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Use of Shareholder Agreements and Other Control Techniques in Japanese Joint Venture Corporations and Their Validity Under Japanese Corporate Law

I. Introduction

A. Basic Nature of Problem

The typical Japanese joint venture corporation will usually be formed by one Japanese and one foreign corporation, with the total shares of the joint venture corporation divided between them. Although this type of enterprise could easily be organized as a Japanese limited liability corporation (*yūgen gaisha*),[1] primarily for psychological and sociological reasons that form is invariably rejected in favor of incorporation as a stock corporation (*kabushiki kaisha—k.k.*).[2] Thus, as in the close corporation situation under the typical American corporation statute, the interests of the parties must be accommodated through use of a corporate form intended primarily for enterprises with much more complex ownership interests. In both countries it is necessary to fashion appropriate devices to protect these interests despite use of the rather cumbersome structure of the corporate law.

Devices used to accommodate the interests of the parties involved in a

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[1]*Yūgen gaishahō* (Limited company law) (Law No. 74, 1938), in 2 EHS No. 2230).

[2]The Japanese equivalent of our state corporation statutes is a part of their Commercial Code. The part applicable specifically to stock corporations is Commercial Code arts. 165-456. Regarding rejection of the limited liability corporation form, see Henderson, *Contract problems in U.S.-Japanese Joint Ventures*, 39 WASH. L. REV. 479, 490-91 (1964) [hereinafter cited as Henderson]; Tatsuta, *Types of Business Organizations* at 56, in 1 M. TATSUTA & D. HENDERSON, JAPANESE BUSINESS CORPORATION LAW (date undetermined) (locally produced textbook for the Asian Law Program, University of Washington School of Law) [Hereinafter cited as Tatsuta-Henderson text]; and N. KOBAYASHI, NIHON NO GOBEN GAISHA (Japanese joint venture corporations) 125 n.2 (1967) [Hereinafter cited as KOBAYASHI].

corporation are quite diverse. In the United States, most consist of provisions inserted in the Articles of Incorporation, in the by-laws, or in shareholder or other agreements.[3] The Japanese have not developed these techniques to anything like the degree of detail and sophistication found in the United States, largely because (1) most corporations are formed without any input from lawyers, and (2) the Japanese when doing business among themselves use alternative techniques for handling the problems which Americans attempt to resolve by anticipatory drafting techniques.[4] Furthermore, the Japanese system is more circumscribed due to the absence of the by-law device, thus relegating the regulation of internal corporate matters not included in the Articles of Incorporation to a lower level of legal formality than the American system.

When corporations steeped in the differing systems come together, they should consider providing safeguards which do not overly depend upon adherence by both parties to the often unwritten rules of the one society, understood faintly, if at all, by the outsider. Thus, the more explicit techniques of the American system have basic appeal as a method of accommodation in the Japanese joint-venture corporation formed by multi-national parties. Frustrations develop, however, in attempting to determine the extent to which the American techniques can be accommodated within the Japanese system.

B. Basic Principles and Guidelines

In attempting to assess the efficacy of various devices under the Japanese law, it is first necessary to cope with the compartmentalization of the Japanese legal system. In Japanese law, not only is there a basic distinction between public and private law, under which agreements in violation of public law provisions may still be enforceable as a matter of private law,[5] but there is also a rather complete segregation of the discrete sections of private law.[6] Thus, the mere fact that a particular technique for achieving the interests of one party in a joint

[3]*See generally* F. O'NEAL, CLOSE CORPORATIONS LAW AND PRACTICE (1971). [Hereinafter cited as O'NEAL]. This two-volume work with supplements is the basic guide through American close corporation law and is an excellent planner's tool.

[4]*See, e.g.*, Henderson, *supra* note 2, at 481-82, and H. GLAZER, THE INTERNATIONAL BUSINESSMAN IN JAPAN 51-90 (1968).

[5]*See, e.g.*, Tomita v. Inoue, 19 *Saikō saibansho minji hanreishū* [hereinafter cited as *Minshū*] 2306 (Sup. Cit., 1st P.B., Dec. 23, 1965) and other cases holding contracts valid even when they violate provisions of regulatory laws. A good general discussion of the public-private law dichotomy can be found in 1 J. TANAKA, GYOSEIHO KOGI (Lectures in administrative law) 109-18 (1965).

[6]The basic provisions relating to contract law are found within Chapter II of Book III of the Civil Code, as part of the law of claim or obligation (*saiken*), while the corporate law, governing corporations, is found as Chapter IV of Book II of the Commercial Code. Legal scholarship in Japan deals with these as compartmentalized and discrete fields of study, with the corporate law specialist rarely, if ever, delving into the realm of contract law in his analysis. A typical example of this is T. ISHII, KAISHAHO (Corporate law) (1967) [Hereinafter cited as ISHII]. A rather exhaustive study of most of this two-volume work discloses that the topic of shareholder agreements is discussed only with regard to the efficacy of shareholder agreements restricting transfer of shares. *See* 1 *id.* at 168-73.

venture corporation cannot be exercised through a provision in the Articles of Incorporation does not necessarily invalidate that technique when made part of a contract. This segregation or dichotomy between basic contract concepts in the Civil Code, on the one hand, and matters of the law of corporations found in the Commercial Code, on the other hand, leads to the widespread belief that an agreement between shareholders to accomplish a given objective will be valid, at least between the parties, even though the result runs contrary to provisions of corporate law.[7] It also leads to a compartmentalization of thinking among the scholars, so that the corporate law scholar rarely considers the role of agreements as they might affect corporate relations, and the contract law specialist rarely applies his knowledge to determine the effects of contracts in separate fields of study not specifically enumerated in the Civil Code.[8]

Looking to the field of contract law, one starts with the basic concept of freedom of contract, applied with greater vigor in Japan than in the United States.[9] If applied in full force to agreements which allocate power among shareholders or bind them to make certain decisions on behalf of the joint venture corporation, this principle would lead to the conclusion that such agreements are fully enforceable. In actual fact, although there is frequently little evidence upon which to base the conclusion, such agreements may be valid and effective within amazingly broad limits. Some of these limits are those generally recognized in the Japanese Civil Code, primarily as built into articles 1, 90, and 91.

Article 1[10] probably could pose a barrier to freedom to contract in the context of the present type of situation. It sets forth essentially three principle doctrines: (1) public welfare, (2) good faith, and (3) the abuse of rights doctrine. Although the first of these three potentially could cause some difficulty when a party seeks to enforce a shareholder agreement, this principle is primarily aimed at protecting rights of the public from being destroyed by private party agreement,[11] and therefore does not appear appropriate where, as here, there

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[7]*See*, Henderson, *supra* note 2, at 486-87, 492, 500; KOBAYASHI, *supra* note 2, at 124 n. 1: and M. Kitazawa, *Sōritsuchū no kaisha* (Corporation in process of formation), in 1 K. TANAKA, KABUSHIKI GAISHAHŌ KŌZA (Lectures on the law of stock corporations) 211, 217-19 (1962). *See generally* Ohara, *Gōben gaisha no setsuritsu tetsuzuki* (Procedures for setting up a joint venture corporation), SHŌJI HŌMU KENKYŪ (Serialized over 30 issues starting with No. 459 (1968) and ending with No. 509 (1969) [hereinafter cited as Ohara, followed by a specific reference to the particular issue and page.]

