Chapter 4

Corporate Governance and M&A

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1. OVERVIEW

This chapter surveys the recent evolution of two closely-linked areas of Japanese law – the law of corporate governance and the law of mergers and acquisitions. In the last decade, the legal framework for corporate governance and M&A in Japan has evolved significantly, and in a clear direction. The relevant statutes have been revised and supplemented so as to reinforce the core values of shareholder democracy, management accountability, disclosure and transparency. Court rulings, the volume of which is increasing as old inhibitions against litigation fall away, articulate, extol and apply the same values.[1] But the most dramatic changes have not been in the specific content of statutes or court rulings – those changes have in fact been incremental – but in a qualitative shift in behavior, attitudes and enforcement. Japanese M&A and corporate governance law – the basic framework of which has been officially in place for many decades – now actually shapes corporate behavior and practice, in a way that is not too different from the way it does in the U.S.

1. For examples of recent litigated cases in the M&A context, *see* Section IV below. *See also*, Carl F. Goodman, 'The Somewhat Less Reluctant Litigant: Japan's Changing View Towards Civil Litigation,' 32 Law & Policy Int'l Bus. 769 (2001).

Gerald McAlinn, *Japanese Business Law*, pp. 143–172.

or Europe.[2] The institutions and legal framework are more transparent than ever, and there is wide acceptance – not simply lip service – for the proposition that the system should operate to maximize corporate value on behalf shareholders.

It was not always so. There are deep-rooted cultural and historical reasons why the model of shareholder democracy, the classical separation of powers, authority and function between a company's management and its owners, was observed in the breach in Japan.[3] That a shareholder democracy model of corporate governance and M&A is gaining traction and legitimacy reflects momentous changes in the structure and fabric of Japanese politics, the economy and society. As discussed more extensively in Section 3, it cannot be understood in isolation from the larger context of the unraveling of the ecology of an older and very different era.

Corporate governance and M&A now dominate the headlines and grip the nation's attention. The ownership structure of public corporations is undergoing rapid readjustment, dramatic contests for control being a highly visible tip of a larger iceberg.[4] As discussed in Section 4, dynamic change in corporate ownership is in turn putting pressure on the legal framework for corporate governance in general and changes in control itself, and more fundamentally the capacity of the legal system itself to keep up. It is still unclear where, when and how a coherent equilibrium will find itself.

The recent arrests of Takafumi Horie of Livedoor and Yoshiaki Murakami of M&A Consulting, two of the leading practitioners of hostile M&A, underscore that this is a dynamic work in progress, and the denouement is yet to come. Prior to their arrests, Horie and Murakami had become household names in Japan for their involvement in a series of front page acquisition attempts, many of them antagonistic to the interests and style of the Japanese business establishment. Both were arrested in 2006 for alleged criminal conduct related to their M&A activities. The arrests, according to one reading in fashion in the Western financial press, indicate that the Japanese establishment is closing ranks and punishing brash upstarts who are trying to open up the market for corporate control on behalf of shareholders. But other readings are equally plausible. The arrests appear to be based on evidence of securities fraud and insider trading, which have been only sporadically prosecuted in the past. If the arrests foreshadow strict, transparent and consistent enforcement of the securities laws, then the implications for the future

2. *See* Curtis Milhaupt, 'In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan,' 2005 Columbia Bus. L. Rev. 2171 (2005).
3. For a critical summary of academic literature positing that Japanese managers have historically been free to ignore shareholder interests, *see* Steven N. Kaplan and J. Mark Ramseyer, 'Those Japanese Firms with Their Disdain for Shareholders,' 74 Wash. U. L.Q. 403, 405 *et seq.* (1996).
4. For data on post-War shifts in ownership of public companies, *see* K. Miyajima, K. Haramura and K. Enan, '*Sengo Nihon no Kabunushi Shoyu Kozo: Antei Kabunushi no Keisei to Kaitai*' (The Structure of Post-War Share Ownership: The Composition and Break-Up of Stable Shareholders) PRI Discussion Paper Series (No.03A – 13) Ministry of Finance, Policy Research Institute (2002).

point in quite a different direction that will make the Japanese securities markets much more like their counterparts in the US and Europe.

2. JAPAN, INC. AND POST-WAR 'CORPORATE GOVERNANCE'

It is often overlooked that Japan has enjoyed a Commercial Code reflecting the ideals of shareholder democracy for over half a century. As the result of Japan's defeat in the Second World War and the work of Occupation lawyers in the late 1940's, Japan's basic framework of commercial law was re-written in the American image.[5] The chapter of the Commercial Code dealing with corporations was revised in 1950, closely to mimic the shareholder-friendly Illinois Corporation Code, complete with fiduciary duties for directors, shareholder derivative suits, and familiar protections for minority shareholders. The Americans also broke up the *zaibatsu* (industrial conglomerates), introduced antitrust laws patterned on the Sherman Act and set the stage for broadly-distributed public share ownership. To complete the picture, they introduced securities laws, patterned on the 1933 and 1934 U.S. Securities and Securities Exchange Acts, providing for robust corporate disclosure and market transparency.[6]

Copying and pasting enlightened concepts of shareholder democracy onto post-War Japan did not work out according to the occupiers' plan. The legal machinery provided by the Occupation gathered dust on the shelves while the Japanese establishment lost no time in spinning the web of symbiotic relationships between politics, government, business and organized crime known as 'Japan, Inc.'[7] The entire phenomenon of Japan, Inc. was antithetical to the values and assumptions of classical shareholder democracy. So long as the institutions and mentality of Japan, Inc. reigned, the shareholder-friendly legal machinery conferred on Japan after the war lay dormant.

