section 590 CC).

The basic function of Section 96 CC and Section 572 CC (and similar provisions) is to ensure fair behavior in contract negotiations and to protect the counterpart against intentional fraud. The scope of application of these provisions, however, is quite narrow. If either provision is applicable, in many cases an additional criminal liability for fraud (Section 246 Penal Code)[20] and a tort liability (Section 709 CC) can also be affirmed.

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18 An exception, for example, is the decision of the District Court Kōbe, 5 November 1965, Hanrei Jihō 442, 50, in a case of a transaction regarding commodity futures.

19 Some legal scholars recommend that at least a deceit committed by an agent should be attributed to the principal and that the deceived party in such case should be allowed to avoid the contract; see T. ISOMURA, Chapter 5 in Ishida (ed.) *Gendai minpō kōgi 1: Minpō sōsoku* [Lecture on Modern Civil Law 1: Civil Code, General Provisions] (Tōkyō 1985) 119 et seq., 166; K. SHINOMIYA, *Minpō sōsoku* [Civil Code, General Provisions] (4th ed., Tōkyō 1986) 186.

bb) Surety contracts: written form requirement functioning as a positive information duty

Another exception is the written form (or electronic form) requirement for the valid conclusion of contracts of suretyship (Section 446(2), (3) CC), which also includes a function to inform the would-be surety and warn him about the specific duties involved in a suretyship. This requirement was introduced by a law reform in 2004.[21]

The reform of the law of obligations will add a specific pre-contractual notarial recording requirement for a declaration of intent from a would-be individual surety. This declaration of intent must detail the performance of an obligation arising from suretyship for a loan debt assumed by the principal debtor for business purposes, before entering into the actual contract for suretyship itself. A violation of this formal requirement renders the later contract for suretyship invalid. Moreover, the notarial recording itself must fulfill certain requirements. The would-be surety, in principle, must, before the public notary, verbally declare the main duties involved in the respective surety obligation that is intended to be assumed. The public notary must subsequently read aloud and show the recorded text to the would-be surety and to confirm the correctness of the recording (new Section 465-6 CC).

Moreover, the reform act will introduce a specific duty of a principal debtor to provide detailed information about its financial situation to an individual person who is about to enter into a contract with the principal debtor, in which the person would promise the principal debtor to enter into a contract of suretyship with a creditor of the principal debtor, and stand surety for the performance of an obligation of the principal debtor, which the principal has assumed for business purposes (new Section 465-10(1) CC). If the principal debtor has omitted to inform the person, that is the would-be surety, or has provided false information, and if the person in false belief then entered into the contract of suretyship with the creditor and become a surety, the person (surety) may avoid the contract of suretyship if the creditor knew or could have known about the omission or false provision of information (new Section 465-10(2) CC). This new information duty has an additional warning function. It intends to ensure that the would-be debtor will be correctly informed not only about the duties of the suretyship, but also about the financial situation of the principal debtor, thus providing a basis for assessment of the actual risk involved in the suretyship should the surety be called to perform the principal obligation instead of the principal debtor. The Japanese legislator thought it necessary to assist

20 刑法, *Keihō,* Gesetz Nr. 45/1907.

21 YAMAMOTO, *supra* note 16, 467.

sureties who have been induced to enter into a contract by fraudulent or misinformation. This is due to the fact that the knowledge of the financial situation is particularly important in making the decision to enter in to contract, and because it is often very difficult for a surety to withdraw from that contract, due to difficulties identifying and proving a relevant error (Section 95 CC) or fraudulent misrepresentation (Section 96 CC). The assistance offered by Japanese legislation is however limited to suretyship for an obligation assumed by the principal debtor for business purposes.

cc) Full information about the contract as a prerequisite for a valid conclusion of the contract?

(i) Requirements for the conclusion of a contract: Implied information duties?

As already mentioned, the conclusion of a contract requires corresponding declarations of intent from the parties to enter into the contract. One is technically called the "offer", the other the "acceptance" (new Section 522(1) CC).

This, however, does not require that both parties were fully informed about the details of the main subject matter of the contract, the further terms and conditions of the contract or the important surrounding circumstances of the contract. The necessary corresponding content of all declarations of intent of the parties involved must only identify the respective parties and the subject matter of the contract as characterized by the main duties of performance under the specific contract *(essentialia negotii).* This may include, for instance, sufficiently clear reference to the specific object of a purchase and to a specific purchase price. It is not necessary that the parties have fully understood what they actually have to do in order to perform their duties or that they know all details about the specific objects of performance, or that they were informed about it by the other party. Moreover, all declarations of intent must clearly refer to all other terms and conditions *(accidentalia negotii)* one party has proposed as *necessary* terms and conditions of the contract, that is, as prerequisites for the conclusion of the contract. As above, this does not require that they have fully understood these terms and conditions or that they were sufficiently informed about their meaning by the other party. Important surrounding circumstances do not need to be addressed at all in the declarations of intent, unless one party has made specific circumstances a necessary condition for entering into the contract. Whether the parties know these surrounding circumstances, understand them or whether they were informed about them is therefore usually irrelevant for the valid conclusion of a contract. Hence, the declarations of intent must only formally correspond to each other in identifying

the specific main duties of performance and necessary terms and conditions in order to bring about a valid conclusion of a contract.

The above description represents the traditional view of the requirements for the conclusion of a contract in civil law. It is based, however, more on historical concepts rather than on explicit legal provisions. There are no specific definitions of the valid "offer" and "acceptance" in the Civil Code from which this traditional concept can be irrefutably deduced. According to the "theory of a defective agreement (合意の瑕疵論, *gōi no kashi-ron*)", this rather formalistic, traditional view has to be modified in view of relevant disparities of information between the parties of a contract, in particular if they can be classified as a structural asymmetry of information, such as in the case of ordinary consumer contracts. In such cases, the proponents of this theory claim that the better informed party has to inform the other party sufficiently about the relevant important items of the transaction and the contract, and in particular must not make false or misleading explanations, even if there are no specific statutory information duties.[22] This concept is based on the general rule of good faith (Section 1(2) CC). In a situation where the provision of sufficient and accurate information is needed by a party who does not itself have full access to the information required to fully evaluate the transaction, but such information was not provided, or where the provided information was misleading or false, and as a result, this foreseeably led this party to the wrong impression about the transaction, i.e. the declaration of intent of the less informed party was not based on full and accurate information, the agreement should be considered defective, meaning invalid. This view, however, is not generally accepted by the courts and also not the prevailing view in legal theory. Accordingly, the concept of the requirements for the conclusion of a contract under civil law in general implies no information duties of either party.

(ii) Valid declarations of intent: Implied information duties?

A declaration of intent to enter into a contract can be invalid due to general reasons, for instance due to a limited capacity to act (制限行為能力, *seigen*

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22 K. YAMAMOTO, *Minpō ni okeru "gōi no kashi"-ron no tenkai to sono kentō* [A Study on the Development of the Theory of a "Defective Agreement" in Civil Law], in: Tanase (ed.), *Keiyaku hōri to keiyaku kankō* [Legal Basis for a Contract and Contract Customs] (Tōkyō 1999) 149–184; Y. IMANISHI, *Shōhi-sha torihiki higai ni okeru shōhi-sha no keiyaku teiketsu ishi ni tsuite* [On the Intent of the Consumer to Enter into a Contract in Cases of Damages Incurred by the Consumer in Consumer Transactions], in: Kōbe Shōdai Ronshū, Vol. 40, No. 4–5 (1989) 169–185, in particular at 171; M. DERNAUER, Verbraucherschutz und Vertragsfreiheit im japanischen Recht (Tübingen 2006) 109 et seq.

kōi nōryoku). This includes, for instance, declarations of intent uttered by minors without the consent of their legal representative, who, as a result of the declaration, would not solely receive a legal right or an exemption of a duty, but rather assume a duty, where the representative may avoid the declaration of intent of the minor (Section 5(1), (2) CC). Furthermore, a declaration of intent is invalid if the person who made the declaration lacks the general capability to form a will (意思能力, *ishi nōryoku*) – now clearly stipulated by new Section 3-2 CC –, as in cases involving young children.[23]

A valid declaration of intent, on the other hand, does not require, as such, that the declarant was fully aware of the main subject matter of a contract, all further terms of the contract or all important surrounding circumstances of the contract, but only to the extent necessary for a valid conclusion of a contract (see above). Moreover, the content of a declaration of intent is not decided based on the actual subjective will of the declarant, but on how the party to whom the declaration of intent is addressed ought to have understood it in view of the particular contract, considering legal and transaction certainty (取引安全, *torihiki anzen*).[24] This prevailing concept is called "declaration principle" (表示主義, *hyōji shugi*). Hence, it is generally of no relevance, what the declarant actually thought about the subject matter of the contract, its further terms and conditions and the basis for the decision to enter into the contract, unless those thoughts were noticeable for the addressee of the declaration as defining and necessary conditions for entering into the contract.

A minority opinion holds that in cases of a relevant disparity or structural asymmetry of information between the parties, such as generally to be assumed in case of consumer contracts, the subjective imagination of the declarant about the contract should be taken as a basis to decide on the content of the agreement reached by the parties. This is called the "rehabilitation of the will principle" (意思主義の復権, *ishi shugi no fukken*).[25] This view, however, is not shared by the courts. Only in exceptional cases of tremendously complicated subject matter or content of the consumer contract, where the consumer additionally was considered to be particularly inexperienced or weak-minded, and where the contract appeared to be particularly disadvantageous or unfitting for the consumer, have some courts denied a valid decla-

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23 The capability to form a will is generally considered to emerge between the age of 7 to 10 years; see M. ARAI/N. OKA, *Minpō kōgi-roku* [Lecture Notes Civil Law] (Tōkyō 2015) 15.

24 ARAI/OKA, *supra* note 23, 89.

25 See J. NAGAO, *Shōhi-sha keiyaku ni okeru ishi shugi no fukken* [The Rehabilitation of the Will Principle in Case of Consumer Contracts], in: Hanrei Taimuzu No. 497, 12–26.

ration of intent of the consumer to enter into the contract. This usually, however, has not included clarifying the legal basis for such judgment,[26] when consumers in court have stated that they had not sufficiently understood the contract and would not have entered into it if they had understood it.

There is only one exception to this general rule that the subjective imagination of the relevant facts is of no relevance for the validity of the contract. According to Section 95 CC, the declaration of intent is void (avoidable according to new Section 95 CC) in case of a relevant error "about an essential element (要素)" of the contract (or other juristic act) not caused by gross negligence. Although the meaning of an error about an essential element is vague, under the current law, only a formal discrepancy between what the declarant intended in making the declaration and the actual statement that was made is considered to fulfill this requirement (表示錯誤, *hyōji sakugo,* literally "declaration error"). This encompasses typing errors and slips of tongue (表示上の錯誤, *hyōji-jō no sakugo*) on the one hand, and using words that unknowingly have a different meaning in the context of use for the declarant (内容の錯誤, *naiyō no sakugo,* literally "error as to content") on the other. This concept does generally not extend to errors in motivation (動機錯誤, *dōki sakugo*).[27] If the declarant formally referred to the actual subject matter of the contract in his declaration of intent, but erred about the substance or object of the subject matter because of not having fully understood, or if the declarant had not fully understood or was unaware of the terms and conditions referred to or the relevance of certain surrounding circumstances, and erred thus about their actual meaning for the contract, all those errors are usually qualified only as errors in motivation to enter into the contract, and are thus legally irrelevant for the validity of the declaration of intent. The courts only treat an error in motivation as legally relevant if any such motivation was actually referred to in the declaration of intent as a basis and precondition for entering into the contract, or if such motivation was at least obvious for the other party.[28] Only in those

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26 District Court Sapporo, 28 August 1986 (unpublished); Summary Court Honjō, 25 March 1985, in: Seikatsu Gyōsei Jōhō No. 318, 109; Summary Court Monji, 18 October 1985, in: Hanrei Taimuzu No. 576, 93; and the summary of these decisions in DERNAUER, *supra* note 22, 111–114.

27 YAMAMOTO, *supra* note 9, 181–188; for the legal treatment of errors in motivation see in particular also H. MORITA, *Minpō 95-jō: dōki no sakugo wo chūshin toshite* [Section 95 CC: In Particular on Errors in Motivation], in: Hironaka/Hoshino (eds.), *Minpō-ten no hyaku-nen II* [Hundred Years of the Civil Code II] (Tōkyō 1999) 147–197.

28 Imperial Court *(Daishin'in),* 15 December 1914, Minroku 20, 1101; Supreme Court, 26 November 1954, Minshū 8, 2087; Supreme Court, 26 March 1963, Hanrei Jihō No. 331, 21; Supreme Court, 25 September 1965, Shūmin 75, 525; Supreme Court,

cases will the courts render the respective declaration of intent invalid, and, as a result, also the contract. However, in such cases, it is better to assume that the motivation has itself become part of the agreement as a precondition for entering into the contract, and that entering the contract therefore was contingent on the respective precondition, which would cause the contract to become invalid where those relevant facts were lacking. The above prevailing concept of a legal error therefore hardly allows the appreciation of information duties in the context of the application of Section 95 CC. Some legal scholars, on the other hand, argue that the dichotomy of distinguishing between legally relevant and legally irrelevant errors (二元的構成説, *nigen-teki kōsei-setsu*) inherent in the prevailing concept, is not adequate and also not prescribed by Section 95 CC. They recommend the application of a uniform concept of error for all kinds of errors (一元的構成説, *ichigen-teki kōsei-setsu*) or a modification of the prevailing concept. Based on this concept of a legal error, all types of errors might become legally relevant depending on the specific circumstances, including errors in motivation.[29] The evaluation of the specific error as relevant could also take into account a disparity in information, knowledge and experience between the parties (in particular for consumer contracts), and whether the better-informed and more experienced party had made efforts to inform and explain the relevant aspects of the contract to the other party.[30] According to this interpretation, therefore, Section 95 CC could also serve as a legal basis for requiring one party to a contract to explain to the other party important aspects of the contract, including its specific main subject matter, its terms and conditions and relevant surrounding circumstances in order to avoid a subsequent judgment rendering the contract void. The courts, however, generally do not follow this concept at all. Only in very few cases have the courts so far departed from the prevailing concept of an error, as explained above, to help consumers to withdraw from unwanted contracts.[31]

After the reform of the law of obligations, the wording of Section 95 CC will change, but not the prevailing concept of a legal error under this provision. Most declaration errors are still included by the new Section 95(1)

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29 May 1970, Hanrei Jihō No. 598, 55; Supreme Court, 14 September 1989, Hanrei Jihō No. 1336, 93; see also H. HIRANO, *Minpō sōsoku* [General Provision of the Civil Code] (Tōkyō 2017) 214–217.

29 YAMAMOTO, *supra* note 9, 183, 188–203; YAMAMOTO, *supra* note 22, 154–155, 166–171; H. MORITA, *"Gōi no kashi" no kōzō to sono kakuchō riron* [The Structure of the "Defective Agreement" and the Theories to Extend it] (1), in: NBL No. 482 (1991) 22, 24–31;

30 In particular YAMAMOTO, *supra* note 22, 154–155, 166–171, with further references.

31 For example: Nagoya High Court, 26 September 1985, Hanrei Jihō 1180, 64; District Court Tōkyō, 30 April 1994, Hanrei Jihō 1493, 49.

No. 1 CC. Errors as to the content and errors in motivation can still be legally relevant as factual errors (事実錯誤, *jijitsu sakugo*) according to new Section 95(1) No. 2, (2) CC, which is formally a new category of a relevant error in regard to relevant facts and circumstances, but which will hardly change the hitherto case law. Henceforth, however, the relevant facts and circumstances must be expressly mentioned by the declarant.[32] This is, in fact, a slightly stricter requirement than the hitherto requirement set by case law for relevant errors in motivation. However, the new Section 95 CC still does not allow for consideration of a relevant disparity of information, knowledge or experience between the parties, or unfair influence by one party (for instance by allowing consideration of negligent or factually insufficient information or incorrect or misleading information, linked to such disparity), which could be classified as a violation of implied positive or negative information duties. The introduction of such a concept was discussed during the preparation stage of a draft text for the reform of the law of obligations, but finally dropped.[33] As a rather technical aspect, the reform will change the legal consequence of a legal error. In the future, the declaration will not be invalid, but the erring declarant may avoid the declaration of intention.

Accordingly, full knowledge and information about the main subject matter of a contract, the terms and conditions of the contract, and relevant surrounding circumstances are not prerequisite for a valid declaration of intent to enter into a contract.

(iii) No implied information duties

As a result, neither the prevailing view of the legal requirements for a valid conclusion of a contract nor the requirements for a valid declaration of intent require full information about the main subject matter of the contract, the further terms of the contract or its surrounding circumstances. It also does not permit consideration of a possible breach of implied information duties, for instance in cases of a disparity or a structural asymmetry of information, knowledge and experience between the parties.

dd) Information duties and the inclusion of general terms and conditions

As explained above, under the general civil law concept regarding the requirements for the conclusion of a contract, the offer and the acceptance must both only formally refer to the terms and conditions that shall become

32 A. YAMANOME, *Atarashii saiken-hō wo yomitoku* [Exploring the New Law of Obligations] (Tōkyō 2017) 42–43, 46–47.

33 YAMANOME, *supra* note 32, 49.

part of the contractual agreement. If one party wants to include its general terms and conditions (GTC) into the contract, that party must explicitly refer to those GTC in its declaration of intent to enter into the respective contract. Since a failure to refer to the GTC usually means they are not included in the contract – a disadvantageous outcome – one may broadly consider classifying the necessity to point to the GTC as a formal information duty. On the other hand, indicating desired terms and conditions to the other party is only part of the contract negotiations, and thus should not qualify as an information duty.

The established case law in Japan, however, holds that GTC have to be treated specially. If one party generally uses certain GTC toward its customers, the courts generally tend to confirm the inclusion of the GTC as part of the applicable terms and conditions of the contract, in all cases where a contract was concluded. The leading case in this regard, decided by the Imperial Court, the highest civil court in Japan before the establishment of the modern Supreme Court in 1947, involves GTC of an insurance company. The company had neither delivered a copy of its GTC nor otherwise fully referred to them during negotiations of the contract. There was only a small reference in the application form for the customer that the insurance company uses GTC. For the Court, this was sufficient to confirm the valid inclusion of the GTC into the insurance contract. Even more, the Court held that if one party generally uses GTC as part of its business transactions, those GTC should generally be treated as part of the contract, unless (at least) one party, for instance the other party, has explicitly stated it did not wish its use before entering into the contract, regardless of whether the other party had knowledge of the existence of the respective GTC. This legal concept is called "theory of the presumed intention (意思推定説, *ishi suitei-setsu*)" and has been generally applied by the courts ever since.[34] The courts make only few exceptions with regard to particularly unfair and unusual clauses in GTC, especially for lease contracts for real property,[35] for arbitration clauses, and for clauses determining the applicable jurisdiction.[36] Therefore, according to the relevant case law, making formal reference to generally used GTC is not necessary for their inclusion into the contract.

This, however, will change with the upcoming reform of the law of obligations. New Section 548-2(1) No. 2 CC will require the user of GTC, now called "fixed terms and conditions (定型約款, *teikei yakkan*)" and defined

34 Supreme Court, 6 February 1962, Shōji Hōmu 248, 31; Supreme Court, 24 October 1967, Saihanshū 88, 741; Supreme Court, 8 May 1980, Hanrei Taimuzu 417, 83.

35 S. KAWAKAMI, *Yakkan kisei no hōri* [The Regulation of General Terms and Conditions] (Tōkyō 1988) 198–199.

36 Supreme Court, 23 February 1982, Minshū 36, 183.

in new Section 548-2(1) CC, to refer to them in contract negotiations, that is, in the declaration of intent to enter into the contract. Moreover, according to new Section 548-3(1) CC, the user has, on request from the other party, to present the GTC in full before the conclusion of the contract, in the appropriate form (and also after entering into the contract). If the user of GTC does not comply with this duty, the GTC will not become part of the contract, even if its inclusion was expressly agreed upon by the parties (new Section 548-3(2) CC). In view of the long-standing case law generally confirming the inclusion of the GTC as part of the agreement, this new regulation can be classified as an information duty for the user of GTC that aims to protect the other party from entering into the contract without having full opportunity to take note of the content. It does, however, not go beyond that. It does not aim to ensure the other party has in fact taken note of it before entering into the contract.

ee) Information duties based on good faith (bona fide)

Although not specifically addressed by the Civil Code, at present there is no longer dispute that a significant information disparity or a structural information asymmetry between the parties in principle gives rise to a pre-contractual information duty for the dominant party (including its assistants), based on the principle of good faith (Section 1 para. 2 CC, *shingi seijitsu no gensoku*). This means, the dominant party has to inform the other party during contract negotiations about all important details (重要事項, *juyō jikō*) regarding the main subject matter of the contract, the further terms and conditions, and the relevant surrounding circumstances, if the other party needs to receive this information. This is not only acknowledged by academic law theory,[37] but also by numerous court decisions of the Supreme Court and other courts at all levels.[38]

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37 KONDA, *supra* note 16, 3–4, 6; K. YAMAKAWA, *Setsumei gimu no hōteki konkyo, zentaizō* [The Basis for Information Duties and the Overall Concept, in: Konda (ed.), *supra* note 16, 9, 10–17; S. MIYASHITA, *Keiyaku kankei ni okeru jōhō teikyō gimu* [Information Duties in Contractual Relations] (1), in: Hōsei Ronshū 2000, 61, 63 et seq., 68 et seq.; M. YOKOYAMA, *Keiyaku teiketsu katei ni okeru jōhō teikyō gimu* [Information Duties Upon Entering into a Contract], in: Jurisuto 1996, 128–138; M. GOTŌ, *Keiyaku-hō kōgi* [Lecture Contract Law] (Tōkyō 2013) 13; Y. SHIOMI, *Kihon kōgi – Saiken kakuron I* [Basic Lecture – Special Law of Obligations I] (3rd ed. Tōkyō 2017) 4–7; YAMAMOTO, *supra* note 16, 474 (recital 43); K. YAMAMOTO, Basic Questions of Tort Law from a Japanese Perspection, in: Koziol (ed.), Basic Questions of Tort Law from a Comparative Perspective (Vienna 2015) 515, 560–561; C. FÖRSTER, Haftung für vorvertragliche Aufklärungspflichtverletzungen im japanischen Recht, Recht der Internationalen Wirtschaft (RIW) 2013, 44–55; M. DERNAUER, Vorvertragliche Aufklärungspflichtverletzungen im japani-

This information duty ensures that both parties enter into a contract with the relevant information about the contract. Depending on the case, this can be a *positive information duty* to actively provide all necessary information to the other party or to explain all relevant details, or a *negative information duty,* not to misinform the other party. The existence and the specific content of an information duty depend on the specific circumstances of the case. In order to decide about whether a party indeed has a duty to inform the other party and about what items, usually the specific experience and knowledge of the parties as well as the presence, availability or opportunity to collect the relevant information on both sides are taken into consideration.

A specific information duty is particularly straightforward where the circumstances involve a general structural information asymmetry between the parties engaged. Such a structural information asymmetry is generally recognized for example with regard to consumer contracts, [39] contracts involving the sale of financial products (e.g. investment products like securities and derivatives, and insurance contracts[40]) where only one party is a professional entrepreneur (financial service provider),[41] labor contracts,[42]

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schen Vertragsrecht, in: Coester-Waltjen/Lipp/Waters, Liber Amicorum Makato Arai (Baden-Baden 2015) 210, 213–214, 232–236.

38 Supreme Court, 27 November 2012, Hanrei Jihō 2175, 15; Supreme Court, 16 September 2005, Hanrei Jihō 1912, 8 – see also the partial English translation and comment of M. DERNAUER, Case No. 7, in: Bälz/Dernauer/Heath/Petersen-Padberg (eds.), Business Law in Japan – Cases and Comments (Alphen aan den Rijn 2012) 65–76; Supreme Court, 18 November 2004, Minshū 58, 2225.

39 N. YAMAGUCHI, *Shōhi-sha keiyaku to setsumei gimu* [Consumer Contracts and Information Duties], in: Konda (ed.), *supra* note 16, 185–199; MIYASHITA*, supra* note 37, Hōsei Ronshū 2000, 63 ff; A. ŌMURA*, Shōhi-sha, shōhi-sha keiyaku no tokusei* [The Particular Nature of the Consumer and the Consumer Contract] (3), NBL 1991, 36 et seq.; GOTŌ, *supra* note 37, 13; M. DERNAUER, *supra* note 22, 54 et seq. The perceived general structural information asymmetry is also reflected in the purpose definition in Section 1 Consumer Contract Act *[Shōhi-sha Keiyaku-hō],* Law No. 61/2000.

40 H. IGUCHI, *Hoken keiyaku to setsumei gimu* [Insurance Contracts and Information Duties], in: Konda (ed.), *supra* note 16, 284–314.

41 T. MATSUSHIMA, *Kin'yū shōhin torihiki to setsumei gimu* [Financial Products Transactions and Information Duties], in: Konda (ed.), *supra* note 16, 226–248; YAMAKAWA, *supra* note 37, 12; T. SAKURAI/T. UEYANAGI/Y. ISHITOYA*, Kin'yū shōhin torihiki-hō handobukku* [Handbook Financial Products Transactions] (Tōkyō 2002) 7–9. See also Section 1 Financial Products Sales Act *[Kin'yū shōhin hanbai-hō],* Law No. 101/2000.

42 KONDA, *supra* note 16, 6.

real property transactions,[43] and other contracts of ordinary individuals with professionals or experts, such as attorneys at law,[44] medical doctors,[45] tax consultants,[46] and public accountants.[47] Some see a general structural information asymmetry also between the parties of franchise contracts.[48] In all these cases, courts frequently acknowledge specific information duties and their violations.[49] Even in contracts between entrepreneurs or merchants (BtoB contracts), information duties will be sometimes acknowledged if there is a specific information disparity between the parties.[50]

(i) Tort law liability I: General features

The courts usually apply general tort law as a basis for sanctioning a violation of an information duty.[51] This results in a claim for compensation of damages (in money) based on a tort liability provision of the Civil Code, in the absence of a specific private law remedy ruling out the application of general tort law. The most important basis for assuming a tort liability in such cases is the general tort law provision Section 709 CC, which provides that a person who has intentionally or negligently (and illegally[52]) infringed

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43 N. YATA, *Manshon hanbai to setsumei gimu* [Sale of Condominiums and Information Duties], in: Konda (ed.), *supra* note 16, 48–71; K. SHIMIZU, *Fudōsan chūkai torihiki to setsumei gimu* [Real Property Transactions Involving Intermediaries and Information Duties], in: Konda (ed.), *supra* note 16, 35–47; Y. HORIE, *Kensetsu-gyō to setsumei gimu* [Construction Industry and Information Duties], in: Konda (ed.), *supra* note 16, 72 – 91; and further contributions in Konda (ed.), *supra* note 16.

44 K. FURUSATO, *Bengoshi to setsumei gimu* [Attorneys at Law and Information Duties], in: Konda (ed.), *supra* note 16, 435–457.

45 R. FUKUHARA, *Ishi to setsumei gimu* [Medical Doctors and Information Duties], in: Konda (ed.), *supra* note 16, 518–534.

46 N. TAKAGISHI, *Zeirishi to setsumei gimu* [Tax Consultants and Information Duties], in: Konda (ed.), *supra* note 16, 479–498.

47 T. AKISAKA / Y. HORINO, *Kōnin kaikei-shi to setsumei gimu* [Public Accountants and Information Duties], in: Konda (ed.), *supra* note 16, 499–517.

48 MIYASHITA, *supra* note 37, Hōsei Ronshū 2000, (10) 334 et seq.; DERNAUER, *supra* note 22, 63. See also O. TANABE, *Furanchaizu keiyaku to setsumei gimu* [Franchise Agreements and Information Duties], in: Konda (ed.), *supra* note 16, 327 – 364.

49 KONDA, *supra* note 16, 6.

50 See O. TANABE, *B to B torihiki to setsumei gimu* [BtoB Transactions and Information Duties], in: Konda (ed.), *supra* note 16, 315–321.

51 See e.g. above the decisions mentioned in *supra* note 38; see also e.g. SHIOMI, *supra* note 37, 6–9; YAMAMOTO, *supra* note 37, 561; YAMAKAWA, *supra* note 37, 13–14.

52 “Unlawfullness” or “illegality” (違法性, *ihō-sei*) is not expressly mentioned as a requirement for a tort (tort liability) in Section 709 CC, or in other special tort liability provisions of the Civil Code, but it is nonetheless generally considered to be

any right or legally protected interest of others, shall be liable to compensate any resulting damages. In this regard, the violation of an information duty is often qualified as an illegal infringement of a right to self-determination (自己決定権, *jiko kettei-ken*).[53]

If a specific information duty for the protection of a party is expressly laid down in a particular legal provision and if the respective legal provision has been violated by the obliged other party, it is also possible to construe a relevant illegal infringement of a right or legally protected interest as required by Section 709 CC, if the law provides no special sanction that excludes tort liability for such violation. Tort liability is most easily assumed where the conduct of a party constitutes a crime stipulated by the Penal Code (PC), such as fraud (Section 246 PC), regardless of criminal liability. A violation of special private law provisions with information duties can also constitute a tort, but most cases of private law information duties explicitly set by law, provide a specific private law consequence. A violation of administrative regulations with public law information duties or rules set through self-regulation alone, on the other hand, does not always constitute a tort.

Tort law liability in principle grants the injured party a monetary claim for compensation of pecuniary damages (Sections 722(1), 417 CC) and non-pecuniary damages (Section 710 CC). Claims for compensation of non-pecuniary damages will be only granted if the injured party has also suffered physical or mental pain.[54] In cases of a violation of an information duty, courts grant claims for non-pecuniary damages only under special circumstances for mental pain (精神的苦痛, *seishin-teki kutsū*), for instance if the incurred pecuniary damage is particularly high and/or if the tort has significantly affected the daily life of the injured party. These cases include those where an ordinary consumer has suffered high financial losses as a result of the purchase of high-risk financial products for investment purposes,[55] through fraudulent investment transactions[56] or other fraudulent

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such a requirement; cf. YAMAMOTO, *supra* note 37, 539–542; Y. SHIOMI, *Kihon kōgi – Saiken kakuron II* [Basic Lecture – Special Law of Obligations II] (3rd ed., Tōkyō 2017) 18–24.

53 SHIOMI, *supra* note 37, 6; YAMAKAWA, *supra* note 37, 11; FUKUHARA, *supra* note 45, 534. Some also assume that a violation of an information duty can qualify as an infringement of a relevant expectation right (期待権, *kitai-ken*), or of a relevant economic interest (*torihiki rieki,* 取引利益 or *keizai-teki rieki,* 経済的利益), see DERNAUER, *supra* note 22, 187.

54 YAMAMOTO, *supra* note 37, 571–575.

55 District Court Saga, 18 July 1986, Hanrei Jihō 1222, 114; District Court Okayama, 28 April 1994, Sakimono Torihiki Saibanrei-shū XVI, 43 (commodity futures transactions).

transactions.[57] In such cases the amount granted as compensation for non-pecuniary damages is often schematically calculated as approximately ten percent of the incurred pecuniary damages.[58] In addition, tort law allows the injured party to claim statutory interest on the due amount of compensation, calculated from the day the damages have occurred[59] and compensation for a part of the fees paid to an attorney at law for pursuing the damage claims.[60]

Sections 709, 710 CC thereby provide a basis for liability for damages of the individual actors. This liability arises from a negligent or intentional violation of a pre-contractual information duty based on good faith, particularly when committed by individual experts, sole entrepreneurs, governing organs, executive officers, partners, or employees of companies (and other legal entities), or assigned third party assistants and agents (including employees and organs of companies and other legal entities). This includes in particular third party experts such as managing partners, organs, or staff of real estate companies entrusted and commissioned with a particular transaction by a party to the contract.[61] Violation of an information duty by governing organs, executive officers and partners of companies automatically extends the tort liability to the respective company itself (based on Sections 350, 600 Company Act). Similar considerations apply for other legal entities established on other special laws. In cases where a legal entity is to enter into a contract, the courts do not always precisely distinguish between the legal entity itself and the individual acting on behalf of the legal entity when they give reasons for a particular pre-contractual information duty relevant in the context of tort law. Depending on the case, the acting individuals and legal entities are treated as a unit with particular expert knowledge, or the acting individuals themselves are the reason for the assumption of an information disparity and a resulting information duty, for example because they are viewed as having the relevant expert knowledge, which also extends to one party to the contract.

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56 District Court Akita, 27 June 1985, Hanrei Taimuzu 494, 116; District Court Kōbe, 28 September 1987, in: Nagoya Shōhi-sha Mondai Kenkyū-kai (ed.), *Hanrei – Shōhi-sha torihiki-hō* [Case law – Consumer Transactions] (Tōkyō 1992) 343.

57 DG Ōsaka, 24 April 1981, Hanrei Jihō 1009, 33.

58 For details, DERNAUER, *supra* note 22, 205–207.

59 Supreme Court, 4 September 1962, Minshū 16, 1834.

60 Supreme Court, 27 February 1969, Minshū 23, 441. Usually about 20 to 30 % of the full lawyers' fees the injured party actually has to bear, see SHIOMI, *supra* note 52, 79.

61 See Supreme Court, 16 September 2005, Hanrei Jihō 1912, as well as the translation and comment on this case, DERNAUER, *supra* note 38, 65–76.

If the individual acting for a party to the contract has committed a relevant violation of a pre-contractual information duty (and is therefore liable based on Section 709 CC) and is not an organ of that party, the tort liability of the contracting party itself is based on Section 715 CC, the employer's or principal's liability. Although the wording of Section 715 CC provides that the employer may in principle escape this liability (by proving due care was taken with respect to the selection and supervision of the employee or auxiliary), in legal theory and practice, employer's liability is considered to be a strict liability.[62] Other individuals that have helped in the solicitation of the contract on behalf of the principal contracting party and which are considered to have assisted in the violation of the information duty, or instigated it, can easily be held liable based on the joint liability pursuant to Section 719 CC. This requires only an objective connection between the main perpetrator and the assistants in the tortious acts, and negligence on behalf of the assistant.[63] All individuals or legal entities liable for the violation of an information duty, be it based on Section 709, 715 or 719 CC, or on any other special tort law provision, are always jointly and severally liable towards the injured person.

Although the acknowledgment of a tort law liability for a violation of a pre-contractual information duty does not automatically invalidate a contract entered into by the contracting parties, in practice, the courts sometimes treat the contract as no longer existing, although they sometimes give no specific further reason for the invalidity of the contract (which could be, for instance, the violation of public order or policy, Section 90 CC). Moreover, the monetary compensation can include an amount equivalent to all the payments made by the injured party. Therefore, the acknowledgement of a tort liability in such cases is by some scholars regarded as "equivalent to a restitution in kind (原状回復的損害賠償, *genjō kaifuku-teki songai baishō*)"[64], involving something like an opportunity for the aggrieved party

62 M. C. CHINO/N. KASHIWAGI/A. OKADA, Contract and Tort, in: McAlinn (ed.), Japanese Business Law (Alphen aan den Rijn 2007) 173, 216; YAMAMOTO, *supra* note 37, 630–633; SHIOMI, *supra* note 52, 141–142; DERNAUER, *supra* note 22, 207–209.

63 CHINO/KASHIWAGI/OKADA, *supra* note 62, 219–220; SHIOMI, *supra* note 52, 177–182; for details, see also DERNAUER, *supra* note 22, 209–211.

64 YAMAMOTO, *supra* note 22, 164; Y. SHIOMI, *Kihan kyōgō no shiten kara mita songai baishō-ron no genjō to kadai* [The present state of the legal theory regarding compensation for damages from of the viewpoint of concurring rules, and the involved functions], in: Jurisuto 1079 (1995) 91, 94–95; Jurisuto 1080 (1995) 86, 91–94; K. YAMAMOTO, *supra* note 37, 561; SHIOMI, *supra* note 37, 9; restitution in kind as a form of compensation for damages is usually available only in special cases, such as defamation (Section 723 CC).

to disengage from an “undesired contract”.[65] However, in many cases the courts also confirm a contributory negligence of the injured party leading to a reduction of the claim for compensation of damages based on Section 722(2) CC.[66] The structure of Japanese tort law and the concept of a disengagement from an undesired contract are hence not fully consistent.

The Japanese Supreme Court, for instance, acknowledged a tort law liability in a case where a real estate company as a landlord wrongly informed the tenants of a housing complex that they would receive a special purchase offer for their apartment if they agreed to leave the apartment for upcoming renovation works, although the company was planning a general purchase offer regardless of the tenants’ conduct.[67]

Another case of the Supreme Court involved failing to inform about the existence and location of a fire door inside a condominium.[68] Here a real estate company acted on behalf of the seller of the condominium, as an agent in regard of the conclusion of the sales contract as well as an assistant in performing the contract. The seller was held liable for damages resulting from a (negligent) failure to inform before entering into the contract and after the conclusion of the contract, based on tort law (Section 709, 715 CC) and for non-performance of the contractual obligation (Section 415 CC, breach of a contractual information duty). However, the real estate company itself was also held liable, as an expert in the real estate business, based on tort law (Section 709, 715 CC). Hence, third parties who act as experts on behalf of a contracting party can also have information duties based on good faith towards the other party to the contract, before (precontractual) and after (equivalent to a contractual information duty) the conclusion of a contract.

In a Supreme Court case regarding a non-consumer transaction, a tort law liability of a financial service provider was acknowledged because the provider did not sufficiently inform a potential finance provider (a bank) about the desolate financial situation of the company that sought financial support.[69] Here again, the main aspect of the case was not the liability of

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65 Based on the concept of S. LORENZ, Der Schutz vor dem unerwünschten Vertrag – Eine Untersuchung von Möglichkeiten und Grenzen der Abschlußkontrolle im geltenden Recht (Munich 1997) 2. This concept has also been picked by some scholars in Japan; see for example Y. SHIOMI, *Kihon kōgi – Saiken kakuron I* [Basic Lecture – Special Law of Obligations I] (2nd ed., Tōkyō 2009) 5 *(„nozomanakatta keiyaku“).*

66 SHIOMI, *supra* note 37, 9; for details see DERNAUER, *supra* note 22, 203–204.

67 Supreme Court, 18 November 2004, Minshū 58, 2225.

68 Supreme Court, 16 September 2005, Hanrei Jihō 1912; translation and comment on this case by DERNAUER, *supra* note 38, 65–76.

69 Supreme Court, 27 November 2012, Hanrei Jihō 2175.

the contractual party, the company that sought financial support, but rather the (additional) liability of the expert acting on its behalf.

(ii) Tort law liability II: "Tortious acts in business transactions"

Although a tort liability can be reasonably construed in cases of a violation of a specific information duty based on good faith in accordance with the requirements explained above (under (1)), most court decisions do not exclusively deal with the violation of one single information duty in the context of tort law, instead taking into account the list of wrongdoings and assessing the overall picture from the rather flexible and vague standard of "unlawfullness (違法性, *ihōsei*)". That means, assessments under Section 709 CC (and Sections 715, 719 CC etc.) do not focus on one single wrongdoing, but a bundle of assumed minor wrongdoings or illegal circumstances on the basis of an overall view (総合判断, *sōgō handan*). Conduct of one party, considered on the whole to be "illegal", gives rise to a tort liability under Section 709 CC. This court practice has been described in legal literature with an analogy from Jūdō competition as a "合わせて一本 *awasete ippon*" judgment.[70] In those cases, the questions of whether a specific right or legal interest has been infringed, of whether one single wrongdoing is sufficient to constitute a tort, or whether negligence occurred, is usually not fully discussed.

Violations of pre-contractual information duties of various kinds play a predominant role in those cases. These are based on good faith, as well as more specific regulations (including public law information duties), but also breaches of other pre-contractual duties, of contractual duties (non-performance), and all sorts of violations of regulations and other rules. These rules include those set through self-regulation, for instance statutes set by stock market operators and rules set by associations of securities dealers.

The number of such court decisions is particularly high in cases involving the sale of financial products[71] (e.g. securities transactions,[72] commodi-

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70 T. MATSUMOTO, *Gimanteki torihiki ni okeru keiyaku no kōryoku to fuhō kōi sekinin – sakimono torihiki higai wo sozai ni* [Validity of Contracts and Tort Law Liability in Fraudulent Business Transactions: The Example of Damages Resulting from Commodity Futures Transactions], in: Sakimono Torihiki Higai Zenkoku Kenkyū-kai (ed.), *Sakimono torihiki higai kenkyū* [Studies on Damages Suffered from Commodity Futures Transactions] No. 9 (1993) 9, 14.

71 S. YAMADA, *Kinyū torihiki ni okeru setsumei gimu* [Information Duties in Financial Transactions], in: Jurisuto No. 1154 (1999) 21–29; S. MIYASHITA, *Kin'yū kikan ni yoru shōhin hanbai no kan'yū to setsumei gimu* [The Solicitation of a Sale of Products by Financial Institutes and Information Duties], in: Shizuoka Daigaku Hōsei Kenkyū Vol. 10, No. 3=4 (2006) 1–56.

ty futures transactions,[73] and other investment transactions[74]), fraudulent consumer transactions,[75] and consumer contracts[76] in general; that is, in cases where a significant disparity in information, knowledge and experience between the parties is presumed. This specific case law is considered to constitute a separate category of tort law application and is called "tortious acts in business transactions" (取引的不法行為, *torihiki-teki fuhō kōi* or 取引型不法行為, *torihiki-gata fuhō kōi*)[77].

(iii) Concept of "culpa in contrahendo": Contractual liability for pre-contractual information duties

Some scholars argue that the relation of good faith established by the commencement of contract negotiations is a key reason for the acknowledgement of specific pre-contractual information duties between the would-be parties to a contract. A liability for a violation of such pre-contractual information duties must therefore be a contractual liability, not a tort law liability. As a basis for this concept, they use the theory of *culpa in contrahendo,* first introduced from Germany to Japan by legal academics in the 1920s and discussed in Japan ever since.[78]

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72 See the analysis of A. M. Pardeck, *Shōken torihiki kanyū no hō-kisei: „kaiji gimu", „setsumei gimu" wo koete* [Regulating the Solicitation of Securities Transactions: Beyond Disclosure and the Duty to explain] (Tōkyō 2001) 95–214.

73 DERNAUER, *supra* note 22, 216–228, with several examples; MIYASHITA, *supra* note 37, Hōsei Ronshū 2003 (7) 213–253, with a list of 245 cases; M. SUMIDA, Anlegerschutz bei Warentermingeschäften in Japan, ZJapanR/J.Japan.L No. 12 (2001) 129–138.

74 For details see T. SHIMIZU, *Tōshi kan'yū to fuhō kōi* [Solicitation of Investment transactions and tort] (Tōkyō 1999).

75 See the court "decisions in the "Toyota Shōji" case and the "Belgian Diamonds" case, DERNAUER, *supra* note 22, 229–243.

76 For details see DERNAUER, *supra* note 22, 181–244; M. SAITŌ, *Shōhi-sha torihiki to fuhō kōi* [Consumer Transactions and Tortious Acts], in: Nihon Bengoshi Rengōkai (ed.), *Shōhi-sha-hō kōgi* [Lecture Consumer Law] (4th ed., Tōkyō 2013) 107–133, in particular 116–119; in Japanese, *culpa in contrahendo* is referred to by the term "契約締結上の過失, *keiyaku teiketsu-jō no kashitsu*".

77 See e.g. S. YAMADA, *Tōrihiki ni okeru fuhō kōi – yōken wo chūshin ni* [Torts in Business Transactions: Focusing on the Requirements], in: Jurisuto No. 1097 (1996) 98; SAITŌ, *supra* note 76, 115; SHIOMI, *supra* note 52, 147. For a detailed explanation see M. OKUDA (ed.) *Torihiki kankei ni okeru ihō kōi to sono hōteki shori* [Illegal Acts in Business Relations and its Legal Handling], Jurisuto Bessatsu (Tōkyō 1996).

78 SHIOMI, *supra* note 37, 4–5; YAMAKAWA, *supra* note 37, 14; for details: see for instance M. TAKAHASHI, *Keiyaku teiketsu-jō no kashitsu-ron no gen-dankai* [The Present State of the Theory of *culpa in contrahendo*], in: Jurisuto 1094 (1996) 121–

This legal theory provides a comprehensive theoretical basis for establishing a liability for damages resulting from negligent or willful breaches of various forms of pre-contractual duties. The commencement of contract negotiations establishes a quasi-contractual relationship with loyalty duties and protective duties between the negotiating parties, which may include mutual information duties in cases of a significant information disparity.[79] In Germany, liability based on the concept of *culpa in contrahendo* was long acknowledged in continuous case law by the German Supreme Court in civil cases (Bundesgerichtshof, BGH) and its predecessor, the German Imperial Court (Reichsgericht, RGH), and was finally codified in 2002 in Sections 280(1), 311(2), 241(2) of the German Civil Code as a special non-tortious statutory form of liability for damages. In the past, however, it was often qualified as a quasi-contractual liability.

Following this concept, some scholars in Japan hold that a breach of pre-contractual information duties can lead to liability for non-performance of an obligation pursuant to Sections 415, 541–543 CC, with a monetary claim for the compensation of damages and a right to rescind the contract.[80] Others hold, that the specific basis for granting claims for the breach of pre-contractual information duties should remain a tort law provision, such as Section 709 CC.[81]

The Japanese courts, however, usually do not mention the concept of *culpa in contrahendo* at all. Moreover, they use tort law as a basis for a liability for the violation of pre-contractual duties, as described above. The courts in particular do not grant any claims based on a liability for non-performance pursuant to Sections 415, 541–543 CC.[82] The Japanese reform commission for the law of obligations temporarily considered proposing the

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128; T. TSUBURAYA, Die Entwicklung der "culpa in contrahendo" in Japan, in: Müller-Freienfels et al. (eds.), Recht in Japan No. 10 (1996) 39–52; N. TANAKA, Zur Befreiung des Verbrauchers aus dem aufgrund unlauterer Verhandlungen abgeschlossenen Vertrag im japanischen Zivilrecht, in: Müller-Freienfels et al. (eds.), Recht in Japan No. 11 (1998) 43–62; J. HONDA, *"Keiyaku teiketsu-jō no kashitsu" riron ni tsuite* [On the Theory of the culpa in contrahendo], in: Endō (ed.), *Gendai keiyaku-hō taikei* [The Modern System of Contract Law], Vol. 1 (Tōkyō 1983) 193–215; YAMAMOTO, *supra* note 16, 472; DERNAUER, *supra* note 22, 132–139; DERNAUER, *supra* note 38, 72–74.

79 SHIOMI*, supra* note 37, 4–5; for the original German concept of *culpa in contrahendo,* see e.g. D. MEDICUS/S. LORENZ, Schuldrecht I (20th ed., Munich 2012) 52–61, with further references.

80 See e.g. HONDA, *supra* note 78, 207–208; TAKAHASHI, *supra* note 78, 144; TANAKA, *supra* note 78, 52.

81 TAKAHASHI, *supra* note 78, 141 (footnote 4), 142–143; YAMAMOTO, *supra* note 16, 473 et seq.

82 Supreme Court, 22 April 2011, Minshū 65, 1405.

inclusion of a new legal provision for the Civil Code as a special basis for pre-contractual information duties in cases of a particular information disparity between the parties. The commission also considered proposing a new special liability provision for the compensation of damages in cases of a violation of this and other pre-contractual duties. This concept, however, was abandoned during the deliberation process.[83]

(iv) Result

Therefore, under the Civil Code, a breach of pre-contractual information duties is often dealt with by the application of tort law in the absence of more specific legal remedies.

b) Special private laws

aa) The Act on the Sale of Financial Products

One of the relevant special private laws in regard of pre-contractual information duties is the Financial Products Sales Act (金融商品販売法, *Kinyū shōhin hanbai-hō,* FPSA[84]), which came into effect in 2001. This law provides a basis for a special tort liability in case of a breach of specifically defined pre-contractual information duties in the context of the sale of many financial products, such as securities, derivatives (e.g. options, financial futures and forward transactions), or insurance certificates, as defined by Section 2 FPSA.

According to Section 3 FPSA, the professional seller has to properly inform a customer who is not a professional financial entrepreneur about certain important details (重要事項, *jūyō jikō*) of the contract, before entering into the contract. These details include the market risks involved (Section 3(1) nos. 1, 2 FPSA) and strict periods for the exercise of rights or for the cancellation of contracts (Section 3(1) no. 7 FPSA). Additionally, the professional financial entrepreneur must also inform the customer about the potential risk of loss of the invested capital because of the financial situation of the respective entrepreneur itself or involved third parties (Section 3(1) nos. 3, 4 FPSA) *("positive information duties").* The information provided must also be accurate to fulfill the legal duties, so that the information duties are at the same time also *"negative information duties".* The degree the customer has to be informed depends on the knowledge and experience of the

83 See the draft provision in Paragraph 27 (p. 48) of the Intermediate Proposal for the Reform of the Civil Code (Obligational Relations) *(Minpō (saiken kankei) no kaisei ni kansuru chūkan shian)* of February 2013.

84 In full: 金融商品の販売等に関する法律, *Kin'yū shōhin no hanbai-tō ni kansuru hōritsu,* Law No. 101/2000. For details see DERNAUER, *supra* note 22, 301–389.

customer on the one hand and, on the other hand, on the financial situation and the customer's purpose for purchase (Section 3(2) FPSA). In addition, pursuant to Section 4 FPSA, the financial entrepreneur must not provide a misleading determinative opinion (断定的判断の提供の禁止, *dantei-teki handan no teikyō no kinshi*) on uncertain circumstances, for instance regarding the possible rate of return *("negative information duty")*.

The liability for a violation of either information duty (Sections 3, 4 FPSA) is a strict liability to compensate the customer for all resulting damages (Section 5 FPSA). All financial disadvantages the customer suffered, including loss of the invested money and money otherwise paid, are presumed to be damages resulting from the violation of the respective information duties (Section 6 FPSA). Moreover, the law does not care whether the financial entrepreneur (its organs) itself or an employee or other agent solicited the contract. An insufficient or incorrect provision of information results in direct liability for the financial entrepreneur.

The reasons for establishing this liability are referred to in Section 1 FPSA as ensuring the fairness of solicitation for financial products such as sales contracts, and protecting customers, thereby also contributing to the sound development of the national economy. The background for the information duties under this law is therefore a presumed structural asymmetry as regards information, knowledge and experience between financial entrepreneurs and their customers. This includes the objective that the customers in financial transactions shall be properly informed about the relevant information of the respective financial transactions before entering into the contract. Liability arises only if a pre-contractual information duty provided by the law was violated. The liability for compensation of damages pursuant to Section 5 FPSA therefore safeguards the information duties in Sections 3 and 4 FPSA. Although this law does more than only protect consumers, consumer protection is its primary objective.

The liability for damages pursuant to Section 5 FPSA is being classified as either a special tort liability[85] or a special statutory liability for a case of *culpa in contrahendo*.[86] Irrespective of the dispute in regard of its classification, the application of the FPSA does not exclude the application of general tort law, be it as a separate basis for a claim for compensation of damages (e.g. based on Section 709 CC), or only regarding the results of a

85 For instance, Y. SHIOMI (ed.), *Shōhi-sha keiyku-hō, Kin'yū shōhin hanbai-hō to kin'yū torihiki* [The Consumer Contract Act, the Financial Products Sales Act and Financial Transactions] (Tōkyō 2001) 127 et seq.

86 For instance, H. KANSAKU, *Shōhi-sha keiyaku-hō to Kin'yū shōhin hanbai-hō* [The Consumer Contract Act and the Financial Products Sales Act], in: Jurisuto 1200 (2001) 39, 40.

claim pursuant to Section 5 FPSA, for which no specific rules are provided in the FPSA (Section 7 FPSA). This means, for instance, that contributory negligence of the customer can be taken into consideration to reduce the claim for compensation of damages against the financial entrepreneur, as in cases of tort based on the Civil Code.

Although the FPSA has certain formal advantages over tort claims based on the Civil Code (e.g. strict liability, presumption of causality and amount of damages), the claims provided by the FPSA in fact are generally not considered to be more advantageous over civil law claims brought in a law suit. This is because customers could already quite easily pursue claims in well-founded cases under the case law based on tort law that had been established to deal with financial losses of customers in investment transactions and other financial transactions before the FPSA came into effect. Therefore, the number of cases predominantly using Section 5 FPSA has turned out to be fewer than expected.[87]

bb) The Consumer Contract Act

The Consumer Contract Act (消費者契約法, *Shōhi-sha keiyaku-hō,* CCA[88]), which also came into effect in 2001, provides for special *negative* pre-contractual information duties for entrepreneurs (including its employees and other assistants) when they are about to enter into a contract with a consumer.

Pursuant to Section 4(1) no. 1, (2) CCA, the entrepreneur must not provide false information (不実告知の禁止, *fujitsu kokuchi no kinshi*) or intentionally conceal disadvantageous facts (事実不告知の禁止, *jijitsu fu-kokuchi no kinshi*) regarding important details (*jūyō jikō*) of the contract, which are defined in Section 4(5) CCA as

1. the quality, usage or further items in regard of the subject matter of the contract, or
2. the price/consideration and further contract terms and conditions, or
3. the factors which usually require prevention measures to avoid a damage to or danger for the life, the body, the property or any other important interest of the consumer,

if they usually influence the decision of consumers to enter into the contract.

87 KIN'YŪ SHŌHIN TORIHIKI-HŌ KENKYŪ-KAI (ed.), *Kin'yū shōhin torihiki-hō kenkyū kiroku dai 27gō: Kin'yū kikan ni yoru setsumei, tekigō-sei no gensoku to Kin'yū shōhin hanbai-hō* [Protocol No. 27 of the Studies on the Law of Financial Products Transactions: The Provision of Information by Financial Institutes, the Suitability Doctrine and the Financial Products Sales Act] (Tōkyō 2009) 2.

88 Law No. 61/2000.

In the former case of a "provision of false information", it is irrelevant whether the information duty was violated negligently or not. In contrast, in the latter case of a "concealment of disadvantageous facts", the concealment must have been carried out intentionally.[89]

Moreover, the entrepreneur must not provide a misleading determinative opinion (断定的判断の提供の禁止 *dantei-teki handan no teikyō no kinshi*) on a future price, an amount of money the consumer should receive in the future or other future items where fluctuations make these amounts uncertain (Section 4(1) no. 2 CCA). Here, negligence is also no precondition for a violation of this information duty.

In all the cases of a violation of a defined pre-contractual information duty, the consumer has a right to avoid the declaration of intent to enter into the contract if the violation resulted in a misunderstanding (誤認, *gonin*) on the part of the consumer, and if this misunderstanding eventually resulted in the conclusion of the contract. Moreover, a specifically registered consumer association may claim injunctive relief for a violation of Section 4 CCA by an entrepreneur for the benefit of all consumers (Sections 12 et seq. CCA).

In addition, Section 3(1) CCA provides a duty of the entrepreneur to make efforts to inform the consumer, before entering into the contract, about the rights and duties of the consumer resulting from the contract as well as about the further content of the contract, and to take care that a draft contract is clearly formulated and easy to understand for the consumer. At the same time, pursuant to Section 3(2) CCA, the consumer also has to make efforts to use the provided information and to understand the content of the contract. There is some dispute whether these "duties of endeavour" are real duties and thus justiciable, or only moral statements or interpretation provisions with no direct result. The CCA stipulates no direct consequence for a violation. The courts do not treat a violation uniformly, some acknowledge a claim for compensation of damages based on tort (Section 709 CC),[90] while others refuse to acknowledge such a claim, with the argument that the legislators would have clearly provided a legal result in the law had they wanted it.[91]

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89 For details see DERNAUER, *supra* note 22, 252–259; K. YAMAMOTO, Das Verbrauchervertragsgesetz in Japan und die Modernisierung des Zivilrechts, in: Becker/Hilty/Stöckli/Würtenberger (eds.), Recht im Wandel seines sozialen und technologischen Umfeldes: Festschrift für Manfred Rehbinder (Munich/Zurich 2002) 819–836; M. DERNAUER, § 13 Verbraucherschutz, in: Baum/Bälz (eds.), Handbuch Japanisches Handels- und Wirtschaftsrecht (Cologne 2011) 567, 581–582.

90 See for example District Court Ōtsu, 3 October 2003, in: Shōhi-sha-hō Nyūsu No. 58, 129; Lex DB Case No. 28090191, also available at *http://www.courts.go.jp/;* see also the comment on the case with summary of S. MIYASHITA, in: *Shōhi-sha-hō Hanrei Hyakusen,* Bessatsu Jurisuto 200 (2010) 78.