[8]*See* note 6, *supra*. An exhaustive search through the periodical literature index (*kiji sakuin*) also discloses a dearth of material spanning the two fields.

[9]*See generally* T. Taneguchi, keiyaku no jiyū (freedom of contract), in 13 CHŪSHAKU MIMPŌ (Civil code annotated) 37-43 (1966).

[10]Civil Code art. 1: All private rights shall conform to the public welfare. 2. The exercise of rights and performance of duties shall be accomplished in good faith and in accordance with the principles of trust. 3. No abusing of rights is permissible.

[11]*See* S. WAGATSUMA, MIMPŌ SOSŌKU (General provisions of the Civil Code) 33-34, 38-39 (1965) [hereinafter cited as WAGATSUMA]. As an example, he mentioned a private right to float

are no outside parties affected by the agreement. Of course, if there were other shareholders in the corporation and they did not adhere to the contract, this principle *might* apply to invalidate the agreement to the extent that they were affected. The same result might also be achieved via the abuse of rights principle. However, at least where there are but two shareholders and no third party interests are involved, it seems doubtful that article 1 will provide a significant barrier to the validity of a contract between two shareholders who own all outstanding shares of the corporation.

Article 90 states that a juristic act (including the making of a contract) "which has for its object such matters as are contrary to public policy or good morals is null and void."[12] Superficially it would appear that an attempt to accomplish by shareholder agreement what the Commercial Code would prohibit if included in the Articles would run contrary to a well-defined public policy. However, the courts have not fully developed this concept, and it has been narrowly limited. *Wagatsuma* indicates that this provision generally would apply only to the following types of situations: (1) juristic acts contrary to morality (such as contracts sustaining immoral relationships), (2) juristic acts contrary to the principles of justice (such as a contract to commit a crime or payment in exchange for not doing a bad act), (3) juristic acts taking unfair advantage of another's distress (such as usury), (4) excessive restrictions on an individual's freedom (usually involuntary servitude types of situations), (5) limitations on freedom to conduct economic enterprises (unreasonable covenants not to compete, contracts between competitors which create monopolies or restraints of trade), (6) acts which dispose of one's basic means of livelihood (*seizon no kisotaru zaisan o shobun suru koto*), and (7) excessively speculative acts.[13] Thus, most provisions in a shareholders' agreement of the type contemplated in this article probably are not precluded by article 90, even though some individual shareholder agreements might clash with that article (such as prohibited limitations on one's freedom to conduct economic enterprises).

Article 91 probably provides the firmest foundation for recognizing the validity of shareholder agreements in the context of this paper. That section provides as follows:[14] "If the parties to a juristic act have declared an intention which differs from any provisions of laws or ordinances which are not concerned with public policy, such intention shall prevail."

Thus, even where the codes indicate that, for example, restrictions on share transfers must be in the articles to be valid, so long as it would not violate public

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logs on a river or canal, indicating that this right cannot interfere with the public's rights related to electrical power, public water systems, and similar uses. *Id.* at 38-39.

[12]Civil Code art. 90.

[13]WAGATSUMA, *Supra* note 11, at 270-82.

[14]Civil Code art. 91.

policy, the shareholders among themselves can agree to restrictions on share transferability and have the agreement enforceable among themselves. A problem arises, however, in that the Japanese recognize a distinction between required provisions (*kyōko hōki*) and optional provisions (*nin'i hōki*), and article 91 applies only when an optional provision is involved.[15] Thus, before it can be said that a particular legal provision is not binding when the contract has a contrary clause, it may be necessary to determine (1) whether the particular provision is mandatory or optional, and, if mandatory, (2) whether the mandatory nature of a legal provision governing the corporation will also affect a contract to which the corporation is not a party.

As can be seen from the above, one's conclusions concerning the efficacy of shareholder agreements under the Japanese Civil Code depends on answers which must be based upon an assessment of the impact of Commercial Code provisions governing the corporation when the corporation itself is not a party to the particular agreement. In this shadowy valley between the two codes, very little Japanese scholarly light has been shed.

C. *Basic Approach*

In this article the writer will enumerate several of the more common American devices for assuring protection of specific shareholder interests in close corporations, indicating briefly how they work in this country. Then, turning to Japanese law, he will determine whether the Commercial Code addresses itself to the problem either by prohibiting use of the device, restricting its use, or permitting or requiring its use. Then it will be necessary to determine the advisability of placing it in the Articles of Incorporation, putting it in a side agreement, or not using it at all. Later, the remedies available when a party has acted contrary to the agreed-to provisions will be discussed.

II. Individual Devices

A. *Voting Agreements, Including Pooling Agreements, Voting Trusts, and Irrevocable Proxies*

There are several types of voting agreements recognized in American law, of which pooling agreements, voting trusts, and irrevocable proxies are the most common.

1. POOLING AGREEMENTS

A pooling agreement is one in which all or a portion of the shareholders of a corporation agree to pool their votes and to vote all of them in favor of

[15] *See* W. Shattuck & Z. Kitagawa, U.S./Japanese Contract and Sales Problems at 113 & 200 (1970) (locally produced textbook for the Asian Law Program, University of Washington) [hereinafter cited as Shattuck & Kitagawa]; and Wagatsuma *supra* note 293-95.

designated directors.[16] In the context of a Japanese-American joint venture corporation with all shares held by two shareholders, such an agreement would, for example, require both parties to vote for a full slate of candidates, half nominated by the Japanese shareholder and half by the American shareholder. O'Neal concludes that:[17]

> By the great weight of authority, an agreement by some or all of the shareholders to combine their votes for directors is valid, even in the absence of specific statutory sanction, at least as long as the agreement does not attempt to control the discretion of the directors, contemplate fraud, oppression or wrong against other shareholders, or otherwise have an illegal purpose.

This kind of arrangement does not easily lend itself to a provision in the articles or by-laws, and there is little American law indicating whether a provision in the articles authorizing such a method of voting would be upheld.[18]

In Japan, there is no specific provision in the Commercial Code dealing with pooling devices. The code does specify, however, that each shareholder shall have one vote for each share,[19] and it has been pointed out that this is mandatory law, so that any provision in the articles to the contrary will be void unless expressly permitted by statute.[20] Thus, a provision in the articles allowing pooling of rights arguably has no validity.

It would appear, however, that regardless of whether such a provision can be inserted in the articles, a shareholder agreement by which the parties agree to restrict their votes would be valid. Scholarly opinions are split on the subject, with some feeling these are void, and others indicating they would be valid.[21] Most indicate, however, that even if such agreements are valid and enforceable, if a shareholder exercises his voting rights in violation of the agreement, his vote would still be valid as cast.[22] On the practical side, as well, there is evidence these agreements are considered valid. Several authors have suggested that agreements between shareholders regarding division of directors in a joint venture corporation should routinely be included.[23] Thus, these types of

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[16] 1 O'NEAL, *supra* note 3, at §5.12.

[17] *Id.*

[18] *Cf.* Sensabaugh v. Polson Plywood Co., 135 Mont. 562, 342 P.2d 1064 (1958).

[19] Commercial Code art. 241.

[20] 1 ISHII, *supra* note 6, at 237-38.