It is no accident that the separation of roles among directors, executive officers and shareholders echoes the classical Liberal separation of powers among the three branches of government. But the assumptions and attitudes of Liberalism and atomistic individualism, which are second nature to Westerners, are not so obvious in a society and culture based on harmony, group identity, status and

5. *See* Mark D. West, 'The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States,' 150 Univ. of Pennsylvania Law Review 527 (2001).
6. Eric C. Sibbitt and R. Daniel Kelemen, 'The Americanization of Japanese Law,' 23 U. Pa. J. Int'l Econ. L. 269, 303 (2002)
7. For origins of the term 'Japan, Inc.' *see* 'Japan, Inc. Was One Big Happy Family, But Now It Has Become Dysfunctional,' *The Wall Street Journal,* April 27, 2000. For an account of the triangular relationship among the Japanese bureaucracy, politics and business interests, *see* Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy 1925–1975* (Stanford University Press 1982), p. 20.

hierarchy. Japan has never adopted the Western 'adversarial' model that is at the heart of classical Liberalism.[8]

Japan's forgiving attitudes toward conflicts of interest and fiduciary duties are just one expression of an essentially feudal mentality. It should come as no surprise that, for example, Japanese legal academics and courts have had a hard time making sense of the American concept of a director's fiduciary duty.[9] Article 254-3 of the Commercial Code, the provision imposing a separate duty of loyalty on directors, was forcibly grafted onto the pre-War Commercial Code by Occupation lawyers and thereafter remained dormant for forty years.[10] For most Americans, the distinction between a director's duty of care (reflecting a concept of negligence) and a director's duty of loyalty (entailing prohibitions against self-dealing, conflicts of interest, etc.) are very clear – the two are qualitatively different. Japanese academics and courts, however, spent a great deal of time pondering whether the duty of loyalty (*chujitsu gimu*) imposed on Japan by the Occupation was distinct from the duty of care (*zenkan chui gimu*) that had been part of the pre-War Commercial Code. They concluded that the two duties were essentially the same, and that the Americans, by adding the fiduciary duties, had simply added suspenders to a statute that already had a belt.[11]

During the 40 years following the end of the Occupation, virtually no shareholder actions were brought to enforce the laws on the books, despite a corporate culture and practices that should have provided irresistible targets for shareholder claims.[12] Similarly the securities laws went largely unenforced, notwithstanding poor to non-existent financial disclosure, and routine insider trading and market manipulation. The antitrust laws on the books did little to prevent widespread cartels and bid rigging. The legal machinery existed to enable changes in corporate control, both friendly and hostile, but in fact corporate control rarely changed hands. When corporate control did change hands, it typically did so under colorfully murky circumstances.

The following brief sketches of two post-War takeover transactions – one from the 1950's, another from the 1980's – impressionistically suggest the way in which government officials, politicians, the business establishment, backroom 'fixers' and the underworld formed a seamless (and seamy) web of interdependence that

8. The shareholder democracy model embodied in the law thrust upon Japan after World War II, of course, was a branch of the larger tree of classical Liberalism itself. The classical Liberal model, in a variety of contexts beginning with Adam Smith, holds that the clash of individual wills and appetites and opinions in an open and democratic marketplace maximizes collective welfare. The adversarial legal system, the 'marketplace of ideas,' and the ideal of shareholder democracy itself are all expressions of Liberalism.
9. Hideki Kanda and Curtis J. Milhaupt, 'Re-Examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law,' 51 Am. J. Comp. L. 887, 892 *et seq*. (2003)
10. *Id*. at 897.
11. *Id*. at 895.
12. Bruce E. Aronson, 'Reconsidering the Importance of Law in Japanese Corporate Governance: Evidence from the Daiwa Bank Shareholder Derivative Case,' 36 Cornell Int'l L.J. 11, 22 (2003).

deviated from the idealized norms of shareholder democracy. Within this environment, the legal system was largely irrelevant and impotent.

Hideki Yokoi was a raffish, bow-tied character who died in 1999 disgraced, in jail, and the nominal owner of the Empire State Building.[13] He made his early fortune in the black market following the War. In 1953, he turned his eye to Shirakiya, a venerable clothing maker and retailer founded in 1662. Yokoi shrewdly sensed a vulnerable target when a Shirakiya subsidiary failed to deliver a large order of underwear Yokoi's company had placed. Chiba Bank sponsored the takeover, financing Yokoi's accumulation of shares in the open market and enlisting the president of Nikkatsu Films, who owned 20% of Shirakiya, as a confederate. Yokoi hired the Tajima *sokaiya*[14] organization to support his bid; for the takeover defense team, Shirakiya management hired the equally powerful Kubo *sokaiya* group. Kubo added the Sumiyoshi *yakuza* gang to the defense team, while Tajima countered by signing up the Ando *yakuza* gang as well as the Ginza police.

Showing a command of legal as well as illegal tactics, Kubo alertly noticed that one of Yokoi's companies was in the textile business, which would create an antitrust issue if combined with the Shirakiya clothing business. Shirakiya successfully obtained an injunction against Yokoi stopping him from exercising the voting rights attached to his stock, which made the stock worthless as a means of obtaining control. In response, Yokoi called in his *yakuza* to break up the next Shirakiya shareholders meeting before the voting could be completed. The meeting was rescheduled for a later date, on which date Yokoi held his own bogus 'shareholders meeting' and raced to file his own slate of 'directors' with the Legal Affairs Bureau where the corporation was registered before the real Shirakiya shareholders vote was completed and could be filed. Shirakiya management was paralyzed for the next year and a half until the Tokyo High Court finally ruled that the Yokoi slate of 'directors,' after all, had no status.

To take an example from a more recent era, in 1986 Sumitomo Bank set its sights on Heiwa Sogo Bank (HSB), a Tokyo-based bank in a financially weakened

