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BOARD REFORMS WITH A JAPANESE TWIST: VIEWING THE JAPANESE BOARD OF DIRECTORS WITH A DELAWARE LENS

Carlo Osi*

I. INTRODUCTION

The Japanese as a people have commonly been characterized as consensus-builders, holding extreme regard for hierarchy, stable,¹ non-confrontational,² and always one with the group (*amae*).³ They adhere to the notions of groupthink, familism,⁴ and rarely deviate from the ideals and structure of the group. Deviants are considered un-Japanese, social outcasts and protruding nails that ought to be hammered down to blend into the harmonious whole.⁵ Culturally unchanged for centuries, it is unsurprising that even within the Japanese boardroom directors carry the same traits and advocate the same philosophies.

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1. GREGORY JACKSON, RESEARCH INSTITUTE OF ECONOMY, TRADE AND INDUSTRY (RIETI), CORPORATE ACCOUNTABILITY: WHAT JAPAN CAN LEARN FROM GERMANY (2002), <http://www.rieti.go.jp/en/miyakodayori/050.html> (The hallmarks of Japanese corporate stability were “concentrated ownership, no open market for corporate control, a central role for banks and bank-based financing, strong participation of employees in corporate management, stable employment and management strategy based on long-term organization building based on mutual trust and cooperation among stakeholders.”).

2. This is contrary to the mistaken notion, notably based on Japan's World War II status as an aggressor, that the average Japanese is aggressive, violent, and confrontational.

3. BRUCE S. FEILER, LEARNING TO BOW: INSIDE THE HEART OF JAPAN 94 (2004) (“By becoming one with the group . . . the Japanese are able to display a strength beyond the scope of the individual.”) (quoting Takeo Doi).

4. The Japanese have a saying that “even if an extended family does not live together, parents and grandparents should live near enough to carry over a bowl of hot soup.” Theodore Bestor & Helen Hardacre, *Contemporary Japan: Culture and Society*, http://afe.easia.columbia.edu/at_japan_soc/.

5. Thomas Dillon, *Hitting the Nail on the Head*, Feb. 28, 2004, THE JAPAN TIMES, available at <http://search.japantimes.co.jp/cgi-bin/fl20040228td.html>. See also MARTIN J. GANNON, UNDERSTANDING GLOBAL CULTURES: METAPHORICAL JOURNEYS THROUGH 28 NATIONS, CLUSTERS OF NATIONS, AND CONTINENTS 37 (2004).

Considered “the West’s exotic Other,”⁶ behaviorally reserved and egalitarian Japan has a corporate history and governance structure that has fascinated and mystified scholars and practitioners alike for decades. Japan follows a radically different corporate mold from the West and yet has steadily increased its national wealth since the Second World War.⁷ Its values, belief system and business perspectives are almost totally opposite that of the United States, but it remains the world’s second largest economy.⁸ Until the bubble burst of the early 1990s, the Japanese economy had been stable and steadily growing for forty years.⁹ Japanese corporate practice differed immensely from the Anglo-American model because: (1) it treated employees as family members;¹⁰ (2) the corporation was run for the benefit of all stakeholders;¹¹ (3) the *keiretsu* system of intertwined shareholdings was pervasive;¹² (4) Main Banks (described below) were the primary source of financing and not institutional investors;¹³ (5) hostile takeovers were uncommon;¹⁴ and (6) mass layoffs did not generally occur.¹⁵ Yet, one thing the U.S. and Japan shared was highly ubiquitous corporate scandals.

According to Christina Ahmadjian and Ariyoshi Okumura, post-war corporate Japan was illuminated by a set of interrelated stakeholders—labor, management, capital, buyers, suppliers, and the state.¹⁶ The Japanese corporation relied primarily on cross-shareholding ownership, whereby a company owned a sizeable number of shares of other corporations within a specific group or “*keiretsu*,”¹⁷ thus enabling it to source out needed inputs

6. Jeffrey Levick, *Japan in the U.S. Press: Bias and Stereotypes*, July 2005, <http://iis-db.stanford.edu/docs/121/press.pdf>.

7. Economy Watch, *Japan’s Economy*, http://www.economywatch.com/world_economy/japan/ (last visited Feb. 9, 2009).

8. *Id.*

9. See generally Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions*, 25 DEL. J. CORP. L. 189 (2000) [hereinafter Shishido, *Japanese Corporate Governance*].

10. TAKIE SUGIYAMA LEBRA, *JAPANESE CULTURE AND BEHAVIOR: SELECTED READINGS* 176 (1986).

11. See generally Luke Nottage, *Japanese Corporate Governance at a Crossroads: Variation in “Varieties of Capitalism”?*, 27 N.C.J. INT’L L. & COM. REG. 255 (2001).

12. See generally Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871 (1993).

13. Ichiro Kobayashi, *Practitioner Note: The Interaction Between Japanese Corporate Governance and Relational Contract Practice*, 2 N.Y.U. J. L. & BUS. 269, 301–03 (2005).

14. Robert Neff, *Japan: Land of the Hostile Takeover? (Int’l Edition)*, BUS. WK., Mar. 30, 2000, available at http://www.businessweek.com/2000/00_11/b3672182.htm.

15. Peter B. Doeringer, Christine Evans-Klock & David G. Terkla, *Hybrids Or Hodgepodes? Workplace Practices of Japanese and Domestic Startups in the United States*, 51 IND. & LAB. REL. REV. 171, 176–77 (1998).

16. Christina L. Ahmadjian & Ariyoshi Okumura, *Corporate Governance in Japan*, in HANDBOOK ON INTERNATIONAL CORPORATE GOVERNANCE 130 (Christine A. Mallin, ed., 2006).

17. Keiretsu is the Japanese corporate model whereby companies and banks owned large chunks of each other’s equity. It is comprised of networks of businesses whose financial base is a

and resources quickly, but at the same time limiting its market. A single bank that provided a majority of the funding (Main Bank)¹⁸ was likely at the center of the group and was deeply involved in all of the corporation's financial transactions, and was revered for this reason.¹⁹ This Main Bank, due to its dual role as lender and owner, had significant control over the policy and operations of the company by deploying its employees as corporate directors or officers.²⁰ This effectively resulted in stable shareholding, passivity amongst institutional investors, and a relatively weak capital market.²¹

Stability also occurred in corporate leadership and amongst rank-and-file employees. In many corporations, the outgoing company president normally handpicked his successor.²² Significantly, a lifetime employment system also emerged from a strong and unshaken belief that once employed, a male employee would forever be connected with the same company.²³ This practice is still firmly rooted in corporate culture despite its applicability to a diminishing subset of the workforce. As late as October 2005, some sectors still felt that the labor force must be prioritized and that retaining redundant employees fosters worker morale and instills loyalty.²⁴ To be sure, the "managerialist and employee-oriented cast to the Japanese firm has not been fundamentally eroded."²⁵

By the early 1990s, however, particularly with the unexpected burst of the bubble²⁶ and the financial crisis afterwards, corporate Japan began the

major bank where such companies typically own stakes of each other as a natural defense against untoward external threats and for mutual security. It is a quid pro quo arrangement: I hold your shares, you hold mine and we will both be protected from any hostile takeover attempt.

18. The Main Bank relationship is the long-term and stable relationship between a corporation and the bank that chiefly finances it.

19. Thayer Watkins, *The Keiretsu of Japan*, available at <http://www.sjsu.edu/faculty/watkins/keiretsu.htm> ("The general structure of the keiretsu is an association of companies formed around a bank. They cooperate with each other and own shares of each other's stock.")

20. *Id.*

21. *Id.*

22. Makoto Toda & William McCarty, *Corporate Governance Changes in the Two Largest Economies: What's Happening in the U.S. and Japan?*, 32 SYRACUSE J. INT'L L. & COM. 189, 205 (2005).

23. In general, companies practiced welfare corporatism and had a tendency to protect their employees while seeking greater productivity from them, amounting to excessive work hours and occasional work-related suicides. Japanese workers have also suffered from *karoshi* or death by being overworked, and have also developed the socially acceptable habit of sleeping in public, on trains to work, during meetings and in other social events.

24. SYMPOSIUM REPORT, BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY: AN AGENDA FOR JAPAN AND THE UNITED STATES 4 (Sept. 30 – Oct. 2, 2005), http://www.law.harvard.edu/programs/pifs/pdfs/2005_jus_symposium_report.pdf.

25. Curtis J. Milhaupt, *A Lost Decade for Japanese Corporate Governance Reform?: What Changed, What Hasn't, and Why* 18 (Working Paper No. 202, Sept. 2004), available at <http://swopec.hhs.se/eijswp/papers/eijswp0202.pdf>.

26. Japan Visitor, *The Japanese Economy: A Look at the Post-Bubble Japanese Economy*, <http://www.japanvisitor.com/index.php?cID=374&pID=768&cName=Travel%20Basics&p> (last visited Apr. 14, 2009) ("At the beginning of the 1990's Japan was set to challenge the U.S. as the

long process of transformation. It began to open up to foreign ideas and experimentation. It was forced to listen to the outside world. Analogous to when U.S. Commodore Matthew Perry forced Japan to trade with the West by threatening to use his mighty Ships in July 1853 near Edo (now Tokyo),²⁷ Japan is gradually capitulating to Western-style corporate governance. More foreign shareholders are entering the securities market while aggressive mergers and hostile takeovers are slowly becoming commonplace.²⁸ Shareholder activists—both Japanese and foreign-born—are steadily chipping away at the deeply imbedded and unbending rigidities of Japan's traditional corporate world.²⁹ In the last few years, Japan has seen the decreasing role of the Main Bank in corporate, financial and shareholder affairs;³⁰ the prevalence of international or cross-border transactions; and the gradual ebbing of the paternalistic lifetime employment system.³¹ The practice of instituting an overly bloated board has been reconsidered and gradually altered.³² For example, the Shareholder Ombudsman was established in Osaka in 1996 to guard against bad boardroom practices by instituting high profile derivative suits and hefty settlements as deterrents.³³ Stronger CEOs have also emerged with the decline of consensual decision-making of the board, and managers have shifted their focus to greater returns on shareholder investments. Recently

world's number one economy. It was the time of the Gucci loafers and two Rolex watches worn on the one wrist . . . by 18 year-olds. The value of land was astronomical: it was calculated that the Imperial Palace grounds in Tokyo were worth more than California in its entirety. Based on land price, the real estate value of Japan was seven times that of the U.S. Then the bubble burst.”)

27. U.S. Department of State, *The United States and the Opening to Japan, 1853*, <http://www.state.gov/r/pa/ho/time/dwe/86550.htm> (last visited on Feb. 9, 2009).

28. See generally Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171 (2005).

29. Examples of these shareholder activists are convicted insider-trader and former high profile fund manager Yoshiaki Murakami, former Livedoor's CEO Takafumi Horie, NY-based Steel Partners, CA-based Dalton Investments, and London-based The Children's Investment Fund Management. See Joseph Chang, *Shareholder Activism in Japan on the Rise, but Change will be Difficult*, ICIS, Nov. 2, 2007, <http://www.icis.com/Articles/2007/11/05/9075289/shareholder-activism-in-japan-on-the-rise-but-change-will-be-difficult.html>; see also Kanako Takahara, *Murakami: Investor Activist Turned Greenmailer?*, THE JAPAN TIMES ONLINE, July 20, 2007, <http://search.japantimes.co.jp/cgi-bin/nb20070720a2.html>; Takashi Betsui, *Livedoor CEO, Other Top Execs Arrested*, CNET NEWS, Jan. 23, 2006, http://news.cnet.com/Livedoor-CEO,-other-top-execs-arrested/2100-1014_3-6029628.html; Christopher Hughes, *More Perspiration than Inspiration*, Apr. 3, 2009, BREAKINGVIEWS.COM, <http://www.breakingviews.com/2009/04/03/Shareholder%20activism.aspx>.

30. See generally Ronald J. Gilson, *Reflections in a Distant Mirror: Japanese Corporate Governance Through American Eyes*, 1998 COLUM. BUS. L. REV. 203 (1998).

31. Gregory Jackson, *Employment Adjustment and Distributional Conflict in Japanese Firms*, in CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY 283 (Masahiko Aoki, Gregory Jackson, and Hideaki Miyajima, eds., 2007).

32. Matthew Senechal, *Reforming the Japanese Commercial Code: A Step Towards an American-style Executive Officer System in Japan?*, 12 PAC. RIM L. & POL'Y 535, 536 (2003).

33. Mark D. West, *Why Shareholders Sue: The Evidence from Japan*, 30 J. LEGAL STUD. 351, 369–70 (2001) [hereinafter West, *Why Shareholders Sue*].

instituted accounting regulations have engendered transparency and further relaxed the once tight grip of cross-shareholding.³⁴ Thus, for almost two decades, corporate governance has changed and evolved at an unprecedented rate—though still slow in terms of U.S. standards—which is something unexpected given the rigidity of Japanese society. Even former Prime Minister Mori Yoshiro (2000–2001) remarked, “the system and the ways of thinking which for 50 years have supported Japan’s astonishing development have now become inappropriate for the world we live in.”³⁵

But not everything is changing. Despite the decrease in board size, independent directors are still a rarity and executive compensation has yet to achieve the same level as top-tier corporations in the United States. Except for notable exceptions such as the Nissan-Renault corporation headed by non-Japanese Carlos Ghosn,³⁶ Japanese corporations still have not imbibed the American corporate value of downsizing for the sake of shareholder interest. Even now, there are many “old guards” heading Japanese boardrooms who see no reason to drastically change their conventional “best practices” just to mirror U.S.-style governance. They clamor for the suppression of homegrown shareholder activists like Livedoor’s Takafumi Horie and Murakami Fund’s Yoshiaki Murakami,³⁷ and see hostile takeovers as destroying corporate “families” (by forcibly segregating children from their parents) or as almost criminal behavior.

This article analyzes the evolution of the Japanese board of directors and pinpoints the factors that obstruct its development. Part II explains in detail the fundamental characteristics of Japanese corporate governance. Part III traces the evolution of the board of directors from the Meiji Restoration in the 1880s to the present day. Part IV tackles the question of whether the Japanese model creates a monitoring or managing board. Next, Part V explains who benefits from corporate management, while Part VI describes the essential criteria for being selected/elected as a director. Part VII illustrates the board reforms that have occurred. However, Part VIII emphasizes the remaining pervasiveness of grey directors. Part IX rationalizes that creeping, not sweeping or drastic, change is enveloping Japan. The article concludes in Part X that despite the legislative reforms and the optional adoption of the committee system, the Japanese board is

34. RALPH PAPRZYCKI & KYOJI FUKAO, FOREIGN DIRECT INVESTMENT IN JAPAN: MULTINATIONALS’ ROLE IN GROWTH AND GLOBALIZATION 6, 65–66, 244–45 (2008).

35. Dr. A. Hernádi, *Japan’s Responses to Globalization* (June 6, 2003), available at <http://www.iem.ro/General/DATA/MRRomUng/AHERNADI.htm>.

36. Carlos Ghosn is a Brazilian-born executive of Lebanese descent who trained in France. He is largely credited for successfully turning around Japanese car manufacturer Nissan. He currently is the CEO of the merged Nissan-Renault. See Executive Profile, Carlos Ghosn, BUS. WK., <http://investing.businessweek.com/businessweek/research/stocks/people/person.asp?personId=752502&symbol=NSANY>.

37. Martin Fackler, *Corporate Raider Arrested in Japan* (June 5, 2006), available at <http://www.iht.com/articles/2006/06/05/business/insider.php>.

still not independent, but rather filled with insiders and grey directors. It remains a managing board with an extremely hindered monitoring role. Finally, this article prescribes remedies for Japanese corporate governance that may be effective within the next decade or so, provided that reformists increase in popularity and gradual changes are embraced by the public. The unmistakable grey hues permeating Japanese boards must be replaced by neutrally-toned independent directors, lest Japan becomes known as the new Potemkin Village.

II. JAPANESE CORPORATE GOVERNANCE AT A GLANCE

The Japanese post-war period of corporate governance spanned from 1945 to the late 1990s, with the bubble burst occurring in the very early 1990s. During that time, for which Japanese post-war corporate governance has been typified as eccentric, slow to change, conservative and insular,³⁸ little changed within the corporate world. In what is informally known as the J-Form, Japanese firms traditionally relied on monitoring by large shareholders and banks.³⁹ Notably absent were hostile takeovers, managerial incentives, mass layoffs, and corporate restructurings. Stable shareholding, meager foreign shareholding, career or lifelong employment, omnipresence of Main Banks and cross-shareholding were the consistent corporate patterns during this period and they continue to a great degree today. These features were attractive to some scholars, who argued that Japanese-style corporate governance was a superior and viable alternative to the governance mechanisms available in the West.⁴⁰

The Japanese system was and is dissimilar from the U.S. system in other ways. As one scholar notes, the “Japanese system is usually characterized as bank and relationship oriented and the U.S. system as (stock) market oriented.”⁴¹ During the post-war period, there was little shareholder litigation,⁴² no rationale for takeover activities, and no impetus

38. Ronald J. Gilson & Curtis J. Milhaupt, *Choice as Regulatory Reform: The Case of Japanese Corporate Governance*, 53 AM. J. COMP. L. 343, 343 (2005).

39. Masahiko Aoki, *Toward an Economic Model of the Japanese Firm*, 28 J. ECON. LIT. 1, 8 (1990).

40. Ushering the pre-bubble concept of Pax Japonica, which some have thought could replace Pax America if not for the economic collapse in the early 1990s. See Etsuo Abe, *What is Corporate Governance? The Historical Implications*, in THE DEVELOPMENT OF CORPORATE GOVERNANCE IN JAPAN AND GREAT BRITAIN 1, 6 (Robert Fitzgerald & Etsuo Abe, eds., 2004). See also Jean-Pierre Lehmann, *Opening Up Japan*, ASIA MEDIA, Oct. 19, 2004, <http://www.asiamedia.ucla.edu/article.asp?parentid=16056> (last visited on Apr. 14, 2009).

41. Steven N. Kaplan, *Top Executive Rewards and Firm Performance: A Comparison of Japan and the United States*, 102 J. POL. ECON. 510, 510–11 (1994).

42. Less than twenty shareholder suits were filed between 1950 and 1990. See Mark D. West, *The Pricing of Shareholder Derivative Actions in Japan and the United States*, 88 NW. U. L. REV. 1436, 1438 (1994). See also R. Daniel Kelemen & Eric C. Sibbitt, *The Americanization of Japanese Law*, 23 U. PA. J. INT'L ECON. L. 269, 306–07 (2002) (“[T]he threat was so minimal that directors and officers insurance, a standard insurance product in the United States, was not

to challenge those sitting in the halls of corporate power. The residual owners of the company were regarded with little importance. Moreover, corporations systematically limited the duration of their annual shareholder meetings to a little less than thirty minutes, ostensibly to prevent shareholders from running wild.⁴³ The limitation was also designed to forestall numerous questions or issues that could stir up controversy.⁴⁴ The unique characteristics of Japanese corporate governance that existed during the post-war period still play a vital role today.

