A Comparative Analysis Of Contract Enforcement

Differences in the interpretation of contract terms in Japan, Brazil and United States

Eduardo Mesquita Pereira Alves kobayashi[1]

ABSTRACT

The legal literature has long showed that common law courts tend to interpret contracts in a more literal and restricted manner, whereas civil law countries grant greater discretionary powers to judges in analyzing the content of these agreements. This paper analyses the interpretation of complex commercial agreements in Japan and illustrate through comparative law different approaches adopted in the US and Brazil, analyzing theories on contracting practices, the willingness of judges to change contracted terms and the use of general principles to understand or alter the intention of the parts. It attempts to the draw from these experiences evidences of the different roles of the state in contract law, and possible reasons of why different countries adopt contrasting ways of policing agreements and enforcing breaches. It may have implications in the understanding of economic consequences of contract law, showing alternative possibilities of dispute resolution outside an US-centric biased view, while at the same time contributing to the understanding of court predictability in different jurisdictions.

Keywords: Brazil. Japan. USA. Contracts. Comparative Study.

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[1] PhD Candidate. Graduated in Law at the Federal University of Parana (UFPR) in 2012. Master in Laws at the University Tokyo (2017)

1. Introduction

There is a clear difference in contract practices around the world, and different ways of enforcing these contracts. Legal scholars have tried to explain these differences using concepts as the divergence between common and civil law systems[2], high and low trust environments[3], coordinated and liberal economies[4], distinctive procedural rules[5] and so on.

In this paper, after introducing some of these theories, we analyze primarily a series of decisions from Japanese courts concerning the interpretation of complex commercial contracts such as Stock Purchase Agreements, a theme that has stirred the interest of scholars and practitioners in recent years[6]. We then compare the Japanese approach to practice and legal theory from the United States and Brazil, applying and testing current theories, while trying to better understand how and why

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2 Aditi Bagchi, "The Political Economy of Regulating Contract," *American Journal of Comparative Law* 62, no. 4 (February 13, 2014); Mariana Pargendler, "The Role of the State in Contract Law: The Common-Civil Law Divide," *NYU Law and Economics Research Paper No. 17-01* (March 2018): 143.

3 E. Farnsworth, "A Common Lawyer's View of His Civilian Colleagues," *Louisiana Law Review* 57, no. 1 (November 1, 1996): 227, https://digitalcommons.law.lsu.edu/lalrev/vol57/iss1/12.; Rubén Kraiem, "Leaving Money on the Table: Contract Practice in a Low-Trust Environment," *Columbia Journal of Transnational Law* 42, no. 3 (2004): 715.

4 Katharina Pistor, "Legal Ground Rules in Coordinated and Liberal Market Economies," *ECGI - Law Wroking Paper*, no. 30 (March 1, 2005), https://doi.org/10.2139/ssrn.695763.

5 John Langbein, "Comparative Civil Procedure and the Style of Complex Contracts," *The American Journal of Comparative Law* 35, no. 2 (1987): 381-394.

6 Hiromi Watanabe, "M&A keiyaku ni okeru hyōmei hoshō jōkō no kōryoku ga mondai ni natta saikin no jirei", *Kyōto gakuen hōgaku/Kyōto gakuen hōgaku gakkai*, no. 2–3 (2008): 179-198; Mitsuhiro Harada, Tatsuya Nakayama, and Keita Yasui, "Kigyōbaishū jitsumu hōkoku kenkyūkai (11) MAC jōkō wo mekuru jitsumu taiō ni kansuru," *Kinyū Shōji Hanrei*, no. 1380 (November 2011).

contract drafting and interpretation differ among jurisdictions.

Most studies deal with these differences in theoretical terms or through examples from the US[7], representing the mainstream common law practices, and Germany[8], as the traditional civil law jurisdiction. Therefore, this paper adds new countries and new dimensions to these studies.

Regarding the choice of countries for analysis, first, not only has the US been mentioned in most works of this kind, due to the increasing globalized trade practices its contracts have influenced commercial interactions all over the world.