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13. Material on Yokoi is based on Takashi Arimori, Hishi: Nottoriya (*Secret History of Nottoriya*), pp. 64–86 (2006).
14. *Sokaiya* are a species of relatively minor league gangster who, as their name indicates (*sokai* = general shareholders meeting) make their living as protection racketeers, often posing as social activists, who pressure public companies to pay money (or take out very expensive magazine subscriptions) to avoid unpleasant disruption at the annual shareholders meeting. Until recently most public companies routinely and quietly paid off *sokaiya*. To give some sense of the seriousness and scope of the *sokaiya* phenomenon even very recently, in 1994 the chief of the General Affairs Department of Fuji Film, who had resisted demands for money from a *sokaiya* group, was found stabbed to death at the entrance to his own home. In 1996–1997 the police and prosecutors mounted a concerted crackdown on *sokaiya*, which flushed out illegal *sokaiya* payments, among others, by all of the then 'Big Four' securities companies, Dai-Ichi Kangyo Bank, Ajinomoto, Takashimaya and Mitsubishi Motors. For an account of the role of *sokaiya*, *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 (1999).*

condition.[15] HSB hired Susumu Ishii, a 'fixer' with ties to LDP boss Shin Kanemaru as well as the Aizu-kotetsu *yakuza* organization, to head its 'takeover defense team.' Ishii had a debt of gratitude to HSB because it had financed his mistress's mansion while he was in prison. Ishii set to work and arranged a transaction under which HSB would buy back the shares of a 33% shareholder also being stalked by Sumitomo Bank. A Ginza gallery owner, a close personal friend of the large shareholder, was recruited to persuade the shareholder to sell his shares back to HSB. The gallery owner demanded payment for his services in the form of a purchase by HSB of a gold screen, worth JPY 120 million, for four billion yen. The negotiations over the gold screen were coordinated in the back room of the gallery by the private secretary of Noboru Takeshita, the sitting Finance Minister (who, in that position, had the authority to approve the HSB acquisition) and Kanemaru's choice to succeed Yasuharu Nakasone as Prime Minister. Proceeds from the sale of the gold screen were shared by Ishii and Takeshita. To complicate matters, having taken the money, Ishii was unable to persuade the large shareholder to sell his shares back to HSB, or perhaps intended to double-cross HSB all along. Upset at being duped, HSB retaliated by hiring an obscure *yakuza* group to tail Takeshita day and night with loudspeaker trucks blaring 'praise' for him as a 'reform' candidate as a way of undermining his bid to become the next Prime Minister.

These episodes anecdotally illustrate the extent to which Japan deviated from the pristine ideal of shareholder democracy during the extended post-War period. Nor were the attitudes and conduct illustrated confined to shareholder meetings and M&A transactions. Lawlessness and corruption were an essential ingredient of the total ecology of the Japanese establishment of the post-War period. Construction companies competing for a public works contract during that period, for example, would have enlisted the aid of the much the same cast of politicians, fixers and gangsters. And it is a safe bet that the winner of the contract would not have been selected by a process of open bidding, any more than that a takeover bid would be decided by a clean tender offer or proxy contest.

3. THE UNRAVELING OF JAPAN, INC.

The emergence of shareholder democracy in Japan coincided with a sequence of changes, some legal but mostly non-legal, that led to the dismantling of the entire edifice of institutional relationships within Japan, Inc.

3.1 Unmasking of the Bubble Economy

The first serious blow to Japan, Inc. was the collapse of the Bubble Economy starting in 1991. The collapse of the Bubble exposed and discredited the seamier side

15. This account of the Heiwa Sogo incident is based on Peter B. E. Hill, *The Japanese Mafia: Yakuza, Law and the State*, Chapter 6 (Oxford University Press 2005).

of Japan, Inc. There was a morning-after realization that the 'partnership' between government and industry that had led to the Japanese 'economic miracle' of the 1950's and 1960's had evolved, under the administration of Prime Minister Kakuei Tanaka and after, into something more sinister and corrupt. In the aftermath of the Bubble, it became clear that large segments of the economy had been infiltrated by organized crime.[16] Japanese politicians and government officials were exposed as active participants in and beneficiaries of the 'excesses' of the Bubble Economy.[17] In the process, Japan, Inc. lost its legitimacy and something new had to be created to take its place. The post-Bubble re-invention of the Liberal Democratic Party, the conservative ruling party identified with big business and pork barrel politics, as the party of reform and deregulation is one of the more significant results of the de-legitimization of the decadent Bubble Era version of Japan, Inc.

3.2 Globalization of Financial Markets in Particular

If the collapse of the Bubble was the set-up punch, globalization was the take-down blow for Japan, Inc. While Japan was still reeling from post-Bubble shock, the multi-faceted economic and technological forces of globalization – the Internet and information technology revolutions, the rise of round-the-clock trading in the financial markets, the emergence of China and India – forced Japan, willing or not, to play by the same rules as the rest of the world. Above all, globalization of financial markets and the penetration of foreign financial services firms, investors, attitudes and techniques in the once-protected Japanese capital markets, opened up a new era of M&A and corporate governance norms.[18]

Roppongi Hills, Tokyo's newest and most spectacular office complex, and its tenants symbolize the impact of financial globalization on Japan, and M&A in particular. Roppongi Hills is home to Goldman Sachs and Lehman Brothers, now in the top tier of investment banks in Japan, Murakami's M&A Consulting, and Horie's Livedoor prominent players in contemporary Japanese M&A before the arrests of their founders, as well as Hiroshi Mikitani's Rakuten, an Internet virtual mall that has actively projected itself into front page contests for control.

As antithesis to Japan, Inc., the very location of Roppongi Hills is telling. It is located in the Tokyo equivalent of Midtown Manhattan, as opposed to the Marunouchi financial district that, one short generation earlier, was the *de rigueur* address of blue chip financial institutions and corporations. Goldman Sachs and other non-Japanese securities firms have, during the last decade, demoted the

16. For example, following the collapse of the Bubble, it was revealed that a large component of the bad debt problem was attributable to shady loans by so-called *jusen*, unregulated, credit companies, to yakuza-controlled shell entities. Peter Hartcher, *The Ministry: The Inside Story of Japan's Ministry of Finance* (Harper Collins 1998) p. 128.
17. In 1993, for example, Liberal Democratic Party Vice Chairman, Shin Kanemaru, was indicted for tax fraud and bribery and exposed as having yakuza ties.
18. *See* Takatoshi Ito and Michael Melvin, 'Japan's Big Bang and the Transformation of Financial Markets,' National Bureau of Economic Research Working Paper (1999).

former Big Four Japanese securities firms (Nomura, Daiwa, Nikko and Yamaichi) to second tier, and largely domestic, status.[19] The Japanese Big Four were simply not equipped to compete in a world of round-the clock trading, relentless product innovation, sophisticated communications and information processing technology, not to mention the end of overt protectionism and the heavy paternalistic hand of the Ministry of Finance.[20]