A. CROSS-SHAREHOLDING

Cross-shareholding is a distinct feature of the corporate system and is characterized by the web-like mutual shareholding structure prevalent among companies that helped maintain stability in post-war Japan. The development of this system has resulted in the following: (1) the illiquidity of equity markets; (2) protection of businesses from hostile takeovers; (3) passivity of shareholders; and (4) corporate management indifference to shareholders' interests.⁴⁵ Cross-shareholding is the clear result of groupism, in which Japanese firms exhibit a predilection to "cluster themselves into groupings of affiliated companies that extend a broad spectrum of markets."⁴⁶ According to Takahiro Yasui, it was originally developed in the late 1940s and early 1950s with the purpose of raising capital while preventing hostile acquisitions.⁴⁷ It has contributed to the relatively concentrated ownership structure of Japanese companies. Presently, cross-shareholding is unwinding as more foreign stockholders have bought into the shares of Japanese companies.⁴⁸

introduced into Japan until 1990, and even then only for risks of exposure to lawsuits overseas. Director's and officer's insurance for threats arising in Japan was not sold until 1994.").

43. Some managers viewed shareholders as disturbances, if not a nuisance, who need not be spoken to and should generally be ignored.

44. As to be explained later, management used Yakuza gangsters and their own employees through irrepressible clapping sessions to suppress legitimate shareholder voice during shareholder meetings. See *Shareholders Meetings: Big Police Presence Checks 'Sokaiya'*, THE JAPAN TIMES ONLINE, June 30, 2000, <http://search.japantimes.co.jp/cgi-bin/nn20000630a4.html> [hereinafter *Shareholders Meetings*]; see also discussion *supra* Part II.F.

45. Toru Umeda, *Corporate Governance Reforms in Japan*, http://www.icac.org.hk/ICAC/ACTIVITIES/leader/ppt/toru_e.ppt (last visited Apr. 14, 2009).

46. Michael L. Gerlach, *Twilight of the Keiretsu? A Critical Assessment*, in *COMPARATIVE LAW: LAW AND THE LEGAL PROCESS IN JAPAN* 379–81 (Kenneth L. Port ed., 1996).

47. Takahiro Yasui, *Corporate Governance in Japan*, in *CORPORATE GOVERNANCE IN ASIA: A COMPARATIVE PERSPECTIVE* 129 (Organization for Economic Co-operation and Development [OECD] ed., 2001).

48. See generally INTERNATIONAL MONETARY FUND, *JAPAN: SELECTED ISSUES* (2008), <http://www.imf.org/external/pubs/ft/scr/2008/cr08254.pdf>.

B. THE MAIN BANK SYSTEM

A Main Bank is a bank that provides loans to a company and at the same time holds that company's stock.⁴⁹ A typical Japanese company develops a long-term relationship with a Main Bank and depends on it for support and financing.⁵⁰ It is the company's largest creditor and often its largest shareholder.⁵¹ It normally holds the largest exposure, among private financial institutions, of loans made to a firm.⁵² As it also holds equity, it is expected to monitor the company but to intervene only when things go wrong.⁵³ Since a Main Bank intervenes only when the company is distressed, this has been described as "contingent governance"; the board enjoys a high degree of autonomy in normal times but will defer to the Main Bank in abnormal situations.⁵⁴

Banks gladly serve as Main Banks because their client-companies are certain to utilize them for transactional purposes, earning the banks fees and profits through deposits, a monopoly in employees' salary accounts, and interest rates.⁵⁵ To ensure a healthy return on Main Bank investments, current or former bank employees are placed in key managerial positions or on the boards of directors of these firms.⁵⁶ Perhaps even more important is the role of the Main Bank when one of its *keiretsu* members becomes financially distressed; because the Main Bank has loan and equity exposures, it will often come to the company's rescue.⁵⁷ Main Banks have even dabbled in the negotiations of a company's debts and its possible restructuring.⁵⁸ This results in rampant inefficiency, where regularly failing companies are kept afloat due to the Main Bank's intervention and patriarchy.⁵⁹ They are treated like lost spoiled children whose parents

49. Main Banks not only finance the companies, but they also own them in part by buying into these companies, particularly if they belong to the same *keiretsu*. They also serve as underwriters of bond issues. See Ahmadjian & Okumura, *supra* note 16, at 130–31.

50. *See id.*

51. See Mark J. Loewenstein, *What Can We Learn From Foreign Systems?: Stakeholder Protection in Germany and Japan*, 76 TUL. L. REV. 1673, 1687 (2002).

52. *Id.*

53. MASAHIKO AOKI & HUGH T. PATRICK, *THE JAPANESE MAIN BANK SYSTEM: ITS RELEVANCE FOR DEVELOPING AND TRANSFORMING ECONOMIES* 3–5 (1994). Main Banks naturally acted as monitors of the corporations they owned because they needed to guarantee that the funds lent were invested well or attained their original purpose.

54. See Yasui, *supra* note 47, at 123–24 ("The governance structure of Japanese corporations is often characterised as 'contingent governance' in which company insiders retain effective control of management as long as the firm performs well, but once performance deteriorates, the control is taken away and they are subject to severe sanctions such as the forced liquidation of the corporation.").

55. See generally Takeo Hoshi, *Evolution of the Main Bank System in Japan*, in *BANKING IN JAPAN* 159–85 (William M. Tsutsui, ed., 1999).

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

stubbornly believe that a turnaround is forthcoming; hence, the Main Bank's monitoring and disciplining role.⁶⁰

In the late 1980s, banks and other financial institutions held about 40% of Japanese publicly listed shares.⁶¹ Although it was illegal for any single bank to hold a stake in a company greater than 5%, banks coordinated with closely affiliated banking institutions, insurance companies and other financial companies to sidestep the law.⁶² The law was easily circumvented to perpetually put companies in the hands of a Main Bank or at least a friendly third party. These Main Banks were also boosted by the coordinated assistance and protection provided by the Ministry of Finance, which made certain that poor performers were ably supported. Since the Ministry of Finance had their support, banks frequently took high lending risks with their clients.⁶³ This, among other interrelated reasons, would later take down some of the behemoth Main Banks.

Main Banks have gradually been replaced by a more capital market-dependent system.⁶⁴ The Main Bank system "has gradually become incompatible with the changing economic environment."⁶⁵ However, Main Banks have not ceased being the main financing core of *keiretsu* companies.⁶⁶ "It would be more accurate to suggest that the main banks have shifted from performing their insurance function through active rescues to relying on passive life-support operations."⁶⁷ While there is a general unwinding of the old Main Banks, some have just merged with other banks to form "megabanks"⁶⁸ that continue to play a key, though often no longer dominating role in the affairs of companies. Some of the Main Banks have gone out of business, but many still exist and continue to

60. See Yasui, *supra* note 47, at 123, 131–32.

61. Sanford M. Jacoby, *Corporate Governance in Comparative Perspective: Prospects for Convergence*, 22 COMP. LAB. L. & POL'Y J. 5, 16–17 (2000).

62. Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927, 1939–41 (1993).

63. See generally Gregory D. Ruback, *Master of Puppets: How Japan's Ministry of Finance Orchestrates its Own Reformation*, 22 FORDHAM INT'L L.J. 185 (1998).

64. MAMIKO YOKOI-ARAI, FINANCIAL STABILITY ISSUES: THE CASE OF EAST ASIA 117–19 (2002).

65. Toshihiko Fukui, Governor, Bank of Japan, *Toward the Reform of Corporate Finance in Japan*, Keynote Speech at the JSLA Symposium on "New Corporate Finance to Revitalize Japan," in Tokyo, Japan (Nov. 17, 2003), available at <http://www.boj.or.jp/en/type/press/koen/ko0312e.htm>.

66. STEVEN KENT VOGEL, JAPAN REMODELED: HOW GOVERNMENT AND INDUSTRY ARE REFORMING JAPANESE CAPITALISM 127–129 (2006).

67. *Id.* at 128.

68. Sumitomo Bank and Mitsui Bank merged in 2001 to become the Sumitomo Mitsui Banking Corporation; Bank of Tokyo-Mitsubishi and UFJ merged in 2004 to become the world's largest bank; Sanwa Bank later became part of the Bank of Tokyo-Mitsubishi UFJ. See Akiko Kashiwagi & Peter S. Goodman, *Japan Merger Creates World's Largest Bank*, WASHINGTON POST, July 16, 2004, <http://www.washingtonpost.com/wp-dyn/articles/A54352-2004Jul16.html>. See also *Bank-merger Mania: And Then There were Five?*, ASIA TIMES ONLINE, Aug. 27, 1999, available at <http://www.atimes.com/editor/AH27Ba01.html>.

perform lending and financing functions.⁶⁹ They are reinventing themselves, “are rushing to unwind their cross-shareholdings,”⁷⁰ and continue to play key roles, albeit more subdued and less interventionist ones.⁷¹

The Japanese have learned their lessons well on the failures of the Main Bank system,⁷² though it took decades, a lot of flack from the public, and necessitated a very firm government hand. After the bubble burst in the early 1990s and the decade-long economic stagnation, the Main Bank system was blamed and solutions were formulated.⁷³ While the Main Banks were correctly identified as the source of the problem, the central solution of various Japanese administrations in the 1990s was to bail out banks, lower interest rates, and offer massive fiscal stimulus packages among other things.⁷⁴ All of these plans failed in Japan, as they wasted large amounts of capital in an attempt to prop up a flawed banking system without making any real substantive changes.⁷⁵ In the late 1990s, Japanese banks still kept loans extended to “zombie” companies on their balance sheets instead of disclosing them and writing them off.⁷⁶

In 2003, after more than a decade of stagnation, Japan’s government, headed by reformist Junichiro Koizumi, instituted a set of complete and “merciless audits”⁷⁷ of the banking system under the so-called Takenaka Plan. Heizo Takenaka, who led the government’s financial reforms, brought to light the real extent of the banking crisis. With a firm, unrelenting approach, the banks finally disclosed and wrote off their bad loans after three years. In the end, the government nationalized one big bank, offended many bank shareholders, and allowed some banks to collapse and fail under

69. VOGEL, *supra* note 66, at 127–29.

70. See Fukui, *supra* note 65. “Cross-shareholdings may have a serious and unpredictable impact on banks’ business given their limited capital bases. In this sense, banks’ reductions of cross-shareholdings represent an attempt to restore themselves to financial soundness. At the same time, I believe that, having freed their capital from stock price volatility, they will be able to increase their extension of loans to firms.” *Id.*

71. *Id.* “The traditional framework for corporate financing in Japan worked well in the economic environment and structures of the past, which explains why it will take a substantial amount of effort and energy to change its direction.” *Id.*

72. Hugh T. Patrick, *The Relevance of Japanese Finance and Its Main Bank System*, in THE JAPANESE MAIN BANK SYSTEM: ITS RELEVANCE FOR DEVELOPING AND TRANSFORMING ECONOMIES 353–408 (Masahiko Aoki and Hugh T. Patrick, eds., 1994).

73. See Hiroko Tabuchi, *Japan sees U.S. Repeating its Mistakes on Bank Plan*, INTERNATIONAL HERALD TRIBUNE, Feb. 13, 2009, at 1.

74. *Id.* There are clearly similarities between the Japanese banking crisis of the 1990s and the United States’ present banking crisis. A plethora of questions on the United States’ response to the crisis thus comes into mind: Are the Japanese solutions to their own banking problems applicable to the United States? See Anthony Randazzo, *Return of the Living Dead: What the U.S. Can Learn from Japan’s Failed Experiment with “Zombie Businesses”*, REASONONLINE.COM, Dec. 17, 2008, <http://www.reason.com/news/show/130626.html>.

75. See Tabuchi, *supra* note 73.

76. *Id.*

77. *Id.*

their own weight.⁷⁸ It is believed that “was a turning point in the banking crisis” because “[a]fter that, markets finally trusted the banks again.”⁷⁹

C. LIFELONG EMPLOYMENT AND THE SENIORITY WAGE SYSTEM

Lifelong or career-long employment, which is applicable only to males, has several key elements. First, the individual is hired directly from school instead of being hired in the open market.⁸⁰ Second, the individual is hired based on his general characteristics and abilities, rather than for a specialized or particular skill.⁸¹ Third, he is expected to remain in the company for the length of his career, and in return, he can expect not to be fired or discharged.⁸² Fourth, an employee chooses a company, not a profession. An employee will ordinarily refuse to job hop.⁸³ Career employment acts as a social safety net, covering everything from health care to housing loans to retirement funds.⁸⁴

Under the Seniority-Wage System, a worker’s salary is not based on his performance, but on the length of his service to the company.⁸⁵ Employees are generally paid a minimally sufficient amount from the start of their careers until they reach 50. When they turn 50, their salaries grow very quickly. By the mandatory retirement age of 60 or 65 (depending on the corporation), they get a large bonus plus a reliable pension that they can use in their old age.⁸⁶ The practices of career employment and seniority wages are waning⁸⁷ and have become difficult to sustain in recent years.⁸⁸

78. *Id.*

79. *Id.*

80. Linda N. Edwards, *Equal Employment Opportunity in Japan: A View from the West*, 41 *INDUS. & LAB. REL. REV.* 240, 244 (1988).

81. See generally Daniel H. Foote, *Judicial Creation of Norms in Japanese Labor Law: Activism in the Service of—Stability?*, 43 *UCLA L. REV.* 635, 651–60 (1996).

82. JAMES ABBEGLEN AND GEORGE STALK, JR., *KAISHA: THE JAPANESE CORPORATION* 183–88, 191–92, 194–206 (1985).

83. Sanford M. Jacoby, *Business and Society in Japan and the United States*, 43 *BRITISH J. IND. REL.* 4 (Dec. 2005), available at <http://www.anderson.ucla.edu/documents/areas/fac/hrob/BJIRWeb.pdf>.

84. Lifelong employment was once the Japanese dream. Men could live their lives out in a company with little or no fear of retrenchment or termination without cause. The reality of the world economy nowadays focuses sharply on reduced costs, a leaner yet meaner work force, efficient management and better output. As Japan is continuously struggling to remain the second largest economy, this may be the end of the dream for the Japanese salary man (*sarariman*), despite being once the paragon of contemporary Japan.

85. Kathleen B. O’Neill, *Industrial Relations in Korea: Will Korea Become Another Japan?*, 12 *COMP. LAB. L.* 360, 382 (1991).

86. Ann R. Klee, *Worker Participation in Japan: The Temporary Employee and Enterprise Unionism*, 7 *COMP. LAB. L.* 365, 375–77 (1986).

87. HIROYUKI FUJIMURA ET AL., *CHANGING CORPORATE SOCIETY AND FUTURE CHALLENGES FOR COMPANIES, INDIVIDUALS, AND SOCIETY: TOWARD AN EMPLOYMENT FOCUSED SOCIETY* (2003), <http://www.jil.go.jp/english/reports/documents/jilpt-research/nol3.pdf>.

88. RESEARCH INSTITUTE OF ECONOMY, TRADE AND INDUSTRY, IAA, *PRESCRIPTION FOR A BETTER JAPAN: RIETI FEATURED FELLOW RONALD DORE RIETI REPORT No. 023*, May 29, 2003, http://www.rieti.go.jp/en/rieti_report/023.html (“Lifelong employment is collapsing, and

D. BOARD OF DIRECTORS

Directors in Japan are commonly classified as either insiders or outsiders; outside directors are further classified as either grey or independent. Directors tend to be lethargic, because independent outside directors are kept in extremely small numbers. There is little board control over the actions and decisions of the company president. Board decisions are likely to be rubber-stamped,⁸⁹ and board meetings are infrequent—all of which results in a rather dysfunctional governance system. Boards likewise tend to be very large, at least when compared to Western standards. For example, as recently as 1990, Sony Corporation's board had thirty-six directors (which increased to thirty-eight in 1997)⁹⁰ while Nippon Steel had forty-two.⁹¹ Many of these directors were insiders; former corporate executives or employees who were promoted to director status.

E. GOVERNMENT-BUSINESS HEGEMONY

Strong government-business ties exist in corporate Japan, allowing for a cozy business relationship between bureaucrats—with strong emphasis on public works ministry bureaucrats—and businessmen. Government agencies and businesses form a symbiotic relationship in which they exchange favors and business deals.⁹² Though not necessarily implying corruption, a government bureaucrat working closely with some high-moneyed industries can be assured that upon his retirement from government, a comfy executive position in a company with the sought-after perquisites awaits him—something like an “Old Boy” network.⁹³ Convoy Capitalism—the intervention by the Ministry of Finance and the Bank of Japan in dying, inefficient or “zombie” banks and borrowers by bleeding successful Japanese corporations, also plays a key role in the government-business hegemony.⁹⁴

F. THE *SOKAIYA* NUISANCE

Beyond being a country highly concerned with formal courtesies and subtleties, Japan is, on the other extreme, well-known for organized crime.

committing to just one company is becoming difficult . . . Japan really is the ‘unsteady archipelago.’”).

89. Ronald Dore, *Papers on Employees and Corporate Governance*, 22 COMP. LAB. L. & POL'Y J. 159, 164 (2000).

90. See Curtis J. Milhaupt, *Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance*, 149 U. PA. L. REV. 2083, 2117 (2001) [hereinafter Milhaupt, *Creative Norm Destruction*].

91. Ahmadjian & Okumura, *supra* note 16, at 132.

92. See generally Ulrike Schaede, *The “Old Boy” Network and Government-Business Relationships in Japan*, 21 J. OF JAP. STUDIES 293 (1995).

93. *Id.*

94. The International Economy, *Will “Convoy Capitalism” Sink Japan?*, Nov. 2000, http://findarticles.com/p/articles/mi_m2633/is_6_14/ai_68145871.

Yakuza organizations have ruled the country for a considerable period.⁹⁵ They sprung from feudal origins, and consisted of the original protectors of the village, masterless samurais (*ronin*), town servants, peddlers and even excessive gamblers.⁹⁶ In the corporate world, they have been reincarnated.

Sōkaiya, literally meaning “general meeting operators,” is a unique Japanese form of extortion practiced by the Yakuza and peddled in the corporate halls. The *Sōkaiya* are gangster corporate racketeers. They have also been known as “‘financial racketeers,’ ‘general meeting mongers,’ ‘black gentlemen in the shadow[s],’ and ‘rent-a-thugs.’”⁹⁷ Their modus operandi is simple: they deploy members or operatives during a stockholders’ meeting and employ an agenda that depends on whether they have been paid off. Their presence effectively frightens stockholders from coming forward with their proposals or actively pushing for reforms. They act as deterrents to stockholders otherwise resolved to participate in the decision-making process, and ensure that the meeting will run smoothly. These corporate racketeers use threats, intimidation and other scare tactics to keep the meetings short, empty, ritualistic and meaningless.⁹⁸

The Yakuza achieve their ends by systematically and illegally obtaining embarrassing evidence on company leaders, blackmailing them in exchange for keeping such disparaging information from the public or the shareholders.⁹⁹ Such information may be about tax evasion, mistresses, the lack of safety guidelines in their plants, or other unsavory information about the company or its officers.¹⁰⁰ Many corporations have used racketeers to keep shareholder meetings brief and infrequent, occurring once a year for only twenty to thirty minutes. Anything beyond that is considered long and unacceptable. The *Sōkaiya* have also been paid to scare away shareholder activists or ordinary stockholders from raising any issues,¹⁰¹ no matter how

95. Christopher Altman, *Japanese Yakuza: History and Cultural Development*, <http://altman.casimirinstitute.net/yakuza.html> (last visited Feb. 17, 2009).

96. Anthony Bruno, *The Yakuza: Origins and Traditions*, http://www.trutv.com/library/crime/gangsters_outlaws/gang/yakuza/1.html (last visited Feb. 17, 2009).