As for Japan, it adopts the civil law system with some American influence, but with a legal scholarship and courts that still rely heavily on continental law theories and practices. Differences in contract practices have not gone unnoticed in Japan, from Kawashima[9], explaining Japanese contracts through culture, to recent and more empirical studies on typical practices of supply and purchase agreements[10]. It offers, therefore a less studied but still

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7 Bagchi, "The Political Economy of Regulating Contract."; Pistor, "Legal Ground Rules in Coordinated and Liberal Market Economies."; Langbein, "Comparative Civil Procedure and the Style of Complex Contracts."

8 See, Steven Casper, "The Legal Framework for Corporate Governance: Explaining the Development of Contract Law in Germany and the United States," *Discussion Papers / Wissenschaftszentrum Berlin Für Sozialforschung, Forschungsschwerpunkt Arbeitsmarkt Und Beschäftigung, Abteilung Wirtschaftswandel Und Beschäftigung*, no. 303 (1998): 41. Ejan Mackaay, "Good Faith in Civil Law Systems – A Legal-Economic Analysis," *Revista Chilena de Derecho Privado*, no. 18 (July 2012): 149–77, https://doi.org/10.4067/S0718-80722012000100004 or Langbein, "Comparative Civil Procedure and the Style of Complex Contracts."

9 Takeyoshi Kawashima, "Dispute Resolution in Contemporary Japan," in *Dispute Resolution in Contemporary Japan*, ed. Arthur Taylor von Mehren (Cambridge: Harvard University Press, 1963): 41-72.

10 Zen'ichi Shishido, "Nihonteki torihiki shūkan no jitai to henyō: Sōron: torihiki tōjishakan no dōkizuke kōshō no kanten kara," *Junkan shōji hōmu = Commercial Law Review*, no. 2142 (August 2017).

sophisticated alternative to German commercial contract view.

Brazil, providing a contrast to developed economies like Japan and US, is a developing country with low trust environment and very traditional civil law approaches. Introducing the Brazilian practice is a chance to better understand the above-mentioned theories by presenting a new element for comparison, while also giving an insight on contract practices and interpretation in a developing Latin American economy.

The paper is organized in three sections. Section I introduces general theories about the civil and common law divide regarding commercial agreements. Section II presents case law from three countries as means to test the theories presented. Section III concludes the work through an analysis of the rulings, emphasizing the contrasts and similarities found.

2. Contract Practices and Enforcement Theories

The importance of contract law has already been underscored by Douglas North[11], emphasizing that the lack of an effective, low-cost enforcement as the main cause for stagnation and underdevelopment in the Third World.

The relevance of asking how legal rules are formulated in contract law has been questioned by scholars, based on the assumption that, in the end, jurisdictions reach the same outcomes. Still, differences exist and can be studied.

First, from the viewpoint of practitioners, civil and common law lawyers differ in their approach to drafting agreements[12]. They have distinctive writing styles that arise from the level of trust (or mistrust) towards law in

11 Douglass North, *Institutions, Institutional Change and Economic Performance* (New York: Cambridge University Press, 1990), 54.

12 Farnsworth, "A Common Lawyer's View of His Civilian Colleagues," 230

general, leading common lawyers to greater prolixity[13]. There is also a clear variation on the use of legal jargons, including key concepts as good faith.

The classical explanation for these differences is that civil lawyers have at their command many synthetic concepts that save a lot of space-consuming enumeration[14]. But this distinction is also considered insufficient to explain the level of differences[15].

Therefore, these divergences can also be explained in terms of trust[16], arguing that levels of social trust "will affect the contracting practices that are considered standard, practical or fair in any legal or business culture" [17].

This would relate to the civil-common law problem because certain features of the Civil Law tradition seem to resonate with the more distrustful attitudes generally[18]. In this context, civil law supposedly relies more on legal provisions concerning the actual effects and contents of specific types of contracts prescribed in legal codes[19], it is less willing than Common Law to divorce the concept of contractual liability from the notion of fault[20], and while civil and commercial codes may contain detailed provisions for specific types of contracts, practitioners are used to invoke broad principles as the applicable rules of law[21].