Section 1 CCA justifies these information duties by reference to a presumed structural information asymmetry between entrepreneurs and consumers, as well as the purpose of ensuring the sound development of the national economy. The information duties are therefore to ensure that the consumer will not enter into a contract with an entrepreneur on the basis of misinformation by the entrepreneur. The CCA does not preclude the additional application of the Civil Code (tort law, Section 96 CC etc.) and, arguably, of the Financial Products Sales Act (Section 11 CCA).

cc) The Act on Specific Commercial Transactions (SCTA) and the Instalments Transaction Act

Similar negative pre-contractual information duties as in the Consumer Contract Act can be found in the Act on Specific Commercial Transactions[92] (Sections 9-3, 6; 24-2, 21; 40-3, 34; 49-2. 44; 58-2, 52; 58-10, 58-24 SCTA) and in the Instalments Transaction Act[93] (Sections 35-3-13 to 35-3-16) with regard to some specific consumer transactions: door-to-door sales transactions and similar transactions outside a commercial office, sales transactions via telephone, multilevel marketing transactions, specific long-term service contracts, occasional business opportunity related sales contracts, purchase transactions outside a commercial office, and consumer credit transactions, pursuant to the Instalments Transaction Act, related to any of the regulated commercial transactions in the SCTA. The entrepreneur (including its employees and other assistants) must not provide false information (不実告知の禁止, *fujitsu kokuchi no kinshi*) or intentionally conceal important information (事実不告知の禁止, *jijitsu fu-kokuchi no kinshi*) about the transaction and the contract. In this law, the relevant details are more precisely defined than in the CCA. They include, for instance, details about the “sort of product, the ability to use the product, the quality of the product”, the “price for the product”, the “time of performance”, “the cooling-off period and the rights involved therewith”, and “other important details in regard of the contract which are important for the decision of the consumer to enter into the contract”, and specific “details listed in an ordinance of the Ministry of Economy, Trade and Industry”. In case of a violation of any of these information duties, the consumer may again avoid and nullify the contract if the violation resulted in a misunderstanding on side of the consumer and if this misunderstanding resulted in the conclusion of the contract. Should a related credit contract for the financing of any of the

91 DG Nagoya, 29 January 2007, unpublished, retrieved at the homepage of the Kōbe Attorneys’ Association.

92 特定商取引に関する法律, *Tokutei shō-torihiki ni kansuru hōritsu,* Law No. 57/1976.

93 割賦販売法, *Kappu hanbai-hō,* Law No. 159/1961.

specifically regulated transactions have been concluded, both contracts can be avoided, regardless of whether the violation of an information duty took place at the occasion of entering into the contract for the financed transaction or on conclusion of the credit contract. Furthermore, here again, a registered consumer association may pursue a violation of any information duty by a claim for injunctive relief.

In contrast to the information duties provided by the Consumer Contract Act, however, the information duties in the SCTA are also of public law nature ("prohibitions"). The Ministry of Economy, Trade and Industry can take administrative measures in case of a violation, and violations may be also punished with a fine of up to 3 Mio. Yen (ca. 25.000 EUR) and/or imprisonment of up to three years. Hence, the information duties are civil law duties, administrative law duties, and penal law duties.[94]

These information duties were introduced to protect consumers in view of their reduced ability to judge the transactions due to a presumed structural asymmetry in information, experience and knowledge. Moreover, as a general purpose of both laws, they contribute to the sound development of the national economy.

dd) Further pre-contractual information duties

This paper cannot explain in detail all pre-contractual information duties. More private law information duties can be found in laws that regulate particular types of contracts where generally an information asymmetry between the parties is presumed, such as for instance in the case of labor contracts (e.g. Section 4 Labor Contract Law)[95] and Insurance Contracts (e.g. Section 4 Insurance Law)[96].

2. Public Law Information Duties

Two types of public law pre-contractual information duties of entrepreneurs vis-à-vis specific customers or consumers have been discussed above; namely, a duty not to provide false information *(fujitsu kokuchi no kishi)* and a prohibition to conceal important information *(jijitsu fu-kokuchi no kinshi).* Both duties can be found in the Act on Specific Commercial Transactions where they also have private law effects. A violation of any of these provisions may at the same time also constitute a fraud under the Penal Code (Section 246 PC)

94 For details see also DERNAUER, *supra* note 22, 301–326; DERNAUER, *supra* note 89, 582–583.

95 労働契約法, *Rōdō keiyaku-hō,* Law No. 128/2007.

96 保険法, *Hoken-hō,* Law No. 56/2008.

There are, however, many other types of (administrative and criminal) positive and negative pre-contractual information duties for entrepreneurs towards customers (mostly consumers or non-professional customers in financial transactions). Most important of these are the general duties to provide certain important information or to explain important details regarding the entrepreneur and the transaction (contract) (情報提供義務, *jōhō teikyō gimu* or 説明義務, *setsumei gimu*),[97] duties to provide formalized documents with specifically required information (書面交付義務, *shomen kōfu gimu*),[98] duties to show or present standard terms of business used by the entrepreneur,[99] duties to provide certain specific information about the entrepreneur and/or its products in public advertisements (広告における表示義務, *kōkoku ni okeru hyōji gimu*),[100] prohibitions of excessive and misleading advertising (誇大広告の禁止, *kodai kōkoku no kinshi kōkoku no kinshi*),[101] and prohibitions to provide a determinative opinion (断定的判断提供の禁止, *dantei-teki handan teikyō no kinshi*).[102] These and other types of public law pre-contractual information duties can be found in many different laws, ordinances and statutes of prefectures and municipalities in Japan;

97 For example: Section 12-4 Travel Business Act (旅行業法, *Ryokō-gyō hō*), Law No. 239/1952 (travel contracts); Section 24 Real Property Funds Act (不動産特定共同事業法, *Fudōsan tokutei kyōdō jigyō-hō*), Law 77/1994 (contracts regarding the sale of shares of a real property fund); Sections 34, 35 Real Property Business Act (宅地建物取引業法, *Takuchi tatemono torihiki-gyō hō,* Law No. 176/1952) (real property sales transactions), Section 37 Financial Instruments and Exchange Act (金融商品取引法, *Kin'yū shōhin torihiki-hō*) Law No. 25/1948 (sales transactions and intermediate transactions regarding financial and investment products).

98 For example: Sections 4, 5 SCTA; Sections 37-3, 37-4 Financial Instruments and Exchange Act (*supra* note 97); Sections 24, 25 Real Property Funds Act (*supra* note 97); Sections 296, 298 Insurance Business Act (保険業法, *Hoken-gyō hō*), Law No. 105/1995 (insurance contracts).

99 For example: Section 20 Electricity Business Act (電気事業法, *Denki jigyō-hō*) Law No. 170/1964) (electricity supply contracts); Section 19 Gas Business Act (ガス事業法, *Gasu jigyō-hō,* Law No. 51/1964) (gas supply contracts); and Section 12-2(3) Travel Business Act (*supra* note 97).

100 For example: Section 11 SCTA; Section 3 Installments Transaction Act, Section 37 Financial Instruments and Exchange Act (*supra* note 97); and Section 12-7 Travel Business Act (*supra* note 97).

101 For example: Section 12 SCTA; Section 37 Financial Instruments and Exchange Act (*supra* note 97); and Sections 12-4, 12-12-8 Travel Business Act (*supra* note 97).

102 For example: Sections 38, 39 Financial Instruments and Exchange Act (*supra* note 97); Section 21 Real Property Funds Act (*supra* note 97), and Sections 214(1), 214-3 Commodity Futures Transaction Act (商品先物取引法, *Shōhin sakimono torihiki-hō*), Law No. 91/2014 (sales transactions and intermediate transactions regarding commodity futures).

for instance, in the Travel Business Act,[103] the Act on the Business of Real Property Transactions,[104] the Financial Products and Exchange Act,[105] and the Act on the Regulation of the Money Lending Business.[106] In particular, public law information duties can also be found in the fields of financial law and consumer law.[107]

All these duties aim at protecting consumers or customers of financial services in view of an assumed asymmetry in information, knowledge and experience between the entrepreneur and the consumer/customer. Moreover, they aim at ensuring fair business and trading practices and fostering a functioning market as part of sound development of the national economy.[108]

In many cases where a law stipulates a duty to provide documents with specific information *(shomen kōfu gimu),* the consumer or customer is also provided with a cooling-off period and may therefore withdraw (rescind) from a contract during a specific period of time, usually between 8 and 20 days from the day the document was given to the consumer/customer, fulfilling all requirements stipulated by law and further ordinances. While the grant of this special right of withdrawal from the contract is not a civil remedy for the violation of the information duty itself – the contract party has the right in any event – the private law remedy for not providing the required information is that the cooling-off period does not start to run. In addition, of course, administrative dispositions and criminal sanctions are possible. Therefore, in Japan, cooling-off periods (rights) are very closely connected with a public law information duty.[109]

3. *Conclusion*

There are plenty of pre-contractual information duties in Japan which all aim to ensure that one party, who is or is presumed to be disadvantaged in regard to information about the contract and surrounding circumstances, will receive sufficient information before entering into the contract in order to enable that party to correctly evaluate the contract. Pre-contractual in-

103 *Supra* note 97.

104 *Supra* note 97.

105 *Supra* note 97.

106 貸金業の規制等に関する法律, *Kashikin-gyō no kisei-tō ni kansuru hōritsu,* Law No. 32/1983.

107 See also KONDA, *supra* note 16, 4–6.

108 For details, see M. DERNAUER, Die Rolle des öffentlichen Rechts beim Schutz von Vertragspartnern in Japan, in: Bälz (ed.), Recht als Verwirklichung individueller Ansprüche in Japan. Diskurse und Anwendungen, Special Issue No. 9, Journal of Japanese Law, forthcoming 2018; DERNAUER, *supra* note 22, 433–455.

109 For details, see DERNAUER, *supra* note 22, 327–382; DERNAUER, *supra* note 89, 575–580.

formation duties always require a general presumption of information asymmetry between the parties or an information disparity in the specific case, which may result from a general lack of knowledge or experience. Private law sanctions or remedies (claims for compensation of damages, rights to avoid the contract, invalidity of the contract or parts thereof), administrative law sanctions (administrative dispositions) and criminal law sanctions safeguard the observation of the duties. Most duties aim at the protection of consumers or non-professional customers, in particular in the field of financial and real property transactions.

IV. Contractual Information Duties

1. Private Law Information Duties

a) The Civil Code

aa) Explicit statutory information duties

As with pre-contractual information duties, the Civil Code also does not provide many explicit contractual information duties. One of the few exceptions here is Section 615 CC, which provides that a lessee/tenant must inform the lessor/landlord when the rented object needs to be repaired or if a third party claims a right in regard of the rented object. The objective of this duty is to prevent damages of the lessor/landlord due to unknown risks, of which the lessor/tenant, on the other hand, is aware.

Further contractual information duties are stipulated in Sections 645, 656 CC which provide that a mandatary, in cases of a mandate, i.e. a contract in regard of the management of affairs of another or in similar contractual relations, must inform the mandator about the state of the activity to be carried out (by the mandatary), and render account after completion. The objective of these duties is to enable the mandator to gather the information he needs to evaluate its own position vis-à-vis the activity.

Section 660 CC, which provides that the depositary has to inform the depositor if a third party claims to have a right in regard of a stored object and when the third party has filed a court action or seized the object. The objective of this information duty is to prevent damages of the depositor due to a claim of a third party, of which the depositor is not aware himself. Section 661 CC, on the other hand, provides that the depositor has to inform the depositary about the particular nature of the object and any defects in order to avoid liability for possible damages. Here, the objective of the duty is to prevent damages for the depositary due to unknown risks.

The reform of the law of obligations will introduce further duties of the creditor to inform an individual surety, upon request, about all (changing)

details of the remaining principal obligation if the surety has entered into the contract of suretyship with the creditor on request of the principal debtor (Section 458-2 CC). Moreover, the creditor also has to inform the surety about any event where the principal debtor has lost a benefit connected to a given time limit (Section 458-3 CC).

Since these information duties are contractual duties, their violation would constitute a case of non-performance of the contract, with the liability as provided by Section 415 CC (compensation for damages), in case of negligence or intent, and by Sections 540 et seq. (possibly a right to rescind the contract).

The objective of all these statutory information duties is to protect one party to a contract from suffering damages or disadvantages resulting from a lack of information about the circumstances regarding the subject matter of the contract. The key reason remains an information disparity between the parties. The reason and function of these contractual information duties is therefore at least similar to pre-contractual information duties.

bb) Information duties based on good faith (bona fide)

Similar to pre-contractual information duties, further contractual information duties may arise in particular cases based on bona fide (Section 1(2) CC, *shingi seijitsu no gensoku*). One example is the duty of financial entrepreneurs to inform the non-professional customer about the details of the hitherto contractual relationship.[110]

A reason for such contractual information duties is, again, often a presumed structural asymmetry or a disparity in a specific case of information, knowledge and professional management of contracts between the parties and the need to protect the less informed and experienced party against damages. In addition to the right to provision of relevant information by the creditor – in appropriate cases – a negligent breach of contractual information duties may again result in an obligation of the debtor to pay compensation for damages based on Section 415 CC due to non-performance of the obligation.

Further contractual information duties based on the principle of good faith are often acknowledged in other types of contracts between professionals, experts or entrepreneurs on the one side and consumers or other non-professionals on the other.[111] In certain cases, such contractual infor-

110 Supreme Court, 22 January 2009, Hanrei Jihō 2034, 29 (financial institute, bank); Supreme Court, 19 July 2005, Kinyū Hōmu 1753, 41 (professional money lender).

111 KONDA, *supra* note 16, 6.

mation duties may also be acknowledged in BtoB or commercial contracts. Pre-contractual information duties, however, are more frequent.

b) Special private laws

In contrast to pre-contractual information duties, however, explicit statutory private contractual information duties are also less frequent in special private laws. Section 526 Commercial Code stipulates a duty for the purchaser in commercial purchase contracts to inform the seller of detected defects in the received products in order to accelerate the execution of such contract relations.

2. Public Law Information Duties

There are also some special public law contractual information duties, mostly aiming to protect consumers or other non-professional customers in the business sector the contract is related to, but to a lesser extent than pre-contractual information duties.

These include, for example, duties of entrepreneurs to provide a formalized document with important information about the subject matter and the further terms and conditions of the contract, or to provide a copy of the written contract (e.g. Section 17 Money Lending Business Act[112]) in order to clarify the contractual obligations of both parties; duties to provide a written document on the remaining contractual obligations after the customer has fully or partly performed its contractual obligations (e.g. Section 18 Money Lending Business Act); and duties to keep and retain records on the implementation of the contract and to allow the customer to inspect the records (e.g. Section 19, 19-2 Money Business Lending Act), and some others.

There are also some prohibitions to provide false information on the possibility to disengage from a contract and thereby impeding the customer in exercising a right (e.g. Section 25 no. 6 Tōkyō Statute on Consumer Protection[113]), and a prohibition to conceal certain facts in order to induce the customer to perform alleged obligations under the contract (e.g. Section 25 no. 4 Tōkyō Statute on Consumer Protection.

All these duties primarily aim at protecting consumers and other similar customers in view of a presumed disparity or structural asymmetry between the parties in regard to information, knowledge, experience, and the professional management of contracts.

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112 *Supra* note 106.

113 東京都消費生活条例, *Tōkyō-to shōhi seikatsu jōrei,* Statute No. 110/1994.

3. *Result*

In Japan, contractual Information duties generally seem to be of less importance than pre-contractual information duties, in particular for the purpose of consumer protection and other non-professional customers.

V. POST-CONTRACTUAL INFORMATION DUTIES

Post-contractual information duties may be acknowledged based on the principle of good faith, but they are generally considered to be of less relevance, compared to pre-contractual and contractual information duties. Statutory post-contractual information duties could not be identified.

VI. DUTIES TO INFORM CUSTOMERS ABOUT THE RISK INVOLVED IN THE PURCHASE OF FINANCIAL PRODUCTS

As one example of regulation under Japanese law, the following demonstrates the existing information duties of a financial entrepreneur (e.g. financial service provider) towards consumers and other non-professional customers. These information duties relate in particular to the risk involved in the purchase of some financial products (investment products such as stocks or derivatives). In such a case, the following regulations apply:

Before the conclusion of the contract:

1) Financial Products Sales Act (FPSA)

Section 3(1) FPSA

Duty […] to explain the following "important details":

(i) if there is a risk of suffering a loss of the invested capital [more specifically defined] directly to be associated with the interest, currency rate, the market rate on financial products markets or the change of other indicators, about the risk, the respective indicator, the important details about the structure of the transaction in regard to the purchase of the financial product and the change of the indicators that that can directly be associated with the risk of suffering a loss of the invested capital.

(ii) *[the same in regard of a risk to suffer a loss exceeding the invested capital]*.

Section 3(2) FPSA

The duty to explain has to be fulfilled to the extent and in the way necessary to ensure the understanding of the customer in view of the customer's knowledge, experience, financial situation and customer's purpose for concluding the contract.

Section 4 FPSA

The financial entrepreneur must not to provide a *determinative opinion in regard of uncertain details* (for instance future market prices) or induce a misunderstanding that the details are certain (provision of a determinative opinion).

A violation of the information duties in Section 3(1) or 4 FPSA leads to a strict liability of the financial entrepreneur to compensate the customer for any losses resulting from the non-fulfillment of the explanation duty or from the provision of the determinative opinion (Art. 5 FPSA).

2) Consumer Contract Act (CCA)

Section 4(1) no. 1, (2), (5) CCA

The financial entrepreneur must not provide *false information* or *intentionally conceal disadvantageous circumstances* in regard of *important details* such as

1. quality, usage or further items in regard of the subject matter of the contract, or
2. the price/consideration and further contract terms and conditions, or
3. the factors which usually require prevention measures to avoid damage to or danger for life, body, property or any other important interest of the consumer,

if they usually influence the decision of consumers to enter into the contract.

The contract may be voidable and a possible claim for return of the invested money based on unjust enrichment may arise. However, an incorrect explanation about future gold prices and other uncertain fluctuations was considered by the Supreme Court not to be an explanation about "important details" under this provision.[114] Therefore, this provision is difficult to apply to misinformation about the risk involved in the purchase of financial products (investment products).

Section 4(1) no. 2 CCA

The financial entrepreneur must *not provide a determinative opinion* in regard of *uncertain details* (for instance future market prices) or induce a misunderstanding that the determinative opinion is certain (provision of a determinative opinion).

This provision however, would be applicable if the financial entrepreneur made a definitive statement about the development of the future price or value of the financial product, implying that no risk or a very low risk is involved in the purchase of the financial product. The contract then would be avoidable, and the customer would have a claim for the return of the invested money based on unjust enrichment.

114 Supreme Court, 30 March 2010, Hanrei Jihō 2075, 32.

3) Civil Code

Sections 709, 1(2) CC

Duty to inform and explain correctly and sufficiently the risk involved in view of the customer's knowledge, experience, financial situation and purpose for concluding the contract.

Incorrect or insufficient information about the risk involved in the purchase of a financial product would result in a tort liability for the financial entrepreneur, involved employees and organs of the company to compensate the customer for the loss incurred as a result of the insufficient or incorrect information/explanation.

4) Financial Products and Exchange Act (FPEA)

Section 37(2) FPEA

In any advertising, the financial entrepreneur must not make any statements on the chances of the profit to be earned from a financial product transaction that significantly differs from the facts or that may induce a significant misunderstanding.

A violation of this provision by exaggerating the chances of a profit or underplaying the risk involved would lead to a possible administrative disposition to change the business practice (Section 51 FPEA), and, in addition, to a possible criminal penalty of imprisonment of up to 6 months and/or a fine of up to 500.000 Yen (Section 205 no. 11 FPEA).

Section 37-3(1) FPEA

Duty to *provide a document before entering into a contract* regarding a financial products' transaction with an explanation

(v) of any risk of suffering a loss of the invested capital directly to be associated with the interest, currency rate, the market rate on financial products markets or the change of other indicators, where such risk exists. This explanation of the risk must include the respective indicator, the important details about the structure of the transaction in regard of the purchase of the financial product and the change of the indicators that that can directly be associated with the risk of suffering a loss of the invested capital

(vi) *[the same in regard of a risk to suffer a loss exceeding the invested capital]*.

A violation of this provision would result in a possible administrative disposition to change the business practice (Section 51 FPEA), and, in addition, to a possible criminal penalty of imprisonment of up to 6 months and/or a fine of up to 500.000 Yen (Section 205 no. 12 FPEA).

Art. 38 no. 1 FPEA

Must not provide false information *(fujitsu kokuchi no kishi)*.

Art. 38 no. 2 FPEA

Must not provide a determinative opinion in regard of uncertain details or induce a misunderstanding that the details are certain (provision of a determinative opinion).

In case of an incorrect explanation of the risks involved, it is likely that either of these provisions would be violated. This would lead to a possible administrative disposition to change the business practice (Section 51 FPEA), and in case of a violation of Section 38 no. 1, in addition, to a possible criminal penalty of imprisonment of up to 3 years and/or a fine of up to 3.000.000 Yen (Section 198-6 no. 2 FPEA).

As a result, for the sale of a financial product, the financial entrepreneur has to positively, correctly and sufficiently inform the consumer or non-professional customer about the risks involved in the purchase of the financial product or in the investment by providing a correct formalized written document and, in addition, by oral explanation. If the entrepreneur fails to do so, he will be at least liable to compensate the customer for incurred damages under Section 5 FPSA and general tort law. In addition, the contract may be avoidable, depending on the specific case, based on Section 4 CCA or Section 96 CC (+ claim to return the invested money as unjust enrichment, Section 703 CC). The entrepreneur may also be sanctioned by an administrative disposition or a criminal penalty. It is questionable whether this plurality of possible civil law, administrative law and criminal law sanctions is not exceeding the necessary legal liability. A similar structure exists with regard to consumer contracts in general.

VII. SUMMARY AND CONCLUSION

In the field of general civil law and consumer law in Japan, information duties are, for the most part, pre-contractual information duties with the aim of protecting consumers or non-professional customers who are treated as or similar to consumers. This pertains in particular to customers of investment or other financial services, but also customers of other professionals and experts. The function of most information duties is primarily to compensate for an assumed information disparity or structural information asymmetry between the parties of a contract, often resulting from a disparity in knowledge and business experience. Contractual information duties are of less relevance than pre-contractual information duties, with post-contractual information duties the least relevant.

Under general civil law in Japan, the main basis for a liability with respect to a breach of pre-contractual information duties is general tort law (e.g. Section 709 CC), but there are many further special private law remedies for the protection of consumers, such as special rights to avoid a con-

tract and a special tort law liability. Special private law pre-contractual information duties are more frequently negative information duties rather than positive pre-contractual information duties: except in the case of information duties for the sale of financial products. The use of written form requirements (including the function to inform a party about the contract) is rarely used in Japan (only surety contracts, Section 446(2) CC). In addition, there are numerous special positive and negative public law pre-contractual information duties.

Under Japanese civil and consumer law, contracts are heavily, if not overly regulated by information duties, in particular by pre-contractual information duties. Information duties are regularly combined with various forms of remedies, in order to ensure their compliance by the duty bearers. The breach of civil law duties by one party can result in specific rights and claims of the other party. The breach of administrative law duties leads to a possibility for the authorities to take administrative measures. The breach of criminal law duties may give rise to criminal prosecution.

Information Duties under German General Contract Law and the German Law of Consumer Contracts

Carsten Herresthal[*]

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I. Introduction: The Age of Information Duties

1. The Tremendous Expansion of Information Duties in German Contract Law

Information duties have evolved as modern "golden rule" in German general contract law as well as in certain areas of German private law, particularly consumer law, insurance law, capital markets law and banking law. While the tremendous and still ongoing expansion of information duties in national private law is driven by both the German legislator *and* the German courts, the European legislator also has a substantial impact. This is especially true as information duties are the main instrument of the European legislator in the process of harmonizing member states private law while ensuring a high level of consumer protection. When discussing the reasons for the tremendous expansion of information duties in both general contract law and specialized contract law in the recent decade three main aspects must be mentioned from a German perspective.[1]

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Above all, the increased complexity of the legal, technical and economical context has contributed to the growing number of information duties. This is followed by a substantial professionalization of the field and segmentation of professional activities. The result is a far-reaching asymmetry of knowledge for market participants: the professional or – more generally – one side of the (pre-) contractual relationship often has a huge advantage in terms of specific knowledge and relevant information regarding the subject matter of the (intended) contract.[2] While one party has the relevant information, which may be easily communicated to the other party at little or no cost, the discovery of that information by the other party may entail substantial cost and effort. Moreover, due to the lack of relevant knowledge, the other party may not even realize the information deficit and thus may not be aware of the need for further information about the subject matter of the contract. It is worth mentioning that the professionalization and segmentation of professional activities has been a very useful and necessary development for the modern economic system. Moreover, this professional and specialized knowledge is usually what the other party lacks. Thus, the issue at hand for the legal system, especially private law, is to define the line between general market knowledge which may be acquired by the parties independently and thus does not need to be communicated, and the special knowledge of one party that must be provided to the other, under certain circumstances.

Additionally, according to the concept of information the (pre-) contractual duty to inform the other party about specific aspects relevant for the contract is a legal mechanism, which usually results in a minor restriction of freedom of contract compared to a binding legal determination of the content of the contract, e.g. with regard to contractual duties. Thus, both the German legislator and the European legislator often refer to the concept of information duties in cases of an actual or alleged market disruption. This is especially true with regard to consumer law, capital markets law and banking law. This protection mainly provides for (pre-) contractual information duties for the party deemed more informed or acting in a professional capacity. In a violation of the duty to inform, the obliged party usually is liable for the damages of the other party that resulted from the ignorance of

1 See C. HERRESTHAL, in: Gsell/Lorenz/Mayer (eds.), Beck'scher Online-Großkommentar BGB (BeckOGK-BGB), 1.1.2018, § 311 BGB marg. no. 385–387; V. EMMERICH, in: Münchener Kommentar zum BGB (7. ed., Munich 2016) § 311 marg. no. 64–70; C. BUSCH, Informationspflichten im Wettbewerbs- und Vertragsrecht (Tübingen 2008) 126 ff.; H. FLEISCHER, Informationsasymmetrie im Vertragsrecht (Munich 2001) 573 ff.

2 E.g. about the benefits and risks of a specific investment, about the drawbacks of an insurance contract or about the risks of a structured loan agreement.

the facts (Sec. 241 para. 2, 311 para. 2, 280 para. 1, 249 ff. BGB). There are however, also specific rules which may provide special remedies in case of the violation of an information duty.[3]

Finally, unwritten information duties provide "leeway" for the court to bolster the legal position of one party, should the court deem the outcome of the contractual agreement or the contractual rights of one party "unjust" or against good faith. In such cases, the judicial *ex-post* finding of an information duty for one party, as well as the violation of this information duty are often decisive.

2. The Underlying Legal Principles in a Free Market Order

a) Freedom of contract and individual responsibility with regard to information

The concept of information duties is widely accepted, and legal practice focusses predominantly on their scope and the details. Despite this, the concept of information duties conflicts with two fundamental legal principles in a liberal market order: freedom of contract and the responsibility of each party to obtain sufficient information to make a decision to enter into a contract.[4]

The principle of freedom of contract protects an individual's decision to enter into a contract.[5] The party is free to make decisions, whether well informed or otherwise, with protections in place for the parties' freedom to decide based on the information gathered. Moreover, the party is free to remain silent on the reasons motivating the decision to enter into the contract and the (from his perspective) decisive information. Thus, the legal duty to

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3 See *infra* III.1.b).

4 For the importance of those principles in German private law cf. C.-W. CANARIS, Wandlungen des Schuldvertragsrechts – Tendenzen zu seiner "Materialisierung", AcP 200 (2000) 273 (292 ff.); E.-J. MESTMÄCKER, Über die normative Kraft privatrechtlicher Verträge, JuristenZeitung (JZ) 1964, 441 (443); W. ZÖLLNER, Die politische Rolle des Privatrechts, Juristische Schulung (JuS) 1988, 329 (330); E. HOPPMANN, Moral und Marktsystem, Ordo 41 (1990) 3 (5); D. REUTER, Freiheitsethik und Privatrecht, in: Bydlinski/Mayer-Maly (eds.), Die ethischen Grundlagen des Privatrechts (Wien 1994) 105 (111); for the likewise importance in Japanese private Law cf. K. YAMAMOTO, Vertragsrecht, in: Baum/Bälz (eds.) Handbuch Japanisches Handels- und Wirtschaftsrecht (Cologne 2011) 461, 467 marg. no. 18; M. DERNAUER, Vorvertragliche Aufklärungspflichten im japanischen Vertragsrecht, in: Coester-Waltjen/Lipp/Waters (eds.), Liber Amicorum Makoto Arai (Baden-Baden 2015) 210, 212.

5 For freedom of contract in German private law, see Federal Constitutional Court (BVerfG), Entscheidungen des Bundesverfassungsgerichts (BVerfGE) 81, 242 (251 f.); CANARIS, *supra* note 4, 278.

provide the other party with relevant information restricts freedom of contract. Those restrictions by the legislator or by the court need to be justified.

Moreover, in a free market order, all parties are responsible for their own knowledge of market conditions. Thus, each party is responsible for the identification and procurement of the information needed for a decision to enter into the contract,[6] and must bear the risk of failing to do so. Each party must determine business opportunities based on the information available. The market price of a product is a means of conferring information to the market with regard to the product. When making a decision about a contract, both parties can rely on the principle of individual responsibility with regard to information and, in general, do not have to provide information relevant for the contract, unless that information is requested by the other side. This matter of trust needs to be taken into account when considering the imposition of an information duty by the court or legislator.

Quite often, the legislator or the courts refer to an (alleged) information asymmetry between the parties to justify an information duty for the more informed party.[7] However, as professionalization is common and sought after in a free market economy, information asymmetry may not justify an information duty itself but only supplement other reasons. Information duties that follow automatically from an information asymmetry would devaluate any substantial investment in professionalization and information procurement. Specialist knowledge is acquired to further the chances of success in a competitive market economy, so it may not trigger *as such* specific information duties. Competition for access to information sources is part and parcel of a market competition, and, significantly, market transactions often follow different assessments of future development based on different information.

b) Trust, market disturbances and structural imbalances

Above all, *disturbances of the market* justify a duty to inform the other party since the market economy and contract law require a functioning market. Thus, insider information usually must be communicated or the party has to abstain from the contract.[8]

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6 Thus, the assumption of a national civil code that both parties are equally informed is not an outdated and unrealistic concept but the normative answer to the conditions of a market economy, cf. for the assumption in German law FLEISCHER, *supra* note 1, 577 f.; cf. for the same assumption in Japanese private law Law DERNAUER, *supra* note 4, 212.

7 See *infra* II.4.c).

8 See FLEISCHER, *supra* note 1, 578 f.

Moreover, the information asymmetry resulting from increased professionality may reduce reliance by the more informed party on the other party providing the necessary information for itself. The less informed party may rely on the procurement of relevant information by the more informed party, especially if the professional party benefits from the asymmetry of information, e.g. asks for higher prices.[9] Whether an information asymmetry may justify information duties is quite disputed in German private law.[10]

Finally, regarding a *structural imbalance* of the parties, there are occasional references to this by the courts.[11] This notion was "invented" by the German constitutional court referring to the relationship between the bank and the guarantor in cases of guarantees by low-income family members.[12] Nevertheless, there is no coherent concept of those imbalances yet in German private law; a mere imbalance does not justify information duties for one party.[13] In the vast majority of the cases, the courts refer to the statutory right of withdrawal and characterize it as a legislative reaction to a structural imbalance.

c) Individual responsibility as a rule and the duty to inform as an exception

In accordance with the fundamental principles of German private law, and in line with majority opinion, the individual's responsibility to obtain information is still the rule – information duties for one party are the exception. Thus, as a rule, all parties may rely on the fact that the other party will obtain the required information independently; or, ask for the information needed.[14] In principle, no party is obliged to inform the other about aspects relevant for

9 E.g. a professional car dealer may ask for a higher price for used cars due to his professional examination of the car.

10 See *infra* II.4.c).

11 For a recent decision, cf. Federal Court of Justice (BGH), Neue Juristische Wochenschrift (NJW) 2016, 2266 marg. no. 26.

12 Federal Constitutional Court (BVerfG), Entscheidungen des Bundesverfassungsgerichts (BVerfGE) 89, 214 (230, 235).

13 See M. WELLENHOFER-KLEIN, Strukturell ungleiche Verhandlungsmacht und Inhaltskontrolle von Verträgen, Zeitschrift für Wirtschaftsrecht (ZIP) 1997, 774; A. TEICHMANN, Aufklärungs- und Schutzpflichten gegenüber Verbrauchern, in: Hönn et al (eds.), Festschrift für Alfons Kraft (Neuwied 1998) 629, 633; for a different situation in Japanese law cf. DERNAUER, *supra* note 4, 213 f.; MIYASHITA, *Keiyaku kankei ni okeru jōhō teikyō gimu, I,* Hōsei Ronshū 2000, 61, 63 ff., 68 ff.; YOKOYAMA, *Keiyaku teiketsu katei ni okeru jōhō teikyō gimu,* Jurisuto 1996, 128 ff.

14 See Federal Court of Justice (BGH), Neue Juristische Wochenschrift (NJW) 2010, 3362 marg. no. 21; BGH, NJW 1989, 763, 764; BGH, Wertpapier-Mitteilungen (WM) 1987, 319 (sub. II 2); BGH, WM 1981, 1224, 1225.

the issue of the contract, the contractual obligations or the contractual risks without it first being requested;[15] the individual responsibility for information still prevails. Thus, an information duty for one party as the exception requires specific circumstances in the fact pattern at hand. Despite this fact, first impressions of German contract law may suggest otherwise.

3. *The Teleological Foundations of Information Duties*

It is worth mentioning that besides the general principles mentioned above, there is no comprehensive teleological basis for *all* information duties in general contract law (no "one fits all").[16] Regarding the teleological underpinnings of information duties, it is necessary to make a distinction between pre-contractual and contractual/post-contractual duties to inform. Additional lines need to be drawn within those categories.

a) *Pre-contractual information duties*

Under German law the pre-contractual relationship is a statutory obligation (Sec. 311 para. 2 BGB). It provides for a general pre-contractual duty to inform the other party about significant information. The main justification is the use and grant of trust ("Inanspruchnahme und Gewährung besonderen Vertrauens") in the pre-contractual relationship. This is still true after the codification of the rules on *culpa in contrahendo* in 2002, as referenced both in the intention of the German legislator and the wording of the new rule itself ("high degree of trust", Sec. 311 para. 3 BGB).

In specific cases, the concept of trust is supplemented by other teleological considerations. These include the principle of consumer protection, the protection of the economically weaker party,[17] (private) investor protection and the protection of legal rights. Those additional aspects may contribute to the arguments that support a specific duty to inform or specify the duty to inform. They may however, also limit or outweigh the arguments in favor of an information duty.

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15 See Federal Court of Justice (BGH), Wertpapier-Mitteilungen (WM) 2010, 1283 marg. no. 15; BGH, WM 2007, 1676 marg. no. 11; BGH, Neue Juristische Wochenschrift (NJW) 1997, 3230 (sub. I 4); BGH, NJW 1996, 1206, 1207.

16 See S. BREIDENBACH, Die Voraussetzungen von Informationspflichten beim Vertragsabschluß (Munich 1989) 52 ff.; BUSCH, *supra* note 1, 149 ff.; FLEISCHER, *supra* note 1, 567 ff.; H. FLEISCHER, Vertragsschlussbezogene Informationspflichten im Gemeinschaftsprivatrecht, Zeitschrift für europäisches Privatrecht (ZEuP) 2000, 272, 274 ff.; G. REHM, Aufklärungspflichten im Vertragsrecht (Munich 2003) 233 ff.

17 This concept is due to the uncertainty to identify the weaker party very doubtful, cf. C. HERRESTHAL, Private Macht im Vertragsrecht (Austauschverträge), in: Möslein (ed.), Private Macht (Tübingen 2016) 145.

b) Contractual duties to inform

The reliance on and granting[18] of trust is also used to justify contractual duties to inform, although, reference is more often made to the general concept of good faith. Additionally, other teleological aspects like consumer protection, the protection of the economically weaker party, (private) investor protection and the general protection of legal rights may contribute to the justification of a contractual duty.

4. The Adequate Allocation of Contractual Risk

As a rule, information duties may not be used, i.e. abused, to allow one party to set aside a contractual agreement that has become disadvantageous due to the development of the market conditions or that is deemed by a court to be – from the perspective of the court – unreasonable or inadequate. The majority opinion in German private law would subscribe to the statement that information duties are not a means of shifting contractual risks after contracting or withdrawing from the no longer favorable contractual agreement. Thus, the main problem in German private law is to determine those cases that fit with an exceptional duty to inform the other party. There is a thin line between the application of an information duty guided by legitimate parties' interests and an abuse of this instrument to foster policy issues, e.g. consumer protection or protection of private investors. Nevertheless, both the legislator and the courts have displayed a remarkable tendency to extent information duties.

II. Information Duties in General Contract Law

1. Taxonomy of Information Duties

In German private law, a systematic approach using a nomenclature or taxonomy is done reluctantly. This is mainly due to the fact that German private law has overcome the so-called conceptual – or conceptionally-led – jurisprudence ("Interessenjurisprudenz"). Actually, it follows interests or values. Moreover, the German civil code does not follow the concept of a *contract* law but codifies general questions in a general part of the law of obligations. As a result, information duties exist on several levels of abstraction, which does not correspond with a concept of contract law. Keeping this in mind, information duties in German general contract law may be classified along the following lines: With regard to the formation of the contract, one may distinguish between *pre-contractual, contractual and*

18 See *supra* I.3.a.

post-contractual duties to inform. Regarding the legal basis of information duties, duties that result from contractual obligation may be distinguished from those established by law (statutory obligation or statutory rule).

Another distinction focuses the relevant area of the law. There are *general information* duties, that apply in all pre-contractual relationships (see Sec. 311 para. 2 BGB) and all contractual relationships (Sec. 242, 241 para. 2 BGB). *Specific information duties* are part of specific areas of private law like consumer law, insurance law and capital markets law. Usually, those specific information duties are codified; however, some are based on court decisions.[19] In general, specific information duties and general information duties differ with regard to the subject matter and the form of the information.[20] While the general duty to inform (Sec. 242 BGB) neither prescribes a specific form (e.g. in writing) nor specific content of the information, special information duties often require written communication of the information and usually prescribe the information to be communicated in detail. This is especially true in consumer protection law, since there are some rules that require specific wording or a durable medium.[21] Some rules prescribe specific language for pre-contractual information, e.g. with regard holiday products,[22] while other rules order a transcript of the contract including the content of the pre-contractual information (e.g. Sec. 312f BGB).

In German contract law, there is no distinction between *positive and negative duties* to inform.[23] Indeed, a distinction is made between the omission of adequate information unknown to the other party and the duty to refrain from the communication of incorrect information. According to the latter, parties only have a duty to confer adequate information, i.e. the party is obliged to confer information sufficient to answer questions posed by the other party or to refuse an answer due to its own lack of knowledge or reluctance to confer the information.

In German private law, the law of standard terms is quite separated from the rules on information duties.[24] There is no duty to inform about the use of standard terms by one party. The incorporation of standard terms into the

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19 E.g. duty of the bank to inform the consumer in specific situations cf. HERRESTHAL, in: BeckOGK, *supra* note 1, § 311 BGB marg. no. 713–734.

20 See for the more detailed distinction in Japanese Law DERNAUER, *supra* note 4, 210, 216.

21 See Sec. 126b BGB.

22 See Sec. 483 para. 1 BGB with regard to the language of the place of residence of the consumer as contract language.

23 See for the distinction between positive and negative duties to inform in Japanese Law cf. DERNAUER, *supra* note 4, 210, 215 f.

24 For the different approach in Japanese private law DERNAUER, *supra* note 4, 216.

contract requires specific elements of contract formation.[25] On the contrary, standard form contracts that consist completely of standard terms do not fall within the scope of the rules that provide for specific requirements for the formation of contracts, as there is no right to be informed that the contract as such is a standard form contract.[26]

2. *The Legal Basis of Information Duties*

a) *Consultancy agreements and information agreements*

The overriding source of information duties are explicit and implicit *contractual agreements,* especially consultancy agreements and information agreements. Under German law, courts quite often resort to implicit (consultancy) agreements as the judicial finding of an (alleged) contractual agreement releases the court from considering and balancing the competing interests mentioned above.[27] Thus, the court claims an implicit agreement of the parties, which obliges one party to inform the other, an agreement which must merely be interpreted by the court.

The critique is obvious. First, the finding of an implicit contractual agreement quite often results in a mere fiction of the parties' intentions by the court. Second, the courts obviously immunize their finding of an information duty of one party against alternative solutions, as the court does not balance the interests mentioned above but merely "finds" that the parties entered in a contractual agreement giving rise to a (contractual) information duty. This then seems to allow the court to "discover" additional information duties that derive from the parties' agreement without balancing the parties' interests.

The main example is the *consultancy agreement* in banking law. A customer, entering into a consultancy with a bank results – according to the German Supreme Court – in an implicit consultancy agreement, if the subject of conversation is a specific investment decision.[28] The factual re-

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25 Those rules provide for the explicit reference to those terms (or a clearly visible notice at the place where the contract is entered into) and the opportunity for the other party to take notice of the content of the standard terms, cf. Sec. 305 para. 2 BGB.

26 Federal Court of Justice (BGH), Neue Juristische Wochenschrift (NJW) 1995, 190.

27 See I.2.

28 Federal Court of Justice (BGH), Neue Juristische Wochenschrift (NJW) 2014, 3360 marg. no. 21; BGH, Wertpapier-Mitteilungen (WM) 2014, 1036 marg. no. 14; BGH, Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 196, 370 marg. no. 17; BGH, Zeitschrift für Bank- und Kapitalmarktrecht (BKR) 2008, 199 marg. no. 12; BGH, Zeitschrift für Wirtschaftsrecht (ZIP) 1997, 580; BGH, ZIP 1996, 872; BGHZ 123, 126 (128) – *Bond;* BGH, ZIP 1993, 997; BGH, WM 1992, 1031.

quirements are quite low, merely beginning a conversation about the specific investment decision qualifies – according to the court – as an implicit agreement.[29] As a result, the *implicit* consultancy agreement is the rule in banking law – information duties following from a pre-contractual relationship (Sec. 311 para. 2 BGB) are the exception.[30] Moreover, the German Supreme Court specifies the information duties that result from the implicit consultancy agreement in detail, while asserting only the interpretation of the (implicit) agreement of the parties. According to the court, that results in a standard consultancy agreement, regularly entered into implicitly by the parties, thus obliging the bank to provide the customer with "investor-adequate" information, i.e. suitable to the specific interests of the investor, and "investment-adequate", i.e. suitable to the specific investment. The specific content and scope of the information duty must be addressed with regard to the particular case at hand.[31] The echoes of the Anglo-American suitability doctrine[32] are obvious.[33]

b) *Pre-contractual Information Duties*

aa) *Specific information duties*

In German private law, there are some specific rules providing for the duty to inform in certain areas of the law.[34] Regarding insurance contracts, ac-

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29 H.-J. BUNTE, in: Schimansky/Bunte/Lwowski (eds.), Bankrechts-Handbuch (5th ed., Munich 2017) § 8 marg. no. 15; for a different approach BGH, Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 100, 117 (118 f.).

30 See M. HANNÖVER, in: Schimansky/Bunte/Lwowski, *supra* note 29, § 110 marg. no. 22; J. SIOL, in: Schimansky/Bunte/Lwowski, *supra* note 29, § 43 marg. no. 7; E. V. HEYMANN/H. EDELMANN, in: Assmann/Schütze (eds.), Handbuch Kapitalanlagerecht (4th ed., Munich 2015) § 4 marg. no. 6, 10.

31 See Federal Court of Justice (BGH), Neue Juristische Wochenschrift (NJW) 2015, 398 marg. no. 18.

32 L. D. LOWENFELS/A. R. BROMBERG, Suitability in Securities Transactions, The Business Lawyer 54 (1999) 1557; R. H. MUNDHEIM, Professional Responsibilities of Broker-Dealers: The suitability doctrine, Duke Law Journal, 1965, 445; H. H. COHEN, The Suitability Doctrine: Defining Stockbrokers' Professional Responsibilities, 3 Journal of Corporation Law (J. Corp. L.) 533 (1977–1978); N. S. POSNER/J. A. FANTO, Broker-Dealer Law and Regulation (Alphen aan den Rijn 2007) § 19; A N. RECHTSCHAFFEN, Capital Markets, Derivatives and the Law: Evolution After Crisis (2nd ed., Oxford 2014) Chapter 13.

33 See for a likewise statutory duty to inform in Japanese law cf. DERNAUER, *supra* note 4, 216.

34 For consumer protection law cf. *infra* III.1; for information duties in the law of unfair commercial practices cf. BUSCH, *supra* note 1, 55 ff.; G. ELSKAMP, Gesetzesverstoß und Wettbewerbsrecht (Baden-Baden 2008); M. KIEFFER, Die Informati-

cording to Sec. 6 VVG, the insurer must inform the other party prior to the formation of the contract about decisive aspects and any aspects that may frustrate the contract for the other party. Pre-contractual deception by the other party is governed by Sec. 19 ff. VVG.

bb) The broad general rule (Sec. 311 para. 2, 241 para. 2 BGB)

In German private law, the general pre-contractual duty to inform the other party is based on the general rules in Sec. 311 para. 2 and Sec. 241 para. 2 BGB. According to Sec. 241 para. 2 BGB, a contractual or non-contractual obligation obliges each party to take account of the rights, legal interests and other interests of the other party, while Sec. 311 para. 2 BGB qualifies a pre-contractual relationship between two parties as a legal obligation/non-contractual obligation. The rule in Sec. 311 para. 2 BGB is quite broad, since every business contact which exposes its own interests and rights to a violation by the other party triggers this rule, resulting in a duty to consider the interests of the other party. Thus, usually there is – at least since the implementation of Sec. 241 para. 2 BGB during the fundamental reform of the German law of obligation in 2002 – no further need to refer to the rule of good faith (Sec. 242 BGB).[35] Both Sec. 311 para. 2 and Sec. 241 para. 2 BGB are interpreted by the courts to mean every party to a pre-contractual relationship has the general duty to inform the other party about those issues that might defeat the purpose of the contract for the other party, which are thus are an apparent crucial consideration influencing the decision of the other party to enter into the contract. This is supplemented by a normative aspect – the duty to inform the other party must be in accordance with the generally prevailing opinion ("Verkehrsauffassung"). It is understood, that the specific circumstances of the case at hand are decisive for the scope and content of the information duty. Additionally, according to the courts, these statutory provisions also provide a duty for parties in a pre-contractual relationship not to provide false information that may influence other parties′ decision about entering into the contract.

There is comprehensive case law applying this broad general rule, which shapes several groups of cases, applying a more specific version of the general rule.[36] More precise versions of the broad general rule that cover all types of contracts include the duty to inform the other party about those

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onspflichten des § 5a UWG und die Bedeutung des Informationsmodells für das Privatrecht (Munich 2014) 59 ff.; B. ZECCA-JOBST, Informationspflichten im Lauterkeits-und im Vertragsrecht (Berlin 2015) 54 ff.

35 For the reference to the general rule on good faith in Japanese Law cf. YAMAMOTO, *supra* note 4, 474 marg. no. 43.

36 See HERRESTHAL, in: BeckOGK, *supra* note 1, § 311 marg. no. 402–406.

aspects that might endanger the purpose of the contract,[37] the duty to inform about aspects that might endanger the execution of the contract[38] and the violation of an information duty of consumer protection.[39] In addition, the courts have shaped several specific pre-contractual information duties for different types of contracts.

Besides these, there are more specific rules on information duties with regard to specific types of contracts,[40] like sales contracts, contracts for labor, leases, corporations and guaranties. Those specific rules are derived from the broad general rule and thus are also based on Sec. 311 para. 2, 241 para. 2 BGB.

c) *Contractual information duties*

Consultancy agreements form the main legal source for contractual information duties.[41] There are also specific types of contract that provide for statutory duties to inform the other party.

Moreover, the information duties that follow from Sec. 241 para. 2 BGB focus on the pre-contractual relationship as legal grounds. Nevertheless, since the reforms of 2002, according to the BGB, every contractual relationship provides for duties that take account of the rights, legal interests and other interests of the other party[42] and also covers information duties. Those duties are quite similar to the duties resulting from Sec. 241 para. 2 BGB in the pre-contractual relationship and also arise from a valid contract. Those duties are therefore contractual (information) duties; the former, i.e. the statutory qualification of those duties asserted prior to the reform of the law of obligation in 2002 is no longer in accordance with statutory provisions, especially with Sec. 241 para. 2 BGB.[43] Thus, there is an obligation

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37 Federal Court of Justice (BGH), Neue Juristische Wochenschrift (NJW) 2007, 3057 marg. no. 35; BGH, NJW 2001, 2163.

38 Federal Court of Justice (BGH), Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 56, 81, 88 (duty to inform about the economic situation of the house builder).

39 Cf. the official reasoning of the German government, BT-Drs. 16/11643, 69; Federal Court of Justice (BGH), Neue Juristische Wochenschrift (NJW) 2008, 1585 marg. no. 18; BGH, Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 169, 109, 120 f. = NJW 2007, 357.

40 Cf. HERRESTHAL, in: BeckOGK, *supra* note 1, § 311 marg. no. 407–452.

41 See *supra* II.2.a).

42 G. BACHMANN, in: Münchener Kommentar (7th ed., Munich 2016) § 241 BGB marg. no. 110 ff.

43 Likewise T. BODEWIG, Vertragliche Pflichten post contractum finitum, Juristische Ausbildung (Jura) 2005, 505 (508); C. GRÜNEBERG, in: Palandt, Bürgerliches Gesetzbuch, 77. ed. 2018, § 241 marg. no. 7; C. FELDMANN/M. LÖWISCH, in: Staudin-

to inform the other party to the contract about those issues that are – from the perspective of the other party – crucial for the contractual performance or his legal interests.[44] This is especially true with regard to those issues that might defeat the purpose of the contract for the other party.[45] One line of cases provides for the duty to inform the other party about legal obstacles unknown to the other party.[46] Moreover, a duty to inform may arise given a specific (high) level of trust in the other party as a result of knowledge or position. This specific trust may reduce the conflict of interests between parties to a contract and the "debtor of trust" may not act in his own interests without taking those of the other party in account. This may also result in an information duty. Finally, the duty to inform the other party may follow from the personal relationships of the parties.

Intentional or negligent misinformation by one party is also a violation of a duty to inform under Sec. 242 para. 2 BGB. Nevertheless, German law makes a substantial distinction between those cases and cases in which one party withholds an information.

d) Subsequent information duties

Finally, there are subsequent duties to inform the other party.[47] Similar to the distinction between pre-contractual and contractual information duties, subsequent information duties may be divided in those which apply after a pre-contractual relationship (Sec. 311 para. 2 BGB) and those applicable after a contract (post-contractual duties).

Regarding the pre-contractual relationship which is a legal obligation/ non-contractual obligation (Sec. 311 para. 2 BGB)[48] – as mentioned above – Sec. 241 para. 2 BGB applies. Thus, each party must consider the rights, legal interests and other interests of the other party.[49] Without doubt, those obligations of protection and consideration do not necessarily cease with

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ger, Kommentar zum BGB (Berlin 2012) § 311 marg. no. 112; cf. also K. LARENZ, Schuldrecht – Allgemeiner Teil (14th ed., Munich 1987) § 9 I b; J. GERNHUBER, Das Schuldverhältnis (Tübingen 1989) § 2 IV 4; W. FIKENTSCHER, Schuldrecht (9th ed., Berlin 1997) marg. no. 76.

44 See Federal Court of Justice (BGH), Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 64, 46, 48 ff. = Neue Juristische Wochenschrift (NJW) 1975, 824.

45 Federal Court of Justice (BGH), Neue Juristische Wochenschrift (NJW) 2001, 1167; BGH, NJW 2007, 3057; BGH, NJW 2010, 858.

46 Federal Court of Justice (BGH), Wertpapier-Mitteilungen (WM) 1976, 1114, 1115 f.

47 See for a comprehensive discussion of post-contractual duties C. HERRESTHAL, Nachwirkende Leistungstreue- und Rücksichtnahmepflichten, in: Arnold/Lorenz (eds.), Gedächtnisschrift für Hannes Unberath (Munich 2015) 181.

48 See *supra* II.2.b).

49 See *supra* II.2.b).

the end of the pre-contractual relationship. They may oblige one party subsequently to the pre-contractual relationship as long as there is – compared with tort liability – an increased possibility that the rights and interests of the other party may be violated due to the former pre-contractual relationship and the other party may legitimately rely on this consideration. These obligations clearly include the duty to inform. Thus, Sec. 241 para. 2, 311 para. 2 BGB may be interpreted in a way that the subsequent obligations after the termination of the pre-contractual relationship also may require informing the other party in specific circumstances. Nevertheless, it has to be emphasized that an actual *subsequent* duty to inform the other party requires the termination of the pre-contractual relationship, i.e. the end of the contract negotiations or of the business contact. There are some duties that continue on into the contract stage (and beyond), for example, if one party to a former pre-contractual relationship (e.g. contract negotiations) comes to know that he suffered from a highly contagious and life-threatening infectious disease during the contract negotiations he may be obliged to communicate this risk to the other party even after termination of the contract negotiations.

The same is true with regard to a contractual relationship. The contract provides for obligations of protection and consideration according to Sec. 241 para. 2 BGB. These obligations comprise the duty to inform the other party about specific issues.[50] Clearly, these obligations may oblige one party subsequently to the contractual relationship, e.g. the exchange of the goods and the money in a sales contract. The teleological underpinnings similarly offer an increased likelihood that the rights and interests of the other party may be violated due to the former contractual relationship and the legitimate reliance of the other party. Even though the legal grounds of those duties subsequent to a contract are disputed, the majority opinion agrees they are contractual duties.[51] They follow from the contractual agreement, as under Sec. 311 para. 2 BGB, every contractual agreement provides implicitly

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50 See *supra* II.2.b).

51 Likewise BODEWIG, *supra* note 43, 508; GRÜNEBERG, in: Palandt, *supra* note 43, § 241 marg. no. 7; FELDMANN/LÖWISCH, in: Staudinger, *supra* note 43, § 311 marg. no. 112; seemingly also in BACHMANN, in: Münchener Kommentar, *supra* note 42, § 241 marg. no. 100; see further B. MARKESINIS/H. UNBERATH/A. C. JOHNSTON, The German Law of Contract. A Comparative Treatise (2nd ed., Oxford 2006) 126 (duties of care are rationalized also in terms of collateral contractual obligations); for a different opinion, H. C. GRIGOLEIT, in: Heldrich/Prölls/Koller et al (eds.), Festschrift für Claus-Wilhelm Canaris zum 70. Geburtstag (Munich 2007) 275, 281 ff.; K. KUHLMANN, Leistungspflichten und Schutzpflichten (Berlin 2001) 78; not quite clear, W. ERNST, in: Münchener Kommentar zum BGB (7th ed., Munich 2016) § 280 BGB marg. no. 111.

for those obligations. There is no reason to resort to a statutory legal basis with regard to subsequent obligations, particularly given those obligations are shaped and limited by the contractual agreement. Thus, even a statutory foundation for those obligations would have to take account of the content of the contractual agreement to specify the obligation.

3. *The Legal Consequences of a Violation of the Duty to Inform*

The legal consequences vary in case of a violation of a duty to inform. Statutory duties to inform usually provide for specific legal consequences like invalidity of contract (e.g. Sec. 494 I BGB) or an amendment of the contractual obligations of the obliged party (see Sec. 494 para. 2, 3, 4, 5, 6 BGB). An important legal consequence is that the statute of limitation does not apply to a right of referral if the information duty giving rise to the right of referral is not complied with (see Sec. 356 para. 1 sentence 1, 356a para. 3 sentence 1, 356b, 356c, 356d sentence 1 BGB).

Moreover, both the statutory and contractual duties to inform are obligations of one party of the legal relationship. Thus, in case of a violation of this duty the general rules on the violation of obligations apply, i.e. the creditor may ask for damages if there is fault on the side of the debtor (Sec. 280 para. 1 BGB). According to the general rule on damages (Sec. 249 para. 1 BGB), the intent is to put the party in the same position he would have been had the violation of the obligation not occurred. This covers any expenses of the creditor frustrated by the violation of the information duty or that were incurred as result of the violation of the duty. Moreover, the creditor may withdraw from the contract if proper communication of the information by the debtor would have led the creditor to decide not to enter into the contract. As a result, for a debtor seeking to withdraw from an unwanted and often disadvantageous contract, the violation of an information duty is a frequently-used opportunity to do so.[52]

4. *Current Issues with regard to Information Duties in General Contract Law*

With regard to information duties in general contract law there are currently several controversial issues in German private law.

a) *Limits to implicit contracts for information*

Regarding implicit contracts for information, especially regarding investment consulting in banking law, the issue is whether there are legitimate

52 See for a general treatiese, S. LORENZ, Der Schutz vor dem unerwünschten Vertrag (Munich 1997) 124.

grounds for the assumption of such a contract or whether those agreements are a mere fiction of contractual agreement by the courts. Firstly, it has to be mentioned, that the signficance of implicit agreements is continuously being reduced by the extension of statutory duties to inform the other party in banking law and consumer protection law. Nevertheless, those implicit agreements still have a lingering function as a means for the judiciary to react to new developments and new lines of cases. With regard to swaps and the use of those financial instruments in bank-to-consumer-relationships, e.g. to structure a synthetic fixed rate lending by combining a swap with a loan agreement with variable interest rates, there are – as yet – no specific statutory information duties. Thus, the courts fill in the (alleged) gaps in statutory duties to inform and interpret the general duties arising from an implicit information agreement[53] in a way that the bank is contractually obliged to[54] inform the client that, firstly, swaps are linked to an unlimited risk of loss also for the client, and secondly, the risk-opportunity-profile of the swap is not balanced but provides an advantage for the bank. Moreover, the bank has a contractual obligation to inform the client about a negative market value of the swap at the time it is contracted. The courts interpret the implicit agreement in a way that the bank is obliged to inform the client about the bank's net profit and the gross margin.[55]

Moreover, implicit duties to inform the consumer or client are a means in German private law to avoid conflicts with EU law, as Member States may not raise the level of consumer protection in areas of the law covered by EU directives that follow the concept of full harmonization. Thus, the German legislator may not provide for information duties in an area of private law covered by an EU directive. Nevertheless, German courts achieve the same result, i.e. a national level of consumer protection or client protection that exceeds the level of the EU directive by interpreting the (alleged) implicit agreement in a way that the agreement gives rise to those information duties. According to the courts, this higher level of protection does not violate EU law even though the national level of consumer/client protection exceeds the level of the EU Directive, as the national information duty is a contractual

53 See *supra* II.2.a).

54 Federal Court of Justice (BGH), Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 189, 13 marg. no. 29 = BGH, Neue Juristische Wochenschrift (NJW) 2011, 1941.

