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# The New World of Corporate Lawyering in Japan

Eric Sibbitt\*

## I. BACKGROUND

Tokyo used to be a sleepy little legal market for most US law firms. There were exceptions of course, but the Tokyo presence of a number of international firms with a Tokyo office amounted to a single partner. In fact, while firms may have made grander claims as to the number of resident lawyers, some Tokyo offices of major international firms comprised nothing more than an ill-attended fax machine and a skeletal secretarial staff, supplemented, on an as-rarely-needed basis, by visiting lawyers from other offices. Many of the lawyers that did reside full-time in Tokyo offices spent a significant portion of their time knocking on doors in Japan and other countries in Asia, or assisting with overflow work from deals originating in Hong Kong and elsewhere. That has all changed.

Despite a prolonged economic recession in Japan—or perhaps more correctly because of it—and a downturn in the world economy, the Japanese offices of many major international law firms have been busier in recent years in terms of average hours worked per lawyer than any other office in their global networks.

In fact, except for the grandfathering of a handful of foreign lawyers that began practicing in Japan within a few years after the end of the Second World War, it is only since 1987 that foreign lawyers were legally permitted to set up shop in Japan,<sup>1</sup>

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1. See Gaikoku Bengoshi Niyoru Horitsujimu No Toriatsukai ni kansuru Tokubetsusochi Ho [Act Providing Special Measures for the Treatment of the Performance of Legal Business by Foreign Lawyers], Law No 66 of 1986 (Japan), translated in Zentaro Kitagawa, ed, Stat Vol 2 *Doing Business in Japan* app 6B, rel 23, Aug 1997 (Matthew Bender 2002); Gaikokubengoshi ni yoru Hōritsu Jimu no Toriatsukai ni kansuru Tokubetsusochi Hō no Shikō Kijitsu o Sadameru Seirei [Cabinet Orders and Ministerial Ordinances Relating to the Act Providing Special Measures for the Treatment of the Performance of Legal Business by Foreign Lawyers: Cabinet Order Determining the Effective Date of the Act Providing Special Measures for the Handling of Legal Business Performed by Foreign Lawyers], Cabinet Order No 29 of 1987 (Japan), translated in Zentaro Kitagawa, ed, Stat Vol 2 *Doing Business in Japan* app 6C, rel 9, Oct 1987 (Matthew Bender 2002).

and even then under restrictive conditions designed to thwart their success and limit their influence on the practice of law in Japan. Foreign lawyers had to go through a lengthy application process to claim the lofty title of *gaikokuho gaikoku-jimu bengoshi* (“foreign law solicitor” or “GJB,” as foreign lawyers use the term), could not hire or form partnerships with Japanese lawyers, and were restricted in their ability to use their firm’s name. A number of gradual reforms have encouraged the emergence of a less abnormal market for international legal services in Japan, though remaining restrictions continue to retard the emergence of Japan as an international legal services market consummate with its global economic importance. Prominent GJBs in Tokyo seeking “unrestricted freedom of association” between foreign and Japanese lawyers continue to go head-to-head with protectionist elements within *Nichibenren* (the Japan Federation of Bar Associations). Even today, foreign law firms cannot hire Japanese lawyers directly (though curiously, foreign businesses can) nor form partnerships with Japanese lawyers, though a number of firms have taken advantage of a limited form of joint venture, unique to associations of non-Japanese lawyers with Japanese lawyers, called a *tokutei kyodo jigyo* (“joint specified enterprise”).

I am an associate at the Tokyo office of Sullivan & Cromwell, an office that, including the two Japanese lawyers in the *tokutei kyodo jigyo*, has grown from five lawyers to twelve in the three years since I transferred to Tokyo from the New York office. The former office was a three-lawyer office suite located in the metallic gray halls of a Japanese insurance company and facing the grounds of the Emperor’s residence. Air-conditioning at the old office shut off automatically at 6:00 p.m., presumably not a problem when working past that time may have been less common, but, if the workload warranted it, it gave rise to literal “sweatshop” conditions during the humid summer months in Tokyo. My first workspace there was the one and only conference room, overlooking the train platforms and bullet trains of Tokyo Station. Soon after my arrival, however, we moved into more spacious digs in one of the most modern office buildings in Tokyo—a move motivated by a skyrocketing increase in demand for international legal services. The new space is now fully occupied, and the Tokyo office has been perhaps the busiest office of the firm in recent years on a per lawyer basis. Although twelve lawyers is a small number for a major firm in most other major legal markets, it is larger than the size of most Japanese firms, a mid-size presence for the Tokyo office of a US law firm, and the largest US law office in Tokyo focusing on capital markets work. The office was one of the first to take advantage of the *tokutei kyodo jigyo* arrangement and has participated, on the underwriter or issuer side, in a majority of the initial listings of Japanese companies listed on the New York Stock Exchange or quoted on the NASDAQ National Market.