All this could somehow relate to lack of trust in deals and therefore

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13 Ibid., 233

14 Van Heecke, "A Civilian Looks at the Common-Law Lawyer", in *International Contracts: Choice of Law and Language*, ed. Willis L.M. Reese (New York: Oceana Publications, 1962)

15 Langbein, "Comparative Civil Procedure and the Style of Complex Contracts," 384

16 Kraiem, "Leaving Money on the Table: Contract Practice in a Low-Trust Environment."

17 Ibid., 4

18 Ibid., 38

19 Ibid.

20 Ibid., 39

21 Ibid., 41

heavier reliance on law and in general concepts, instead of specific contract provisions designed by the parties.

In the opposite direction, there is also the opinion that contracts drafted in the United States, for example, are more detailed than in civil law jurisdictions because the American civil procedure is inefficient, expensive, protracted, and unpredictable, while European systems are more efficient and more predictable[22]. Here, the lack of trust in institutions lead the American lawyer to "handle all eventualities in the contract rather than leave them to the decision of the judge"[23] and incorporating in a contract all sorts well-settled principles of law and canons of interpretation, the so-called default rules[24].

In any case, in terms of practice, there is a consensus that common law contracts tend to be longer and more detailed than civil law agreements, be it by lack of trust on the legal system or higher trust among contracting parties.

Having seen these general ideas about contract practice differences between common and civil law countries, we look at some theories on enforcement.

In general, courts can play stronger or weaker roles depending on how proactive they act in interpretation and enforcement. Stronger courts may take in consideration evidence extrinsic to the contract and implied or unwritten terms, while weaker courts tend to be reluctant about rewriting agreements, even if better reflecting the parties intentions[25]. The general idea is that courts play stronger roles in civil law countries and weaker roles in common law countries.

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22 Langbein, "Comparative Civil Procedure and the Style of Complex Contracts," 386

23 Van Heecke, "A Civilian Looks at the Common-Law Lawyer," 14

24 Langbein., 384

25 Pargendler, "The Role of the State in Contract Law: The Common-Civil Law Divide," 23

Also, while common law courts are better suited at interpreting agreements ex-post to advance regulatory objectives, in civil law, since precedent is not formally binding, judges can apply statutes directly to individual cases and "default rules, applied through interpretation ex post, will be ad hoc and ineffective"[26], so we expect to see more cases of judges ignoring certain contracted terms.

In the next session, we provide examples of a series of Japanese judicial decisions and compare them with American and Brazilian rulings to see how these countries realities fit in the general assertions presented above.

Most works focus their analysis of the quality of contract enforcement institutions based on measures of procedure, and do not take enough considerations to the substance of what is actually enforced[27]. This paper contributes to the evaluation of this "substance" and faces one fundamental question of contract law, namely which agreements or clauses courts enforce[28], and in which terms enforcement happen.

3. Case Law on Contract Interpretation

A) Japan

The specificities of Japanese commercial contracts have been vastly studied, especially concerning the distinctive[29] characteristics of agreements between suppliers and purchasers, such as the use of vague clauses; the absence of clauses detailing the whole content of the agreement; use of informal means outside of the contracted terms to deal with unpredicted

[26] Bagchi "The Political Economy of Regulating Contract," 28

[27] Mariana Pargendler, "Comparative Contract Law and Development: The Missing Link?," *George Washington Law Review*, no. 85 (2017): 1718.

[28] Ibid.

[29] Distinctive compared to US practices.

problems; low expectation of literal enforcement and avoidance of courts as a mean to solve disputes arising from the contract[30].

But this paper deals with a different problem, the practice and interpretation of less " continuous" commercial contracts, such as stock purchase agreements. There is reason to believe that due to globalization they may have distanced themselves from the contract traditions mentioned above, emulating American standards, providing more details and leading to parties expecting a higher level of literal application of its terms. Still, practice shows that they tend to maintain many of civil law characteristics explained above.

This theme has already attracted the attention of Japanese scholars[31], and in the last 10 years there has been an increase in the number of judicial decisions concerning the interpretation of Warranties & Representations, Material Adversity Clauses and other clauses typical of complex commercial transactions.