55 Federal Court of Justice (BGH), Wertpapier-Mitteilungen (WM) 2016, 821 marg. no. 10; BGH v. 7.2.2017 – XI ZR 379/14 = BeckRS 2017, 106801 marg. no. 10; for the exception in cases with a linked underlying transaction cf. BGH, WM 2015, 1273 marg. no. 42, citing BGH, Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 189, 13 marg. no. 26 = WM 2011, 682.

duty, and EU law is not violated by the Member State where an agreement of the parties exceeds EU requirements. This approach is heavily criticized.[56]

Finally, it is worth mentioning that the assumption of information duties based on implicit contractual agreements fulfills the same functions as the general statutory information duties based on Sec. 311 para. 2, 241 para. 2 BGB. As a result, the majority opinion prefers those rules as a base of pre-contractual (statutory) duties to inform. The main difference between the two approaches, implicit contractual information duties and statutory information duties, is that courts do not need to balance the interests of the parties in case of a contractual information duty. Interpreting Sec. 311 para. 2, 241 para. 2 BGB to provide for a statutory duty to inform requires a balancing of the fundamental principles of the market economy, as mentioned above. On the contrary, by the mere referral to the parties' agreement, the German Supreme Court may set its own standard of duty to inform. Thus, the majority opinion opposes the approach of the German Supreme Court.

b) Rule of thumb for formulating specific duties to inform

Currently, efforts are being made to provide a rule of thumb to derive specific duties to inform from the general rule in Sec. 241 para. 2 BGB in specific situations.[57] Above all, there is increased legal uncertainty regarding statutory and contractual information duties due to the strong tendency in German private law to protect the consumer, client etc., often referred to as "weaker party" in a legal relationship. Moreover, there is an inclination to judicial hindsight bias resulting in a retrospective affirmation of a duty to inform about specific circumstances, and a claim for damages where this duty is violated, which has driven the judiciary's continuous increasing of the level of information duties.

The general test for information duties is whether the other party to the contract or the pre-contractual relationship has legitimate expectations of the other party that specific information be provided. This test is quite

56 See C. HERRESTHAL, Die Weiterentwicklung des informationsbasierten Anlegerschutzes in der Swap-Entscheidung des BGH als unzulässige Rechtsfortbildung, Zeitschrift für Wirtschaftsrecht (ZIP) 2013, 1049; C. HERRESTHAL, Die Rechtsprechung zu Aufklärungspflichten bei Rückvergütungen auf dem Prüfstand des Europarechts, Wertpapier-Mitteilungen (WM) 2012, 2261; C. HERRESTHAL, Kritik der aktuellen Ausdifferenzierungen in der höchstrichterlichen Kick-back-Rechtsprechung, Zeitschrift für Bankrecht und Bankwirtschaft (ZBB) 2010, 305.

57 BREIDENBACH, *supra* note 16, 52 ff.; BUSCH, *supra* note 1, 149 ff.; FLEISCHER, *supra* note 1, 567 ff.; FLEISCHER, *supra* note 16, 274 ff.; REHM, *supra* note 16, 233 ff.

vague and promotes hindsight bias. Thus, there are some efforts to identify more precise aspects which may be balanced by an information duty. Those aspects include the costs for the obliged party to determine the specific information, the possibility of the other party to secure the specific information, the cost of communication of the information for the obliged party and the position taken by the obliged party. The intended contractual obligation is also relevant. One party carrying the responsibility for obtaining its own information is characteristic of an exchange contract with competing interests and thus an information duty is the exception. In cooperation contracts with parallel interests of the parties, like corporation contracts, the duty to inform the other party is more often justified. The same is true for contracts, which provide for long-term obligations of the parties while one-off exchange contracts argue against an information duty. Additional aspects, which may contribute to an information duty, include the previous behavior of the parties, the accessibility of the information, information asymmetry between the parties, and the intellectual and economical superiority of one party. Aspects that may limit information duties include the fundamental principle that no party is obliged to self-incrimination and that the communication of personal information may be required only after a thorough balancing of the interests of the parties.

These elements are – according to the majority opinion under German law – elements of a "bewegliches System" (movable system). Thus, no single aspect is decisive nor are those aspects always present in a case. Instead, it is necessary to weigh those aspects that are present in the fact pattern at hand.

c) *The importance of information asymmetry*

The significance of information asymmetry between the parties to a pre-contractual or contractual legal relationship is still subject to a quite controversial discussion. As a starting point, there is quite often an information asymmetry between the parties to legal relationships, e.g. between a consumer and a business or a bank and a client. This information asymmetry is often referred to as the main consideration for justifying an information duty for the more informed party. [58] Moreover, due to the risk of substantial legal uncertainty, the information duty in those situations is based on the assumption of an information asymmetry in a typical situation. Thus, the actual knowledge of the consumer or client in the specific situation is irrelevant for the information duty of the other side if – according to the courts – the consumer or client is presumed to be less informed than the other party.

58 See for the information asymmetry as one reason for information duties in Japanese Law DERNAUER, *supra* note 4, 201.

There are substantial arguments against information asymmetry as the decisive factor for an information duty. Firstly, there is a lack of precision regarding the fact pattern of the supposed typical situation. In any given situation, the level of information held by both parties may vary. Thus, an information duty for the party presumed to be better informed is not justified. Moreover, the main relevance of those information duties is the claim for damages including the cancellation of the agreement with *ex tunc*-effect in case of a violation of the information duty. Quite often, the "uniformed" party resorts to those claims where the contract becomes disadvantageous. This is especially true in bank-client relationships with regard to investment contracts.

Moreover, often the information asymmetry is the result of a professionalization in a market economy and thus a common appearance. Special knowledge is necessary in a market economy that relies largely on the prosperity and wealth generated by the specialization of the different professions. Hence, there is a fundamental contradiction between the legal duties and the concept of the market economy if any information advantage results in an information duty. Market transactions are devaluated if the parties are obliged to communicate their information about the subject matter of the contract, as different assessments of a product by market participants are often based on different information. Additionally, any efforts to acquire special knowledge is – at least in part – devaluated if it is linked with a duty to inform the other party even though the concept of the market economy requires the parties to acquire knowledge to persist in market competition. While the availability of information sources provides for an advantage in market competition, the rules of contract law would reduce the value of this advantage by an unquestioned duty to inform.

Thus, information asymmetry is a prerequisite for an information duty but not a sufficient condition. Particularly when dealing with market knowledge, information asymmetry cannot be a justification. The knowledge of the general market conditions, which all market participants may acquire, does not have to be communicated to the other party. The knowledge of the relevant market and its conditions is part of the individual responsibility of each market participant. Moreover, expert knowledge and special knowledge do not have to be revealed in a case of a mere information asymmetry, i.e. only substantial additional reasons may justify an information duty and balancing the parties' interests, while the principle of market economy speaks against an information duty. Finally, it has become clear that the scope of an information duty based only on an information asymmetry is quite unprecise.

d) *The adequate allocation of the burden of proof for a violation of the information duty*

Under German law, the general rule with regard to the burden of proof is that each party has to prove those facts that are advantageous for its case. For a violation of information duty, the creditor has to prove the existence of the information duty, its violation and that the violation caused damages. The latter aspect is especially difficult as the creditor has to prove that his decision to enter into the contract or to invest in a certain asset was caused by the violation of the information duty, i.e. he would not have entered into the contract or invested his money had the debtor not violated the information duty. For the creditor, it is difficult to prove the internal facts behind supposed aberrant behavior as the burden of proof lies in the conviction of the court. However, the same is true for the debtor regarding proof that the creditor would have entered into the contract or invested money in the same way had the information been provided.

Nevertheless, there are some rules in consumer law that shift the burden regarding fulfillment of an information duty to the business (Sec. 361 para. 3 BGB). In addition, the courts operate with the presumption that a creditor would have acted reasonably had performance of the information duty been adequate ("aufklärungsrichtiges Verhalten"), i.e. that he would not have entered into the contract or invested money. The earlier line of decisions added an important restriction to this presumption: The presumption did not apply if there was conflict in decision-making for the creditor – i.e. for actions other than presumed rational behavior, the alternative presented by, or, in the case of a failure to provide information, the alternative not presented, must have been vastly preferable. This restriction was dropped in 2012, and the courts do not presume a violation of an information duty has resulted in creditor behavior that differs from that which would have happened. The debtor may assert and prove that the creditor nevertheless would have behaved in the same way even with the information owed, e.g. because he ignored similar information in other circumstances. This new approach of the courts is heavily criticized.

III. Information Duties in Consumer Contracts

1. *Scope of Information Duties in Consumer Contracts*

a) *Objects of information duties*

In German consumer law, there is an increasing number of specific information duties for equally specific types of consumer contracts and/or kinds of contracts (e.g. doorstep selling). Those information duties result mainly

from a transformation of EU Directives into national law. Since the major revision of the German law of obligation in 2002, those rules on consumer contracts have been included in the German Civil Code and thus also the duties to inform the consumer.[59]

Regarding the EU directives, there is a tendency in EU law to enact Directives that follow the concept of the so-called "full harmonization".[60] According to this concept, Member States are not allowed to increase the level of consumer protection provided by the Directive within the area covered by the rules of that Directive – for the purposes of this discussion, meaning that the Member States may not increase the information duties prescribed by the Directive within this area. This means they may not provide for additional information duties or stricter formal requirements regarding the information duties of the Directive. It is worth mentioning that there is some discussion in German private law about the identification of the "area covered by the rules of the Directive" since this area determines the scope for Member States´ own additional rules. The issue is, for example, whether the Member States may impose a general information duty under Sec. 241 para. 2 BGB[61] also for contracts that are thoroughly covered by an EU Directive like consumer credits. Member States do, unquestionably, retain the right to extend the information duties prescribed by an EU Directive to legal areas not covered by it.

Duties to inform the consumer are structured according to pre-contractual information duties[62] and contractual information duties.

Pre-contractual information duties in consumer contracts, i.e. contracts between a consumer (Sec. 13 BGB) and a business (Sec. 14 BGB), carry a duty under to Sec. 312a para. 2 BGB and Art. 246 EGBGB to inform the consumer about the main conditions of the contract and the main characteristics of the product. Regarding *specific kinds of contracting* there are information duties regarding consumer contracts negotiated away from business premises and distance contracts (Sec. 312d BGB, Art. 246a EGBGB). The same is true for consumer contracts in e-commerce (Sec. 312i BGB). Additionally, there are information duties for *specific kinds of consumer contracts*. Those information duties cover contracts for timeshare or long-

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59 For a different situation in Japan cf. DERNAUER, *supra* note 4, 212 f.

60 Also called "maximum harmonization", cf. for a thorough analysis of the concepts of harmonization of the member states law C. HERRESTHAL, Mindestharmonisierung, Vollharmonisierung, 'targeted harmonisation' – Harmonisierungskonzepte und ihre Folgen für das deutsche Vertragsrecht, in: von Bar/Wudarski (eds.), Deutschland und Polen in der europäischen Rechtsgemeinschaft (Munich 2012) 25.

61 See *supra* II.2.

62 See for information duties related to the right of withdrawal in Japanese Law DERNAUER, *supra* note 4, 219 f.

term holiday products (Sec. 482 para. 1 BGB), consumer credits (Sec. 492 II BGB), deferred payment and other similar financial accommodation (Sec. 492, 506 para. 1 BGB) and installment delivery contracts (Sec. 507 BGB, Art. 246 para. 3 EGBGB). Finally, there is the duty to inform about the right of withdrawal if the contract provides for a statutory right of withdrawal (Sec. 356 para. 3 BGB).

Post-contractual duties in consumer law include the duty to inform the consumer about the content of the contract in a specific form for consumer contracts negotiated away from business premises and distance contracts (Sec. 312f BGB) and the duty of the lender to provide to the borrower with a copy of the contract (Sec. 492 para. 3 BGB).

If the general information duties apply, pre-contractual information must be provided according to Sec. 311 para. 2, 3, 241 para. 2 BGB and the contractual duty to inform the other party that arises under Sec. 241 para. 2 BGB.

b) Legal consequences of a violation of the duty to inform

aa) The claim for damages

The consequences of a violation of the duty to inform the consumer are the general consequences, i.e. the violation of an information duty is a breach of duty and thus results in a claim for damages of the consumer (Sec. 280 para. 1, 249 ff. BGB).[63] The consumer can ask for frustrated expenses or additional costs due to the violation of the duty to inform by the other party, as is consistent with the principle of restitution in kind as the main principle of the German law of damages. The question is whether the consumer can ask for the annulment of the contract if he would not have entered into the contract had proper communication of the information occurred. According to the principle of restitution in kind and the general concept of German private law, the violation of an information duty may result in the annulment of the contract. On the other hand, the right of withdrawal in consumer contracts is limited to specific cases and situations and is significantly expanded if the violation of any information duty results in an annulment of the contract. The solution is provided by the appropriate application of the rules governing the burden of proof. Consistent with the general rules on the burden of proof, the consumer must prove that he would not have entered into the contract if the other party had complied with the duty to inform. The consumer must convince the court that the violation was not

63 See the official reasoning of the German government, BT-Drs. 16/11643, 69; Federal Court of Justice (BGH), Neue Juristische Wochenschrift (NJW) 2008, 1585 marg. no. 18; BGH, Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 169, 109 (120 f.) = NJW 2007, 357.

trivial – i.e. it is not sufficient to claim a violation of the information duty with regard to minor aspects like the address or phone number of the business or the way of handling of complaints. However, in specific circumstances the consumer may meet the burden of proof and thus achieve the annulment of the contract.

bb) Specific legal consequences

There are also specific consequences triggered by the violation of information duties in consumer contracts. One specific consequence is the *unenforceability of specific contractual rights*. According to Sec. 312a para. 2 sentence 2 BGB, Sec. 312e para. 2 BGB, the business has no right to ask for any freight, delivery, or postal charges and other costs, if the information duty concerning those costs was violated by the business.

Some rules provide for an *amendment of the contractual agreement* should the information duty be violated. Thus, even though a consumer credit is void in case of a violation of the information duty by the business according to Sec. 494 para. 1 BGB, there is a valid contract if the consumer made use of the credit. Nevertheless, the rule provides for a statutory amendment of the contractual agreement in those cases. According to this amendment, the lending rate, on which the consumer credit agreement is based, is reduced to the statutory rate of interest if there is no information on the lending rate, the effective annual rate of interest or on the total amount. In a similar manner, the instalment payment transaction is void if the requirement of written form is not observed or if one of the items of required information is omitted in the contract (Sec. 507 para. 2 BGB). However, according to this rule, the instalment payment transaction becomes valid if the item is delivered to the consumer or the service performed. However, if the information on the total amount or the effective annual rate of interest was lacking, the statutory rate of interest applies as maximum rate of interest on the cash payment.

Finally, there are rules that provide for an extension of the withdrawal period in case of violation of an information duty (Sec. 485a, Sec. 356a para. 2, Sec. 356b para. 2, Sec. 356c para. 1 BGB).

2. Rationale for Information Duties in Consumer Contracts

The rationale of information duties in consumer contracts is to eliminate an information asymmetry between consumers and businesses.[64] The rules intend to put the consumer in a position to make an informed decision with regard to entering into a specific contract and the content of this contract.

64 See *supra* I.3.

Thus, information duties identify central aspects that are typically relevant for deciding whether or not to enter into a contract. Moreover, some information duties ensure that the consumer is aware of specific duties resulting from the contract.

Regarding information duties that originate from EU directives, EU law also intends to harmonize and to favor the position of the consumer throughout the EU. This will increase consumer cross-border demand in the EU and strengthen the single market. The basic assumption is that a consumer who is aware of the identical consumer rights throughout the EU will seek to form contracts within the single market. Seeking to strengthen the single market through consumer protection, the EU directives on consumer protection are usually based on the competence of the single market.

3. *Current Issues for Information Duties in Consumer Contracts*

a) *Information overload; one-page limitation*

In EU law, as well as in German contract law, there is a substantial discussion about the risk of consumer information overload.[65] The question is whether there is a diminishing marginal utility related to the continuous expansion of information duties, and even a serious lack of understanding on the part the consumer due to the amount of information provided. There is no need to repeat the discussion here, but it is worth mentioning that the EU legislator as well as the national legislator have resorted to one-page information sheets linked to a presumption of an adequate information for the consumer.

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65 See P. MÜLBERT, Anlegerschutz und Finanzmarktregulierung, Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 177 (2013) 160 (187); J. KOCH, Grenzen des informationsbasierten Anlegerschutzes – Die Gratwanderung zwischen angemessener Aufklärung und information overload, Zeitschrift für Bank- und Kapitalmarktrecht (BKR) 2012, 485, 486; W. SCHÖN, Zwingendes Recht oder informierte Entscheidung – zu einer (neuen) Grundlage unserer Zivilrechtsordnung, in: Festschrift Canaris (Munich 2007) 1191, 1211; I. KOLLER, Die Abdingbarkeit des Anlegerschutzes durch Information im europäischen Kapitalmarktrecht, in: FS Huber (Tübingen 2006) 821, 824; T. M. J. MÖLLERS/E. KERNCHEN, Information Overload am Kapitalmarkt, ZGR 2011, 1 ff.; N. CHATER/S. HUCK/R. INDERST, Consumer Decision Making in Retail Investment Services: A Behavioural Economics Perspective (Brussels 2010) 51 f., 231; for critics cf also E. M. KIENINGER, Verhandlungen des 69. Deutschen Juristentages (Munich 2012) Vol. II/1, 29 ff.; H. WIEDEMANN/R. WANK, Begrenzte Rationalität – gestörte Willensbildung im Privatrecht, JuristenZeitung (JZ) 2013, 340, 345; C. STAHL, Information overload am Kapitalmarkt (Baden-Baden 2012).

b) Malfunctioning of information duties

Regarding the information duties in e-commerce,[66] at least in German law, the huge gap in relevance between this duty in competition law and contract law has caused somewhat of a malfunction. Those information duties are subject to extensive adjudication triggered by competition law. The reason is that the violation of an information duty is a violation of a statute and thus triggers the rules on unfair competition due to a violation of the law. Thus, other competitors may pass a written warning to this competitor, which imposes a duty on the latter to compensate the competitor for his legal expenses and a duty to refrain from the use of the wrongful information sheet. Thus, there are numerous cases on the statutory information duties in e-commerce and their precise content triggered under competition law. Nevertheless, the content of the statutory information duty in those cases is only a preliminary question of an issue of competition law. On the other hand, there are only a few decisions, if any, about the content of the information duties that originate under consumer protection law, i.e. there are only a few cases where a violation of those information duties is relevant for damages to the consumer or for the application of the deadline of the right to referral.[67]

Thus, at least for information duties in e-commerce, in part also with regard to those of specific consumer contracts, there is an issue of a malfunctioning of the statutory information duty. The aim of those duties is the protection of consumer while their practical application and adjudication is predominantly anchored in competition law. There is an assumption that the small number of those information duties for the consumer parallel the small number of cases in consumer law. Were this not the case, there would be more disputes about the content of those information duties. It is worth mentioning that the German legislator makes efforts to reduce the number of cases in competition law related to the violation of information duties, e.g. by a reduction of the amount in dispute in those cases which decreases the incentive for attorneys to file those claims.

c) The "Widerrufsjoker" (The 'wild-card' – the right of rescission)

Another issue of information duties in consumer law is the so called right of rescission as a wild-card ("Widerrufsjoker").[68] This is based in law on the

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66 See *supra* III.1.a).

67 See *infra* III.3.c).

68 C. KROPF, Widerrufsbelehrungen in Verbraucherdarlehensverträgen – eine Absage an den „Widerrufs-Joker", Wertpapier-Mitteilungen (WM) 2013, 2250; H. EDELMANN/T. HÖLLDAMPF, Der Widerrufsjoker, Kölner Schrift zum Wirtschaftsrecht

connection between the withdrawal period and the information duty of the business. According to the former legal situation in German consumer protection law, the withdrawal period began after the business correctly informed the consumer about his right of rescission and further information. Hence, should there be a violation of the duty to inform the consumer, the withdrawal period of two weeks has not yet begun and the consumer may withdraw from the contract, e.g. a loan agreement, years after contracting. Thus, the consumer could make use the right of rescission to rescind an agreement should the contract to become economically disadvantageous.

This is especially true for loan agreements as these usually include a ten year fixed interest rate and premature contract termination triggers a prepayment penalty. The tremendous decline of interest rates provided consumers with a very strong interest in terminating previous loan agreements, but seeking to avoid prepayment penalties, which would be calculated on the high interest rates agreed upon. Thus, they resort to claiming a violation of an information duty by the business and the fact that the withdrawal period had not commenced, let alone ended, due to this violation. They may therefore withdraw from the contract even though years may have passed since entering into the contract.

On the one hand, there are arguments in favor of the consumer as the duty to inform the consumer – besides other duties – about the right to withdraw is intended to protect him against rash decisions by providing an opportunity to cancel the contract for a short period after contracting. This protection is surely mitigated if the consumer is improperly informed – if at all – about his withdrawal right. Moreover, there may be an inadequate incentive for the business to violate the information duty if this violation is more or less without consequences. On the other hand, in the vast majority of cases the consumer does not withdraw from the contract because the contract was unwanted at the time of contracting but due to economic reasons, i.e. the conditions of the contract, especially the interest rate, have become disadvantageous for the consumer. While the issue of forfeiture is quite intensively discussed and rejected by the majority of the courts as most cases do not meet the prerequisites for this rule, the issue of abuse of rights, more precisely the abuse of a specific right, has not yet been sufficiently discussed.

(KSzW) 2015, 148; A. FRISCHEMEIER/R. JORDANS, Verwirkung des Widerrufsrechts bei Verbraucherkrediten – der Widerrufsjoker aus Perspektive der Bank, Deutsche Zeitschrift für Wirtschafts- und Insolvenzrecht (DZWiR) 2016, 101; M. SINGER, Der Widerrufs-Joker im Kreditvertrag: Rien ne va plus?, Zeitschrift für die Anwaltspraxis (ZAP) 2016, 101; B. PETERS, in: Schimansky/Bunte/Lwowski, *supra* note 29, § 81 marg. no. 276–282.

The issue addressed here relates to contracts entered into between 1 November 2002 and 11 June 2010, mainly because consumer protection law was amended in Germany with regard to contracts closed after 11 June 2010.

IV. FUTURE PROSPECTS

The concept of information duties in German contract law as well as in German consumer protection law is at a turning point. The tremendous expansion of those duties in recent years, the issue of information overload, the malfunction of specific information duties e.g. in e-commerce, and the misuse of the right of referral triggered by the duty to inform has resulted in large numbers calling for a legislative revision of the concept. This is especially true for the general information duty, which is under a cloud of substantial legal uncertainty. Certainly, the concept of an information duty does have some benefit: restrictions of freedom of contract are limited compared to mandatory rules regulating contract content. Nevertheless, this benefit is substantially reduced if the limitation of the right of referral is linked to the duty to inform and if those duties are misused. While the conceptual dead-end for information duties is increasingly acknowledged in the legal profession, the German and the European legislator still usually draw on the concept of information duties in consumer protection law. The "modern approach" of the legislator to fulfill those information duties by mandatory one-page information sheets and the presumption that this one-page represents sufficient information does not qualify as a substantial development of the concept of information duty but as an act of desperation. The preferable option rests on an implied focus on specific information of substantial importance for the contract at hand. Thus, it is necessary to refocus statutory information duties to those issues that are of typical and substantial importance for the relevant contract. Information duties that are subject mainly to adjudication in areas of the law different from consumer protection law should be repealed. Finally, the German legislator must seek to limit the abuse of the right of withdrawal regardless of the European genesis of those rights, either by using the concept of forfeiture or by limiting the meaning of violation to exclude some duties to inform of minor importance.

Information Duties under the Japanese Law Governing Public Interest Incorporated Associations and Foundations

Makoto Arai[*]

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I. Reform of Public Interest Incorporated Associations

1. Background

For a period of almost 100 years after Japan's Civil Code was promulgated, a non-profit associations or foundation could only become a juridical person by incorporation (hereinafter a "former public interest corporation"). Following, and in conjunction with the 2006 revisions to the Civil Code (hereinafter "the revised Civil Code"), the former Article 34 stipulated that:

"Any association or foundation relating to any academic activities, art, charity, worship, religion, or other public interest which is not for profit may be established as a juridical person with the permission of the competent government agency."

Criticism of former public interest corporations had long included allegations that: 1) Some public interest corporations were "public interest" in

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name only, and it was difficult to accurately describe them as actually being "in the public interest"; 2) the determination of whether or not they really served utilitarian purposes was left to the discretionary powers of the competent authorities, and was therefore extremely vague; 3) there were suspicions that public interest corporations were being recklessly used as convenient places to dispatch reappointed public servants; 4) the content of the work of public interest corporations was not being transparently made available to the public, and 5) public interest corporations that were in fact making money were subject to lenient tax benefits, which was unfair. In an attempt to redress these problems, public interest corporation reforms came into force in 2008. As an example of a former public interest corporation, the Nihon Sumo Kyōkai (Japanese Sumo Association), which was founded in 1925 as a foundational juridical person, is the only juridical person hosting sumo tournaments on a nationwide scale and on a for-profit and occupational basis.

The former public interest corporations established prior to 1 December 2008 – when the "three laws aimed at reforming public interest corporations," which I will discuss in more detail later, came into force – were established by satisfying the following three conditions: 1) that they would conduct work for the public benefit; 2) that they would be non-profit, and 3) that they obtained the authorization of the competent authorities. Public interest corporations meeting these conditions and established as of October 2006 numbered 24,893 organizations (12,572 public interest incorporated associations, and 12,321 public interest incorporated foundations).

The public interest corporation reforms altered the system for the former public interest corporations greatly; the new system made a major distinction between non-profit organizations (public interest corporations) whose public benefit had been approved, and all other non-profit organizations (general corporations). Under the new system, the appraisal of establishment and public benefit were separated, and the structure made it became possible to obtain juridical personality (to become a general corporation) merely by completing registration, while corporations that set their main objective as conducting projects for the public interest require approval from the administrative agency (the prime minister or prefectural governor) according to the opinions of a specially convened meeting composed of private sector experts (the Public Interest Corporation Commission).

2. Laws Related to the Reform of the Public Interest Corporation System

In response to the process of reforms to the public interest corporation system, three new laws were established in May 2006, coming into force in December 2008. These laws were the "General Corporation Act", the "Public Interest Corporation Act" and the "Act Concerning Establishment of

Laws etc. on General Incorporated Associations and General Incorporated Foundations Accompanying the Execution of Laws Concerning the Authorization etc. of Public Interest Incorporated Associations and Public Interest Incorporated Foundations" (hereinafter "the Establishment Act"), collectively known as the "three public interest corporation laws."

The General Corporation Act created a system for general corporations in which organizations and foundations, whose objective is not the allotment of surplus funds, can obtain juridical personality regardless of whether or not their work is in the public interest. All that is required is the completion of a process of creating articles of incorporation, authorization and registration, and it provides regulations regarding their establishment, organization, operations and management. The Public Interest Corporation Act created a system in which the prime minister or prefectural governor is involved in independent commissions set up to approve and monitor public interest corporations and public interest foundations. Finally, the Establishment Act stipulated the procedures for transferring former public interest corporations and preparing the Civil Code and related legislation accompanying the enforcement of the two above laws.

3. An Outline of the Systems after the Reform

The laws related to the reform of the public interest corporation system, as I have mentioned, numbered three in all. In the General Corporation Act that serves as their bedrock, with regard to the proposed articles of incorporation it became possible to establish a general corporation (public interest corporation or public interest foundation) by following the registration procedures and obtaining the attestation of a notary public. This format of establishment is known as the "rule-based approach," and it enables the establishment of a non-profit organization (general corporation) with the same ease and over a similarly short span of time as it takes to set up an ordinary company.

The overriding principle of general corporations is that their purpose is not to generate profits; a general incorporated association can be established with just two staff and a general incorporated foundation with contributory assets of just three million yen or more, and there are no particular restrictions on them as long as the purpose of their establishment and their activities do not violate the law or public order and morality. Moreover, when they are dissolved, a meeting of employees (in the case of general incorporated associations) or a board of trustees (in the case of general incorporated foundations) are free to allot dividends to personnel, executives and founders, and they enjoy a high level of freedom due to an absence of any governmental supervision.

In contrast, public interest corporations must firstly satisfy the demands of the General Corporation Act, and having met these various conditions, they must then meet all the authorization conditions and criteria of the Public Interest Corporation Act. This results in public interest corporations, in view of their societal role, being restricted or weighed down, not only by the above-mentioned requirements demanded of general corporations but also in terms of their purposes, project plans, qualification of directors, disclosure of information and assessment of any surplus assets they may possess. Table 1 below compares the details of general corporations and public interest corporations.

Table 1: Comparison between general corporations and public interest corporations

	General Corporations	Public Interest Corporations
Corporate establishment	Rule-based approach (establishment through registration)	Same
Personnel/sum of assets	Two or more personnel (three million yen or more for foundations)	Same
Purpose	No restrictions on purpose	To contribute to increasing the profit of an irregular and multiple number of persons
Business	Unrestricted, unregulated	Main business shall be one cited in the Public Interest Corporation Act (excluding business unsuitable for the maintenance of society's trust in the above law)
Allotment of surplus funds	Not possible	Same
Allotment of residuary assets	Possible	Allotment to personnel and directors *not* possible
Information disclosure	Restricted to personnel and creditors	Includes the general public
Supervision	Unsupervised	Government authority (the Public Interest Corporation Commission)
General meeting of personnel (corporate juridical person)	Body deciding upon legalities and articles of incorporation (when a board of directors is not in place the body deciding all matters)	Body deciding upon legalities and articles of incorporation

	General Corporations	Public Interest Corporations
Board of trustees	Body deciding upon legalities and articles of incorporation (At least 3 persons required to form a board of trustees)	Same
Director(s)	At least 3 persons when a board of directors is put in place; 1 or more persons when a non-directors meeting format is in place	Three or more persons
Board of Directors	Setting up a board of directors is optional (mandatory in the case of foundations)	Mandatory (the body decides upon the execution of business and supervises the director)
Auditor	Appointment of auditor is optional (mandatory in the case of large scale corporations, corporations with a board of directors and all foundations)	One or more auditors mandatory
Independent auditor	Mandatory at large scale corporations	Same

II. Establishment of Corporations

1. General Incorporated Associations

a) From the authorization approach to the rule-based approach

Previously, establishing a former public interest corporation required authorization from the competent authorities (the approval approach, Article 34 of the Civil Code prior to amendment (Establishment of Public Interest Corporation)). With regard to the approval (or lack thereof) according to the Civil Code, the discretion of the competent authorities was far-reaching, and the issues I have mentioned above were often cited. Therefore, separate decisions now determine acquisition of juridical personality and public benefit, meaning that regardless of the presence or absence of any public benefit, the non-profit organization system has made establishment easier according to the rule-based approach. The establishment of non-profit organizations (general corporations) does not require the approval of the competent authorities and their establishment is recognized simply by registration.

b) Creation of articles of incorporation

In order to establish a general incorporated association, the two or more people who intend to operate as its personnel, (the founders), are required to create together articles of incorporation, (Article 10 of the General Corporation Act).

The articles of incorporation must state the following: the purpose, the name, and the organisational details matters (Article 11 of the General Corporation Act).

aa) Purpose

There are no specific limitations, as there are no restrictions on the business that a general corporation conducts. However, Paragraph 2 of Article 11 states that: “Any provision in the articles of incorporation that grants to members the right to receive the distribution of a surplus or residual assets shall not be effective.” This is in keeping with the nature of a non-profit organization.

bb) Name

The name must include the words “general incorporated association,” furthermore Article 5 of the law states that: “A general incorporated association shall not use words in its name that are likely to cause it to be mistaken for a general incorporated foundation.”

cc) Organisational details

In addition to aa) and bb) above, the association must state its main place of business, the names and addresses of the members of the incorporation, personnel at the time of establishment, provisions on the acquisition or loss of member qualifications, method of public notice and dates of business year.

The articles of incorporation shall not take effect unless they are certified by a notary (Article 13). Members at incorporation shall keep the articles of incorporation in a place specified by a member at incorporation (or, after the formation of a general incorporated association, at the principal office and a branch office of the said general incorporated association) (Article 14).

c) Appointment officers (and director) at incorporation

In the event that a director is not stipulated at incorporation, a director must be appointed without delay, pursuant to the articles of incorporation after fulfilment of the commitment to contribute property (Article 159). The director(s) in question at incorporation must investigate without delay

whether the procedures employed in incorporating the general incorporated association comply with all relevant laws and regulations as well as with the articles of incorporation (Article 20-(1)). Furthermore, under Article 20(2), the directors must notify the members at incorporation if the above-mentioned investigations revealed any procedures which violated any laws and regulations or the articles of incorporation, or contain any wrongful matters. Article 23(1) also goes on to stipulate that if, at incorporation, a member, a director, or an auditor is negligent in performing his or her duties with respect to the incorporation of the general incorporated association, he or she shall be liable to compensate the general incorporated association for any resulting damages.

d) Registration

Article 22 states that a general incorporated association is formed when its incorporation is registered at the address of its main place of business. This registration must be completed within two weeks of the completion of the investigation by the director(s) at incorporation ((iii) above) or a day specified by the members at incorporation, whichever of the two dates is the later (Article 301(1)).

At incorporation, the details of the articles of incorporation, the purpose, name, address of main place of business and any branch offices, the name of the director(s) and name and address of the representative director (Article 301(2)) must be registered.

This registration must be conducted by the appropriate representative director of the association in question. The required documents, other than the articles of incorporation, are as prescribed in Article 318.

e) Members

Article 27 states that members, as provided by the articles of incorporation, are responsible for the payment of expenses to the general incorporated association. They may withdraw from the association whenever they wish. Although the articles of incorporation may make alternative provisions, if a member still has to withdraw due to unavoidable circumstances they may do so (Article 28). Article 29 enables members to withdraw for the following reasons: 1) the occurrence of grounds for leaving as set forth in the articles of incorporation; 2) the agreement of all the other members; 3) death or dissolution and 4) expulsion of the member.

Finally, Article 31 states that the general incorporated association must compile a member registry that includes the names and addresses of all its members.

2. *General Incorporated Foundations*

a) *Creation of articles of incorporation*

As stated in Article 152 of the Act on General Incorporated Associations and General Incorporated Foundations, in the incorporation of a general incorporated foundation, the founder (if there are two or more founders, both or all of them) shall prepare articles of incorporation, which the founder(s) must sign, or to which they shall affix their names and seals. Article 152(2) further provides that a founder may express in their will their intent to incorporate a general incorporated foundation. In such a case the executor, after said will has taken effect, shall, without delay, prepare articles of incorporation that include the matters provided for in the will, and either sign them or affix their name and seal on the articles.

The following items a) to d) must be included in the articles of incorporation (Article 153(1)).

aa) Purpose

As a general incorporated foundation had no restrictions placed upon its business there are no particular limitations. However, none of the provisions in the articles of incorporation which grant the founder the right to receive any surplus monies or residual assets shall be effective, which is consistent with its purpose as a non-profit organization.

bb) Name

The name shall contain the words "general incorporated foundation" and no name may be used that could lead to the foundation being confused as a general incorporated association (Article 5).

cc) Method for appointing and dismissing board of trustees

Article 153(3)(i) states that no provisions in the articles of incorporation which provide that either a director or the council appoints or dismisses the board of trustees shall be effective.

dd) In addition to a) to c), Article 153(1) stipulates that the following must be detailed: the main place of business, the name and address of the founder, the assets to be contributed by the founder at incorporation and the amount, and matters pertaining to the selection of the board of trustees and auditors at incorporation. Furthermore, Article 153(1) stipulates that if the general incorporated foundation to be incorporated has accounting auditors,

it must detail matters related to the appointment of the auditors at incorporation, the method of publication and the dates of its business year.

The articles of incorporation may be changed by decision of the board of trustees, (with the exception of a) to c) above (Article 200). With regard to items a) to c) when, due to conditions that were unforeseeable at the time of incorporation, the operation of the organization in question becomes impossible or extraordinarily difficult to continue, changes may be made by the board of trustees with the authorization of a court to all or any of a) to c) (Article 200(3)).

The articles of incorporation shall not take effect unless they are certified by a notary. Members at incorporation (or, after the formation of a general incorporated association, the said general incorporated association) shall keep the articles of incorporation in a place specified by a member at incorporation (or, after the formation of a general incorporated foundation, at the main place of business and branch offices of the said general incorporated foundation) (Articles 155 to 157).

b) Officers at incorporation (director)

If a director at incorporation is not provided for in the articles of incorporation, this person shall be appointed without delay (Article 159(1)). The director at incorporation shall, without delay, investigate to ensure that the commitment to contribute property is fulfilled and that the procedures employed in the establishment of the general incorporated foundation are not in violation of laws and regulations (Article 161).

If, as a result of this investigation, the director at incorporation or the auditors at incorporation find any violation of the applicable laws and regulations or articles of incorporation they shall give notice to such effect to the founder (Article 161(2)). Moreover, Article 166(1) provides that if a founder, a director or auditor at incorporation is negligent in performing their duties with respect to the incorporation of the general incorporated foundation, they shall be liable to the general incorporated foundation for any damages arising as a result.

c) Fulfilment of the commitment to contribute property

The founder (or executor) shall, after certification by a notary, pay the total amount of the monies pertaining to the contribution prescribed, or deliver all non-monetary property pertaining to the contribution prescribed without delay; provided, however, that this does not preclude the performance of acts necessary to assert the establishment or relocation of registration, recording and other rights with respect to a third party after the formation of the general incorporated foundation if such is prescribed by the founder

(Article 157). According to Article 153(2) the total value of the property may not be less than three million yen. If property has been contributed by inter vivos transfer, the property shall belong to the general incorporated foundation when the formation of the general incorporated foundation is accomplished, but if the property has been contributed to a general incorporated foundation by will, it shall be deemed to belong to the general incorporated foundation when the will comes into effect (Article 164).

d) Registration

Article 163 states that a general incorporated foundation is formed when its incorporation is registered at the address of its principal office. Article 302(1) provides that the registration of incorporation shall be completed within the space of two weeks from the day the investigations (ii above) are completed, or on a day stipulated by the founder, (whichever is the later date). The items for registration at incorporation include the details of the articles of incorporation; the purpose, name, addresses of main place of business and any branches; the method of publication; the names of the members of the board of trustees, director and auditor; and the names and addresses of officers (Article 302(2)).

The registration of incorporation of a general incorporated foundation shall be effected by application of a person representing the general incorporated foundation. The required documents that upon registration, including the articles of incorporation, are stated in Article 319.

3. Authorization of Public Interest Corporations

a) The public interest corporation system

Article 1 of the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations ("the Public Interest Corporation Act") asserts that, given the importance of the implementation of business voluntarily conducted by organizations in the private sector for public interest purposes, the Act aims to "[…] establish a system for authorizing public interest corporations capable of implementing such business in a suitable manner […] and thereby to contribute to the promotion of the public interest and the realization of a vibrant society."

The Act, consisting of just 66 articles, is relatively brief, and its details are entrusted to the government ordinances and enforcement regulations with which the Act is associated. The Cabinet Office has published its "Public Authorization Guidelines" with regard to unclear specific items. The Cabinet Office also releases FAQs on the subject when deemed necessary.

Under the Public Interest Corporation Act, those involved in "work for public interest purposes (business for public interest purposes)" are general incorporated associations or general incorporated foundations that have been "authorized" by government authorities (Article 4 of the Public Interest Corporation Act). These authorizations are granted by the prime minister and prefectural governors (as stated in Article 3) who are shown in the table of public interest corporation categories below as authorized to act for the competent authorities subsequent to the amendments made to the public interest corporation system. Traditionally the competent authorities were given free powers of discretion to approve both the benefit to the public and award juridical person status. However, as I have mentioned, there were problems with this system, and therefore the establishment of juridical persons and the approval of their benefit to the public were separated into a two-tier system. First of all, the establishment of a juridical person follows the General Corporation Act, and comes into effect by registration according to the rule based approach, simplifying the process. At this stage, public benefit is not required to affect establishment; as establishment has become possible quite regardless of the discretion of the competent authorities, it could be said that in cases in which efforts are made to become a juridical person the likelihood of succeeding has increased. Furthermore, removing the competent authorities' discretion regarding the approval of establishment and public interest, has also potentially removed the obstacle of the so-called vertically divided administration. In addition, when becoming a public interest corporation, the public interest of the corporation becomes approved under the Act. Under the Public Interest Corporation Act, the administrative government agencies approve the public benefit of general corporations based on the opinions of a committee composed of private sector experts, and conduct the supervision of the approved juridical persons (i.e. the corporations)[1].

Table 2: Conditions for approval of public interest corporations

Public interest corporations whose approval by administrative government agencies is conducted by the prime minister:
(i) Corporations with a place of business in two or more prefectures;
(ii) Corporations whose articles of incorporation state that the corporation will conduct business with the purpose of the public benefit in two or more prefectures. (In such cases this also includes corporations whose articles of incorporation state that they will conduct business for the public benefit

1 FAQ – A Commentary on the General Corporation Act and Public Interest Corporation Act, I. KOMACHIYA/I. FUJIWARA/J. MAKITA/J. AKIYAMA (Tōkyō 2008) 114–115.

overseas. Furthermore, it is not adequate for a corporation merely to state in its articles of incorporation that it will conduct its business in two or more prefectures, and it is necessary for that state of affairs to actually be demonstrated (FAQ Question I-9–(1).)

(iii) Corporations stipulated by Cabinet order whose purpose is work for the public interest and whose work (projects) are closely related to the national government.

Public interest corporations whose approval by administrative government agencies is conducted by a prefectural governor:
The governor of the prefecture where the corporation's place of business is located is the administrative government agency conducting approval for public interest corporations other than those listed in (i) to (iii) above.

b) *Works constituting public benefit*

According to Article 2-4 of the Public Interest Corporation Act, works for the public benefit must satisfy the following two conditions:

(1) Business that relate to scholarship, art, charity or other public interests
(2) That contribute to the promotion of interests for many and unspecified persons.

The conditions in a) above are nearly all covered by the appended table of the Act.[2] However, businesses that do not provide good grounds in their

2 Business for the public interest is defined as that conducted for the following purposes: (i) Business to promote academia and scientific technology; (ii) Business to promote culture and art (iii) Business to support persons with disability or needy persons or victims of accident, disaster or crime; (iv) Business to promote welfare of senior citizens; (v) Business to support persons having the will to work in seeking employment; (vi) Business to enhance public health; (vii) Business to seek sound nurturing of children and youths; (viii) Business to enhance welfare of workers; (ix) Business to contribute to sound development of mind and body of the citizen or to cultivate abundant human nature through education and sports, etc.; (x) Business to prevent crimes or to maintain security; (xi) Business to prevent accident or disaster (xii) Business to prevent and eliminate unreasonable discrimination and prejudice by reason of race, gender or others; (xiii) Business to pay respect or protect the freedom of ideology and conscience, the freedom of religion or of expression; (xiv) Business to promote the creation of gender-equal society or other better society; (xv) Business to promote international mutual understanding and for economic cooperation to overseas developing regions; (xvi) Business to preserve the global environment or protect and maintain natural environment; (xvii) Business to utilize, maintain or preserve the national land (xviii) Business to contribute to sound operation of national politics; (xix) Business to develop sound local community; (xx) Business to secure and promote fair and free opportunity for economic activity and to stabilize and enhance the lives of the citizenry by way of activating the economy; (xxi) Business to secure stable supply of goods and energy indispen-

articles of incorporation or their purpose, may in some cases not be approved as a public interest corporation (refer to the Cabinet Office's Public Authorization Guidelines, I-1).

It is the condition b) above that presents problems. [The condition that a corporation] "contributes to the promotion of interests for many and unspecified persons" must mean the true public interest of society as a whole, not just the benefits of individuals or small groups. However, even if an interest superficially appears to be specific and small-scale, if it is foreseeable that a larger number of entities may benefit, it may be deemed as being for the public interest (FAQ IX-6).

c) Public interest authorization criteria

These are the criteria used by the administrative government agencies when authorizing public interest, and as long as they are met, the corporation or foundation is authorized as being of the public interest.

The authorization conditions are provided in detail in Article 5 (nos. 1–18) of the Public Interest Corporation Act,[3] and are listed here in footnote

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sable for the lives of the citizenry; (xxii) Business to protect and promote the interest of general consumers (xxiii) In addition to each of the foregoing items, business provided for in Cabinet Order as one relating to the public interest.

3 *Public Interest Corporation Act, Article 5 (nos. 1–18)*

Its principal objective is to operate the business for public interest purposes. (ii) It has an accounting base and technical capability necessary to operate the business for public interest purposes. (iii) When it operates its business, it does not provide its members, councillors, directors, auditors, employees or other concerned persons specified by Cabinet Order with any special benefits. (iv) When it operates its business, it does not engage in any act providing donations or other special benefits to any persons who run a stock company or other business for profit purposes, or any other persons specified by Cabinet Order as engaging in any activity to seek interest for any specific individual or entity; provided, however, that this shall not apply to cases in which it engages in any act providing a public interest corporation with any donation or other special benefit for the business for public interest purposes operated by said public interest corporation. (v) It does not operate any speculative transaction, financing with high interest or other businesses specified by Cabinet Order as unsuitable for maintaining the social trust of a public interest corporation or any business that could be harmful to public policy. (vi) With respect to the business for public interest purposes operated by it, the revenue pertaining to said business for public interest purposes is expected not to exceed the amount compensating the reasonable costs for its operation. (vii) If it operates any business other than the business for public interest purposes (hereinafter referred to as "Profit-Making Businesses"), the operation of the Profit-Making Businesses does not interfere with the operation of the business for public interest purposes. (viii) When it operates its business activities, the ratio of the business for public interest purposes set forth in Article 15 is

3. What should be noted is that the obligation to submit business reports and calculation documents (Article 21(2)) and undergo on-site inspections (Article 27(1)) in a series of checks applies not only businesses undergoing public interest authorization for the first time, but all businesses in each subsequent business year. This differs from determinations made concerning the authorization of a corporation: although its past track record of activities is not generally considered, the difference is that while its future plans are looked at (FAQ I-10-i), in subsequent checks the emphasis is placed upon its actual performance. It is essential that all of these conditions are satisfied at all times. Should there be a lapse in just one area, the administrative government agencies must issue recommendations to the corporation in question (Article 28(1)); if the said corporation fails to rectify these maters, the government agencies can order them to do so (Article 28(3)). Failure to comply at this point will result in the Public Interest Corporation Authorization being cancelled (Article 29(1)(iii)).

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expected to exceed 50/100 (the "50% rule."). (ix) The amount of idle property is expected not to exceed the restrictions stipulated. (x) With respect to directors and auditors, the total number of directors and their spouses or relatives within the third degree of kinship does not exceed one third of the total number of directors. (xi) The total number of directors, auditors or employees who are directors, auditors or employees of similar organizations (excluding public interest corporations) does not exceed one third of the total number of directors. The same shall apply to auditors. (xii) Large-scale corporations must have an auditor. (xiii) It has standards for payment, so that the amount of remuneration is not unsuitably high. (xiv) It does not attach any unreasonably discriminatory conditions for treatment, or any other unreasonable conditions, for the acquisition or loss of qualification of members, it does not treat voting rights of members in a different manner according to the amount of money or other properties provided by members to the juridical person in question, and it has a board of directors. (xv) It has no stock or other properties that enable it to be involved in the decision making of other organizations. (xvi) In the event that it has specific property indispensable for operating the business for public interest purposes, its articles of incorporation specify such circumstance and necessary matters for its maintenance and restriction on disposition. (xvii) In the event that its public benefit authorization is revoked or extinguished as a result of a merger, it provides in its articles of incorporation that it shall donate the property equivalent to such amount to another public interest corporations having a similar purpose of business. (xviii) It provides in its articles of incorporation that, in case of liquidation, it will cause the remaining property to be attributed to any other public interest corporations having a similar business purpose.

III. International Comparison of Public Interest Corporation Systems

1. *Organizations Authorizing Public Interest*

a) *The four types of organizations authorizing public interest*

Internationally, how does this compare to the authorization process for public interest corporations (and the tax concessions accompanying authorization)? This comparison is structured by a range of questions:. For example, 1) whether or not there is a corporate system for regular non-profit or public interest corporations, 2) what is the state of legislative systems regarding public interest, and what organizations are involved, and 3) whether tax laws grant concessions based on determinations of public interest, or if they conferred only by certain legislation. However, leaving aside the finer details, for ease of discussion here, the organizations authorizing (determining) public interest have been categorized into four main types.

The first is the national tax authority. Where the regulations concerning determination of public interest of private sector corporations are included in taxation law, the taxation authorities decide whether or not a corporation is of the public interest and confer financial tax concessions such as tax exemptions. In addition to Germany (as mentioned below) this system can be observed in Holland, Sweden, Finland, Portugal and Denmark.

The second is the minister or head of a department or ministry. In the United States (as mentioned below) the administrative government agency varies from one state to another. For example, the documentation required to become a non-profit organization in the state of California is submitted to the state's attorney-general (in the Department of Justice) while in New York, it is submitted to the secretary of state (in the regional legal affairs bureau).

The third is an advisory body, a joint council system composed of several committees. The UK Charity Commission (as mentioned below) and Japan's Public Interest Corporation Commission both fit into this category. This type includes two formats, one in which the commission is a governmental body, and one in which it is a consultative body, but in either case an effort is made to secure impartiality and expertise by leaving the substantive right of non-profit determination to a council-based body.

The fourth and final type is when the authorization of public benefit is made by a court of law. This is the system adopted in nations including France (as mentioned below), Greece and Hungary.

In all the above-mentioned cases, decisions about tax concessions are made according to the stipulations of the respective nations' tax laws, but when a body other than the taxation authority authorizes public benefit, this is usually divided into two ways, one in which the authorization of public

benefit and tax concession measures are aligned, and one in which partial tax concession measures are made while the subject's public benefit is authorized. In the case of Japan, under the former Civil Code system, Specified Public Service Promotion Corporations enjoying preferential tax treatment were just a fraction of all the public interest corporations (as of the year 2008 the proportion was just 4%), but after the 2008 reforms to the system all public interest corporations were treated as Specified Public Service Promotion Corporations.

b) Japan's Public Interest Corporation Commission

Japan's Public Interest Corporation Commission is a deliberation council (consultative body) within the Cabinet Office, consisting of seven members who are all private sector experts. The Commission receives inquiries from the prime minister, and 1) deliberates on the conversion of general corporations to public interest corporations, and 2) makes recommendations about public interest corporations, deliberates on commands and the revocation of public interest authorization, and replies to the prime minister. Administrative actions such as authorization, approval and revocation are conducted by the prime minister as the administrative office in charge, but the effective determination in such cases is carried out by the Commission.

Furthermore, the Commission itself is empowered by law to collect reports from public interest corporations and hold on-site inspection visits in its own right. In addition, the Public Interest Corporation Commission is able under law to express its opinions on related Cabinet orders and the tentative plans of the Cabinet to either establish or revoke a corporation. Looked at in this light, the Commission could be described as possessing functions very close to those of a government office. (With regard to corporations operating within a single prefecture, administration is carried out by the prefectural governor in question. Each of the prefectures has a council system in place, composed of local private sector figures. These councils do not, however, have any rights to comment on government ordinances.)

2. Stipulations Regarding Non-profit and Public Interest Corporations

a) The wide scope of public interest corporations

As previously stated, Japan's public interest corporations are non-profit and must contribute to the increase in benefits (public interest) of a large but unspecified number of people to qualify for such a distinction. In order to obtain the authorization of the Public Interest Corporation Commission, their business must be for the public interest, and relate to "[…] scholarship, art, charity or other public interest […] that contributes to the promo-

tion of interests for many and unspecified persons" under Article 2 of the Public Interest Corporation Act. The table appended to the Act lists 23 types of business. Again, Japan's public interest corporations are general corporations that apply for and receive authorization under the General Corporation Act, for which they must demonstrate their non-profit status.

It is in this way that the public interest corporations authorized by the Japan Public Interest Corporation Commission represent a system in parallel to the non-profit organization system that is composed of juridical persons that are both non-profit and work for the public interest. However, religions, schools, social welfare and offender rehabilitation organizations are all separately established from the outset.

The authorization of religious corporations is conducted by either the Minister of Education, Culture, Sports, Science and Technology (MEXT) or a prefectural governor (under the Religious Juridical Person Law). The authorization of educational corporations that establish private universities and higher educational institutions is conducted by the Minister of Education, Culture, Sports, Science and Technology, while the authorization of educational corporations establishing only private high schools or schools for younger students is the remit of the prefectural governor in question (under the Private Schools Act). Establishing a medical corporation requires the authorization of the prefectural governor in question according to the Medical Care Act, while under the Social Welfare Act social welfare corporations are authorized either by the prefectural governor or the competent authority in the case of designated cities and designated mid-level cities. The establishment of a rehabilitation corporation is authorized by the Ministry of Justice.

The system for NPOs is also regulated by the Cabinet Office's Director-General for Policy Planning, Economic and Social Systems, but the competent authority is the prefecture where the office of the NPO is located (under the Act on Promotion of Specified Non-profit Activities). For this reason, in a narrow sense, Japan's public benefit corporations (despite a few exceptions such as hospitals run by public benefit corporations) do not include temples, shrines, churches, schools, hospitals and social welfare facilities, whereas in overseas nations the systems that can be perceived as roughly equivalent to Japan's public interest corporations, in the vast majority of cases, include what in Japan would be defined as "religious corporations," "educational corporations," "medical corporations" and "social welfare corporations." Moreover, in Japan, juridical persons such as independent administrative corporations, authorized corporations and special public corporations that have become public corporations are sometimes also included.

In the case of the United Kingdom, large charities include churches, universities and hospitals; in Japan the equivalent religious corporations, edu-

cational corporations, national university corporations and medical corporations appear to be few and far between. Furthermore, entities such as the British Council and the British Red Cross, which in Japan take the form of independent administrative institutions (the Japan Foundation) or authorized corporations (the Japanese Red Cross Society), are charitable bodies in the United Kingdom. In the United States too, institutions such as churches, schools and hospitals are representative types of public charities under the Internal Revenue Code.

In Germany, churches, universities, chambers of commerce and professional occupational bodies are NPOs under public law. With regard to the institutions in Germany that are roughly equivalent to Japan's independent administrative institution, it can be assumed that nearly all of them are also juridical persons under public law. In France, while some private universities exist, they are not fully independent from the French government.

As one can see, the composition of the systems that serve as prerequisites varies from nation to nation and society to society, and the domains shouldered by the non-profit sector are different too. Thus, when comparing public sector non-profit and public benefit bodies (juridical persons), we need to consider what we are going to compare and for what purpose.

b) Legislative differences between nations

Simultaneously comparing the legal systems for organizations and juridical persons and the taxation concessions accompanying them is, in other words, a comparison of legislation. With regard to the systems, the many differences between nations are conspicuous, but the United Kingdom and the United States have a common law concept of charity and "the charitable," which is in contrast to those of Germany and France, which have their roots in continental law. In this paper, I specify those that I feel are nearest to the Japanese public benefit corporation system (in a narrow sense), and focus on a comparison between the mechanisms of these systems, but a wider comparison of the scope and scale of activities of the non-profit sector, and the repercussions for society and economics would no doubt require a broader perspective.

c) Differences in capacity to hold rights in juridical persons

Thus far, I have treated non-profit and pubic benefit organizations and juridical persons rather loosely and without any particular definitions, but not all of these bodies are necessarily juridical persons or can become juridical persons. Moreover, even if they are a juridical person there may be differences in their ability to acquire and dispose of assets, and their competency to stand trial.

The charities of the United Kingdom include trusts for the sale of charitable work. However, it has been pointed out that in recent years the juridical person-type of charity is becoming more common. In the United States too, the majority of foundations take the form of a trust. In the US, the lion's share of academic societies, professional occupational qualification boards and clubs undergo a series of tests according to the stipulations of the Internal Revenue Service Code, by which they obtain qualification for national and state tax exemptions without obtaining juridical person status according to state laws. However, in the case of such organizations with neither trusts nor juridical person status, the non-business liability of its directors etc. is unlimited.

In Germany, in recent years, the offer of limited liability for directors has meant the legal forms of limited liability companies and closed companies are increasing being used for non-profit purposes under the *Handelsgesetzbuch* (Commercial Code). These company structures are gaining in popularity as registration obligations and public surveillance are minimal, they are easy to establish, and are user friendly for non-profit businesses.