97. D. KAPLAN AND A. DUBRO, *YAKUZA: THE EXPLOSIVE ACCOUNT OF JAPAN’S CRIMINAL UNDERWORLD* 169–73 (1986).

98. See *Shareholders Meetings*, *supra* note 44.

99. In the last ten years, some company officials were found guilty of paying off the gangsters to keep secret certain sensitive information on directors or officers that would likely cause embarrassment and social humiliation in front of their own employees. See Brian Bremner & Emily Thornton, *BLACKMAIL! A Rash of Scandals and a Government Crackdown are Showing how Mob-linked Investors—The Sokaiya—Prey on some of Japan’s Biggest Companies. Can Business Break Free?* (1997), available at <http://www.calbaptist.edu/dskubik/scandal.htm>.

100. See *id.*

101. See, e.g., *Japan v. Hobo*, 23 Keishu 1359, SUP. CT., P.B., Oct. 16, 1969. In the same case but during the trial at the lower court (Tokyo District Court), a *Sokaiya* was described “as one who holds a few shares of stock in many companies, and at the request of one of these companies, professionally attends the general meetings of that company, for the express purpose of assisting the company in holding the meeting and passing all company-proposed resolutions.” 7 Kakeishu 1712 (Tokyo Dist. Ct., Aug. 27, 1965).

relevant or material to the company. They have likewise taken seemingly legitimate forms by becoming corporate insiders, company consultants and advisers.¹⁰² In essence, however, the *Sōkaiya* attend meetings for three reasons: for corporate blackmail, to manage shareholder meetings, and to use violence if necessary.¹⁰³

G. THE GRADUAL DEMISE OF, AND RECENT CHANGES IN, TRADITIONAL JAPANESE CORPORATE GOVERNANCE

The burst of the otherwise stable bubble economy signaled the diminution, if not the eventual demise, of these key elements of Japanese corporate governance. Japan's traditional strengths that led to its 40-year stability would turn out to be its critical weaknesses. After the bubble burst, there was almost a decade-and-a-half-long regression of the economy, highlighted by low economic growth, job insecurity,¹⁰⁴ unexpected bankruptcies, bad loans, national anxiety, and a shift of industrial operations, primarily to China.¹⁰⁵

During these times, Japanese companies shifted from bank-based financing to capital market financing, resulting in a smaller percentage of bank debts and the eventual disappearance of the Main Bank stranglehold.¹⁰⁶ Companies were able to raise more funds from places like London and New York than from Tokyo.¹⁰⁷ As a result, cross-shareholding and the *keiretsu* system gave way to greater foreign equity ownership. Banks, experiencing liquidity problems stemming from the failure of Japanese companies to repay their loans, and from revisions in accounting regulations mandating that shares be reported at market, needed to sell most of their shares. Foreign investors who wanted to get a foothold in imperial Japan bought the shares peddled by the banks.¹⁰⁸ Foreign share ownership quickly rose from 6% in 1992 to a staggering 18% in 2003, and to 28% in 2007.¹⁰⁹ Meanwhile, shareholding by financial institutions dropped to

102. CURTIS J. MILHAUPT & MARK D. WEST, ECONOMIC ORGANIZATIONS AND CORPORATE GOVERNANCE IN JAPAN: THE IMPACT OF FORMAL AND INFORMAL RULES 112 (2004).

103. *Id.* at 109–13 (2004).

104. Suvendrini Kakuchi, *Japan: Amid Shrinking Paychecks, Signs of the 'New Worker'*, ASIA TIMES ONLINE, Dec. 24, 1999, available at <http://www.atimes.com/japan-econ/AL24Dh01.html>.

105. Irene M. Kunii, Alysha Webb & Dexter Roberts, *In Japan, "China Is Sexy"*, BUS. WK., Oct. 7, 2002, available at http://www.businessweek.com/magazine/content/02_40/b3802154.htm.

106. See generally Arikawa, Yasuhiro & Miyajima, Hideaki, *Relationship Banking in post Bubble Japan: Co-existence of Soft-and Hard Budget Constraint* (Mar. 2005), RIETI, <http://www.rieti.go.jp/jp/publications/dp/05e015.pdf>.

107. ARTHUR ALEXANDER, THE ARC OF JAPAN'S ECONOMIC DEVELOPMENT 100–102 (2008).

108. They were mostly U.S. or U.K. institutional investors.

109. Foreign investments have been increasing steadily, with 2003–2004 showing 21.8% of the stocks to be foreign-owned; 23.7% in 2004–2005; and at 26.7% as of 2005–2006. As of October 2005, M&A activities account for \$171B, up over 84% compared to the figures during the same month in 2004, or about 20% of the M&A volume in North America in 2006. See generally INTERNATIONAL MONETARY FUND, *supra* note 48.

approximately 35% in 2002.¹¹⁰ Shareholding by commercial banks, or specifically Main Banks, declined to just 6% in 2004 from 16% in 1992.¹¹¹ Corporate share ownership decreased to just 24% by 2004.¹¹²

In 2006, one scholar remarked, “There is a shift underway in Japan about the role of shareholders and the importance of getting return on equity . . . one of the beneficial outcomes is a heightened awareness on the part of CEOs, investors and employees of the radical changes that are occurring in the Japanese investment environment.”¹¹³ This is quite interesting considering that in 1983—during the time when the United States was experiencing an influx of mergers and acquisitions, when the U.S. equity base was increasingly held by institutional investors, and when Martin Lipton of the renowned New York firm Wachtell Lipton Rosen & Katz LLP was developing his shareholder rights plan or the “poison pill”—it was said that:

In most listed companies in Japan, a sizeable portion of the stock remains permanently in ‘safe’ hands, thus assuring continued control by management. Shareholdings are fragmented between ‘insiders’ and ‘outsiders.’ Insiders are small circles of executives and financiers often connected with the issuer’s enterprise group. Outsiders consist primarily of individual investors, and to a lesser degree, of investment advisory firms, insurance companies, banks or other groups and foreign firms. Outsiders occupy a position analogous to second-class creditors; they receive dividends, smaller but more consistent than in the U.S., and capital gain treatment when they sell, but have no real voice over the way corporate affairs are conducted. The insiders are in charge, not by virtue of their position as shareholders, but as a product of the multiplicity of their roles in the firm; they are creditors, shareholders, lifetime employees, management and business partners.¹¹⁴

The contrast between this pronouncement about Japan in 1983 and the gradual changes that have appeared in the last few years only confirm the fact that change can and will occur even in such a highly traditional and conservative society, though it will take much time and persuasion. Belated

110. Katsumasa Suzuki, *Future Prospects of Takeovers in Japan Analyzed from the View of Share-ownership Structures and Laws in Comparison with the United States and the European Union*, 42 COLUM. J. TRANSNAT’L L. 777, 815–16 (2004).

111. See Dan W. Puchniak, *The Japanization of American Corporate Governance*, 9 ASIAN-PACIFIC L. & POL’Y J. 7, 61. See generally Richard Schwindt & Devin McDaniels, *Competition Policy, Capacity Building, and Selective Adaptation: Lessons from Japan’s Experience*, 7 WASH. U. GLOBAL STUD. L. REV. 35, 81–84 (2008).

112. Knowledge@Wharton, *How Two Young Japanese Internet Companies Are Shaking Up Corporate Governance in Japan*, Feb. 8, 2006, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=1348>.

113. Knowledge@Wharton, *Radical Change in the Investment World*, Feb. 3, 2006, <http://www.whartonsp.com/articles/article.asp?p=437458&seqNum=2&rl=1>.

114. Christopher Lee Hefel, *Corporate Governance in Japan: The Position of Shareholders in Publicly Held Corporation*, 5 U. HAWAII L. REV. 135 152–65 (1983).

as they were, the Western-style changes in corporate governance were direly needed for Japan to maintain its position as the world's second largest economy.

III. THE EVOLUTION OF THE JAPANESE BOARD OF DIRECTORS¹¹⁵

The evolution of the present-day Japanese board of directors can be traced all the way back to the 1870s Meiji Restoration¹¹⁶ when authority was centrally reposed to the Emperor.¹¹⁷ Around that time, the state decided it would develop its industrial capabilities to catch up, if not match, the military strength of European and American colonial powers.¹¹⁸ It wanted to transform Japan from a peasant economy into an industrial power by introducing Western technology.¹¹⁹ Fearful of possible occupation, yet harboring its own geographic ambitions, Japan favored companies that were directly involved in warfare.¹²⁰ The state played a critical monitoring role to ensure that these companies were well run, developed good technology, were subsidized if needed, and delivered the required supplies to the government.¹²¹ The interventionist-minded state coordinated the business and affairs of vast enterprises, especially in times of crisis.¹²²

The powerful men behind the restored Meiji government not only wanted to assure their hold to power but also, more importantly, feared Western subjugation. They knew Japan was too economically weak and agriculturally dependent to compete with Europe and the United States, so the country would need to co-opt Western concepts and laws. Under this theme, in 1877, the government invited German scholar and professor Hermann Roesler to serve as legal adviser to the Foreign Ministry in Tokyo.¹²³ He began by revising Japan's treaty with Korea.¹²⁴ By April

115. For further discussion, see ALEXANDER, *supra* note 107, at 1–7, 12–14, 36–38, 62–64, 68–69, 72–73, 81–82, 92–99.

116. The Restoration began in 1868.

117. Columbia University, East Asian Curriculum Project, *The Meiji Restoration and Modernization: Japan Answers the Challenge of the Western World*, <http://afe.easia.columbia.edu/japan/japanworkbook/modernhist/meiji.html> (last visited Feb. 17, 2009).

118. *Id.*

119. Franklin A. Gevurtz, *The European Origins and the Spread of the Corporate Board of Directors*, 33 STETSON L. REV. 925, 937 (2004).

120. Leading to Japan's defeat of China in the 1894–95 war and Russia in the 1904–05 war. See generally Hoshimi Uchida, *Short History of the Japanese Technology*, 1995, http://www.ied.co.jp/isan/sangyo-isan/JS7-history.htm#_Toc442163148.

121. JANET HUNTER, INSTITUTIONAL CHANGE IN MEIJI JAPAN: IMAGE AND REALITY 8 (2005), <http://www.e.u-tokyo.ac.jp/cirje/research/workshops/papers/hunter/hunter2.pdf>.

122. *Id.* at 8–9.

123. Philip Mitchell, *The Japanese Commercial Code of 1890, and its Reception in the First Two Sessions of the Imperial Diet, 1890-1*, in JAPAN'S EARLY PARLIAMENTS, 1890–1905: STRUCTURE, ISSUES & TRENDS 196, 201 (Andrew Fraser, R.H.P. Mason, & Philip Mitchell, eds., 1995).

1881, he began drafting the country's commercial code.¹²⁵ Little is known of his methodology on drafting the code except that he typically worked alone and "undertook a worldwide study of commercial law."¹²⁶ Almost three years after he started, he submitted a completed draft to the government consisting of 1,133 articles divided into four books on such topics as "Commerce . . . , Maritime Commerce, Bankruptcy, and Commercial Litigation."¹²⁷ Based largely on the German code and practice, the commercial code included governance provisions that were anti-shareholder¹²⁸ in nature. It was implemented in 1899,¹²⁹ and subsequently revised many times thereafter.

In the late 1890s and early 1900s, businesses (military, industrial and agricultural)¹³⁰ did not have a formalized "board of directors" as we know it today—they were either loosely organized or boards were comprised entirely of government officials and appointees.¹³¹ These businesses were mainly composed of individual entrepreneurs, groups or families who managed thousands of workers, and were supervised and financed by the state through its organs.¹³² It is even said that some members of the Samurai, who by then were fading into obsolescence, went into business and secured government contracts.¹³³ These businesses, known as joint stock companies, were established largely as joint ventures between

124. *Id.* at 201.

125. *Id.* at 202.

126. *Id.*

127. *Id.*

128. Makoto Yazawa, *The Legal Structure for Corporate Enterprise: Shareholder-Management Relations Under Japanese Law*, in *LAW IN JAPAN: THE LEGAL ORDER IN A CHANGING SOCIETY* 547 (Arthur Taylor von Mehren, ed. 1963).

129. Shōhō (Commercial Code), Law No. 48 of 1899.

130. Other than military supply companies, there were also joint stock companies in railways, cotton spinning and banks. See generally KENICHI OHNO, *EAST ASIAN GROWTH AND JAPANESE AID POLICY* 37–59 (2003). This book is a collection of Mr. Ohno's essays. The specific article in the book that deals with the subject matter is entitled *The Industrialization and Global Integration of Meiji Japan*, found in Chapter 5.

131. "Boards" were composed of the bosses of investor groups who were mostly part-time directors, did not have any technical skills or knowledge in the business, and sat on the board exclusively to ensure return on investment. But even at that time, there were company share disputes, shareholder meetings, dividends and inter-director politics. "Boards" were also composed of government ministry officials, elected governors or bank officials. See R.H. Myers, *Japanese Imperialism in Manchuria: The South Manchuria Railway Company, 1906-1933*, in 4 *MEIJI JAPAN: POLITICAL, ECONOMIC AND SOCIAL HISTORY, 1868-1912*, at 21, 23–25 (Peter Francis Kornicki, ed., 1998).

132. See generally Avram Agov, *Meiji Japan, 1868-1911: Government's Role in Economic Growth and the Rise of Mitsui Zaibatsu*, *MEDIA TIMES REVIEW*, <http://www.mediatimesreview.com/february05/meiji.php> (last visited Feb. 17, 2009). See also Shunsuke Sumikawa, *The Meiji Restoration: Roots of Modern Japan* (Mar. 29, 1999), (unpublished research paper, Lehigh University), <http://www.lehigh.edu/~rflw1/courses/1999/spring/ir163/Papers/pdf/shs3.pdf>.

133. JOHN C. BECK & MARTHA N. BECK, *THE CHANGE OF A LIFETIME: EMPLOYMENT PATTERNS AMONG JAPAN'S MANAGERIAL ELITE* 35 (1994). See also JOHANNES HIRSCHMEIER & TSUNEHICO YUI, *THE DEVELOPMENT OF JAPANESE BUSINESS 1600-1973*, at 82 (1975).

investor groups or business promoters due to the underdevelopment of the stock market.¹³⁴ Each business or investor group leader, called a “boss,” nominally assumed a seat in the “board of directors” to act as a business representative and maintain the balance of power.¹³⁵ As such, they were “owner-controlled firms.”¹³⁶

These boss-directors, even if they owned and controlled the firm, were busy with other companies and delegated management to administrative staff.¹³⁷ They did not manage the corporate entity directly and were mainly concerned with how secure their investments were. As a result, Japanese scholars disagree on whether pre-war corporate governance can be likened to the Anglo-Saxon model, since (1) boss-directors did not manage firms as directors; and (2) investor groups eventually sold their shares and thus helped to disperse ownership.¹³⁸ However, the boss-directors did not effectively monitor management and the dispersal of ownership was very brief.¹³⁹ By World War I, ownership and authority were again concentrated in the hands of the few.¹⁴⁰ Thus, Japan’s pre-war corporate governance structure did not reflect the U.S. model.

Another attribute of these companies was that their well-connected owners cemented exceptional ties with the powers-that-be in the government, which is comparable to today’s comfy government-business liaison.¹⁴¹ This explains how these businesses were able to thrive through various wars, a totalitarian government in the 1930s,¹⁴² foreign occupation, and economic downturns.

A third attribute was that these trading houses and companies considered their employees as family. Since they had to import technology for armament production, they spent much time and resources training employees. These skilled laborers were provided with housing, good

134. See generally Atsushi Tokuda, *The Origin of the Corporation in Meiji Japan* (U. London, Working Paper No. DP21), <http://www.cefims.ac.uk/documents/research-9.pdf>.

135. Matao Miyamoto & Takeshi Abe, *The Corporate Governance of Japanese Firms at the Early Stages of Industrialization: Osaka Cotton Spinning and Nippon Life Assurance*, in *THE DEVELOPMENT OF CORPORATE GOVERNANCE IN JAPAN AND GREAT BRITAIN 10* (Robert Fitzgerald & Etsuo Abe, eds., 2004).

136. *Id.* at 10–28. The more important joint stock companies during that era were the Osaka Cotton Spinning Company (now Toyobo) founded in 1882, and Nippon Life Assurance established in Osaka in 1889. See *id.*

137. *Id.* at 10, 20–21, 29.

138. *Id.* at 30.

139. JULIAN FRANKS, COLIN MAYER & HIDEAKI MIYAJIMA, *EVOLUTION OF OWNERSHIP: THE CURIOUS CASE OF JAPAN* 8–9 (Preliminary First Draft, Mar. 25, 2007), <http://www.hbs.edu/units/bgie/pdf/miyajima.pdf>.

140. See Zenichi Shishido, *Reform in Japanese Corporate Law and Corporate Governance: Current Changes in Historical Perspective*, 49 *AM. J. COMP. L.* 653, 657 (2001) [hereinafter Shishido, *Reform in Japanese Corporate Law*].

141. Yoshiro Miwa & J. Mark Ramseyer, *The Value of Prominent Directors: Lessons in Corporate Governance from Transitional Japan*, Nov. 1999, <http://papers.ssrn.com/sol3/Delivery.cfm/991103100.pdf?abstractid=192388>.

142. FRANKS, MAYER & MIYAJIMA, *supra* note 139, at 1.

benefits and treated as familial members to encourage them to stay with the company. This paternalistic pattern would continue for over a century.¹⁴³

During the 1920s and from 1935 to 1945, Japan's expansionist ambitions, coupled with its state interventionist approach, were in full swing.¹⁴⁴ It again heavily supported and subsidized companies aiding the war effort. These cartel-driven, tightly-held companies¹⁴⁵ were known as *zaibatsu*, large family-controlled conglomerates with holding companies that supplied government requirements and other products and services. Due to their ties with politicians, *zaibatsu* umbrella companies cornered government-business relations. By the mid-1930s, the banks became the largest supplier of capital for *zaibatsu* companies.¹⁴⁶ The *zaibatsu* emphasized growth through reinvestment of profits back into the company. Equity shares were typically illiquid, as they were generally restricted to *zaibatsu* family members.¹⁴⁷ The *zaibatsu* holding companies supervised subsidiaries through budget control and managerial allocations, authorized their financing, intervened in conflicts and disciplined them.¹⁴⁸ The pre-war *zaibatsu* model was a form of "non-market-based governance."¹⁴⁹ As a result of the war efforts, the government concentrated planning and administration of large companies to a central planning agency, which ordered existing boards of directors to seek government approval before implementing fundamental corporate changes or issuing debt or equity.¹⁵⁰ For example, in 1939, boards were prohibited from declaring dividends and reassigned this right to the central planning agency.¹⁵¹

In 1943, Japan ushered in the Munitions Corporation Law, a law that substantially altered corporate governance.¹⁵² Corporate executives in

143. Kozo Yamamura, *Entrepreneurship, Ownership, and Management in Japan*, in THE CAMBRIDGE ECONOMIC HISTORY OF EUROPE: THE INDUSTRIAL ECONOMIES: CAPITAL, LABOUR AND ENTERPRISE, THE UNITED STATES, JAPAN AND RUSSIA 254–58 (Peter Mathias & M. M. Postan, eds., 1983).

144. FRANKS, MAYER & MIYAJIMA, *supra* note 139, at 3, 15, 22.

145. Haruhito Takeda, *Corporate Governance in the Inter-War Zaibatsu*, in THE DEVELOPMENT OF CORPORATE GOVERNANCE IN JAPAN AND GREAT BRITAIN 59, 62–63 (Robert Fitzgerald & Etsuo Abe, eds., 2004) ("The principle of ownership was based on investment exclusivity, the limiting of investors to the same family, and the tendency to exclude potential sources of capital from outside the family.").