[21] *See* 4. CHŪSHAKU, KAISHAHŌ (Corporate law annotated) 78 (1968). *See also* M. HISHIDA, KABUNUSHI NO GIKETSUKEN KŌSHI TO KAISHA SHIHAI (Exercise of shareholder voting rights and corporate control) 153-59 (1964) [hereinafter cited as HISHIDA]. Hishida indicates the majority view probably opposes such agreements, but feels their position is not well taken. He does state, however, that agreements which contain provisions contrary to express prohibitions of the code or which constitute an abuse of rights would be invalid—not on general principles, but due to the particular purpose and nature of the specific provisions. *Id.* at 155-56.

[22] 4. CHUSHAKŪ KAISHAHŌ at 78; HISHIDA at 156.

[23] See, e.g., KOBAYASHI, *supra* note 2, at 139; Ohara, *supra* note 7, No. 11, SHŌJI HŌMU KENKYŪ (No. 474) at 23; *cf.* GAIKOKU KAWASE BŌEKI KENKYŪKAI, GAIKOKUJIN NO NIHON NI OKERU GŌBEN GAISHA SETSURITSU KEIYAKU NI TSUITE (Regarding formation contracts for joint venture corporations with foreigners in Japan) 36-38 (1963) [hereinafter cited as BŌEKI KENKYŪKAI; and KOKUSAI TŌSHI KENKYŪKAI, GŌBEN GAISHA NO SETSURITSU YORI KESSAN MADE (Joint venture corporations from formation to liquidation) 71-73 (1962) [hereinafter cited as TŌSHI KENKYŪKAI].

agreements would appear to be a viable means of committing the parties to a pre-determined organization of the board of directors, even though a vote in violation of the agreement would not be invalidated.

2. VOTING TRUSTS

Voting trusts as used in the United States are devices by which the shareholders transfer title to their shares to voting trustees in return for "voting trust certificates."[24] The trustees become shareholders of record and the transferors become beneficial owners. The trust agreement can then spell out how the trustee is to exercise his rights. Washington and many other states have explicit statutory provisions governing voting trusts,[25] with the Washington provision allowing a trust to be initially set up for ten years and renewable for a like period.[26] It is generally held that where there is a voting trust statute, any voting trust violative of its provisions is invalid.[27]

The Japanese Commercial Code makes no explicit provision for voting trusts; however, article 239-2 seems to imply the existence of such trusts, as it indicates the corporation can refuse to allow a shareholder to cast his votes "disunitedly" unless "he accepted a trust of shares or otherwise . . . possesses the shares for the benefit of another."[28] However, it would appear that these provisions refer to ordinary trusts, governed by ordinary trust law, and not to voting trusts.[29] Consequently, there is probably no basis for inserting a provision allowing voting trusts into the articles, especially since doing so would appear to violate the one-share, one vote concept of article 241.[30]

Provision for a voting trust through a shareholder agreement would perhaps be acceptable. Scholarly opinion is split on the matter. Such agreement is considered by many to be void either (1) because it is an illegal transfer of a voting right, or (2) because it has the purpose of conferring on another a personal voting right. However, some others feel that such an agreement can be valid like any other trust agreement, depending primarily upon the provisions in the agreement and similar matters.[31] Ishii, on the other hand, finds other grounds for objecting to such agreements, indicating that voting trusts must be

[24]*See* 1 O'NEAL, §5.31.

[25]*See, e.g.,* WASH. REV. CODE §23A.08.330.

[26]*Id.*

[27]*See,* O'NEAL §5.31.

[28]Commercial Code art. 239-2.

[29]*See* 4 CHŪSHAKU KAISHAHŌ at 67-68. *Accord,* HISHIDA, *supra* note 21, at 178, stating flatly there are no provisions for voting trusts in Japaense law.

[30]*See* note 19 and accompanying text, *supra.* Henderson, *supra* note 2, at 502 & nn.96-98 indicates that scholars are unanimous in considering these as unacceptable. He states this conclusion is based in part on the provisions indicating that proxies are only good for one general meeting.

[31]*See* 4 CHŪSHAKU KAISHAHŌ at 78-79, where the split of authorities is set out. HISHIDA, who authored that portion of CHŪSHAKU KAISHAHŌ, has long advocated the view that such agreements are valid. *See* HISHIDA, *supra* note 21, at 182-83.

considered void primarily because they are contrary to the spirit of the Commercial Code and either illegal or void as attempts to evade its provisions.[32] To bolster the view that such agreements, if not void, are at least risky, it should be noted that authors who suggested that pooling-type agreements should routinely be used in joint ventures apparently have not given serious consideration to voting trusts.[33]

3. IRREVOCABLE PROXIES

In United States law, an irrevocable proxy was long in disrepute, even though it essentially accomplished nothing more than what could be gained by other forms of voting agreements. Perhaps the major exception was the "proxy coupled with an interest" concept based on a very early Supreme Court opinion. Lately, however, there has been an increasing tendency to consider such irrevocable proxies to be valid in an increasingly large variety of situations, so that at least in the close corporation context they may have become generally acceptable devices.[34]

In Japan, irrevocable proxies have no sanction under the Commercial Code, which explicitly states that proxies are good for only one general meeting.[35] There is some controversy concerning whether this restriction is also binding on shareholder agreements. *Ishii* flatly states that a proxy can only be good for one meeting, and that a continuing power of attorney (or irrevocable proxy) is invalid, except where a foreigner has elected an individual representative to administer his property in Japan.[36] Henderson, however, based upon the contract-corporate law dichotomy, indicates that such agreements would be valid.[37] The irrevocable proxy, however, would appear to be a rather inflexible tool. Even if valid, it would only work to give one or the other of the two shareholders, or a third party to whom both had given irrevocable proxies, absolute decision-making power at the shareholder level. Thus, faced with the rather more explicit language of the Commercial Code and the absence of support for irrevocable proxies from the Japanese authorities, it would be best to disregard this particular device and to consider one of the other voting agreement devices as the better instrument to protect minority rights.

B. High Voting and Quorum Requirements, Including Express Veto Powers, and Special Requirements for Amending the Articles, Authorizing the Issuance of Stock and Fundamental Corporate Acts

[32]1 Ishii, *supra* note 63, at 148.
[33]*See* authorities cited in note 23, *supra.*
[34]*See* 1 O'Neal at §5.36.
[35]Commercial Code art. 239(4); *see* Henderson, *supra* note 2, at 502.
[36]1 Ishii, *supra* note 6, at 245.
[37]*See* Henderson, *supra* note 2, at 502.

1. VETO POWERS

In the United States, it is often possible to include an express veto power in the articles or by-laws. This veto can be in the form of a requirement of shareholder unanimity or an equivalent requirement for director action.[38] Express veto provisions have also been included in shareholder agreements, although O'Neal feels this method is much more risky than a charter or by-law provision.[39] Ordinarily these provisions are included only if all shareholders are parties to the agreement, and even then they might not be enforceable, especially as against the corporation.[40]

In Japan there is no express statutory prohibition against the veto power concept. While certain minimum requirements for passing resolutions of shareholders are set out in the Commercial Code, there is no prohibition on making these more stringent.[41] Note, however, that scholarly opinion is split on whether the two-thirds requirement of article 343, which applies to several fundamental corporate decisions,[42] can be raised by a provision in the articles,[43] and *Ishii* states, without further authority, that a requirement of unanimity would be void.[44] The Commercial Code also has specific provisions regarding voting requirements for directors' decisons, with article 206-2 permitting a more stringent requirement to be placed in the articles.[45] However, there are many who feel that a veto-type provision would be void, including one by which the vote of a particular director must be included in those favoring a proposition.[46] Thus, even though there is some authority which would recognize a veto power provision in some situations, the issue is sufficiently beclouded to raise a warning that such a provision is not advisable. This conclusion is especially true when the capital liberalization problems are considered. For an enterprise to qualify for automatic approval of up to 50 percent foreign investment (the

[38]*See* 1 O'NEAL at §§4.01, *et seq.;* but note that he cautions that some jurisdictions would not allow a requirement of unanimity. *Id.* at §§4.19-4.20.