In France, the legal stipulations concerning non-profit corporations *(associations)* are somewhat laxer than those governing profit-making corporations *(sociétés),* but *associations* can acquire only the property directly needed for the business of a juridical person, and it is not possible to confer inheritances in the case of publicly authorized non-profit corporations.

d) Associations and foundations

From the perspective of one used to the Japanese system, the fact that systems for associations and foundations run side by side does not raise any particular questions. However, the French Civil Code of the year 1804 contained no stipulations whatsoever about associations or foundations. Even after the French clearly defined the grounds for founding associations in 1901, there was no law for foundations until the enactment of the *Loi sur le Développement du Mécénat* (the first law on foundations) in 1987, prior to which the Conseil d'État (Council of State) had individually authorized foundations through declarations. In Germany too, the Federal Civil Code provides the grounds for establishment of associations, but the precise requirements for private foundations are in effect left to the discretion of each state. This demonstrates how the treatment of associations and foundations is quite different from one country to another, (although one feels that there is a link with the basic human right of freedom of association, and that associations that bind people together are seen as fundamental).

Thus, in the basic legislation concerning non-profit and public benefit corporations, it is not always clear whether or not associations and founda-

tions are being regulated in the same way. Japan's Civil Code is thought to have drawn on German and French law when it was first drafted in the Meiji Era (it was adopted in the year 1896), but where the systems concerning public interest corporations are concerned, there are certain manifest differences.

Table 3: An international comparison

	Type of non-profit organization	Judgmental criteria for public benefit	Tax concessions
England and Wales	• Limited liability company (The Company Act) • Organizations and trusts without juridical personality • provident societies, housing trusts etc.	The Charities Act (registration with the Charity Commission) (Some charities are exempted from registration such as traditional universities, the Boy Scouts Movement etc.)	Stipulations of separate tax laws and practice under these
France	• Corporations (Law of July 1 1901) • Foundations (*Loi sur le Développement du Mécénat* 1987) (authorized by declarations of the *Conseil d'État* according to 1990 Law on Corporate Foundations (other NPOs include mutual associations, cooperatives and trade unions)	Same as left-hand column	Separate tax law stipulations
Germany	• Registered associations (federal law) (certification through public notary, registration with court of law of regional authority • Foundations (effectively delegated by Civil Law to each state's foundation laws (authorized by each state)	General Tax Law (Abgabenordnung) (regional tax offices decide upon whether public benefit, charitable or church support is applicable)	State tax offices decide according to General Tax Law and its stipulations.

	Type of non-profit organization	Judgmental criteria for public benefit	Tax concessions
Japan	• General incorporated associations • General incorporated foundations In either case registration by a notary required under General Corporation Act (rule-based approach)	Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations (determination by the Public Interest Corporation Commission and authorization procedures by administrative government agency)	Income and corporate taxation (interlocked with authorization of public benefit)
United States	• Non-profit organizations (NPO law of each state or company law) (registration with each state authority) • Organizations without juridical personality (most academic societies, professional occupational bodies, clubs etc. enjoy exemptions from federal taxes through this format.) • Trusts (this format is common amongst foundations).	Company system is as to the left, tax concessions as to the right (they share the charity concept that is part of common law.) E.g. Internal Revenue Code 501 (c) (3) stipulates charitable organizations as subject to federal income tax exemption.	Internal Revenue Code (authorization can be obtained through submitting Form 1023 (Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code) (Distinction between Public Charity and Private Foundation etc.) Tax laws of each state (tax concessions are led by treatment of federal tax laws)

IV. THE OPERATION OF PUBLIC INTEREST CORPORATIONS AND SUPERVISION BY ADMINISTRATIVE GOVERNMENT AGENCIES

1. *Operation of Public Interest Corporations*

The competent authority is decided upon for all public benefit non-profit organizations, including public interest corporations, social welfare corporations, educational corporations and so on, and they undergo different degrees of supervision. However, general corporations do not operate under a similar level of oversight by a supervisory agency, nor are they required to regularly submit any documentation. In the event that a problem arises, it is judged by a court of law. Furthermore, with regard to the disclosure of information, as only members (trustees in the case of foundations) and creditors may request

information, certain documents must be prepared and kept in their offices for perusal or reproduction according to legal stipulations (article 129 and 199 of the General Corporation Act), and these requirements are more limited than the legislation concerning public interest corporations (refer to Table 5).

Table 4: Disclosure requirements for a General Corporation: Documents to be kept on premises

Documentation	Timeframe	Disclosure method	Disclosure Audience
Articles of incorporation	At all times	Perusal/copying	Employees (trustees), creditors
List of employees	At all times	Same as above	Employees
Records of employee meetings and board of trustees meetings	For 10 years (5 years at branch offices)	Same as above	Employees (trustees), creditors
Record of meetings of boards of directors	10 years	Same as above	Employees (trustees), creditors (permission of a court of law required except in the case of trustees)
Annual reports of each business tear and supplementary details	5 years (3 years at branch offices) (must be kept for 10 years)	Same as above	Employees (trustees), creditors
Accounting documents (balance sheet, profit and loss statement) and supple-mentary details	Same as above	Same as above	Same as above
Accounting books	At all times (Must be kept for 10 years after closure)	Same as above	One tenth or more of employees and one or more trustee

When a general corporation is authorized as being of public interest, it must register the change in its name at the place where its main business office is located within the space of two weeks (three weeks for branch offices). The name of the corporation changes from “general incorporated association (or foundation)” to “public interest incorporated association (or foundation),” but since its juridical personality remains unchanged, as a juridical person it is still subject to the General Corporation Act.

However, gaining authorization as a public interest corporation brings a number of rules that must be observed, and places the public interest corporation under the supervision of the administrative government agency with jurisdiction over it, which changes its position from an ordinary juridical person, as I shall explain below.

a) Observance of public benefit criteria and standards

The criteria for acquiring authorization as being of public benefit that I have explained above continue to apply after authorization and must still be observed once the entity has become a public interest corporation. In particular, over the course of each business year the corporation has to satisfy the conditions laid down for the ratio of business for public interest purposes, restrictions on possession of idle property, and the principal balance amortization.

Furthermore, Article 18 of the Public Interest Corporation Act established the concept of "Property for Business for Public Interest Purposes," stipulating income should be used for public interest works (50% or more of the donations, subsidies and membership fees designated for use in public interest works, 50% or more of income received in consideration of business conducted for the public benefit, and profits from the management of assets owned for public interest purposes), and its expenditure on business for the public benefit. On annulment of public interest authorization the sum of its donated assets ("the remaining amount of the public interest purposes acquired property") has to be calculated and managed at the end of every period of operation (Article 30 of the Public Interest Corporation Act). Moreover, Article 17 of the Act prohibits public interest corporations from making excessively persistent solicitations for donations.

b) Disclosure of information

In order that public interest corporations are accountable to society, they are required to keep in their offices various types of documents concerning their organization, business activities and finances in their offices, and must accept demands from members of the public who wish to peruse them (Article 21 of the Public Interest Corporation Act). Table 5 (next page) lists the documents that a corporation must keep in its offices and disclose to the public when necessary.

c) Regular submission of documents to the administrative government agencies and disclosure through the agencies

As stipulated in Article 22 of the Public Interest Corporation Act, public interest corporations must, within the three months of the end of each business year, submit a business report and accounts to the respective administrative government agency. This regular submission may be carried out electronically. Furthermore, the administrative government agency receiving this report may disclose the documents on the Internet for perusal by the public.

Table 5: Disclosure requirements for a Public Interest Corporation: Documents to be kept on premises

Documentation	Term to be kept in the office	Disclosure method	Disclosure audience
Articles of incorporation	At all times	Perusal	Anybody
List of employees	At all times	Same as above	Anybody (the corporation is, however, allowed to conceal addresses of those other than employees and trustees)
List of directors	From within the first 3 months of fiscal year for a space of 5 years (3 years for branch offices here and in the rest of the table)	Same as above	Anybody (the corporation is, however, allowed to conceal addresses of those other than employees and trustees)
Criteria for directors' remuneration	From within the first 3 months of fiscal year for a space of 5 years	Same as above	Anybody
Business and budget plans	Until end of business year	Same as above	Same as above
Fundraising and capital expenditure plans	Same as above	Same as above	Same as above
Inventory of assets	From within the first 3 months of fiscal year for a space of 5 years	Same as above	Same as above
Cash flow statement	Same as above	Same as above	Same as above
Outlines of operational organization, business activities and documents containing vital figures	Same as above	Same as above	Same as above
Specific cost reserve funds/reserve limits on assets acquired for funding/ basis of calculations	Same as above	Same as above	Same as above

2. *Supervision by Administrative Government Agencies*

Administrative agency supervision includes requesting reports, making on-site inspections, recommendations, orders and the annulment or cancellation of the authorization of a public interest corporation. The most extreme case is that in which authorization is cancelled, but even when a corporation violates the authorization criteria, or fails to observe regulations, its authority is not immediately cancelled. The administrative agencies, while continually checking on the changing situation of the public interest corporation and its efforts to reform itself, go through the various steps of demanding reports, making on-site inspections, recommendations and giving orders. Only when the corporation in question appears incapable or unwilling to remedy the situation will the final measure of cancelling its authority be taken.

The Cabinet Office has announced the following outline of its approach to supervising public interest corporations.

(i) In principal, it will supervise corporations in line with the conditions clearly stipulated by law
(ii) It will act from a perspective of providing support, to enable new corporations to appropriately adapt themselves to new systems, and thereby increase their benefit to the public while retaining self-governance as the main premise
(iii) When necessary to secure the trustworthiness of the system it will act swiftly and stringently against new corporations with problems
(iv) It will at every available opportunity strive to ascertain the state of corporations through the screening of applications for authorization, the verification of regularly submitted documents and on-site inspections etc.

a) *Requests for reports (Article 27 of the Public Interest Corporation Act)*

To the extent to which it is necessary to secure the appropriate management of public interest corporations, a corporation may be requested to submit the requisite reports on its operational organization and business activities. This request for reports is an irregular measure and is generally regarded as being an indicator that there are suspected irregularities in the management of the corporation in question.

b) *On-site inspections (Article 27 of the Public Interest Corporation Act)*

To the extent to which it is necessary to secure the appropriate management of public interest corporations, on-site inspections are carried out in order to verify the operational state of a corporation with regard to the matters, clearly stipulated by law, which they have to observe as a public interest corporation.

Specifically, the on-site inspections are conducted according to the following procedures.

(i) The first inspection is carried out once within the first three years of authorization
(ii) About one month's notice is provided regarding the date, time and place of the inspections
(iii) The inspections are carried out in a focused manner that uses the items handed over at the time of screening for public interest, periodically submitted documents, notifications of changes, tax collection reports etc.
(iv) The director and auditor and any other people involved are expected to give an account of themselves.

3. Recommendations (Article 28 of the Public Interest Corporation Act)

If an administrative agency has reasonable grounds to believe that public interest corporations could fall under any one of the respective following items, it may issue a recommendation including a time limit by which necessary measures, including improving their work, must be made:

(i) In the event that they no longer conform to the authorization criteria.
(ii) In the event that they fail to comply with the criteria.
(iii) In the event that they are in violation of laws and ordinances or administrative disposition (acts carried out under law)

It should be noted that, in principal, recommendations are issued after consultation with the Public Interest Corporation Commission and following the receipt of their reply, and the details of the recommendations are disclosed to the general public.

4. Orders (Article 28 of the Public Interest Corporation Act)

Should, despite having received the above-mentioned recommendations, a corporation fail to take the relevant measures without any justifiable reasons, the administrative government agency may issue an order that the corporation in question takes the recommended measures. Orders are also principally given after consultation with the Public Interest Corporation Commission and following the receipt of their reply, and the details of the orders are disclosed to the general public.

5. Cancellation of Public Interest Corporation Authorization

a) Compulsory cancellation

In the event that a public interest corporation falls under any of the following, its public benefit authorization shall be cancelled without fail (Public Interest Corporation Act 29(1)).

(i) In the event that they fall under any of the items (excluding item (ii)) of Article 6
(ii) In the event that they obtain the Public Interest Corporation Authorization, the authorization for change under paragraph 1 of Article 11 or the approval under paragraph 1 of Article 25 by fraudulent or illegal means
(iii) In the event that they fail to comply with the order pursuant to the provisions of paragraph 3 of the preceding Article without justifiable grounds
(iv) In the event that they apply for the cancellation of the Public Interest Corporation Authorization

b) Cancellation at the discretion of the competent authorities

In the event that a public interest corporation falls under any of the following, its public benefit authorization shall be cancelled without fail (Aricle 29(2) Public Interest Corporation Act).

(i) In the event that they no longer conform to any of the public benefit criteria
(ii) In the event that they fail to comply with the provisions of Chapter 2 Section 2 of the Public Interest Corporation Act
(iii) In the event that they violate laws and regulations

In the case of cancellation by discretion, the administrative government agencies shall in principle enquire to and seek the response of the Deliberation Council of the Public Interest Corporation Commission, and the reason for cancellation is published under the Administrative Procedures Law.

Information Duties
under the German Law Governing Non-profit Entities

Moritz Bälz[*]

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I. INTRODUCTION

The number of non-profit entities in Germany continues to grow.[1] One recurring theme in this context is the issue of transparency in the non-profit sector.[2] This already indicates that an analysis of information duties in private law, as undertaken by the contributors to this volume, should benefit from including the law of non-profit entities as well. Furthermore, it seems worthwhile to contrast the German rules with the Japanese experience in this field as outlined in this volume.[3] This contribution therefore undertakes to give a concise sketch of information duties in the law governing non-profit entities in Germany.

I shall start by giving an introduction to non-profit entities under German law (II.). In a second step, the information duties in the rules applicable to the two most frequently used forms of non-profit entities, namely a

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1 J. PRIEMER/H. KRIMMER/A. LABIGNE, Ziviz Survey 2017. Vielfalt Verstehen. Zusammenhalt Stärken. (Berlin 2017) 5.

2 See, e.g., H. KRIMMER et al. Transparenz im Dritten Sektor. Eine wissenschaftliche Bestandsaufnahme (Hamburg 2014).

3 M. ARAI, Information Duties under the Japanese Law Governing Public Interest Incorporated Associations and Foundations, *supra* pp. 121 (in this volume).

registered association *(eingetragener Verein)* and a foundation with legal personality *(rechtsfähige Stiftung)*, shall be examined more closely (III.). Given the importance of tax law for the emergence of financially robust non-profit entities as well as for, at least indirectly, the governance of non-profit entities, the analysis shall be complemented by a brief outline of the rules under which non-profit entities can receive tax-privileged status (IV.). I shall conclude with a summary of my key findings (V.).

II. NON-PROFIT ENTITIES IN GERMAN PRIVATE LAW

The term "non-profit entity" as found in English literature on the various legal forms used by the so-called third sector (i.e., non-state, non-market actors), does not have a legally defined equivalent in German law.[4] The smallest common denominator of the various types of non-profit entities observed under German law is that these entities may not distribute profits (the so-called non-distribution constraint).[5]

1. Three Common Forms of Non-profit Entities

There are primarily three common forms of non-profit entities under German private law:

Firstly, there is the registered association (*eingetragener Verein*, abbreviated *"e.V."*). Among the more than 600,000 registered associations in Germany,[6] well-known examples include the German Red Cross (*DRK*), the General German Automobile Club *(ADAC),* the German Academic Exchange Service *(DAAD)* and the German Soccer Association (DFB).[7] Among the forms of non-profit entities in Germany, the registered association is by far the most common. The rules on registered associations are stipulated in Sects. 21 to 79 of the German Civil Code (BGB).[8]

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4 For the definition of public benefit *(gemeinnützig)* under tax law see *infra* at IV.

5 T. VON HIPPEL, Grundprobleme von Nonprofit-Organisationen (Tübingen 2007) 12; T. VON HIPPEL, Nonprofit Organizations in Germany, in: HOPT/VON HIPPEL (eds.), Comparative Corporate Governance of Nonprofit Organizations (Cambridge et al. 2010) 197, 200.

6 PRIEMER/KRIMMER/LABIGNE, *supra* note 1, 9.

7 Most sports clubs are organized as registered associations, even those with major professional soccer teams. In such a case, the professional division is hived-down into a subsidiary. There is some controversy on whether an association should still be considered as non-profit under these circumstances. See *infra* at II.2.a).

8 It may be mentioned here that besides their importance for the non-profit sector, the rules on registered associations are foundational for all corporations under German law. To the extent no special rules are stipulated, the rules on registered associations apply also to companies organized as limited liability companies *(GmbH)* or stock

Sect. 21 BGB reads as follows:

> An association whose object is not commercial business operations acquires legal personality by entry in the register of associations of the competent local court [*Amtsgericht*].[9]

If registered, the association thus can be subject to rights and duties, act in its own name, sue and be sued, and hold assets including real estate. Creditors of the association can only look to the assets of the association.

Secondly, there is a foundation with legal personality (*rechtsfähige Stiftung*). Prominent examples of this type of non-profit entity include the VolkswagenStiftung, the Bertelsmann Stiftung, and the Fritz Thyssen Stiftung. Besides these large and wealthy foundations, the number of small foundations has increased in recent years. The rules on foundations are set forth in Sects. 80 to 88 BGB as well as in the state foundation laws of the individual states *(Länder)*.[10] The former contain most of the applicable private law rules, whereas the latter regulate in particular administrative matters. Currently, a major reform of the law of foundations is being discussed, which *inter alia* aims at unifying and simplifying the applicable rules through stronger regulation on the federal level.[11]

As of now, Sect. 80(1) BGB, standing as the basic rule on foundations, reads as follows:

> The creation of a foundation with legal personality requires an endowment transaction and recognition of the foundation by the competent public authority of the *Land* [state] in which the foundation is to have its seat.

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companies *(Aktiengesellschaft)*. An important example is Sect. 31 BGB providing for liability of the association for acts committed by the association's organs.

9 Unless stated otherwise, the English translations of German statues used in this contribution follow the translation prepared on behalf of the German Federal Ministry of Justice and Consumer Protection (BMJV) available at *https://www.gesetze-im-internet.de/Teilliste_translations.html*.

10 For a list of the foundation laws of the *Länder* see the homepage of the Bundesverband Deutscher Stiftungen at *https://www.stiftungen.org/stiftungen/basiswissen-stiftungen/stiftungsgruendung/landesstiftungsgesetze.html*.

11 See the report published by a joint working group of the federal government and the governments of the *Länder*, Bericht der Bund-Länder-Arbeitsgruppe "Stiftungsrecht" an die Ständige Konferenz der Innenminister und –senatoren der Länder vom 9. September 2016 at *https://www.innenministerkonferenz.de/IMK/DE/termine/to-beschluesse/2016-11-29_30/nummer%2026%20reform%20stiftungsrecht.pdf*. For a comprehensive assessment of these proposals see B. WEITEMEYER, Reformbedarf im Stiftungsrecht aus rechtsvergleichender Perspektive, Archiv für civilistische Praxis (AcP) 217 (2017) 431. In part, reform efforts also aim at answering to the challenges posed to foundations by the current low-interest-rate environment.

The most fundamental difference between a registered association and a foundation with legal personality is that the former must have members and thus constitutes a membership association, whereas the latter must not have members and thus constitutes an organization without members.[12]

Thirdly, limited liability companies *(GmbH)* are increasingly used for charitable purposes. As is well known – and contrary to Japan, where the German-inspired limited liability company *(yūgen gaisha)* never proved particularly popular with larger enterprises and where the form is since the enactment of the Companies Act[13] no longer available for newly established corporations[14] – the GmbH is the dominant corporate form in Germany, whereas the stock company is used primarily by financial institutions and those corporations aiming at financing through capital markets.[15] Even large international companies such as the automotive supplier Robert Bosch GmbH are organized as a limited liability company.[16] The latter is an interesting example here, as the majority of its shares are held by the Robert Bosch Foundation, which – irrespective of its name – is also organized as a GmbH and counts among the largest philanthropic foundations in Germany.[17] Today, kindergartens, homes for the elderly and hospitals are also often organized as limited liability companies.

The rules on limited liability companies are contained in the Limited Liability Companies Act (GmbHG), which in its Sect. 1 expressly provides that a GmbH can be formed by one or several persons for any purpose permitted by law. Where the purpose is charitable in nature, such a limited liability company can under certain conditions acquire public benefit status *(Gemeinnützigkeit)* under tax law. Sect. 4 sentence 2 GmbHG allows such charitable limited liability companies to indicate their special status in their trade name by using the abbreviation "gGmbH" for *gemeinnützige Gesellschaft mit beschränkter Haftung*:

> If the company exclusively and directly pursues tax-privileged purposes in accordance with sections 51 to 68 of the Fiscal Code *[Abgabenordnung, AO],* the abbreviation "gGmbH" may be used.

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12 VON HIPPEL, Nonprofit Organizations, *supra* note 5, 200.

13 *Kaisha-hō*, Act No. 86/2005.

14 See H. KANSAKU/M. BÄLZ, § 3 Gesellschaftsrecht, in: Baum/Bälz (eds.) Handbuch Japanisches Handels- und Wirtschaftsrecht (Köln 2011) n. 2 with further references.

15 This owes partly to the fact that the rules of the German Stock Company Law *(AktG)* are in principle of a mandatory nature (Sect. 23 AktG) and thus offer far less flexibility than the rules applicable to a GmbH.

16 Remarkably, the Japanese subsidiary of Robert Bosch GmbH is organized as a stock company *(kabushiki kaisha)* and until rather recently even used to be listed on the Tokyo Stock Exchange.

17 See the homepage at *http://www.bosch-stiftung.de/de/verfassung-des-hauses-bosch*.

It should be mentioned that non-profit activities in Germany are pursued also in various other forms. As the focus here is on non-profit legal entities under civil law, public law entities as they are used, for instance, by most universities and churches, are not covered in the following discussion. Nor will those non-profit activities be dealt with which are pursued without (full) legal personality. Therefore, falling beyond the scope of the contribution are, in particular, associations without legal personality *(nicht rechtsfähiger Verein)*[18] and foundations without legal personality *(nicht rechtsfähige Stiftungen)*. As to the former, many exist in Germany, including – for historical reasons – political parties; the latter, which are also often referred to as foundation trusts *(Treuhandstiftungen),* constitute in essence a specific form of gift contract.[19] Not covered here, finally, are cooperatives *(Genossenschaften),* even though they sometimes are included in a broad definition of the non-profit sector.[20]

2. Key Features of the Main Forms of Non-profit Entities

The three main forms of non-profit entities under German private law differ significantly with regard to their key features. As illustrated by the table next page, this concerns the rules on, *inter alia*, establishment, the entry and exit of members, a change of structure or dissolution, and governance.

a) Registered association

A registered association is set up fairly easily by agreement of its founding members. To be registered, at least seven members have to sign the articles of association (Sects. 56, 59(3) BGB). No minimum capital is required. An application for registration may not be denied if the statutory conditions are fulfilled *(System der Normativbedingungen).*

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18 According to Sect. 54 BGB, associations without legal personality are subject to the rules on civil law partnerships, and any person entering into a transaction on behalf of an association without legal personality is personally liable. However, there is a strong tendency nowadays to also treat associations without legal personality – notwithstanding the wording of the code – as a subject of rights and duties and to apply the rules for registered associations *mutatis mutandis*. On this issue see M. SCHÖPFLIN, in: Bamberger/Roth/Hau/Poseck, Beck'scher Online Kommentar BGB (45th ed., 2017), Sect. 54, n. 4 f.; A. ARNOLD, in: Münchener Kommentar BGB (7th ed., Munich 2015) Sect. 54, n. 3 ff.

19 See VON HIPPEL, Nonprofit Organizations, *supra* note 5, 204.

20 The establishment of many German cooperatives predates 1945, but the last 20 years have witnessed a kind of boom of newly established cooperatives, especially in the field of alternative energy. See H. KRIMMER / J. PRIEMER, Ziviz Survey 2012. Zivilgesellschaft verstehen (Berlin 2013) 17.

	Registered association *(eingetragener Verein)*	Foundation with legal personality *(rechtsfähige Stiftung)*	(g)GmbH *((gemeinnützige) Gesellschaft mit beschränkter Haftung)*
Establishment	few formalities (fundamental prohibition against commercial operations), registration	adequate endowment plus recognition by the state required	notary public required, in principle minimum share capital of € 25,000
Entry/Exit	flexible	[no members/ owners]	transfer of shares only in notarial deed
Change of structure/dissolution	at any time	inflexible; exists in principle forever	at any time
Governance	representation by board, general assembly as supreme organ (voting by headcount)	board acting independently restricted by founder's will (additional board of trustees is common)	shareholders govern (voting according to share)

In practice, whether the association will be registered and thus acquire legal personality depends fundamentally on the prohibition against commercial business operations. An association whose purpose is commercial business operations *(Wirtschaftsverein)* acquires legal personality only by state grant (*Konzessionssystem*, Sect. 22 BGB). In practice, such a concession is granted only very rarely. The rationale behind this rule is that, in the interest of creditors in particular, commercial activities should normally be carried on in the various forms provided for by commercial law (i.e., corporations, commercial partnerships, etc.).[21] By contrast, an association whose purpose is not commercial business operations *(Idealverein)* can acquire legal personality by registration (Sect. 21 BGB).

The important distinction between a non-profit association and a for-profit association is made typologically based not only on what is defined in the articles as the association's purpose, but also with view to its de facto activities.[22] However, Sect. 21 BGB does not prohibit non-profit associa-

21 Bundesgerichtshof, Entscheidungen des Bundesgerichtshofs in Zivilsachen (BGHZ) 22, 240, 244.

22 For an in-depth discussion see SCHÖPFLIN, *supra* note 18, Sec. 21, n. 90 ff.

tions from engaging in any commercial activities altogether. Rather, as long as a non-profit association's commercial activities remain subordinate to and serve its non-profit activities, the activities are considered compatible with Sect. 21 BGB *(Nebenzweckprivileg)*.[23] The Federal Supreme Court (BGH) takes a fairly generous view on this point. In a recent case concerning a registered association running nine day-care facilities for children, the court held that the association, while undoubtedly engaging in significant commercial activity, could still be considered a non-profit association (and thus should not be deleted from the registry for violating Sect. 21 BGB) as the association's commercial activities served the association's non-profit purpose.[24] The court even expressly acknowledged that an association could pursue non-profit activities through commercial activities without becoming a for-profit association.[25] Furthermore, the Federal Supreme Court's famous, though controversial, ADAC case of 1982 has allowed non-profit associations to engage in commercial activities through a subsidiary organized as a separate legal entity under commercial law, the argument being that in such cases the subsidiary's creditors remain protected by the rules applicable to the subsidiary (normally, a GmbH or a stock company).[26] Well-known sports clubs do the same. For instance, FC Bayern München e.V., holds 75% in Bayern München AG, a stock company into which the association has hived down its professional soccer activities with a turnover amounting to hundreds of millions of euros. Nevertheless, the Munich District Court has recently confirmed the association's status as non-profit association.[27]

Members of an association can join and leave the association in principle freely (subject to the formalities stipulated in the articles). Also, the general assembly can decide upon an amendment of the articles and even on dissolution at any time. To do so, a super-majority is required (Sects. 33, 41 BGB). Governance is characterized by voting per headcount in the general

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23 The details are controversial. For an overview see T. HEIDEL/D. LOCHNER, in: Heidel/Hüßtege/Mansel/Noack, Nomos Kommentar BGB (3rd ed., Baden Baden 2016) Sect. 21, n. 32 ff.

24 Bundesgerichtshof, Neue Juristische Wochenschrift (NJW) 2017, 1943. A key argument for the court was that the association in question had been granted tax-privileged status as serving public benefit *(gemeinnützig)*.

25 *Id*. at n. 31–32.

26 Bundesgerichtshof, Entscheidungen des Bundesgerichtshofs in Zivilsachen (BGHZ) 85, 84.

27 See the press release of the Amtsgericht (AG) München at *https://www.justiz.bayern.de/gerichte-und-behoerden/amtsgerichte/muenchen/presse/2016/73.php*. An analysis of this remarkable case is provided by U. SEGNA, Die Registersache FC Bayern München, Zeitschrift für das Recht der Non Profit Organisationen (npoR) 2017, 3.

assembly as the association's supreme organ (Sect. 32 BGB). In addition, the association must have a board. The appointment of the members of the board is by resolution of the general assembly, which in principle can revoke the appointment at any time (Sect. 27 BGB).

b) Foundation

The establishment of a foundation with legal personality, by contrast, requires an endowment transaction and recognition by the competent state authorities (Sect. 80 BGB). Nowadays, this recognition is not at the discretion of the supervisory authorities, but it must be granted if the conditions are met. In practice, the authorities tend to withhold recognition for lack of adequate funding unless the endowment amounts to at least 50,000 euros (Sect. 80 BGB).[28] By definition, in a foundation no members or owners exist.

At the core of the foundation lies its purpose, as it has to be defined in the charter. The founder is free to define any purpose unless it endangers the common good (Sect. 80(2) BGB). If not stipulated otherwise in the charter, a foundation is established for an unlimited period of time. If the purpose of the foundation has become impossible to fulfil, the competent public authority may revise the purpose or dissolve the foundation (Sect. 87 BGB). In practice, dissolution for lack of assets is the most common example in this regard. Under normal circumstances the purpose of the foundation cannot be amended after it has been established, not even by the founder. According to the prevailing view, the charter cannot stipulate a general right of the founder to amend the purpose during her lifetime. Whether this should be changed remains disputed even in the current reform debate.[29] Foundations with legal personality are governed independently by a foundation board, whose composition must be specified in the charter (Sect. 81(1)(5) BGB). The board is restricted by the founder's will as expressed in the charter. It is quite common to have a board of trustees in addition.

c) Charitable limited liability company

The rules on non-profit limited liability companies are in principle the same as those for a GmbH used for commercial purposes. Establishment can be

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28 A. SCHLÜTER / S. STOLTE in: Schlüter/Stolte (eds.), Stiftungsrecht (3rd ed., Munich 2016) Chapter 5, n. 65.

29 See Bericht der Bund-Länder Arbeitsgruppe "Stiftungsrecht", *supra* note 11, 82 ff. and WEITENAUER, *supra* note 11, 474 ff.; J. NIKOLAI / N. KUSZLIK, Reform des Stiftungsrechts. Wichtige Ziele für die derzeit tagende Arbeitsgruppe des Bundes und der Länder, Zeitschrift für Rechtspolitik (ZRP) 2016, 47 f.

accomplished by a single person and requires notarization of the articles of association (Sects. 1, 2 GmbHG). The GmbH starts to exist as such once it is registered in the commercial registry at the place of its registered office (Sect. 11 GmbHG). In principle, establishing a GmbH requires a minimum share capital of 25,000 euros (Sect. 5(1) GmbHG). Reacting to regulatory competition, in particular to the increasing number of English Private Companies Limited by Shares (Ltd.) having their effective seat of administration in Germany, the German legislature, effective 2008, introduced the entrepreneur company with limited liability *(Unternehmergesellschaft (haftungsbeschränkt))* as a special form of the GmbH. For an entrepreneur company a minimum share capital of one euro suffices, but the company may not distribute, but must accumulate profits until there is sufficient equity to increase the share capital to 25,000 euros (Sect. 5a GmbHG). The UG can also be used for non-profit purposes.[30]

Entry into and exit from a GmbH are comparatively cumbersome, as transfer of any shares can only be accomplished by notarial deed (Sect. 15(3) GmbHG). The GmbH is governed by its shareholders, who vote according to their shares (Sect. 47 GmbHG). The GmbH must have one or more directors who represent the company. The shareholders can change the company's structure by amending the articles of association or dissolve the company, both of which require a supermajority (Sects. 53, 60(1) GmbHG).

d) Additional subjective motives influencing choice

Those initiating a non-profit entity in principle may choose the form most suitable for their purposes. Apart from the aforementioned differences in the applicable rules, their choice may be influenced by subjective motives as well. For example, a foundation *(Stiftung)* may be appealing where the founder wishes to express in the entity's name his or her charitable intention, given the fact that the German verb *stiften* has strong connotation of doing something good. Where the entity aims at collecting gifts, donating to a foundation may sound more attractive than donating to a GmbH.[31] However, even a registered association or a charitable GmbH may under certain conditions include the word *Stiftung* in its name (as it is the case in the aforementioned example of the Robert Bosch Stiftung GmbH or in the

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30 See M. RIEDER, in: Fleischer/Goette, Münchener Kommentar zum GmbHG (3rd ed., Munich 2018) Sect. 5a, n. 56b; P. OBERBECK/S. WINHELLER, Die gemeinnützige Unternehmergesellschaft – Die Pflichtrücklage nach § 5a Abs. 3 GmbHG als Stolperstein?, Deutsches Steuerrecht (DStR) 2009, 516.

31 I. VAN RANDENBORGH, in: Schauhoff (ed.), Handbuch der Gemeinnützigkeit (3rd ed, Munich 2010) § 1 Rechtsformwahl, n. 5.

case of the majority of the political "foundations" established by the major political parties (Konrad-Adenauer-Stiftung e.V., Friedrich-Ebert-Stiftung e.V., etc.). Using the word *Stiftung* in the name of a registered association may be considered misleading, unless the association possesses sufficient assets to fulfill its charitable purpose at least for a certain time.[32]

3. *Non-profit Entities as a Social Factor*

Non-profit entities play an important role in many fields of German society, including, but by no means limited to, sports and leisure, education and science, health, and environmental politics. For some time, statistics have been showing an increase in the numbers of non-profit entities. Traditionally, associations with legal personality make up by far the largest part, their number since 2016 exceeding 600,000.[33] In recent years, the number of foundations with legal personality and charitable limited liability companies has increased particularly sharply.[34] As of 31 December 2017, there were more than 22,000 foundations with legal personality[35] and as of August 2016 more than 11,000 charitable GmbHs.[36]

Whereas many foundations and particularly associations are rather small, some non-profit entities own very substantial assets or have millions of members. The Bertelsmann Foundation, for example, owns a majority of the shares in the media giant Bertelsmann Group and thus is able to spend about 70 million euros annually on their influential studies and other social reform projects. Respected by many as an important voice in the public debate, the foundation also faces sharp criticism for promoting its allegedly neo-liberal agenda.[37] The General German Automobile Club (ADAC), with almost 20 million members, is an influential political player. In recent years, the association also has made headlines for vote-rigging in its prestigious annual "car of the year" award competition; it is now undergoing substantial restructuring.

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32 VAN RANDENBORGH, *supra* note 31, § 1 Rechtsformwahl, n. 5; Oberlandesgericht (OLG) Köln, Neue Juristische Wochenschrift Rechtsprechungs-Report (NJW-RR) 1997, 1531.

33 PRIEMER et al. *supra* note 6, 9.

34 KRIMMER/PRIEMER, *supra* note 20, 18.

35 See the statistics on the homepage of the Bundesverband Deutscher Stiftungen at *https://www.stiftungen.org/stiftungen/zahlen-und-daten/statistiken.html.*

36 PRIEMER et al. *supra* note 6, 51.

37 See recently, P. MUNZINGER, Eine Stiftung vermisst die Welt, Süddeutsche Zeitung 9 May2018, online at *http://www.sueddeutsche.de/bildung/gesellschaft-und-politik-das-glashaus-1.3899280.*

Repeated scandals involving associations and foundations have, in fact, contributed their share in keeping alive the debate on stricter regulation and enhanced transparency of non-profit entities. Additional examples here include the Hertie Foundation, alleged to have been used for tax avoidance, the corruption charges lodged against the German Soccer Association (DFB) in connection with the 2006 FIFA World Cup, and the embezzlement of donations at the Deutsches Tierhilfswerk e.V.

III. Information Duties in the Law of Non-profit Entities

Let us now turn to information duties in the law applicable to non-profit entities in German private law. With the exception of the rules on tax-privileged status,[38] these rules depend on the respective legal form of the entity. The following description focusses on information duties in the law of registered associations and foundations with legal personality. For charitable limited liability companies, the same rules apply as for commercial limited liability companies (especially Sect. 51a GmbHG regarding shareholders' information rights), which are covered elsewhere in this volume.[39]

1. Information Duties in the Law of Registered Associations

As regards registered associations, several information duties can be distinguished. The association's board as an organ owes an information duty to the association, which corresponds to a collective information right of the association (a.). In addition, each member is generally assumed to have an individual information right resulting from membership (b). Finally, there is limited disclosure vis-à-vis the public based on the registry of associations (c.). In principle, even for large associations no obligation to audit or file accounts exists (d.).

a) The board's information duty (collective information right of the association)

The board *(Vorstand)*[40] owes the association – here represented by the general meeting – an information duty. Pursuant to Sect. 27(3) BGB, the relationship between the association and its board is governed by the rules on mandate *(Auftrag)* contained in Sects. 664–670 BGB). Sect. 666 BGB reads:

38 See *infra* at IV.

39 I. SAENGER, Information Duties under German Trade Law and Company Law, *supra* pp. 191 (in this volume).

40 The board may consist of one person only (Sect. 26(2) BGB).

The mandatary is obliged to provide the mandator with the required reports, and on demand to provide information on the status of the transaction and after carrying out the mandate to render account for it.

Under Sec. 666 BGB, three different duties of the board can be distinguished, which are subject to modifications in the articles of association (Sect. 40 BGB).[41]

Firstly, the board must provide reports *(Berichtspflicht)*. For the general meeting to effectively exercise its rights (the right to appoint and dismiss the members of the board, the right to issue directives, etc.), even without being so requested the board must provide the necessary information. Therefore, the scope of the information to be provided primarily depends on the powers vested in the general meeting and the organizational structure of the specific association.[42] Most commentators assume that written form may be required depending on the circumstances.[43]

Secondly, the board must answer requests for information raised at the general meeting *(Auskunftspflicht)*. If the board is requested by a resolution of the general meeting, it may not refuse to provide such information, not even "in the interest of the association", as the general meeting is the association's supreme organ.[44] In principle, this information duty refers to all affairs of the association.[45] At times problematic is whether this includes information on the association's subsidiaries, especially given the widespread practice to hive down commercial activities of the association into subsidiaries.[46]

Thirdly, the board must render account *(Rechenschaftspflicht)*. This is normally fulfilled in the form of a simple compilation of earnings or expenses complimented by receipts (Sect. 259 BGB). Commercial accounting (Sects. 238 ff. Commercial Code (HGB)) generally is not required. According to the prevailing view, the duty to render account is to be fulfilled periodically (even if the wording of Sect. 666 suggests otherwise), because

41 For details, see U. HAAS/S. SCHOLL, Informationsansprüche und -pflichten im Idealverein, in: Häuser et al. (eds.), Festschrift für Walther Hadding zum 70. Geburtstag am 8. Mai 2004 (Berlin 2004) 365, 369 ff.

42 HAAS/SCHOLL, *supra* note 41, 369 ff.

43 ARNOLD, *supra* note 18, Sect. 27, n. 39; HAAS/SCHOLL, *supra* note 41, 371.

44 ARNOLD, *supra* note 18, Sect. 27, n. 39; HAAS/SCHOLL, *supra* note 41, 381.

45 ARNOLD, *supra* note 18, Sect. 27, n. 39; HAAS/SCHOLL, *supra* note 41, 381

46 Bundesgerichtshof, Neue Juristische Wochenschrift Rechtsprechungs-Report (NJW-RR) 2003, 830; HAAS/SCHOLL, *supra* note 41, 367 ff. For this practice, see *supra* at II.2.a.

rendering account only "after carrying out the mandate" would make it virtually impossible for the general meeting to exercise its rights.[47]

The question arises how these duties can be enforced. The general meeting can threaten to dismiss a board which does not answer an information request. In addition, some consider it possible that an individual member would be empowered to enforce the collective information right on behalf of the association *(actio pro socio)*.[48] Most commentators, however, take the view that the collective information right cannot be enforced in court. They consider the individual member sufficiently protected by the right to exit.[49]

b) Members' individual information right

In addition to the aforementioned information duty of the board vis-à-vis the association, which corresponds to a collective information right of the latter, each individual member has an individual information right resulting from his or her membership.[50] While it is widely recognized that each member must have the right to receive the information necessary to effectively exercise membership rights, no express statutory rule exists.[51] It is therefore based either on Sects. 27(3), 666 BGB[52] or – more convincingly – on a *mutatis mutandis* application of Sect. 131 AktG.[53] The members' information right may be extended but arguably not restricted in the articles of association.[54] This right is to be asserted against the association represented by the board.[55]

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47 HAAS/SCHOLL, *supra* note 41, 372; U. SEGNA, Rechnungslegung und Prüfung von Vereinen – Reformbedarf im deutschen Recht, Deutsches Steuerrecht (DStR) 2006, 1568, 1569 with further references.

48 K. SCHMIDT, Informationsrechte in Gesellschaften und Verbänden. Ein Beitrag zur gesellschaftsrechtlichen Institutionenbildung (Heidelberg 1984) 57 and 85.

49 B. GRUNEWALD, Auskunftserteilung und Haftung des Vorstandes im bürgerlichrechtlichen Verein, Zeitschrift für Wirtschaftsrecht (ZIP) 1989, 962, 963; HAAS/SCHOLL, *supra* note 41, 373.

50 This has been developed as a general principle of membership associations *(Verbände)* by SCHMIDT, *supra* note 48, 21 ff. Cf. also I. SAENGER, *in this volume*, p. 194.

51 By contrast, Sect. 51a GmbHG and Sect. 131 AktG expressly stipulate such rights for the shareholders of a GmbH or stock company. See I. SAENGER, *in this volume*, pp. 198 ff.

52 Bundesgerichtshof, Neue Juristische Wochenschrift Rechtsprechungs-Report (NJW-RR) 2003, 830.

53 SCHMIDT, *supra* note 48, 57; ARNOLD, *supra* note 18, Sect. 38, n. 32f.

54 M. SCHÖPFLIN, in: Beuthien/Gummert/Schöpflin (eds.), Münchener Handbuch des Gesellschaftsrechts Bd. 5, Verein. Stiftung bürgerlichen Rechts (4th ed., Munich 2016) § 34 Mitgliederrechte, n. 18 f.; ARNOLD, *supra* note 18, Sect. 38, n. 34.

55 HAAS/SCHOLL, *supra* note 41, 374.

The prevailing view, by applying Sect. 131 AktG *mutatis mutandis,* limits the individual information right to the general meeting. This means a member can demand information at least in principle only within the general meeting and to the extent such information is necessary to permit a proper evaluation of the relevant item on the agenda. This is justified with the argument that an association is designed for large organizations, and it would be impracticable to allow each individual member to request information at any time.[56] Independently from this, the Federal Supreme Court has recently confirmed that a member does have the right to inspect the books and records of the association, including the members list, if there is a legitimate reason and if the association's interests in keeping the data confidential do not outweigh such interest.[57]

A member can enforce his or her individual information right in court.[58] However, the board may (and must) refuse the request where interest of the association to keep the information confidential outweighs the interest of the individual member (cf. Sect. 51a(2) GmbHG, Sect. 131(3) AktG).[59]

c) *Limited disclosure to the public through the registry of associations*

Registered associations must register and keep up-to-date certain information with the registry of associations (*Vereinsregister*). This registry is today operated electronically (Sect. 55a BGB). It may be inspected by everyone (Sect. 79 BGB), resulting in a (limited) disclosure to the general public.

To register an association, the board has to file the articles of association *(Vereinssatzung),* which must fulfill the minimum requirements. Pursuant to Sect. 57 BGB, the articles must contain the associations purpose, the name and the seat of the association and indicate that the association is to be registered. In addition, copies of the documents recording the appointment of the board must be filed (Sect. 59). Finally, the application must state the name and the registered office of the association as well as the date of the adoption of the articles of association, the names of the members of the board and their power to represent the association (Sect. 64 BGB). The application for registration must be filed in the form of a public document (Sect. 77 BGB), usually produced by a notary public (Sect. 129 BGB).

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56 SCHMIDT, *supra* note 48, 56 f.; ARNOLD, *supra* note 18, Sect. 38, n. 33. For a more flexible approach see VON HIPPEL, Grundprobleme, *supra* note 5, 329; T. HEIDEL/ D. LOCHNER, in: Heidel et al. *supra* note 23, Sec. 38, n. 11.

57 Bundesgerichtshof (BGH), Neue Zeitschrift für Gesellschaftsrecht (NZG) 2010, 1430.

58 HAAS/SCHOLL, *supra* note 41, 380; SCHÖPFLIN, *supra* note 54, § 34 Mitgliederrechte, n. 21.

59 ARNOLD, *supra* note 18, Sect. 38, n. 33; HAAS/SCHOLL, *supra* note 41, 381 ff.

If a change in the composition of the board has not been disclosed by registration, it cannot be asserted against a third party who did not know about such change (Sect. 68 BGB). Sect. 70 BGB extends this protection to restrictions on the scope of the board's power to represent the association as well as arrangements on the power to represent which diverge from the default rule in Sect. 26(2) BGB. While this mechanism is similar to the protection granted by Sect. 15(1) and (2) HGB with regard to the commercial registry *(negative Publizität),*[60] the scope of protection in the case of the registry of associations is limited to the power to represent the association. Also, different from Sect. 15(3) HGB, public confidence in information incorrectly registered with the registry of associations is not protected.[61]

d) *No obligation to audit or file accounts*

In principle, there is no obligation to audit or file accounts even for large non-profit associations.[62] This means that associations do not have to inform the public from where they receive their funds and how they use these funds. Some associations do so voluntarily. These associations are able to receive the DZI donation seal *(Spenden-Siegel)* which non-profit entities fulfilling certain conditions can earn to foster their reputation.

The rudimentary nature of financial disclosure as stipulated by the current law has been criticized as "archaic".[63] It is, of course, possible to stipulate an obligation to audit accounts in the articles of association (Sect. 40 BGB). Thus far calls for introducing a mandatory auditing of accounts[64] have not been followed by the legislature. The limited financial disclosure is problematic as it weakens governance of registered associations. Scandals not only tarnish the individual registered association but tend to undermine trust in the third sector in general. While characteristics of non-profit associations should be taken into account, in particular their non-profit purpose and the fact that members of the board often are not paid for their work, this hardly can mean that management is permitted to be less prudent.

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60 Cf. I. SAENGER, *in this volume*, p. 192 f.

61 Arguing in favor of introducing such *positive Publiziät* NICOLAI/KUSZLIK, *supra* note 18, 50.

62 For exceptions in special cases see SEGNA, *supra* note 47, 1569; KRIMMER et al. *supra* note 2, 112 ff.

63 M. LUTTER, Zur Rechnungslegung und Publizität gemeinnütziger Spenden-Vereine, Betriebs-Berater (BB) 1988, 489, 490. For a similar view see SEGNA, *supra* note 47, 1569.

64 LUTTER, *supra* note 63, 492 ff.; SEGNA, *supra* note 47, 1571 ff.

2. *Information Duties in the Law of Foundations with Legal Personality*

A lack of transparency and disclosure is no less – if not even more – an issue with regard to foundations with legal personality.[65] The status quo is characterized by a mostly irrelevant information duty of the board vis-à-vis the foundation (a.), rather heterogeneous state supervision by the *Länder* (b.), very limited public disclosure through the directory of foundations (c.), and the absence of mandatory auditing and financial disclosure (d.).

a) *Limited relevance of the board's information duties vis-à-vis the foundation*

For foundations with legal personality, Sects. 86, 27(3), 666 BGB stipulate a similar information duty of the board as in the case of registered associations. The practical importance of this duty, however, is very limited. This is because by default there is no other organ (no general meeting or the like) which could request such information on behalf of the foundation. The board's information duty may have practical relevance where the charter provides for a supervisory board.[66]

b) *Information duties as part of state supervision (Stiftungsaufsicht)*

To make up for the lack of members or shareholders who could oversee the foundation, the law provides for state supervision by the *Länder (Stiftungsaufsicht),*[67] which in turn is based on certain information duties of the foundation vis-à-vis the supervisory authorities.[68] State supervision relates to the establishment of the foundation (Sects. 80, 81 BGB) as well as to its operations. It is, however, strictly limited to oversight of legality *(Rechtsaufsicht),* i.e., the supervisory authority aims at enforcing compliance with the foundation's charter and the relevant laws. Apart from this, they in principle do not exercise any oversight as to how the foundation is operated and how available funds are spent. Even where the charter stipulates that funds must be used "efficiently and economically", the supervisory authori-

65 For a comprehensive treatment see B. VOGT, Publizität im Stiftungsrecht (Hamburg 2013) 13 ff.

66 B. WEITEMEYER, in: Münchener Kommentar BGB, *supra* note 18, Sect. 86, n. 51.

67 V. HIPPEL/R. WALZ, Tax law as an instrument to strengthen the corporate governance of the nonprofit sector, in: HOPT/VON Hippel, *supra* note 5, 940, 946.

68 T. VON HIPPEL, Nonprofit Organizations, *supra* note 5, 216; H. HOF in: V. CAMPENHAUSEN/RICHTER (eds.), Stiftungsrechts-Handbuch (4th ed., Munich 2014) 147 ff.; KRIMMER et al. *supra* note 62, 80 ff.

ties may not simply use their own definition of what is efficient and economical.[69]

The foundation laws of the *Länder* are far from being homogeneous with regard to which information foundations have to provide to the supervisory authorities. All state laws stipulate that the foundation must annually provide simple accounts and reports on how the foundation has fulfilled its goals *(Jahresabrechnung mit Vermögensaufstellung und Geschäftsbericht).* It should be noted that this information is not disclosed to the public.[70] In most of the *Länder* the supervision is occasioned supervision *(Anlassaufsicht),* while some state foundation laws grant the authorities the right to request information at any time.[71] Even in these states, limited resources of the state authorities hamper the effectiveness of state supervision, which therefore has been subject to reform discussions for many years.[72] With few exceptions a foundation no longer needs prior approval by the authorities to carry out certain transactions, but some state laws require prior notice to be given, *inter alia*, in cases involving the sale or encumbrance of immovable property.

c) Directory of foundations (Stiftungsverzeichnis)

Even though the existence of a foundation with legal personality does not depend on registration, nowadays a public directory of foundations *(Stiftungsverzeichnis)* exists in each *Land*. The contents of this directory, with few exceptions, can be inspected online by any individual without having to show a legitimate interest. However, state foundation laws provide for only limited information to be registered, including the name, the seat, and the purpose of the foundation. Some state foundation laws require the entry of additional information regarding, for example, the foundation's address, organs, year of establishment, or its initial assets.[73] State foundation laws also differ with regard to the extent that foundations are obliged to keep the information in the foundation directory up-to-date and, in particular, which sanctions are attached to such obligations in case of violations.[74]

Generally, it must be said that this key information is of rather limited use for third parties. This is because, as opposed to the commercial registry and the registry of associations, the directories of foundations cannot be

69 K.J. SCHIFFER/M. PRUNS, in: HEIDEL et al. *supra* note 23, Sect. 80, n. 111.

70 T. V. HIPPEL, Nonprofit Organizations, *supra* note 5, 220.

71 See WEITEMEYER, in: Münchener Kommentar BGB, *supra* note 18, Sect. 80, n. 52, who argues for a restrictive use of such rights.

72 WEITEMEYER, in: Münchener Kommentar BGB, *supra* note 18, Sect. 80, n. 65.

73 For details see C. MECKING, *supra* note 54, § 90 Publizität und Stiftungsverzeichnis, n. 11; VOGT, *supra* note 65, 27 ff.

74 KRIMMER et al. *supra* note 62, 83 ff.

relied upon by third parties with regard to any of their content (neither *negative* nor *positive Publizität*).[75] Proposals to establish a public registry upon which the public can rely have so far been rejected as too costly, but remain part of the ongoing reform discussions.[76] Where an organ must provide proof of its power to represent the foundation, under the current law, it can request a certificate issued by the supervisory authority *(Vertretungsbescheinigung)*.[77]

d) No obligation to audit and disclose annual accounts to the public

Under the current law, it is only in exceptional cases that a foundation with legal personality has a legal obligation to have its annual accounts audited and to disclose them to the general public. As has been mentioned, all state foundation laws require rendering account annually in a simple form vis-à-vis the supervisory authority. In some states third parties are able to access these documents based on the freedom of information laws of the relevant state.[78] Public disclosure of these documents, by contrast, is not required.

Partly based on comparative studies, not having mandatory disclosure of annual accounts has been subject to criticism for many years.[79] It is broadly acknowledged that having information about the financial matters of the foundation is important for actual and potential creditors as well as for the general public, and last but not the least for potential donors.[80] Critics, furthermore, have emphasized that requiring the filing of accounts as well as disclosure of salaries of top employees or contracts with third parties is not only important to improve the governance of foundations, but also to strengthen the public's support for tax privileges.[81] It seems highly doubtful whether voluntary measures can be successful in this case. The Association of German Foundations *(Bundesverband Deutscher Stiftungen),* an umbrella organization for foundations in Germany, has issued non-binding Guiding Principles of Good Practice for Foundations *(Grundsätze guter Stiftungspraxis),* which include also some general recommendations on

75 *Cf. supra* at III.1.c).

76 MECKING, *supra* note 54, § 90 Publizität und Stiftungsverzeichnis, n. 6; Bericht der der Bund-Länder-Arbeitsgruppe, *supra* note 11, 93 ff.

77 VOGT, *supra* note 65, 47 ff.; WEITEMEYER, *supra* note 18, Sect. 80, n. 61 f.

78 VOGT, *supra* note 65, 76 ff.; WEITEMEYER, *supra* note 18, Sect. 80, n. 64.

79 WEITEMEYER, *supra* note 18, Sect. 80, n. 63 ff. with further references.

80 See Bericht der der Bund-Länder-Arbeitsgruppe, *supra* note 11, 93. The majority of the working group, however, rejected proposals to introduce mandatory auditing and financial disclosure rules for foundations only. *Id*. 10 ff.

81 WEITEMEYER, *supra* note 18, Sect. 80, n. 65 with further references.

financial reporting and public disclosure.[82] While the organization observes a positive trend, its own empirical survey also demonstrates that there is still considerable room for improvement.[83]

At least for those foundations aiming at tax-privileged status, the oversight exercised by the tax authorities in part fills the gap. An analysis of the information duties in the law of non-profit entities therefore would be incomplete without touching at least briefly upon the relevant rules under tax law.

IV. Information Duties Vis-à-Vis the Tax Authorities

How easily non-profit entities can acquire tax-privileged status is essential not only regarding the question of whether it is possible to build financially robust third sector organizations.[84] Rather, given the aforementioned weaknesses in the governance of non-profit entities under German law, supervision by tax authorities also indirectly fulfills an important ancillary role in relation to the prevention of abuses, at least for those non-profit entities which aim at tax-privileged status. This has led some to ask whether – in order to foster governance of non-profit entities – the most promising option might actually be to further develop tax rules on non-profit entities.[85]

While there is no uniform "tax law for non-profit entities", Sects. 51 to 68 of the Fiscal Code (*Abgabenordnung*, AO) regulate the recognition of a non-profit entity as pursuing public-benefit *(gemeinnützige)* purposes irrespective of the legal form. Such recognition constitutes the basis for the tax treatment, under the individual tax laws, of both the non-profit entity's activities and the donations made to it.[86] In particular, a public-benefit corporation is in principle exempt from corporate income tax (Sect. 5(1) no.9 Corporate Income Tax Act (KStG)), trade tax (Sect. 3 no.6 Trade Tax Act

82 Availabe also in English on the Association's homepage at *https://www.stiftungen.org/en/home/german-foundations/what-is-a-foundation.html*.

83 BUNDESVERBAND DEUTSCHER STIFTUNGEN, StiftungsStudie – Führung, Steuerung und Kontrolle in der Stiftungspraxis (Berlin 2010) 5.

84 See for Japan in a broader context also H. HOLBIG/M. BÄLZ, Strengthening the nation and protecting the weak: Shifting modes of state-society relations in Japan and China, in: Amelung/Bälz/Holbig/Schumann/Storz, Protecting the Weak in East Asia: Framing, Mobilisation and Institutionalisation (forthcoming Abington 2018).

85 See VON HIPPEL/WALZ, *supra* note 67, 948 ff.

86 For details on the taxation of registered associations see A.K. GOLLAN/C. ORTLOFF, §42 Besteuerung, in: Beuthien/Gummert/Schöpflin, *supra* note 54; regarding the taxation of foundations see A. RICHTER/C. WÖRLE-HIMMEL/C. ORTLOFF, *ibid.* § 98 Besteuerung.

(GewStG)) and inheritance and gift tax (Sect. 13(1) no.16b Inheritance and Gift Tax Act (ErbStG)).[87] For donors, donations and endowments to a public benefit corporation are, within certain limits, tax-deductible (Sect. 10b Income Tax Act (EStG).

The tax authorities grant tax-privileged status under the condition that the articles of association or the charter state that the corporation pursues, directly and exclusively, public-benefit, charitable or religious purposes (as defined in Sects. 52-68) and actual management conforms to this (Sect. 59 AO). According to Sect. 52 AO, a corporation pursues public-benefit purposes if its activity is dedicated to the altruistic advancement of the general public in material, spiritual or moral respects. Sect. 52(2) AO stipulates a rather comprehensive list of activities recognized as advancement of the general public. "Altruistic" means in particular that a public-benefit corporation's income and other funds may not be used for anything other than public-benefit purposes (particularly that funds may not be distributed as profits) and that they must be used promptly for the public-benefit purposes as set out in the articles of association or the charter (Sec 55 AO). The tax authorities may revoke tax-privileged status with retrospective effect if the statute of the corporation or the actual management activity no longer fulfills these requirements.