## II. TRANSFORMATION OF THE JAPANESE FINANCIAL AND LEGAL MARKETS

The work of international law firms in Tokyo may be roughly divided into "inbound" work from foreign clients conducting activities in Japan and "outbound" work for Japanese companies conducting work abroad. Examples of inbound work include the purchase of a stake in or assets of a Japanese company or entering into a joint venture. Although inbound work typically involves large elements of Japanese law, foreign firms are often retained for their expertise in cross-border transactions and transactions with legal implications in multiple jurisdictions or to supervise the coordination of legal advice. Outbound work includes selling securities abroad and overseas acquisitions. Outbound work may be conducted directly in the Tokyo office, or the Tokyo office lawyers may serve as intermediaries for work conducted by lawyers located in other offices.

Although the work in which I have been involved in Tokyo includes as diverse areas of corporate law as syndicated lending, joint venture work, and mergers and acquisitions, perhaps 80 percent of my time in Tokyo has been devoted to securities offerings by Japanese issuers. The balance of work at other firms differs. Some firms have churned out significant numbers of hours on securitizations, mergers and acquisitions, and general corporate work. Firms such as Tokyo Aoyama Aoki/Baker & McKenzie and White & Case have even emerged as relatively large providers in Japan of a wide range of legal services, even covering some domestic litigation and tax advice.

Several years ago, there would have been virtually none of the capital markets work that now occupies most of my time. Why this transformation? Part of the reason is that many Japanese companies simply have little choice. Back when authors were writing about "Japan as number one," large sectors of the Japanese economy had seemingly unlimited access to cheap domestic capital, primarily debt financing from Japanese banks often within the same corporate group or *keiretsu*. Japanese issuers could also supplement this funding source with debt offerings in the euromarkets. With the collapse of the stock and land price bubble and over a decade of economic stagnation, access to cheap domestic capital has become less readily available. Even though Japanese interest rates remain virtually zero, it is difficult for many companies to borrow money. Japanese financial institutions have focused on their massive debt problems and have become more conservative in their lending practices. More generally, international lending to Japan has been subject to a "Japan premium" and a number of previously creditworthy companies have seen their ratings from international agencies downgraded. At the same time, tapping the European markets for cheap debt has become more costly for many companies than in the past, or in some cases impossible. In the current environment, the only debt financing vehicles for many companies are high-yield or convertible bonds, permitting the investor to claim a higher priority than a shareholder in the event of bankruptcy. The collapse of

the Mycal supermarket chain even put a partial temporary stop to new issuances in the commercial paper market in Japan. In short, the cost of capital has been raised and the ability to access domestic capital has been reduced for many companies in Japan. The difficulty in accessing cheap debt capital has contributed to the demand for capital-raising on the equity markets. This trend reinforces the longer-term trend away from an economy dominated by direct financing (for example, loans from banks) to indirect financing (for example, securities offerings).

A domestic stock market that seems to be in perpetual decline can absorb only a limited amount of new equity issuances. Companies wishing to raise capital through new issuances must also compete with existing shareholders desiring to unload shares, including company founders seeking to cash out and other shareholders desiring to reduce their equity holdings. Competition for investor money in a declining market is increased by periodic government sales of enormous stakes in formerly wholly government-owned companies. The deficit-ridden government and its budget-makers in the Ministry of Finance have made sell-offs in government-owned companies a regular part of their budget calculations. Companies restructuring their operations, a number of whom have suddenly taken a seemingly first time interest in return on equity, have felt pressure to reduce their *mochiai*, or cross-shareholdings, the equity glue that holds together the once vaunted *keiretsu*. Mergers among bank institutions have led to additional pressures to sell in order to avoid violating anti-monopoly law limits on shareholding percentages in operating companies by financial institutions. The convergence of such selling pressures has put substantial downward pressure on stock prices in Japan.

Under such conditions, existing shareholders wishing to sell shares may consider several options. They could gradually sell off these shares in the market, but this may lead to sustained downward selling pressure on the stock, limiting the ability to realize the best price for the holding. Moreover, the thin trading volume of many Japanese issues, partially the result of the fewer number of shares and higher price of those shares, may mean that a gradual sell-off may be difficult to achieve and may require an extended period of time. A holding could also be reduced through a large privately negotiated "block-trade" of a large holding, but finding a willing buyer of such large stakes in a stagnant market is not easily done.