One of the most important cases concerning this theme is Tokyo District Court, 2006 (Wa) 8241 (January 1, 2008). This widely criticized decision[32] established what can be called the standard expected approach to the interpretation of Representations & Warranties.

In this case, the sellers of company A represented to buyer X that the

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30 Shishido, "Nihonteki torihiki shūkan no jitai to henyō: Sōron: torihiki tōjishakan no dōkizuke kōshō no kanten kara," 8

31 Hiroto Dōgauchi, Kazuhiko Yamamoto, Tarō Kogayu, and Akio Hoshi, "Hyōmei hoshō jōkō ihan wo ryū to suru songai baishō seikyū soshō," *Ronkyū Juristo = Quarterly Jurist*, no. 22 (2017): 156-179; Watanabe, "M&A keiyaku ni okeru hyōmei hoshō jōkō no kōryoku ga mondai ni natta saikin no jirei"; Harada et al., "Kigyōbaishū jitsumu hōkoku kenkyūkai (11) MAC jōkō wo mekuru jitsumu taiō ni kansuru," 2-11

32 See, Mika Takashi, "Shōji hanrei kenkyū (Heisei 22 nendo) Kabushiki jōto keiyaku ni okeru hyōmei hoshō no taishō [Tōkyo chisai heisei 22.3.8 hanketsu]," *Jurisuto = Monthly Jurist, Yuhikaku*, no. 1439 (2012): 115-118

Financial Statements of the target company were perfect and accurate and were elaborated following generally accepted accounting standards. Later, X, having found accounting irregularities in the company's ledger, brought suit against the Sellers for violation of the representations and warranties clause provided in the Stock Purchase Agreement.

According to the decision, if a violation was committed by the Sellers in good faith and X did not find out irregularities due to its own gross negligence, then the Sellers should not be liable for damages caused by such irregularities.

Although the court, after analyzing the due diligence process and its general role in M&A deals denied X's gross negligence in identifying the accounting irregularities during the due diligence process, by affirming that the Sellers could have avoided liability for damages in case of negligence was a major departure from the contracted terms.

It has been pointed out that the Court imposed an anti-sandbagging clause in a contract where it did not exist, what seems consistent with the idea that civil law countries have problems divorcing the concept of contractual liability from the notion of fault.

Not long after, in a different but also pro-active interpretation of contracted terms, once again Japanese Courts steered away from written contracted terms.

In Tokyo District Court, 2006 (Wa) 4129 (July 26, 2007), Buyer X acquired Company A from Seller Y, but after the acquisition, X found out that Y had misrepresented facts concerning the current business and financial situation of A, not being able to achieve the projected revenue and being forced to pay debts that were not mentioned during the negotiations. X filed suit against Y for violation of the representations and warranties clause, demanding compensation for the damages caused.

The Court concluded that Seller Y had a duty to provide accurate information to the buyer during the negotiation process, but also acknowledged that it is extremely difficult to provide complete information about all the target company's assets and liabilities without committing mistakes that may affect the value of the enterprise in the future.

Considering that it is unrealistic to demand such level of accurate disclosure, the Court ruled that the Seller had only represented and guaranteed the accuracy of important or material aspects of the information provided, although only some items of the reps and warranties clause contained the expression "important" or "material".

Again, the Court departed from the contracted provisions, ignoring what may have been deliberate wording negotiated by the parties for the purpose of risk allocation. While it didn't rely on the concept of fault, as the previous decision, it did go after what it thought was the real intention of the parties, regardless of the written terms.

Steering away from the trend set by both decision analyzed before, Tokyo District Court, 2006 (Wa), 9829 (September 9, 2007) went for a more passive and literal interpretation. Here, Plaintiff X and Defendant Y signed capital tie-up and business partnership agreements, leading X to adopt Y's commercial name. Soon after, Y officers were found guilty of window-dressing accounts and the company was delisted from the Stock Exchange. Although not provided by the contract, X claimed that, based on the good faith principle, Y was liable for damages due to the loss of credit and confidence caused to the company's name by those illegal acts.

Emphasizing party autonomy and freedom of contract principles and considering that there was no structural asymmetry of information between both companies, the Court underscored that collecting and analyzing information is a duty of the contracting parties.