Even prior to formation of the non-profit entity, an application can be filed with the tax authorities to have the draft articles of association or charter reviewed for compliance with the aforementioned requirements for public-benefit recognition (Sect. 60a AO). Once the non-profit entity is established, non-profit entities normally have to renew their tax-exempt status every three years. In addition, changes in the purpose of the non-profit entity have to be approved by the tax authorities. The regular review of tax-privileged status, alongside the obligation to file tax returns, entails a level of supervision of public-benefit corporations that often will have more of a disciplinary effect than the supervision by the supervisory authorities. Of course, this information is not disclosed to the public and thus does not amount to public disclosure.

V. CONCLUSION

The German law of non-profit entities shows a broad variety of information duties. In the case of registered associations, we primarily observe a combination of a collective information right of the association represented by the general assembly and an individual information right of each member,

87 Where a non-profit entity carries on commercial activities, the income so achieved is taxable, but this does not affect the tax-privileged status as such (Sect. 64(1) AO).

which are supplemented by limited public disclosure through the register of associations. In the case of foundations with legal personality, by contrast, given that a foundation by definition does not have members or owners, it is primarily state supervision by the *Länder*, which is supposed to ensure good governance. Information duties owed by foundations with legal personality vis-à-vis the relevant authorities again play a significant role here. However, the effectiveness of this state supervision often is doubtful, last but not the least due to limited resources. So far, no public register for foundations with legal personality exists which could be relied upon by the public. Furthermore, under current law, neither registered associations nor foundations with legal personality are obliged to audit and disclose financial statements, irrespective of their size. For those non-profit entities aiming to achieve and maintain tax-privileged status as public benefit corporations, supervision by the tax authorities in practice often constitutes the most effective supervision. While tax law thus fulfills a welcome ancillary function with regard to the governance of many non-profit entities in Germany, a lack of transparency of the third sector remains an issue. After all, the non-profit sector crucially depends on public trust. Only if, even in the future, sufficient people are willing to engage in, to donate to and to politically support non-profit entities will they be able to fulfill the increasingly important societal role attributed to them.

II. Trade Law and Company Law

Information Duties under Japanese Trade Law and Company Law

Masao Yanaga[*]

I. Introduction
II. Trade Law
III. Company Law
1. Commercial Register *(shōgyō tōki)*
2. Shareholders' Rights in General
3. Partnership-type Company
4. Stock Corporation
5. "Collective Information" as a General Principle?
IV. Reporting
V. Conclusion: Three Material Weaknesses in the Japanese System
1. Poor Enforcement
2. Failure to Make Good Use of ICT
3. Ungoverned Selective Disclosure

I. INTRODUCTION

With respect to trade law, the information duties of one party are intended to facilitate doing business in a quick and efficient manner and, to some extent, to protect the other party from unforeseen damages.

On the other hand, the information duties of a companies' management are considered a shareholder right. The most basic rights of shareholders include sharing in the company's profits as well as participating in the company's decisions, at least fundamental ones, by participating and voting in general shareholders' meetings in stock corporations.

II. TRADE LAW

The commercial register *(shōgyō tōki)* is one of the most important sources of information in Japanese trade law. The items to be registered pursuant to the provisions of the Commercial Code (hereinafter: ComC)[1] may not be duly asserted against a third party who has no knowledge of such items until after registration. The same applies after the registration if the third

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1 *Shōhō,* Law No. 48/1899, as amended by Law No. 91/2014.

party did not know that such items were registered, on justifiable grounds.[2] The items to be registered by non-corporate merchants are, however, limited, and most of the requirements relate to the power of representation. Generally speaking, non-corporate merchants are to register only in cases where they have appointed a manager (typically a branch manager). They are not even required to register their trade names.

Japanese courts and legal doctrine have recognised pre-contractual liability under a duty of good faith as *culpa in contrahendo,* or the breach of secondary obligation *(Nebenpflicht). Culpa in contrahendo* means that contracting parties are under a duty to act in good faith during negotiations, so that a party who acts improperly in preventing the culmination of an agreement is liable to the injured party. It is recognised either in cases where the fault of one contracting party has prevented the formation of a contract or in cases where one party has failed to inform the other party of circumstances that might have prevented the other party from entering into the contract. While it can be categorised as a theory in contracts, most of the Supreme Court and lower court in Japan decisions appear to have regarded it as relating to torts.[3] In one case, the Supreme Court found that a bank and a construction company were liable, in light of the principle of good faith, for the failure to provide information that a planned building would be in violation of the Building Standards Act *(Kenchiku kijun-hō)* if part of the site were sold.[4] In another case it held that the seller and the construction company were liable for damages in tort due to their failure to supply information on fire shutters.[5]

Moreover, in consumer contracts, business operators are required to inform or disclose to some extent. Under the Consumer Contract Act *(Shōhsha keiyaku-hō),* a consumer may rescind their manifestations of intention to offer or accept a consumer contract if a business operator represents to the consumer the advantages as to important matters or things related to said important matters but intentionally fails to represent disadvantageous facts regarding important matters, and the consumer has thereby incorrectly understood that such facts do not exist.[6] The Act on Designated Types of Commercial Transactions *(Tokutei shō-torihiki-hō)* imposes on operators

2 Art. 9 para. 1 ComC.

3 A judgment of the Supreme Court, 22 April 2011 (Minshū 65, 1405), held that a party who has failed to inform the other party of information that might have prevented the other party from concluding the contract, in breach of the duty to inform arising from the principle of good faith and fair dealing, is not liable in breach of contract but might be liable in tort.

4 Supreme Court, 12 June 2006, Hanrei Jihō 1941 (2006) 94.

5 Supreme Court, 16 September 2005, Hanrei Jihō 1912 (2006) 8.

6 Art. 4 para. 2 of the Consumer Contract Act.

the duty to provide material information, including information about the right of withdrawal (cooling-off), in writing, since a lack of parity has been found in entrepreneur–consumer transactions in terms of information access and bargaining power (i.e. psychological aspects or in the decision-making process). As the cooling-off period starts from the day of delivery of the document, the failure to provide the information leads to the client-consumer's unlimited right to withdraw from a contract.

In addition, some types of business – for example, insurance companies and real-estate agents – are required to make material information available to their clients by branch-specific laws and regulations. Under the Financial Instruments and Exchange Act (hereinafter: FIEA),[7] business operators offering financial instruments are subject to the statutory duty to supply information in writing before the conclusion of the contract as stipulated in the FIEA's conduct rules and implementing ordinances. As an example, the Supreme Court ruled that a commodity futures firm was liable for breach of contract in a case where it failed to provide information and notice to its client.[8]

Furthermore, a party is sometimes under an obligation to supply information even in business-to-business transactions. For example, there have been a number of cases in which the court has held that franchisors were liable for damages they caused to franchisees by providing false information or failing to provide adequate information[9] in accordance with the principle of good faith and fair dealing.[10] In addition, the Supreme Court found that the arranger in a syndicated loan had to supply the information to the participating institutions under the principle of good faith[11] but did

7 *Kin'yū shōhin torihiki-hō,* Law No. 25/1948, as amended by Law No. 63/2015.

8 Supreme Court, 16 July 2009, Minshū 63, 1280.

9 A general duty of disclosure is provided for in the Medium-Small Retail Business Promotion Act (*Chūshō ko'uri shōgyō shinkō-hō,* Law No. 101/1973) and the Implementing Regulation for the Medium-Small Retail Business Promotion Act (*Chūshō ko'uri shōgyō shinkō-hō sekō kisoku,* Ordinance of Ministry of Trade and Industry No. 100/1973). The Act is not franchise specific, but its articles 11 and 12 are of relevance to retail franchising.

10 See *e.g.* Nagoya High Court, Kanazawa Branch, 20 June 2005, Hanrei Jihō 1931 (2005) 48; Fukuoka High Court, 31 January 2006, Hanrei Times 1216 (2006) 172; Fukuoka High Court, 31 January 2006, Hanrei Times 1235 (2006) 217; Saitama District Court, 8 December 2006, Hanrei Jihō 1987 (2008) 69, Otsu District Court, 5 February 2009, Hanrei Jihō 2071 (2009) 6, Sendai District Court, 26 November 2009, Hanrei Taimuzu 1339 (2010) 113; Ōsaka District Court, 12 May 2010, Hanrei Jihō 2090 (2010) 50. *See* S. KOZUKA, The Franchisor's Duty to Provide Information before Concluding Franchise Agreement, International Journal of Franchising and Distribution Law 2(1) (2000) 13.

11 Supreme Court, 27 November 2012, Hanrei Jihō 2175 (2013) 15.

not uphold the general rules as to arrangers' duty to provide information nor the idea of what amounts to "material information" as delineated in the original decision.[12]

On the other hand, the Tōkyō District Court ruled[13] that

> "the acquisition of a company by another company, which is a transaction between private parties, is subject to the principle of party autonomy, based on which the information collection and analysis for concluding an acquisition agreement are the individual responsibility of each of the parties. Thus, even if one of the contracting parties has suffered disadvantage due to insufficient information collection and analysis, the disadvantage should be borne, in principle, by the party itself. Accordingly, since it is common in cases where an acquisition involves a capital tie-up and business alliance agreement that the parties enter into the contract on even footing with each other, it is appropriate to presume that the above-mentioned principles apply and cannot be modified to impose upon the other party the duty to inform or account unless special circumstances are found".

III. Company Law

Most of the items to be disclosed under the Companies Act (hereinafter: CA)[14] consist of information which matters for creditors in stock corporations *(kabushiki kaisha)* and limited liability companies *(gōdo kaisha)* or is primarily important for shareholders, bondholders and option holders. However, some are to be disclosed in the interest of the general public.

1. Commercial Register (shōgyō tōki)

The fundamental source of information for the general public is the commercial register. Articles 907 through 938 of the CA govern companies' duty to register in the Commercial Registry.

A company is incorporated at the time of registration of incorporation and the principal items to be registered are as follows:

<table>
<tr><th>Stock corporation</th><th>Limited liability company</th><th>General partnership company</th><th>Limited partnership company</th></tr>
<tr><td colspan="4">Objects</td></tr>
<tr><td colspan="4">Trade name (which should contain indication of the company's legal form)</td></tr>
<tr><td colspan="4">Addresses of the head office and branch offices</td></tr>
</table>

12 Nagoya High Court, 14 April 2011, Hanrei Jihō 2136 (2011) 45.

13 Tōkyō District Court, 27 September 2007, Hanrei Jihō 1987 (2008) 134.

14 *Kaisha-hō,* Law No. 86/2005, as amended by Law No. 62/2016.

<table>
<tr><td colspan="3">Provisions in articles of association regarding duration or grounds for dissolution of company, if any</td></tr>
<tr><td>Stated capital</td><td colspan="2" rowspan="5"></td></tr>
<tr><td>Information on shares</td></tr>
<tr><td>Information on share options</td></tr>
<tr><td>Type of organ structure (including power of representation, allocation of powers)</td></tr>
<tr><td>Identities of members of bodies (organs)</td></tr>
<tr><td rowspan="3"></td><td colspan="2">Names and addresses of partners and representing partners. If the partner representing the company is a juridical person, the name and address of the person who is to perform the duties of such.</td></tr>
<tr><td rowspan="2"></td><td>Indication of who the partners with limited liability and the partners with unlimited liability are</td></tr>
<tr><td>Subjects and value of contributions to be made, as well as value of the contributions already made, by members with limited liability</td></tr>
<tr><td>Provisions in articles of association to discharge or limit organ’s liability</td><td colspan="2"></td></tr>
<tr><td colspan="3">Information regarding the ways company information is to be published</td></tr>
</table>

	Stock corporation	Limited liability company	General partnership company	Limited partnership company
Trade name	xx	xx	xx	xx
Stated capital	xx			
Names and addresses…		xx	xx	xx

2. Shareholders' Rights in General

Information rights are considered to be a fundamental type of shareholder right in companies. This is especially true for minority shareholders or non-executive members of partnership-type companies. Access to information is a prerequisite for the effective exercise of the substantial rights or remedies available to those shareholders under the CA. In particular, information duties under the CA enable shareholders to participate in decision-making, supervise the management and, in some cases, apply to the court for injunctions. The information disclosed will sometimes be of assistance to shareholders who are considering whether to initiate a derivative suit against directors and officers.

The CA does not prescribe a very significant list of duties with regard to information supply for partnership-type companies and provides great autonomy to companies. In cases where a company is so private and small that the members are in close contact with the management, inspection of documents upon request and requests for reports are efficient ways to access information because they provide what members need and are flexible.

On the other hand, the Act presents more rigid and mandatory rules for stock corporations. This is partly because the number of shareholders might be so large that to supply information individually might be burdensome, costly, inconvenient and inefficient for both the corporation and shareholders, and partly because minority shareholders seldom have the bargaining power to demand information from the management. Theoretically, the articles of association may set out additional information duties for the company. However, this is rare in practice.

The CA stresses collective information instruments for stock corporations, while it emphasises individual information instruments for partnership-type companies.

a) Individual information

The provision of information to individuals is required in stock corporations as well. Though a shareholder may demand information at a general meeting, the right to do so has not been of primary importance for providing relevant information in practice, partly because both the management and most of the shareholders present at the meeting do not wish to spend much time at the meeting and partly because the answers given are not necessarily so detailed as to add information value. Irrespective of the effectiveness, the legislator stresses inspection rights in stock corporations.

Since 2006, the Implementing Regulation for the Companies Act[15] has increased the number of matters to be disclosed by the head office of a company before corporate reorganisation. Moreover, the 2014 amendments to the CA introduced ex ante disclosures for the acquisition of class shares subject to wholly call and reverse stock splits which generate fractions of less than one share, as well as squeeze-outs by the special controlling shareholder.

b) Collective information

This kind of information is required in stock corporations, not only to enable shareholders to make investment decisions – i.e. hold, sell or buy shares – but also to facilitate the improved exercise of voting rights.

3. Partnership-type Company

a) General partnership company (gōmei kaisha) and limited partnership company (gōshi kaisha)

In these types of companies, partners have individual information rights, but they do not have collective information rights unless the articles of association stipulate otherwise. This is partly because the partners might not be powerless vis-à-vis the management due to the frequent non-separation of ownership and control in these types of companies. The partners may therefore have less need for statutory and mandatory disclosures. Another reason for the more limited disclosure regulation is the need for flexibility in light of the particularity of each company and for reasons of cost-effectiveness.

As a default rule in cases where executive partners are specified in the articles of association, any partner, including non-executive partners, may investigate the state of the business and assets of the partnership-type company, even if he/she does not have the right to execute the business of the company.[16] While the articles of association may stipulate otherwise, they may not restrict the carrying out of investigations by a partner at the end of the business year or if the partner has substantial grounds to do so.[17]

Any executive partner is required to report on their fulfilment of their duties whenever there are requests by the partnership-type company or other partners, and must report on the progress and outcome of their duties

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15 *Kaisha-hō sekō kisoku,* Ordinance of the Ministry of Justice No. 12/2006, as amended by Ordinance of the Ministry of Justice No. 1/2016.

16 Art. 592 para. 1 CA.

17 Art. 592 para. 2 CA.

without delay after carrying them out.[18] The articles of association may, however, stipulate otherwise.[19]

A partnership-type company must prepare annual accounts for each business year[20] pursuant to the provisions of the applicable ordinance of the Ministry of Justice (i.e. Companies Accounts Regulation[21]).[22] Annual accounts consist of a balance sheet and other statements prescribed by the Companies Accounts Regulation as necessary and appropriate in order to present the status of a partnership-type company's property. For general partnership companies and limited partnership companies, these accounts comprise a profit and loss statement, a statement of partners' equity, and notes to annual accounts if the company has decided to prepare them in accordance with the Companies Accounts Regulation.[23] Annual accounts may also be prepared in the form of electromagnetic records.[24] A partnership-type company must keep its annual accounts for ten years from the time of the preparation.[25] A partner in a partnership-type company may, at any time during the company's business hours, make a request to (1) inspect or copy the annual accounts, in cases where the annual accounts are prepared in writing, and (2) inspect or copy any items recorded in the electromagnetic records in a manner prescribed by the Implementing Regulation for the Companies Act,[26] in cases where the annual accounts are prepared in the form of such electromagnetic records.[27] While the articles of association may stipulate otherwise, they are not permitted to have the effect of restricting partner requests at the end of the business year.[28]

A partner may also inspect the register of corporate bonds.[29]

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18 Art. 593 para. 3 CA.

19 Art. 593 para. 5 CA.

20 While a partnership-type company must prepare a balance sheet as of the day of its incorporation pursuant to the provisions of the Companies Accounts Regulation (Art. 617 para. 1 CA), the balance sheet is not subject to inspection by partners in the same manner as annual accounts.

21 *Kaisha keisan kisoku,* Ordinance of the Ministry of Justice No. 13/2006, as amended by Ordinance of the Ministry of Justice No. 1/2016.

22 Art. 617 para. 2 CA.

23 Companies Accounts Regulation, Art. 71, para. 1, item 1.

24 Art. 617 para. 3 CA.

25 Art. 617 para. 4 CA.

26 Items in the electromagnetic record can be presented on paper or a display screen. Companies Accounts Regulation, Art. 226, item 30.

27 Art. 618 para. 1 CA.

28 Art. 618 para. 2 CA.

29 Art. 684 para. 1 CA; Art. 167 of the Implementing Regulation for Companies Act.

b) *Limited liability company*

The regulation regarding general partnership companies and limited partnership companies also applies to limited liability companies, with the exception of certain aspects.

Firstly, the Companies Accounts Regulation stipulates that limited liability companies are to prepare a profit and loss statement, a statement of partners' equity, and notes to annual accounts.[30]

Secondly, creditors of a limited liability company may, at any time during the company's business hours, make a request to (1) inspect or copy the annual accounts, in cases where the annual accounts are prepared in writing, and (2) inspect or copy of any items recorded in the electromagnetic records in a manner prescribed by the Implementing Regulation for the CA, in cases where the annual accounts are prepared in the form of such electromagnetic records.[31]

4. *Stock Corporation*

a) *Individual information*

The shareholders of a stock corporation may, firstly, inspect the articles of association,[32] the register of shareholders, the register of share options holders, and the register of bonds, as well as the minutes of shareholders' and class shareholders' meetings. Shareholders may also, with the leave of a court as necessary for the purpose of exercising their rights, inspect the minutes of the board of directors and of the board of company auditors *(kansayaku),* as well as those of the remuneration committee, the nominating committee, and the audit or audit/supervisory committee. In addition, the proxies, voting cards, and electromagnetic records of electromagnetic votes are to be made available for inspection by shareholders three months after a shareholders' meeting.[33]

Secondly, as discussed later in detail, shareholders may inspect the annual accounts (and interim accounts, if any), business reports, and supplementary schedules (including audit reports and accounting audit reports). They may also inspect the accounting adviser's reports, if any, at the office of the accounting adviser.

Thirdly, *ex ante* disclosure *(jizen kaiji)* and *ex post* disclosure *(jigo kaiji)* are required for absorption-type mergers, incorporation-type mergers, absorption-type demergers, incorporation-type demergers, share exchanges,

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30 Art. 71 para. 1, item 2 of the Companies Accounts Regulation.
31 Art. 625 CA.
32 Art. 31 para. 2 CA.
33 Art. 310 paras. 6 and 7, Art. 311 paras. 3 and 4, Art. 312 paras. 4 and 5 CA.

and share transfers (hereinafter collectively termed corporate reorganisation), as well as for reverse stock splits *(kabushiki heigō)* which generate fractions of less than one share or the acquisition of class shares subject to wholly call *(zenbu shutoku jōkō tsuki shurui kabushiki).* In addition, registration of the fundamental items is required, similarly to the case for the incorporation of a company, in the event of absorption-type mergers, incorporation-type mergers, incorporation-type demergers or share transfers.

As a part of *ex ante* disclosure, the company (except for the absorbed company in an absorption-type merger) must keep the agreement regarding the action (in the case of a share transfer, the plan) and other fundamental information prescribed by the Implementing Regulation for the Companies Act[34] at its head office for a period beginning two weeks before the shareholders' meeting approving the agreement or plan until six months after the effective date of the act. The absorbed company is subject to the disclosure obligations until the date that the merger takes effect. These disclosure requirements are intended to assist the shareholders and company creditors to make informed decisions with regard to the particular action and take appropriate measures (voting at shareholders' meetings, raising objections, seeking injunctions or appraisals, etc.).

As part of *ex post* disclosure, the company (except for the absorbed company in an absorption-type merger and the consolidated company in an incorporation-type merger) must, following the effective date of the action and without delay, prepare documents or electromagnetic records stating or recording the items prescribed in the Implementing Regulation for the Companies Act,[35] and must keep them at the head office for six months. This kind of disclosure is required to enable the shareholders and company creditors to take appropriate measures (challenging the validity of the action, etc.). At the same time, it can be presumed the legislature expected the ex ante and ex post disclosure requirements to motivate the management of the companies to abide by the laws and regulations as well as the articles of association and give due consideration to the legitimate interests of stakeholders.

In order to protect minority shareholders' interests, ex ante and ex post disclosure are provided in the same manner for reverse stock splits which

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34 For example, information on the appropriateness of the action under consideration for the shares and other relevant information about it, information on the appropriateness of the provisions for share options, the financial statements of the other party, information on the prospect of fulfilling obligations after the corporate reorganisation as well as on the post-disclosure events.

35 For example, the effective date, the history of the appraisal procedures and the procedures designed for protecting creditors, as well as information on material rights and obligations taken over by the company.

generate fractions of less than one share or the acquisition of class shares subject to wholly call.

Fourthly, shareholders may raise questions concerning the agenda or proposals at the shareholders' meeting. Directors, accounting advisors, company auditors, and executive officers are responsible for providing answers. When a shareholder poses a question, the chairperson will designate someone to answer the question (at the chairperson's discretion). While the questions are sometimes answered by several respondents, most questions will be answered by the president (chairperson) in practice. The CA and its Implementing Regulation[36] outline the justifiable reasons for refusing to answer.[37]

Finally, shareholders holding 3 per cent or more of the voting rights or the outstanding shares may inspect the accounts book and relevant materials.

A member of the parent company may, with the leave of a court, also inspect the subsidiary company's documents (including those in the form of electromagnetic records) for the purpose of exercising the shareholder's rights.[38]

b) Collective information

A stock corporation has to issue notice to its shareholders to convene shareholders' meetings. It has the statutory duty to send or make available certain documents to all the shareholders with voting rights at the general meeting without a specific request from the shareholders.

The first type of documents are annual accounts and reports, as discussed below.

The second type of documents are reference materials *(sankō shorui).* A corporation that has 1,000 or more shareholders with voting rights should allow those shareholders who do not attend the shareholders' meeting to vote by mail. A corporation may decide that shareholders not attending the shareholders' meeting may exercise their voting rights via the Internet or other information and communication technology means. In such cases, the

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36 Art. 71 of the Implementing Regulation for Companies Act.

37 (i) The items are not relevant to the subject of the shareholders' meeting; (ii) giving explanations will cause serious detriment to the common interests of the shareholders; (iii) preparation is necessary to provide an explanation of the items (except for cases where the shareholder has notified the company of the items a reasonable amount of time prior to the date of the meeting or cases where the necessary preparation is extremely easy to undertake); (iv) giving explanations would infringe the legitimate rights of the company or any other person; (v) the shareholder is repeatedly seeking explanation of essentially identical matters at the same shareholders' meeting; or (vi) there is a justifiable ground for not being able to explain other than (i) through (v).

38 Art. 31 para. 3 CA.

corporation's convocation notice should provide the shareholders with the documents stating matters of reference for votes (reference materials), in addition to accounting information and business reports, so that the latter, especially absentee shareholders, can make informed decisions. While it is true that annual accounts and reports as well as the accounting auditor's reports are essential with regard to the election or remuneration of directors, they are not necessarily sufficient for shareholders' voting decisions. Reference materials can help shareholders better understand and assess the items on the agenda.

The reference materials should include the proposals, the grounds for the proposals, and the summary of the company auditors' reports, if any, to be delivered at the shareholders' meeting. The additional information to be included is stipulated in the Implementing Regulation for the Companies Act and includes proposals for the election or dismissal of directors, accounting advisors, company auditors or accounting auditors (hereinafter collectively termed company officers); the non-re-election of accounting auditors; and the remuneration (including retirement benefits) of company officers. It also includes materials related to the approval of annual accounts, reverse stock splits which generate fractions of less than one share, the acquisition of class shares subject to wholly call, agreements or plans for corporate reorganisation, and the assignment of business and other contracts prescribed in Article 467 of the CA.

With a few exceptions, a company may provide information on a website instead of sending it as reference materials, as long as the articles of association allow for this and no objections have been raised by a company auditor, the audit and supervisory committee, or the company's audit committee.

There are also other types of collective information which are not related to or are less related to the general meeting. Firstly, disclosure is required with regard to the issuing of shares or share options. In public corporations the board of directors may, in principle, decide to issue new shares or share options or dispose of treasury stock.[39] However, after the board of directors determines the terms and conditions for the subscription of shares or options, the company must notify the shareholders of these terms and conditions, or post a public notice, at least two weeks before the date of payment so that the dissenting shareholders are given the opportunity to file an enjoinment against the issue or disposal.[40] Even in public corporations the

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39 In private corporations, an extraordinary resolution must be passed at the shareholders' meeting for the issue of new shares or share options as well as the disposal of treasury stocks.

40 In cases where a securities registration statement is filed at least two weeks in advance or in certain cases prescribed by the Implementing Regulation for the

shareholders' meeting must approve[41] large private placements of shares or share options through which the subscriber of newly issued shares or disposed treasury stock becomes a new parent company by holding more than half of the shares as a result of the issuance or the disposal. In this case, the issuer company must disclose the name of and other information about the subscriber so that shareholders can raise objections to the issuance or disposal to that subscriber.[42]

Secondly, in the case of squeeze-out by the special controlling shareholder, ex ante disclosure and ex post disclosure are required, similarly to the case for corporate reorganisation, reverse stock splits which generate fractions of less than one share, or the acquisition of class shares subject to wholly call, as discussed above.

c) *Appointment of inspector*

Shareholders holding 3 per cent or more of the voting rights or the outstanding shares may file a petition with the court to appoint an inspector to investigate the corporation's affairs and assets.[43] While the inspector prepares and submits a report to the court,[44] he/she also provides a copy of the report to the corporation and the shareholders who filed the petition.[45] Therefore, the appointment of the inspector is, on the one hand, an instrument for individual information.

Though other shareholders do not have the right to access the report, the court shall order the directors to (i) call a shareholders' meeting within a defined period of time and/or (ii) notify shareholders of the result of the investigation if it finds this to be necessary. In this case, the investigation by an inspector also functions as an instrument for collective information.

Companies Act, e.g. those cases where it is unlikely that the protection of shareholders is at risk, the provision of notice to shareholders or of public notice is not required.

41 The approval of the shareholders' meeting is even required in public corporations in cases where the shares are offered on "particularly favourable" terms for the subscriber.

42 In cases where objections have been raised by shareholders holding 10 per cent or more of the voting rights, the allotment to the subscriber must be approved by an ordinary resolution of the shareholders' meeting. This approval is not required, however, in cases where the financial condition of the company has worsened so dramatically that there is an urgent need for fundraising via the issuance or disposal of shares to keep the company in operation.

43 Art. 358 para. 1 CA. The inspector may investigate the affairs and assets of subsidiaries of the corporation necessary for carrying out its duties (Art. 358 para. 4 CA).

44 Art. 358 para. 5 CA.

45 Art. 358 para. 7 CA.

While a shareholders' meeting may appoint an inspector to investigate the corporation's affairs and assets in cases where the shareholders' meeting has been convened by shareholders,[46] there is no explicit provision regarding how shareholders may access the results of the investigation.

d) *Corporate governance*

While the FIEA and listing rules require companies to provide extensive information on their compliance with the Corporate Governance Code and/or their corporate governance, the CA requires only that listed companies without an outside director as a board member disclose "the reason why [the] appointment of an outside director is unreasonable for that company" in their business reports and reference materials, and at the annual general meeting (AGM).[47] The Implementing Regulation for the Companies Act requires public companies to disclose the total amount of remuneration of directors, company auditors, officers, accounting advisors and external auditors[48] – as well as the policy for deciding the remuneration, if any[49] – in the business report. It requests that stock corporations state the gist of the decisions made by the board of directors regarding the internal control system,[50] as well as the fundamental policy for controlling shareholders and anti-takeover measures, in the business report.[51]

5. *"Collective Information" as a General Principle?*

New information technology might change the landscape. If shareholders could access the information database on the company's website, they could effectively exercise their right to inspect. While it would not be appropriate to allow shareholders to access the books and records in general, there seems to be no serious problem with allowing them to access the annual accounts, group accounts, business reports, and auditors' reports, as well as the minutes of the shareholders' meetings. In addition, ex ante disclosure on corporate reorganisation and squeeze-out would no longer be an unattainable ideal if shareholders could access the information via the Internet. Some of the information that is subject to inspection would become collective information in substance because the company would not need to respond and the information would available to all the shareholders.

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46 Art. 316 para. 2 CA.

47 Art. 327-2 CA.

48 Art. 121, item 4 and Art. 126, para. 2 of the Implementing Regulation for Companies Act.

49 Art. 121, item 6 of the Implementing Regulation for Companies Act.

50 Art. 118, item 2 of the Implementing Regulation for Companies Act.

51 Art. 118, item 3 of the Implementing Regulation for Companies Act.

IV. REPORTING

Firstly, in a corporation with a board of directors, the annual accounts (and the group accounts, if any) and business report that have been approved by the board of directors must be provided to the shareholders in the convocation notice for the annual shareholders' meeting. Any audit reports and accounting audit reports must also be provided in a similar manner. These requirements do not, however, apply to corporations without a board of directors. A company may provide a statement of shareholders' equity, notes to annual accounts and group accounts, and the company auditors' report, as well as the accounting auditors' report on the latter, on a website instead of sending them to shareholders, as long as the articles of association allow for this. With a few exceptions, a company may also do the same with information to be included in the business report, as long as the articles of association permit this and no objections have been raised by a company auditor or the company's audit and supervisory committee or audit committee.

Secondly, a corporation with a board of directors must keep the annual accounts, business reports and supplementary schedules (including audit reports and accounting audit reports, if any) at the head office from at least two weeks before the date of the annual shareholders' meeting for a period of five years for inspection by shareholders, creditors and members of the parent company. In corporations without a board of directors, the disclosure must be made one week before the date of the annual shareholders' meeting. These documents must also be made available for inspection for a period of three years at the branch offices. The annual accounts and other documents may be prepared and disclosed in the form of electromagnetic records. Corporations are not required to keep group accounts for inspection. This is because most of the corporations that prepare group accounts submit their securities report to the prime minister, while this is not the case for corporations that are not subject to the FIEA.

The shareholders and creditors may request to inspect, or to receive a transcript or extract of, the documents to be disclosed at any time during the corporation's business hours. In cases where it is necessary for a member of the parent company to exercise their rights, the member may seek the permission of the court to inspect the documents. Annual accounts and supplementary schedules may be inspected at the office of the accounting adviser, if there is one.[52]

Thirdly, directors are required to provide the annual accounts (and the group accounts, if any) and the business report as well as audit reports and

52 Art. 378 CA.

accounting audit reports, if any, to the AGM. The annual accounts are to be approved or reported at the meeting. The group accounts, where applicable, and the business report as well audit reports and accounting audit reports are to be presented at the AGM.

Fourthly, the corporation must give public notice of its balance sheet without delay following the approval of this document at the shareholders' meeting. A large corporation must give public notice not only of the balance sheet but also of the profit and loss statement. For a corporation that gives this public notice via publication in the official gazette or in a daily newspaper which reports on current affairs, a summary of the balance sheet (for a large corporation, a summary of the balance sheet and the profit and loss statement, hereinafter the same) is considered sufficient.

Corporations may give public notice of the annual accounts via an electronic public notice if their articles of association so stipulate. In this case, a corporation is required to continue posting the balance sheet information for five years from the conclusion of the annual shareholders' meeting where the approval took place. In addition, corporations which specify publication in the official gazette or a daily newspaper which reports on current affairs as their method of public notice may also make the information contained in the balance sheet available to the general public via an electromagnetic method for five years from the conclusion of the annual shareholders' meeting instead of giving public notice.

As an exception to the above, companies that have submitted the securities report pursuant to the FIEA are not required to give public notice of the balance sheet under the CA. This is because the information included in the annual accounts has already been disclosed in more detail in the securities report.

V. Conclusion: Three Material Weaknesses in the Japanese System

1. *Poor Enforcement*

Firstly, failure to disclose ex ante material information on planned corporate reorganisation or squeeze-out might result in the suspension or nullification of these activities. Failure to issue individual notice or to post public notice in cases of issuance of shares or options, corporate reorganisation or squeeze-out might have the same consequence. It is the prevailing view of the lower courts, however, that failure to provide annual accounts or audit reports does not lead to the revocation of resolutions appointing directors or setting the ceiling for directors' remuneration but only to the revocation of those resolutions approving annual accounts or distribution of surplus which

are closely related to the failure to disclose. This applies to cases where shareholders' questions have not been adequately addressed. With regard to the duties of directors and other corporate organs to provide information at a shareholders' meeting, there is no enforcement of disclosure.[53]

Secondly, claim for damages is not effective to enforce information duties because it is quite difficult for the plaintiff shareholders to prove the amount of damages arising from non-disclosure.

Thirdly, although misrepresentation or failure to register, disclose or explain are generally subject to administrative fines, the Ministry of Justice has never been too keen to impose such fines, except in the case of failure to register the appointment of directors and other organs. In particular, it is said that more than 99 per cent of corporations have not complied with the requirement to post public notice of their balance sheets, but the Minister of Justice once responded in the Diet that she was not willing to improve the situation.[54] For comparison, the misrepresentation of group accounts or the failure to prepare group accounts does not even result in administrative fines under the CA.

Fourthly, the courts have been inactive in enforcing information duties. For example, the Tōkyō High Court ruled that a shareholder is not entitled to require the company to allow him/her to inspect its business report and supplementary schedules or to prepare them in cases where the it has failed to do so.[55]

Fifthly, there is no external enforcement mechanism by supervisory authorities in regard to the disclosure requirements under the CA. Even the enforcement by the Securities and Exchange Surveillance Commission under the FIEA is confined almost exclusively to ex post actions.

2. *Failure to Make Good Use of ICT*

Generally speaking, shareholders of Japanese companies do not have the right to require the companies to make information available electronically. Accordingly, they have to visit the principal office of the company to obtain detailed information – for example, ex ante information on planned corporate reorganisation or squeeze-out. The Implementing Regulation allows companies to disclose the retirement bonuses for directors at the head office only instead of in the reference materials. Under the CA, even the articles of asso-

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53 For fear of abuse by corporate racketeers *(sōkai-ya),* the information duty at a shareholders' meeting was deliberately not couched as a right of shareholders but rather as a duty of company organs.

54 An answer given by Ms Chieko Noono at the Legal Committee of the House of Councilors (Minutes of the Legal Committee of the House of Councilors, 162nd Session, No. 23 (14 June 2005) p.14).

55 Tōkyō High Court, 11 November 2015 (ne) No. 4114 of 2015, unreported).

ciation are not required to be posted on the company's website, they are available via the EDINET (Electronic Disclosure for Investors' Network) site as one of the accompanying documents[56] to a securities report under the FIEA.

While the commercial register can be accessed via the Internet, the items registered are quite limited, as explained above, and do not include annual accounts and so on.

3. *Ungoverned Selective Disclosure*

Japanese company legislation had no explicit regulation covering selective disclosure befor the 2017 amendments. As Japanese insider trading regulation under the FIEA is based on "disclose or abstain", companies were free to decide whether and to whom they provide information or access to company documents and records as long as the recipient of the information does not make use of it in securities trading.[57] As shown above, shareholders' statutory individual information rights are quite limited outside the shareholders' meeting. Moreover, if there are hundreds of questions from shareholders, they cannot be answered during one shareholders' meeting. In addition, it appears that the management (and most shareholders) prefer not to spend much time on Q&As at shareholders' meetings. This may result in a lack of parity among shareholders because the management sometimes talk with significant shareholders outside the shareholders' meeting. It is difficult in practice to prevent large shareholders from engaging informally in more intensive information exchange with the management.

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56 The notice convening the shareholders' meeting and reference materials for the purpose of the Companies Act are included and are thus accessible via the Internet, though on an ex post basis.

57 The Law amending the FIEA (Law No. 37 of 2017) was enacted and the FSA has invited public comments on the draft ordinances, in response to a report of the Fair Disclosure Rules Task Force under the Working Group on Financial Markets, the Financial System Council at the Financial Services Agency (December 2016) (English summary: *http://www.fsa.go.jp/en/refer/councils/singie_kinyu/20170303-1/01.pdf*). The regulations are designed to close a gap in the information available to different investors. They require companies sharing non-public material information with "certain parties", professionals at securities and asset management firms such as brokerage analysts, to immediately disclose it publicly as well, on their website or by any other means. The press are excluded from the scope of "certain parties" in order to encourage corporations to continue to talk to the media and to protect freedom of speech.

Information Duties under German Trade Law and Company Law

Ingo Saenger[*]

I. Introduction
II. Trade Law
III. Company Law
 1. Members' Rights in General
 2. Partnership
 3. Corporation
 4. Collective Information as a General Principle
IV. Disclosure
V. Conclusion

I. Introduction

In trade law as well as in company law we have to deal with a growing number of information and disclosure duties as well as transparency obligations. Professionals, merchants and companies are obliged to provide information to a whole range of stakeholders in many ways. German law, often of European origin in this field, implies various rules that force mandatory information provision, either on request or at least voluntarily. In this contribution, concerning trade law, the commercial register and its significance will be the centre of attention (II.), before moving to company law, which is characterized by members' information rights of a totally different scope (III.). Finally, trade and company law are overarched by various reporting provisions, which are essential for merchants and companies alike (IV.).

II. Trade Law

Disclosure is the cornerstone of trade law. In order to ensure this transparency, the German Commercial Code (GCC, *Handelsgesetzbuch – HGB*)[1]

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1 Of 10.05.1897 in the revised version published in the Official Journal of the Federal Republic of Germany *(Bundesgesetzblatt),* BGBl. III, Sect. 4100-1, as amended by Art. 1 of the Act of 10.5.2016, BGBl. I 2016, 1142.

contains provisions concerning the commercial firm name *(Firma)*[2] and the commercial register *(Handelsregister)*[3] as well as, needless to say, reporting.[4] Indeed, the rules concerning the publication in the commercial register, Sect. 15 GCC, are the centrepiece for disclosure in German trade law. Merchants and enterprises are not only obliged to register the company but also to disclose facts[5] which may be of relevance for commercial transactions.[6] Registrations are published by the court[7] by means of electronic information systems.[8] The online availability via the website of the central Business Register *(Unternehmensregister)*[9] since 2007,[10] has guaranteed that everybody can inspect the Commercial Register and the documents filed therein easily.[11] That has refined this instrument and increased its importance significantly in recent years.[12]

In contrast to capital market law, disclosure in this context aims to inform about the standing of an enterprise, its legal ownership, constitution and financial situation, and is not only aimed at disclosing specific legal acts.[13] This is all with the benefit of certainty and efficiency of trade.[14] On the one hand, the commercial register is the basis for the protection of trust-based commerce while on the other hand, it aims to be a publication organ for eliminating reliance[15] Cover is provided not only if a fact is registered. Also, a the lack of a registration or disclosure can be significant. As a consequence, Sect. 15(2) GCC states that "where a fact is registered and published, it may be asserted against a third party."[16] And in contrast to this "positive publication", Sect. 15(1) states that "as long as a fact requiring

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2 Sects. 17 et seq. GCC.

3 Sects. 8 et seq. GCC.

4 K. SCHMIDT, Handelsrecht – Unternehmensrecht I (6th ed., Cologne 2014) § 11, para. 1.

5 Sect. 29 GCC.

6 M. HENSSLER, in: H. BROX/Handelsrecht (22nd ed., Munich 2016) para. 71.

7 Sects. 8 and 10 GCC.

8 Sect. 10 GCC.

9 *http://www.unternehmensregister.de,* cf. SCHMIDT, *supra* note 4, § 13, para. 11.

10 Sect. 8b GCC, cf. HENSSLER, in: Brox*, supra* note 6, para. 72.

11 Sect. 9 GCC.

12 For the situation in the past, see C.-W. CANARIS, Handelsrecht (24th ed., Munich 2006) § 4, para. 3 ff.

13 SCHMIDT, *supra* note 4, § 11, para. 1.

14 HENSSLER, in: Brox*, supra* note 6, para. 72.

15 CANARIS, *supra* note 12, § 5, para. 1.

16 For the translation (of the version of 1993) of the GCC cf. here and elsewhere *https://www.gesetze-im-internet.de/englisch_hgb/englisch_hgb.html#p0131* and M. PELTZER/J.J. DOYLE/M-T. ALLEN, Handelsgesetzbuch – Deutsch-englische Textausgabe (2nd ed., Cologne 1993).

registration in the commercial register is not registered and published, knowledge thereof cannot be asserted against a third party by the one to whom the entry pertains, unless the third party knew of such fact." Therefore, "negative", or failure to disclose becomes an element of prima facie liability.[17] This is complemented by the regulatory law concerning the commercial firm name.[18] Sect. 18(2) GCC states that the firm name may not include any information that may be deceptive as to the relevant circumstances of the business.

III. COMPANY LAW

Rather broad provisions apply for members of a partnership or a private company. By contrast, shareholders' rights of information are more restricted. Section 131 of the German Stock Corporation Act (GSCA, *Aktiengesetz – AktG*)[19] states that each shareholder shall, upon request, be provided with information (only) at the shareholders' meeting by the management board regarding the company's affairs, and (only) to the extent that such information is necessary to permit a proper evaluation of the relevant item on the agenda. To put it another way: If a topic is not on the agenda, there is no right to access information at all. Despite a broad number of accounting rules and securities laws, there remain subjects of both interest and importance that are not covered. This is why the GCC as well as the German Corporate Governance Code (GCGC, *Deutscher Corporate Governance Kodex – DCGK*)[20] provide detailed provisions on disclosure, especially in the context of transparency (in part 6) and on reporting and auditing (in part 7).

1. *Members' Rights in General*[21]

The ability to exercise a right as member of a company depends on the availability of participation rights. The right to attend the meeting, to argue and to vote are worthless if there is a lack of information. In other words: information influences voting or even is the indispensable prerequisite for it.

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17 CANARIS, *supra* note 12, § 5, para. 7.

18 Sects. 17 et seq. GCC.

19 Of 6.9.1965, Official Journal of the Federal Republic of Germany *(Bundesgesetzblatt),* BGBl. I 1965, 1089, as amended by Art. 5 of the Act of 10.5.2016, BGBl. I 2016, 1142.

20 *http://www.dcgk.de/en/code.html* <13.06.2016>.

21 See generally I. SAENGER, Beteiligung Dritter bei Beschlussfassung und Kontrolle im Gesellschaftsrecht (Berlin 1990) 14 ff.

a) *Individual information*

A right of information is legally provided for every legal company form. In the broadest sense, it grants the individual member the possibility to gain knowledge about "matters of the company".[22] One may question whether this right of information really forms a part of the broader rights to administer the company. And indeed, some propose classifying the right of information and right of oversight as an independent membership right, unattached to the general administrative rights.[23] One can argue that this is due to the fact that the right of information is of relevance not only in relation to the membership in the company but also from a financial perspective. On the one hand, it grants the member access to information about the economic situation of the company which he would normally only receive at the end of the business year by means of the annual financial statement or in case of dissolution. Thereby, the right can also ensure the protection of monetary claims.[24] On the other hand, it offers an insight into current business and grants oversight over whether the managing partners and other company bodies comply with their legal and statuary duties. By having access to this information, a partner is supposed to be able to make an informed decision and take the appropriate steps to exercise his administrative rights. Therefore, the right of information is of particular importance in the process of decision making. Consequently, the right of oversight is most of all a manifestation of the individual's participation in the company's decision making process and is thus with good reason considered a part of the administrative rights.[25]

b) *Collective information*

Information duties of the responsible managers towards partners as a "collective" also foster the process of decision making.[26] For these obligations

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22 Cf. Sect. 716(1) GCLC *(Gesellschaft bürgerlichen Rechts – GbR),* Sects. 118 and 161(2) GCC *(Offene Handelsgesellschaft – OHG, Kommanditgesellschaft – OHG),* Sect. 131(1) GSCA *(Aktiengesellschaft)* and Sect. 51a (1) LLCA (Limited Liability Company Act, *Gesellschaft mit beschränkter Haftung – GmbH*); cf. K. SCHMIDT, Informationsrechte in Gesellschaften und Verbänden. Ein Beitrag zur gesellschaftsrechtlichen Institutionenbildung (Heidelberg 1984) 32.

23 I. SAENGER, in: Hk-GmbHG (3rd ed., Baden-Baden 2016) Sect. 45, para. 4.

24 In this way also R. HEINSHEIMER, Über die Teilhaberschaft. Beiträge zum inneren Recht der Personalgesellschaften (Heidelberg 1930) 55; L. ZANDER, Die Ausübung der Gesellschafterrechte nach BGB durch Stellvertreter (Gießen 1948) 29.

25 R. FISCHER, in: Großkommentar HGB, 3rd ed., Sect. 118, para. 4; R. HEINSHEIMER, *supra* note 24, 55; identical in its conclusion Federal Court of Justice (BGH), Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 25, 115, 122.

26 K. SCHMIDT, Gesellschaftsrecht (4th ed., Cologne et al. 2002) § 21, 628 f.

to disclose information in the company meeting, the term 'collective right of information' is wide-spread. In contrast to each partner's individual right of information, the "collective right" does not originate from a *right* in the true sense but rather from the management body's *obligation* to inform about the progress of their tasks on their own initiative.[27]

There is a very significant difference between these two rights. Concerning the individual right of information, the partner can only demand information that he knows or at least suspects exists. So, it is necessary to have at least some basic knowledge in order to frame and specify the questions asked. In contrast, the collective right of information is broader. The managing partners or the management body are obliged to take the initiative. Of their own accord, they have to disclose information that a non-managing partner cannot inquire about due to his lack of knowledge. For example, it is necessary to get the relevant information to allow the exercise of the right to object, which is granted to every non-managing partner of a partnership.[28] The right of information in this situation will strengthen to a duty to inform.[29] But for the partner, it is not only important that the initiative to provide the information come from the obligated party, the temporal aspect can also be of importance. As an example, if a limited partner *(Kommanditist)* receives information from the collective right of information, this comparatively weak individual right would mean information is only provided at the end of the business year.[30]

Explicitly, the law only foresees a collective right of information for the German civil law partnership *(Gesellschaft bürgerlichen Rechts – GbR)* in the form of a reference to contract law.[31] It was controversial for a long time whether this provision[32] also applies to the general commercial partnership *(Offene Handelsgesellschaft – OHG)* and the limited commercial partnership *(Kommanditgesellschaft – KG)*.[33] In corporate law, there is no comparable regulation. Nevertheless, the differentiation between collective

27 SCHMIDT, *supra* note 22, 16; C. SCHÄFER, in: Münchener Kommentar BGB (6th ed., Munich 2013) Sect. 713, para. 8–11.

28 Sect. 711-1 GCLC (German Civil Law Code, *Bürgerliches Gesetzbuch – BGB*) Sect. 115(1) GCC, cf. C. SCHÄFER, *supra* note 27, Sect. 711, para. 3; P. RAWERT, in: Münchener Kommentar HGB (4th ed., Munich 2016) Sect. 115, para. 20.

29 M. ENZINGER, in: Münchener Kommentar HGB (4th ed., Munich 2013) Sect. 118, para. 14; U. HAAS, in: Röhricht/Graf von Westphalen/Haas (eds.), HGB (4th ed., Cologne 2013) Sect. 161, para. 20.

30 Sect. 166(1) GCC; cf. H. GUMMERT, in: Henssler/Strohn (eds.), Gesellschaftsrecht (3rd ed., Munich 2016) Sect. 166, para. 19; B. GRUNEWALD, in: Münchener Kommentar HGB (3rd ed., Munich 2012) Sect. 166, para. 46.

31 Sects. 713, 666 GCLC.

32 See the referral in Sects. 105(2), 161(2) GCC.

and individual rights of information is commonly accepted, despite some controversial aspects.[34]

Concerning the collective right of information, the management body's duty to inform poses the question of how this duty is to be fulfilled. It is not sufficient that management related questions are answered, regardless of how thoroughly. Rather, the managing individuals have a duty, on their own initiative, to inform the non-managing partners about circumstances that are unknown to these partners. This duty is not limitless, but all the unknown information necessary to allow the other partners to assume their rights and make informed and considered decisions has to be provided.[35] Sect. 90(1) GSCA conveys an idea of what is required. It regulates the management board's duty to report to the supervisory board and thus constitutes a collective right of information, the supervisory board being at the receiving end.[36] The necessity of the management board's duty to report also emerges from Sect. 93(4)1 GSCA. Accordingly, a managing individual is not liable for actions based on a lawful resolution of the shareholders' meeting. How should the shareholders be responsible for such important decisions if the management board does not have a duty to report, on their own initiative, about all circumstances relevant to decision making?[37] This concept has become law for special cases in the form of a written report by the management body on the occasion of a capital increase with exclusion of subscription rights[38] and on the occasion of a transformation.[39] The same applies for the duty to report under Sect. 46 6 Limited Liability Companies Act (LLCA, *Gesetz betreffend die Gesellschaften mit beschränkter Haftung – GmbHG*) in order to effectively control the management body.[40]

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33 U. HUBER, Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR) 1982, 539, 542 f.; GUMMERT, in: Henssler/Strohn, *supra* note 30, Sect. 166, para. 19.

34 C. WILDE, Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR) 1998, 423, 426 ff.; C. SCHÄFER, *supra* note 27, Sect. 713, para. 9; SCHMIDT, *supra* note 22, 15; A. HUECK, Das Recht der offenen Handelsgesellschaft (4th ed., Berlin et al. 1971) 187, who sees the right of information towards the managing partner as a part of the rights provided by Sect. 118 HGB; P. HOMMELHOFF, Zeitschrift für Wirtschaftsrecht (ZIP) 1983, 383, 390; B. GRUNEWALD, Zeitschrift für das gesamte Handels- und Wirtschaftsrecht (ZHR) 146 (1982) 211, 225 f.; SAENGER, *supra* note 21, 17 ff.

35 H. SEILER, in: Münchener Kommentar BGB (6th ed., Munich 2012) Sect. 666, para. 5; HUBER, *supra* note 33, 539, 544.

36 M. ROTH, Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR) 2012, 343 ff.; SCHMIDT, *supra* note 22, 17 f.

37 P. KARL, Deutsches Steuerrecht (DStR) 1995, 940, 942; HOMMELHOFF, *supra* note 34, 383, 389.

38 Sect. 186(4)2 GSCA.

39 Sect. 8 German Transformation Act (GTA, *Umwandlungsgesetz – UmwG*).

2. Partnership

The personally liable partner's right of control is regulated in Sect. 716 German Civil Law Code (GCLC, *Bürgerliches Gesetzbuch*) for the civil law partnership and in Sects. 118,[41] 161(2) GCC for the general commercial partnership OHG and the limited commercial partnership KG. For the most part, the regulations are identical, differences only occur due to special accounting rules for commercial partnerships that lead to a divergent point of reference. The right grants the partner the opportunity to inform himself about company matters. Moreover, and here the regulations vary, the commercial partner is entitled to examine the accounting books and other company documents in order to compile an overview of the current company assets or a balance sheet and an annual financial statement.

In contrast to other administrative rights that a partner can only exercise through participation in the partners' meeting, the aforementioned right can also be exercised independently. Every personally liable partner is entitled to this right, even those in a non-managing capacity. Especially for the latter, this is an important aspect. Besides the information received through the partners' meeting and the collective right of information, it is the only opportunity to gain knowledge about current business matters while the managing partners have access to information in this respect at any time.[42]

In order to inform himself about company matters, the partner may enter the business premises, visit facilities, and examine account books as well as other relevant documents (e.g. contracts, correspondences, memos) and make transcripts of them.[43] A more extensive right of information is not granted by law. Courts and legal scholars acknowledge an advanced interest in information only if the business documents are incomplete and require further explanation.[44] Furthermore, a right of information shall be allowed if the business documents are complete but the partner is only able to form an opinion with difficulty and the managing partner could give the desired information without significant effort.[45]

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40 N. MEIER, Deutsches Steuerrecht (DStR) 1997, 1894 f.; K. SCHMIDT, in: Scholz, GmbHG (11th ed., Cologne 2013) Sect. 46, para. 114 and in distinction to that Sect. 51a, para. 1.

41 Cf. S.E. DE GROOT, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2013, 529 ff.

42 HUECK, *supra* note 34, 186 f.

43 HUECK, *supra* note 34, 187.

44 Imperial Court (RG) Juristische Wochenschrift (JW) 1907, 523; Court of Appeals (OLG) Hamburg JW 1921, 687; C. SCHÄFER, *supra* note 27, Sect. 716, para. 12.

45 W. VOGEL, Gesellschafterbeschlüsse und Gesellschafterversammlung (2nd ed., Cologne 1986) 114 f.

An increasing number of legal scholars wants to grant the personally liable partner an unlimited right of information, as that personal liability means business matters may become a personal concern at any time, and he should thus be able to inquire about the current state of business affairs.[46] However, even then a right of each partner to periodic reporting or previous notification about planned projects is not intended to be included.[47]

In principal, the partners' right of *insight* cannot be exercised during the partners' meeting as this would unreasonably disrupt its procedure. Exceptions are possible if business documents are of importance in the objective context of the agenda and for the partners' decision but prior examination was not possible. In the same way, *information* can only be demanded during the partners' meeting if it has an objective relation to the agenda and is suited to influence the partner's decision.[48]

However, a "limited partner" (Kommanditist) by Sect. 166(1) GCC may only demand a copy of the annual financial statement and test its correctness by inspecting books and documents. This right of information covers all the transactions that have been integrated in the balance sheet. Events of the finished business year can only be reviewed once per year. In contrast, the personally liable partner's right of information, even in a non-managing position, is temporally unrestricted and broader concerning the content as it is not limited to matters covered by the business books.[49] The limited partner's lower quality right of control can be explained with his limited liability. However, some think the limited partner has a right of information if the necessary information is not included in the company books or documents and the partner therefore is not able to obtain knowledge about the relevant business matters without the desired information.[50]

3. *Corporation*

a) *Limited liability company*

Since an amendment in 1980, the limited liability company (*Gesellschaft mit beschränkter Haftung, GmbH*) partner's right of information and control has been explicitly regulated in Sect. 51a LLCA. Every partner may request information about business matters and insight in business books

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46 HUBER, *supra* note 33, 539, 546 ff.

47 KESSLER, in: Staudinger BGB (Berlin 2003) Sect. 716 para. 5.

48 VOGEL, *supra* note 45, 115.

49 Cf. Sect. 118(1) GCC; W. SCHILLING, in: Großkommentar HGB (5th ed., Berlin 2015) Sect. 166, para. 5, 8 f.

50 Federal Court of Justice (BGH), Wertpapier-Mitteilungen (WM) 1983, 910, 911; SCHMIDT, *supra* note 22, 69.

and documents at any time, even outside of a partners' meeting.[51] The notion of 'business matters' covers all circumstances related to the company and everything the company deals with.[52] Thus, this right of information goes beyond the scope of the shareholder's right who can only demand information within the shareholders' meeting and only insofar as it is necessary to adequately assess the topics of the agenda. This difference can be explained with the greater risk posed by involvement in a limited liability company *(GmbH)*.[53]

b) Stock corporation

In contrast to other legal company forms, the law on stock corporations not only provides for a shareholders' meeting (an assembly of all members) and an executive board (the management body, Sects. 95 et seq. GSCA) but also for a mandatory further institution, the supervisory board. By Sect. 111(1) GSCA, the latter has the duty to monitor the executive board.[54] In order to facilitate this task, the executive board has an extensive duty to report to the supervisory board.[55] Furthermore, there are information duties in the context of the invitation for the general meeting.[56] Due to this monitoring duty, the shareholder's right of information under Sect. 131 GSCA is less an instrument of control as it is one of providing facts. The shareholders are supposed to exercise their rights within the shareholders' meeting in an appropriate way and thus need all the information necessary to form their decision.[57] Additionally, the right of information is supposed to facilitate the shareholder's decision whether he wants to file an action of voidance[58] or assert other minority rights, e.g. a special audit.[59] Therefore, this is a right of each shareholder, even those not eligible to vote.[60]

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51 W. ZÖLLNER, in: Baumbach/Hueck (eds.), GmbHG (20th ed., Munich 2013) Sect. 51a, para. 1; H. G. KOPPENSTEINER/M. GRUBER, in: Rowedder/Schmidt-Leithoff (eds.), GmbHG (5th ed., Munich 2013) Sect. 51a, para. 10.

52 SCHILLING, in: Hachenburg (ed.), GmbHG (8th ed., Berlin 1992) supplemental volume, Sect. 51a, para. 11.

53 ZÖLLNER, *supra* note 51, Sect. 51a, para. 10.

54 Further to the details WILDE, *supra* note 34, 423, 426 f.

55 Cf. Sect. 90 GSCA; see also ROTH, *supra* note 36, 343 ff.; R. MANGER, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2010, 1255; K. VON SCHENCK, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2002, 64 ff.

56 Sects. 121 ff., 92 GSCA.

57 C. KERSTING, Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR) 2007, 319, 333; C. KERSTING, in: Kölner Kommentar AktG (3rd ed., Cologne 2010) Sect. 131, para. 6.