Livedoor and Rakuten are emblematic in their own way. Both were new companies, operating in the New Economy. Their founders consciously and proudly projected an anti-establishment aura. Both companies grew rapidly by a combination of organic growth and M&A. As time went on, and as will be looked at in more detail below, it became less clear whether these companies were really conventional operating companies making strategic acquisitions to supplement their core businesses, or the operating businesses were simply window dressing for a core business most accurately characterized as M&A arbitrage. That these two companies were just an elevator ride away from three of the most powerful M&A intermediaries and financiers at work today, and that some combination of Roppongi Hills tenants has been involved in many of the recent headline-making deals, reinforces the perception that their core business is M&A itself.[21]

3.3 Repression of Organized Crime

One of the most profound – but often unremarked – changes in Japanese corporate governance and M&A during the last decade has been the virtual elimination of organized crime from the scene. As a result of coordinated enforcement by police and prosecutors, *sokaiya* activity appears to have been shut down in major public corporations during the last decade.[22] Nor is there any evidence that old-fashioned payoffs to politicians or regulators, or the use of mob muscle, have been involved in any recent M&A deals of any significance. As recently as ten years ago, however, the underworld continued to cast a long shadow.

3.4 Unwinding of Stable Shareholdings; Erosion of Lifetime Employment

A large and slow-moving non-legal reason for the historically low volume of Japanese M&A as well as management insensitivity to return on investment and other

19. Yamaichi collapsed in 1997 and no longer exists.
20. Lee Branstetter, 'The Japanese Economy, Banking Industry and Securities Markets at the Turn of the Millennium,' Chazen Web Journal of International Business (Spring 2003) http://www-1.gsb.columbia.edu/chazenjournal/JapanSecMkts.pdf.
21. *See* 'The Big Wash: How Japan is acting to clean up its revitalised markets,' Financial Times, June 7, 2006.
22. Hill, note 15; Commercial Code Article 294-2 and Article 497 banning payments to *sokaiya* were enacted in 1982.

conventional shareholder concerns has been – and continues to be – that a majority of a public company's shares tend to be held by 'stable shareholders' – *i.e.*, the company's own banks, employees (current and retired), financial advisors, customers, suppliers and other friendly concerns that have some primary relationship with the company separate from, and economically more important than, that of an equity investor.[23] Typically the shares held by 'stable shareholders' were issued deep in the past at the time the company was first established or went public. One special form of stable shareholding is the *keiretsu* – cross-shareholdings within a distinctly identified industrial 'family.' In addition there are a large number of founder- or family-controlled companies that have, for reasons of perceived prestige and vanity, issued a nominal public float. A corollary of the stable shareholding phenomenon has been the reliance of Japanese corporations on bank financing rather than equity financing, which has, historically, greatly reduced the need for Japanese companies to issue shares and compete for funds in the equity markets.[24]

It is not accurate to say that Japanese corporate management has been indifferent to shareholders. What is true is that 'stable shareholders' tend to wear two hats, as shareholders and as something else (lender, customer, supplier, employee), and the second hat is usually economically far more important. Japanese management is highly sensitive to lender, customer and supplier demands. But lenders, customers and suppliers are not overly fussy about dividend yields so long as their loans are being repaid on time and their day-to-day trade is otherwise satisfactory. Further, since stable cross-holdings go in both directions, the possibility of being on the receiving end of a demand for, say, higher dividends tends to make one think twice before making the demand oneself.[25]

The stable shareholder system reflects and answers strongly felt group and inter-personal psychological needs. Japanese are awkward dealing with strangers,

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23. *See* Miyajima, Haramura and Enan, '*Sengo Nihon no Kabushiki Shoyu Kozo: Antei Kabunushi no Keisei to Kaitai*' (The Structure of Stock Ownership in Post-War Japan: The Make-up and Break-up of the Stable Shareholder, PRI Discussion Paper Series (No.03A – 13), Ministry of Finance General Policy Research Center (2002) (available at http://www.mof.go.jp/jouhou/soken/kenkyu/ron065.pdf for an analysis of the changing composition of stable shareholders of Japanese public companies.
24. Some scholars have argued that, while the level of corporate cross-shareholding is high, statistical analysis fails to show any significant concentration of cross-ownership into identifiable *keiretsu* groups. Yoshiro Miwa and J. Mark Ramseyer, *The Fable of the Keiretsu Miwa, Urban Legends of the Japanese Economy*, (Univ. of Chicago Press 2006). The argument that *keiretsu* are a figment of the imagination is unconvincing when juxtaposed against, for example, the recent efforts to rescue Mitsubishi Motors by Tokyo-Mitsubishi Bank and other members of the Mitsubishi group. *See* 'Mitsubishi's *Keiretsu* to the Rescue,' The Economist, May 27, 2004. It is also implausible to anyone familiar with the rule of etiquette that, when ordering beer in a restaurant, one must order the brand that belongs to one's own (or one's host's) *keiretsu* group – Kirin in the case of Mitsubishi, Asahi in the case of Sumitomo, etc.
25. For a description of overlapping ownership, financial and supplier relationships in the auto industry, *see* Christina L. Ahmadjian and James R. Lincoln, '*Keiretsu*, Governance, and Learning: Case Studies in Change from the Japanese Automotive Industry,' Organization Science, Vol. 12, No. 6, November – December 2001, pp. 683–701, available at http://faculty.haas.berkeley.edu/lincoln/Papers/ahmadjian-lincoln.pdf.

and most comfortable with fuzzy, long, stable relationships developed and defined within in a group or institutional context. The same psychological needs underpin the lifetime employment system. For most Japanese, the notion of working outside the company one has become a member of and absorbed as part of one's own identity – becoming a stranger in an alien organization – is highly stressful and often unsuccessful in practice. Conversely, the idea of embracing an outsider into one's own group as an equal and full-fledged member is counter-instinctive.[26]

Because of this distinctively Japanese anthropology and psychology, until recently corporate mergers in Japan have occurred only as a measure of last resort for companies that otherwise faced bankruptcy and liquidation. When a company failed, a council of stable shareholders would typically identify a 'sponsor' company to absorb and 'take care of' the failed firm.[27] Efforts to integrate the two organizations typically took an entire working generation, and in practice typically operated as separate and jealous organizations under one roof. Employees of the 'absorbed' (*i.e.*, failed) company could expect to be treated as second-class citizens for the remainder of their careers.[28]

In the past decade several developments have contributed to some extent to make management more sensitive to investment return and other pure shareholder concerns, as well as to mitigate the psychological resistance of management and employees toward mergers.