146. See generally HIDEMASA MORIKAWA, *ZAIBATSU: THE RISE AND FALL OF FAMILY ENTERPRISE GROUPS IN JAPAN* (1992).

147. *Id.*

148. Takeda, *supra* note 145, at 68–71.

149. *Id.* at 71.

150. WALTER LAFEVER, *THE CLASH: U.S.-JAPANESE RELATIONS THROUGHOUT HISTORY* 162–63 (W.W. Norton & Co. 1998).

151. Shishido, *Reform in Japanese Corporate Law*, *supra* note 140, at 660.

152. The state could ratify company elections and also fire the president. On the other hand, the company president could make decisions that were supposed to be made in a shareholders meeting without the shareholders actually meeting. In short, the president assumed the power of the shareholders. Tetsuji Okazaki, *The Japanese Firm Under the Wartime Planned Economy*, in THE

Munitions Companies were no longer the agents of the shareholders, as was stated in the Commercial Code.¹⁵³ They became responsible for attaining manufacturing targets as dictated by the government or their industrial groups. Instead of shareholder-elected directors, “selection of directors was to be made independently of the shareholders; instead management experience in the firm would be the chief criterion for appointment. Profits were no longer to belong solely to the shareholders, but should be allocated to workers, shareholders and directors.”¹⁵⁴ Nearing the end of the war, about 700 firms were designated as Munitions Companies.¹⁵⁵ Each company was assigned a bank by the Ministry of Finance that provided the funds they needed to expand production (much like a Main Bank).¹⁵⁶ These banks were required to provide the funds. They were also encouraged, but not required, to monitor the affairs of the entity (similar to a Main Bank’s “contingent monitoring”).¹⁵⁷

After Japan’s devastating defeat in 1945, it was occupied by the Americans for seven years. “The final attacks on Japan . . . destroyed production capacity, infrastructure and housing; disrupted supplies from former trading partners in Asia . . . Production collapsed, jobs and incomes disappeared and hunger was rampant.”¹⁵⁸ Because the country fell apart, people had to work cohesively. Desperate for food and jobs, they steadfastly clung to each other. But the old bureaucrats who managed Japan’s pre-war and wartime economy did not disappear; with a dearth of individuals who could run the devastated country, they were tapped by the Americans to fashion out policy reforms.¹⁵⁹ This promoted the continuity of government patriarchy as a policy that emphasized state intervention when necessary or desirable (later on manifesting itself in the deployment of Ministry officials as board directors).¹⁶⁰ Many of the features of the Japanese economy, such as bank-based financing, were also left in place. But the American-led effort of “economic democratization”¹⁶¹ broke up and

JAPANESE FIRM: THE SOURCES OF COMPETITIVE STRENGTH 372 (Masahiko Aoki & Ronald Dore, eds., 1994).

153. *Id.* at 462.

154. See ALEXANDER, *supra* note 107, at 64.

155. YOSHIRO MIWA, STATE COMPETENCE AND ECONOMIC GROWTH IN JAPAN 64 (2004).

156. Akira Hara, *Wartime Controls*, in ECONOMIC HISTORY OF JAPAN 1914-1955: A DUAL STRUCTURE 276 (Takafusa Nakamura and Konosuke Odaka, eds., 2003).

157. *Id.*

158. ALEXANDER, *supra* note 107, at 7.

159. Indiana University Northwest, *Japanese Economic Takeoff After 1945*, http://www.iun.edu/~hisdc1/h207_2002/jecontakeoff.htm (last visited Feb. 18, 2009).

160. The underpinnings of post-war Japanese corporate governance—notably long-term business relations, subsidies and protection for disadvantaged industries and groups, close government-business connections, and political protection for favored clients—clearly all were the result of corporate developments from the 1870s to the 1940s when Japan was defeated in the Second World War. See John K.M. Ohnesorge, *States, Industrial Policies & Antidumping Enforcement in Japan, South Korea and Taiwan*, 3 BUFF. J. INT’L L. 289, 320–23 (1996–97).

161. See ALEXANDER, *supra* note 107, at 81.

dismantled the concentrated ownership structure of major *zaibatsu* holding companies such as Mitsui, Mitsubishi, Sumitomo, Yasuda and Fuji through the Anti-Monopoly Law of 1947.¹⁶²

The American occupation regime clearly had a reformist approach as to where Japanese corporate law should go. Because the legal division of the Supreme Commander for the Allied Powers (SCAP) in Tokyo was dominated by lawyers, judges and scholars with training from the University of Illinois and Chicago-based experience (headed by Lester Salwin and Irving Eisenstein), SCAP rewrote the Japanese Commercial Code with an obvious inclination towards Illinois corporate law.¹⁶³ It specifically emphasized shareholder rights as opposed to the German-inspired 1899 Japanese Commercial Code or Law No. 48, which German scholar and professor Hermann Roesler helped draft. The Illinois law-leaning¹⁶⁴ draft revision immediately drew antagonistic reactions from the Japanese as they have long viewed active shareholders as troublemakers.¹⁶⁵ When the Japanese Diet passed the final draft in May 1950 (1950 Commercial Code), shareholder rights were heightened,¹⁶⁶ an evolved board of directors was formally established,¹⁶⁷ the concept of director accountability was introduced, and the power of the statutory auditor was reduced.¹⁶⁸ The final draft was a mix of Illinois law, old German concepts

162. Gregory K. Bader, Note, *The Keiretsu Distribution System of Japan: Its Steadfast Existence Despite Heightened Foreign and Domestic Pressure for Dissolution*, 27 CORNELL INT'L L.J. 365, 368–69 (1994).

163. Mark D. West, *The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States*, 150 U. PA. L. REV. 527, 539–43 (2001) [hereinafter West, *The Puzzling Divergence of Corporate Law*].

164. The interesting question is why the Americans who were in charge of reconstructing Japan's corporate law and governance chose Illinois law instead of the more developed Delaware corporate law. Understandably, since they were Chicago practitioners who studied at the University of Illinois, they would choose their own. However, it went beyond that. There appears to be some apprehension and mistrust towards Delaware law and jurisprudence on their part. See Katharina Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PA. J. INT'L ECON. L. 791, 852–53 (2002) (“American advisors chose the Illinois model because it offered ‘better’ shareholder protection. They viewed the developments in Delaware with suspicion and supported a stronger hand of the legislature in lawmaking The more pragmatic evolution of corporate law in Delaware, where practitioners rather than law professors had the decisive influence on the laws’ contents, took a different, and ultimately more successful, path.”).

165. ALEXANDER, *supra* note 107, at 98. See also Thomas L. Blakemore & Makoto Yazawa, *Japanese Commercial Code Revisions Concerning Corporations*, 2 AM. J. COMP. L. 12, 20 (1953).

166. The 1950 revision gave the shareholders a voice, regulated potential conflicts of interest, and required periodic disclosure of financial data. See West, *The Puzzling Divergence of Corporate Law*, *supra* note 163, at 545.

167. Directors shall be appointed at the general meeting of shareholders. SHŌNŌ, art. 254, para 1. Boards shall be composed of a minimum of three members (SHŌNŌ, art. 255), whose terms shall not be more than two years. SHŌNŌ, art. 256, para 1.

168. See West, *The Puzzling Divergence of Corporate Law*, *supra* note 163, at 545.

and Japanese norms; it was generally unpopular.¹⁶⁹ The Americans also permitted unionization,¹⁷⁰ which further entrenched workers and made them immovable. Threatened, too, with the specter of frivolous shareholder lawsuits, the Japanese pressured the Americans to make it more expensive for lawsuits to be filed. The required bond was subsequently so expensive,¹⁷¹ that it chilled shareholder litigation until its revision in 1993, when the filing fee was reset to a mere 8,200 yen (about \$82.33).¹⁷²

It was a different story when the Americans left in 1952. By then, the former *zaibatsu* companies had merely recombined into looser federations (*keiretsu*), where bank financing, mutual assistance, government connections and patriarchy played key roles, thus mirroring the dynamics of their *zaibatsu* predecessors.¹⁷³ The *zaibatsu* conglomerates resurrected themselves through the *keiretsu* companies' web-like cross-shareholding pattern, minus the dominant families' ownership monopoly.¹⁷⁴ Admittedly, however, the de-concentration and anti-trust activities of the Americans weakened the business concentration fabric.¹⁷⁵ The holding company structure of the *zaibatsu* companies and the investments of the privileged *zaibatsu* families were successfully discontinued.¹⁷⁶

When the Americans left and the Japanese bureaucrats were placed in charge of implementing the 1950 Commercial Code, they interpreted and administered it their way. As a result, there was a large gap between the black-letter provisions of the 1950 Commercial Code and actual practice. Since there was general opposition towards the American-made, Illinois law-leaning corporate governance structure, there was an informal protest against the 1950 Commercial Code.¹⁷⁷ Instead of boards monitoring the

169. See Blakemore & Yazawa, *supra* note 165, at 12 (The "product is far from pleasing, and in practice it has produced confusion . . . [causing] bewilderment to Japanese legal scholars.").

170. Japanese unions emphasized job security and the Seniority-Wage System.

171. Before 1993, plaintiffs had to pay a filing fee on a sliding scale, the basis of which was the amount of damages sought. Thus, a \$10 million claim in a derivative suit would have required a filing fee of about \$25,000, which plaintiffs would forfeit if they lost. See Curtis J. Milhaupt, *Nonprofit Organizations as Investor Protection: Economic Theory, and Evidence from East Asia*, 29 YALE J. INT'L L. 169, 188 (2004).

172. See West, *Why Shareholders Sue*, *supra* note 33, at 353.

173. Kenichi Osugi, *What is Converging? Rules on Hostile Takeovers in Japan and the Convergence Debate*, 9 ASIAN-PACIFIC L. & POL'Y J. 143, 150 (2007) ("In Japan, however, *zaibatsu* (vertically formed corporate groups) were dismantled by General Headquarters as a key occupation policy after World War II. Instead, large companies in Japan developed a horizontal ownership structure or interlocking share holding schemes. Until recently, this horizontal scheme, coupled with a social norm that favored long-term relationships, effectively prevented hostile takeovers of listed companies.").

174. Masahiro Shimotani, *Recent Changes in Inter-Firm Relations in Japan: the Six Large Corporate Complexes*, in THE DEVELOPMENT OF CORPORATE GOVERNANCE IN JAPAN AND GREAT BRITAIN 196 (Robert Fitzgerald & Etsuo Abe, eds., 2004).

175. EIJI TAKEMAE ET AL., ALLIED OCCUPATION OF JAPAN 336-37 (2003).

176. See ALEXANDER, *supra* note 107, at 96.

177. Shishido, *Reform in Japanese Corporate Law*, *supra* note 140, at 664-65. See also West, *The Puzzling Divergence of Corporate Law*, *supra* note 163, at 569.

company officers and charting strategic directions, directors nominally performed such functions. They made the directorship the highest position a loyal employee could ever aspire to and filled the board with as many members as possible.¹⁷⁸ Since the board was now composed of senior managers, it did not normally sanction its members. The Japanese erased the board's monitoring function not by amending the law but by indirectly circumventing it. They subtly turned the U.S. creation into a Japanese one.

IV. A MONITORING OR MANAGING BOARD?

According to Martin Lipton and Jay Lorsch, the ideal U.S. board should be a monitoring board with three important committees composed solely of independent directors.¹⁷⁹ The board's role is to select, evaluate and reward CEOs.¹⁸⁰ It must also ensure that corporate officers comply with federal and state laws.¹⁸¹ In addition, it should approve corporate strategy, assess this strategy, and undergo CEO and board performance evaluation.¹⁸² Moreover, Eugene Fama and Michael Jensen illustrate that the monitoring function is embedded in the separation of ownership and control, and in which the residual risk bearers are separate from the ones who are going to make corporate policies.¹⁸³

The post-war Japanese board model is a managing board, which is drastically different from the framework described by Lipton and Lorsch (1992), Fama and Jensen (1983), or Berle and Means (1932). Most of the directors are managing directors (*jugyoin kenmu torishimariyaku* or directors functioning as employees of the company). There is virtually no distinction between execution and supervision. Decision-making and monitoring functions congruently overlap.¹⁸⁴ This board can even be described as an operations board. Directors, once elected, are independently responsible to shareholders for managing the company. Thus, once the board makes certain managerial decisions, the director responsible or assigned by the board must see to it that it is carried out.¹⁸⁵ The board, as a body, must then oversee the assigned or appointed director. This is possible because the inside directors are promoted from within the corporate

178. See West, *The Puzzling Divergence of Corporate Law*, *supra* note 163, at 559.

179. See generally Martin Lipton & Jay W. Lorsch, *A Modest Proposal For Improved Corporate Governance*, 48 BUS. LAW. 59 (1992).

180. *Id.*

181. *Id.*

182. *Id.*

183. See generally Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J. L. & ECON. 301 (1983).

184. As an example, see the complicity of the managing-director of the New York Daiwa Bank during the 1999 scandal where a Daiwa bond trader successfully hid \$1.1 billion in losses for eleven years through illegal trading. See generally Tsuyoshi Yamada, *The Daiwa Bank Case (1999)*, 15 COLUM. J. ASIAN L. 193 (2002).

185. See Yasui, *supra* note 47, at 124.

structure—middle management employees who see directorship as the pinnacle of their lifetime company service. In most cases, these inside directors continue to be employees of the corporation and receive both employee salary and director pay.

Beyond these employees who become directors while retaining their worker status, the Main Bank, as the owner of huge numbers of shares, sends executives to occupy directorship positions.¹⁸⁶ Other stakeholders, particularly customers and business partners who also own significant holdings, are likewise represented in the board. These “shareholders [who] are usually affiliated companies in the same corporate group . . . or important business counterparts of the company . . . sometimes send their personnel to the board as directors or statutory auditors, which proves a means to control management directly.”¹⁸⁷ Instead of a separation between ownership and control, there is a marriage between the residual owners and the corporate controllers. They own it, they control it.

There are certain advantages for the Japanese board model. It gives sufficient incentives for employees to be loyal to the company, since the possibility of becoming a director is not far-fetched. As board members actively manage employees, they know the company well and can chart strategic growth and optimal use of its resources. Japanese managers may complain that the U.S. board model is full of independent directors who are elected to promote shareholders’ interests and increase share value, the consequence of which is that these outsiders may not know much about running the company.¹⁸⁸ The ranks-to-director approach also leads to stability and harmony with the organization.

But there are inherent flaws in the managing board model. First, it tends to entrench the company president and other officers. Many board insiders are still company employees and therefore subservient to the president. They will not be able to monitor his activities well enough, and even if they do find something amiss, they will neither have the courage nor temerity to question it. This echoes the point of UCLA Professor Bainbridge when he found that U.S. directors tended not only to be friends or colleagues of the CEO, but also people beholden to him.¹⁸⁹ The CEO’s accountability is even more dramatic in Japan where the director position is subordinate to the president. Second, as there is seniority within the employees’ ranks, there is

186. Paul Sheard, *Banks, Blockholders and Corporate Governance: The Role of External Appointees to the Board*, in JAPANESE FIRMS, FINANCE AND MARKETS 181 (1996).

187. Yasui, *supra* note 47, at 130.

188. See Yoshiro Miwa, *Corporate Social Responsibility: Dangerous and Harmful, Though Maybe Not Irrelevant*, 84 CORNELL L. REV. 1227, 1234 (1999) [hereinafter Miwa, *Corporate Social Responsibility*].

189. See generally Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1 (2002). See also Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2000: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007).

a similar seniority and rigid hierarchy within the directorship level. Younger employee-directors are inclined to view older employee-directors as their progenitors/senior officers and will bestow more reverence than monitoring. Concomitantly, the board is divided between senior members and junior directors, with the latter providing most of the employee functions as instructed by the board.¹⁹⁰

Third, the company president is predisposed—as a result of the large board membership, which can be anywhere between 20 to 40 directors during any given year¹⁹¹—to form a smaller, elitist committee of directors composed of himself and senior members of the board (*jomu-kai*).¹⁹² The segregation between senior and junior board members, plus the establishment of a smaller senior executive committee, destroys any notion that the board is performing monitoring functions or acts in a collegial manner. Lastly, the management decisions by this elite committee are mechanically rubber-stamped by the bigger, all-inclusive board of directors since the younger directors essentially have no voice.

In post-war corporate Japan, if the word “monitoring” is mentioned, it is not associated with the board of directors. It is more related to the self-interested role of the Main Bank, which is to monitor the business and affairs of the company, if not periodically at least. This monitoring role of the Main Bank is not shared by other stakeholders, who are simply free-riders.¹⁹³

V. MANAGED FOR WHOM?

In post-war corporate Japan, corporations are primarily managed for the stakeholders. This includes employees, banks, suppliers, customers, business partners, the community and, in some respect, shareholders.¹⁹⁴ This stakeholder-oriented model¹⁹⁵ is quite different from the shareholder

190. See, e.g., Takashi Araki, *A Comparative Analysis: Corporate Governance and Labor and Employment Relations in Japan*, 22 COMP. LAB. L. & POL'Y J. 67, 76 (2000) [hereinafter Araki, *A Comparative Analysis*].

191. See Nottage, *supra* note 11, at 269.

192. Sanford M. Jacoby, *Convergence by Design: The Case of CalPERS in Japan*, 55 AM. J. COMP. L. 239, 283 (2007). See also Dore, *supra* note 89, at 164.

193. See Yasui, *supra* note 47, at 133.

194. Nottage, *supra* note 11, at 262–93.

195. This may mirror Lynn Stout's theory of a Mediating Board. Professor Stout believes that boards should mediate with asset-specific groups as it is the directors' duty to protect these other groups or stakeholders. Maximizing the value of corporate law requires maximizing all of the investments of all the stakeholders in a company. “[M]any directors do view themselves as mediators trying to balance shareholders' interests against those of creditors, employees and the like. . . . [T]he mediating model does not confine the directors' role only to limiting how much wealth the firms' executives extract from the firm. Directors also limit how much wealth is distributed to the firm's shareholders, creditors, and even to the local community. . . . Directors are also fiduciaries of the *firm itself*, an entity that can be understood as a nexus of firm-specific commitments made by investors, managers, and other corporate constituencies.” Lynn A. Stout,

primacy model advocated in the United States. Some have described the Japanese type as an “employee-centered stakeholder model” and an “employee-sovereign firm”, but as Takashi Araki said in defending his home country’s system, “Japanese law resembles more the Anglo-Saxon shareholder-value model than the stakeholder model.”¹⁹⁶ However, he himself admits that there is a divergence between black-letter law and practice in that “law and reality often diverge. There has been a consensus among Japanese corporate law professors that, irrespective of the principles and theories stated in the corporate laws, in practice, larger companies are administered by the prioritization of the interests of employees.”¹⁹⁷ Araki avers that it is actually a “practice-dependent stakeholder model,” with practice meaning the culture of managing directors, lifetime employees, focus on employee welfare, balancing of other stakeholders’ interests, and cross-shareholders’ interests.¹⁹⁸ In reality, beyond the statutory text, the role of management is not necessarily to increase the value of the shares and satisfy the passive shareholders. Rather, its critical task is to always balance corporate obligations with the interests of employees, suppliers, partners, customers and other stakeholders by allocating specific pieces of the corporate pie.