58 Sect. 245 GSCA.

59 Sects. 258 et seq. GSCA.

The fact that the shareholder's right of information can only be exercised within the shareholders' meeting, contrary to other legal company forms, can also be explained with the existence of a supervisory board.[61] This right is directed at information about company matters, like the right of information of the partner in a limited liability partnership *(GmbH),* but is restricted in the way that the information must be necessary to appropriately assess the topics of the agenda. This means that the request has to concern a specific item on the agenda that has not yet been settled.[62] The executive board has to disclose the requested information verbally.[63] However, this does not comprise a duty to prove or document the information given with certificates or local inspection, e.g. in the form of a visit of the company facilities.[64,65]

c) *In particular: Corporate Governance*

Starting with a purely voluntary and non-binding Corporate Governance initiative decades ago, recommendations of the "Government Commission German Corporate Governance Codex" were published in 2002 by the Federal Ministry of Justice in the official part of the Federal Law Gazette.[66] The GCGC, giving recommendations and suggestions that reflect the best practice of Corporate Governance, is based on the shareholder value-concept and follows the "comply or explain" model.[67] According to Sect. 161 GSCA, the management board and the supervisory board of a listed company have to declare annually that the recommendations have been and will be complied with, or which recommendations have not been or will not be applied and

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60 C. H. BARZ, in: Großkommentar AktG (3rd ed., Berlin 1973) Sect. 131, annot. 2; KERSTING, *supra* note 57, Sect. 131, para. 6.

61 SCHMIDT, *supra* note 22, 49.

62 KERSTING, *supra* note 57, Sect. 131, para. 107.

63 BARZ, *supra* note 60, Sect. 131, annot. 23.

64 BARZ, *supra* note 60, Sect. 134, annot. 24.

65 Further information duties of the executive board exist towards the shareholders (e.g. information relevant to the calling of a shareholders' meeting, Sects. 121 ff.; 92 GSCA, relevant to substantial changes of the company, i.e. measures falling under the *Holzmüller/Gelatine* doctrine; relevant to the duty to transfer the entire assets of the, Sect. 179a GSCA), towards the supervisory board (Sect. 90 GSCA); towards the special auditor (Sect. 145 GSCA) as well as towards the public (e.g. announcements concerning the composition of the supervisory board, Sect. 97 GSCA; announcements about the end of a contesting action, Sect. 248a GSCA) and also in a group of companies (Sects. 20, 21, 293a, 312, 314 GSCA).

66 *www.dcgk.de/en*.

67 C. SCHRADER, Nachhaltigkeit in Unternehmen – Verrechtlichung von Corporate Social Responsibility, Zeitschrift für Umweltrecht (ZUR) 2013, 451, 453.

why. The mandatory declaration of conformity, that has to be continuously available to the public on the company's website, is the legal basis of the code. But it is far more than that. On several occasions, the code has been used as pattern for a legislative reform, or at least as a source for legal interpretation of the GSCA.[68] Furthermore, there are additional information duties for the management board arising from the GCGC, e. g. concerning the total compensation of each one of its members by name[69] or members' conflicts of interests to the supervisory board.[70] In its election recommendations to the general meeting, the supervisory board must disclose the personal and business relations of each individual candidate within the enterprise, the executive bodies of the company, and with a shareholder holding a material interest in the company.[71] Finally, there is the recommendation that the management board and the supervisory board report each year on Corporate Governance and publish this Corporate Governance report in connection with the statement on Corporate Governance.[72]

4. Collective Information as a General Principle

These considerations lead to the general principle that the management body, i.e. the managing partner in a (limited liability) partnership or the executive board, on its own initiative, has a duty to provide the deciding body and its members with all the company related information necessary for a carefully considered decision.[73] The flow of information resulting from the *collective* right of information also affects the *individual* right of information. The more intense the management body's reporting, the less important the individual partner's right of information becomes.[74]

The collective right of information's scope, however, can vary and depends on the existence of a special supervisory body as recipient of the information. This is especially the case for stock corporations. For this legal form, a collective right of information can only be in place within

68 J. J. DU PLESSIS/I. SAENGER, An Overview of the Corporate Governance Debate in Germany, in: du Plessis et al., German Corporate Governance in International and European Context (3rd ed., Berlin 2017) 2.6.7.

69 Art. 4.2.4 GCGC.

70 Art. 4.3.3 GCGC.

71 Art. 5.4.1 GCGC.

72 Cf. H. M. ANZINGER, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2015, 969, 971.

73 This basic principle is explicitly acknowledged by SCHMIDT, *supra* note 22, 17, and HOMMELHOFF, *supra* note 34, 390.

74 HOMMELHOFF, *supra* note 34, 291 f.; M. LUTTER, Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR) 1982, 1, 8; SCHMIDT, *supra* note 22, 17 f.

narrow limits.[75] In partnerships and limited liability companies *(GmbH),* such supervisory bodies do usually not exist. Then, and in cases when a collective right of information is granted despite a supervisory body being in place, the duty to report can result in detailed statements delivered to each member, e.g. by submitting reviews or newsletters, or the duty to convene an extraordinary shareholders' meeting.[76] As a rule, the duty to report (based on the collective right of information) will be complied with as part of the decision making process for the ordinary shareholders' meeting.[77] Thus, the collective right of information is part of the basis for the discussion in the members' meeting and can therefore be categorized as a participation right.

IV. Disclosure[78]

Reporting has been of importance for European legislation from the beginning. Directive 68/151/EEC "on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community"[79] dates back to 1968. This "First Company Law Directive on Disclosure" concerns company registrations, transactional validity, the effect of ultra vires transactions, or transactions by improperly incorporated businesses. Although the Directive was only applicable for corporations, or in other words, companies with limited liability, it comprises the basic information duties under trade law entirely. The recital states that (1st) "the basic documents of the company should be disclosed in order that third parties may be able to ascertain their contents and other information concerning the company, especially particulars of the persons who are authorised to bind the company", (2nd) "the protection of third parties must be ensured by provisions which restrict to the greatest possible extent the grounds on which obligations entered into in the name of the company are not valid" and (3rd) that "it is necessary, in order to ensure

75 WILDE, *supra* note 34, 423, 440; SCHMIDT, *supra* note 22, 20; KERSTING, *supra* note 57, Sect. 131, para. 8.

76 Cf. for the partnership only SCHÄFER, *supra* note 27, Sect. 713, para. 8, and for the corporation K. SCHMIDT, in: Scholz, GmbHG (11th ed., 2013) Sect. 49, para. 13; SCHMIDT, *supra* note 22, 20.

77 SCHÄFER, *supra* note 27, Sect. 713, para. 9.

78 This paragraph is based on I. SAENGER, Gesellschaftsrecht (3rd ed., Munich 2015) para. 981 ff.

79 Official Journal of the European Union, OJ L 65, 14.03.1968 [English special edition: Series I Volume 1968 (I) 41–45].

certainty in the law as regards relations between the company and third parties, and also between members, to limit the cases in which nullity can arise and the retroactive effect of a declaration of nullity, and to fix a short time limit within which third parties may enter objection to any such declaration." This shows that information duties under trade law aim to protect not only members of a company and potential contractual partners but also the general public.

Today, a corporation[80] or a partnership without any personally liable member like the *GmbH & Co. KG*,[81] and other large enterprises,[82] have to follow the strict regulations concerning financial reporting and disclosure.[83] Slightly less strict rules are in place for the smallest, small, and medium-sized enterprises.[84] Therefore, there is an interrelation between the duty to disclose and the limitation of personal liability.

The annual financial statements of companies with a duty of disclosure have to be submitted to the German Federal Gazette's operator in electronic form. Each merchant in the sense of the GCC has a duty to compile a balance sheet at the beginning of the business year.[85] Furthermore, he is also obliged to prepare a profit and loss statement.[86] The balance sheet is a comparison of assets and liabilities, while the profit and loss statement shows income and expenses.[87] Corporations and partnerships with limited liability[88] have a duty to add notes to their annual financial statement.[89] These have to explain the balance sheet as well as the profit and loss statement and, if necessary, correct and complete them or even incorporate some of their details to lessen the their complexity.[90]

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80 Sect. 325 GCC.

81 Sect. 264a GCC.

82 Sect. 1 German Disclosure Act *(Publizitätsgesetz, PublG).*

83 See also S. H. SCHNEIDER, Informationspflichten und Informationssystemeinrichtungspflichten im Aktienkonzern. Überlegungen zu einem Unternehmensinformationsgesetzbuch (Berlin 2006) 44 ff.

84 Less strict rules for small business sole proprietorships are imposed by Sects. 241a, 242(2) GCC; the basic regulations applicable to all merchants (Sects. 238–263 GCC) are complemented by special regulations for corporations (Sects. 264–335 GCC); in the latter case, it has to be further distinguished according to the size of the company (Sect. 267 GCC); cf. SCHMIDT, *supra* note 4, § 15, para. 10.

85 Sect. 242(1) GCC.

86 Sect. 242(2) GCC.

87 B. GROßFELD/C. LUTTERMANN, Bilanzrecht (4th ed., Heidelberg 2005) no. 28–31 and 37–38.

88 Sect. 264a GCC.

89 Sect. 264(1)1 GCC.

90 J. BAETGE/H.-J. KIRSCH/S. THIELE, Bilanzen (13th ed., Düsseldorf 2014) chapter XIV 1 (p. 731 f.).

Financial reporting serves the purpose of documenting the business circumstances. This fosters "independent sourcing of information" on the one hand, and accountability on the other.[91] The notes' information that comments and interprets parts of the balance sheet, e.g. by naming the accounting or valuation method, have *interpretative function*.[92] Legislatively, the notes' *corrective function* can be found in Sect. 264(2)2 GCC. If a balance sheet and profit and loss statement do not convey a realistic picture of the company's assets, revenues, and its financial situation, this may be corrected by introducing additional information in the notes. This potential "outsourcing" of specific information enhances the significance and clarity of the notes, the balance sheets and profit and loss statements, with the result that the notes possess a *relieving function*. Furthermore, information that belongs neither to the balance sheet nor the profit and loss statement but is still relevant for an evaluation of the company's assets, revenues, and its financial situation, can be published in the notes *(complementing function)*.

Large and medium-sized corporations as well as partnerships without a natural personally liable person have to add a management report according to Sect. 289 GCC on top of the notes.[93] While the notes are part the annual financial statement, the management report is an independent element of financial reporting. Its purpose is to describe the course of business and the state of the corporation "in such a way that it provides a factually accurate picture". This includes going into the risks of future development.[94] Meanwhile, the revision of the German Accounting Standard No. 20 (GAS 20 Management Reporting)[95] is intended to strengthen the so called opportunities reporting.[96] Lastly, especially market listed companies have to issue an explanation concerning Corporate Governance according to Sect. 289f GCC, forming its own paragraph in the management statement. Altogether, at the end of the day these revisions have the consequence that the management report is no longer just a financial instrument but will provoke the compulsion to adopt an increasing number of Corporate Governance recommendations.[97]

But disclosure requirements are expanding enormously. The latest development is marked by "Directive 2014/95/EU of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity

91 SCHMIDT, *supra* note 4, § 15, para. 3.

92 Sect. 284(2)1 GCC; BAETGE/KIRSCH/THIELE, *supra* note 90, chapter XIV 3 (p. 739 f.).

93 Sects. 264(1)1,4 and 264a GCC. For the latest development see FINK/SCHMIDT, Der Betrieb (DB) 2015, 2157 ff.

94 C. RINKER/J. DITGES/U. ARENDT, Bilanzen (14th ed., Herne 2012) 252 f.

95 Deutscher Rechnungslegungs Standard Nr. 20 (DRS 20) – Konzernlagebericht.

96 K. EISENSCHMIDT/J. SCHERNER, Deutsches Steuerrecht (DStR) 2015, 1068 ff.

97 C. FINK/R. SCHMIDT, Der Betrieb (DB) 2015, 2157, 2164 f.

information by certain large undertakings and groups",[98] often abbreviated just as "Corporate Social Responsibility (CSR)-Directive". One may discuss whether it is appropriate to justify this Directive with the primary aim of increasing investor as well as consumer trust.[99] But nevertheless, EU Member States were forced to create provisions to improve the CSR reporting practices by 6 December 2016.[100]

Despite that, today already more than half of German corporations are committed to CSR.[101] Shareholders, investors and the public are obviously interested in whether a company is following the law and, furthermore, whether there is an effective Compliance Management System (CMS) – or in other words, whether it behaves like a "good corporate citizen".[102] CSR may also provide important benefits to companies in risk management, cost savings, access to capital, customer relationships, human resource management, and their ability to innovate. Understandably enough, it is of importance whether social, environmental, ethical, consumer, and human rights concerns are integrated into the business strategy and operations. According to communication operatives, a survey of 2013 has stated that CSR-communication exercises substantial influence over corporate reputation (30.1 %), employee relations (17.7 %), stakeholder relations (15.5 %) and customer relations (14 %) as well. In contrast, the relevance for shareholder value is negligible; the impact on stock prices is quoted at 1.2 %.[103] One may be sceptical as to what will be the benefit of a provision which expressly confesses not to provide a distinct guideline but allows "high flexibility of action, in order to take account of the multidimensional nature of corporate social responsibility […] and the diversity of CSR policies".[104] Even up to the present day, nobody has a clear understanding of what is meant by a "'sufficient level of comparability' that "meet(s) the needs of […] stakeholders as well as the need to provide consumers with easy access to information on the impact of businesses on society."[105] It does not improve matters that

98 OJ 2014 L 330/1.

99 Directive 2014/95/EU, recital 3.

100 Directive 2014/95/EU, Art. 4 para. 1. Cf., in particular, Sects. 289b–e GCC by the Law of 11.04.2017, Official Journal of the Federal Republic of Germany *(Bundesgesetzblatt),* BGBl. I 2017, 802.

101 Cf. *http://de.statista.com/statistik/daten/studie/*168058*/umfrage/verbreitung-von-csr-in-unternehmen-*2010.

102 J.J. DU PLESSIS, Disclosure of non-financial information: A powerful Corporate Governance Tool, (New York 2016) 34 Company and Securities Law Journal (C&SLJ) 69 (71).

103 *http://de.statista.com/statistik/daten/studie/*255075*/umfrage/einfluss-der-csr-kommunikation-auf-unternehmensbereiche* <13.06.2016>.

104 Directive 2014/95/EU, recital 3.

the EU Commission had to prepare non-binding guidelines on the methodology for reporting non-financial information by the end of 2016.[106]

It is doubtful whether hard law, especially in this field, will be an effective way of ensuring that corporations act responsibly and adhere to good corporate governance principles or really improve corporate governance practices significantly. This opinion is shared by *Lutz Strohn,* the long-standing Vice President of the Company Law Senate of the Federal Court of Justice. In an editorial, he reflects upon the relation of moral behaviour and CSR. He even goes a step further and brings up the question of whether increasing regulatory density has precisely the opposite effect, limiting the options for moral behaviour. *Strohn* believes that a director has not to be just a mere manager but an "honest merchant" who can be expected to behave morally and act as a socially responsible member of the community, independent of any regulation.[107] So the latest Directive may be taken as what it is: Another European compromise and a nice declaration of intent that will produce no more than much ado and enormous costs.[108]

V. Conclusion

All in all, German Trade Law provides various duties to inform, that should be complied with to avoid liability. In contrast, German Company Law contains mostly rights of information but rarely foresees duties due to reasons of private autonomy. However, a duty to inform may exist in order to enable partners or shareholders to even exercise their rights of information. Especially in Stock Corporation Law, mandatory duties to inform have become more and more important. In reference to information for the general public, this also applies to accounting duties concerning financial reporting *(accountability).* Recent developments have led to a duty to disclose non-financial information with statements concerning Corporate Social Responsibility being a major aspect.

105 Directive 2014/95/EU, recital 3.

106 Directive 2014/95/EU, Art. 2 and recital 17; see also A. Eufinger, Die neue CSR-Richtlinie – Erhöhung der Unternehmenstransparenz in Sozial- und Umweltbelangen, Europäische Zeitschrift für Wirtschaftsrecht (EuZW) 2015, 424, 428. Cf. Communication from the Commission "Guidelines on non-financial reporting (methodology for reporting non-financial information) (2017/C 215/01)", published 05.07.2017, Official Journal of the European Union C 215/1.

107 L. Strohn, Moral im Geschäftsleben – verdrängt durch das Recht?, Zeitschrift für das gesamte Handels- und Wirtschaftsrecht (ZHR) 180 (2016) 2 (5-6).

108 To take it as a 'low-cost approach', as D.G. Szabó/K.E. Sørensen, New EU Directive on the Disclosure of Non-Financial Information (CSR), European Company and Financial Law Review (ECFR) 2015, 307 (340) do, can be considered as the result of extreme carelessness.

III. Capital Markets Law

Information Duties under Japanese Capital Markets Law

Toshiaki Yamanaka[*] */ Gen Goto* [**]

I. Introduction
II. FIFA Regulations on Information Duties
  1. Disclosure Requirements
  2. Regulation of Financial Instruments Business Operators' Activities
  3. Soft-law Principles on Recent Regulatory Discussions
III. Civil Liability for Breach of Information Duties
  1. Civil Liability for Breach of Information Duties under the FIEA
  2. Civil Liability under the ASFI
  3. Recent Cases

I. Introduction

This chapter provides an overview of information duties under Japanese capital market law.[1] Relevant rules regarding information duties on financial instruments are incorporated into the Financial Instruments and Exchange Act (*Kin'yū shōhin torihiki-hō,* hereinafter, "FIEA"),[2] the Act on Sales, etc. of Financial Instruments (*Kin'yū shōhin no hanbai-tō ni kansuru hōritsu,* hereinafter, "ASFI")[3] and general tort law provisions of the Civil Code *(minpō)*.[4]

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1 For an informal English translation of Japanese acts and related legal rules referenced in this chapter, see the website of Japan's Ministry of Justice *(http://www.japaneselawtranslation.go.jp/)*. For a more detailed comparative analysis with Germany, see H. BAUM/T. YAMANAKA, The Information Model as a Means of Investor Protection: A Comparative Analysis of Secondary Markets Regulation in Germany and Japan (forthcoming, draft on file with the authors). For an overview of the capital market regulation in Japan, see H. BAUM/H. KANDA, Financial Markets Regulation in Japan, Journal of Japanese Law 44 (2017) 65.

2 Act No. 65/2006 amended Act No. 25/1948.

3 Act No. 101/2000.

4 Act No. 89/1896. See *infra* note 11.

The basis of Japanese capital market law is laid out by the FIEA, the purpose of which is to ensure fairness in the issuance of securities and transactions of financial instruments and to facilitate a smooth distribution of securities. It also seeks to achieve fair price formation for "Financial Instruments"[5] through the full implementation of capital market functions, thus contributing to the sound development of national economy and the protection of investors.[6] To achieve this aim, the FIEA sets rules regarding disclosure of corporate affairs and regulates "Financial Instruments Businesses"[7] and "Financial Instruments Exchanges".[8]

The ASFI also plays an important role in protecting customers of "Financial Instrument Providers" *(kin'yū shōhin hanbai gyōsha)*[9] by modifying general tort law and providing strict liability for Financial Instrument Providers and the presumption of causation and damages for "Sales of Financial Instruments".[10]

In addition, investors or customers are able to collect damages from the financial institutions from which they bought financial products pursuant to the general tort law,[11] regardless of whether information duties are imposed on financial institutions under the FIEA or the ASFI.

The remainder of this chapter will first provide a brief overview of the FIEA regarding disclosure requirements and the regulation of Financial Instruments Businesses, with an analysis of recent regulatory discussions on how Financial Instruments Businesses should operate (Part II), and then describe civil liability for violations of information duties under Japanese law (Part III).

II. FIEA Regulations on Information Duties

1. Disclosure Requirements

The FIEA provides disclosure rules for both the primary and the secondary markets. For disclosures in the primary market, the FIEA mandates the issuers of securities to file a notification of public offerings and secondary

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5 "Financial Instruments" include securities, securities or certificates indicating claims based on a deposit contract, currencies and commodities (Article 2 para. 24 FIEA).

6 Article 1 FIEA.

7 For the definition of "Financial Instruments Business", see Article 2 para. 8 FIEA.

8 For the definition of "Financial Instruments Exchange", see Article 2 para. 16 FIEA.

9 The term "Financial Instrument Providers" is defined as a person carrying out sales, etc. of financial instruments as a conduct of its business (Article 2 para. 3 ASFI).

10 For the definition of "Sales of Financial Instruments", see Article 2 para. 1 ASFI.

11 Article 709 Civil Code.

distributions of securities with the Commissioner of the Financial Services Agency by submitting a registration statement.[12] The issuer is also obliged to prepare a prospectus for any public offering and secondary distribution.[13] For disclosures in the secondary market, an issuer is obliged to submit annual reports[14] and quarterly[15] or semiannual reports.[16] The requirements for the registration statement, prospectus and periodic reports are further specified in the Cabinet Office Ordinance on Disclosure of Corporate Affairs *(Kigyō naiyō-tō no kaiji ni kansuru naikaku-fu-rei).*[17]

In some cases, issuers are exempted from the above disclosure obligations. One example is when only "Qualified Institutional Investors" *(tekikaku kikan tōshika)*[18] are solicited to acquire securities, and the likelihood of these securities being transferred to any person other than Qualified Institutional Investors is small.[19] Another exemption arises when the number of persons other than Qualified Institutional Investors being solicited to acquire securities is less than fifty.[20] There is also a deregulated market called "TOKYO PRO Market",[21] which limits participation to professional investors called "Specified Investors" *(tokutei tōshika).*[22]

12 Articles 4 and 5 FIEA.

13 Article 13 FIEA. See also Article 15 FIEA (duty to deliver prospectus to purchaser of securities).

14 Article 24 FIEA.

15 Article 24-4-7 FIEA.

16 Article 24-5 FIEA. Ad hoc disclosure is also required under Rule 402 of the Securities Listing Regulations *(Yūka shōken jōjō kitei)* by Tokyo Stock Exchange (hereinafter, "TSE") for the listed companies on the TSE. See website of Japan Exchange Group at *http://www.jpx.co.jp/english/rules-participants/rules/regulations/index.html*.

17 Ordinance of the Ministry of Finance No. 5/1973.

18 For the definition of "Qualified Institutional Investors", see of Article 2 para. 3 item 1 FIEA and Article 10 of the Cabinet Office Order on Definitions under Article 2 Financial Instruments and Exchange Act (*Kin'yū shōhin torihiki-hō dai-ni-jō ni kitei suru teigi ni kansuru naikaku-fu-rei,* Order of the Ministry of Finance No. 14/1993).

19 Article 2 para. 3 item 2(a) FIEA.

20 Article 2 para. 3 item 1 FIEA, Articles 1-4 and 1-5 of the Order for Enforcement of the Financial Instruments and Exchange Act *(Kin'yū shōhin torihiki-hō sekō-rei),* Cabinet Order No. 321/1965, Article 10-2 para. 1 of the Cabinet Office Order on Definitions under Article 2 of the Financial Instruments and Exchange Act.

21 See Articles 27-31, 27-32 and 117-2 FIEA.

22 See Article 45 FIEA. For the definition of "Specified Investors", see Article 2 para. 31 FIEA. They include Financial Instruments Business Operators and listed companies. Regulations exempted include Article 37-3, Article 38 items 4 through 6 and Article 40 item 1 FIEA, which are referenced below.

2. Regulation of Financial Instruments Business Operators' Activities

In addition to disclosure requirements, the FIEA regulates activities by "Financial Instruments Business Operators" *(kin'yū shōhin torihiki gyōsha).*[23]

To begin with, Financial Instruments Business Operators and their directors and employees must act in good faith and be fair to their customers in the course of their operations.[24] When Financial Instruments Business Operators receive orders from a customer for a purchase or sale of securities, they must notify the customer clearly in advance whether they will conclude the purchase or sale with the customer as the counterparty, or whether they will act as a mediator, a broker or an agent for the transaction.[25] Financial Instruments Business Operators must establish and disclose their policy on how they will execute orders from customers to achieve the best terms and conditions.[26]

With regard to information duties, Financial Instruments Business Operators seeking to conclude "Financial Instruments Transaction Contracts" *(kin'yū shōhin torihiki keiyaku)*[27] are required to deliver documents describing the summary of the contract, applicable fees, the nature and the extent of risks that will be borne by the customer and other relevant information to their customers in advance.[28] Financial Instruments Business Operators and their directors and employees are prohibited from concluding a Financial Instruments Transaction Contract, without explaining the above information to customers other than Specified Investors in a manner and to the extent necessary for the customer to understand, considering the customer's knowledge, experience, the status of the customer's properties and the purpose of concluding the contract.[29]

Financial Instruments Business Operators, their directors and employees are also prohibited from engaging in certain practices, such as: providing a

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23 Chapter 3 of the FIEA. "Financial Instruments Business Operators" are clarified as persons who carry out as a conduct of its business, including among others, sale and offer of securities, providing management and advisory on assets and providing administration and maintenance of assets (Article 2 paras. 8 and 9 and Article 29 FIEA).

24 Article 36 para. 1 FIEA.

25 Article 37-2 FIEA.

26 Article 40-2 para. 1 FIEA.

27 For the definition of "Financial Instruments Transaction Contract", see Article 34 FIEA.

28 Article 37-3 para. 1 FIEA. Details of the required information are stipulated at Articles 79 through 96 of the Cabinet Office Order on Financial Instruments Business, etc *(Kin'yū shōhin torihiki-gyō-tō ni kansuru naikaku-fu-rei),* Cabinet Office Order No. 52/2007.

29 Article 38 item 9 FIEA, Article 117 para. 1 item 1 of the Cabinet Office Order on Financial Instruments Business, etc.

customer with false information in connection with the conclusion of a Financial Instruments Transaction Contract or in connection with the solicitation thereof;[30] providing a customer with a conclusive assessment of a matter that is uncertain or with information that could mislead the customer into believing that a matter that is uncertain is actually certain, thereby soliciting the customer to conclude a Financial Instruments Transaction Contract;[31] unsolicited contacting of a customer inducing the conclusion of a Financial Instruments Transaction Contract;[32] soliciting a customer to conclude a Financial Instruments Transaction Contract without obtaining confirmation from the customer, prior to solicitation, regarding whether or not the customer is willing to be solicited;[33] and continuing to solicit a customer to conclude a Financial Instruments Transaction Contract despite the customer having indicated an unwillingness to conclude such a contract (including an intention that indicates unwillingness to continue to be solicited) after being solicited.[34]

The FIEA also provides that Financial Instruments Business Operators shall conduct their business in such a manner that any solicitation for a "Financial Instruments Transaction Activity" *(kin'yū shōhin torihiki-kōi)*[35] would not be inappropriate in light of a customer's knowledge, experience, assets and the purpose for which a Financial Instruments Transaction Contract is concluded.[36] This requirement is known as the suitability rule.

3. *Soft-law Principles on Recent Regulatory Discussions*

In addition to the above regulations, the Financial Services Agency published a document titled "The Principles for Customer-Oriented Business Conduct" on 30 March 2017.[37]

The background for this initiative was a view that some financial service providers only formalistically follow the regulations under the FIEA and do not respect the interests of their customers. For example, some banks were said to have promoted particular mutual funds to their customers based on the amount of commission they receive, not on the suitability of that mutual

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30 Article 38 item 1 FIEA.
31 Article 38 item 2 FIEA.
32 Article 38 item 4 FIEA.
33 Article 38 item 5 FIEA.
34 Article 38 item 6 FIEA.
35 For the definition of "Financial Instruments Transaction Activity", see Article 34 and Article 2 para. 8 FIEA.
36 Article 40 item 1 FIEA.
37 Financial Services Agency, The Principles for Customer-Oriented Business Conduct *[Kokyaku hon'i no gyōmu un'ei ni kansuru gensoku]* (30 March 2017) (available at *http://www.fsa.go.jp/news/28/20170330-1/02.pdf,* in Japanese).

fund to the customer. On other occasions, some banks recommended products of asset management companies belonging to the same financial group over those of asset management companies outside of the group.

To correct this, the Principles request financial service providers, for example, to disclose, in understandable manner, information regarding the reason for recommending particular financial products and sources of conflict of interests, such as commissions they receive from third parties. It must be noted, however, that this requirement is not a mandatory regulation but a soft-law recommendation and that the decision to accept these principles is left to individual financial service providers.

III. Civil Liability for Breach of Information Duties

1. *Civil Liability for Breach of Information Duties under the FIEA*

Civil liability plays an important role in ensuring that information duties are fulfilled and correct information is provided to customers. The FIEA however, does not stipulate civil liability of Financial Instruments Business Operators for violation of regulations described in Section 2 of Part II.[38]

While it is generally accepted in Japanese law that violation of administrative regulations does not necessarily give rise to civil liability of the offender, the Supreme Court has held that a Financial Instruments Business Operator is liable to its customer under general tort law when its employee clearly deviated from the suitability rule, for example by aggressively soliciting the customer to make a clearly excessively risky investment against the will and the circumstances of that customer.[39]

When Financial Instruments Business Operators fail to follow other information duties under the FIEA, it is also likely that such failure is considered as a breach of the duty of one contracting party to provide explanation to the other party, which is recognized as one form of the principle of good faith,[40] and that the Financial Instruments Business Operator will be held liable under tort law.[41]

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38 For civil liability for violation of disclosure rules described in Section 1 of Part II, see G. GOTO, Growing Securities Litigation Against Issuers in Japan: Its Background and Reality, in: Huang/Howson (eds.), Enforcement of Corporate and Securities Law: China and the World (Cambridge 2017) 416.

39 Supreme Court Case of 14 July 2005, Minshū 59-6-1323.

40 Article 1 para. 2 Civil Code.

41 See Supreme Court Case of 22 April 2011, Minshū 65-3-1405 (holding that one contracting party who violated the duty to explain under the principle of good faith by failing to provide information, which would have influenced the decision of the other contracting party whether or not to conclude the contract, before the conclu-

2. *Civil Liability under the ASFI*

In a lawsuit claiming compensation for damages based on general tort law under the Civil Code, the plaintiff is required to establish the amount of the damage caused, and that the defendant caused such damage intentionally or by negligence.[42] The ASFI seeks to ease this burden of customers of Financial Instrument Providers by specifying matters that must be explained by Financial Instrument Providers at or before the time that the Sales of Financial Instruments was carried out,[43] imposing a special liability on Financial Instrument Providers when they failed to provide the required explanation, regardless of whether that failure was intentional or negligent,[44] and assuming the amount of loss of principal suffered by customers as the amount of damage caused by such failure, thereby shifting the burden of proof to Financial Instrument Providers.[45]

3. *Recent Cases*

Traditionally, most lawsuits claiming compensation for loss caused by a failure to provide an explanation of financial instruments were filed by retail investors.

While similar lawsuits have also recently been filed by non-retail investors, the Supreme Court seems to be reluctant to grant relief in such cases. For example, in a case where an unlisted company brought an action against a major bank insisting a breach of information duties regarding a plain-vanilla interest rate swap transactions, the Supreme Court denied the breach by the defendant bank because the fundamental structure is so simple that it is generally understandable without difficulty, at least for a director of a company.[46] In another case, a large listed company in consumer loan business sued Merrill Lynch International and its Japanese subsidiary for a huge amount of loss arising from the purchase of structured bonds,

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sion of the contract to the other party could be liable under tort law, but not under contract law for non-performance of a contractual obligation).

42 See *supra* note 11.

43 Article 3 para. 1 ASFI. The matters required to be explained include, for example, a risk, if any, of incurring a loss of principal or suffering a loss that exceeds the amount of principal, the sources of such risk, such as the fluctuation of interest rates, currency exchange rates or market value of financial instruments, and the important portions of the structure of transactions pertaining to the sales which generate such risk. Article 3 para. 1 items 1 and 2 ASFI.

44 Article 5 ASFI.

45 Article 6 ASFI.

46 Supreme Court cases of 7 March 2013, Shūmin 243-51 and 26 March 2013, Shūmin 243-159.

which was arranged and sold by the defendants to enable the plaintiff to offset its own bond, when the value of the structured bonds plummeted after the bankruptcy of Lehman Brothers in 2008. While the Tōkyō High Court held the defendants partially liable for failure to provide sufficient explanation,[47] the Supreme Court reversed and overruled the decision based on a view that the plaintiff, itself a listing company engaging in the finance industry, must have been able to understand the explanation given by the defendants, even if the employee of the plaintiff in charge of the purchase did not have detailed knowledge of financial transactions.[48]

47 Tōkyō High Court Case of 27 August 2014, 2239 Hanrei Jihō 118.

48 Supreme Court case of 15 March 2016, Shūmin 252-55. See TOSHIAKI YAMANAKA, *Han'hi* [Case Note], 1509 Jurisuto 107 (2017).

Information Duties under German Capital Markets Law

Harald Baum[*]

I. Foundations of the German Capital Markets Law
1. Growing Importance of External Finance
2. Regulatory Concept and Assumptions
II. Regulatory Architecture
1. EU
2. Germany
III. Information
1. Information Matrix
2. Information Duties under the STA
3. Information Duties Created by the Courts
4. Tension Between Public and Civil Law Information Duties
IV. Challenges to the "Information Model"
1. Bounded Rationality, Lack of Expertise, Information Overload
2. General "Right of Repentance"?
V. Regulatory Reactions
1. Key Information Document
2. Product Governance and Product Intervention
3. Fee Based Investment Advice
4. Evaluation

I. Foundations of the German Capital Markets Law

The regulation of German capital markets has seen a rapid development with manifold changes during the last three decades. The term capital markets law (as it is called in Europe), or securities regulation (as it is labelled in the US), refers to the "rules which deal with the constitution of the capital markets".[1] These include the rules dealing with transactions in the primary market on the one hand – transactions between issuers, banks, and investors – and those in the secondary market on the other – transactions between investors and financial intermediaries of various kinds.[2] Germany's capital market law regime is in constant flux. Between 2008 and 2016

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1 K. J. HOPT, Capital Markets Law, in: Basedow/Hopt/Zimmermann/Stier (eds.), The Max Planck Encyclopedia of European Private Law (Oxford 2012) Vol. I, 141.

some 40 legislative measures were enacted.[3] Whereas reforms during the 1990s and 2000s were characterized by deregulation to a significant degree, developments in last ten years have shown a reverse tendency towards re-regulation in reaction to the global financial crisis of 2008.[4] One characteristic feature of most reforms, both deregulatory and re-regulatory, was that they dealt with the role *information* plays in capital market activities.

What are the economic reasons that caused the rapid development of capital markets law as a legal field in its own right in Germany and which regulatory assumptions brought information into to the regulatory focus? Both questions are answered below in 1. and 2. respectively. The ensuing parts of this chapter are then organized as follows. Part II provides a brief overview of the regulatory architecture governing capital markets in the EU and Germany. Part III discusses the different types of information duties and Part IV throws a light on the challenges to the "information model". Part V concludes with a look at some regulatory reactions to these.

1. Growing Importance of External Finance

In Germany as elsewhere, the importance of external finance via the capital markets has been constantly increasing over the last decades. Correspondingly, the traditional way of financing business activities via the banks – the so-called German "house bank system" – has lost its dominance.[5] Instead, the use of financial products via the capital markets has grown as a means for supplying financing. This development coincides with the need of aging populations, with their increased life expectancy, to provide for private pensions. The precondition for achieving this aim are sufficient opportunities to invest in lucrative, but at the same time safe, financial products.

These trends had regulatory consequences. Whereas banks in their role as supplier of finance are pretty much in a position to look after their own interest vis-à-vis their corporate customers based on their professional experience and their often long-term relationships with them, the opposite is true for average investors who engage in anonymous capital markets by purchasing financial products. Accordingly, capital markets law has become

2 *Ibid.*

3 *See* P. BUCK-HEEB, Entwicklung und Perspektiven des Anlegerschutzes, Juristen-Zeitung (JZ) 2017, 279.

4 *See* J.-H. BINDER, Vom offenen zum regulierten Markt: Finanzintermediation, EU-Wirtschaftsverfassung und der Individualschutz der Kapitalanbieter, Zeitschrift für europäisches Privatrecht (ZEuP) 2017, 569.

5 *See* W.-G. RINGE, Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG, American Journal of Comparative Law 63 (2015) 493.

increasingly important for providing sufficient investor protection and thus for the functioning of the market. Investor protection must be distinguished from shareholder protection. Traditionally, shareholder protection was provided by company law and, additionally, by some rules on stock exchange trading, whereas investor protection is a fairly new concept based on capital markets law and encompassing all kinds of investments in publicly traded financial instruments.[6] In the age of globalized financial markets and international competition for funds, a country's regulatory regime for the capital markets has had to become globally competitive. This poses an additional challenge for a national legislator or a regional rule maker like the European Union to keep up with international benchmarks.

2. *Regulatory Concept and Assumptions*

The regulatory aim of capital markets law in Germany as elsewhere is the promotion of the efficiency of these markets in terms of allocation, operations, and institutions. This approach rests on the following assumptions.[7] Firstly, that capital markets are at least moderately efficient. Second, market participant trust is fundamental to the functioning of that market. Third, the participants' trust in turn depends on sufficient investor protection.[8] Fourth, for securing sufficient protection, it is crucial to solve the problems arising out of information asymmetries and conflicts of interests. Fifth, to achieve this aim, all relevant information should be made available in a timely manner, and without distortion. To this end, sixth, mandatory information (and disclosure) duties have been regarded, at least until very recently, as the most suitable means. In other words, modern investor protection so far has been based on the so-called "information model": If investors have received all relevant information in an appropriate form – and thus information asymmetries are deemed to be compensated for – they are bound to their investment contract and have to bear the economic consequences of their investment decision. Sensibly, differences exist regarding the scope of information with respect to what kind of financial services are offered to which type of investor.[9]

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6 *See* K. J. HOPT, Investor Protection, in: Basedow/Hopt/Zimmermann/Stier (eds.), The Max Planck Encyclopedia of European Private Law (Oxford 2012) Vol. II, 996 f.

7 For a comprehensive discussion *see* K. LANGENBUCHER, Anlegerschutz. Ein Bericht zu theoretischen Prämissen und legislativen Instrumenten, Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 177 (2013) 679.

8 K. J. HOPT, Die Haftung für Kapitalmarktinformationen, in: Kalss/Torggler (eds.), Kapitalmarkthaftung und Gesellschaftsrecht (Vienna 2013) 55 (58).

9 *See infra* at III.1.

II. Regulatory Architecture

The regulation of stock exchanges has a long history in Europe reaching back centuries, with the first modern (statutory) exchange laws dating from the 19th century.[10] Germany enacted its Stock Exchange Act in 1896.[11] Capital market law in the modern sense, on the other hand, is a more recent phenomenon that developed in the 20th century from the U.S. securities regulation of the 1930s, especially the Securities Act of 1933 and the Securities Exchange Act of 1934, that are administered by the Securities and Exchange Commission, an independent central agency.[12] This regulatory model spread to Europe and developments in the U.S. securities regulation are still often reflected to a certain degree in EU regulation. Germany's capital market regulation developed to a significant extent, though by no means exclusively, under the influence of EU law which it had to implement as did all Member States of the European Union.

1. EU

The EU's first core instrument of modern capital market regulation was the *Investment Services Directive* of 1993.[13] It was replaced by the *Markets in Financial Instruments Directive* (MiFID I) of 2004[14]. In 2017, the revised *Directive on Markets in Financial Instruments* of 2014 (MiFID II)[15] in turn replaced MiFID I.[16] This Directive is seen as "at least as broad and ambi-

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10 A comparative historical overview can be found with H. MERKT, Zur Entwicklung des deutschen Börsenrechts von den Anfängen bis zum Zweiten Finanzmarktförderungsgesetz, in: Hopt/Rudolph/Baum (eds.), Börsenreform (Stuttgart 1997) 17; A. FLECKNER, Exchanges, in: Basedow/Hopt/Zimmermann/Stier (eds.), The Max Planck Encyclopedia of European Private Law (Oxford 2012) Vol. I, 658.

11 The original version of the Act is reprinted at H. POHL, Deutsche Börsengeschichte (Frankfurt a.M. 1992) 377 ff.

12 A classical analysis of the U.S. regulatory setting can be found with L. LOSS, Fundamentals of Securities Regulation (Boston/Toronto 1988) 35 ff.

13 Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, Official Journal L 141, 11.6.1993, p. 27.

14 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, Official Journal L 145, 30.4.2004, p. 1.

15 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, Official Journal L 173, 12.6.2014, p. 349.

16 An informative overview can be found with D. BUSCH/G. FERRARINI (eds.), Regulation of the EU Financial Markets: MiFID II and MiFIR (Oxford 2017).

tious as the Dodd-Frank Act" – the US's regulatory response of 2010 to the global financial crisis.[17] The three consecutive Directives – together with their accompanying regulatory instruments – are regarded as the "basic law" of the EU financial markets and the central building block for the EU regulatory architecture that governs the provision of investment services in financial instruments by investment firms throughout the European Union. It primarily promotes market integration by granting market access and market integrity by regulating market supervision. As part of this, it also emphasizes investor protection as a regulatory goal in its own right. Thus, the Directives pursue the two-fold aim of protecting investors and ensuring the smooth operation of securities markets.[18] It should be noted that, from the beginning, the regulatory regime of capital markets law in the EU embraced the information model.

EU regulation in general comes in two forms: either in the form of a directive that needs to be implemented in the Member States' national laws to be applied or, increasingly, in the shape of a regulation that is directly applicable in the Member States without the need for prior implementation. A prominent example of the latter is the *Markets in Financial Instruments Regulation* (MiFIR) of 2014,[19] which supplements MiFID II and should therefore be read together with the Directive.[20] All directives are accompanied by delegated regulatory instruments.[21] In our context, the *Delegated Regulation* 2017/565 of 2016[22] is of special interest. As far as they apply, regulations directly replace the prior national Member States' law.

17 The Economist, 30 September 2017, 15.

18 *Cf.* Recital 44 of MiFID I, Recitals 3, 7 (et passim) of MiFID II; for a critical review of the specific aims and means of investor protection, *see* P. MÜLBERT, Anlegerschutz und Finanzmarktregulierung – Grundlagen, Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 177 (2013) 160–211.

19 Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, Official Journal L 173, 12.6.2014, p. 84.

20 *Cf.* Recital 7 of MiFID II.

21 For an overview over the EU's regulatory architecture *see* M. LEHMANN/ C. KUMPAN, Financial Services Law (Baden-Baden 2018, forthcoming); R. VEIL (ed.), European capital markets law (2nd ed., Oxford 2017); N. MOLONEY, EU securities and financial markets regulation (Oxford 2014).

22 Commission Delegated Regulation (EU) 2017/565 of 25 April 2016, supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, Official Journal L 87, 31.3.2017, p. 1; to be applied from 3 January 2018.

2. *Germany*

The first major step to creating a modern capital market regulation was the enactment of the *Securities Trading Act* (STA, *Wertpapierhandelsgesetz – WpHG*) in 1994,[23] which implemented the EU's *Investment Services Directive* of 1993. Since then the STA has been amended numerous times to adopt the multitude of increasingly comprehensive reforms of pertinent EU regulation. The Act constitutes the legislative foundation of German capital market regulation and is characterized by a market-based approach.[24] Partly for historical reasons and partly because of the regulatory dynamics within the EU, various specific other laws dealing with different activities in the capital markets complement the STA.[25] Additionally, since 2016, the EU's *Market Abuse Regulation*[26] has replaced those previous sections of the STA that dealt with insider trading and market abuse. From 3 January 2018, MiFIR and the *Delegated Regulation* 2017/565 mentioned above will be directly applicable, partly substituting for sections of the STA, partly supplementing the Act. The STA itself was substantially revised in 2017 in order to implement MiFID II into German law. The major parts of the revised STA also enter into force on 3 January 2018 (hereafter "STA 2018" as opposed to the [old] STA). In short, capital market law in Germany resembles a kind of regulatory kaleidoscope but, all of the regulatory instruments stipulate, among others, varying types of information duties as a means of investor protection.

III. INFORMATION

1. *Information Matrix*

When we look at the manifold forms of information duties stipulated under the various regulatory instruments we see a complex matrix: The duties vary depending on, first, who of the different market players offers, second, what

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23 Gesetz über den Wertpapierhandel *(Wertpapierhandelsgesetz – WpHG),* Act of 26. July 1994 (Federal Law Gazette I, 1749), as redrafted by Publication of 9 September 1998 (Federal Law Gazette I, 2708) and as amended by the Act of 17. August 2017 (Federal Law Gazette I, 3202).

24 *See* A. FUCHS, in: *id.* (ed.), WpHG (2nd ed., Munich 2016) Einl., marginal note 4 f.

25 The most important being the Securities Prospectus Act *(Wertpapierprospektgesetz),* the Capital Investment Act *(Kapitalanlagegesetzbuch),* the Stock Exchange Act *(Börsengesetz),* and the Takeover Act *(Wertpapiererwerbs- und Übernahmegesetz)* to name but a few.

26 Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, Official Journal L 173, 12.6.2014, p. 1.

kind of financial services to, third, which type of investor or "client". The major players in the capital markets are marketplaces (e.g. exchanges), financial intermediaries (e.g. investment services firms like banks), issuers, and information intermediaries (e.g., rating agencies). With respect to clients, the STA distinguishes between three different classes of "clients": professional clients (institutional investors), retail clients (private investors), and eligible counterparties. In the context of this paper we will restrict our discussion to the information duties that are attached to the professional handling of financial products (or, in the legislative parlance, "financial instruments") in the secondary market in the form of the provision of "investment services" by "investment services firms" to "retail clients".[27]

Investment services within the meaning of the Act include, among others and broadly speaking, the promotion, recommendation, offering, purchase or sale of financial instruments.[28] *Financial instruments* are namely shares in companies, debt securities and derivatives.[29] *Investment services firms* are, in Germany, mostly banks that provide investment services.[30] *Retail clients* are clients who are not professional clients.[31] Professional clients are in turn investors whom an investment services firm can assume possess sufficient experience, knowledge and expertise to make their own investment decisions and properly assess the risks that they incur.[32] The protection provided by the STA depends on the type of client.[33] This concept of layered levels of protection is upheld under MiFID II and thus under the STA 2018. The Directive

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27 Information duties in primary market come in form of issuer disclosure under prospectus regulation.

28 Sec. 2 (3) STA (in future Sec. 2 (8) STA 2018); for details see H. BAUM, in: Hirte/Möllers (eds.), Kölner Kommentar zum WpHG (2nd ed., Cologne 2014) § 2, marginal notes 141 ff.

29 Sec. 2 (2b) STA (in future Sec. 2 (4) STA 2018); for details see G. ROTH, in: Hirte/Möllers, *supra* note 28, at § 2, marginal notes 14 ff.

30 Sec. 2 (4) STA (in future Sec. 2 (10) STA 2018); for details see BAUM, *supra* note 28, at § 2, marginal notes 216 ff.

31 Sec. 31a (3) STA (in future Sec. 67 (3) STA 2018); for future details *see* P. BUCK-HEEB/D. POELZIG, Die Verhaltenspflichten (§§ 63 ff. WpHG n.F.) nach dem 2. FiMaNoG – Inhalt und Durchsetzung, Zeitschrift für Bank- und Kapitalmarktrecht (BKR) 2017, 485.

32 Sec. 31a (2) STA (in future Sec. 67 (2) STA 2018); for details see T.M.J. MÖLLERS, in: Hirte/Möllers, *supra* note 28, at § 31(a), marginal notes 40 ff.

33 The German legislator (like the EU regulator) sharply distinguishes between consumer protection and investor protection. Capital markets regulation is addressed to investors whether these are consumers or not. If they also fall under the latter category, an additional layer of consumer protection may apply under certain circumstances like, e.g., in the context of door-to-door selling; for a discussion of this is-

stipulates that measures to protect investors should be adapted to the particularities of each category of investors although, irrespective of the categories of clients concerned, the principle of acting honestly, fairly and professionally and the obligation to provide fair, clear and not misleading information duties apply to the relationship with all clients.[34]

2. *Information Duties under the STA*

The above is reflected in the regulation of information duties under the STA. All information, including marketing communications, which investment services firms make available to their clients must be fair, clear and not misleading and marketing communications must be clearly identifiable as such.[35] Investment services firms are required to provide clients with information in a comprehensible form and in a timely manner. This information must be reasonably appropriate for these clients to understand the nature of, and risks involved with, the financial instruments or investment services being offered or demanded, and to take investment decisions on this basis. This information must relate to: the investment services enterprise and its services; the types of financial instruments and proposed investment strategies, including the risks associated therewith; the execution venues; and the costs and associated charges.[36] Regarding the risks of financial instruments, the investment services firms must not only inform about the risks specifically inherent to the given product, but also about the general risk that its issuer might become insolvent and a unable to repay, resulting in a loss of the capital invested.[37] All relevant aspects of the various types of information to be provided are laid out in great detail in an ordinance.[38]

One of the central regulations for the protection of retail investors is the so-called "appropriateness rule".[39] An investment services firm that provides either investment advice or financial portfolio management must obtain from its clients all *information* necessary to enable the recommendation of financial instruments or investment services that are appropriate for

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sue, *see* P. BUCK-HEEB, Vom Kapitalanleger- zum Verbraucherschutz, Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 176 (2012) 66.

34 Recital 86.

35 Sec. 31 (2) STA (in future Sec. 63 (6) STA 2018).

36 Sec. 31 (3) STA (in future Sec. 63 (7) STA 2018).

37 One could argue that the latter general risk is self-evident, *see* H. BAUM, Garantie-Zertifikate und 'Emittentenrisiko': Hinweispflicht in Werbefoldern?, Der Gesellschafter. Zeitschrift für Gesellschafts- und Unternehmensrecht (GesRZ) 2010, 311.

38 Sec. 4 ff. Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung, Ordinance of 20. July 2007 (BGBl. I, 1432) as amended; in future Art. 48 Delegated Regulation 2017/565.

39 Sec. 31 (4) STA (in future Art. 54 (2) Delegated Regulation 2017/565).

their clients, as will be explained hereafter. For an investment services firm that provides neither investment advice nor financial portfolio management but other financial services, the appropriateness rule also applies but is less strictly conceived.[40]

If an investment services firm plans to provide investment advice or financial portfolio management, it has to determine beforehand whether the product or investment service offered or demanded is appropriate for the given client. For this, the investment services firm must collect the relevant information from its client and undertake an assessment as to whether the pertinent investment service satisfies the following three criteria: (i) does it meet the investment objectives of the client in question, including the client's risk tolerance?; (ii) is the client financially able to bear any related investment risks consistent with his investment objectives?; (iii) does the client have the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio? The aim is to create a basis of understanding, enabling the investment services firm to provide the client with appropriate *information* and competent investment advice, which in turn enables a retail investor to make a rational evaluation of the risks of his or her own investment decision.

An investment services firm is entitled to rely on the information provided by its clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.[41] If the investment services firm does *not obtain* the information required, it may *not* recommend a financial instrument when it provides investment advice.[42] If the firm *does obtain* the information required it may recommend to its clients *only* those financial instruments and investment services that are appropriate based on the information obtained.[43] The overarching regulatory aim is thus *information,* but not paternalism. If the investor has received all relevant information in an appropriate form, he or she has to bear the economic consequences of the investment decision ("information model").

3. *Information Duties Created by the Courts*

Largely independent of the pertinent EU law and partly earlier to that, German courts developed an information-based approach when judging the civil liability of investment firms towards their clients. Insufficient regulation and supervision had led in the 1980's to wide-spread scandals defrauding investors. The scandals produced a flood of decisions by the German

40 Sec. 31 (5) STA (in future Sec. 63 (10) STA 2018).
41 (For the future) Art. 55 (3) Delegated Regulation 2017/565.
42 Sec. 31 (4) STA (in future Art. 54 (8) Delegated Regulation 2017/565).
43 Sec. 31 (4a) STA (in future Art. 54 (9) Delegated Regulation 2017/565).

Federal Court of Justice and appellate courts dealing with the duties of investment firms when providing investment services and especially when giving investment advice. The lack of specific statutory duties caused the German courts to develop standards based on general private law to be followed by the securities industry – the so-called "Bond"-jurisprudence.

The first major decision was the famous "Bond Judgment" by the Federal Court of Justice in 1993.[44] In its decision, the Court formulated the basic duty that investment advice has to be tailored, first, according to the need of the specific investor and, second, to the characteristics of the investment product in question. This rule is still held valid today. The basis of such information is either an explicit or, mostly, an implied advisory contract between the bank and its client. German courts regularly assume the implicit conclusion of such a contract from the moment the bank and its client start an advisory talk that concerns financial products. The result of this 25 years of development of case law is a highly refined structure of rights and obligations in the area of investment services based on private law rules, namely contract law and agency, as interpreted and developed by the courts. Statutory capital markets regulation played only a very marginal and indirect role in this context, if any.

Some 20 years later, the Federal Court of Justice issued the so-called "Spread Ladder Swap Judgment". In this controversial decision of 2011, the Federal Court of Justice extended the parameters of the Bond judgment for information duties of investment services firms when advising clients in complex and purely speculative swap transactions without underlying business transactions.[45] The Court interpreted the fact that the swap in question

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44 Decision of 6 July 1993, Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 123, 126; confirmed by BGH, decision of 9 May 2000, Wertpapier-Mitteilungen (WM) 2000, 1441; BGH, decision of 25 June 2002, WM 2002, 1683; BGH, decision of 21 March 2006, WM 2006, 851; BGH, decision of 25 September 2007, Zeitschrift für Bank- und Kapitalmarktrecht (BKR) 2008, 199; BGH, decision of 19 February 2008, WM 2008, 825; BGH, decision of 12 May 2009, WM 2009, 1274; BGH, decision of 22. March 2011, BGHZ 189, 13; BGH, decision of 27 September 2011, BGHZ 191, 119; BGH, decision of 12 November 2013, WM 2014, 24; BGH, decision of 8 April 2014, WM 2014, 1036; for an analysis, see V. LANG/P. BALZER, Die Rechtsprechung des XI. Zivilsenats zum Wertpapierhandelsrecht seit der Bond-Entscheidung, in: Habersack et al. (eds.), Festschrift für Gerd Nobbe (Cologne 2009) 639; A. HELLGARDT, Praxis- und Grundsatzprobleme der BGH-Rechtsprechung zur Kapitalmarktinformationshaftung, Der Betrieb (DB) 2012, 673.

45 Decision of 22 March 2011, Entscheidungen des Bundesgerichtshofes in Zivilsachen (BGHZ) 189, 13; for a detailed analysis of that decision *see* H. C. GRIGOLEIT, Grenzen des Informationsmodells, in: Habersack et al. (eds.), Anlegerschutz im Wertpapiergeschäft. Bankrechtstag 2012 (Berlin 2013) 25 ff. The decision was con-

had an initial negative market value hidden in its complex structure as an indication for a severe conflict of interest for the bank selling the swap and held the bank without any restriction liable for damages because of its failure to inform the investor about this conflict beforehand. It did not make a difference that the pertinent investor was a medium sized company represented by its financial officer (a qualified economist) and not a retail investor. The Federal Court furthermore stated that the bank must make sure that its client (i) fully understands risk of the financial instrument involved in all its aspects and (ii) has achieved basically the same understanding and knowledge as the bank with respect to the product.

Regarding this second line of reasoning by the Federal Court, the decision has been criticized as overstretching the information duties of investment services firms and as an invitation for frivolous suits.[46] The decision indicates a paradigmatic shift in the interpretation of the information model.[47] Until this point, banks were obliged to deliver appropriate information on the financial instruments they promote and sell to their clients. Once that was done, clients could not hold them liable for any losses resulting from the purchase of that instrument. Now, that is no longer sufficient, banks must make also sure their clients had fully understood the information supplied. At least with regard to complex financial instruments this is virtually impossible and thus, in effect, the ruling leads to a *de facto* prohibition of such products (which may or may not be a good thing – probably a good one – but, it is scarcely a policy decision to be made by the courts instead of the legislator).[48] In other words, the baanks have to bear the consequences of the information overload caused by over ambitious regulatory demands. A more straightforward, but highly paternalistic, and also in itself questionable, approach would be a general prohibition of such products by the legislator.[49]

4. Tension Between Public and Civil Law Information Duties

The information duties established under the STA differ in scope and, partially, also in content from those created by the German courts. Capital market regulation is intended to guaranty a *general* and *preventive* protection that is granted *ex ante,* which is typical for public law. This contrasts

firmed by further decisions of the Federal Court of Justice in 2015, for an overview *see* P. CLOUTH, Aufklärungs- und Beratungspflichten bei Swaps, in: Grüneberg et al. (eds.), Bankrechtstag 2015 (Berlin 2016) 163.

46 GRIGOLEIT, *supra* note 45, at 62 f.; for frivolous investor suits *see infra* at IV.2.

47 J. KOCH, Grenzen des informationsbasierten Anlegerschutzes, Zeitschrift für Bank- und Kapitalmarktrecht (BKR) 2012, 485, at 487 ff.

48 *Ibid.,* at 490 f.

49 *See infra,* at V.2.

with the *individual* protection courts provide *ex post* in a given case, which is characteristic for private law enforcement.