[39]1 O'NEAL at §5.19.

[40]*See id.*

[41]*See* Commercial Code arts. 239 & 243. *Accord,* 1 ISHII, *supra* note 6, at 260.

[42]Commercial Code art. 343. This article requires that certain shareholder resolutions be adopted by "two-thirds or more of the votes of the shareholders present who hold shares representing more than one-half of the total number of the issued shares." ISHII lists 14 decisions for which the requirements of article 343 apply. *See* 1 ISHII, *supra* note 6, at 267-69. For the most part, these come within the American understanding of fundamental corporate decisions, and are clearly enumerated in various parts of the Commercial Code.

[43]*See* 1 ISHII, *supra* note 6, at 267, where he indicates Matsuda and Nishihara claim the requirements of articles 343 cannot be raised, as article 343 does not expressly so state, and that Ōkuma and Nōtsu indicate an increase to a three-quarter vote requirement would be valid. 8(1) CHŪSHAKU KAISHAHŌ at 24-25 gives a fuller elaboration among opposing views and lists ISHII as a supporter of the view that the requirements can be made more stringent.

[44]ISHII at 267.8(1) CHŪSHAKU KAISHAHŌ at 24-25 indicates, however, that some authorities would accept a unanimity requirement as valid.

[45]Commercial Code art. 260-2. The basic voting requirement is an affirmative vote of a majority of the directors present, with a quorum consisting of a majority of all directors.

[46]*See* 4 CHŪSHAKU KAISHAHŌ at 343, and 1 ISHII at 325.

so-called partially liberalized sector), there can be no provision that the decisions of the corporation require the unanimous agreement of all the shareholders or the consent of any particular member of the board of directors.[47]

Assuming that an explicit veto-type of provision in the articles risks being considered invalid, it is next necessary to determine if a unanimity provision or a veto provision inserted in a shareholders' agreement would be acceptable. Such a provision has been rarely considered in Japan. Based upon the Japanese legal distinction between corporate law and contract law, theoretically, at least, such a provision in a shareholders' agreement should be valid between the shareholders. One should be concerned, however, that this might be one place where article 1 of the Civil Code might be applied to nullify such a provision, either on the basis of "public welfare" or as an "abuse of rights." In inserting these kinds of provisions in shareholder agreements, the parties are in effect surreptitiously altering the apparent decision-making structure of the corporation, so that the public policy behind the Commercial Code provisions requiring certain votes in the corporation is circumvented, a factor likely to be weighed adversely by a court which finds that the corporation's interests in policing its own voting procedures have been thwarted by a contract giving veto power to a foreign minority. So long as the corporation is considered a third party as to this contract, a provision which in effect amends a provision of its articles (in contrast to one merely agreeing among the shareholders as to how they will vote) may be attacked both due to the interference with public interests regarding the operation of the corporation and because the shareholders have abused their rights in ways affecting seriously the operation of the third party corporation. Although no explicit authority for this proposition can be found, the general tenor of legal authorities would seem to support it.[48]

2. SPECIAL VOTING AND QUORUM REQUIREMENTS

In the United States, it is common for the articles to contain higher voting requirements for shareholder decisions than required by law, and this custom is expressly sanctioned in the statutes of many states.[49] In additon, the statutes require a greater majority for certain fundamental acts, even without a provision

[47]*Tainai chokusetsu tōshi nado no jiyūka ni tsuite kakugi kettei* (Cabinet decision concerning liberalization of inward investments), No. 3, 1(1)I(a)(vi)(June 6, 1967), in F. YOSHIDA, SHIHON JIYUKA TO GAISHIHŌ (Capital liberalization and the law concerning foreign investment) at 158 (1967). Note, however, that the prohibition on veto or unanimity provisions does *not* apply as a condition to automatic validation in the fully liberalized sector. *Id.* at No. 3, 1(1)I(b). Does this provision impliedly permit such provisions in Japanese Law?

[48]Concerning abuse of rights in the setting of corporate relations, see especially the discussion and examples in 1 CHŪSHAKU MIMPŌ at 135-37. Regarding public welfare, *see id.* at 53-67. *See generally* WAGATSUMA, *supra* note 11, at 33-41.

[49]*See, e.g.*, WASH. REV. CODE §23A.44.070.

in the articles.[50] The quorum can be freely set in the articles, although low quorums are impractical where a high percentage of total issued shares must approve a decision.[51] Likewise, quorum and voting requirements for directors can be freely raised by provisions in the articles or by-laws of the corporation.[52] These same matters probably can be accomplished by a shareholder agreement, as in the case of agreements regarding unanimity or veto powers, but this method appears to be rarely if ever used.[53]

In Japan, the Commercial Code already provides the structure for higher quorum and voting requirements for certain fundamental acts, and these provisions of themselves are often sufficient to protect the interests of substantial minorities, so long as the articles include express pre-emptive-rights provisions.[54] However, often in the case of certain ordinary decisions of shareholders or the election of directors, express arrangements may be desirable. This result can be readily achieved by a provision inserted in the articles.[55] Likewise, the quorum and voting requirements for director action can be made more stringent through a provision in the articles.[56] Thus, the kind of protection for minority shareholders which we seek can best be attained by the existing statutory requirements plus statutorily authorized provisions in the articles. This solution often can be every bit as effective as any attempt to obtain a requirement of unanimity or an express veto right, and for this reason, this method is decidedly preferable to an attempt to use the other techniques.[57]

Since arrangements for higher quorum and voting requirements can be adequately handled without resort to a shareholder agreement, there usually will be little reason for resorting to the latter technique for this purpose.

[50]*See, e.g.*, WASH. REV. CODE §§23a.16.020, 20.030, and .24.020.

[51]*See, e.g.*, WASH. REV. CODE §23A.08.290, which states: "Unless otherwise provided in the articles of incorporation, a majority of the shares entitled to vote . . . shall constitute a quorum at a meeting of shareholders. . . ." But note that certain fundamental decisions require at least a two-thirds vote of all shareholders, and thereforce can be accomplished only with a quorum of at least that number. *See, e.g.*, WASH. REV. CODE §§23A.16.020, .20.030, and .24.020.

[52]*See, e.g.*, WASH. REV. CODE §23A.08.390, which indicates:

> A majority of the number of directors fixed by the by-laws, or . . . in the articles of incorporation, shall constitute a quorum . . . unless a greater number is required by the articles of incorporation or the by-laws. The act of the majority of the directors present . . . shall be the act of the board of directors, unless the act of a greater number is required by the articles of incorporation or the by-laws.

[53]Since the inclusion of such provisions in the articles or by-laws is both simple and generally accepted, such shareholder agreements have proved unnecessary. In contrast to the express veto provision whereby a particular individual must approve, this form of control can more easily be handled by a non-contractual provision. *See generally* 1 O'NEAL at §5.19.