This model is essentially related to the Japanese “Company Community” model, which consists of “management, board members and core employees who share an identity as ‘company men’ . . . ‘company’ refers to the collective Company Community . . . [whose] members . . . owe their loyalty to both the Community itself and their fellow members” with “employees as the quasi-residual claimants.”¹⁹⁹ But this Company

The Shareholder As Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance, 152 U. PA L. REV. 667, 686–88 (2003).

196. Takashi Araki, *Changing Employment Practices, Corporate Governance, and the Role of Labor Law in Japan*, 28 COMP. LABOR LAW & POL’Y J. 251, 263 (2007) [hereinafter Araki, *Changing Employment Practices*]. See also Araki, *A Comparative Analysis*, *supra* note 190, at 87. See also Gilson & Milhaupt, *supra* note 38, at 348 (stating that board members are typically representative of, and are, current employees).

197. Araki, *Changing Employment Practices*, *supra* note 196, at 263–64.

198. *Id.* at 265. This is in conjunction with what Gilson and Milhaupt call “stakeholder tunneling,” a type of diversion of resources away from shareholders and representative of the Japanese commitment of maximization of employee interests instead of shareholder value (for example, maintaining employees even in the face of serious financial difficulties or pursuit of expansion without careful review of profitability). See Gilson & Milhaupt, *supra* note 38, at 361.

199. See Shishido, *Japanese Corporate Governance*, *supra* note 9, at 189, 202. Shishido further advocates that, despite certain differences, the U.S. and Japan “still maintain the same basic structure” and “nearly identical corporate legal systems,” that “Japanese corporate law is more loyal to shareholder ownership than American corporate law,” and that there exists “a mechanism to relieve oppressed minorities.” *Id.* at 194, 195, 197, 201. These are not entirely accurate. It is true that Japan’s corporate law has been influenced tremendously by the U.S. since the latter revised its Commercial Code during the Occupation years. However, to say that both countries maintain the same basic structures is to stretch matters rather awkwardly. Japan has its own way of doing things which may stray from the bare recitals of black letter law. The board is dominated by the company president, is composed primarily of insiders, and sprinkled with grey directors.

Community, together with lifetime employment, has been declining in recent years as companies hire new staff on a short-term basis or as part-time contractors instead of treating them as part of the corporate family. Not only due to global competition and the storm of M&A activities, younger Japanese white-collar workers have also refused to make the company the center of their lives and have subtly discarded corporate paternalism by shifting jobs²⁰⁰ or professions.²⁰¹

Under the stakeholder-oriented model, the company has no choice but to see to it that the stakeholders are satisfied and happy with corporate performance. Specifically, stakeholders include: (a) employees and their lifetime employment guarantee system; (b) the Main Bank; (c) customers, other banks and business partners; and (d) the state's strategically-placed retired or soon-to-retire ministry officials.²⁰² It is therefore not managed for shareholders other than the Main Bank and companies under the same *keiretsu*. In a way, because of the unique system in Japan, the corporation is managed for only those shareholders who have representatives sitting on the board. Individual shareholders and institutional investors are largely ignored. There are no mechanisms in place to communicate with unaffiliated shareholders, no shareholder dialogues or resolutions, and derivative suits are uncommon and deliberately expensive.²⁰³ Therefore, it is essential for a shareholder to gain a voice on the board to defend its interests.

VI. CRITERIA FOR BECOMING A JAPANESE DIRECTOR

Japanese directors are elected by the shareholders at a general shareholder meeting.²⁰⁴ However, the company president has a lot of influence over who will be selected to serve as directors. The president

This is a far cry from the U.S. model. Japan's loyalty to shareholder ownership is also no greater than the U.S. Japanese corporations' loyalty to the insider shareholders (e.g. Main Bank, creditors, business partners, consumers) and such insiders' positions. Moreover, companies did not care at all, until very recently, with domestic/unaffiliated shareholders and institutional shareholders. Even if there was a written way to assuage oppressed minorities, these non-insider shareholders have suffered inattention and disregard for decades. Shareholder proposals were relatively unknown to Japan for a very long time. Many companies orchestrated and scripted their annual shareholder meetings to stifle dissent and suppress opinion by instructing their employees to clap continuously when a shareholder raises a point, or hired and paid off the *Sokaiya* or corporate gangsters to intimidate courageous shareholders. *See id.*

200. Workers are shifting jobs even though leaving the company is considered a form of betrayal by older generations.

201. THE ECONOMIST, *Sayonary, Salaryman*, Jan. 5, 2008. Younger generations of Japanese workers are seeking "work-life balance." *Id.*

202. Peter Lawley, *Panacea or Placebo? An Empirical Analysis of the Effect of the Japanese Committee System Corporate Governance Law Reform*, 9 ASIAN PACIFIC L. & POL'Y J. 105, 121 (2007) (It "reflects the status quo of the corporate structure in Japan whereby the directors of a company represent various divisions of the company.").

203. *See generally* West, *Why Shareholders Sue*, *supra* note 33.

204. Miwa, *Corporate Social Responsibility*, *supra* note 188, at 1231.

chooses the nominees, who are confirmed by the shareholders during the annual meeting.²⁰⁵ Directors are mostly representative directors²⁰⁶ who act for their respective stakeholder groups.

Before the bubble burst²⁰⁷ and almost ten years thereafter, it was not particularly difficult to become a director in a Japanese entity, markedly because of the large size of the board and the fact that most board members were insiders.²⁰⁸ Inside directors were essentially middle-level employees who rose up the ranks and were awarded the distinction of serving the board of directors because of the strength of their loyalty and commitment to the company.²⁰⁹ The directorship was dangled as the “ultimate prize of the permanent employment system.”²¹⁰ These directors were regarded as the ultimate leaders of all of the employees, particularly since they still retained their managerial and operational responsibilities.²¹¹ These employee-insiders were handpicked by management and confirmed during the shareholders meeting.

Outside directors may either be grey directors or independent ones. Independent outside directors (*dokuritsu shagai torishimariyaku*) are those who have absolutely no ties with management, have never been employees, suppliers, or creditors of the company, and are truly independent in perspective. The Japanese Commercial Code does not require the presence of independent directors.²¹² Grey outside directors, on the other hand, are never truly independent and hardly possess an outsider’s point of view. Many are current government officials from ministries or agencies that have strong links with the company such as the Ministry of Finance. They are deployed to the board of directors in their twilight years²¹³ not just to serve as conduit officers, but similarly to reward them for their good government service. These directors are known as *amakudari*, literally meaning “sent

205. MAKOTO OHTSU & TOMIO IMANARI, *INSIDE JAPANESE BUSINESS: A NARRATIVE HISTORY, 1960-2000*, at 359 (2002). *See also* Senechal, *supra* note 32, at 541–42 (One problem in corporate Japan is that there are “too-powerful chief executives . . . [and] a corporate governance system that provides few controls on executive action and little emphasis on shareholders.”).

206. Senechal, *supra* note 32, at 542–43.

207. *See* ALEXANDER, *supra* note 107, at 191 (“Businesses indulged in over-investment, hired too many employees and borrowed too heavily. Banks lent too freely to over-leveraged customers and acquired large amounts of loans that could not be repaid, especially after the collapse of a land and shares asset price bubble in the early 1990s. The financial authorities were complicit in allowing banks to cover up their non-performing loans, which were eroding bank capital.”).

208. Senechal, *supra* note 32, at 536.

209. Miwa, *Corporate Social Responsibility*, *supra* note 188, at 1234.

210. *See* Ahmadjian & Okumura, *supra* note 16, at 132.

211. *See* Yasui, *supra* note 47, at 123.

212. In 2005, a complete revision of Japanese Commercial Code took place and the Diet ushered in the new Company Act that went into effect on May 1, 2006. This new law requires the presence of independent directors only if the company chooses the Committee System over the Statutory Auditor system. Companies Act, Act No. 86 of 2005, art. 47, *translated in* CABINET SECRETARIAT, *available at* http://www.cas.go.jp/jp/seisaku/hourei/data/CA1_4_2.pdf.

213. *See* ALEXANDER, *supra* note 107, at 99–100.

down from heaven,” and strengthen government-business relations. They are also sent to supplement their meager government income with the higher salaries provided by the private sector.²¹⁴ Grey outside directors are also comprised of retired government ministry officials, likewise part of the *amakudari*, who are deployed to guarantee the good performance of the company—a way for the government to look out for the interests of the private sector.²¹⁵ Grey outside directors may likewise be bank executives, or the officers of customers or parent companies. Their primary role is to make sure that the good, harmonious relationship between the company and their original employers is maintained; or if they are from the Main Bank, to act as overseers during any corporate reorganization.

Despite impressions to the contrary, Main Bank board directors are generally found to be inordinately successful in their monitoring functions (or at least they were before the bubble burst), as they capably oversee the activities and decisions of the board and its corporate officers.²¹⁶ They are able to intervene when necessary, remove underperforming CEOs,²¹⁷ and provide much needed liquidity to the company.²¹⁸

VII. BOARD REFORMS, JAPANESE-STYLE

Japan reacted swiftly and drastically to the market conditions resulting from the bubble burst and the economic stagnation of the 1990s. In response to the introduction of legislative reform, the boards of directors, once described as merely ceremonial and comprised of the elders of the corporate community,²¹⁹ responded affirmatively. Many companies downsized their board of directors for efficiency and some included independent outside directors for objectivity.²²⁰ More importantly, by the end of the 1990s, the Japanese business monoliths were reduced to a game of survival of the fittest. Because the Main Banks were no longer

214. See Ahmadjian & Okumura, *supra* note 16, at 132.

215. Kenji Suzuki, *The Changing Pattern of Amakudari Appointments – The Case of Regional Banks 1991-2000* 8 (Working Paper No. 187, Jan. 2004), available at <http://swopec.hhs.se/eijswp/papers/eijswp0187.pdf>.

216. YUWA WEI, *COMPARATIVE CORPORATE GOVERNANCE* 151–152 (2003).

217. See generally John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1300 (1991).

218. See generally Yoshiro Miwa & J. Mark Ramseyer, *The Myth of the Main Bank: Japan and Comparative Corporate Governance*, 27 LAW & SOC. INQUIRY 401 (2002).

219. SIMON LEARMOUNT, *CORPORATE GOVERNANCE: WHAT CAN BE LEARNED FROM JAPAN?* 125–143 (2002). Many directors view board meetings as simply ceremonial since decisions are really made by the senior executive committee or *jomu-kai* of the board, while the plenary board just rubber-stamps and ratifies them.

220. However, some Japanese companies resorted to merely renaming their structures without a substantial change in functions, attitude and outlook. Since their boards were composed of the elitist senior management committee (with the company president) and a larger plenary group inclusive of junior board members who were concurrent executive officers, they simply renamed the former as the “board” (hence making it a 10-man member) while denominating the junior members as “executive officers.” See Araki, *A Comparative Analysis*, *supra* note 190, at 74–78.

functioning at their previous levels, companies were continuously looking for external financing via the capital markets.²²¹ Consequently, the economic pendulum swung from crisis to promise of recovery to crisis once again. There was also a clear corporate governance vacuum as the government did not know how to respond to the burgeoning equity dominance of U.S and U.K. shareholders.²²² The Japanese government knew that reform was necessary despite howling protests and resistance from hardliners in the corporate boardrooms.

The series of reforms undertaken by the Japanese government in the 1990s, known as the “financial Big Bang,”²²³ stressed deregulation.²²⁴ It included limiting the board presence of retired government officials “descen[d] from heaven” or *amakudari* by withholding National Personnel Authority waivers.²²⁵ The *amakudari* were viewed as inefficient by foreign shareholders, and in 2007, a law was passed aimed specifically at reducing the *amakudari* problem.²²⁶ In 1997, stock options were allowed, and in December 2001, directors’ personal liability was limited.²²⁷ In 2002, the government introduced the alien concept of independent directors when it amended the Commercial Code.²²⁸ The definition, however, of independent outside directors was so weak²²⁹ that it permitted the appointment of

221. Trends in Japan, *Banging on Japan’s Door: Big Bang Reforms Attract Overseas Banks*, Sep. 9, 1997, <http://web-japan.org/trends98/honbun/ntj970909.html>.

222. See Nottage, *supra* note 11, at 269.

223. Shinji Fukukawa, *Development of the Japanese Big Bang and its Impact*, Nov. 11, 1997, <http://brie.berkeley.edu/research/forum/fukukawa.html>.

224. Edward J. Lincoln & Robert E. Litan, *The “Big Bang”? An Ambivalent Japan Deregulates Its Financial Markets*, BROOKINGS (1998), available at http://www.brookings.edu/articles/1998/winter_globaleconomics_lincoln.aspx?rssid=japan.

225. RICHARD A. COLIGNON & CHIKAKO USUI, *AMAKUDARI: THE HIDDEN FABRIC OF JAPAN’S ECONOMY* 23 (2003).

226. The Diet approved on June 30, 2007 a bill revising the National Public Service Law specifically on the regulation of future employment of retiring national public servants called “Amakudari.” See Hiroko Nakata, *Cabinet OKs ‘Amakudari’ Bill, Bureaucrat Reform*, Apr. 25, 2007, THE JAPAN TIMES ONLINE, available at <http://search.japantimes.co.jp/cgi-bin/nn20070425f2.html>. See also Hiroko Nakata, *‘Amakudari’ Too Entrenched to Curb?*, May 29, 2007, THE JAPAN TIMES ONLINE, <http://search.japantimes.co.jp/mail/nn20070529i1.html>.

227. Bernard S. Black, Brian R. Cheffins & Michael Klausner, *Shareholder Suits and Outside Director Liability: The Case of Korea* 17–18 (European Corporate Governance Institute Law Working Paper N 47/2005; University of Texas Law School Law and Economics Research Paper No. 35; and Stanford Law School John M. Olin Program in Law and Economics Working Paper No. 298; 2005), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=628223. See also Australian Institute of Company Directors, *Risky Business Directors and Lawsuits*, Feb. 2005, <http://www.companydirectors.com.au/Media/Company+Director/2005/February/Risky+business+directors+and+lawsuits+Cover+Story.htm> (citing and analyzing the above article written by Bernard S. Black, Brian R. Cheffins, & Michael Klausner); Barry Metzger, Kym Bavceovich & Shintaro Kuroda, *Japan: Overview of Recent Corporate Governance Reforms*, http://www.globalcorporategovernance.com/n_ap/283_291.htm (last visited Mar. 14, 2009).

228. Shoho to no ichibu wo kaisei suru horitsu [Act Partially Amending the Commercial Code], (Law No. 44, 2002).

229. Individuals who have never previously been an executive director, are not currently employed by the company, and have never been employed by the company or any of its

“family members, golf buddies, or old dormitory roommates as outside directors to ensure entrenchment of the incumbent management.”²³⁰ Even the *amakudari* could be legally appointed. In particular, the 2002 law allowed the companies to choose between: (1) the U.S.-style board which has three committees, nominating, audit and remuneration, that are to be composed primarily by independent directors (the Company with Committees system (*iinkai setchi gaisha*)); or the (2) traditional statutory auditor system (*kensayaku*) by which no independent directors were required to be appointed.²³¹

Before the onslaught of U.S.-style reforms such as the Company with Committees system, the Japanese Commercial Code required firms to have statutory auditors²³² (theoretically elected directly by shareholders) whose function was to audit the board and to ensure accuracy of financial reports.²³³ The auditors would sometimes sit in board meetings as non-voting members. These statutory auditors, though mandated by law to be chosen by the shareholders and nominally empowered with vast oversight authority,²³⁴ served in fact at the pleasure of the company president. They were typically not independent²³⁵ since the post could be occupied by former employees who had not worked for the firm in the last five years.²³⁶ There were no special qualifications to become a statutory auditor. Due to their weak and often conflicted status,²³⁷ statutory auditors did not play the role of independent directors²³⁸ as would be expected of members of an

subsidiaries Kaisha Ho [Company Law], (Law No. 86, Art. 2, Par. 15, 2005). The same broad, weak definition of outside directors was found in Article 188 of the Commercial Code. See Shōhō [COMMERCIAL CODE], Art. 188(2)(7.2) (2002) (Japan).

230. See Tomotaka Fujita, *Modernising Japanese Corporate Law: Ongoing Corporate Law Reform in Japan*, 16 SING. ACAD. L.J. 321, 340 (2004).

231. See generally Toda & McCarty, *supra* note 22.

232. Statutory Auditors have been in existence since the Commercial Code's enactment in 1899. However, the position is essentially functionally weaker if compared to the supervisory board of German corporate governance. In 1993, as part of the reforms as a result of the bubble burst, the government introduced the board of statutory auditors (for companies with paid-up capital exceeding 500 million yen or with total liabilities in excess of 20 billion yen) composed of at least 3 auditors, with one full time and one “independent.” See LAWS & REGULATIONS ON SETTING UP BUSINESS IN JAPAN, JAPAN EXTERNAL TRADE ORG. 6 (Nov. 2008), http://www.jetro.go.jp/en/invest/setting_up/pdf/2008setting_e.pdf

233. Lawley, *supra* note 202, at 109.

234. Statutory auditors can demand reports from employees and the board of directors, attend but not vote in board meetings, seek the re-study or suspension of a director's actions or program if deemed not in the best interest of the company, and examine the financial condition of the firm. They cannot appoint or seek the removal of directors, and do not necessarily represent shareholder or employee interests. See generally LAWS & REGULATIONS ON SETTING UP BUSINESS IN JAPAN, *supra* note 232.

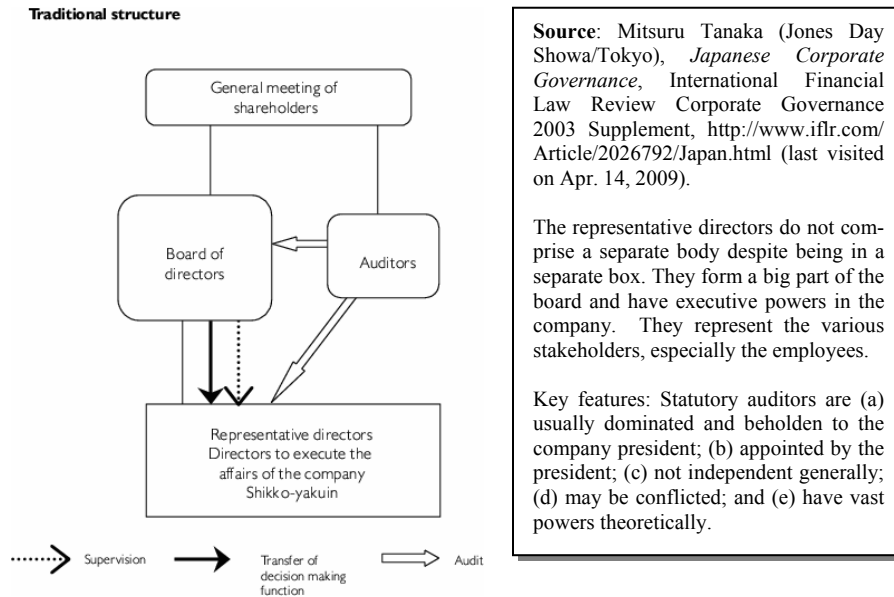
235. See LEARMOUNT, *supra* note 219, at 131–33.

236. See Toda & McCarty, *supra* note 22, at 204.

237. Other than being former employees, statutory auditors may also be employees of business partners, group companies, the Main Bank or other large shareholders.