The representations and warranties clause concerning Y was composed by only three items, and the contract did not provide that Y had to inform X about any irregularities such as window-dressing, leading to the conclusion that during negotiations the parties agreed that there was no need for Y to make any guarantees about its financial situation.

The Court did not deny that, for X, the objective of the contract was to profit through the use of Y's name and reputation, but the contract did not impose on Y any duties related to maintaining its reputation, and this was not a key issue during the negotiation process, concluding therefore that Y did not bear any duty to explain its financial situation and that X was negligent during the due diligence process.

Not only this decision respected the literal meaning of the contracted terms, it departed from the well-established civil law tradition of imposing good faith duties during negotiations.

Following the trend of a more passive role for courts, Tokyo District Court, 2008 (Wa) 34582 (March 8, 2010) also opted by a literal interpretation of contracts. In this case, X signed a Stock Purchase Agreement to acquire all stocks of Company A from Sellers Y1~Y8. The contract provided that if between signing and closing there was a variation of 10% in the company's assets' value, the parties would adjust the purchase price. The sellers also warranted X that no material facts capable of causing adverse effects on the company's financial conditions had occurred.

Only 3 days after the closing of the contract, X asked for termination due to the occurrence of materially adverse facts, including operating losses higher than what was predicted in the business plan and a sharp difference in the price of real estate owned by the company, bringing it to a condition of insolvency.

The Court decided that the business plan was nothing more than a

prediction, and that the increase in losses from 15,800,000 yen to 54,200,000 yen, as well as the difference in real estate prices were not caused by fabricated numbers in the valuation reports. Therefore, those differences did not constitute a material fact affecting the company's financial condition, but rather questions of appropriateness of valuation methods.

The court emphasized the lack of asymmetry between contracting parties and the fact that the appropriateness of valuation methods was not subject to the representations and warranties clause. It found that while a drop in real estate prices could constitute basis for a price adjustment under Clause 2.2, it did not constitute a false statement or material inaccuracy that could be considered cause for termination of contract under Clause 6.4.3.

The Court considered the parties ability to negotiate each clause and adopted a more literal approach when interpreting respecting the voluntary allocation of risks that resulted from a negotiation between sophisticated parties. In this case once again the Japanese judiciary did not adopt the expected behavior of civil law courts.

Finally, in the more recent Tokyo District Court, 2013 (Wa) 32578 (June 3, 2016), a case concerning another Stock Purchase Agreement, among a variety of points at issue, the parties contended the interpretation of the price adjustment clause.

Buyer X and Seller Y signed a contract for the acquisition of all stocks from Company A. During negotiations, both parties agreed that part of the real estate owned by A would not be appraised. After the closing of the contract, X asked for adjustment of the purchase price due to accounting irregularities. Y claimed that if prices would be adjusted, the price of real estate previously valuated at 0 yen should also be reviewed.

The Court decided that, regarding the price adjustment clause, the parties considered only the possibility of variation of liquid assets prices, reaching

this conclusion based annotations by the Buyer in the balance sheets and in a low probability of real estate prices variating in the short period between signing and closing.

In this case the court departed from the contract by looking for the parties' intentions in other written documents and in the negotiation procedure. While it seems to be a less "invasive" method, the Court could have dismissed the seller arguments by relying only in the wording of the contract, that provided for adjustments based on the variation of assets prices and not revaluation of previously agreed values. Still, it decided to play a "stronger role" in a search for the real meaning of the contracted words.

B) United States

From the cases above it is hard to say if Japanese courts favor a literal approach to contract interpretation or a more active role of the state in shaping the understanding of agreements, but it is clear that some judges go beyond the wording of the contracts to guarantee the fairness of deals based on their vision of fairness or in the conditions imposed by law.

In this sense, it does seem to differ from American courts typical understanding. Focusing on rulings from Delaware, not only contracted terms are almost always respected, there is a tendency to emphasize the importance of this respect.