From the traditional German point of view, the regulatory regime of the STA qualifies as a regulation that falls into the domain of public law – as opposed to that of private law. German legal doctrine makes a clear distinction between (mandatory) public law and private law that is largely not mandatory but ruled by party autonomy. The EU, however, does not know such a clear distinction. The EU has refrained from unifying civil law because of the lack of authority. The *Treaty on the Functioning of the European Union* of 2012[50] does *not* provide a general authority for a unification of private law. There are some limited exceptions such as consumer protection or product liability but, in general, the EU has respected the substantial conceptual differences between the private law regimes in the Member States and has been hesitant to interfere in contractual relations between citizens out of fear of disrupting the consistency of national private law regimes. This lack of harmonization allows the German courts to deal with the liability of investment firms towards their clients under *national* civil law without being bound, at least not directly, by EU law.

By dealing with the way the firms have to do business in relation to their customers, the conduct of business rules in Sec. 31 ff. STA / Sec. 63 ff. STA 2018, despite being public law in principle, obviously have at least some connection with the contractual relations between an investment services firm and its customers and thus with private law. Accordingly, these rules are often qualified as "functional" civil law. The central question that arises here is whether the rules do actually create civil law effects, which interfere in the contractual relations and which the courts have to take into account.[51]

The answer has obvious practical consequences. If one sees the MiFID as a legal instrument that creates such effects, it would imply, among other conclusions, that investors are entitled to claim damages from the investment firms, which are in breach of the conduct of business rules under the STA. The Directive is – somewhat surprisingly – quiet on these matters. As before, Art. 51 of MiFID I, now Art. 70 of MiFID II, only postulates that the Member States must ensure in their national laws that their competent authorities may impose administrative sanctions and measures applicable to

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50 Official Journal of the European Union, C 326, 26 October 2012.

51 *See* H. BAUM, Public vs. Civil Law: The German Controversy About the Interaction Between Capital Market Regulation and Contract Law, Hikakuhō Zasshi 48/3 (2014) 41; ID., Das Spannungsverhältnis zwischen dem funktionalen Zivilrecht der 'Wohlverhaltensregeln' des WpHG und dem allgemeinem Zivilrecht, Österreichisches Bank Archiv (ÖBA) 2013, 396; from the Austrian perspective M. OPPITZ, Kapitalmarktaufsicht (Vienna 2017) 391 ff.

all infringements of the Directive, MiFIR and national provisions adopted in the implementation of these. Member States must also ensure that these measures are effective, proportionate, and dissuasive. The *European Court of Justice (ECJ)* ruled in May 2013 that the Member States are free to decide whether or not they want to implement civil law sanctions against a violation of conduct of business rules.[52] If they do, however, the civil law effects have to be effective and proportionate.

A major question is therefore how the interaction of supervisory law and civil law can be managed and it has yet to be clarified how "functional" civil law can be consolidated with the traditional (general) civil law framework in the face of the pronounced dichotomy between public and private law that emerged in the early nineteenth century in German law.[53] This is an unsolved fundamental issue permeating all German capital market regulation.[54] While the duties of investment services firms based on private law as elaborated by the courts and their obligations under the conduct of business rules qualified as "functional" civil law do overlap part of the supervisory law to a certain extent, they are *not* identical. As a rule, the contractual duties developed by the German Federal Court of Justice for investment services firms are more *comprehensive* than the obligations resulting from supervisory law.[55] Thus the question is whether *only* behavior which fulfills *both* the private *and* the public law requirements is legitimate, or whether behavior that fulfills at least *one* of the two standards is also covered, and, if so, whether the *lighter* or the *stricter* standard should be the guideline. Three opposing views can be observed.

The Federal Court of Justice postulates a strict primacy of civil law in relation to the conduct of business rules of the STA.[56] According to the Federal Court, the conduct rules exclusively qualify as public law and es-

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52 Decision of 30 May 2013 – Rs. C-604/11 (Juzgado de Primera Instancia n° 12 de Madrid, Spain), Zeitschrift für Wirtschaftsrecht (ZIP) 2013, 1417; *see* also ECJ, decision of 19 December 2013 – Rs. C-174/12 (Handelsgericht Wien, Austria), Die Aktiengesellschaft (AG) 2014, 445.

53 K. ROTHENHÖFER, Interaktion zwischen Aufsichts- und Zivilrecht, in: Baum et al. (eds.), Perspektiven des Wirtschaftsrechts. Beiträge für Klaus J. Hopt (Berlin 2008) 55; for an extended discussion, see J. FORSCHNER, Wechselwirkungen von Aufsichtsrecht und Zivilrecht (Tübingen 2013).

54 S. GRUNDMANN, Wohlverhaltenspflichten, interessenkonfliktfreie Aufklärung und MiFID II, Wertpapier-Mitteilungen (WM) 2012, 1745.

55 But sometimes it is also the other way round: the obligations under the "functional" civil law are stricter than the ones under general civil law.

56 *See* especially the Federal Court's reasoning in the decision of 17 September 2013, JuristenZeitung (JZ) 2014, 252, at nos. 15 – 24; for a comment see C. KROPF, Keine zivilrechtliche Haftung im beratungsfreien Anlagegeschäft, Wertpapier-Mitteilungen (WM) 2014, 640.

tablish only public law duties that have absolutely *no* civil law effects of their own.[57] In the view of the Federal Court, the conduct rules thus have neither a limiting nor an enlarging effect with respect to the civil law liability of investment firms.[58] A second opinion, diametrically opposed to the first one, emphasizes an unrestricted primacy of the "functional" civil law of the STA over the general civil law. Proponents of this view argue that the conduct of business rules have to be qualified as general civil law rules – though located outside the Civil Code – because of MiFID's expressed legislative aim of investor protection.[59]

A third view builds a compromise between these two contradictory views: it does not claim a primacy of public law in the form of "functional" civil law, but much more modestly assumes a "diffusion" *("Ausstrahlung")* of the pertinent public law rules into the general civil law and its application. This is probably the leading opinion in German academia today.[60] The "diffusion" is accordingly reduced to a *potential* but *not* mandatory interaction between both spheres of law. Supervisory law *might* influence contract law, but it does not necessarily do so.[61] The civil courts should have the freedom to deviate from the duties defined in the conduct of business rules as they deem appropriate.[62]

IV. Challenges to the "Information Model"

The concept of the "information model" as the basis for capital market regulation is challenged from two sides.

1. Bounded Rationality, Lack of Expertise, Information Overload

Recently, doubts have grown whether the fundamental assumption that a properly informed investor makes always a reasonable investment decision is

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57 *Id.* at nos. 16–18.

58 Somewhat more ambiguous BGH, decision of 3 June 2014, Zeitschrift für Bankrecht und Bankwirtschaft (ZBB) 2014, 421; *cf.* R. FREITAG, Überfällige Konvergenz von privatem und öffentlichem Recht der Anlageberatung, *Ibid.,* 357.

59 *See, e.g.,* GRUNDMANN, *supra* note 54, 1752; D. EINSELE, Verhaltenspflichten im Bank- und Kapitalmarktrecht – öffentliches Recht oder Privatrecht?, Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 180 (2016) 233.

60 For a detailed discussion, *see* FORSCHNER, *supra* note 53, at 113 ff.; ROTHENHÖFER, *supra* note 53, at 70 ff.; FUCHS, *supra* note 24, vor §§ 31 bis 37a, marginal notes 76 et seq.; each with extensive further references.

61 R. SETHE, Anlegerschutz im Recht der Vermögensverwaltung (Cologne 2005) 749.

62 GRIGOLEIT, *supra* note 45, at 39 f.

valid under all circumstances.[63] The fallout of the global financial crisis has amplified these doubts. Research in behavioral finance has shown that the average investor does not necessarily behave rationally. Among others, one can observe an asymmetrical approach to risk and chances, overconfidence as well as over optimism, an "irrational exuberance", and herd behavior influencing the investment decisions of retail investors.[64] Furthermore, these investors often have no expertise in financial matters in general, let alone any understanding of complex structured (derivative) financial products where the true relationship of risks and chances is hidden by their complexity. Also, and most critically, too much or overly complex information leads to a complete non-reception of information as cognitive limits prevent further processing ("information overload" or "information overkill").[65] In particular, prospectuses supplying extensive information as a precondition for initial public offerings of shares and other financial products are, as a rule, by far too long and complex for retail investors. These investors, furthermore, often do not the read periodical disclosures (annual reports etc.) of the companies in which they have invested. Thus, basic assumptions of the information model seem to come into question when speaking of retail investors.

2. *General "Right of Repentance"?*

A second challenge to the information model comes from what can be dubbed "right of repentance". German courts have been overwhelmed in the last two decades with tens of thousands of investor suits seeking damages from issuers and/or investment firms. An early climax came in 2001 when some 17,000 shareholders of *Deutsche Telekom* filed roughly 2,500 individual lawsuits as plaintiffs against the company at the Frankfurt trial court, involving more than 700 attorneys. Retail investors who had lost most of their investments due to a dramatic drop in the company's share price claimed the relevant prospectus had been false. The German legisla-

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63 For an interdisciplinary state of the art discussion *see* K. U. SCHMOLKE, Information and Disclosure Duties from a Law-and-Economics Perspective – A Primer, in this volume, with manifold further references; *see* further the overviews by D. ZIMMER, Vom Informationsmodell zu Behavioral Finance: Brauchen wir „Ampeln“ oder Produktverbote für Finanzanlagen?, JuristenZeitung (JZ) 2014, 714, L. KLÖHN, Der Beitrag der Verhaltensökonomik zum Kapitalmarktrecht, in: H. Fleischer/D. Zimmer (eds.), Beitrag der Verhaltensökonomie (behavioral economics) zum Handels- und Wirtschaftsrecht (Frankfurt am Main, 2011) 83.

64 *Ibid.*

65 *See* S. KALSS, Das Scheitern des Informationsmodells gegenüber privaten Anlegern, in: Gutachten für den 19. Österreichischen Juristentag, Bd. II/1 (2015) 3, 21; GRIGOLEIT, *supra* note 45, at 25 ff.; for a comprehensive discussion *see, e.g.,* C. STAHL, Information Overload am Kapitalmarkt (Baden-Baden 2013).

ture reacted by enacting a special law in 2005, the so-called "Capital Markets Model Case Act".[66] The aim of the Act is to provide a means for collective redress for investors, especially retail investors, who have suffered damages because of faulty capital markets information.[67]

One reason for the frequent redress to the courts is that the private law investor protection by the German courts is functioning well, sometimes even too well. Increasingly, courts have shown a tendency to overshoot, making peripheral or only perceived violations of the constantly expanding information duties a base for granting investors damages or even a right to rescind the contract.[68] This leads to the reverse problem of an open misuse of information duties and a perversion of investor protection providing an opportunity to step back *ex post* and be free of costs resulting from failed investment decisions.[69] The pertinent court decisions are in danger of creating *contra legem* a "right of repentance" *("Reuerecht")* and a general liberation of contractual duties violating the principle of *pacta sund servanda*. Investors take a chance of making profit with their investments, but in case of failure they refuse to bear the negative economic consequences and try to shift the loss to the investment services firms as their contract partners and/or advisors. In effect, this strategy amounts to nothing more than a socialization of their losses to the detriment of the public, i.e. other customers and owners (often shareholders) of the investment services firms. Courts in Germany as well as in Austria are swamped with such frivolous suits not only in the area of capital markets law but also in other consumer related fields of law. This poses an unexpected challenge to the information model.

In the light of the above findings, some simply state that the information model has failed with respect to private (retail) investors.[70]

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66 Kapitalanleger-Musterverfahrensgesetz (KapMuG) of 19 October 2012 (Federal Law Gazette I, 2182), last amended by Art. 16 (1) of the Act of 30 June 2016 (Federal Law Gazette I, 1541).

67 For a brief overview in English *see* H. BAUM, The German Capital Markets Model Case Act – A Functional Alternative to the US-Style Class Action for Investor Claims?, available at *http://ssrn.com/abstract=2909545*.

68 KALSS, *supra* note 65, at 23.

69 For a detailed analysis *see* H. BAUM, Das prospektrechtliche Widerrufs- bzw. Rücktrittsrecht im Spannungsverhältnis zwischen Anlegerschutz und Reuerecht: gestörte Vertragsparität zu Lasten der Kreditinstitute, Österreichisches Bank Archiv (ÖBA) 2018 (forthcoming); ID., Reuerecht und Emittentenrisiko – Grenzen der Aufklärungspflicht aus prospektrechtlicher und beratungsvertraglicher Sicht, Der Gesellschafter. Zeitschrift für Gesellschafts- und Unternehmensrecht (GesRZ) 2015, 11.

V. Regulatory Reactions

The German legislator opened the regulatory floodgates in reaction to the fallout of the global financial crisis.[71] Among others, the following legislative reforms have a specific reference to information duties.

1. *Key Information Document*

In 2011, Germany introduced the obligation for investment services firms, when providing investment advice to retail clients, to supply a brief and easily understandable information sheet concerning the financial instruments being recommended for purchase. This has to be done well before a transaction in these instruments is concluded.[72] The information provided must not be false or misleading and must be in accordance with the information given in the prospectus. The obligation to supply such an information sheet arises only in relation to retail and not to professional clients and only with respect to certain types of financial instruments.[73] The length of the document depends on the complexity of the instrument in question: up to 2 pages as a rule and the maximum length is 3 pages in a pre-defined format. The restriction of length is mandatory.

The German initiative was a national one in reaction to the fallout of the global financial crisis and (at that time) not induced by European Community law. Due to the implementation of MiFID II, this obligation applies from 2018 onwards for *all* financial products, although still only within the context of investment advice provided to retail investors.[74] Additionally, at the end of 2016 the EU Regulation on Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs) became effective, and is directly applicable in the Member States.[75]

The main purpose of the short information documents is to reduce the amount and the complexity of information – ironically induced by government regulation to enhance the information model – to avoid “information overload” especially for the average retail investor.[76]

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70 Kalss, *supra* note 65, at 23.

71 *See supra* at I.

72 Sec. 31 (3a) STA.

73 Details are regulated in Sec. 5a Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung.

74 Sec. 64 (2) STA 2018.

75 Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products, Official Journal L 352, 9.12.2014, p.1.

76 *See supra* at IV.1.

2. *Product Governance and Product Intervention*

In reaction to the global financial crisis and perceived shortcomings of the information model, the EU Commission introduced the regulatory means of "product governance" and "product intervention".[77] MiFID II introduced a system of "product governance". Art. 24 (2) MiFID II obliges investment services firms, which manufacture financial instruments for sale to clients, to make sure that the instruments have been initially designed to meet the needs of an identified target market of end clients. Also, the strategy for the distribution of these financial instruments must be compatible with the identified target market, and the firm has to take reasonable steps to ensure that the financial instruments are (only) distributed to that market.[78]

The Markets in Financial Instruments Regulation (MiFIR) of 2014[79] introduced a "product intervention" by the competent authorities as a regulatory measure which will be effective from 2018 and applies directly in the Member States. The powers of the authorities are complemented with an explicit mechanism for prohibiting or restricting the marketing, distribution and sale of any financial instrument that gives, among others, rise to serious concerns regarding investor protection or the orderly functioning and integrity of financial markets.[80] Appropriate coordination and contingency powers were vested with the European Securities and Markets Authority (ESMA).[81]

A competent authority may prohibit or restrict the marketing, distribution or sale of financial instruments or financial activities if it is satisfied on reasonable grounds that the pertinent financial instrument or activity gives rise to significant investor protection concerns or poses a threat to the orderly functioning and integrity of financial markets and, furthermore, that the existing regulatory requirements under Union law such as, e.g., information duties, applicable to the financial instrument or activity do not sufficiently address the risks.[82] The action has to be proportionate with respect to the nature of the risks identified, the level of sophistication of investors

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77 For an overview of the new regime *see* D. BUSCH, Product Governance und Produktintervention unter MiFID II/MiFIR, Wertpapier-Mitteilungen (WM) 2017, 409. The regulation was preceded by the Final Report of the International Organization of Securities Commissions (IOSCO), Regulation of Retail Structured Products (2013), that discusses some similar measures; available at *https://rdmf.files.wordpress.com/2014/01/informe-iosco.pdf*

78 For an overview from the German perspective *see* P. BUCK-HEEB, Der Product-Governance-Prozess – MiFID II, Kleinanlegerschutzgesetz und die Auswirkungen, Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 2015, 782, 797.

79 *Supra* note 19.

80 *Cf.* Recital 29 MiFIR.

81 *Cf.* Art. 40 MiFIR.

82 Art. 42 (1),(2)(a),(b) MiFIR.

concerned and the likely effect of the action on investors who may hold, use or benefit from the financial instrument or activity.[83]

The German legislator had already introduced a regulation on "production intervention" in 2015 that was modeled along the lines of Art. 42 MiFIR. The aim was to create a supervisory instrument for direct intervention in the capital market. This legislative activity was motivated by the insolvencies of two issuers of financial products unsuitable for retail investors who had suffered massive losses caused by these defaults.[84] The German Federal Financial Supervisory Authority *(BaFin)* may now restrict or prohibit the marketing, distribution or sale of financial instruments etc. based upon the powers granted to it under the newly added Sec. 4b STA[85]. A first intervention in 2016 caused an intense discussion about the pros and cons of such a measure.[86]

Product governance and product intervention indicate a paradigmatic regulatory change and at least a partial departure from the information model. While the latter is based on an *ex post* control of financial instruments and services by the courts, the former relies on a paternalistic *ex ante* market control by the bureaucracy. The regulation under Sec. 4b STA / Sec. 15 STA 2018 is regarded as a general shift towards a collective consumer protection that is far more encompassing in its design than the traditional investor protection.[87] One obvious drawback is that even experienced retail investors with no need for protection are protected "by force".[88]

3. *Fee Based Investment Advice*

In 2014, the German legislator introduced a regulation for obtaining independent fee based investment advice as an alternative to the traditional commission based advisory business with its intrinsic conflicts of interest.[89] Again, the coming regulation under MiFID II was taken as a guideline. Any

83 Art. 42 (2)(c) MiFIR.

84 *See* M. BOUCHON/N. MEHLKOPP, in: Fuchs, *supra* note 24, § 4a, marginal note 2.

85 In future Sec. 15 STA 2018.

86 *See, e.g.,* J.-H. EHLERS, Das Produktinterventionsrecht der BaFin nach § 4a WpHG, Wertpapier-Mitteilungen (WM) 2017, 420; P. BUCK-HEEB, Aufsichtsrechtliches Produktverbot und zivilrechtliche Rechtsfolgen – Der Anleger zwischen Mündigkeit und Schutzbedürftigkeit, Zeitschrift für Bank- und Kapitalmarktrecht (BKR) 2017, 89.

87 J.-P. BUßALB, Produktintervention und Vermögensanlagen, Wertpapier-Mitteilungen (WM) 2017, 553.

88 BUCK-HEEB, *supra* note 3.

89 Sec. 31 (4)(b)–(d) STA (in future Sec. 64 (1),(5),(6) STA 2018); for an overview *see* P. BALZER, Rechtliche Rahmenbedingungen der Honorarberatung, in: Habersack et al. (eds.), Bankrechtstag 2013 (Berlin 2014) 157.

investment services firm that intends to provide investment advice has to inform its clients beforehand whether or not it offers an independent fee based advice.[90] The legislator aimed at raising investor awareness of the difference between commission and fee based investment advice, with the intention of promoting the later.[91] The already existing duty to inform a client about the general nature and the source of unavoidable conflicts of interest prior to the execution of the transaction under Sec. 31 (1) STA was regarded as insufficient. An investment services firm that provides an independent fee based investment advice has to offer a sufficiently broad spectrum of financial instruments and may not accept monetary contributions from third parties.[92]

Whereas the UK prohibited commission based advisory business as early as 2013, the financial industry in Germany still mostly refuses to offer such advisory business on a large scale.

4. *Evaluation*

Simplifying mandatory information as well as holding investment services firms responsible for overly complex information are attempts to mitigate the problem of an information overload. The introduction of a strictly fee based investment advice may be a means to finally overcome the information and conflict of interest problems inherent to the traditional commission based advisory business model. Both measures fit into the concept of the information model. However, whether and, if so, how the (potentially) paradigmatic shift to paternalism in the form of product governance and product intervention by the supervisory authorities fits into the regulatory framework of the information model that is still officially upheld in general is an entirely open question to say the least.[93] As long as these regulatory instruments serve as a limited supplement to the information model and not as a principal alternative and substitute, we might learn to live with them. But a look to Japan may serve as a comparative caveat to a principal regulatory change towards paternalism: One should keep in mind that Japan had, till fairly recently, a long and not altogether happy history with general bureaucratic (paternalistic) *ex ante* regulation of its financial markets which was at least one of the causes of its lasting structural economic crisis.[94]

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90 Sec. 31 (4)(b) STA (in future Sec. 64 (5) STA 2018).

91 FUCHS, *supra* note 24, § 31, marginal note 202 f.

92 Sec. 31 (4)(c) STA (in future Sec. 64 (6) STA 2018).

93 Critical, e.g., P. BUCK-HEEB, *supra* note 3, 286 f.

94 *Cf.* H. BAUM, Der japanische „Big Bang“ 2001 und das tradierte Regulierungsmodell: ein regulatorischer Paradigmenwechsel?, Rabels Zeitschrift für ausländisches und internationales Privatrecht (RabelsZ) 64 (2000) 633.

IV. Insurance Law

Information Duties under Japan's Insurance Act

Yuji Ito[*]

I. Introduction
II. Information Duties Held by Insurers
  1. Characteristics
  2. Specific Examples
  3. Analysis
III. Information Duties Held by Policyholders
  1. Introduction to the Rules
  2. Analysis
IV. Conclusion
  Appendix

I. INTRODUCTION

Information duties under Japanese law are the subject of much debate among scholars and, at least for many consumers, result in much confusion.

For insurance contracts, we can view the information duty as two-directional. Put another way, an insurance contract is an agreement between an insurer and an insurance policyholder, which leads to a bidirectional dynamic.

On the one hand, there is the insurer's or the agent's[1] duty to provide information regarding an insurance contract;[2] and on the other hand, a duty is

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1 In Japan, there are two types of intermediaries in the context of insurance sales, namely, the insurance agent *(hoken boshū-nin)* and the insurance broker *(hoken nakadachi-nin)*. While the former is affiliated with an insurance company (or sometimes more than one insurance company) and works as an insurance company's agent and thus owes a duty, in principle, only to the insurance company, the latter owes a duty of good faith to his or her customer, i.e. the policyholder (Art. 299 of Business Insurance Act), so that, undoubtedly, the insurance broker owes an information duty to his or her customer.

2 Article 7 of the German Insurance Contract Act provides that the insurer owes an obligation to provide to the policyholder the conditions of an insurance contract, including the policy and other information. When scholars talk about the information duty of insurers, in most cases they are referring to this obligation in Article 7. However, when I refer to the information duty of insurers in this essay, while the duty to provide the policy to the policyholder is of course not excluded, I am not

placed on potential policyholders to provide certain information to the insurer. The former is said to be based on the ground that an insurance product is an invisible and legally constructed concept, and its features are difficult to understand, especially for consumers.[3] The latter, namely the duty of a policyholder to an insurer, is called the "duty to disclose" *(kokuchi gimu; Anzeigepflicht)*. This duty (or obligation) serves as a means for insurers to estimate risk (the possibility of the occurrence of a covered event), to decide whether they will underwrite the risk or not, and to determine the premium. Whereas the insurer's duty has become the subject of discussions only relatively recently, the duty held by policyholders has been recognized by statute since the late 19th century, and there are a plenty of precedents regarding it. This essay focuses on these two duties. More specifically, while matters related to these duties involve public and private law in certain contexts, I will explore issues related to the duties in the private law context.

II. Information Duties Held by Insurers

Let us begin with the information duties held by insurers.

1. Characteristics

The Insurance Act (hereinafter, InsA),[4] which regulates insurance contracts from the viewpoint of private law, contains no article regarding the duty of

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limiting myself to the duty to provide the policy. (For example, in a case which I share later in this essay, the main issue is the information duty to inform the policyholder of the existence of an earthquake exclusion in a fire insurance contract. If we recognize such a duty, then it is submitted that the information duty is breached even if the insurer provides the policy to the policyholder.) When scholars speak of the information duty of the insurer in Japan, the main points of view are, first, the policyholder has neither a sufficient ability to understand the conditions of contracts nor the capacity to decide whether the product matches their needs and, second, in the context of the sale of insurance products there is the potential for a salesperson to inappropriately solicit business – by explaining the policy in a misleading way, for instance – and thus there is a fear that the decision making of the policyholder could be distorted.

3 See, T. Yamashita, *Hoken-hō* [Insurance Law] (Tōkyō 2005) 178; Y. Fukazawa, *Hoken boshū* [Sale of Insurance], in: Yamashita/Nagasawa (eds.) *Ronten taikei hoken-hō 1* [Survey of issues on insurance law, vol.1] (Tōkyō 2014) 32.

4 *Hoken-hō,* Law No. 56/2009. Legislation establishing the InsA was adopted in 2008, and the Act came into effect in 2010. Before the promulgation of the InsA, rules in the area of private law regarding insurance contracts were based in the Commercial Code *(Shōhō, Law No. 48/1899),* which came into force in 1899 and was slightly

an insurer to provide information.[5] Thus, it is necessary to look at court cases in order to examine the extent to which that duty is recognized and the function the duty is performing. With that in mind, I am going to deal with these problems by introducing a few characteristic court cases. Before that, however, I would like to explain some of the characteristics of the insurer's information duty in Japan.

First of all, it should be noted that, in Japan, courts deal with insurers' information duties mainly under the law of tort.[6] One reason for this is that there are no articles in the InsA which define insurers' information duties. In addition, Article 709 of Japan's Civil Code allows for an easier and more flexible recognition of a tort in comparison with German law. Under Article 709, a plaintiff can bring a tort action alleging an infringement of a "protected legal interest".[7] In contrast, Article 823 of the German Civil Code sets a higher standard for the recognition of a tort: infringement of so-called "other rights" *(sonstiges Recht).*

It should be noted that these characteristics of Japanese regulations on insurers' information duties lead to an interesting difference between German law and Japanese law. What I mean by this is that the duty to inform is dealt with as a matter of tort law in Japan, and because of that, the agent or intermediary holds primary liability to the policyholder while the insurance company (as a principal) holds secondary liability.[8] By contrast, in Germany it

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amended with respect to the part regulating insurance law in 1911. The contents had not been changed from that point on.

5 In the legislative process associated with the InsA, there was debate on whether the Act should include an article on the duty of the insurer to compensate the damage of the policyholder and/or the right to cancel the contract on the side of the policyholder. In the early stages of the legislative process, however, the proposal to include such an article was abandoned. The reasons behind this were apparently twofold: (i) There are detailed rules about providing information in laws and/or guidelines based on the Insurance Business Act (to which I refer later), and (ii) the existence of a duty to inform on the side of insurance companies is established in court cases. See, M. KOBAYASHI, *Hoken-sha no jōhō teikyō gimu* [Insurer's Information Duty], in: Ochiai/Yamashita (eds.), *Aatarashii hoken-hō no jitsumu* [The New Practice under the Insurance Act] (Tōkyō 2008) 67.

6 There is another type of decision as well.

7 Article 709 of the Civil Code (*Minpō,* Law No. 9/1986, as amended by Law No. 94 /2013) provides that one who knowingly or negligently violates the rights of others or the legally protected interests of others owes a duty to compensate the damages caused by his or her act.

8 Article 715 of the Civil Code provides for a principal's liability for an agent. Article 283 Paragraph 1 of the Insurance Business Act also establishes this liability. Specifically, Article 283 states the following: "An Affiliated Insurance Company, etc. shall be liable for any damage caused by an Insurance Agent to a Policyholder in-

seems that the insurer owes a duty under contract law to inform the policyholder and that the intermediary (as a person employed to perform a task – *Erfüllungsgehilfe*) creates vicarious liability for the insurer.[9]

Secondly, the legal basis – especially the basis often cited by courts – for regarding the insurer's duty to provide information as a matter of tort can be found in a statute addressing the supervision of insurance companies called the Insurance Business Act.[10] The Insurance Business Act contains some articles regarding the information duty of insurers. But it might sound odd, because the Insurance Business Act is part of administrative law. Although it establishes a legal basis for exercising administrative actions, it does not, in principle, regulate legal relationships between private persons, and it cannot be utilized to establish a claim for compensation of damage on the part of policyholders.[11] Almost without exception, however, courts refer to this administrative duty when adjudicating a private suit involving issues regarding the information duty of insurers. And this kind of connection between private law and administrative law is a specific characteristic of Japanese case law on insurers' duties. This characteristic could become even more significant considering that the Insurance Business Act was amended in 2014 and several new articles regarding the information duty of insurers were inserted.[12]

Thirdly, while the total number of cases in which plaintiffs assert a breach of an insurer's information duty is not small, the actual number of cases in which such an assertion is recognized by the court remains low.[13]

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volving Insurance Solicitation […].” This Article is premised upon the liability that an agent owes as established under tort law. The insurance company to which the agent is affiliated with owes secondary liability.

9 DÖRNER, § 63 Rn. 10, in: Prölss/Martin, VVG (29. ed., 2015).

10 *Hoken-gyō-hō,* Law No. 105/1995, as amended by Law No. 45/2017. The Insurance Business Act regulates, for example, the organization of insurance companies, registration duties of intermediaries, and the solicitation process by intermediaries and insurance companies.

11 KOBAYASHI, *supra* note 5, 72; O. TAKEHAMMA, *Hoken keiyaku to setumei gimu, kokuchi gimu* [Insurance Contracts and the Duty to Explain – The Duty to Disclose], Hanrei Taimuzu 1178 (2005) 92.

12 Reference to this 2014 revision is made in the appendix.

13 My report excludes one unique set of violations that occurred in great number during Japan's “bubble economy” of the 1980s. Many variable life insurance plans were sold during that time. These variable life insurance plans were marketed with the promise that policyholders could save on inheritance taxes. However, when the bubble economy collapsed, many policyholders suffered big losses. Suits were then brought against insurers. Those types of plans were very complex, and although courts recognized the responsibility of the insurers, the variable life insurance plans could be viewed as financial instruments rather than traditional insurance plans. See,

Why? One plausible answer is that the agency's strict supervision under the Insurance Business Act has reduced the number of breaches. In my view, the supervisory agency in Japan, namely, the FSA (Financial Services Agency), has much more authority than BaFin, and insurance companies' staff members are always sensitive to the intention of the FSA. Of course, there may be other explanations. But at any rate, it must be kept in mind that the function which the insurers' duty of information performs in the private law arena in Japan is a limited one.

2. *Specific Examples*

Many cases involve issues surrounding the insurer's obligation to provide information in the context of a misunderstanding on the part of a policyholder as to the scope of the insurance contract's coverage in instances where an accident has occurred that is not covered by the insurance contract. In such cases, the relevant contract's provision on the scope of coverage is often examined by a court to determine whether the policyholder's coverage should remain bound by the terms of the contract. Now, I would like to provide three examples. In the first case, the court recognized a breach of duty by the insurer and awarded damages for solatium. In the second case, the court said even if a duty to explain an exception in a policy was violated, it does not lead to emotional damages. In the third case, the court said there was a breach of duty as in the first case, but, based on the rationale of the Supreme Court, it recognized actual financial loss, not solatium.

(1) Decision by the TōkyōDistrict Court, 8 September 2003[14]

The issue in this case was whether the insured suffered from a type of cancer covered by the insurance policy.

Under the terms and conditions of the insurance contract, the policyholder was entitled to ¥10 million if he or she contracted a specific disease like cancer. Epithelium cancers were excluded from coverage, however. The plaintiff, a woman who was suffering from breast cancer (in particular, ductal carcinoma in situ) and had had surgery to remove her left breast, filed a claim for an insurance payment. The insurer refused, saying carci-

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for example, Tōkyō District Court, 31 October 2005, Hanrei Jihō 1954 (2006) 84; Tōkyō Court of Appeals, 10 December 2003, Hanrei Jihō 1863 (2004) 41 (both recognized the liabilities of banks and insurance companies). In this kind of dispute, there are decisions which hold the insurance contract and the loan contract as invalid because of a mistake on the side of the policyholders (e.g., Tōkyō District Court, 21 November 2012 (no publication available); Tōkyō Court of Appeals, 31 March 2005, Kin'yū Shōji Hanrei 1218 (2005) 35).

14 Tōkyō District Court, 8 September 2003 (no publication available).

noma in situ was excluded under the policy. The plaintiff filed suit, arguing that the insurer was liable under tort law for not explaining the meaning of epithelium cancers in the policy.

The court held in favor of the plaintiff, stating the following:

"Considering the fact that carcinoma in situ is misunderstood even by some clinicians who have professional knowledge of the term's reference to a disease which can easily be excised without hospitalization like stomach cancer or colon cancer, it is easily premised that a general person who has no special medical knowledge possesses no precise information on what carcinoma in situ is and its method of treatment."

The purpose for which general people enter into an insurance contract is to be compensated for payments like the payment required for hospitalization, cure, living expenses, mitigation of mental pain/suffering, and so on; thus, if the policyholder has no recognition that carcinoma in situ as specified in an insurance contract is based on the classification of epidemiology, and does not reflect on the difficulty associated with a concrete treatment method, he or she cannot make an appropriate decision regarding entering into the contract, and there could be a chance for him or her to suffer unexpected loss.

[…] Thus, the defendant as an insurer, owes a duty to the plaintiff as an offeror of an insurance contract to explain either orally or documentarily at least this point [i.e., the definition of epithelium cancer]."

(2) Decision by the Supreme Court, 9 December 2003[15]

This case related to earthquake exception clauses in fire insurance contracts. Policyholders whose homes burned down after the Great Hanshin-Awaji Earthquake (or Kobe Earthquake) in 1995 sought insurance payments, and alternatively sought payment of solatium, alleging that the insurers should have explained the earthquake exception clauses. Therefore, issues related to the duty to inform arose. The lower court held in favor of the plaintiffs, and granted solatium for emotional distress, but the Supreme Court overturned this decision and ruled for the defendants.

The Supreme Court said:

"The decision regarding whether one enters into the earthquake insurance or not concerns not a personal interest (such as an interest related to one's life or body) but a property interest. Thus, even if an insurer's provision or explanation of information was insufficient or inappropriate, absent special circumstances, that insufficiency or inappropriateness cannot be regarded as a tort which gives rise to a claim to solatium."

(3) Decision by the Nagoya District Court, 3 March 2006[16]

This case related to the terms of automobile insurance policies. The issue here was a provision that said no insurance would be paid for a single-car

15 Supreme Court, 9 December 2003, Minshū 57 (2004) 1887.

accident. The plaintiff, the named insured and also the owner of the insured car,[17] was not in good physical condition and that fact was found by the court to be revealed to the staff of the agent (defendant) in the process of the sale of the insurance. An accident occurred in which the car veered from a road and fell into a river. Because payment of the insurance claim was denied, suit was brought against the insurance agent.[18] The plaintiff was required to show that, if the plaintiff had been given the proper information regarding the single-car accident exception, the plaintiff would have purchased another policy that would have covered a single-car accident.

The court stated:

> "The concrete contents of insurance contracts, including automobile insurance contracts, are prescribed in the policies, and these contents are complicated and include many different elements. Thus, it is not always easy for general policyholders to know the concrete contents of insurance contracts. This results in a major disparity in the knowledge or amount of information held between the insurer (the insurance company) and a policyholder, so that it could be fairly said that during the finalization and signing of an insurance contract, the explanation by the insurer has tremendous influence on the decision making of the policyholder."

That is the reason why Paragraph No. 1 of Article 300 of the Insurance Business Act prohibits an insurer or its agent in the solicitation process from providing false information to the policyholder or the insured, or from failing to disclose thereto any important particular stipulated in the insurance contract, and imposes on the insurer and its agent a duty to explain important matters proactively.

In light of such a relationship between an insurer and a policyholder, and in light of the regulation of the Japanese Insurance Business Act, an insurer owes a duty based on the principle of good faith to explain important matters concerning the terms of an insurance contract to the policyholder. And if the insurer fails to explain these matters or if the insurer explains these matters inappropriately or insufficiently, and as a result the policyholder suffers a loss such that he cannot receive the compensation which he expected to receive from the insurance policy – and provided that (i) the policyholder would have acted in another way had he received a proper explanation from the insurer and (ii) the policyholder would have received such

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16 Nagoya District Court, 3 March 2006, Kōtsū Jiko Minji Saiban Reishū vol. 39 no. 2 (2006) 305.

17 The policyholder was a company of which the plaintiff was the CEO.

18 In this case, there was a special situation that by failing to pay the premium which is needed to establish a contract, the contract did not become effective in reality. Because that was the agent's fault, the contract was regarded as effective in the relationship between the plaintiff and the agent.

compensation had he acted in that other way – the insurer can be held liable for the damage(s) incurred by the policyholder.

The court explained:

"At the moment the request for the insurance contract was made [by the plaintiff], the plaintiff's wife told the defendant [agent] that the plaintiff was not in good health. That conversation could be regarded as pointing out the possibility for the plaintiff to be involved in an accident while he was driving the car. Thus, […] if the defendant had explained that the insurance would not be paid in the case of a single car accident, then it could be said with high probability, that the plaintiff would have sought a contract which covered a single car accident."

3. Analysis

In the wake of our consideration of the specific cases (1), (2), and (3), let us now analyze the information disclosure duties placed on insurers.

(i) First of all, with respect to the type of information that must be provided to the policyholder by the insurer, as cases (1) and (3) reflect, I think that the duty arises especially when the terms and conditions for a covered accident are not consistent with the expectations of the policyholder.

I have just referred to "the expectations of policyholders". What kind of policyholder shall we suppose here? Case (1) seems to focus on normal or universal policyholders. On the other hand, case (3) seems to focus on the exact policyholder who filed the suit. It could be interpreted in this way: Insurers owe some information duty in general, and, in cases where the special circumstances of the policyholder could be perceived by the insurer, the duty of the insurer to the policyholder can be recognized.

Plus, whether or not a provision is contrary to policyholder expectations will depend on how well-known the terms and conditions are among members of society. In this respect, earthquake exemption clauses become significant. With respect to the ruling in case (2), it is at least not impossible to interpret the Supreme Court's ruling as having acknowledged a duty falling upon insurers to provide information regarding an earthquake exception. However, in recent court cases, there is a tendency to reject the information duty regarding earthquake exceptions on the ground that they are considered to be sufficiently known by the general public.[19]

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19 For example, there are cases which reject a duty to inform the insured of the existence of an earthquake exclusion, a violation of which would lead to liability to compensate, pointing to the facts that the insurance industry makes pamphlets on the existence of the exclusion and carries out PR activities in this regard, and that books on fire insurance and earthquake insurance are sold in bookstores (see, Hakodate District Court, 30 March 2000, Hanrei Jihō 1720 (2001) 32).

(ii) Furthermore, the function of the insurers' duty to inform is fairly limited by case (2) as decided by the Supreme Court. Namely, if the policyholder seeks a remedy for a breach of the information duty regarding the terms which limit the scope of coverage, he or she must establish proof that he or she would have entered into another insurance contract without such a limitation. Although such proof was acknowledged by the court in case (3), in light of the special situation that enabled that proof,[20] it would be difficult in most cases for policyholders to establish the requisite proof.

On the other hand, if and only if the policyholder succeeds in establishing such proof is the result almost the same as in the legal construction under which the limitation terms have no binding force on the parties. This is reminiscent of the interpretation of standard contracts.

III. INFORMATION DUTIES HELD BY POLICYHOLDERS

1. Introduction to the Rules

Next, let us turn to the duties held by insurance policyholders, particularly the information duties with respect to the likelihood (i.e., the risk) of an accident. In contrast to the duties held by insurers, Japanese private law – both before the enactment of the Japanese Insurance Act and Japanese Commercial Code and after the promulgation of the Japanese Insurance Act – has prescribed duties on policyholders from the outset. Although there has been some controversy surrounding the doctrinal bases,[21] there seems to be general consensus on the practical reason(s) underlying policyholders' information duties. That is to say, it is necessary to force the policyholders to disclose the possibility of the occurrence of a covered accident in order to reduce the chance of adverse selection within the insurance market.[22]

I would now like to provide a brief overview of the information duties that the Insurance Act places upon policyholders.

First, this duty was the duty to inform insurers of "material facts" before the passage of the Insurance Act,[23] but now it is only a duty to respond to

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20 In case (3), the plaintiff had a clear intention to enter into a full coverage contract and that intention was successfully proved by the testimony of parties.

21 See, U. NISHIJIMA, *Hoken-hō shinpan* [Insurance Law New Edition] (Tōkyō 1991) 46-50.

22 See, YAMASHITA, *supra* note 3, 283.

23 See Art. 644, 678 Commercial Code before the amendment in 2002. Art. 644 para.1, which prescribed that "the insurer can cancel the contract if the policyholder knowingly or from gross negligence did not make a statement on the material facts or made the false statement at the time of contract." Although no explicit definition of "material facts" was provided, the term has been interpreted to have the same

questions as posed by the insurer.[24] The duty is not a requirement on a policyholder to voluntarily provide information as to certain facts. In addition, the information that is subject to this duty is limited to "material facts." The concept of "material facts" here includes two types of information: (1) information[25] that would be likely to increase the insurance premium or (2) facts that, if known, might cause the insurer to refuse to enter into an insurance contract.[26]

Secondly, when there is an intentional or grossly negligent breach of the information duty held by the policyholder, the insurer may cancel the insurance contract. This ability to cancel the contract (a) is not retrospective, but prospective[27] and, (b) even if a covered accident occurs before the contract is cancelled, the insurer is not obligated to make an insurance payment. Moreover, the insurer does not have to return the premiums paid up to that point in time by the policyholder. However, (c) if the covered accident was

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meaning as defined in the Japanese Insurance Act (See, Ōsaka Court of Appeals, 11 November 1999, Hanrei Jihō 1721 (2000) 47).

24 See, Art. 4 Insurance Act. Insurance Act of 2008, stating "Those who become a policyholder or an insured must inform those who become an insurer of the material facts that the latter request to be informed of; material facts include those concerning the probability of the occurrence of damage which is to be covered by a non-life insurance contract". Art. 37 provides the same for life insurance contracts.

25 It could be disputed whether information such as genetic information is permitted to be the object of the information duty of policyholders. In Japan, in contrast to some other countries, there are no legal rules which prohibit such information from being the object of information duties at this time. Yamashita claims the reason is the fact that the incidence of single gene disorders such as Huntington's disease is relatively low in Japan, so genetic testing in the context of entering into an insurance contract is not a significant concern. (YAMASHITA, *supra* note 3, 302).

A case determined by the Ōsaka Court of Appeals on 27 May 2004 (Kin'yū Shōji Hanrei 1198 (2004) 48) may be related to the discussion above. The policyholder entered into a life insurance contract with permanent disability coverage, and after that he completely lost function in both of his lower limbs. He took a genetic test on the advice of the insurance company's staff and was diagnosed with Krabbe disease, a genetic disorder. Based on the results of the test, the insurer refused to pay the insurance, basing its position on the term excluding coverage for diseases developed before the policy's inception date. The court said that, in light of the current situation in which no legal regulation regarding the control of genetic information exists, there was no reason to exclude genetic information as evidence. (But the court ruled in favor of the policyholder because the invocation of the relevant clause on the part of insurer was against the principle of good faith considering that the genetic test was suggested by the insurance company's staff.)

26 Arts. 4, 37, 66 Insurance Act.

27 Art. 31 para. 1 Insurance Act.

not caused by an undisclosed fact, the obligation to make an insurance payment still remains.[28]

Thirdly – and this is supplementary to (b) – if the insurer knew that the policyholder failed to provide certain information yet would have agreed to an insurance contract with a higher premium, the insurer is still relieved of the obligation to make an insurance payment.

Under German insurance contract law, an insurer is not allowed to cancel the contract in such a case. Article 19, Paragraph 4 German Insurance Contract Act permits the insurer to claim higher insurance premiums. Japanese insurance law has not gone in this direction. However, there were discussions on whether or not to adopt such a rule before the Insurance Act of 2008 was passed in Japan.[29] Therefore, the current configuration of Japanese law can be said to have been formed consciously.

The rules described above may seem complicated. To simplify matters, let us suppose a situation in which an accident occurs and, at some point thereafter, the insurer finds out that that accident was caused by a material fact which the policyholder failed to disclose at the time of entering into the contract. In that situation, (1) the insurer has to make the insurance payment if the policyholder's non-disclosure was due to mere negligence, but (2) the insurer does not have to pay the insurance if the policyholder's non-disclosure was intentional or based on gross negligence, provided that the insurer had inquired about the fact, even in a situation in which the insurer would have entered into the contract at a higher premium. Moreover, the insurer is entitled to keep the premium it has received.

2. *Analysis*

As discussed earlier, with respect to the information duties imposed on insurers, an analysis must look at the current regulations as well as decisions handed down by courts. As for the information duties that policyholders must obey, however, the contents are relatively clear, and we do not have to look at court decisions at this time. Thus, partly by way of summary and conclusion, I would like to make a quick comparison between the duties of policyholders and those of insurers.

(1) The policyholder's duty is a duty to answer the questions asked by the insurer, whereas the insurer's duty is not subject to such a limitation.

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28 Art. 31 para. 2 No. 1 Insurance Act.

29 See, K. KINOSHITA, *Kokuchi gimu, kiken zōka* [Duty to Disclose, Increase in Risk], Jurisuto 1364 (2008) 23. One of the reasons was strong opposition by the insurance industry. Apparently, insurance companies did not want the criteria for underwriting to be revealed, which would have been inevitable had such a rule been adopted.

This distinction comes from the fact that the knowledge and ability of the insurer with respect to insurance contracts far exceed the knowledge and ability of a policyholder. In other words, while the insurer knows the type of facts that are material to their decisions, the policyholder does not.[30]

(2) Sanctions for a breach of the information duties placed on policyholders only apply when the policyholder acted intentionally or with gross negligence. In contrast, a breach of the insurer's information duties, as connected in part to the law of tort, leads to sanctions even when the insurer's breach was caused by mere negligence.

In my opinion, this is not a significant difference because it is firmly established that the policyholder's duty does not include the duty to ascertain facts. A policyholder does not need to inform the insurer of what the policyholder does not know. Combined with the nature of the duty as a duty to answer, it is hardly imaginable that a breach of the policyholder's duty would be caused by mere negligence.

(3) Thirdly, in the case of a violation of a duty by an insurer, the sanction is the damages caused to the policyholder. The damages are the difference between the actual financial situation and the financial situation that would have resulted had the insurer properly explained the contract.

On the other hand, if an accident has occurred and the insurer finds out there was a breach of duty, then the insurer will cancel the contract, pay no refunds of premiums, and, in addition, not make an insurance payment. But if we look at it in the same way as a breach by the insurer, the damages are the difference between actual premiums paid and the hypothetical premiums that would have been paid. That means, the difference should be the premium paid as compared to the hypothetical premium paid had the policyholder fulfilled his or her duty. Thus, the sanction is more severe when the policyholder breaches his or her duty than when an insurer breaches its duty.

What is the reason for these stronger sanctions? One possible answer might be that the duties of insurers and the duties of policyholders are fundamentally different. I think no one would argue against the idea that the duty of a policyholder comes from the asymmetry of information between the parties. But as for the duty of an insurer, it could be said that the duty does not come from that kind of asymmetry but rather from the lack of

30 Assuming that the duty to inform arises when there is a disparity of information between two parties, we can say that the insurer has much more information regarding what is material to estimate the risk, and thus the insurer owes a duty to inform in this regard. "The duty to answer" rule might be seen as an implicit expression of this duty.

sophistication of the policyholder. Even if that were so, however, I doubt that such a difference could justify the difference in rules.

Another possible answer is that, in order to encourage policyholders to avoid breaching their information duties, a more powerful sanction is required because the problem occurs only when the undisclosed information would have led to a higher premium, not to the insurer refusing to enter the contract. In that situation, the probability of discovery by the insurer is relatively lower. In such a situation, the incentive of the policyholder to avoid disclosing the fact would be higher. Thus, a severe consequence for the policyholder is necessary.[31] On its face, this seems plausible as an explanation of the rules on the policyholder's duty to inform, but, in actuality, it is not a satisfactory explanation of the difference between the rules regarding the policyholder's duty and the rules regarding the insurer's duty.[32] (Administrative supervision of the insurer's duties in subrogation of the high execution costs faced by policyholders *may* provide an explanation.)

IV. CONCLUSION

This essay has provided an overview of the information duties owed both by the insurer and the policyholder in Japanese insurance law. If we look to the statutes, we could say that there is no particular article in the area of private law which prescribes the insurer's information duty, and disputes between parties are dealt with as matters of tort law. But we should keep in mind that there are a plenty of detailed legal rules in the area of administrative supervision, and these rules provide a de facto basis for determining whether a claim should be acknowledged or not. By contrast, there are provisions in private law which explicitly define the policyholder's information duty, and the sanction for a breach thereof can be more severe than that for a breach of the insurer's information duty. That asymmetry could be explained by the strong (or effective) supervision over insurance companies

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31 See, T. FUJITA/T. MATSUMURA, *Torihiki mae no jōhō kaiji to hōteki rūru* [Disclosure of Information Prior to the Contract and the Law], Hokudai Hōgaku Ronshū, vol. 52 no. 6 (2002) 2112.

32 The difference in rules undoubtedly comes from the different backgrounds on which these two notions have been developed. Whereas the policyholder's information duty is based on the traditional thinking (especially in common law countries) that an insurance contract is a contract based upon utmost good faith, and that characterization justifies the special effect of a breach of duty by the policyholder, the insurer's duty has only relatively recently begun to be discussed, and the notion is theoretically based on the trend of consumer protection. Thus, there may be no rational explanation which justifies the rules as they currently exist, but we can inquire if there is a need to change the rules.

as performed by the government; this supervision substitutes for the enforcement of the insurer's information duty by private persons.

APPENDIX

The regulation of the Japanese Insurance Business Act on the information duty of the insurer[33]

Before the amendment in 2014, the Insurance Business Act had prohibited "falsely informing the policyholder or the insured, or failing to disclose thereto any important particular stipulated in the insurance contract" (Art. 300 para. 1 No. 1 (i) Insurance Business Act).

After the amendment, a new article was inserted in addition to Art. 300, pursuant to which an insurance company or an insurance agent must "provide the contents of insurance contract and other information which are useful to the policyholder, etc., according to the specification by the Cabinet Office Ordinance" (Art. 294 para. 1 Insurance Business Act). The list of information includes many different points, for example, (i) the structure of the product, (ii) points concerning insurance payment (including *the event which gives rise to the payment)* and main cases in which insurance payment is not performed, (iii) points concerning special provisions which the policyholder can enter into, (iv) points concerning the insurance period, (v) the amount of insurance payment and other conditions concerning the underwriting, and (vi) points concerning the premium. (Art. 227-2 para. 3 Ordinance for Enforcement of the Insurance Business Act).[34]

At the same time, the amendment inserted an article concerning the duty to grasp the intention of the customer, according to which an insurance company or an insurance agent "must grasp the intention of a customer, propose the closing of an insurance contract, etc. which is in accordance with the intention of the customer, and provide a chance for the customer to make sure that the explanation of the contents of the insurance contract and the intention of the customer are consistent with the contents of the contract" (Art 294-2 Insurance Business Act).

Both an insurance company and an insurance agent owe a duty to "take measures to ensure sound and appropriate management" concerning the duties prescribed in those articles (Art. 100-2 and 294-3 Insurance Business Act), and the FSA supervises them to enforce this duty.

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33 See, T. YAMAMOTO, *Kokyaku e no jōhō teikyō gimu* [Information Duty to Customers], Jurisuto 1490 (2006) 14.

34 *Hoken gyōhō sekō kisoku*.

On the basis of these regulations, the FSA created "the general guidelines for supervision of insurance companies" and listed information to be provided. The list divides the requisite information into two categories, one of which is called "*keiyaku gaiyō* (the outline of a contract)" (information necessary to understand the contents/details of an insurance product), and the other of which is called "*tyuikanki jōhō* (information to be notified)" (information to which an insurance company should call customers' attention). The FSA even gave examples of the appropriate font size of letters and paper size. These guidelines are, by their nature, guidelines for FSA staff members, but in practice they are accepted by the insurance industry as mandatory as if they were legal rules.

Pre-contractual Information Duties in German Insurance Contract Law

Giesela Rühl[*]

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 2. European Law: Harmonization of Insurance (Contract) Law
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I. INTRODUCTION

Information play a key role for insurance contracts:[1] The insurer needs to know the risk before he can offer insurance coverage and calculate the insurance premium.[2] And the policyholder needs to know whether a certain insurance policy actually suits his needs.[3] Naturally, assessing risks and understanding insurance policies is not a piece of cake. To ease at least the information gathering process, national laws, including German law, impose numerous information duties on numerous parties involved in the conclusion of an insurance contract.[4] To begin with, the insurer is usually under a duty to inform the prospective policyholder about the terms of the insurance policy prior to conclusion of the contract.[5] If the contract comes

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1 L. LOACKER, Informed Insurance Choice? (Cheltenham et al. 2015) 1 ff.

2 See, for example, J. BASEDOW/T. FOCK, Rechtsvergleich, in: Basedow/Fock (eds.), Europäisches Versicherungsvertragsrecht, Volume I (Tübingen 2002) 69; U. KNAPPMANN, § 14 Verletzung der vorvertraglichen Anzeigepflicht, in: Beckmann/ Matusche-Beckmann (eds.), Versicherungsrechts-Handbuch (Munich 2009) para 1.

3 LOACKER, *supra* note 1.

into existence with the help of an insurance intermediary, a similar duty usually falls on the intermediary.[6] The policyholder, in turn, is under a duty to disclose to the insurer all facts that might turn out to be material for the insured risk.[7] And he is usually obliged to inform the insurer should the insured risk increase after conclusion of the contract.[8]

For reasons of time and – more importantly – space, I cannot discuss the details of all these information duties under German law. I will, therefore, limit my contribution in several ways. First, I will focus on information duties that fall on the insurer and the policyholder prior to conclusion of the contract.[9] I will, therefore, neither elaborate on information duties that fall on the insurer and on the policyholder after conclusion of the contract, nor will I elaborate on information duties that fall on third parties, such as insurance intermediaries. Second, when examining the insurer's and the policyholder's pre-contractual information duties, I will focus on provisions that apply to insurance contracts in general. In contrast, I will ignore provisions that apply only to specific insurance contracts like motor, life or health insurance. And, third, I will only examine the insurer's and the policyholder's pre-contractual information duties concerning the mass risk insurance sector. As a consequence, I will disregard information duties concerning the large risk insurance sector. Before going into the details, however, I will briefly sketch the overall regulatory landscape in which insurance contracts operate in Germany.[10]

II. THE REGULATION OF INSURANCE CONTRACTS IN GERMANY

Insurance contracts are complex legal products. To the extent that they are governed by German law, they are subject to a multitude of rules and regulations which are of both national and European origin.

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4 See, for example, BASEDOW/FOCK, *supra* note 2, 31, 70; BASEDOW/BIRDS/CLARKE/COUSY/HEISS/LOACKER (eds.), Principles of European Insurance Contract Law (PEICL) (2nd ed., Cologne 2016) Article 2:201, para N1.

5 See, for example, BASEDOW/FOCK, *supra* note 2, 30; BASEDOW et al., *supra* note 4, Article 2:201, para C1, N1.

6 See, for example, BASEDOW/FOCK, *supra* note 2, 41; BASEDOW et al., *supra* note 4, Article 3:101, para N4, N5.

7 See, for example, BASEDOW/FOCK, *supra* note 2, 69 f.; BASEDOW et al., *supra* note 4, Article 2:101, para N1.

8 See, for example, BASEDOW/FOCK, *supra* note 2, 82; BASEDOW et al., *supra* note 4, Article 4:202, para C1, N1.

9 See *infra* III. and IV.

10 See *infra* II.

1. German Law: Insurance Contracts Act and Insurance Supervision Act

At the level of German national law, essentially two statutes regulate insurance contracts. The first one is the Insurance Contract Act (ICA).[11] Adopted in 1908, the ICA is a wholesale codification of the private law aspects of the insurance business meant to complement and, as the case may be, supersede the general provisions on contract law to be found in the German Civil Code. The Act was substantially reformed in 2007 to adjust it to the needs of modern life, most importantly the needs of enhanced consumer protection.[12] It contains all provisions that are relevant for the following contribution, namely provisions on the insurer's pre-contractual information duties as well as provisions on the policyholder's pre-contractual duty of disclosure.

The second German statute that regulates insurance contracts is the Insurance Supervision Act (ISA).[13] Adopted in 1901 and reformed several times ever since to implement European Directives, the ISA deals with the public law aspects of the insurance sector. Most importantly, it determines the conditions for the admittance and operation of insurance undertakings and regulates the power of the government to oversee insurance companies. Since I will focus on the private law aspects of information duties, I will not discuss the provisions of the ISA in detail.

2. European Law: Harmonization of Insurance (Contract) Law

a) Current status

The fact that insurance contracts are governed by two national statutes might lead us to believe that German insurance law is a purely national matter. However, this is not the case. In fact, a large part of German law derives from Euro-

11 Insurance Contract Act of 23 November 2007 (Federal Law Gazette I, 2631), as amended. An English translation of the Act is available at *https://www.gesetze-im-internet.de/englisch_vvg/englisch_vvg.html.*

12 See for a more detailed discussion of the reform E. B. FRANZ, Die Reform des Versicherungsvertragsrechts – ein großer Wurf?, Deutsches Steuerrecht 2008, 303; E. LORENZ, Reform des Versicherungsvertragsrechts in Deutschland. Grundsätze und Schwerpunkte, Versicherungsrundschau 2005, 265; E. NIEDERLEITHINGER, Generaleinführung, in: Baumann/Beckmann/Johannsen/Johannsen (eds.), Versicherungsvertragsgesetz, Volume I (9th ed., Berlin 2008) 248 ff. (with further references). An English summary of the reform is offered by H. HEISS, Proportionality in the new German Insurance Contract Act 2008, Erasmus Law Review 5 (2012) 105.