238. Senechal, *supra* note 32, at 543–44.

audit committee in a U.S. corporate board setting. Below is a flowchart of the traditional statutory auditor system:



As a result of the 2002 amendment, companies such as AEON, a leading supermarket chain that boasts of large retail areas in major cities, can choose to institute the U.S.-inspired committee system.²³⁹ Once a company opts for the committee system by amending the certificate of incorporation, it is required to appoint three members for each of the committees, a majority of whom should be independent outside directors.²⁴⁰ The same independent outside director may sit in all three committees.²⁴¹ This means that the minimum requirement for a committee system corporation is two independent directors who can concurrently sit in all three committees. If the company wishes to remain steadfastly traditional,

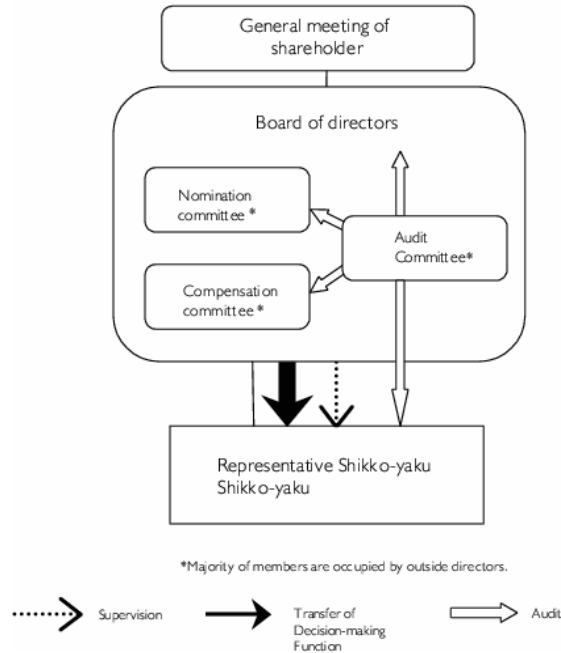
239. See generally *id.*

240. The 2002 amendment to the Commercial Code paved the way for a choice between the statutory auditor model and the U.S.-style committee system. This was reinforced in 2005 with the passage of Kaisha Ho [Company Law], Law No. 86, Article 400, in 2005. Gilson and Mihaupt described this choice as regulatory reform, made in an unusual fashion, and was an enabling strategy of reform. It allowed companies to choose what they felt was best for them. This enabling system mirrors the U.S. corporate governance model where traditionally everything is available and nothing is required. This has been changing, however, with strict NYSE and SEC requirements. See Gilson & Milhaupt, *supra* note 38, at 344. With the 2002 reform, the Company with Committee system (Company with Three Committee System or *iinkai setchi gaisha*) is available only for large companies, specifically those with capitalization was more than 500 million yen or whose total debt on a balance sheet was more than 20 billion yen. With the 2005 overhaul (the new Company Act), however, the committee system has been opened to all companies, regardless of capital or debt. If companies chose the Company with Committee structure, they will have to amend their articles of incorporation or memorandum of association.

241. See Senechal, *supra* note 32, at 551–53.

as most have, it can opt for the statutory auditor system and still not be required to appoint independent directors.²⁴² This was further clarified in the 2005 Company Act,²⁴³ the law that completely overhauled the Commercial Code. Below is a flowchart of the Company with Committees model:

Company with Committees



Source: Mitsuru Tanaka (Jones Day Showa/Tokyo), *Japanese Corporate Governance*, International Financial Law Review Corporate Governance 2003 Supplement, <http://www.iflr.com/Article/2026792/Japan.html> (last visited on Apr. 14, 2009).

According to Tanaka, the "*Shikko-yaku*" (corporate executive officer) is "entitled to make decisions regarding business operations (as) entrusted by the board of directors and operate the business of the company . . . although the board of directors retains the authority to determine the business operations of the company, most of its decision-making function can be transferred to the *Shikko-yaku* except for certain specified items."

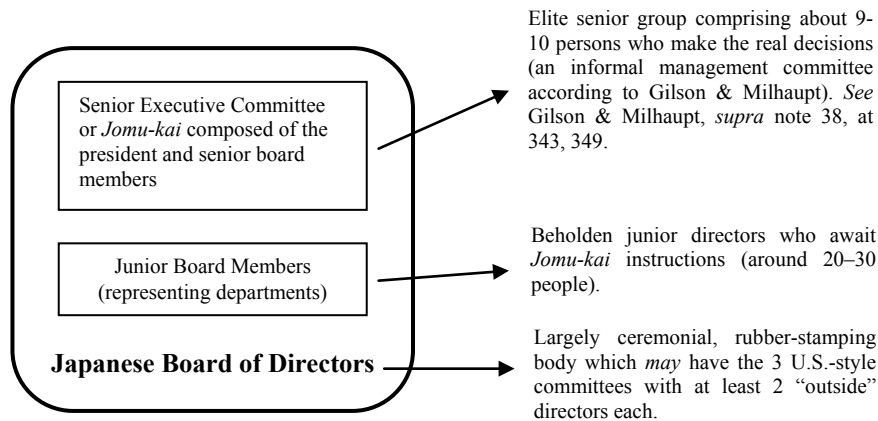
The *Shikko-yaku* is like the U.S. CEO, except that his powers and authority are wholly dependent on the board. Since 2003, Sony has adopted the Company with Committees model together with the *Shikko-yaku* system, thus separating the functions of monitoring and management.

Key features: (a) incorporates a U.S.-style committee system; (b) the majority of committee members must be "independent"; (c) a diluted definition of "independent" outside directors; and (d) is not preferred by most Japanese corporations.

242. See *id.* at 536.

243. Kaisha Ho [Company Law], Law No. 86 (2005).

Whether a firm chooses the Company with Committees system or the statutory auditor model, the following diagram illustrates the *general* composition of the board of directors:



The choice to have either the committee system or the statutory auditor system was a compromise between the Ministry of Justice and the business sector; with the business oligarchs not wanting to be compelled to appoint independent directors.²⁴⁴ The 2002 reform and 2005 overhaul were intended to increase the oversight function of the board and to further segregate decision-making from supervisory functions within a company.²⁴⁵ But since the 2005 Company Act also provided for directors simultaneously serving as executive officers or employees of the corporation,²⁴⁶ an idiosyncratic feature of Japanese corporate culture, the attainment of these goals was limited.

As expected, the old oligarchs at the helm of the great Japanese companies prevailed not only in giving the companies the right to choose which system was good for them, but also to convince their respective companies that the conventional statutory auditor approach was already satisfactory. As a result, most companies chose the statutory auditor system. By the end of 2004, only about sixty firms chose the committee system with independent directors.²⁴⁷ Tradition was preferred over efficiency, proving

244. See Gilson & Milhaupt, *supra* note 38, at 353–54. The Ministry of Justice was the proponent of the abolition of the Statutory Auditor system and its replacement by the U.S.-style board of committees. *Id.*

245. Toda & McCarty, *supra* note 22, at 205.

246. Kaisha Ho [Company Law], Art. 402, Par. 6.

247. By the end of March 2004, the number of companies that switched to the committee system was 37 firms. If Hitachi Ltd.'s and Nomura Holding's subsidiaries were added, this would result to 71 firms in total, with 45 publicly listed companies. This increased to about 60 (from 37) by the end of 2004. Two years after, the number did not change much. As of late 2006, a total of 76 corporations (from 60) had chosen the committee system. If Hitachi Ltd.'s and Nomura

that the statutory flexibility by which boards can choose their governance and monitoring systems did not work well in Japan. However, it must be remembered that this is Japan, still a highly conservative society where changes take time.

From the U.S. perspective, the fact that Japanese moguls and business leaders successfully pushed for a choice of the board system and persuaded their companies to adhere to the old statutory auditor form may be seen as unfortunate signs of a static, broken system. But Japan has its own time for change, unperturbed by how fast the West changes and adapts to its environs. Even without the U.S.-style committees, Japanese companies have fared well vis-à-vis North American companies. J-Form/statutory auditor companies like Toyota have outsold American car manufacturers since late 2007.²⁴⁸ Toyota once dominated the cheaper car market in the 1970s and 1980s, then outperformed classic American car companies for the higher-end market with the Camry model and Lexus line in the 1990s, and is now again penetrating the lower-end market again with the Echo (now Yaris).²⁴⁹ Toyota also fiercely competes in the gas-electric hybrid market with its Prius.²⁵⁰ Corporate cultural differences aside, nothing can be taken away from these great Japanese companies. These incremental, inch-by-inch changes are just the way the Japanese have done things for centuries and will continue to in this new millennium.

The main contention of the old guards is that corporate Japan does not need independent directors the way American corporations need them.²⁵¹

Holding's affiliates and subsidiaries are included, the total is 110. In 2004, there were almost 700,000 stock companies in Japan. Of this number, as of 2006, there were 2,323 that were listed with the Tokyo Stock Exchange. Hence, the number of adopting companies is staggeringly low: from 2004 to 2006, only 16 firms were added to the list. The initial excitement immediately wore off. However, some of the companies that adopted the committee system were the large ones such as Sony, Toshiba, Konica Minolta, Orix, Columbia Music Entertainment, Mitsubishi Electric, Seiyu (a large retail entity controlled by Wal-Mart), Tokyo Star Bank (acquired by Lone Star), Shinsei Bank, Fidelity Securities and the JASDAQ Securities Exchange. There were two basic reasons given for why they adopted the committee system: (a) they had large foreign shareholders; and (b) they were listed in foreign stock exchanges. It may encourage foreign shareholders or Westerners in general to know that the board is transparent, performs monitoring functions and adheres to "global best practices." Other reasons given were that they were global market players or had strategic motivations. Gilson and Milhaupt asserted that these firms adopted the new system because they were independent from the traditional patterns of Japanese corporate behavior as they were either mavericks, new start-ups, had no Main Bank, or were concentrated in such industries as electronics, finance and retail. See Gilson & Milhaupt, *supra* note 38, at 356.

248. Nick Bunkley, *G.M. Says Toyota Has Lead in Global Sales Race*, N.Y. TIMES, Apr. 24, 2008, available at <http://www.nytimes.com/2008/04/24/business/worldbusiness/24auto.html?>

249. Elizabeth Johnson, *Toyota Yaris*, Conceptcarz.com, <http://www.conceptcarz.com/vehicle/z6942/Toyota-Yaris.aspx> (last visited Feb. 20, 2009).

250. New Car Test Drive, *Toyota Prius: Introduction*, N.Y. TIMES, Feb. 20, 2009, available at <http://autos.nytimes.com/2008/Toyota/Prius/286/3326/293013/NCTD/researchReviews.aspx>.

251. Barney Jopson & David Pilling, *U.S. Corporate Governance not Suited to Japan*, Says Ministry, FIN. TIMES, June 21, 2003. See also Toda & McCarty, *supra* note 22, at 225–26 (discussing how "[t]here is a great deal of opposition to the introduction of outside directors. Criticism to this system amounts to the question: 'What do those from the outside know about our

Certainly, there was the bubble burst and the economic stagnation of the 1990s, but there is no one person or single corporate entity that can be identified as the cause. For many of the old guards, the independent director is a liberal American concept that will not work well in insular Japan. Independent directors are bereft of any understanding or expertise of how the company works and thus cannot properly supervise it.²⁵² The antipathy regarding the presence of independent directors is widespread and the reforms which began in 2002 are moving at snail's pace. To select an independent director is to distrust management and the board, and it constrains the notion of a company family or community.²⁵³ The concept of independent directors does not sit well with these corporate old guards since they generally trust directors and managers.²⁵⁴ Some are also of the view that board meetings, in contrast to the U.S. perspective that it is a critical platform for corporate governance, are a mere "formality . . . just a festivity,"²⁵⁵ and utilized only for information dissemination²⁵⁶ in Japan—thus, nothing drastic is needed. At best, a choice between the old and new systems should be provided.

However, one thing these old guards cannot claim is that the scandals that hit the U.S. in 2001–2002 never had a Japanese counterpart. Corporate

company?" The main concern is that such board members would not be capable of properly judging the company's business practices to make an appropriate decision. . . . One of the companies that made no changes is Canon Inc. Its President, Mr. Mitarai, strongly defends the current corporate governance structure. He argues that the existing corporate system under supervision of its auditors works just fine for Canon. At many U.S. companies what outside directors actually do is just listen to corporate executives' explanations about companies, rather than performing their supposed role of supervising management. This is because they have little knowledge about day-to-day operations of companies due to part-time status."). Mr. Mitarai's comments were originally derived from *U.S.-Style Corporate Governance?*, NIKKEI WEEKLY, June 30, 2003, at 9.

252. Mark Poe, Kay Shimizu & Jeannie Simpson, *Revising the Japanese Commercial Code: A Summary and Evaluation of the Reform Effort*, 2 STAN. J. EAST ASIAN AFF. 71, 74 (2002). Additionally, Gilson and Milhaupt opined that independent directors are not "well suited to perform a useful role in highly relational Japanese corporate affairs" and that even finding independent directors suited to the task is daunting. See Gilson & Milhaupt, *supra* note 38, at 354.

253. See Alison Tudor, *Proxy Adviser Targets Japan Inc.: Investors Are Urged to Reject Chief Executives, Support Independent Directors*, WALL ST. J., Feb. 24, 2009, at C2. See also Curtis J. Milhaupt, Speech & Q&A on his article entitled *Choice as Regulatory Reform: The Case of Japanese Corporate Governance* (May 12, 2004) (transcript available at <http://www.rieti.go.jp/en/events/bbl/04051201.html>) [hereinafter Milhaupt, Speech].

254. This belief cannot be compared to E. Merrick Dodd's notion that managers should have primacy—thus placing extreme trust on directors and officers. This is because, considering the essential features of the Japanese corporate model, even if they trusted their managers (and not the shareholders), they still heavily relied upon the monitoring of large stakeholders and even by the state through the Ministry of Finance's deployed officials as board members. Dodd did not adhere to government regulation; corporatist Adolf A. Berle did, as he believed that managers cannot be fully trusted and must be subject to strict regulation. See generally E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

255. See LEARMOUNT, *supra* note 219, at 126.

256. See *id.*

governance scandals in Japan are aplenty.²⁵⁷ These scandals may not compare in magnitude to Enron or Worldcom (which ushered in the Sarbanes-Oxley Act), but they have caused grave dishonor to Japanese companies. Daiwa Bank, due to rogue trader Toshihide Iguchi, lost \$1.1 billion on illegal bond trading from 1984 to 1995.²⁵⁸ Since the 1980s, Tokyo Electric Power filed at least 29 falsified reports to nuclear-safety regulators, with these reports failing to include safety problems at eight nuclear reactors.²⁵⁹ The *Sokaiya* have also been responsible for bringing negative press to Japanese companies by physically harassing directors during shareholder meetings, exerting extortionist influence, and allegedly masterminding the killing of corporate leaders.²⁶⁰ In July 2000, Snow Brand's milk caused 14,000 people to get sick after drinking its bacteria-contaminated product.²⁶¹ In September 2000, Mitsubishi admitted it covered up vehicle defects, which resulted in the belated recall of approximately 600,000 to 800,000 cars and trucks that led to deaths, fires, accidents and injuries since the 1980s.²⁶² Some of these scandals came to light because of the efforts of whistleblowers, leading to the Whistleblowers Protection Law, passed in 2004.²⁶³ In response to these big scandals, Arthur M. Mitchell, Asian Development Bank's General Counsel, stated in 2002 that:

The Japanese corporate scandals over the last ten years too represent a kind of perversion of the stakeholder model, where management, in the name of protecting employees and other stakeholders, diverted corporate assets to pet projects, hid losses in subsidiaries and destroyed corporate value. . . . [T]he Japanese systems of corporate governance converged into a kind of managerial capitalism—or capitalism for the benefit of those who control the corporation.²⁶⁴

257. See Ahmadjian & Okumura, *supra* note 16, at 142 (discussing “[s]ubstantial losses at Sumitomo Corporation and Daiwa Bank due to rogue traders, cover-ups of defects by Mitsubishi Motors, sales of spoiled milk by Snow Brand, and inadequate maintenance and monitoring of nuclear power plants by Tokyo Electric Power.”). See also Ruback, *supra* note 63 at 185, 207.

258. Yamada, *supra* note 184, at 211.

259. *Japanese Corporate Scandals: A Critical Mass of Disgust?*, THE ECONOMIST, Sept. 5, 2002, available at http://www.economist.com/business/displaystory.cfm?story_id=E1_TPTRDVG.

260. See Mark D. West, *Information, Institutions, and Extortion in Japan and the United States: Making Sense of Sokaiya Racketeers*, 93 NW. U. L. REV. 767, 767–68 (1999).

261. Unfortunately, the head of the factory was merely fined \$1,000 and received a two-year suspended sentence, while the company was fined \$4,500 by the Osaka District Court. Anthony Faiola, *New Cover-Up Allegations Hobble Japan's Fourth-Largest Automaker*, WASHINGTON POST, July 6, 2004, at E01.

262. *Id.* (“Mitsubishi officials concede that a culture of cover-up existed at the company.”).

263. See Whistleblower Protection Act of 2004, Act No. 122 (2006), available at <http://www.asianlii.org/jp/legis/laws/wpa2004an122o2004371/>.

264. Arthur M. Mitchell, *What is the Right Model for Corporate Governance in Developing Asia?*, Asian Institute of Management Annual Conference of CEOs, COOs and Directors in Asia (Manila, June 5–6, 2003), <http://www.adb.org/Documents/Speeches/2003/sp2003024.asp>.

The flexibility of choosing between the Japanese statutory auditor system and the U.S. committee model has been met with open arms by many Japanese corporate giants that benefit from such flexibility. This flexible, enabling approach allows them to advertise to the world that, in law, they have followed the U.S. committee model, but in practice have chosen the old statutory auditor system by a great majority. This also gives them the ability to avoid Enron/Worldcom-like scandals. As aptly put by the Chairman of Fuji Xerox, Yotaro Kobayashi:

The board structure is being changed in a number of Japanese companies, some are reducing the board size and inviting outside board members. The direction is right, but I'm not really sure that many of those outside independent directors are given the freedom that many of the independent directors have on the boards of [U.S.] corporations. Still, I remain positive about the outlook. One thing which is unique in Japan is that we have the company position of statutory auditor; and that's part of the law. There's an argument, a debate as to whether a truly effective audit can be done either by the statutory auditors or by an audit committee made up by independent directors, the [U.S.] way. My feeling is that we can probably combine the two. We will live with the statutory audit system as it is part of our commercial code, but also we will invite outside board members to the board so that the board, and, of course, most importantly, the management can really benefit from the different views. And, if we can actually combine, that might produce some interesting structure for the Japanese version of corporate governance.²⁶⁵

Yet those who clamor for more changes and reforms, such as more independent directors and increased shareholder returns, have been chastised as corporate radicals, boardroom bullies, company raiders, unnecessary "shareholder champion(s),"²⁶⁶ "financial insurgent(s),"²⁶⁷ and "unscrupulous asset stripper(s)."²⁶⁸ There has been widespread antagonism toward reformers fueled by negative media coverage and government prosecution, implying that reformers were Japanese by blood but not by character.²⁶⁹

265. Yotaro Kobayashi, *Japan's Changing Corporate Structure*, 2000 http://www0.gsb.columbia.edu/null/Op45?exclusive=filemgr.download&file_id=592779&showthumb=0.

266. Kenji Hall, *An Activist's Fall From Grace*, BUS. WK., June 5, 2006 http://www.businessweek.com/globalbiz/content/jun2006/gb20060605_562253.htm?campaign_id=rss_topStories/.