Starting with the recent Lazard Technology Partners, LLC, v. Qinetiq North America Operations LLC[33] ruling, it welcomed the Court of Chancery decision to give plain meaning to a merger agreement clause prohibiting the buyer from taking any action to divert or defer revenue with the intent of reducing or limiting an Earn–Out Payment,following the reasoning of a line of

[33] Lazard Technology Partners, LLC v. Qinetiq North America Operations LLC, 114 A.3d 193 (Del. 2015)

decisions establishing that Courts are "constrained by a combination of the parties' words and the plain meaning of those words where no special meaning is intended"[34].

This reasoning comes from a commonly accepted practice according to which "the plain, common, or normal meaning of language will be given to the words of a contract"[35], leading to the well-established general understanding in Delaware that "it is not the proper role of a court to rewrite or supply omitted provisions to a written agreement"[36].

Absent some ambiguity, the courts of that American State "will not destroy or twist policy language under the guise of construing it" [37] because " when the language of a [contract] is clear and unequivocal, a party will be bound by its plain meaning because creating an ambiguity where none exists could, in effect, create a new contract with rights, liabilities and duties to which the parties had not assented"[38].

While it is true that in Abry Partners V LP v. F&W Acquisition LLC, the Delaware Court decided that sellers may not insulate themselves from liability for misrepresentations if they were made intentionally by the seller or with the seller's knowledge of their falsity, overriding contracted terms, it also reaffirmed the line of cases that held that sophisticated parties may, in most situations, contract away the right to bring extracontractual fraud claims.

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34 Lorillard Tobacco Co. v. Am. Legacy Found., 903 A.2d 728, 739 (Del. 2006)

35 Arthur L. Corbin, *Corbin on Contracts*. (St. Paul, Minn: West Publishing, 1952)

36 Cincinnati SMSA Ltd. P'ship v. Cincinnati Bell Cellular Sys. Co., 708 A.2d 989, 992 (Del. 1998)

37 Rhone–Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co., 616 A.2d 1192, 1195–96 (Del. 1992)

38 Rhone–Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co., 616 A.2d 1192, 1195–96 (Del. 1992)

Even in the presence of good faith clauses the Court has been careful in interpreting them too extensively. In Nemec v. Shrader, the Court affirmed that "when conducting this analysis, we must assess the parties' reasonable expectations at the time of contracting and not rewrite the contract to appease a party who later wishes to rewrite a contract he now believes to have been a bad deal. Parties have a right to enter into good and bad contracts, the law enforces both"[39], clearly emphasizing the parties' autonomy.

In a later case, it added that "the implied covenant of good faith and fair dealing should not be applied to give plaintiffs contractual protections that they failed to secure for themselves at the bargaining table", showing the importance given to the negotiation process[40].

Also, US courts have also been reluctant in applying other doctrines that allow a more expansive interpretation such as doctrines of impracticability or frustration of purpose[41].

C) The Brazilian Approach to Contract Interpretation

Considering that in Brazil most complex commercial agreement disputes end up in arbitration procedures, confidential by nature, there is a smaller set of precedents to analyze, but the doctrine and similar contract disputes can hint about the understanding in the country.

Past works have identified an active role of Courts adopting, for example, anti[42] and pro[43] creditor bias in contract interpretation. Other works,

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39 Nemec v. Shrader, 991 A.2d 1120, 1125 (Del. 2010)

40 Winshall v. Viacom Int'l, Inc., 55 A.3d 629, 636–37 (Del. Ch. 2011)

41 Pargendler, "The Role of the State in Contract Law: The Common-Civil Law Divide," 22

42 Ivan Cesar Ribeiro, Robin Hood vs. King John Redistribution, How Do Local Judges Decide Cases in Brazil, *UC Berkeley: Berkeley Program in Law and Economics Working Paper* (2007), https://ssrn.com/abstract = 938174.

implicitly denying biases, have emphasized the unpredictability of appeals in the enforcement of forward contracts.[44]

A key concept in Brazilian law, as in many other jurisdictions, is "pacta sunt servanda", meaning that a breach of contract among equals is inadmissible. However, according to Article 421 of the Brazilian Civil Code: "The freedom to contract shall be exercised within reason and within the limits of the social function of the contract". Also, Article 422 provides for a duty of good faith during negotiations and closing of contracts[45].