Increasingly, the alternative has been to do an underwritten offering of the stock to attempt to increase investor interest, diversify the investor base and thereby increase demand for the stock, and boost the stock price, or at least retard downward pressure on share prices. Issuer involvement is necessary to produce an offering document with adequate disclosure, and issuers are often willing to undertake and even bankroll such offerings for the purposes of reducing selling pressure and maintaining good relations with their larger shareholders. Increasingly, rather than doing an offering only in Japan, these offerings have been also directed outside Japan, primarily to the United States and Europe. Expanding beyond Japan increases the potential market for the shares, reducing short-term selling pressure in the Japanese

market by reaching out to a broader community of investors. In some instances, the pricing on foreign markets may even be more attractive, as was true for a number of technology-related offerings in the United States at the height of the Internet bubble.

Issuers opting to do an offering abroad, whether a secondary offering of the existing shares of certain shareholders, a primary offering of newly issued shares to raise capital for the company, or a combination of the two, face a fundamental choice between doing a public offering or a private placement. Due to a variety of reasons—including the onerous ongoing disclosure obligations associated with doing a public offering in the United States, the ongoing costs of preparing US GAAP financial statements or Japan GAAP financial statements reconciled to US GAAP, and the fear of increased exposure to litigation in the United States—the majority of Japanese issuers have traditionally opted for a private placement done pursuant to Regulation S and Rule 144A. For some, such a private placement may be a “one-off” offering to raise money for the company or reduce the stake of an existing large shareholder, while for others this may be a “toe-in-the-water” offering preparing the company for a later public offering and listing.

An increasing number of Japanese issuers, however, have opted to do public offerings. The number of Japanese issuers choosing to list in the United States, even without an offering, has also been increasing dramatically. Listings on exchanges are generally driven by a combination of factors. Listings may be motivated by a belief that a larger investor base, higher valuations, and a greater number of financing options—and hence a lower cost of capital to the company—could be achieved by listing abroad. For some, listing in the United States provides a stock currency with which to make acquisitions in the United States. Others see listing as a means of acquiring added prestige and drawing attention from investors, analysts, the media, and potential business partners. Still others are motivated by the desire to “internationalize” by subjecting themselves to the rigors of international investor scrutiny and disclosure requirements. In this regard, although the rash of disclosure-related scandals has somewhat tarnished the reputation of US capital markets, the speed with which the United States has responded with legislative and regulatory reforms has impressed many Japanese observers used to a slower, more gradual approach to reform. Listing in the United States and complying with what are widely regarded as more stringent disclosure standards are still seen as a hallmark of transparency in Japan.

Listing on an exchange generates further ongoing legal work as foreign issuers strive to meet ongoing disclosure obligations. Issuers require legal services from US-qualified attorneys, ranging from assistance with the preparation of annual reports on Form 20-F, review of English language press releases and certain interim disclosures on Form 6-K, and review of compliance with additional requirements for the exchanges on which they list, to coordination of the timely disclosure of information in multiple countries.

### III. THE PRACTICE OF LAW IN TOKYO

Practicing US law in the Tokyo office of a New York firm sometimes has a bit of a frontier feeling to it. Foreign offices such as those in Tokyo are thinly staffed, perhaps due in part to the expense of expatriate employees and the dearth of qualified professionals with the appropriate language background and a desire to live abroad for years at a time. Without the same hierarchy one would face in New York, an associate in a foreign office at any given level of seniority probably has more responsibility, and as a result more is expected of a lawyer, than an associate at the same level of seniority in New York. With a limited number of lawyers and a greater degree of mutual interdependence than would generally be true in a large office environment, the *esprit de corps* is probably also higher than would be typical in a large office. More senior lawyers have a vested interest in ensuring that more junior lawyers are developing the proper skills, as it will make their lives easier later on. This contrasts with the situation at the junior level in many firms in New York, where after working with someone once you may never see them again. On the downside, the range of work tends to be more limited, the workload is onerous, and downtime between transactions is minimal. Working on international transactions from a foreign office also requires long and irregular hours, as lawyers must coordinate with clients, lawyers, and regulators in multiple time zones.

While in the past it was not uncommon for meetings to be in English or for professional translators to be provided to translate for non-Japanese-speaking foreign lawyers, this is less common today. Although many companies have a few employees adept in English, this typically does not extend to most members of the company, particularly senior management. As a result, with the exception of some drafting meetings involving discussion of English documents, most of the meetings I attend and conversations I have with clients are conducted primarily or entirely in Japanese. However, non-Japanese-speaking attorneys also play significant roles in the practice of law in Japan, as documentation remains primarily in English and language ability is not a proxy for legal expertise.