267. Yoshiaki Murakami, BUS. WK., July 8, 2002, http://www.businessweek.com/magazine/content/02_27/b3790623.htm.

268. *Id.*

269. In 2005, Livedoor's CEO Takafumi Horie was championed by some as the first Japanese homegrown shareholder activist. Although his actions were not traditionally Japanese, he espoused the enhancement of shareholder value. He was, however, arrested and indicted in January 2006 on allegations of accounting fraud and stock market manipulation. In March 2007, the Tokyo District Court sentenced him to two and a half years imprisonment. Hisane Masaki, *The*

Despite the weak definition of independent directors and the fact that most firms choose tradition over reform, not all firms have rejected reform. Some firms, particularly those with strong foreign shareholdings, have introduced independent directors.²⁷⁰ Firms that chose the statutory auditor system have made moves to make them more independent and not beholden to the company president or chief executive.²⁷¹ For example, Sony reduced its top-heavy board by decreasing directors from thirty-eight to just ten in 1997, long before the 2002 amendment.²⁷² The twenty-eight former directors were not terminated by the company but were transformed into “executive officers,” a unique Sony creation in 1997.²⁷³ They were formerly the directors in charge of managing subsidiaries. By 2003, Sony chose the committee system with a corporate executive officer system or *Shikko-yaku*, further establishing itself as the leading Japanese institution closely following the U.S. corporate governance model.²⁷⁴ As of May 2001, 38% of first-section firms listed in the Tokyo Stock Exchange added outside directors to their boards.²⁷⁵ By 2002, about one-third of listed companies adopted a reduction in board membership, 80% of which “scaled back to fewer than ten directors.”²⁷⁶ Though reduction in board size and an increase in the number of outside directors were the favored governance reforms, there was no corollary shift to the committee system. Corporate boards, now reduced and with fewer outsiders, were still dominated by company insiders.

Fall of a Japanese Business Iconoclast, ASIA TIMES ONLINE, Mar. 17, 2007, available at <http://www.atimes.com/atimes/Japan/IC17Dh01.html>. Another homegrown activist, Yoshiaki Murakami, CEO of Murakami Fund, a highly confrontational investment fund, was making headlines for attempting to take over large, well-established corporations. In June 2006, Murakami was arrested on allegations of a series of insider trading scandals. In July 2007, just a few months after Horie’s sentencing, the Tokyo District Court fined Murakami 3 million yen, sentenced him to two years of incarceration, and additionally seized 1.15 billion yen. See *Japan Fund Manager Found Guilty*, BBC NEWS, July 19, 2007, available at <http://news.bbc.co.uk/2/hi/business/6905780.stm>; but see *Livedoor Manager Spared Jail*, STRAITS TIMES ONLINE, Feb. 3, 2009, http://www.straitstimes.com/Breaking%2BNews/Asia/Story/STIStory_333744.html (discussing the Tokyo High Court’s decision to suspend Murakami’s two-year prison sentence while upholding the 1.15 billion yen fine).

270. Some reputable large companies such as Hoya Corp., Square Co., Densen-Lambda KK and Seiyo Food Systems Inc. have boards comprised of more than one half of outsiders; Kinki Nippon Railway Co., SSP Co. and five other companies have appointed more than five outside directors. See Poe, Shimizu & Simpson, *supra* note 252, at 84.

271. Japan Corporate Auditors Association, *The Corporate Auditor System in Japan*, Mar. 11, 2007, http://www.kansa.or.jp/english/about_02.html. See also Metzger et al., *supra* note 227.

272. See Milhaupt, *Creative Norm Destruction*, *supra* note 90, at 2117.

273. See *id.*

274. See Senechal, *supra* note 32, at 554–55.

275. See MILHAUPT & WEST, *supra* note 102, at 195.

276. *Id.*

VIII. INSIDE, INDEPENDENT AND GREY DIRECTORS

Despite the evolution of Japanese corporate boards and increasing application of Delaware-style governance structures, grey directors are still prevalent in Japan. As mentioned previously, Japanese corporate boards are composed of inside, independent and grey directors, differing significantly from U.S. practice. An inside director is an employee or officer of the company, or an officer of an affiliate company or subsidiary.²⁷⁷ In contrast, an independent director is someone who is not an inside director and who, at least conceptually, enforces the regulations set by government, monitors compliance of the company, and sets clear goals for the company.²⁷⁸ Independent directors provide the functions of highly staffed regulatory agencies, but they are cheaper and have less agency costs.²⁷⁹ Independent directors do not have a real stake in the company, and if the situation calls for it, perform a monitoring role and criticize the performance of the CEO, the management or the entire board. They are the monitors and watchdogs of the board and the agents of stewardship. Their presence is needed in all of the committees and their approval or confirmation may cleanse an otherwise self-dealing transaction.

The Japanese practice regarding independent directors (or the option to introduce independent directors into the board) can be sharply juxtaposed with the ideal corporate board described by Martin Lipton and Jay Lorsch in 1992.²⁸⁰ According to Lipton and Lorsch, the maximum board should be ten members, but the ideal is eight or nine members, with the CEO as the only insider on the board.²⁸¹ Though many Japanese companies have reduced their overpopulated boards to around ten directors, most of them are still comprised of insiders.²⁸² Lipton and Lorsch also proposed that the ideal board should have term limits and that the maximum number of boards that directors can serve on is three (to ensure valuable performance).²⁸³ As of now, there are no term limits²⁸⁴ nor is there a ceiling

277. See generally Cheryl L. Wade, *What Independent Directors Should Expect from Inside Directors: Smith v. Van Gorkom as a Guide to Intra-Firm Governance*, 45 WASHBURN L.J. 367 (2006).

278. See generally Victor Brudney, *The Independent Director – Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597 (1982).

279. Gordon, *supra* note 189, at 1476 (“Large public firms have moved to a pattern of one, perhaps two, inside directors and an increasing number of independent directors. Some academics and practitioners have characterized the emerging pattern as the cynosure of corporate governance because of its maximum control of managerial agency costs.”).

280. See generally Lipton & Lorsch, *supra* note 179.

281. *Id.* at 67. For the National Association of Corporate Directors, the ideal board size is between eight to eleven directors. See Roger Raber, *Corporate Governance in the Global Economy: Roles and Responsibilities of Corporate Directors*, RIETI, July 26, 2006, <http://www.rieti.go.jp/en/events/bbl/06072601.html> (last visited Feb. 23, 2009).

282. RALF BEBENROTH & LI DONGHAO, PERFORMANCE IMPACT AT THE BOARD LEVEL: CORPORATE GOVERNANCE IN JAPAN 24 (Nov. 2006), <http://www.bebenroth.eu/Downloads/BoardroomBebenrothLi.pdf>.

283. Lipton & Lorsch, *supra* note 179, at 69.

on the number of boards that directors can serve on in Japan. Lipton and Lorsch similarly advocated for a Lead (Independent) Director who would counterbalance the power and authority of the CEO.²⁸⁵ Japanese companies have been unable to install true independent directors on their boards²⁸⁶ and thus obtaining a majority of independent directors or a lead independent director is unlikely. However, Lipton and Lorsch's idea of three important board committees (Audit, Nominating, Compensation)²⁸⁷ is already a reality in Japan; the problem is that it is merely a choice between the U.S.-style committee system or the old, static statutory auditor system. As stated by Japanese Professor Kenichi Osugi:

[M]ost directors of Japanese companies are also officers of the same company, which is quite different from American and British companies. Independent, non-executive directors are uncommon, although Japanese company auditors could be seen as a type of non-executive director. Nearly a half of listed companies adopt outside directors, but most of them still come from another company in the same corporate group. Such outside directors are not considered independent enough from the executives of the company to make fair judgment when a control contest occurs.²⁸⁸

Lipton and Lorsch likewise envisioned that there ought to be a minimum time commitment for board members.²⁸⁹ They argued that there

284. Only the length of each term is specified but not the number of times a director can be reelected. Kaisha Ho [Company Act], Act No. 86 of 2005, article 332 (Directors' Terms of Office).

285. Lipton & Lorsch, *supra* note 179, at 70–71.

286. ULRIKE SCHAEDE & WILLIAM W. GRIMES, JAPAN'S MANAGED GLOBALIZATION: ADAPTING TO THE TWENTY-FIRST CENTURY 216 (2003).

287. See Lipton & Lorsch, *supra* note 179, at 68–69.

288. See Osugi, *supra* note 173, at 154. See also Gilson & Milhaupt, *supra* note 38, at 349 (stating “it is safe to assume that a significant percentage of these new outside directors are not truly independent of the firms on whose boards they serve.”).

289. Lipton & Lorsch, *supra* note 179, at 64–65. In 2006, fourteen years after publication, Martin Lipton complained, *inter alia*, in a memorandum written on November 1, 2006, (1) the three committees were turning into individualized fiefdoms; (2) the CEO was excluded from committee meetings; (3) public pension funds demanded meetings with independent directors; (4) the definition of “independence” was narrowing; (5) time demands on directors were increasing; (6) CEO or business people were limited to just one outside board, if any; (7) extensive questionnaires were needed to determine potential conflict of interests or independence; (8) the number of outside advisors was increasing; and (9) special investigation committees composed of independent directors were proliferating. These recent complaints, though rational and relevant, seem to be at odds with his and Lorsch's proposals back in 1992. Were they not the ones who proposed most of them? Back in 1992, they advocated for (a) the formation of these three committees with independent directors; (b) the non-interference of the CEO to preserve independence; (c) the necessity for directors and officers to “meet annually in an informal setting with five to ten of the larger investors in the company . . . to promote understanding between the two groups and provide a convenient and informal opportunity for the investors to tell the directors . . . any concerns the investors have” otherwise known as the “annual meeting with large investors” proposal; (d) the importance of director independence; (e) the need for more director time spent on corporate affairs; (f) limitation to just three outside boards for proper focus and due

should be at least eight to twelve board meetings a year, and the board should regularly and formally break into committees entirely composed of independent directors, have comprehensive full-board sessions, and at least one day of preparation before each board or committee session.²⁹⁰ There should also be annual three-day strategy meetings.²⁹¹ In all, directors should spend at least 100 meaningful hours per year for board service.²⁹² In contrast, research shows that Japanese plenary boards infrequently meet.²⁹³ The Company Act of 2005 requires that the board meet only once every three months.²⁹⁴ However, the Senior Executive Committee of the board (*Jomu-kai*) meets very regularly and typically exceeds the monthly suggestion of Lipton and Lorsch as they may meet twice monthly or even weekly.²⁹⁵ Directors of *keiretsu* companies also meet twice a year for a few days in a hotel (most likely owned by a *keiretsu* member) where they discuss general corporate matters and socialize.²⁹⁶ Some *keiretsu* company directors may meet more often, such as the monthly First Friday meetings (*Kinyokai*) of the Presidents' Club (*Shacho Club*).²⁹⁷ Corporate meetings, like Japanese academic meetings, are long, dreary and exhausting. Even with frequent meetings, there is a lot to be done legislatively and culturally if the plenary board is to perform a monitoring role.

If measured against Delaware corporation law standards, the Japanese definition of "independent" director pales in comparison. A famous Delaware case, *Orman v. Cullman*,²⁹⁸ provides the best explanation of what independence means. In *Orman*, it was critical to determine whether a majority of the board was interested, conflicted and thus not independent. In determining whether the board was independent, the court said that such a determination:

[I]nvolves an inquiry into whether the director's decision resulted from that director being controlled by another. . . . [I]f in fact he is dominated

to time constraints; and (g) selection of a Lead Independent Director to counterbalance CEO power. Now, Martin Lipton is complaining about some of the things he himself was proposing in 1992. Though times have changed, Enron and Worldcom occurred, and Sarbanes-Oxley was passed, there seems to be some oddity to this. See Martin Lipton, *Deconstructing American Business II*, 10 Nat'l Legal Center for Pub. Int. 1, 2-6 (2006), available at http://www.aei.org/publications/pubID.26666/pub_detail.asp.

290. Lipton & Lorsch, *supra* note 179, at 68-69.

291. *Id.* at 69.

292. *Id.*

293. OHTSU & IMANARI, *supra* note 205, at 353.

294. Kaisha Ho [Company Act], Act No. 86 of 2005, art. 363, no. 2 (Authority of Directors of Companies with Board of Directors).

295. See OHTSU & IMANARI, *supra* note 205, at 350, 353.

296. See LEARMOUNT, *supra* note 219, at 143.

297. See generally MIN CHEN, ASIAN MANAGEMENT SYSTEMS: CHINESE, JAPANESE AND KOREAN STYLES OF BUSINESS (2004). See also Brian Bremner, Emily Thornton & Irene M. Kunii, *Mitsubishi: Fall of a Keiretsu (Int'l Edition)*, BUS. WK., Mar. 15, 1999, http://www.businessweek.com/1999/99_11/b3620009.htm.

298. *Orman v. Cullman*, 794 A.2d 5 (Del. Ch. 2002).

by that other party, whether through close personal or familial relationship or through force of will. A director can also be controlled by another if the challenged director is beholden to the allegedly controlling entity. A director may be considered beholden to (and thus controlled by) another when the allegedly controlling entity has the unilateral power . . . to decide whether the challenged director continues to receive a benefit, financial or otherwise, upon which the challenged director is so dependent or is of such subjective material importance to him that the threatened loss of that benefit might create a reason to question whether the controlled director is able to consider the corporate merits of the challenged transaction objectively.²⁹⁹

Japanese inside directors (and grey directors) are definitely not independent, as they are dominated by the appointing authority. They are current employees or subsidiary companies' officers who can immediately be fired and whose benefits may be reduced at the discretion of the president of the company.³⁰⁰ The president can also choose not to reappoint them the following year (with shareholder "confirmation").³⁰¹ While some may view Japanese directors' objectivity as suspect, others argue that such objectivity does not exist at all.³⁰² Japanese directors are loyal senior executive officers before appointment, and are still employees after appointment to the board.³⁰³ Board members are not inclined to bite the hand that feeds them and are culturally bound to return the favor by unwavering fealty and blind allegiance.³⁰⁴ It would be unconditionally un-Japanese to dissent from or contradict the opinion of management.

Grey directors are also typically dominated by and beholden to the company president. Grey directors include "former officers or employees, relatives of management, professional advisors to the firm (e.g. consultants, bank officers, legal counsel), officers of significant suppliers or customers of the firm, and interlocking directors"³⁰⁵ and are "closely aligned with [the

299. *Id.* at 25 n.50 (emphasis removed).

300. Ryuichi Yamakawa, *New Wine in Old Bottles?: Employee/Independent Contractor Distinction Under Japanese Labor Law*, 21 COMP. LAB. L. & POL'Y J. 99, 113–15 (1999) ("In Japan, however, corporate directors quite often work as employees under the direction and supervision of top management, such as the company president or chairperson. In many cases, directors concurrently hold positions as employees (their business card may read, for example, "Director/Head of Sales Department," if literally translated). Since not many directors are appointed from outside of a corporation, it is quite common that managerial employees get promoted to a directorship while continuing to hold the status of employee.").

301. OHTSU & IMANARI, *supra* note 205, at 359.

302. See generally Laura Lin, *The Effectiveness of Outside Directors as a Corporate Governance Mechanism: Theories and Evidence*, 90 NW. U.L. REV. 898, 919–20 (1996).

303. Toda & McCarty, *supra* note 22, at 205.

304. *Id.*

305. Joseph V. Carcello & Terry L. Neal, *Audit Committee Characteristics and Auditor Reporting* 1 n.2 (University of Tennessee, Working Paper, July 1997), available at <http://ssrn.com/abstract=53917>.

interests] of management.”³⁰⁶ They often have some unwritten or latent investments and vested interests in the company. Therefore, grey directors, neither clearly independent or insiders, incline towards being insiders. As they have ties with management, they generally do not go against the wishes of the president or other offices lest they risk ruining their long-running business relationships. They are not considered explicitly as insiders as they are not present or past employees of the corporation or any of its subsidiaries. However, they are absolutely dependent on pleasing management due to obligations made through their business dealings or familial relationships.³⁰⁷

Accordingly, a majority of the Japanese directors could be classified as either insiders or grey directors. They are grey directors if they are: (a) directors sent by the Main Bank; (b) directors sent by suppliers, customers or business partners; (c) directors sent by the parent company; (d) statutory auditors; (e) consultants or external legal counsels; (f) former employees; (g) managers’ relatives; or (h) *amakudari* (both retired and soon-to-retire Ministry officials). While it can be argued that the *amakudari* are independent directors because they are not strictly grey and are employed, or were once employed, by the state, their agenda is typically centered around trying to secure an officer position for post-retirement, and thus they are unlikely to challenge management.

Even with the institution of the committee system and the option to implement that system, the dilution of “independent” directors weakens the committee model. However, grey directors are not categorically bad for the Japanese corporation. An empirical study of the impact of the committee system through interviews with Japanese lawyers, auditors, ratings analysts, bankers and institutional investors reveals that outsiders are in fact almost always grey directors, and are rarely independent.³⁰⁸ The general conclusions reached by the study are five-fold: (1) most of the outsider directors are not independent; (2) it is extremely difficult to find a truly independent director in Japan; (3) outside directors do not improve monitoring;³⁰⁹ (4) the distinctions between, and the advantages of, the committee system over the statutory auditor approach have been severely blurred in practice; and (5) as an exception, companies adopting the committee system that have listed with foreign exchanges or seek foreign investment may be valued higher by the market³¹⁰ due to the familiarity of

306. *Id.*

307. Amy J. Hillman, Albert A. Cannella, Jr. & Ramona L. Paetzold, *The Resource Dependence Role of Corporate Directors: Strategic Adaptation of Board Composition in Response to Environmental Change*, in THEORIES OF CORPORATE GOVERNANCE: THE PHILOSOPHICAL FOUNDATIONS OF CORPORATE GOVERNANCE 139 (Thomas Clarke ed., 2004).

308. See Lawley, *supra* note 202, at 122–134.

309. See Miwa, *Corporate Social Responsibility*, *supra* note 188, at 1242.

310. This higher valuation is due to “the illusion of stronger governance.” Lawley, *supra* note 202, at 133.

U.S. and U.K. firms with the committee and monitoring systems.³¹¹ Auditors in the empirical study were also more cautious when auditing firms with grey outside directors.³¹²

Because of their stake in the company, grey directors may actually be more incentivized to police management than independents.³¹³ Main Banks, for one, have successfully monitored companies effectively before and have intervened to remove underperforming CEOs and senior management³¹⁴ who threatened the company and the *keiretsu* structure in general.³¹⁵ However, though grey directors may have the incentive to monitor, it is still likely their interests are aligned with management. Independent monitoring may be more of the exception than the rule for grey directors. They are monitoring only to ensure their money is protected and for sound investment purposes, not because they are selected as professional monitors or equipped to serve as independent directors. Moreover, the danger with a grey Japanese director is that he has chameleon abilities—one will never know if he is white (siding with management) or black (siding with the monitors). The director can shift colors to avoid detection by the company president or active shareholders, or simply for convenience just as fast as he is appointed to the board.

Nevertheless, it is difficult to imagine Japan without its insiders and grey directors. They are a significant part of the corporate culture and eliminating them or minimizing their presence to reflect the U.S.'s 1-to-9 ratio of insiders-to-independents seems impossible.³¹⁶ They have been instrumental to Japan's immense success. The government will not support such reform, the boards will certainly reject it, and the public at large will find it unreasonable.