First, starting in 1990's the percentage of public company shares held by stable shareholders declined, while the percentage held by individual and foreign investors significantly rose. The sell-off of stable shareholder shares was in part triggered by the need for cash in the dark period following the Bubble. Between 1990 and 2003, foreign ownership of Japanese stocks increased from 4.8% to 21%.[29] Foreign institutional investors and fund advisors became a constituency that Japanese management could no longer ignore as they became a critical 'swing vote.' As one indication, by now most major companies have set up English language investor relations Web sites. Because foreign investors are scouring the market for undervalued companies, Japanese management is now being forced to focus on stock performance as never before.

Second, companies relied less on bank financing. The main bank lost its dominance, and acted less paternalistically and protectively of its clients during a

26. *See* for example, *Takie Sugiyama Lebra*, *Japanese Patterns of Behavior* (University of Hawaii Press, 1976)
27. The rehabilitation of Sogo Department Stores and Sanyo Electric are recent examples of corporate rescues overseen by the troubled company's main banks.
28. The merger of Dai-Ichi Bank and Nihon Kangyo Bank in 1971, to form Dai-Ichi Kangyo Bank, is typically cited as an example of the difficulty of integrating different organizations in Japan. Members of the predecessors continued to identify themselves with their original banks long after the merger. Because of personnel rivalries and jealousies, the merged bank continued to maintain two separate branches – one a former Dai-Ichi branch and the other a former Nihon Kangyo branch – operating side-by-side in the Toranomon district of Tokyo for many years.
29. Ministry of Economy, Trade and Industry, *M&A Rules in Japan* available at http://www.meti.go.jp/policy/economic_oganization/pdf/rontenkoukai_gaiyou_eng.pdf.

period in which the banks had to deal with thousands of non-performing loans. The relationship between banks and their corporate clients became more restrained and objective, and in the case of financially troubled borrowers, outright adversarial.[30]

Third, market consolidation in the post-Bubble period led to a sharp rise in strategically driven domestic mergers. Consolidation was especially intense in the banking sector; all of the surviving major banks are the amalgamation of two or three predecessor banks. As a consequence large numbers of employees have now experienced and survived the human resources side of M&A – the painful psychological and inter-personal adjustments entailed when organizations merge. Because of this accumulated experience among a wide cross-section of companies, the prospect of a merger is probably less terrifying to management and employees than in the past.[31]

Fourth, corporate down-sizing and restructuring in the post-Bubble period significantly compromised the institution of lifetime employment itself. Large numbers of white collar workers had to scramble and find new jobs and adapt to new employers and work environments. The population of temporary and contract employees significantly rose. The erosion of lifetime employment and related feelings of dependence, belonging and identity tied to the company create a more hospitable psychological climate for M&A.[32]

3.5 Intellectual and Ideological Influences

The emergence of Goldman Sachs and other foreign firms in the aftermath of the Bubble as first tier investment banks within Japan also coincided with the re-writing the intellectual playbook of Japanese M&A. Within a very short period of time, the intellectual framework and jurisprudence of M&A law that developed in the Delaware courts during the 1980's (as the result, one should add, of dozens of contested and litigated deals that the foreign firms were directly involved in) has been absorbed by the relevant sectors of the Japanese elite – academics, regulators, the legal profession, company executives – as the natural and legitimate lens through which M&A transactions ought to be evaluated.[33]

The intellectual pollination process began during the Bubble Era when Japanese companies began to acquire U.S. companies on a large scale. When Matsushita acquired MCA in 1989, it learned more than it wanted to about the poison

30. White Paper on International Trade 2003, Ministry of Economy, Trade and Industry, pp. 102–104, available at http://www.meti.go.jp/english/report/data/gIT03maine.html.
31. Annual Report on the Japanese Economy and Public Finance 2003 – No Growth Without Reforms, Cabinet Office, Government of Japan, October 2003 (in Japanese) available at http://www5.cao.go.jp/j-j/wp/wp-je03/pdf/03-00203.pdf.
32. Policy Research Institute Ministry of Finance. June 2003. Report of the Research Committee on the Diversification of Japanese Companies and Corporate Governance – Analysis of Business Strategy, Group Management, and Decentralized Organizations (in Japanese) available at http://www.mof.go.jp/jouhou/soken/kenkyu/zk063/02.pdf.
33. Milhaupt, note 2.

pill defense, and was pulled into a complicated litigation that went all the way to the U.S. Supreme Court.[34] In the same year, Sumitomo Bank became a major investor in the Goldman Sachs partnership, allowing the partnership to postpone becoming a public company for several years and giving the Japanese bank a window into the leading edge of global finance.[35] Throughout the same period, large numbers of young elite Japanese bankers, lawyers and business executives were sent to U.S. law schools and business schools (to which their employers made generous donations) and were placed in internships with prominent American law firms and investment banks. The result, nearly 20 years later, is a generation of elite Japanese professionals, now in their 40's and 50's, conversant with the law and lore of American M&A developed during the 1980's. For many of these people, a re-enactment of the American M&A drama of the 1980's in the Japan today would satisfy long-simmering professional and career ambitions.[36]

By a similar process, the heightened sensitivity to corporate governance issues in the U.S. and Europe triggered by the Worldcom and Enron scandals in 2001 traveled instantaneously and without controversy to Japan. The Big Four international accounting firms, which had by 2001 locked up the market as auditors for public Japanese companies, were major conductors of the message that corporate governance standards and practices needed to be improved and unified under global standards. Even prior to 2001, Japan had received numerous lectures from foreigners teaching that the dismal performance of the Japanese economy during the 1990's, in contrast to what appeared to be the stellar performance of the vibrant New Economy outside Japan, was proof that Japanese-style corporate governance – *i.e.*, not putting shareholder return above all else – was the root cause of Japan's post-Bubble 'lost decade.' By 2001, most Japanese had heard the lecture and assumed it to be largely true.[37]