The above-mentioned research concerning future contracts provides some insights on how powerful these two provisions are. The research found that, regardless of the heterogeneity appeal decisions subject to the study, 75% of rulings changing contracted terms have been based "on the principles of the social function of the contract, good faith, and economic balance, as provided for in articles 421 and 422 of the Brazilian Civil Code"[46].

While this analysis on future contracts was conducted only in the State of Goias, we also found recent evidence of the Sao Paulo Court of Appeals taking a pro-active role in denying the enforcement of a contract for acquisition of a limited liability company based on principles of good faith[47].

But going one step above in the judicial hierarchy, there seems to exist a recent trend in decisions of the Superior Court of Justice that are less invasive

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43 Luciana Luk-Tai Yeung and Paulo Furquim de Azevedo, Nem Robin Hood, nem King John: Testando o Viés Anti-Credor e Anti-Devedor dos Magistrados Brasileiros, *Economic Analysis of Law Review* 6, no. 1 (2015): 1.

44 Christiane Leles Rezende and Decio Zylbersztajn, Pacta sunt servanda versus the social role of contracts: the case of Brazilian agriculture contracts. *Revista de Economia e Sociologia Rural, 50*(2), (2012): 207-221.

45 Rezende and Zylbersztajn, "Pacta sunt servanda versus the social role of contracts: the case of Brazilian agriculture contracts," 215

46 Ibid.,

47 TJSP, Ap. 0007092-28.2006.8.26.0581, Rel. Francisco Loureiro, DJ 31/10/2012

in their approach to commercial contracts interpretation.

As a matter of fact, concerning the Special Appeals related to the future contracts mentioned before, the Superior Court have reversed the Court of Appeals rulings and enforced those contracts denying any violations of the principle of good faith[48].

Also, in a recent shopping center property lease contract dispute, the Court have enforced clauses imposing double rent in the 12th month of the year emphasizing the importance of party freedom and autonomy in commercial contracts[49] despite claims of abusive behavior.

According to the ruling, judicial control over commercial contracts should be more restricted than in other areas of private law do to a certain amount of equality between contracting parties. Still, the decision also emphasizes that private autonomy is not an absolute principle and that it can be relativized based on objective good faith, social function of contracts and public interest

In other words, while enforcing the contract on its literal terms and refusing to deny enforcement, based on notion of fairness[50], to supposedly abusive clauses, the decision did affirm the active role of the judiciary in reviewing contracts based on general principles, in an approach somewhat similar to Tokyo District Court, 2006 (Wa) 8241 (January 1, 2008), where a contract was also enforced with reservations, creating an environment of unpredictability.

Finally, it is important to remember that it is not rare to find the Superior Court reviewing contracts based on principles of good faith[51]. Therefore, it is hard to determine exactly what is the real trend in Brazil.

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48 STJ, REsp 803481/GO, Rel. Nancy Andrighi, Terceira Turma, 28/06/2007, DJ 01/08/2007, 462

49 STJ, REsp 1.409.849-PR, Rel. Paulo de Tarso Sanseverino, julgado em 26/4/2016, DJe 5/5/2016.

50 Pargendler, "The Role of the State in Contract Law: The Common-Civil Law Divide," 15

4. Analysis and Concluding Remarks

The similarities between Japan and Brazil and how they differ profoundly from the US seem to confirm most of the ideas presented in the first part of this paper regarding the divergence between civil and common law as an effective framework for explaining differences in contract practices and enforcement. However, is the current scholarship able to explain how the characteristics of both legal systems create this disparity?

As for the literal interpretation of US courts, it may be explained by the idea that US contract law is constructed around classical principles, based on the idea that parties are sophisticated and that by enforcing formal written agreements, courts protect their freedom to contract. This may lead to US courts enforcing even flawed written contracts[52].

On the other hand, the more proactive interpretation of Japanese and Brazilian courts seems to be consistent with typical characteristics of civil law countries, such as the presence of a stronger duty of good faith and a greater number of mandatory rules, leading state actors to proactively intervene in contracts[53].