Becoming a mirror image of the U.S. corporate governance model has never been part of the Japanese agenda. Neither has entirely revamping corporate governance structures just to please U.S. and U.K. shareholders.³¹⁷ This should not come as a surprise because foreigners have

311. *Id.* at 122–34.

312. *Id.* at 126.

313. *Id.* at 116.

314. See generally Kaplan, *supra* note 41. See also Justin Wood, *Director Duties and Creditor Protections in the Zone of Insolvency: A Comparison of the United States, Germany, and Japan*, 26 PENN ST. INT'L L. REV. 139, 159 (2007).

315. Coffee, Jr., *supra* note 217, at 1300 (“Because the main bank holds an ownership level that is below five percent by definition, it must secure the consent of its fellow keiretsu members before it can take disciplinary action or remove senior management. Yet these other members share a common interest in restricting main bank interventions in the internal affairs of each member to occasions in which the demonstrated delinquency of a member firm threatens the keiretsu as a whole.”).

316. See Tudor, *supra* note 253, at C2.

317. In fact, instead of totally borrowing Western ideas, they are spun into Japanese-style practice. Companies may even “borrow” an American physically and place him as an insider in one of their boards. American Jim Press, the first non-Japanese head of Toyota Motors North America, became the first non-Japanese director at Toyota. As a concurrent employee of the

never been completely accepted in Japan. Their ideas have in general been regarded with suspicion and distrust, with some notable exceptions such as Japan's embrace of the propositions of German professor Hermann Roesler in the 1870s. Thus, Japan will take slow, small, measured steps towards reforming the J-Form and its governance style. The Japanese will likely avoid appearing as if they are chasing the American form. As a consequence, any absolutely independent director hoping to institute change will face a steep climb, and the establishment of a truly independent board may still be decades in the making.

IX. SWEEPING OR CREEPING CHANGE?

Despite resistance, things are gradually changing in the corporate landscape. The Company Community, with all of its unique features, is slowly ebbing away. Furthermore, Japanese CEOs are increasingly reaching out to, and aligning their interests with, investors and shareholders.³¹⁸ Shareholders, according to the 2005 Company Act, can propose that a director be removed and may actually resolve to remove a director without cause.³¹⁹ Shareholder activism led by homegrown activists, the Osaka-based Shareholder Ombudsman, and the institutional investor Pension Fund Association is gradually being recognized.³²⁰ Foreign hedge funds such as Steel Partners, Perry Capital and the U.K.'s The Children's Investment Fund are beginning to rock the Japanese corporate boat with either their aggressive or milder approaches to corporate change.³²¹ Their demands

company, he was an inside director. See Chris Isidore, *First American on Toyota's board*, CNNMONEY, June 22, 2007, http://money.cnn.com/2007/06/22/news/international/toyota_american_director/index.htm. However, Mr. Press's stint as Toyota board member was short-lived. Just a few months after his appointment, he defected to Chrysler and assumed the position of President and Board Vice-Chairman. See Dee-Ann Durbin, *Top Toyota Exec Jim Press Joins Chrysler*, OAKLAND TRIBUNE, Sept. 7, 2007, http://findarticles.com/p/articles/mi_qn4176/is_20070907/ai_n19518579.

³¹⁸ Xu Peng, *Latest Development in Corporate Governance*, RIETI, June 27, 2007, <http://www.rieti.go.jp/en/projects/cgp/columns/04.html>.

³¹⁹ A shareholder who owns one percent or 300 shares in a company may propose to the company to remove its directors from office. Kaisha Ho [Company Act], Act No. 86 of 2005, art. 305, no. 1. The shareholders may likewise resolve to remove a director by majority vote without cause. Kaisha Ho [Company Act], Act No. 86 of 2005, art. 339, no. 1; Kaisha Ho [Company Act], Act No. 86 of 2005, art. 309, no. 1.

³²⁰ Zenichi Shishido states, however, that outside shareholders (such as foreign, institutional and unaffiliated domestic shareholders) do not and cannot monitor management, and that the only recourse for them in case of disagreement is "by exit" or by selling their shares. See Shishido, *Japanese Corporate Governance*, *supra* note 9, at 189, 205, 206, 208, 216. But this does not reflect contemporary corporate Japan since shareholder activism has been on the rise for the last few years, a gradual strengthening of institutional investors has emerged, and the occurrence of occasional confrontation with management in lieu of merely selling.

³²¹ *Sunrise? Japan is a Cornucopia of Great Business Names and is full of Promise in Terms of Mergers and Acquisitions. Yet, Japan also has a Habit of Disappointing. Could this be About to Change?*, ACQUISITIONS MONTHLY, July 1, 2008, http://goliath.ecnext.com/coms2/gi_0199-8145072/Sunrise-Japan-is-a-cornucopia.html#abstract.

include more transparency, payment of larger dividends, appointment of more independent directors, and the “promot[ion] and unlock[ing of] shareholder value through effective corporate governance.”³²²

Recently, corporations have come to understand that shareholders are an important constituency. However, they still have not embraced shareholder primacy altogether. The stakeholder-centered model, with the Company Community as a backdrop, is still the general philosophy adopted by corporations around Japan, with shareholder value merely as one of many objectives. However, instead of being the last in line on the stakeholders list, shareholder value has been promoted to a status equal or near to employees and customers.³²³

Japan unquestionably has a long way to go to incorporate shareholder primacy. As Professor Osugi argues, Japanese corporations are generally ambivalent about shareholder primacy and seldom entertain the idea of adding more independent directors.³²⁴ In agreement, Ronald J. Gilson and Curtis J. Milhaupt argue that Japan has merely imported U.S. corporate governance principles but has either failed to institute or does not have the much-needed resources to complement them.³²⁵ They believe that Japan’s “Americanized” board committee system is a formal—but not a functional—convergence.³²⁶ It is formal because Japan has imported the concepts of outside directors, board committees, and accountability principles, but does not have the complementary mechanisms and systems to make sure that these Anglo-American governance precepts are functional.³²⁷

American corporate governance forms have failed to reach full potential in Japan for three reasons. First, in Japan the full board has only ministerial and rubber-stamping functions, not genuine monitoring and supervisory authority. Second, there is no strong judicial review of board actions in Japan. This is unlike in the United States, especially Delaware, where boards are generally given deference to perform their functions even to the point of “expropriation of minority shareholder wealth” as long as independent directors (or committees) made the decision or it was an arms’ length transaction, in good faith and using good governance practices.³²⁸ If the board has not done so, then U.S. courts, such as the Delaware Chancery

322. Subodh Mishra & John Taylor, *Investors Focus on Pills, Pay Disclosure as Japan’s Proxy Season Begins*, June 15, 2006, http://blog.riskmetrics.com/2006/06/investors_focus_on_pills_pay_d.html.

323. See generally LEARMOUNT, *supra* note 219, at 125.

324. See Osugi, *supra* note 173, at 158.

325. See Gilson & Milhaupt, *supra* note 38, at 369.

326. *Id.* at 373.

327. *Id.* at 369. See also Ronald J. Gilson, *Globalization of Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 331 (2001).

328. See Gilson & Milhaupt, *supra* note 38, at 345, 370; see also, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

Court, will typically come down hard on the directors and rule against the validity of the board decision.³²⁹ If, however, the board was fully informed, reached the decision in good faith, and were not interested in the transaction, then U.S. courts will not usually disturb it under the Business Judgment Rule presumption.³³⁰ In Japan, courts may expeditiously agree that a board decision is valid simply because it was made by an “outside committee” without investigating whether it was truly independent.³³¹ Third, Japan does not have a body of jurisprudence and doctrine that will ably support the transplanted three-committee/independent director system.³³² More time and more experience with handling litigation or issues in regards to director independence will be needed.

Shareholders in Japan are gradually having a voice in the company. In the past, shareholders “either felt it was rude to question management or lacked an appropriate platform to do so.”³³³ However, with the changing times, “[s]uch deference is becoming a thing of the past.”³³⁴ Shareholders are slowly transforming into empowered stakeholders who are demanding not only the right to be heard, but also change. Culture and endogeneity will play large roles in this era of change. Gilson and Milhaupt believed that culture, perhaps, plays too big of a role in the field of corporate governance and may very well hinder the necessary evolution of corporate laws and practice in Japan.³³⁵ Many hardliners still inhabit the corporate boardrooms and the government is still run conservatively. Nevertheless, Japanese culture can adapt to global corporate changes, if not gradually at first.

What is happening is a hybridization of the post-war corporate governance structure with the U.S.-style model. Pragmatically, an increasing minority of Japanese boards will be reduced to ten-member boards in the years to come. The ebbing concept of the Company Community will be retained generally, but the shareholder will be further

329. *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (“The rule itself ‘is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.’ . . . Thus, the party attacking a board decision as uninformed must rebut the presumption that its business judgment was an informed one.”).

330. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (A court will not substitute its own notions of what is or is not sound business judgment since the Business Judgment Rule “is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”).

331. See Milhaupt, Speech, *supra* note 253.

332. See Gilson & Milhaupt, *supra* note 38, at 369–71.

333. William Pesek, Jr., *Barbarians Edging Closer to Japan’s Gates*, BLOOMBERG, Jan. 27, 2004.

334. *Id.*

335. See Gilson & Milhaupt, *supra* note 38, at 361–63. These authors themselves believe that Japan is “slow to change but capable of enormous change once engaged” and that, following Newton’s First Law of Motion, its corporate governance tends to remain at rest unless compelled to change. *Id.* at 345–46.

promoted as one of the most important stakeholders. This will be pursued by the hedge funds and institutional activists currently investing in Japan, as well as the entry of newer homegrown shareholder activists such as Murakami and Horie. Reformists will push for more independent board membership, and they will be able to reach three or four independents out of ten directors in the coming years. There will be a further decrease in the number of insiders, notably managers, as corporate leaders realize that bestowing directorship as the “grand prize” to fiercely loyal employees is not always rewarding. This will allow many boards to be stripped of their operating functions and to take on a monitoring role. The weak statutory auditor paradigm will be strengthened to hopefully match that of the U.S.-style audit committee composed of independents (unless the company has already chosen the committee system). Instead of focusing solely on growth, companies will also focus on profitability and shareholder return through dividends. As shareholders grow bolder and as more New York law firms enter and entrench themselves in Tokyo, it can be expected that there will be more shareholder resolutions and proposals, more mergers and acquisitions, and more shareholder litigation.

Independent directors will have a rough time at first. They are expected to bow to the company president and the first few batches of independents will likely do so until they increase their numbers. In time, real independents, despite being in the minority,³³⁶ will have the courage to constructively question and thus properly monitor the heavy hand of management. They will be able to say no, *inter alia*, if the executives are procuring excessive wealth from the company. It is almost certain that there will not be an independent board for at least fifteen to twenty years. However, once China dislodges Germany and eventually overtakes Japan in terms of the size of its economy, and large Japanese corporate brands begin to see lower incomes and profitability, then Japan may finally open up to the concept of a fully independent board. When that happens, they will determine that the concept of Company Community is obsolete and continue their shift to a more Western style of governance.³³⁷

The following list summarizes what may be attainable in the next decade or so:

336. Perhaps three or four directors, maybe even five, in a ten-man boardroom.

337. One thing is for certain: executive compensation will not generally be a problem for Japanese corporations. A CEO compensation that is too high or too divorced from the average *sarariman* (salary man's) pay is something the Japanese cannot stomach. With the emotional attention of American media perennially focused on exorbitant CEO pay, Japanese chief executives will most certainly stay away from this ruckus for fear of being socially damaged and professionally ridiculed. See Kenji Hall, *No Outcry About CEO Pay in Japan*, BUS. WK., Feb. 10, 2009, http://www.businessweek.com/globalbiz/content/feb2009/gb20090210_949408.htm. See also Yuka Hayashi & Phred Dvorak, *Japanese Wrestle With CEO Pay as They Go Global*, WALL ST. J., Nov. 28, 2008, at B1, available at http://online.wsj.com/article/SB122782362228562381.html?mod=todays_us_marketplace.

- (1) Downsizing the bloated board of directors to a maximum of ten board members for effective governance and decision-making;
- (2) Increasing the proportion of independent directors;
 - a. At least three or four independents with six to seven insiders and grey directors, with the goal of eventually obtaining a majority of independent directors;³³⁸ and
 - b. Doing so gradually, as immediately and drastically reducing or eliminating insiders and grey directors will not work culturally, legally and pragmatically;
- (3) Increasing boldness of and monitoring by independent directors, peculiarly versus the President's authority;³³⁹
- (4) Increasing the length and comprehensiveness of board meetings (not a rubber-stamp board);
- (5) Holding roughly ten to twelve board meetings per year;³⁴⁰
- (6) Strengthening the statutory auditor by making it truly independent:
 - a. More active involvement during board meetings and arming statutory auditors with voting rights;
 - b. Introduction of non-statutory corporate executives (corporate officers) who will deal with day-to-day priorities of the corporation;³⁴¹
 - c. Providing statutory auditors with their own staff, budget and outside professional assistance;
 - d. A stricter definition of independent statutory auditor; and
 - e. The requirement of at least three statutory auditors for larger corporations, with all of them being independent;
- (7) Strengthening of the Committee System:
 - a. Creating clear distinctions between the committees in terms of functions;

338. In 2003, about one-third of sampled Japanese companies had appointed outside directors to their boards. See BEBENROTH & DONGHAO, *supra* note 282, at 25. This meant one or two outside directors for a 10-man board if they also chose to reduce the board's members. This is bound to increase in the coming years. In contrast, in 2005, a survey of the largest public companies in the United States, uncovered that 81% of companies had boards comprised of at least 75% independents. ABIGAIL ARMS, CORPORATE GOVERNANCE PRACTICES OF THE 100 LARGEST U.S. PUBLIC COMPANIES, IN CORPORATE GOVERNANCE 2005: DEALING WITH THE GOVERNANCE & DISCLOSURE CHALLENGES AHEAD 3 (Practising Law Inst. Handbook, No. 6273, 2004), http://www.pli.edu/emktg/compliance_coun/Corp_Gov10a.pdf.

339. Company presidents in general have the exclusive authority to appoint and dismiss executives and even directors. See Poe, Shimizu & Simpson, *supra* note 252, at 85.

340. The law requires that the board meet at least quarterly. NEW JAPAN CORPORATIONS LAW, <http://www.japanlaw.info/japancommercialcode/NEWCOMPANIESLAW.html>. In some companies, however, the plenary board meets once a month but the board's Senior Executive Committee or *Jomu-kai* meets twice a month or more.

341. This is intended to organizationally segregate the board from management so as to distinctly clarify the role of the directors and the managers. See Poe, Shimizu & Simpson, *supra* note 252, at 85. Moreover, the 2002 amendment allows for this.

- b. Establishment of the Audit, Appointment and Remuneration committees composed solely of independent directors;
 - c. Increasing adoption by companies to 250–350 listed companies; and
 - d. Correction of the weak and loose definition of independent/outside directors;
- (8) Creating a clear dichotomy between operations/management and supervision/monitoring;
- (9) Increasing openness of boards to shareholder activism of individuals and institutions (e.g. the Pension Fund Association), and to ordinary shareholder proposals, dialogues and resolutions:
- a. Elimination of *Shan-Shan* shareholder meetings in which managers deliberately assign employees to clap as long and as hard as they can whenever a shareholder raises a proposal or to support management;³⁴²
 - b. Full eradication of the *Sokaiya* (corporate gangsters) menace; and
 - c. Movement towards and cultural openness to a shareholder-oriented model;³⁴³
- (10) Systematic diminution of the cross-shareholding system since “the rate of cross-shareholding has been slightly increasing;”³⁴⁴
- (11) Full implementation of the 2005 Company Law (*Kaisha Ho*);
- (12) Increasing board openness to takeovers attempts, whether hostile or friendly;
- (13) Appointment of more foreigners (like Carlos Ghosn) to top positions;³⁴⁵ and
- (14) Increasing director pay to the level of the Organisation for Economic Co-operation and Development.³⁴⁶

X. CONCLUSION

The Japanese board is unlikely to reflect the U.S. board model anytime soon. The Americanization of Japan is unpopular amongst Japan’s older citizens, likely forestalling such a movement.³⁴⁷ However, the hybrid corporate governance form—particularly the reworked board of directors—

342. See LEARMOUNT, *supra* note 219, at 134 (“When the chairman announces the agenda, the employees clap and shout ‘we agree,’ so the chairman usually says that the agenda is carried – I think probably 70 percent of Japanese companies are still like this” in 2002.).

343. Suzuki, *supra* note 110, at 820.

344. See Osugi, *supra* note 173, at 161.

345. Miki Tanakawa, *Imitating Mr. Ghosn in Japan*, N.Y. TIMES, May 20, 2001, §3, at 2.

346. To give Japanese directors more skin in the game; at the same time to serve as incentive to be informed, more responsive to shareholder concerns, and more professional in their approach. See generally Ira Millstein, *The Professional Board*, 50 BUS. LAW 1427 (1995).

347. See Hall, *supra* note 337.

will be reflective of many of the features of the U.S. model while still retaining some of the qualities of the post-war model. In that way, it will have a Japanese twist.

A few years ago, it was feared that barbarians (a.k.a. reformists) were edging ever closer to Japan's gates. It is too late: the barbarians are already operating within the gates,³⁴⁸ and will open the palace gates for anyone wishing to enter the imperial grounds. Nevertheless, the barbarians are still few.

Will more independent and fewer grey directors speed the evolution of the Japanese board of directors? To a certain extent, yes, but it will take much greater time and effort for an overhaul to be completed. Impatient U.S. and U.K. interests may simply move their funds elsewhere or not invest at all. But in those cases, they will miss out on an excellent investment opportunity. The Tokyo Stock Exchange is still the second largest securities exchange in the world in terms of market value,³⁴⁹ just behind the New York Stock Exchange. Moreover, it is undeniable that change for the benefit of shareholders is creeping up in Japan, and it is taking one careful step at a time. Are real changes forthcoming? Time and experience will be the ultimate judges. For now, changes lie somewhere between cosmetic reform and real reform. The corporate governance facade is being altered but it is still uncertain how deep the changes will go and if the corporate decision-makers will follow them.

As aptly written by a renowned Japanologist, "[it] seems unlikely that countries can embrace the shareholder supremacy norm for corporate activity without wholesale revision of deeply entrenched views and practices in other areas of society."³⁵⁰ Despite recent changes, Japan should further legislate, implement and adhere to continuing corporate governance reforms, lest it be viewed that the independent director under the 2005 Company Act is just a mere Potemkin Village.

348. This raises some fears within the Japanese business community, much like how the Household International board was very fearful and uneasy with Moran not only being one of their directors but who was then exploring the possibility of a leveraged buy-out of the company by his D-K-M entity. Moran was a so-called "barbarian" who was not nearing the gates, but was a duly-elected director inside the board. The difference was that the Household International board had a legitimate fear of an imminent takeover, while the Japanese may just be cautious of foreigners generally. See *Moran v. Household International, Inc.*, 500 A.2d 1346 (Del. 1985).

349. The Tokyo Stock Exchange has a market capitalization of 5 trillion dollars. See Ayny, *Tokyo Stock Exchange: 130 Years of Success*, ECOMMERCE JOURNAL, Dec. 11, 2008, http://www.ecommerce-journal.com/articles/11824_tokyo_stock_exchange_130_years_of_success.

350. Milhaupt, *Creative Norm Destruction*, *supra* note 90, at 2126–27.