Lawyers are generally more highly regarded in Japan than in the United States. This probably stems in part from the approximately 3 percent passage rate for the test to enter the sole training institute for lawyers in Japan (*Shiho Kenshujo*), and from less of an association of lawyers with excess litigiousness. In addition, there are a limited number of US lawyers in Japan. Issuers tend to rely more on foreign lawyers than domestic clients would in the United States, because of the language barrier and limited familiarity with US regulations. Lawyers not only translate the law, but serve as intermediaries between the client and a different legal and business culture and approach to regulation.

The globalization of financial markets also requires that the practice of securities law be multi-jurisdictional. A securities offering by a Japanese issuer may involve multiple offerings and possibly separate syndicates of underwriters in Japan, the

United States, and elsewhere. An overseas offering requires preparation of an English language prospectus and hiring of foreign lawyers, accountants, and investment bankers. The issuers and underwriters will typically have their own separate Japanese counsel and US counsel. The issuers will also have Japanese and/or US qualified accountants working on the financial statements, depending on whether the financial statements are presented in US GAAP or Japanese GAAP. The inclusion of UK, Hong Kong, Singapore, Japanese, Italian, German, Dutch, and other legends in the document, depending upon where the securities may be sold, may also entail review by lawyers qualified in other jurisdictions. Publicity and research report guidelines must also be devised to ensure compliance with restrictions in multiple jurisdictions.

#### IV. IMPACT OF US LAW ABROAD

From Tokyo, one can also see the impact of US regulations abroad. The Investment Company Act of 1940,<sup>2</sup> for example, prevents a number of otherwise willing Japanese companies from listing or engaging in capital-raising efforts in the United States. The Investment Company Act generally deems companies with "investment securities" exceeding 40 percent of their non-cash assets to be investment companies, subjecting such companies to regulation like a mutual fund. The 40 percent standard was devised in the context of what typical US operating companies looked like at the time of its enactment. However, of particular significance to Japanese companies, the term "investment securities" generally includes minority shareholdings in other companies. In Japan, the business practice of maintaining cross-shareholdings in the range of 1 to 5 percent in business partners and affiliated companies means that a number of companies exceed or come close to this threshold. Companies that come close to the 40 percent threshold and wish to raise capital in the United States must carefully monitor their holdings and generally have to sell off securities and maintain massive amounts of cash in bank accounts or US Treasuries.

US tax laws can also have adverse effects. For example, passive foreign investment company ("PFIC") rules, designed to prevent US investors from avoiding tax on passive assets (such as rent or royalties) by using foreign corporations to hold these assets, have the effect of creating potential material adverse effects for US investors holding ADRs or shares in a foreign company deemed to be a PFIC. Although PFICs occasionally list on US exchanges and conduct offerings in the United States, the regulations potentially subject holders of shares in these companies to more onerous tax and reporting obligations.

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2. Investment Company Act of 1940, 15 USCA §§ 80a-1 et seq (1997 & Supp 2002).



The recently passed Sarbanes-Oxley Act<sup>3</sup> has also caused concern in Japan. Japanese issuers have traditionally been granted “home country” exemptions from the corporate governance requirements of the New York Stock Exchange and NASDAQ marketplace rules to the extent home country practice diverges from these requirements. For example, very few Japanese companies have independent directors or audit committees, and instead are required to appoint *kansayaku* (“statutory auditors”) in addition to the board of directors to perform various oversight functions. Although the extent to which a number of the provisions of the Sarbanes-Oxley Act apply to foreign issuers is currently unclear, the sweeping provisions of the act appear to require stricter disclosure requirements and potentially changes in corporate governance requirements. It is unclear whether the new law may dissuade some Japanese issuers from participating in the public US capital markets or whether it will come to be seen as merely an additional cost to access the most important public capital markets in the world.

## V. CONCLUSION

The frenetic pace of activity for US transactional lawyers in Japan is likely to continue, though it may be slowed by the recent dips in financial markets worldwide and the environment of regulatory uncertainty in the United States created by the Sarbanes-Oxley Act. The unabated globalization of financial markets and trade means that cross-border legal services will continue to flourish. The need for efficient provision of international legal services will encourage more collaborative effort among Japanese and US counsel, and may also eventually encourage the Japanese government to move further toward the “freedom of association” among legal professionals characteristic of other leading OECD countries. Against this backdrop, Tokyo will remain an interesting vantage point from which to observe and participate in the ever-increasing globalization of the practice of corporate law.

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3. Sarbanes-Oxley Act of 2002, Pub L No 107-204, 116 Stat 745 (2002), to be codified at 15 USCA §§ 7201 et seq (Supp 2002).