[54]*See, e.g.*, Commercial Code art. 343. *See* note 42, *supra*, regarding what areas are controlled by this provision. *See* Henderson, *supra* note 2, at 501-04.

[55]Commercial Code art. 239 expressly authorizes higher requirements or ordinary resolutions, while art. 256-2 does the same for the election of directors. Inclusion of such a provision governing election of directors is essential, as the code only requires a quorum of one-third.

[56]Commercial Code art. 260-2.

[57]*See* notes 41-48 and accompanying text, *supra*.

Moreover, an attempt to raise quorum or voting requirements by shareholder agreement probably would encounter many of the same problems that were explored in discussing contract provisions regarding veto powers.[58]

C. Classification of Shares and Classification of Directors

In American law, it is often common to set up two classes of shares, and then to establish two classes of directors, each to be elected solely by the shareholders of a particular class.[59] This classification of shares will reflect in other corporate decisions as well, such as some major decisions requiring a two-thirds vote of each class of shareholders.[60] There appears to be no practical way to accomplish the same objective via a shareholder agreement, as the types of shares and certain information about each class of shares must be included in the articles.[61]

In Japan, multiple classes of shares may be issued, but particulars and numbers of shares must be determined by the articles.[62] Note, however, that many details related to these shares and their allocation need not be stipulated in the articles, and thus these matters could be the subject of a shareholder agreement.[63] It is also possible to create non-voting shares, so long as they do not exceed 25 percent of all issued shares.[64] However, since so many details concerning the classes of shares and related matters must be included in the articles,[65] a shareholder agreement can only be of limited usefulness as a supplement to provisions found in the articles.

D. Cumulative Voting

Cumulative voting is a popular method of assuring minority representation in American corporations. Almost all corporate statutes have some reference to

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[58]*See* note 48 and accompanying text, *supra.*

[59]*See* 1 O'NEAL at §3.23. This classification of directors is not to be confused with classification of directors as used in WASH. REV. CODE §23A.08.360 and other corporation statutes. The latter is a method of classifying the director positions so that only a portion of them will be filled by election each year. Such a system is popular as a method of destroying the effectiveness of cumulative voting rights, and thus suppressing some minority voice in the corporation. Classification of shares, with some directors to be elected by distinct classes of shareholders on the other hand, guarantees representation to diverse groups of shareholders.

[60]1 O'NEAL at §3.24; *see, e.g.,* WASH. REV. CODE §23A.16.030.

[61]*See, e.g.,* WASH. REV. CODE §23A.12.020.

[62]Commercial Code art. 222.

[63]Commercial Code art. 222(3) indicates: "[S]pecial stipulations may be made in respect of each class of shares, as to the taking of new shares, the consolidation or retirement of shares, or the allotment of shares by reason of amalgamation, even where no provisions have been made in the articles of incorporation." *See* 1 ISHII at 74-75.

[64]Commercial Code art. 242.

[65]*See, e.g.,* Commercial Code art. 166, recognized as a mandatory provision for the formation of a corporation. *See* 1 ISHII at 67-71. It should also be noted that article 242 appears to authorize non-voting shares only when they are preferred shares, and that the non-voting aspect only extends to decisions related to the distribution of profits.

it—some making the right to cumulative voting mandatory, some rejecting it outright, and others making it optional.[66] Washington, for example, has passed through all three phases. At present, cumulative voting is statutorily authorized, unless the articles of a corporation expressly remove the right to cumulative voting.[67] This posture is a departure from prior Washington law, which first provided only for straight voting and later shifted to mandatory cumulative voting.[68] The cumulative voting area probably is one in which there was little room for shareholder agreements. However, it might not be out of place for the shareholders to agree among themselves not to exercise this right even when authorized, or not to seek an amendment to the articles abolishing the right.

In Japan, the right to cumulative voting is based upon article 256-3 of the Commercial Code.[69] However, the Code authorizes a provision in the articles prohibiting cumulative voting.[70] Prior to the amendment of the Commercial Code in 1974, a prohibition against cumulative voting placed in the articles was ineffective where shareholders with 25 percent or more of the total voting shares wished to exercise cumulative voting rights, but the 1974 amendments to the code deleted this limitation on the ability of the corporation to abolish cumulative voting.[71] As in the United States, there is little room for a shareholder agreement to operate in this area. However, where the initial articles have not included a prohibition on cumulative voting, the shareholders, or at least a block of shareholders large enough to prevent amendment of the articles, may wish to agree that they will refrain from any attempt to amend the articles to prohibit cumulative voting. Were such an agreement to be made, there is no reason it would not be valid, as it clearly does not conflict with any provision of the various codes.[72]

E. *Restrictions on the Transfer of Shares*

In the United States, although the practice varies from jurisdiction to jurisdiction, many forms of restrictions on the transfer of shares have been upheld. These can be placed in the articles, the by-laws, a shareholders'

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[66]*See generally,* W. Cary, Cases and Materials on Corporations 285-88 (1969).

[67]Wash. Rev. Code §23A.08.300.

[68]For discussion of the prior Washington law, see State *ex rel.* Swanson v. Perham, 30 Wn.2d 368, 191 P.2d 689 (1948).

[69]Commercial Code art. 256-3.

[70]*Id.*

[71]Former Commercial Code art. 256-4. A comparative text of the new and old Codes following the 1974 amendments can be found in *Shōhō Kaisei san hōritsu Shinkyū taishōhyō* (Comparison of the new and old texts of three commercial laws), Juristo (No. 560) 56 *et. seq.* (1974).

[72]Although explicit authority is lacking, there is no reason this type of agreemeht would be contrary to any of the major principles of Japanese law, including the provisions of article 1 of the Civil Code.

agreement, or all three.[73] O'Neal recommends that these matters be handled at the inception by both an agreement and a provision in the articles and perhaps inserted yet a third time in the by-laws.[74] In addition to problems involved in deciding where to place the restrictions, it is also necessary to choose the type of restrictions, noting particularly that "absolute restrictions unlimited in time . . . have almost without exception been held invlaid."[75] The forms of restraints obtaining the approval of a number of courts in the United States include consent restraints, first options, buy-out arrangements, and redemption provisions.[76] In considering the use of various instruments, the American draftsman often avoids a straight shareholder agreement as the sole method, as such a restriction may not be effective to block a transfer in violation of it, and it often is held that such an agreement would also not be binding on the third party transferee, who would take the shares free of any further restriction.[77]

In Japan, a 1966 amendment to the Commercial Code expressly allowed insertion of a provision in the articles requiring approval of the board of directors before shares can be transferred to a third party.[78] The selling shareholder can request the board to name a substitute buyer should it disapprove of the buyer originally intended by the seller.[79] This amendment somewhat blunted a previously heated debate concerning whether shareholder agreements restricting transferability would be valid.[80] Use of this provision would seem highly desirable in many cases.

Despite the 1966 amendment, there are two situations in which use of a shareholder agreement may become important. The first case occurs when the articles are silent concerning restrictions on transferability, and the second occurs when the shareholders wish to insert into a shareholder agreement restrictions on transferability which differ from those which can be placed in the articles under the 1966 amendments. The extent to which these matters can be accomplished by shareholder agreement remains quite controversial.