13 Act on the Supervision of Insurance Undertakings of 1 April 2015 (Federal Law Gazette I, 434), as amended. An English translation of the Act is available at *https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Aufsichtsrecht/Gesetz/VAG_va_en.html?nn=8356586.*

pean law.[14] This holds particularly true for the public law provisions to be found in the ISA. They have been enormously influenced by a large number of European Directives adopted ever since the 1970s and aimed at realizing the freedom of establishment and the freedom of services within the European Union.[15] In addition, the provisions relating to the insurer's pre-contractual information duties go back to various European Directives, notably the E-Commerce Directive,[16] the Distance Marketing of Financial Instruments Directive,[17] the Solvency II-Directive,[18] and the Insurance Distribution Directive.[19] Originally placed in the ISA, the provisions implementing these Directives were moved to the ICA by the German legislature in 2007.

All other provisions of German insurance contract law, notably those provisions in the ICA that relate to the policyholder's pre-contractual duty of disclosure, have remained unaffected by European law – even though the European Commission considered the harmonization of insurance contract law as an important means to make the Single European Market for insurances come true.[20] However, an official proposal for a Directive on the coordination of insurance contract law submitted in 1979[21] and modified in

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14 L. LOACKER/S. PERNER, Einleitung, C. Europäisches Versicherungsvertragsrecht, in: Looschelders/Pohlmann (eds.), VVG (2nd ed., Cologne 2011), para 1.

15 J. BASEDOW, Towards a European Insurance Contract Law? The Commission Expert Group, its Antecedents and Consequences, in: Contratto e Impresa/Europa 2015, 2 ff. See also P. POHLMANN, Principle-based insurance regulation: lessons to be learned from a comparison of the EU and German law of risk management, in: Burling/Lazarus (eds.), Research Handbook on International Insurance Law and Regulation (Cheltenham/Northampton 2011) 329 ff.

16 Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce'), OJ 2000 L 178, p. 1.

17 Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, OJ 2002 L 271, p. 16.

18 Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast), OJ 2009 L 335, p. 1.

19 Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast), OJ 2016 L 26, p. 19.

20 General Programme for the abolition of existing restrictions on freedom of services, OJ 1962 No 2, p. 3.

21 Proposal for a Council Directive on the coordination of laws, regulations and administrative provisions relating to insurance contracts, OJ 1979 C 190, p. 2. See for a more detailed account *infra* I.1.

1980[22] never came close to adoption.[23] Despite intensive negotiations, the Member States simply could not reach agreement on the many detailed provisions of the proposal, among them the rules concerning the policyholder's pre-contractual duty of disclosure.[24] In 1993, the European Commission eventually declared that it no longer considered the harmonization of insurance contract law a necessary condition for the realization of the Single European Market – and withdrew the proposal.[25]

b) Future prospects

As a result of the above, the law of insurance contracts – with little exception[26] – remains a domain of national law up to the present day. However, this is not, at least not necessarily, the end of the story. During the past decades it has become clear that – despite the large number of European Directives – insurance companies refrain from cross-border activity within the European Union at least as far as small commercial and consumer insurance is concerned.[27] This finding is usually attributed to the interplay of several factors, one of which has been recognized as being the lack of a

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22 Amendment of the Proposal for a Council Directive on the coordination of laws, regulations and administrative provisions relating to insurance contracts, OJ 1979 C 335, p. 30. Article 1 of the Proposal limited the scope of application to direct insurance with the exception of life assurance, health insurance as well as marine, aviation, transportation and some other types of insurance.

23 See for a more detailed discussion G. RÜHL, Common Law, Civil Law, and the Common European Market for Insurances, International and Comparative Law Quarterly 55 (2006) 879.

24 Art. 3 and 4 of the Proposal.

25 Withdrawal of certain proposals and drafts from the Commission to the Council, OJ 1993 C 228, p. 4, 14.

26 See R. BECKMANN, Auswirkungen des EG-Rechts auf das Versicherungsvertragsrecht, Zeitschrift für Europäisches Privatrecht 7 (1999) 809 ff.; U. HÜBNER/A. MATUSCHE-BECKMANN, Auswirkungen des Gemeinschaftsrechts auf das Versicherungsrecht, Europäische Zeitschrift für Wirtschaftsrecht 1995, 263, 269 f.; M. PRÖLSS/C. ARMBRÜSTER, Europäisierung des deutschen Privatversicherungsrechts, Deutsche Zeitschrift für Wirtschaftsrecht 1993, 449, 451 ff.

27 Frankfurter Allgemeine Zeitung, No. 187 of 14 August 1998, p. 26. See also J. BASEDOW, The Case for a European Insurance Contract Code, The ICFAI Journal of International Business Law 2001, 569, at 573; J. BASEDOW, European Insurance Market, Harmonization of Insurance Contract Law, and Consumer Policy, Connecticut Insurance Law Journal 7 (2001) 495, at 500; BASEDOW/FOCK, *supra* note 2, 4; RÜHL, *supra* note 23, 883 f. See also the Final Report of the Commission Expert Group on Insurance Contract Law (2014), available at *http://ec.europa.eu/justice/contract/files/expert_groups/insurance/final_report.pdf,* p. 9 para 6.

common – or at least harmonized – insurance contract law.[28] At the end of the 1990s a group of European academics, therefore, set out to revive the idea of harmonization and founded the Project Group Restatement of European Insurance Contract Law.[29] In 2009 and 2015 this Group published the Principles of European Insurance Contract Law (PEICL)[30] that were meant to serve as a basis for a future European instrument in the field.[31] In 2013, the European Commission took up the idea and decided to set up an Expert Group on European Insurance Contract Law.[32] The Expert Group submitted a report in 2014 concluding that legal differences prevented cross-border activities in the mass risk insurance market.[33] It is now for the European Commission to decide how to proceed further. Chances are that we will see some form of European legislation relating to insurance contracts, including the policyholder's information duties, in the near future.

III. The Insurer's Pre-contractual Information Duties

The core provision that establishes pre-contractual information duties of the insurer under German law is Section 7 ICA. In conjunction with the Regulation on Information Obligations for Insurance Contracts, adopted and published by the Federal Ministry of Justice in accordance with Section 7(2) ICA,[34] the provision implements a large number of European

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28 See Final Report of the Commission Expert Group on European Insurance Contract Law, *supra* note 27, p. 6 para 5, p. 7 para 7. See also Basedow, European Insurance Contract Code, *supra* note 27, 574; Basedow, European Insurance Market, *supra* note 27, 501; Basedow/Fock, *supra* note 2, 4; Rühl, *supra* note 27, 883 f.

29 Detailed information about the Group is available at *http://www.restatement.info*.

30 Basedow/Birds/Clarke/Cousy/Heiss (eds.), Principles of European Insurance Contract Law (1st ed., Cologne 2009); Basedow/Birds/Clarke/Cousy/Heiss/Loacker (eds.), Principles of European Insurance Contract Law (PEICL) (2nd ed., Cologne 2016).

31 See for a more detailed account of the PEICL H. Heiss, Optionales Europäisches Versicherungsvertragsrecht, Rabels Zeitschrift für ausländisches und internationales Privatrecht 76 (2012) 316 ff.; H. Heiss/M. Clarke/M. Lakhan, Europe: towards a harmonised European insurance contract law – the PEICL, in: Burling/Lazarus, *supra* note 15, 603 ff. See also the list of references to be found in Basedow et al., *supra* note 4, pp xlvii ff.

32 Commission Decision of 17 January 2013 on setting up the Commission Expert Group on a European Insurance Contract Law, OJ 2013 C 16, p. 6.

33 Final Report of the Commission Expert Group on Insurance Contract Law, *supra* note 27, 6. See for a more detailed presentation of the Group's work J. Basedow, Die Expertengruppe für Europäisches Versicherungsvertragsrecht – Ein analytisch-kommentierende Erfahrungsbericht zur Politikberatung, in: Ackermann/Köndgen (eds.), Festschrift für Wulf-Henning Roth (2015) 21 ff.

Directives[35] and requires insurance companies to provide prospective policyholders with a broad array of information relating to the insurance contract on the one hand and to the insurance company on the other.

1. Purpose

Owing to the instrument's European origin, the pre-contractual information duties of the insurer that are enshrined in Section 7 ICA serve different purposes.[36] The primary purpose is, of course, informing the policyholder.[37] He is to be placed in a position that allows him to make an informed decision before entering an insurance contract. This, in turn, is meant to foster two additional aims: The first aim relates to the policyholder himself. His bargaining position vis-à-vis the insurer shall be improved by bridging any existing information gap.[38] The second aim goes beyond the individual policyholder and relates to the single European market for insurance.[39] By informing the policyholder he shall be enabled to compare different insurance policies which, in turn, will stimulate competition between insurance companies – nationally and internationally.

Of course, all this sounds wonderful and convincing – in theory. The problem, however, is that policyholders – in practice – almost never read all the information provided to them by insurers prior to conclusion of the contract. The costs associated with reading the paperwork simply exceed the expected benefits. And even if policyholders do the reading, this does not necessarily mean that they make better decisions.[40] In fact, there is abundant evidence from the field of behavioural science showing that humans are only able to take in and process a certain amount of information. Too much information, in contrast, will lower the actual quality of decisions because important information gets lost *(information overload)*.[41] Against this background there is a fairly broad consensus that providing

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34 Regulation on Information Obligations for Insurance Contracts of 18 December 2007 (Federal Law Gazette I, p. 3004), as amended. An English translation of the Regulation is available at: *https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Aufsichtsrecht/Verordnung/VVG-InfoV_va_en.html?nn=8232246.*

35 See *supra* II.2.a).

36 See, for example, P. POHLMANN, § 7 Information des Versicherungsnehmers, in: Looschelders/Pohlmann (eds.), *supra* note 14, para 6.

37 POHLMANN, *supra* note 36, para 7.

38 LOACKER, *supra* note 1, 3.

39 Solvency II Directive, *supra* note 18, Recitals 2, 3, 77, 79; POHLMANN, *supra* note 36, para 6.

40 See for more details and with further references LOACKER, *supra* note 1, 110 ff.

41 See for a detailed account S. BECHER, Behavioral Science and Consumer Standard Form Contracts, Louisiana Law Review 68 (2007) 117 ff.; R. HILLMAN/

policyholders with a large volume of information prior to conclusion of the contract neither improves their bargaining position vis-à-vis insurance companies nor stimulates competition between insurance companies.

The decisive question, therefore, is whether there is any way to make the insurer's pre-contractual information duties more effective? Unfortunately, I cannot provide a fully fledged answer in this contribution. In particular, I cannot discuss the various insights from behavioural science that might help to design better regulatory responses to the information problem just described. However, I should note that the European legislature has recognized the problems associated with the currently applied information model and adopted measures designed to ensure that the policyholder takes note of and understands what product he is about to buy. I will briefly discuss two of these measures further below.[42]

2. *Design*

As indicated above, the core provision regulating the insurer's pre-contractual information duties under German law is Section 7 ICA. It applies to all kinds of insurance contracts[43] and to all kinds of policyholders, whether consumers or businesses.[44] Also, it applies irrespective of whether the contract is concluded at a distance or in person.[45] As I look at Section 7 ICA in more detail, I will focus on three aspects, namely the information to be provided, the time at which the information is to be provided and the effects of non-disclosure.

a) *Information to be provided*

The information the insurer has to provide in accordance with Section 7(1) ICA first and foremost covers the terms of the contract, including the general conditions of insurance. In addition, Section 7(2) ICA requires the insurer to provide all information set out in the Regulation on Information Obligations for Insurance Contracts. Implementing the information requirements of the earlier mentioned European Directives[46] the Regulation starts in Section 1

J. RACHLINSKI, Standard-Form Contracting in the Electronic Age, New York University Law Review 77 (2002) 429 ff.

42 See *infra* III.2.a).

43 Pursuant to Section 210(1) ICA an exception applies only to large risk insurances.

44 C. ARMBRÜSTER, § 7 Information des Versicherungsnehmers, in: Langheid/Wandt (eds.), Münchener Kommentar zum VVG (2nd ed., Munich 2016) para 12 ff.; POHLMANN, *supra* note 36, para 8, 12.

45 POHLMANN, *supra* note 36, para 2.

46 See *supra* II.2.a).

with a list no less than 20 items of information that need to be provided prior to conclusion of any insurance contract including, among others:

– the premium as well as any costs, fees and taxes to be paid,
– the precise extent of insurance coverage,
– the right to revoke or cancel the contract,
– alternative dispute resolution mechanisms, and
– the competent supervisory authority.

Sections 2 and 3 of the Regulation go on and list additional items of information that the insurer has to communicate when offering life insurance, certain disability insurance and health insurance. Section 5 of the Regulation, finally, complements and modifies the information the insurer has to provide when he contacts prospective policyholders by phone.

It does not need to be emphasized that the amount of information the insurer has to provide under Section 7 ICA and the Regulation on Information Obligations for Insurance Contracts is enormous – so enormous that no policyholder will ever take the time to read everything prior to conclusion of the contract. However, as indicated earlier the European legislature has adopted measures that are meant to ensure that the policyholder takes note of and understands at least the most important aspects of the product he is about to buy. The first measure is to be found in Section 4 of the Regulation on Information Obligations for Insurance Contracts. It requires insurance companies to prepare a short product information leaflet that sums up the most important features of the insurance contract if the policyholder is a consumer.[47] The second measure is embodied in the Regulation on Key Information Documents for Packaged Retail and Insurance-Based Investment Products,[48] the so-called PRIIPs-Regulation,[49] which deals with information about investment instruments and also covers insurance contracts having an investment character, such as funds-linked life insurance. It requires insurers who offer insurance contracts with an investment character to provide the policyholder with a so-called key information document that contains a brief summary of essential information that retail investors need before making their investment decision.[50] The key information doc-

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47 For details see Section 4 of the Regulation on Information Obligations for Insurance Contracts.

48 Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs), OJ 2014 L 352, p. 1.

49 See for a detailed discussion of the PRIIPS-Regulation and insurance contracts L. LOACKER, Basisinformation als Entscheidungshilfe, in: Wandt/Reiff/Looschelders/Bayer (eds.), Festschrift für Egon Lorenz (2014) 259 ff.

50 Article 13(1) PRIIPs-Regulation.

ument is to be a short stand-alone document, clearly separate from marketing material, written in a concise manner and no longer than three pages on A-4 sized paper.[51] It must contain the information required by the Regulation and meet certain layout and design standards meant to ensure that consumers will actually be able to understand the product and to compare it with others.[52] Together with the product information leaflet, the key information document certainly increases the chance that the policyholder can understand the insurance product in question. Whether they also help to improve his bargaining power vis-à-vis insurance companies and to stimulate competition between insurance companies remains, of course, to be seen.

b) Timing of information

This brings me to the time at which information is to be provided: Since the insurer's information duty is meant to allow the policyholder to make a well-founded decision as regards the insurance coverage offered, Section 7(1) ICA, requires the insurer to provide the policyholder with the requested information in "in good time"[53] before he submits his "contractual declaration"[54], i.e. before the policyholder declares that he wants to be contractually bound. What "in good time" means is not further specified in Section 7(1) ICA. However, there is consensus that it requires the insurer to provide the requested information before the policyholder declares that he wants to be bound so as to ensure that he may actually read, understand and, as the case may be, compare what he is offered.[55] The exact time span depends on the form, the complexity and the economic significance of the insurance contract in question.[56] Information regarding complex retirement

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51 Article 6(2) Sentence 1 and (4) Sentence 1 PRIIPs-Regulation.

52 Article 6 (4) Sentence 2, Articles 7 and 8 PRIIPs-Regulation.

53 See the official English translation of the ICA reprinted in the Annex to this contribution.

54 See the official English translation of the ICA reprinted in the Annex to this contribution.

55 ARMBRÜSTER, *supra* note 44, para 62; H. HERRMANN, § 7 Information des Versicherungsnehmers, in: Baumann/Beckmann/Johannsen/Johannsen, *supra* note 12, para 60; T. LANGHEID, § 7 Information des Versicherungsnehmers, in: Langheid/Rixecker/Gal/Muschner, Versicherungsvertragsgesetz mit Einführungsgesetz und VVG-Informationspflichtenverordnung (5th ed., Munich 2016) para 25; POHLMANN, *supra* note 36, para 23; M. RUDY, § 7 Information des Versicherungsnehmers, in: Prölss/Martin, Versicherungsvertragsgesetz: VVG (29th ed., Munich 2015) para 11.

56 ARMBRÜSTER, *supra* note 44, para 62; HERRMANN, *supra* note 55, BASEDOW et al., 60; POHLMANN, *supra* note 36, para 23. See, however, LANGHEID, *supra* note 55, para 25, who argues that the insurer's pre-contractual information duties are general

insurance contracts will, therefore, have to be sent out earlier than information relating to a simple liability insurance contract that may be cancelled after one year. If, upon request of the policyholder, the contract is concluded by telephone or by other means of communication which do not permit the information to be provided in writing prior to the policyholder's contractual declaration, Section 7(1) Sentence 3 ICA allows the insurer to provide the requested information "without undue delay" after the contract is made.

c) Effects of non-disclosure

The above analysis shows that German law – under the influence of European law – imposes fairly complex information duties on the insurer. So, what happens if the insurer violates any of these duties through his failure to provide the requested information in writing in a timely manner before the policyholder submits his contractual declaration? Unfortunately, the effects of non-disclosure are not specifically spelled out in the ICA. Nor are they prescribed by the European Directives that Section 7 serves to implement. However, it follows from Section 8(1) and (2) ICA that the policyholder is allowed to revoke the contract. In addition, the policyholder may claim damages.

aa) Revocation of the contract

Pursuant to Section 8(1) ICA, the policyholder may always, i.e. no matter how the contract has been concluded, revoke the contract within 14 days. Under Section 8(2) ICA the revocation period begins when the policyholder has received all information required by Section 7 ICA in the way and at the time prescribed by Section 7 ICA. This, in turn, means that the revocation period will not begin if the insurer fails to comply with his information duties.[57] As a result, violation of the insurer's information duty – whether severe or not – will allow the policyholder to revoke the contract for an indefinite period of time.[58]

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in nature and do not require the insurer to consider the complexity of the insurance contract or the knowledge of the policyholder in question when deciding when to send out the requested information.

57 J. HEINIG/M. MAKOWSKY, § 8 Widerrufsrecht des Versicherungsnehmers, in: Looschelders/Pohlmann, *supra* note 14, para 62; K.-O. KNOPS, § 8 Wiederrufsrecht des Versicherungsnehmers, in: Baumann/Beckmann/Johannsen/Johannsen, *supra* note 12, para 43.

58 HEINIG/MAKOWSKY, *supra* note 57, para 62; KNOPS, *supra* note 57, para 43.

bb) Damages

In addition to revoking the contract, the majority of academic authors assume that the policyholder may also claim damages under Section 311(2) of the German Civil Code if non-disclosure was intentional or negligent.[59] The problem with this view, however, is that there is nothing in the ICA or the European Directives that would suggest that the policyholder will be entitled to damages should the insurer violate any of his information duties. In contrast to a violation of the insurer's duty to advise the policyholder, which is regulated in Section 6 ICA and expressly sanctioned with a claim for damages, the ICA does not mention any such claim in the context of the insurer's pre-contractual information duties. Therefore, one might conclude that the policyholder is limited to revocation of the contract.[60]

In a recent decision, however, the German Federal Supreme Court joined the majority view and ruled that the policyholder may rely on the general remedies for breach of pre-contractual duties that are available under the German Civil Code and claim damages if the insurer violates any of his pre-contractual information duties.[61] The Court found that the right to revoke the contract and a claim for damages served different purposes – and that there was nothing in the ICA suggesting that the policyholder's right to revocation was meant to be exclusive.[62] As a result, even slight violations of the insurer's extremely broad information duties may result in severe consequences – consequences that insurers will have to consider when calculating the premium the policyholder has to pay.

IV. The Policyholder's Pre-contractual Information Duties

As indicated at the beginning, pre-contractual information duties are not a one-way street when it comes to insurance contracts. In fact, it is not only the policyholder but also the insurer who needs information prior to conclusion of the contract. More specifically, he needs information about the risk he is about to insure. Section 19 ICA, therefore, requires the prospective

59 ARMBRÜSTER, *supra* note 44, para 118; HERRMANN, *supra* note 55, para 82; KNOPS, *supra* note 57, para 44; LANGHEID, *supra* note 55, para 37; POHLMANN, *supra* note 36, para 55; P. PRÄVE, Die VVG-Informationspflichtenverordnung, Versicherungsrecht 2008, 151, 152; RUDY, *supra* note 55, para 40.

60 See, for example, O. MEIXNER/R. STEINBECK, Das neue Versicherungsvertragsrecht (Munich 2007) § 1 para 75.

61 German Federal Court (Bundesgerichtshof), 28 June 2017, Versicherungsrecht 2017, para 35.

62 R. RIXECKER, Information, Beratung Versicherung – Zur informationellen Konstruktion eines Rechtsprodukts, in: Rüßmann (ed.), Festschrift für Gerhard Käfer (Saarbrücken 2009) 273, 277.

policyholder to disclose all facts that might affect the risk he is seeking coverage for.

1. Purpose

The policyholder's pre-contractual duty of disclosure enshrined in Section 19 ICA is of fundamental importance for the insurer and the community of policyholders.[63] This is because the insurer must calculate the insurance premium to be paid by the policyholder prior to conclusion of the insurance contract. And he must ensure that the premium corresponds to the risk that the policyholder wishes to insure.[64] If – for want of information – the insurer fails to calculate the premium correctly, he risks charging too much for "good risks" and too little for "bad risks". This, in turn, may lead to an adverse selection process that leaves him with the "bad risks" while the "good risks" go somewhere else.[65] Since the factors that are necessary for the assessment of the risk and the calculation of the premium are usually to be found in the sphere of the policyholder, all modern legal systems require the policyholder to disclose information affecting the risk prior to conclusion of the contract.[66] He is – in economic terms – the cheapest-cost-avoider.[67]

2. Design

Just like Section 7 ICA, Section 19 ICA applies to all insurance contracts no matter how they are concluded and to all policyholders no matter whether they are consumers or businesses. The provision was heavily modified when the ICA was reformed in 2007 because the old law did not live up to the perceived needs and modern conceptions of consumer protection.[68]

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63 O. BRAND, Die Grenzen der vorvertraglichen Anzeigepflicht des Versicherungsnehmers, Versicherungsrecht 2009, 715; T. LANGHEID, § 19 Anzeigepflicht, in: Langheid/Wandt, *supra* note 44, para 1; LOOSCHELDERS, § 19 Anzeigepflicht, in: Looschelders/Pohlmann (eds.), *supra* note 14, para 3; G. RÜHL, Die vorvertragliche Anzeigepflicht: Empfehlungen für ein europäisches Versicherungsvertragsrecht, Zeitschrift für die gesamte Versicherungswissenschaft 94 (2005) 479.

64 C. ROLFS, § 19 Anzeigepflicht, in: Baumann/Beckmann/Johannsen/Johannsen, *supra* note 12, para 6.

65 BASEDOW/FOCK, *supra* note 2, 69-70. See also N. HARNETT, The Doctrine of Concealment: A Remnant in the Law of Insurance, L. Contemp. Probl. 15 (1950) 391, 408-409.

66 BASEDOW/FOCK, *supra* note 2, 70; RÜHL, *supra* note 63, 479.

67 BRAND, *supra* note 63, 715; H. FLEISCHER, Informationsasymmetrien im Vertragsrecht (Munich 2001) 508; RÜHL, *supra* note 63, 485; G. RÜHL, Obliegenheiten im Versicherungsvertragsrecht: Auf dem Weg zum Europäischen Binnenmarkt für Versicherungen (Tübingen 2004) 106.

68 T. LANGHEID, *supra* note 63, para 4; LOOSCHELDERS, *supra* note 63, para 4.

Under the old law the policyholder was bound to disclose all material facts known to him regardless of whether the insurer had made any inquiry regarding such facts in the proposal form.[69] In addition, the old law potentially sanctioned any violation of the duty of disclosure with a complete loss of all benefits under the insurance policy. Of course, German courts did their best to avoid that result where it was deemed inappropriate. However, this was not always possible, with the result also being an undesirable tension between statutory and case law. The policyholder's duty of disclosure, therefore, took centre stage in the process leading to the reform of the ICA in 2007 – and came out considerably changed.[70] In what follows I will shed light on three aspects of the newly framed duty of disclosure: the extent of disclosure, the time of disclosure, and the effects of non-disclosure.

a) Facts to be disclosed

Under Section 19(1) ICA the policyholder has to disclose all material facts known to him prior to conclusion of the contract. However, in contrast to the old law, the policyholder is only bound to disclose facts which the insurer has specifically asked for in writing. Just like other European countries[71] and consistent with the Principles of European Insurance Contract Law,[72] the new law, thus, heeds the fact that the insurer knows much better than the prospective policyholder which facts will influence the assessment of the risk. As a result, Section 19(1) ICA substantially decreases the policyholder's risk of losing insurance coverage for non-disclosure. The provi-

69 See for a detailed account of the old German law RÜHL, *supra* note 67, 65 ff.; RÜHL, *supra* note 23, 889 ff.; RÜHL, *supra* note 63, 479 ff.

70 See for an overview of the new duty of disclosure BRAND, *supra* note 63, 715 ff.; C. ROLFS, Die vorvertragliche Anzeigeobliegenheit nach der Reform des VVG, Wand/Reiff/Looschelders/Bayer (eds.), Festschrift für Egon Lorenz (2014) 389, 394.

71 See, for example, Section 22 of the Finish Insurance Contract Act, No. 543, of 28 June 1994; Article L113-2 (2) of the French Insurance Code (= Act no. 89-1014 of 31 December 1989, Article 10, Official Journal of 3 January 1990); Article 10 of the Spanish Insurance Contract Act of 17 October 1980 as amended by Act no. 21/1990 of 19 December 1990); Article 4 of the Swiss Insurance Contract Act of 2 April 1908. In Greece the facts that have to be disclosed are limited to those asked for in a questionnaire in the event the insurer uses a questionnaire: Article 3 of the Greek Insurance Contract Act, Law no. 2496/1997.

72 See for a detailed discussion of the policyholder's duty of disclosure under Art. 2:201 PEICL H. COUSY, The Principles of European Contract Law: the Duty of Disclosure and the Aggravation of Risk, ERA Forum 9 (2008) 119 ff.; Y. DELFOS-ROY, The PEICL and the Duty of Disclosure, European Review of Private Law (2011) 71 ff.

sion nonetheless raises problems as regards the precise extent of the policyholder's duty.

aa) Substantive limits

The first problem relates to the substantive limits of the duty. Are there any questions that insurers must not ask – or questions the policyholder is not bound to answer if they are asked? On the face of Section 19(1) ICA the answer to this question should be "no": The provision requires the policyholder to disclose all material facts known to him under the condition that the insurer has asked for them in writing. The only limit to the policyholder's duty of disclosure, therefore, seems to be a formal one, namely the insurer's written request. Nonetheless there is agreement that the insurer may not ask for everything and, hence, that there are limits as to what the policyholder is required to disclose.[73] Sources for such limits are the General Law on Equal Treatment[74,75] as well as fundamental rights.[76]

(i) Antidiscrimination law: Race, ethnic origin and gender

The General Law on Equal Treatment was adopted in 2006 to implement a number of European Antidiscrimination Directives.[77] In Sections 1 and 19(1) it declares illegal any discrimination on grounds of race or ethnic origin, gender, religion or belief, disability, age or sexual orientation. Since the provision expressly extends to private insurance contracts, insurers are, at least as a matter of principle, not allowed to consider any of these factors

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73 See for a detailed discussion C. BARTHOLOMÄI, Die Begrenzung von Anzeigepflichten durch berechtigte Interessen des Versicherungsnehmers (Karlsruhe 2014).

74 General Law on Equal Treatment of 14 August 2006 (Federal Law Gazette I, p. 1897), as amended. An English translation of the Act is available at *http://www.antidiskriminierungsstelle.de/SharedDocs/Downloads/EN/publikationen/agg_in_englischer_Sprache.pdf?__blob=publicationFile.*

75 C. ARMBRÜSTER, § 19 Anzeigepflicht, in: Prölss/Martin, *supra* note 55, para 10; LOOSCHELDERS, *supra* note 63, para 27.

76 BRAND, *supra* note 63, 715 ff.; LOOSCHELDERS, *supra* note 63, para 36.

77 Council Directive 2000/43/EC of 29 June 2000 implementing the principle of equal treatment between persons irrespective of racial or ethnic origin, OJ 2000 L 180, p. 22; Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation, OJ 2000 L 303, p. 16; Directive 2006/54/EC of the European Parliament and of the Council of 5 July 2006 on the implementation of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation (recast), OJ 2006 L 204, p. 23; Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods and services, OJ 2004 L 373, p. 37.

when assessing the insured risk and are not allowed to ask for them in the proposal form. However, the General Law on Equal Treatment provides for an exception specifically tailored to the needs of the insurance business: Pursuant to Section 20(2) Sentence 2, differences of treatment on grounds of religion or belief, disability, age or sexual orientation are permissible where these are based on recognized principles of actuarial risk assessment and statistical evidence. By way of counter-exception, insurers are, thus, allowed to resort to these factors when assessing the insured risk – and to ask for them in the proposal form. Policyholders will, in turn, be required to answer these questions.

Interestingly, however, Section 20(2) Sentence 2 does not mention race or ethnic origin or gender as a ground for different treatment. As regards race and ethnic origin, it was never disputed that neither of these factors should serve as a reason to discriminate against policyholders. Gender, however, was a different story because there is clear statistical evidence indicating that men and women pose different risks, for example, when it comes to health insurance. The original version of Section 20(2) therefore allowed different treatment of policyholders based on their gender under the condition that a risk assessment based on precise actuarial and statistical data revealed that gender had a decisive influence on the insured risk.[78] However, in a landmark decision issued of 2011 the European Court of Justice[79] decided that insurance companies were not allowed to discriminate against policyholders based on their gender and held that national provisions allowing exemptions from the rule of unisex premiums and benefits would violate the principle of equal treatment of men and women incorporated in the European Treaties and the Charter of Fundamental Rights. The German legislature, therefore, modified Section 20(2) in 2012 and deleted any reference to the policyholder's gender. In addition to race and ethnic origin, the insurer may, therefore, not ask the policyholder to reveal his or her gender. If he does ask, the policyholder may refuse to answer without having to fear any consequences.

(ii) Fundamental rights: Predictive genetic tests

In addition to the General Law on Equal Treatment, fundamental rights may set substantive limits to the policyholder's pre-contractual duty of disclosure.[80] From the many issues that one could discuss in this context, I want to highlight one that has received a lot of academic and political attention

78 BRAND, *supra* note 63, 718.

79 European Court of Justice, 30 April 2011, C-236/09, ECLI:EU:C:2011:100 – Test-Achats, ECR 2011 I-00773.

80 BRAND, *supra* note 63, 718 f.; LOOSCHELDERS, *supra* note 63, para 36.

during the last decade. It relates to genetic defects and the results of predictive – or presymptomatic – genetic tests that allow the identification of genetic mutations increasing a person's risk of developing disorders having a genetic basis, such as certain types of cancer. May the insurer ask the prospective policyholder to take such a predictive test or to disclose the result of any such test already taken? Or does any such duty violate the policyholder's fundamental right to control the use of his personal data *(Recht auf informationelle Selbstbestimmung)*?

For a long time, the answer to these questions was unclear. The majority of academics, however, took an insurer-friendly view. Pointing to the legitimate information interests of the insurer and the community of policyholders at large as well as the dangers of an adverse selection process, they found that the insurer was allowed both to ask the policyholder to take a predictive test and to require the policyholder to disclose the result of any such test already taken.[81] The German legislature, however, did not share this view and settled the matter with the adoption of the Act on Genetic Testing in Humans in 2009.[82] Under Section 18(1) of that Act, insurance companies may not require predictive genetic testing as part of their risk assessment, and they may not ask applicants to disclose the results of any such tests.[83] Exceptions apply to life insurance for an insured sum of more than € 300,000.00 or to a disability insurance carrying an annual disbursement of more than € 30,000.00. As a result, German law effectively bans the use of predictive genetic tests for most insurance contracts and releases the policyholder both from taking any such tests and from revealing the results. It should be noted, however, that other genetic tests, notably those that serve to find a genetic cause for existing disorders or clinical symptoms are not covered by Section 18 of the Genetic Testing Law. Insurers may, therefore, ask for the results of such tests, and the policyholder will be required to reveal them.[84]

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81 See, for example, S. KUBIAK, Gendiagnostik bei Abschluss privater Versicherungsverträge (Baden-Baden 2008) 149 f.; E. LORENZ, Zur Berücksichtigung genetischer Tests und ihrer Ergebnisse beim Abschluß von Personenversicherungsverträgen, Versicherungsrecht 1999, 813 ff.

82 Act on Genetic Testing in Humans of 31 July 2009 (Federal Law Gazette I, p. 2529, 3672), as amended.

83 See for a more detailed discussion P. PRÄVE, Das Gendiagnostikgesetz aus versicherungsrechtlicher Sicht, Versicherungsrecht 2009, 857 ff.

84 ARMBRÜSTER, *supra* note 75, para 20; LANGHEID, *supra* note 68, para 13; LOOSCHELDERS, *supra* note 63, para 32.

bb) Open questions

The second – very obvious – problem that comes with the new version of the policyholder's duty of disclosure is whether the insurer, at the end of the proposal form, may ask "open questions" such as: "Is there anything else that we need to know"? Or: "Are there any other material facts that you wish to disclose"?[85] The problem with open questions is obvious: they shift the burden of assessing the materiality of a certain fact to the policyholder and re-create the spontaneous duty of disclosure that the reform of 2008 meant to abandon. Since open questions may defeat the very purpose of the newly phrased Section 19(1) ICA and amount to a de facto return to the old law, one might be inclined to prohibit open questions.[86] The problem with this view, however, is that insurers – even in the standardized mass insurance sector – may not always be in a position to precisely name the facts that might affect the risk for which coverage is offered.[87] In addition, completely prohibiting open questions would lead to extremely long, complex and most likely intransparent and incomprehensible proposal forms.[88] Therefore, there is broad agreement that even under Section 19(1) ICA, insurers must not be completely banned from asking open questions.[89] However, open questions must not result in a return to the old law, and they must be sufficiently precise to allow a correct and complete answer by the average policyholder.[90] In this vein, the Court of Appeals in Frankfurt in a 2011 case approved of – and required the policyholder to answer – a question in the proposal form which asked the applicant to list "other illnesses, sicknesses, etc. he suffered from during the last five years […]".[91]

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85 ARMBRÜSTER, *supra* note 75, para 36 ff.; BRAND, *supra* note 63, 717 f.; LOOSCHELDERS, *supra* note 63, para 23.

86 See, for example, E.B. FRANZ, Das Versicherungsrecht im neuen Gewand – Die Neuregelungen und ausgewählte Probleme, Versicherungsrecht 2008, 306; T. LANGHEID/GOERGEN, Auswirkungen der VVG-Reform auf die D&O-Versicherung, Die Versicherungspraxis 2007, 162; P. REUSCH, Die vorvertraglichen Anzeigepflichten im neuen VVG 2008, Versicherungsrecht 2007, 1314; R. RIXECKER, VVG 2008 – Eine Einführung, Zeitschrift für Schadensrecht 2007, 370.

87 BRAND, *supra* note 63, 717.

88 BRAND, *supra* note 63, 717.

89 ARMBRÜSTER, *supra* note 75, para 37; BRAND, *supra* note 63, 717.

90 KNAPPMANN, *supra* note 2, para 22a. In a similar vein FRANZ, *supra* note 86, 306; RIXECKER, *supra* note 86.

91 Court of Appeal (Oberlandesgericht) Frankfurt a.M., 19 January 2011, Beck online Rechtsprechung (BeckRS) 2011, 28322, para 31.

cc) Actual knowledge

A third problem revolving around the policyholder's duty of disclosure relates to the question of whether the policyholder is under any obligation to do research to comply with his duty or whether he can rely on his (current) knowledge.[92] On the face of Section 19(1) ICA the answer seems to be straightforward: According to the provision's clear wording, the policyholder only has to disclose those facts that he actually knows. In contrast to other European legal systems as well as the Principles of European Insurance Contract Law,[93] he is not required to disclose facts which he is not actually, but ought to be aware of. As a result, Section 19(1) ICA does not seem to impose any duty on the policyholder to do more than just answer the insurer's question to the best of his actual and current knowledge.

This reading of Section 19 ICA, however, comes with problems because it may, in real life, honour the lazy and oblivious policyholder. In addition, it increases the risk that the insurer in the end will not get the information that he needs for assessing the risk even though the policyholder could, with some effort, provide the necessary information. German courts have therefore long held that the policyholder must try to remember and that he is – to a certain degree – obliged to refresh his recollection with documents.[94] It is, therefore, not enough to sit back and answer the form over a cup of tea. Rather, he must focus on the questions and seriously try to remember all facts that might be relevant.[95] He may even be asked to check available records or documents in his possession or look into other easily accessible sources of information.[96] As a result, policyholders are under a limited obligation to undertake reasonable steps to correctly and comprehensively comply with their duty of disclosure.[97]

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92 BRAND, *supra* note 63, 717; KNAPPMANN, *supra* note 2, para 45 ff.; LANGHEID, *supra* note 63, para 60, LANGHEID, *supra* note 68, para 28.

93 Article 2:101 PEICL.

94 See, for example, Federal Supreme Court (Bundesgerichtshof), 11 February 2009, Versicherungsrecht, 2009, 529; Court of Appeal (Oberlandesgericht) Oldenburg, 16 January 1991, Versicherungsrecht 1992, 434; Regional Court (Landgericht) Bielefeld, 14 February 2007, Versicherungsrecht 2007, 636. See also KNAPPMANN, *supra* note 2, para 45 ff.; LANGHEID, *supra* note 2, para 60, LANGHEID, *supra* note 68, para 28; LOOSCHELDERS, *supra* note 63, 35.

95 LANGHEID, *supra* note 68, para 28.

96 LANGHEID, *supra* note 68, para 28.

97 Federal Supreme Court (Bundesgerichtshof), 3 November 1966, Versicherungsrecht 1967, 56; LANGHEID, *supra* note 68, para 28.

b) *Time of disclosure*

As a matter of principle, the policyholder has to fulfil his duty of disclosure prior to conclusion of the contract. This follows naturally from the duty's purpose of allowing the insurer to assess the risk that the prospective policyholder wishes to insure. However, what exactly does this mean? Prior to the reform of the ICA the policyholder was required to disclose any material fact up until the contract had been formally concluded.[98] This was usually the time when the insurer accepted the policyholder's request for insurance, which, in turn, meant that the policyholder was under an obligation to disclose material facts even after completion of the proposal form (the so-called *Nachmeldeobliegenheit*).[99] For many unexperienced policyholders this came as a surprise because they felt that they had complied with any disclosure requirements by filling out the proposal form. Section 19(1) ICA, therefore, makes clear that the policyholder is only bound to disclose facts up until he submits his "contractual declaration", which is normally the submission of the proposal form.[100] After that point the duty of disclosure may only revive if the insurer, after receiving and reviewing the policyholder's documents, asks more questions. Section 19 ICA thus strikes a fair balance between the reasonable expectations of the policyholder and the legitimate information interests of the insurer.

However, the provision raises problems in cases where completion of the proposal form by the policyholder does not qualify as a "contractual declaration" but merely as an invitation to treat *(invitatio ad offerendum)*.[101] In that case the wording of Section 19(1) ICA suggests that the policyholder has to disclose material facts up until he accepts the insurer's offer for insurance and, thus, even after completion of the proposal form. Academic literature has suggested that any such interpretation would defeat the very purpose of the newly phrased provision.[102] However, since this view is not undisputed[103] – and for lack of case law – the precise temporal reach of Section 19(1) ICA remains unclear.

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98 See the wording of Section 16(1) ICA as valid up until 31 December 2007: "at conclusion of the contract" *("bei der Schließung des Vertrages")*. See also KNAPPMANN, *supra* note 2, para 39; (with further references).

99 See, for example KNAPPMANN, *supra* note 2, para 39 (with further references).

100 KNAPPMANN, *supra* note 2, para 38; LANGHEID, *supra* note 68; ROLFS, *supra* note 70, 395.

101 KNAPPMANN, *supra* note 2, para 38; LANGHEID, *supra* note 68; ROLFS, *supra* note 70, 395 f.

102 BRAND, *supra* note 63, 719 f.; P. HÄRLE, § 19 Anzeigepflicht, in: Schwintowski/ Brömmelmeyer (eds.), Praxsikommentar zum Versicherungsvertragsrecht (Münster 2008) para 100; KNAPPMANN, *supra* note 2, para 38; ROLFS, *supra* note 70, 395 f.

103 LANGHEID, *supra* note 68, para 48.

c) *Effects of non-disclosure*

Prior to the reform of the ICA, non-disclosure resulted in potentially devastating effects for the policyholder: Any slightly negligent non-disclosure of material facts gave the insurer the right to avoid the insurance contract *ab initio,* i.e. with retrospective effect.[104] The policyholder, therefore, was at risk of losing his entire coverage for non-disclosure even if the insurer had not even made inquiry as to the non-disclosed fact. This result was widely considered to be too harsh and not in line with the enormous socio-political function of insurance contracts. The German legislature, therefore, decided to completely overhaul the effects of non-disclosure. The result has been described as "overly complicated",[105] "incoherent",[106] "curious"[107] and "incomprehensible".[108,109] In the remainder of this contribution I will nonetheless do my best to describe the rules that have been in place ever since the reform of the ICA in 2007.

The effects of non-disclosure are now regulated in Section 19(2) to (4) ICA. The provision is exclusive, which means that any recourse to other contractual or quasi-contractual remedies available under the Civil Code is excluded.[110] There is only one exception to this rule: Under Section 22 ICA the insurer may always avoid the contract in accordance with the general rules of the Civil Code in cases of fraudulent non-disclosure. Other than that, the effects of any form of non-disclosure are governed by Section 19 ICA, which provides for no less than three different remedies, namely avoidance of the contract *ab initio (Rücktritt),* prospective termination of the contract *(Kündigung)* and modification of the contract *(Vertragsanpassung).* Which remedy the insurer may exercise in a given case and which effects this remedy has in terms of the insurer's obligation to make payments under the contract depend on a variety of factors, including the policyholder's fault, the nexus between the non-disclosed fact and the for-

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104 BRAND, *supra* note 63, 716; T. LANGHEID, §§ 16, 17, Anzeigepflicht, Unrichtige Anzeige, in: Römer/Langheid, Versicherungsvertragsgersetz mit Pflichtversicherungsgesetz (PflVG) und Kraftfahrzeug-Pflichtversicherungsverordnung (Kfz-PflVV) (2nd ed., Munich 2003) para 4; RÜHL, *supra* note 67, 76 ff.; RÜHL, *supra* note 63, 500; RÜHL, *supra* note 23, 898 f.

105 BRAND, *supra* note 63, 715, 721.

106 BRAND, *supra* note 63, 715, 721.

107 T. LANGHEID, Die Reform des Versicherungsvertragsgesetzes, NJW 2007, 3665, 3668.

108 K.-J. NEUHAUS/A. KLOTH, Praxis des neuen VVG (2007) 49.

109 In a similar vein LANGHEID, *supra* note 63, para 4; REUSCH, *supra* note 86, 1322; RIXECKER, *supra* note 86, 369.

110 P. SCHIMIKOWSKI, § 19 Anzeigepflicht, in: Rüffer/Hallbach/Schimikowski (eds.), Versicherungsvertragsgesetz (3rd ed., Baden-Baden 2015) para 2.

mation of the contract as well as the nexus between the non-disclosed fact and the occurrence of the insured event.

aa) Avoidance of the contract

Under Section 19(2) ICA the insurer's first – and arguably most important – remedy in a case of non-disclosure is retrospective avoidance of the contract. If the insurer chooses to exercise this right, the policyholder loses all entitlements under the contract and must reimburse the insurer for all payments previously disbursed under the policy.[111] Naturally, he also loses his right to claim money for any future events. Thus, obviously, avoidance of the contract may have severe consequences for the policyholder, which is why the new law limits the insurer's right to avoid the contract in several ways: First, pursuant to Section 19(3) ICA, the insurer will only be allowed to avoid the contract in cases of intentional or grossly negligent non-disclosure. In cases of simple or normal negligence, by contrast, the insurer will only have the right to terminate the contract prospectively. Second, in cases of grossly negligent non-disclosure the insurer will not be allowed to avoid the contract if the non-disclosed fact did not affect the insurer's decision to enter into the contract because the insurer would have nonetheless agreed to cover the risk. The same holds true if the insurer would have agreed to cover the risk, but on different terms. In that case, however, the insurer may request that the contract be governed by these terms. Third, even if the insurer is entitled to avoid the contract (because non-disclosure was intentional or grossly negligent and because the insurer would have refused to conclude the contract in the event of proper disclosure), Section 21(2) ICA stipulates that the policyholder will not lose his right to receive and keep payments under the contract if the non-disclosed fact neither caused the insured event nor influenced the amount to be paid. It follows that even grossly negligent non-disclosure will not always leave the policyholder without insurance coverage. On the contrary: If the non-disclosed fact neither influenced the insurer's decision to enter into the contract nor caused or influenced any insured event, the grossly negligent non-disclosure will remain without any effects.

bb) Termination of the contract

The second remedy, foreseen by Section 19(3) ICA, is prospective termination of the contract. It will be available if the policyholder fails to disclose material facts as a result of simple or normal negligence. If the insurer chooses to exercise his termination right, the policyholder will not lose his

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111 KNAPPMANN, *supra* note 2, para 93; LANGHEID, *supra* note 68.

entitlements under the contract for past insured events.[112] And he will not be required to reimburse the insurer. However, just like the right to avoid the contract, Section 19(3) ICA excludes the insurer's right to terminate the contract prospectively if the non-disclosed fact did not affect the insurer's decision to enter into the contract, i.e. if the insurer would have agreed to cover the risk even upon proper disclosure. And, again, the insurer may request that the contract be governed by different terms if he would have accepted the risk only on different terms.

cc) Modification of the contract

The third remedy of the insurer in cases of non-disclosure is modification of the contract. It is available where the insurer may neither avoid nor terminate the contract and, thus, in cases of negligent non-disclosure where the non-disclosed fact did not influence the insurer's decision to enter into the contract. If in such a case the insurer would have accepted the risk only on different terms, Section 19(3) ICA allows the insurer to request a modification of the contract. In cases of innocent non-disclosure the modification takes effect prospectively only. In all other cases any modifications will apply retrospectively.

dd) Exclusion of rights

It goes without saying that the just described system is extremely complex. And, unfortunately, it becomes even more complex when looking at Section 19(5) ICA. Under Sentence 1 of Section 19(5) ICA, the insurer may not invoke any of the rights just described if he has not previously informed the policyholder of the consequences of any breach of the duty of disclosure in writing and in a stand-alone document. And pursuant to Sentence 2 the insurer is not entitled to avoidance, termination or modification of the contract if he was aware of the non-disclosed fact or the incorrectness of the disclosure. The policyholder, thus, has a good chance not to lose insurance coverage at all even if he has violated his duty of disclosure.

V. CONCLUSION

As indicated at the beginning, information are key for both the insurer and the policyholder. The role of the law, therefore, is to incentivize the parties to provide all necessary information in a way that allows the other party to act upon it. Unfortunately, it is unclear whether German law as it currently stands lives up to this expectation: On the one hand it imposes heavy in-

112 KNAPPMANN, *supra* note 2, para 108; LANGHEID, *supra* note 68, para 91.

formation duties on insurers which are unlikely to actually improve the policyholder's decisions but that nevertheless trigger severe sanctions if violated. On the other hand it substantially limits the policyholder's duty of disclosure and very often refrains from sanctioning violations. Against this background, it does not take a clairvoyant to predict that the current design of information duties under German insurance contract law will not stand the test of time, but be subject to further reform in the future.

ANNEX: EXCERPTS FROM THE GERMAN INSURANCE CONTRACT ACT[113]

Section 7 – Information provided to the policyholder

(1) The insurer shall inform the policyholder in writing of his terms of contract, including the general terms and conditions of insurance, as well as the information set out in a statutory ordinance referred to in subsection (2), in good time before the policyholder submits his contractual acceptance. This information shall be provided clearly and comprehensibly in keeping with the means of communication employed. If, upon the request of the policyholder, the contract is concluded by telephone or using another means of communication which does not permit the information to be provided in writing prior to the policyholder's contractual acceptance, that information must be provided without undue delay after the contract is made; this shall also apply if the policyholder explicitly waives the right to information by a separate written declaration prior to submitting his contractual acceptance.

(2) The Federal Ministry of Justice and Consumer Protection shall be authorized, with the consent of the Federal Ministry of Finance, to determine the following by statutory ordinance without the consent of the Bundesrat for the purposes of providing comprehensive information to the policyholder:

1. which details of the contract, in particular in respect of the insurer, the benefit offered, the general terms and conditions of insurance and the of revocation shall be provided to the policyholder,
2. which other information shall be provided to the policyholder in respect of life insurance, in particular regarding the expected benefits, their determination and calculation, regarding a model calculation, and acquisition and distribution costs and the administrative costs, insofar as these are set off against insurance premiums, and regarding other costs,
3. which other information shall be provided in respect of health insurance, in particular regarding the development and form of insurance premiums, and the acquisition and distribution costs and the administrative costs,
4. what information shall be provided to the policyholder if the insurer has contacted him by telephone, and

113 English translation provided by the German Federal Ministry of Justice and for Consumer Protection at *http://www.gesetze-im-internet.de/englisch_vvg/index.html.*

5. in what manner this information is to be provided.

When determining the notifications in accordance with the first sentence, the information required in accordance with Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life insurance and amending Directives 73/239/EEC and 88/357/EEC (OJ EC L 228 p. 1), Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC (OJ EC L 271 p. 16), as well as Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life insurance (OJ EC L 345 p. 1), shall be observed.

(3) The statutory ordinance referred to in subsection (2) shall, furthermore, specify what information the insurer must communicate in writing throughout the policy period; this shall in particular apply in the case of changes to information previously supplied, further in respect of health insurance in the event of increases in insurance premiums and regarding the possibility of changing tariffs, as well as in respect of life insurance with surplus sharing regarding the development of the policyholder's entitlements.

(4) The policyholder may at any time throughout the policy period demand that the insurer send him the terms of contract, including the general terms and conditions of insurance, in the form of a document; the costs of the first dispatch shall be borne by the insurer.

(5) Subsections (1) to (4) shall not apply to insurance contracts covering a jumbo risk within the meaning of section 210 (2). If under such a contract the policyholder is a natural person, the insurer shall inform him in writing prior to the conclusion of the contract of applicable law and the competent supervisory body.

Section 8 – Policyholder's right of revocation

(1) The policyholder may revoke his contractual agreement within 14 days. The policyholder shall declare his revocation to the insurer in writing, but need not state any reason; timely dispatch shall suffice for compliance with the time limit.

(2) The revocation period shall begin at such time as the policyholder receives the following documents in writing:

1. the insurance policy and the terms of contract, including the general terms and conditions of insurance, as well as the other information in accordance with section 7 (1) and (2), and
2. a clearly worded instruction regarding the right of revocation and the legal consequences of the revocation which makes clear to the policyholder his rights commensurate with the requirements of the means of communication employed, and the names of the person to whom the revocation is to be declared, with an address at which documents may be served, as well as a note making reference to the commencement of the revocation period and to the rules set out in subsection (1), second sentence.

Proof of receipt of the documents in accordance with the first sentence shall be incumbent on the insurer.

(3) The right of revocation shall not apply

1. to contracts of insurance with a term of less than one month,
2. to contracts of insurance for provisional cover, unless they are distance contracts within the meaning of section 312c of the German Civil Code,
3. to contracts of insurance with pension funds based on the provisions set out in a contract of employment, unless they are distance contracts within the meaning of section 312c of the German Civil Code,
4. to contracts of insurance covering a jumbo risk within the meaning of section 210 (2).

The right of revocation shall cease to apply if the contract has been wholly fulfilled by both sides at the explicit request of the policyholder before the policyholder has exercised his right of revocation.

(4) Notwithstanding subsection (2), first sentence, the revocation period in e-commerce shall not commence until the obligations set out in section 312i (1), first sentence, of the German Civil Code have also been fulfilled.

(5) The instruction to be given in accordance with subsection (2), first sentence, no. 2. shall be deemed to meet the requirements stipulated therein if the model of the Annex to the present Act is used in text form. The insurer may deviate from the model in terms of format and font size, subject to subsection (2), first sentence, no. 2, and may insert addenda such as the firm name or a mark of the insurer.

Section 9 – Legal consequences of revocation

(1) If the policyholder exercises his right of revocation in accordance with section 8 (1), the insurer shall only be obligated to repay that share of the premiums paid for the period after receipt of the revocation if the policyholder has been instructed in accordance with section 8 (2), first sentence, no. 2 about his right of revocation, the legal consequences of revocation and the contribution to be paid, and he has agreed that the insurance cover commences prior to the end of the revocation period; the duty to reimburse shall be fulfilled without undue delay, at the latest 30 days after receipt of the revocation. If no note was provided as required under the first sentence, the insurer shall in addition reimburse the insurance premiums paid for the first year of insurance cover; this shall not apply if the policyholder has claimed benefits on the basis of the insurance policy.

(2) If the policyholder has effectively exercised his right of revocation in accordance with section 8, he shall also no longer be bound by a contract associated with the insurance contract. An associated contract shall be deemed to exist if it is connected to the revoked contract and relates to a service of the insurer or of a third party on the basis of an agreement between the third party and the insurer. No contractual penalty may be either agreed or demanded.

Section 19 – Duty of disclosure

(1) The policyholder shall disclose to the insurer before making his contractual acceptance the risk factors known to him which are relevant to the insurer's decision to conclude the contract with the agreed content and which the insurer has requested in writing. If, after receiving the policyholder's contractual acceptance and before accepting

the contract, the insurer asks such questions as are referred to in the first sentence, the policyholder shall also be under the duty of disclosure as regards these questions.

(2) If the policyholder breaches his duty of disclosure under subsection (1), the insurer may withdraw from the contract.

(3) The insurer's right to withdraw from the contract shall be ruled out if the policyholder breached his duty of disclosure neither intentionally nor by acting with gross negligence. In such cases the insurer shall have the right to terminate the contract subject to a notice period of one month.

(4) The insurer's right to withdraw from the contract on account of grossly negligent breach of the duty of disclosure and his right to terminate the contract in accordance with subsection (3), second sentence, shall be ruled out if he would also have concluded the contract in the knowledge of the facts which were not disclosed, albeit with other conditions. The other conditions shall become an integral part of the contract with retroactive effect upon the request of the insurer; in the case of a breach of duty for which the policyholder does not bear responsibility they shall become an integral part of the contract as of the current period of insurance.

(5) The insurer shall only be entitled to the rights under subsections (2) to (4) if he has instructed the policyholder in writing in separate correspondence of the consequences of any breach of the duty of disclosure. These rights shall not exist if the insurer was aware of the disclosed risk factors or the incorrectness of the disclosure.

(6) In the case of subsection (4), second sentence, leading to an increase in the insurance premium of more than 10 per cent on account of an alteration of the contract, or if the insurer refuses to cover the risk for the undisclosed circumstance, the policyholder may terminate the contract without prior notice within one month of receipt of the insurer's communication. The insurer shall notify the policyholder of this right in the communication.

Section 20 – Policyholder's representative

If the contract is concluded by a person representing the policyholder, both the representative's knowledge and fraudulent conduct as well as the policyholder's knowledge and fraudulent conduct shall be taken into account in the application of section 19 (1) to (4) and section 21 (2), second sentence, and subsection (3), second sentence. The policyholder may only invoke the duty of disclosure not having been breached intentionally or with gross negligence if neither the representative nor the policyholder has incurred responsibility for intent or gross negligence.

Section 21 – Exercising of the insurers rights

(1) The insurer must assert the rights afforded him in accordance with section 19 (2) to (4) in writing within one month. The period shall commence at such time as the insurer learns of the breach of the duty of disclosure on which the right he is asserting is founded. When exercising his rights, the insurer shall disclose the circumstances on which his declaration is based; he may subsequently disclose further circumstances as grounds for his declaration if the time limit in accordance with the first sentence has not yet expired.

(2) In the event of a withdrawal in accordance with section 19 (2) after the occurrence of the insured event, the insurer shall not be obligated to effect payment, unless the breach

of the duty of disclosure refers to a circumstance which is neither responsible for the occurrence or for the establishment of the occurrence of the insured event nor for the establishment or the extent of the insurer's liability. If the policyholder has fraudulently breached the duty of disclosure, the insurer shall not be obligated to effect payment.

(3) The rights of the insurer in accordance with section 19 (2) to (4) shall lapse five years after the contract expires; this shall not apply to insured events which occurred prior to the expiry of this time limit. If the policyholder has breached the duty of disclosure intentionally or by acting fraudulently, this period shall be ten years.

Section 22 – Fraudulent misrepresentation

The right of the insurer to avoid the contract on account of fraudulent misrepresentation shall remain unaffected.

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