4. WATERSHEDS IN THE LAW OF M&A AND CORPORATE GOVERNANCE

This section traces a series of watersheds in the law of M&A and corporate governance during the last decade. The legal evolution has taken the form of court

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34. *Matsushita Elec. Indus. Co., Ltd.. v. Epstein*, 516 U.S. 367 (1996).
35. For a description of the Goldman Sachs-SMBC relationship, *see* Business Week, December 5, 2005, http://www.businessweek.com/magazine/content/05_49/b3962141.htm.
36. For example, a leading practice guide to hostile M&A in Japan by a group of Japanese lawyers active in the field prominently advertises the U.S. law schools the authors attended and the U.S. law firms for which they clerked. Large sections of the book summarize U.S. law as background and context for discussions of Japanese law. Y. Ota and R. Nakaya, eds *Tekitaiteki M&A Taiyo no Saisentan* (Leading Edge Techniques in Hostile M&A), (*Shoji Homu*, 2005).
37. The Japanese Financial Services Agency is currently drafting new legislation based on Section 404 of the Sarbanes-Oxley Act designed to raise disclosure standards applicable to public companies. The Japanese version of Sarbanes-Oxley (known as 'J-SOX') is expected to be presented to the Diet in 2007.

opinions and new legislation in some – but by no means all – cases. Highly publicized contests for corporate control that stopped short of litigation and court opinions also played an important role.

4.1 The Daiwa Bank Case – Shareholder Litigation Puts Teeth into Directors' Duties

In the U.S., the threat of a shareholders derivative action concentrates the minds of public company directors wonderfully. Class action law firms make their livings trawling for incriminating material and plaintiff-clients.[38] The litigation, once brought, is personally unpleasant for the defendant parties, time-consuming and, when the plaintiffs succeed, imposes stiff penalties on the company as well as the individual director-defendants. Fiduciary duties with real substance and real teeth drive American corporate governance.

By contrast, Article 254-3 of the Commercial Code, the provision establishing directors' fiduciary duties, did not result in any litigation between 1950, when it was enacted, and 1989.[39] The lack of litigation led to a vicious cycle – no litigation, no precedents, no clear rules, no litigation. It goes without saying that until issues are litigated, the specific content of general standards such as 'fiduciary duty' will remain indeterminate. In turn, if the rules are empty fewer lawsuits will be brought in the first place.

Thus, one of the first hurdles that had to be cleared in order to establish a legal framework for corporate governance and M&A were the indigenous inhibitions against bringing lawsuits at all. There were, and remain, plenty of inhibitions against litigation besides the indeterminacy of the substantive law itself. In a culture that values 'harmony' and 'consensus' bringing a lawsuit stigmatizes the plaintiff as an anti-social misfit unable to work things out according to the informal ethic of give and take. As if to deliberately discourage plaintiffs at the outset, the court process is notoriously slow and, even when plaintiffs eventually win, damages awards, by U.S. standards, are laughably small.[40] Multi-million dollar jury awards do not exist. The lack of pre-trial discovery and class actions also puts a heavy lid on litigation.

Against this background, the launching of a series of shareholders derivative suits during the mid-1990's against the directors of major corporations, and the award of an unprecedented amount of damages in the Daiwa Bank case, was a

38. Japanese law does not provide for class actions, trial by jury, extensive pre-trial discovery or punitive damages.
39. Hideki Kanda and Curtis J. Milhaupt, 'Re-Examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law,' 51 Am. J. Comp. L. 887, 892 *et seq*. (2003)
40. The famous Minamata case, in which 2,955 people contracted Minamata disease (mercury poisoning), and 1,784 died, as a result of dumping of mercury into Minamata Bay by Chisso Corporation, ended in an award of roughly two million U.S. dollars against Chisso and USD 700,000 against the Japanese government 22 years after the lawsuit was commenced.

significant turning point.[41] The cases tended to be brought by individual plaintiffs organized by activist law firms, in many cases based in Osaka. The suits were typically triggered by news reports or criminal prosecutions of Bubble-era corporate malfeasance – payment of bribes, payments to *sokaiya*, bid rigging, etc.

One important factor enabling the suits was the revision of the Commercial Code in 1993 sharply reducing what had been prohibitive filing fees for derivative actions.[42] The steep filing fees had originally been adopted as a measure to prevent strike suits by *sokaiya*, and were abolished under pressure from U.S. trade negotiators. Another factor was outrage at misfeasance and malfeasance on a grand scale during the Bubble Era that was exposed by the press and prosecutors in the aftermath.

Most of the cases resulted in modest settlements. Nor did the cases produce much new jurisprudence because the underlying offenses were just so blatant. The Daiwa Bank case, however, commanded attention. In September 2000, the Osaka District Court ordered eleven current and former Daiwa Bank Directors to pay an eye-popping USD 775 Million for breach of their duties as directors. In addition, and perhaps just as importantly, the liability of the directors was based not on overt malfeasance, but on omissions and negligence. The case significantly expanded the outer ambit of director oversight responsibility and imposed liability on what had, until then, been routine procedure (or lack of procedure) at many Japanese corporations.[43]

The Daiwa Bank case stemmed from USD 1.1 billion in uncovered securities trading losses accumulated by a rogue trader in Daiwa's New York branch. When Daiwa management learned of the losses, the decision was made – with the tacit approval of the Ministry of Finance – to cover them up.[44] The losses and the cover up were discovered by U.S. regulators, who summarily revoked Daiwa's license to operate in the U.S. and effectively kicked Daiwa out of the country.