Some authorities believe that where there is no article provision restricting transferability of shares, any attempt to bind all shareholders and the corporation by agreement would be void, as a violation of the principle of free transferability of shares.[81] Nonetheless, many believe the same result may be

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[73]*See generally* 2 O'NEAL at Ch. 7.

[74]2 O'NEAL at §7.14.

[75]*Id.* at §7.06.

[76]*Id.* at §§7.08-7.11.

[77]*Id.* at §7.14.

[78]Commercial Code arts. 204 to 204-5. *See* ISHII at 168-73.

[79]Commercial Code art. 204-2.

[80]*See, e.g.*, Henderson, *supra* note 2, at 492-95.

[81]*See, e.g.*, 1 ISHII at 172; *see also* the split of authorities which existed prior to the 1966 amendment of the Commercial Code cited in Henderson at 493 n.65.

accomplished by agreements between individual shareholders and the corporation, so long as they are not unfair restrictions,[82] and most state categorically that such agreements when made among shareholders (without the participation of the coporation) will be valid, as they are outside the scope of coverage of article 204 of the Commercial Code.[83] It should be noted, however, that these agreements suffer from a problem similar to that seen in the United States—namely, that they may not be set up against a third party transferee.[84] Amazingly, there seems to be little discussion concerning whether shareholder agreements which go beyond what could be accomplished by a provision in the articles could be valid if they pass the test of fairness. It would appear, however, based primarily upon the fact that prior to the 1966 amendment some shareholder agreements were upheld, that such restrictions, if not unfair, would be considered valid.[85]

F. Employment and Management Contracts: Agreements as to Who Will Be Officers

A number of shareholder agreements in the United States contain provisions naming the persons to occupy some or all corporate offices or giving certain contracting parties the right to name certain officers. Although increasingly accepted, these types of provisions have been attacked on the following grounds:[86] (1) the agreement violates the statutory section (in the corporate law of practically every state) providing that the directors shall manage the corporation's affairs; (2) it violates statutes (found in many jurisdictions) which expressly provide that the directors shall select corporate officers; (3) it tends to cause the directors to disregard their fiduciary duties to the corporation and to other shareholders; (4) it is unfair to non-contracting shareholders or might injuriously affect them. The path to acceptability for these kinds of provisions has been smoothed by provisions such as that in the Washington corporate code which authorizes officers to be appointed by the board of directors "or chosen in such other manner as may be prescribed by the by-laws."[87]

Management contracts are agreements between the corporation and others entrusting aspects of its management to particular individuals or corporations. They have proved less acceptable than shareholder agreements regarding officers and employment, and have been attacked primarily as violations of statutory requirements that the affairs of a corporation shall be managed by its

[82]*See, e.g.*, 1 ISHII at 172-73 and authorities cited therein.

[83]*See* 1 ISHII at 173 and authorities cited therein. *Accord*, Henderson at 493 and authorities cited therein at 493 n.66. *See also* Ohara, *supra* note 7, No. 20, SHŌJI HŌMU KENKYŪ (No. 497) at 26.

[84]*See* Henderson at 493; 1 ISHII at 173; and 3 CHŪSHAKU KAISHAHŌ at 66.

[85]*Accord*, KOBAYASHI, *supra* note 2, at 126. *But see* 3 CHŪSHAKU KAISHAHŌ at 66, which can be read to the contrary.

[86]1 O'NEAL at §6.17.

[87]WASH. REV. CODE §23A.08.470; *see* 1 O'NEAL at §5.17.

board and on the basis that the directors do not have the capacity to enter into long-term contracts binding future boards for long periods on such basic policy or management matters.[88] They still remain quite vulnerable in the United States, despite some recent decisions upholding some management contracts.[89]

Employment contracts between the corporation and a given key employee, whether a shareholder or not, have been used in the United States, but, like management contracts, their validity beyond a short period of time is quite speculative.[90] Such contracts, if extending for any length of time, should be based upon clear authority derived from the board of directors by resolution.[91]

In Japan much the same type of statutory problem must be faced. The Commercial Code requires the directors both to administer the affairs of the company and to appoint the representative director(s).[92] However, shareholder agreements regarding designation of officers and other key employees are considered to be a natural matter of legitimate concern in joint venture corporations, and they do not appear to have been seriously challenged.[93] Such shareholder agreements appear to be valid; however they probably are not enforceable against the corporation, should its board of directors choose to exercise its powers without regard to the shareholder agreement. A close analogy can be drawn to pooling agreements already discussed.[94] On the other hand, any attempt to shift the actual formal designation from the board of directors to the shareholders probably would be invalid as contrary to the Commercial Code.[95]

Attempts to set up management contracts or similar employment contracts would also have to be channeled through the directors to be effective, as these can be formalized only by making the corporation a party to them. Considering the extent to which there is controversy over the scope to which the board can delegate authority to the representative directors and other officials on a regular

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[88]*See* 1 O'NEAL at §5.39.

[89]*See id.* There he indicates:

> [T]he validity of a contract by which a corporation vests control of its affairs in another person or company seems to depend on the number and importance of the powers that are delegated, the length of time for which the powers are to be held, and perhaps on the purpose of the contract or the situation out of which it arises. Management contracts delegating substantially all management powers to outsiders for indefinite or extended periods of time are usually held invalid.

[90]*See id.* at §§6.05-6.06.

[91]*See id.* at §6.07.

[92]Commercial Code arts. 260 and 261.

[93]*See, e.g.,* Ohara, *supra* note 7, No. 19, SHŌJI HŌMU KENKYŪ (No. 495) at 26; BŌEKI KENKYŪKAI, *supra* note 23, at 36-38; and TŌSHI KENKYŪKAI, *supra* note 23, at 71-73.

[94]*See* notes 16-23 and accompanying text, *supra.*

[95]*See* 4 CHŪSHAKU KAISHAHŌ at 335, and Commercial Code art. 230-2, the latter reading as follows: "The resolution shall be adopted by a general meeting [of shareholders] as to only the matters provided for in this code or the articles of incorporation." This article was added in the 1950 revision of the code and was designed to narrow the scope of decision-making power of the shareholders.

basis,[96] it would be reasonable to conclude that any long-term delegation of authority or any excessive delegation of significant authority beyond this immediate circle of officials would likely be struck down as an evasion of the provisions of article 260.

G. Restrictions on Salaries of Directors and Officers

In a close corporation where a shareholder with sizeable minority interest is basically an outsider regarding day-to-day management, the majority insiders can establish high salaries for themselves and thereby increase their return while reducing the return to the minority through dividends. One method of preventing this tactic in the United States involves inclusion of a provision in the articles or by-laws concerning the method for fixing compensation.[97] Restrictions on compensation can also be included in shareholder agreements.[98]

In Japan the Commercial Code requires that the compensation of directors as directors be fixed in the articles or by resolution of the shareholders.[99] Since the code clearly indicates that this decision belongs to the shareholders, it should be possible for the shareholders to agree among themselves concerning what the salaries should be, and for such an agreement to be valid. If combined with a higher than majority voting requirement for shareholder resolutions,[100] minority shareholders can usually be adequately protected in this way. When it comes to the salaries of officers or director-officers, however, the problem is more complex. Since directors are charged with the administration of the affairs of the corporation,[101] there is a valid argument that this is a matter solely for the directors' discretion.[102] However, the prevailing opinion apparently supports the view that the shareholders can set the salaries of directors working in other capacities, both where the directors are working in these capacities primarily because they are directors, and where their employment in the position is not related to the fact that they are directors.[103] In both cases, this subject would be appropriate for inclusion in a shareholder agreement. The salaries of other employees, however, probably should not be handled through a shareholder agreement, as this responsibility would ordinarily fall solely upon the directors, and any such agreement would only be binding upon the corporate parents. Thus, even if technically valid, an agreement setting the salaries of ordinary employees would be ineffective should the directors choose to ignore it.