It is true that Brazilian judges rely more on general principles like good faith and social function, that give ample discretion to courts, while Japanese judges use less of these principles. But this is not a surprise, since not all civil law jurisdictions embraced enthusiastically the good faith principle[54]. Still,

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51 STJ, AgRg no Ag 1383974/SC, Rel. Min. Luis Felipe Salomão, 13/12/2011, DJe 01/02/2012

52 Casper, " The Legal Framework for Corporate Governance: Explaining the Development of Contract Law in Germany and the United States," 4

53 Pargendler, "The Role of the State in Contract Law: The Common-Civil Law Divide," 4

54 Ibid., 10

judges in Japan rely on the internal logic of the positivized system to create duties that are not provided in contract, what is consistent with the civil law approach presented until now.

In the cases presented here, this may be related to an attempt to identify the relation between positivized mandatory rules and contract clauses. In the context of representations and warranties, for example, instead of considering these declarations as a "sui generis" clause, they end up being interpreted as warranties against defects, or as illegal acts instead of breaches of contracts. In both cases subjective factors concerning both parties, such as fault, play a relevant role, and this could explain why judges in Japan depart from written terms in contracts and search for the parties' intentions.

Also, by acting in this way they confirm a more pro-active role of the state in interpreting and enforcing contracts in civil law jurisdictions, precisely because they have the freedom (and to some extent what they can see as a duty) to use tools given by the positivized system to find fairness in deals based on socially accepted conception of what is fair. This seems consistent with the ideas that in civil law "a moderate amount of judicial activism may ensure maintenance of the status quo, as judges may use general clauses to reinforce social preferences even after specific legal incarnations of such principles have been abolished[55].

On the other hand, theories of trust didn't hold as well as theories based on institutional characteristics of civil and common law countries.

If trust was truly relevant, we would not expect to see so many similarities between Japan, a high trust society, and Brazil, that has some of lowest levels of trust in the world. It seems, therefore, that contracting practices, including complexity of agreement, and enforcement, including

[55] Pistor, "Legal Ground Rules in Coordinated and Liberal Market Economies," 14

how terms are interpreted, may be more related to institutional factors than to social or cultural characteristics. Maybe contracts in Japan are not vague because of a sense of harmony or excessive trust, but because of institutional characteristics of the civil law system. For example, what would be the point of adding definitions that are provided by law, or terms that will not be enforced by judges due to the power of default statutory rules?

In this context, at least regarding the cases and realities presented here, a stronger duty of good faith in the civil law world seems to be heavily present in the Brazilian case law, while statutory rules seem to influence Japanese judges approach to agreements, working as "sticky" default rules[56] even when parties contract out some these positivized rules.

In other words, be it by means of general principles, be it by means of specific rules disciplining contracts, state supplied terms and notions of fairness may trump the parties' preferences[57] in Brazil and Japan, a result probably related to how the civil law system works, and not to how social relations are structured.

Importantly, these differences may also be explained in terms of political economy, by the distinct role of the state in different jurisdictions, which is stronger in civil law countries, since the system allows policing "substantive terms of agreement to ensure compliance with broader social values and objectives" [58], while embracing a different role in the common law world, a system structured around leaving more space to private ordering. All this seems to be consistent with the more active interpretation seen in Japan and Brazil and the more hands-free approach in the US.

We believe that the heterogeneity of the decisions presented, with some

56 Pargendler, "The Role of the State in Contract Law: The Common-Civil Law Divide," 15

57 Pargendler., 16

58 Ibid., 5

cases of literal interpretation of contracts in Japan and Brazil, do not refute the idea that in civil law there is a tendency to a more invasive interpretation of contracts. Rather, it helps to refute the notion that the power of judges is always more limited in civil law countries[59].

As explained by Pistor, "in crucial areas civil law judges wield much more power and have much greater discretion than common law judges do. More important than this stylized comparison seems to be the extent to which judges are empowered to subject private contracts to social norm conditionality" [60].

The Japanese, Brazilian and American experiences appear to confirm this idea. If so many differences in the civil and common law systems seem to explain divergent contract practices in those countries, we believe it is worth to focus on institutional factors to understand practices underlying commercial transactions and its enforcement by courts.

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[60] Pistor., 19

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