The Daiwa case is notable in that it was the first case to impose director liability for a board's failure to establish and implement an appropriate internal control and risk management system.[45] The inclusion of requirements for formal internal control and compliance mechanisms in the new Company Law reflect and codify, to some extent, this aspect of the Daiwa case.[46] Further, the court rejected the Daiwa directors' defense that the Ministry of Finance had approved the cover up.[47]

41. In 1993, in the wake of the revision of the Commercial Code to reduce filing fees for derivative actions, 80 derivative suits were launched, including actions against Mitsui Mining, Nihon Sunrise, Japan Airlines, Cosmo Securities and Ohbayashi Gumi.
42. Commercial Code Article 267(4) established a flat JPY 8,200 filing fee in contrast to a filing fee calculated as a percentage of the damages claimed.
43. Bruce E. Aronson, 'Reconsidering the Importance of Law in Japanese Corporate Governance: Evidence from the Daiwa Bank Shareholder Derivative Case,' 36 Cornell Int'l L.J. 11, 22 (2003).
44. Decision in First Daiwa Bank Shareholder Derivative Case, (Osaka District Court, September 20, 2000), published in *Hanrei Jiho* No. 1721, November 1, 2000 edition, pp. 3–52.
45. Aronson, note 44 at 26 *et. seq*.
46. *See* Company Law Articles 348, 362 and 416, requiring establishment of formal internal controls.
47. Daiwa Bank Case, note 45.

This was an important blow against the legitimacy of 'administrative guidance.'[48] The Osaka District Court ruled that the directors' failure to report the trading loss in violation of U.S. law was a violation of the Japanese version of the 'business judgment rule,' which was again significant against a long line of cases that, in result, were highly deferential to the business judgments of management.

The Daiwa directors eventually settled for a much smaller amount. The huge damages award was symbolic in any event because the individuals did not have the financial resources to pay anywhere near the full amount. There is no question, however, that the Daiwa case, which was avidly covered in the press, served as a wake up call to Japanese management, and that the concrete threat of effective shareholder actions instantly altered attitudes and behavior.[49]

4.2 Corporate Raiders – Shareholders Rights Crusaders or Greenmailers?

In post-War Japan, the accumulation of a public company's stock by an outsider was assumed – usually with good reason – to be the prelude to greenmail. Corporate raiders, known as *nottoriya* ('hijackers'), as a rule associated with organized crime, rarely succeeded in capturing control, but were amply rewarded by ransom paid by target companies. There was little consciousness that corporate raiders might in fact be beneficial for other shareholders by putting pressure on management to maximize corporate value.

In 1989, T. Boone Pickens loudly invoked the rhetoric of 'shareholders rights' to legitimate what the Japanese establishment perceived as a classic greenmail. Pickens acquired 20% of Koito Manufacturing Ltd. from Kitaro Watanabe, widely assumed within Japan to be a greenmailer himself.[50] Koito was a supplier to the automobile industry, primarily Toyota. Following the typical *keiretsu* pattern, Koito's largest shareholders (other than Pickens himself) were Toyota (19%) and Nissan (5.9%), together with Koito's banks. Whether Pickens was acting for himself or serving as a convenient foreign fig leaf for Watanabe was never fully clarified. In any event Pickens, as Koito's largest shareholder, demanded board representation, which Toyota and the other Japanese shareholders rejected. In response Pickens mounted a noisy publicity campaign complaining about Japan's *keiretsu* system, cartels and closed trade and investment markets.[51] The timing coincided perfectly with the Structural Impediments Initiative (SII) of the U.S. Trade Representative,

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48. Aronson, note 42, at 30–31.
49. *See* H. Karino, *Shoho Kaisei to Koporeto Gabanansu to Junen* (A Decade of Reform in the Commercial Code and Corporate Governance) in *Koporeto Gabanansu ni Okeru Shoho no Yakuwari* (The Role of Corporation Law in Disciplining Corporate Governance), H. Kanda, ed. (*Chuo Keizai Sha*, 2005).
50. Arimori, note 13, pp. 273–277.
51. Speech of T. Boone Pickens to Chicago World Trades Association, Chicago, Illinois, May 23, 1989, available at http://digital.library.okstate.edu/pickens/1989/052389A2.html.

which located the cause of the massive U.S. trade deficit with Japan in a welter of non-legal 'structural impediments' – including the *keiretsu* system – that effectively kept foreigners from competing on equal terms in Japan.[52]

Pickens' run at Koito, and the larger critique of Japan's 'structural impediments' by the US government, were of course closely covered by the press and planted the germ of the idea that corporate raiders – at least in theory – could be good for Japanese shareholders. It chipped away at the legitimacy of the old system of cross-shareholdings and exposed the potential conflict between management interests and shareholder interests. No doubt, Pickens was not the ideal missionary for this new religion, given that he himself was associated, through Watanabe, with old-fashioned greenmail, and his own motives and tactics appear to have been less than holy. In the end, stymied in his attempt to take over Koito, Pickens resold his shares to Watanabe, further fueling speculation that the deal was a sham from the start.

In the late 1990's other opportunistic investors, typically funded with foreign money, began to take positions in undervalued Japanese companies and use their status as shareholders to jawbone management into improving performance and yields. Steel Partners and the M&A Consulting (a/k/a, Murakami Funds)[53] were the two leading exponents of this new – at least to Japan – style of investing. Like Pickens, they used the rhetoric of shareholders rights and corporate value.

M&A Consulting's highly publicized proxy fight with Tokyo Style in 2002, the prototype of this genre, was stage-managed as a corporate governance morality play. Murakami's M&A acquired 11% of Tokyo Style, a relatively obscure apparel maker that had nearly $1 billion in idle cash sitting on its balance sheet. This represented 70% of its total assets and more than its market capitalization. M&A Consulting proposed that the cash be paid out as a special one-time dividend and also be used to buy back one-third of all outstanding shares. Like Pickens, Murakami insisted that his fund be given seats on the Tokyo Style board. In response, Tokyo Style management sought to portray Murakami as an unprincipled greenmailer engaged in 'asset stripping in the guise of corporate governance.' With the support of foreign shareholders who held 29% of Tokyo Style, Murakami launched a proxy contest to force a special dividend, but was ultimately unable to win over a majority of shareholders.[54]

As a result of the Tokyo Style bid and other lesser 'raider'-type challenges, M&A and corporate governance came to be understood by the business establishment – as well as growing segments of the general public – as twin threads of a double helix. Ultimately the outside investor's attempt in Tokyo Style and other similar cases during the same period to use a minority share position to lobby for 'shareholder value' enhancing policies failed, largely because – like Pickens – they failed to win the hearts and minds of the target's inner circle of friendly shareholders.