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[96] *See* 4 CHŪSHAKU KAISHAHŌ at 336-37 and authorities cited therein.
[97] *See* 2 O'NEAL at §8.10.
[98] *See* 1 *id.* at §5.02.
[99] Commercial Code art. 269.
[100] *See* notes 49-58 and accompanying text, *supra.*
[101] Commercial Code art. 260.
[102] *See* 4 CHŪSHAKU KAISHAHŌ at 532.
[103] *Id.*

H. Restrictions on Dividends

One of the most frequent causes of controversy in close corporations is its dividend policy. This problem is often most acute where one side is running the corporation and deriving substantial salary and other remuneration, while the other can derive benefits solely via the extraction of dividends. On the other hand, especially in a multi-national corporation, the parties may disagree on dividend policies due to different views on fundamental policies, different tax considerations, and different national customs. In the United States, parties often have attempted to control dividend policies by shareholder agreements, but these still are frequently struck down in many states as an unjustified interference with the powers of the directors.[104]

In Japan, a shareholder agreement regarding a corporation's dividend policy would probably be valid and effective. This conclusion is based primarily upon the different locus of power regarding dividends. The Japanese Commercial Code leaves the actual approval of dividends to the shareholder meeting, even though in reality the shareholders merely have the opportunity to pass upon what has already been decided by the directors.[105] The formality of placing the dividend decision in the hands of the shareholders may mean little in the average corporation; however, this provision does afford a reasonable basis for holding that a shareholder agreement regarding dividends does not interfere with any decision-making power of the directors, thus eliminating one of the principal objections to these agreements in the United States. Primarily for this reason, shareholders in Japanese corporations probably are free to agree among themselves that they will only approve dividends of a certain amount or will refrain from approving dividends not meeting certain criteria.[106] This type of agreement, however, although useful to block certain dividends contrary to the agreements, probably cannot be effective to compel a recalcitrant shareholder to approve dividends which meet the criteria of the agreement.

I. Pre-Emptive Rights

Many effective methods for protecting minority rights require the minority to have a significant block of stock. Usually the minority must have at least one-third of the total shares to be assured of effective checks upon majority actions.[107] Thus, it is necessary to assure that such a percentage of shareholding can be maintained. Perhaps the most effective tool for preserving this position is

[104]1 O'NEAL at §5.20. American law usually leaves the decision regarding dividends to the board of directors. *See, e.g.*, WASH. REV. CODE §23A.08.420.

[105]Commercial Code arts. 281-283.

[106]This form of agreement was used in *Ohara, supra* note 7, No. 19, SHŌJI HŌMU KENKYŪ (No. 495) at 26.

[107]*See* Commercial Code art. 343 with its two-thirds majority requirement for certain major decisions, and note that it extends, *inter alia*, to amendments of the articles under art. 342.

to guarantee pre-emptive rights to existing shareholders.

In the United States, it is generally considered that, absent provisions in the articles or statutes, a shareholder has a common law right to pre-emptive rights on issuance of new shares.[108] Many statutes have modified these rights. The Washington statute, for instance, allows such rights to be extinguished altogether through a provision in the articles.[109] It is also possible to modify and even to enhance these rights through a provision in the articles.[110] It would appear that in American law, these rights ordinarily are not a subject of shareholder agreement, although a shareholders' agreement may include somewhat similar rights.

In Japan, unless the articles otherwise specify, it is a director decision whether there will be pre-emptive rights upon the issuance of new shares, and, if so, under what terms and conditions.[111] Thus, the articles should set out these matters in detail sufficient to guarantee a meaningful opportunity for the minority to protect itself by exercise of pre-emptive rights. If for some reason it is undesirable to place all of these details in the articles, the code permits a corporation to leave the matter of pre-emptive rights to the shareholders by including a provision in the articles stating that matters relating to pre-emptive rights are to be determined by shareholder resolution.[112] This code provision opens the possibility that the scope of pre-emptive rights can be the subject of a shareholder agreement spelling out the form of such rights and the various details concerning their operation. In fact, this approach appears to be generally acceptable in joint ventures in Japan, and a shareholder agreement is a common method of handling the preemptive rights problem, where, for some reason, a more detailed article provision is not desired.[113]

J. Other Matters: Agreements as to Dispute Resolution, Dissolution of the Corporation, Arbitration, etc.

Shareholder agreements frequently include matters relating to the resolution of shareholder deadlocks, often a critical point where there is an elaborate system of checks and balances. One such method is an arbitration clause. Arbitration of intracorporate disputes has had a painful history in the United States, and cannot yet be considered a reliable remedy, due largely to judicial reluctance to apply it to this field and to often-restrictive arbitration statutes.[114]

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[108] *See* 1 O'NEAL at §3.39.
[109] WASH. REV. CODE §23A.08.220.
[110] *Id. See generally* 1 O'NEAL at §3.39.
[111] Commercial Code art. 280-2(1) (5-8).
[112] Commercial Code art. 280-2(1)
[113] *See, e.g.*, Ohara, *supra* note 7, No. 11, SHŌJI HŌMU KENKYŪ (No. 474) at 23.
[114] *See generally* 2 O'NEAL at §§9.08-9.25.

On the other hand, in Japan, with its stronger tradition of non-litigious settlement of disputes of all sorts, the use of an effective arbitration clause seems quite practicable. Arbitration of most disputes among shareholders would appear to fall within the broadly permissive purview of arbitration under the Japanese Code of Civil Procedure, which reads as follows:[115] "An agreement for submission of a controversy to one or more arbitrators shall be valid insofar as the parties are entitled to effect a compromise regarding the subject matter in dispute." Note, however, that it may be difficult to settle some disputes when the decision may have to be imposed directly on the joint venture corporation, unless the joint venture corporation is also made a party to the agreement to arbitrate. Nevertheless, arbitration agreements are routinely used in joint venture corporations in Japan.[116] In including such a clause, however, the draftsman should specify that the arbitration will be held in Japan under Japanese law, in order to avoid possible application of American arbitration law.

A more drastic method of dispute resolution involves an agreement to dissolve the corporation on the happening of certain events or in case of irreconcilable deadlock. This kind of provision has proved successful in many American close corporations.[117] Use of the same type of clause would also be feasible in Japan, as its validity is determined under contract law principles and it would merely obligate the parties to take action not prohibited by the Commercial Code, as dissolution can be based upon a resolution of the shareholders supported by a sufficient number of votes required for major corporate decisions.[118] The Commercial Code also provides for dissolution of a deadlocked corporation upon demand of a shareholder when irreparable injury would otherwise occur. This right can be exercised by any ten-percent shareholder and does not require a contractual provision to carry it out.[119]

III. Remedies for Violation

A. Violation of Provisions in the Articles

When there has been a violation of provisions in the articles, the Commercial Code provides rather specific remedies. Some of these are relatively ineffective, while others are quite useful. This section will merely sketch the nature of these remedies and will not be a study in depth.

Article 247 of the Commercial Code provides a mechanism for the rescission

[115] Code of Civil Procedure art. 786.

[116] *See, e.g.*, KOBAYASHI, *supra* note 2, at 127-32; Ohara, *supra* note 7, No. 13, SHŌJI HOMŪ KENKYŪ (No. 477) at 23; TŌSHI KENKYŪKAI, *supra* note 23, at 77; and BŌEKI KENKYUKAI, *supra* note 23, at 53.

[117] *See* 2 O'NEAL at §9.06.

[118] *See* Commercial Code arts. 404,405, and 343.

[119] Commercial code art. 406-2.

of a shareholder resolution which has been adopted by procedures which, *inter alia,* are contrary to the articles.[120] This action must be brought within three months of the date of the resolution,[121] and the courts have tended to blunt the effectiveness of this tool by reserving the remedy only to a limited range of situations, usually only those of most serious nature where the defects substantially affected the result.[122] This remedy would be available where, for example, the resolution lacked the proper votes, or cumulative voting was wrongfully prevented.

Where the contents of a shareholder resolution violate the Articles of Incorporation, the resolution is subject to a demand for nullification, which is not circumscribed as to when it must be brought, or by whom.[123]

If the directors have acted in violation of the articles, by resolution or otherwise, participating directors are jointly and severally liable to the corporation in performance or damages.[124] Should the corporation not institute an action to enforce this liability, a shareholder-derivative suit is available much as in the United States.[125] There is also the possibility of obtaining an injunction against the acts of a director which violate the articles and "give rise to fear of irreparable damage done to the company."[126]

B. Violation of Contractual Provisions

The first remedy for breach of a shareholder-contract that should be considered is specific performance (*kyōsei rikō*). Specific performance is of three types, direct enforcement (*chokusetsu rikō kyōsei*), enforcement by substitute performance (*daitai rikō kyōsei*), and indirect enforcement of performance (*kansetsu kyōsei*).[127] Most of the contractual rights discussed in this paper probably would be difficult to enforce through specific performance. Direct performance, based upon Civil Code article 414, is considered not to extend to an obligation to act or to forbear to act, which are the fundamental subjects of most of the contractual provisions discussed.[128] Substituted

[120]Commercial Code art. 247.

[121]Commercial Code art. 248.

[122]*See, e.g.*, Itō v. Nippon Germanium Kōgyō K.K., HANREI JIHŌ (No. 311) 27)Sup. Ct., Aut. 30, 1962). The reasoning of that case, literally taken would limit rescission only to cases in which the defect can be demonstrated to have produced an outcome different from the result which would be expected from following proper procedures. This view ignores the therapeutic effect of using provisions like article 247 to force corporations to follow proper procedures as a matter of routine.

[123]See Commercial Code art. 252, and T. ISHII, KABUNISHI SŌKAI NO KENKYŪ (Studies on shareholder meetings) 208-15 (1958).

[124]Commercial Code art. 266.

[125]Commercial Code art. 267.

[126]Commercial Code art. 272. One wonders if a court would find that irreparable damage to the corporation would result from an action contrary to the articles which injures the minority shareholder but strengthens the hand of the majority shareholder. Would the policy factors weighed depend on the nationality of the party urging the suit?

[127]Shattuck & Kitagawa, *supra* note 15, at 388.

[128]Civil Code art. 414(1).

performance can apply to require performance of an act by a third party in substitution for the agreed-to performance, and can include an act of forbearance.[129] To use this remedy, for example, to enforce a voting agreement, would require the court to designate a third party to cast the votes of the defaulting shareholder. This method appears not to be feasible in ordinary circumstances. Indirect performance can be used to enforce an act or forbearance which is not interchangeable,[130] and would appear to depend on the volition of the obligor, with the only remedy for non-performance being in damages—and not via a contempt of court action.[131]

A second remedy is ordinary damages, used in Japan as an alternative to specific performance.[132] Both remedies can be used simultaneously.[133] A major problem in the context of this article, however, is the inability to quantify the extent of damages resulting, *e.g.*, from breach of a vote-pooling agreement or agreement regarding pre-emptive rights or restrictions on transferability of shares.[134]

A third remedy, similar to our injunction, is a provisional disposition (*kari shobun*). This remedy, found in the Code of Civil Procedure,[135] can be used, for example, when a party has sufficient advance knowledge that the other party will take action in breach of a contractual provision, and it can be demonstrated that contractual rights would be destroyed if the breach is allowed to take place;[136] but it frequently may be difficult to obtain a timely injunction, the injunction will not act against third parties, and an act performed in defiance thereof is likely to be valid.[137]

A fourth remedy is rescission of the contract.[138] This remedy, however, is not likely to be useful in the context of a shareholder agreement, and probably can be dismissed from consideration.

A fifth remedy, frequently considered the most useful,[139] is a liquidated damage or penalty clause setting in advance the amount of damages resulting from a breach of contract.[140] Despite the validity of these clauses where they would not work under American law, in the present context, they do not lend themselves to ready application. An all-purpose penalty or liquidated damages

[129]Civil Code art. 414(2) & (3).
[130]SHATTUCK & KITAGAWA, *supra* note 15, at 390; Code of Civil Procedure art. 734.
[131]Code of Civil Procedure art. 734; SHATTUCK & KITAGAWA, *supra* note 15, at 387.
[132]Civil Code arts. 414(4) and 416; Kitagawa, *Damages in Contracts for the Sale of Goods*, 3 LAW IN JAPAN 43, 51-52 (1969).
[133]Civil Code art. 414(4).
[134]*Cf.* Henderson, *supra* note 2, at 493-94.
[135]Code of Civil Procedure arts. 755-761.
[136]*See* Code of Civil Procedure arts. 755, 758, and 760.
[137]Concerning these difficulties, *see, e.g.*, Henderson, *supra* note 2, at 494-95.
[138]*See* Civil Code arts. 541-42.
[139]*See, e.g.*, Henderson, *supra* note 2, at 495.
[140]This remedy is specifically authorized by Civil Code art. 420.

clause sufficient to fit the range of breaches of performance possible in a shareholder agreement would be extremely difficult to fashion. Furthermore, despite the Japanese law's receptivity to these kinds of clauses, the Japanese courts can and do limit enforcement of them when they are considered excessive under the circumstances.[141]

In summary, even though many forms of shareholder agreements may be valid, their effectiveness may leave much to be desired. Not only will an act done in breach be considered valid, but the contract is only operative among and between the actual parties. Furthermore, it will frequently be difficult to obtain an effective remedy when the contract is breached or about to be breached. This dilemma points out the need to include in the contract appropriate means for settlement of the dispute which rely primarily upon other than lawsuit-based remedies. Well-drafted clauses providing for arbitration, dissolution on the happening of certain events, or other methods of this sort are more likely to prove satisfactory over the long course. In addition, there is no substitute for the willingness of both parties to understand the fears and preconceptions of the other party at every step in the process of working together.

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[141]*See, e.g.*, Yamamura v. Kanzaki, 23 MINSHŪ 147 (Gr. Ct. Cass., Nov. 14, 1944); Yokosuka Kigyō K.K. v. Hayakawa Tekkō K.K., 9 KŌTŌ MINSHŪ (Tokyo High Ct., Mar. 28, 1956).