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52. *See* Joint Report of the US-Japan Working Group on the Structural Impediments Initiative, June 28, 1990 available at http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_005583.asp.
53. Yoshiaki Murakami, principal of M&A Consulting, was indicted and arrested for insider trading in 2006. *See* discussion below.
54. 'Rare Proxy Vote Fails in Japan,' New York Times, May 24, 2002.

4.3 TOKYO MITSUBISHI FINANCIAL GROUP-UFJ HOLDINGS: DELAWARE LAW EMERGES AS THE PRESUMPTIVE REFERENCE POINT FOR JAPAN

Within the mental universe of the Japanese establishment, the thought that management's desire to perpetuate itself in office might be in conflict with the interests of shareholders rarely rose to a conscious level. This blind spot revealed itself in the way that friendly strategic mergers were typically negotiated. When Japanese corporations publicly announced a negotiated strategic merger, the press release would typically state that the merger had been agreed (subject to shareholder approval), the name of the company post-merger, and the post-merger management line-up.[55] The merger ratio or other consideration – i.e., the economic aspect of the deal that should be of greatest interest to shareholders – would typically be left to be 'announced at a future date.' The merger ratio was rarely the subject of aggressive negotiation. Independent valuations and fairness opinions were almost never ordered. Because Japanese companies typically did not have independent outside directors, the merger and its economic terms were not reviewed by any independent parties. By far the most heavily negotiated issue between management was the emotionally charged matter of post-merger personnel issues. The merger contract itself was primitive, representations and warranties and due diligence both equally cursory.[56]

The latent fiduciary tensions in Japanese-style strategic mergers rose awkwardly to the surface in 2004, when Mitsubishi Tokyo Financial Group ('MTFG') and UFJ Holdings ('UFJ') announced a 'basic agreement' calling for a full merger of operations in 2005, and a capital injection of JPY 700 billion by MTFG. In keeping with the typical pattern, the 'basic agreement' contained a great deal of detail about post-merger personnel issues but left the specific merger ratio for future negotiation.[57]

Meanwhile, Sumitomo Mitsui Financial Group (SMFG) broke the unwritten rules and crashed the party by submitting a competing proposal to UFJ management for a merger that, unlike the MTFG proposal, contained a specific 1:1 merger ratio. At prevailing stock prices, this ratio would have given UFJ's shareholders a 30% premium. SMFG also offered a capital injection in an amount equivalent to that offered by MTFG. Faced with these competing bids, UFJ management announced its decision to proceed with a merger with MTFG and to reject the SMFG proposal, even though the MTFG proposal contained no specific merger ratio. In addition, to implement the promised capital infusion, UFJ Bank, UFJ's wholly-owned banking subsidiary, issued JPY 700 billion of preferred stock to

55. *See e.g.*, Foundation of the Mizuho Financial Group Through the Consolidation of DKB, Fuji Bank, and IBJ available at http://www.mizuho-fg.co.jp/english/pdf/release/2000/e_991222.pdf.
56. *See* e.g. 'Merger Memorandum' between Meiji Life and Yasuda Life' available at http://www.meijiyasuda.co.jp/profile/release/integration/pdf/20021018e.pdf.
57. 'Basic Agreement Regarding the Management Integration of Mitsubishi Tokyo Financial Group and UFJ Group' available at http://www.mufg.jp/english/pressrelease/2004-ufjh/pdffile/040812e.pdf.

MTFG. The preferred stock was in turn linked to a series of defensive features designed to deter SMFG from attempting a direct appeal to UFJ's shareholders in the form of a tender offer or proxy contest.[58]

The contest for UFJ upset the notion that the management of two companies could quietly shake hands and decide to merge without evaluating other options and candidates. It raised awkward questions about the UFJ board's judgment (and conflict of interest) in the pre-emptive acceptance of the MTFG offer without requiring MTFG to put forward a concrete counter-offer or using the SMFG bid as an opportunity to ratchet up the merger consideration. An article appeared in a legal journal arguing that UFJ's pre-emptive decision to merge with MTFG in these circumstances, and the defensive features – inaccurately and naively characterized as a 'poison pill' by the press – designed to sandbag SMFG's bid, would be illegal and invalid under Delaware law.[59] The article was picked up by Nihon Keizai Shimbun, Japan's leading financial daily, putting a spotlight on the propriety of the merger, which in turn led all three principals in the transaction to hire prominent U.S. law firms and investment banks to educate them, in the context of a purely domestic Japanese merger, with respect to Delaware law. Ultimately, SMFG withdrew from the contest, but not before its competing bid had driven the UFJ stock price up to a level that in effect forced MTFG to pay the same premium (in relation to the price before SMFG's bid) that SMFG had offered.

SMFG's uninvited bid forced the Japanese business establishment to think, in some sense for the first time, about mergers in terms of fiduciary duties and through the shareholder-centered prism of Delaware law. Japan's own lack of jurisprudence in this area made U.S. law – and lawyers – relevant by default. In many of the deals following MTFG-UFJ, including the highly-publicized Livedoor-Nippon Broadcasting bid, the principals have retained U.S. law firms for transactions that are purely domestic – an interesting indication of the globalization of the intellectual dimension of M&A and corporate governance, and how insulated Japan had been from those influences.[60]

4.4 Livedoor – Nippon Broadcasting System: The Courts in the Spotlight

The contest for UFJ raised public consciousness but did not generate significant litigation or jurisprudence. Livedoor's bid for Nippon Broadcasting System (NBS) in 2005, and the gambit NBS used to try to block Livedoor's bid, did generate litigation and a court precedent that serves as the beginning of what one assumes

58. '*Capital Injection from Mitsubishi Tokyo Financial Group*' available at http://www.mufg.jp/english/pressrelease/2004-ufjh/pdffile/040910-3e.pdf.
59. Stephen Givens, '*Derawea-shu Saikosai de Attara, Konkai UFJ Horudingusugawa ga Totta Gappei Togo Boshisaku in Taishite, Dono Yo na Shiho Handan wo Kudashita de aro ka*?' (What Judicial Decision Would Have Been Handed Down if the Defensive Measures Adopted by UFJ Holdings Were Before the Delaware Supreme Court?), 32 *Kokusai Shoji Homu* 1295 (2004).
60. *See* Milhaupt, note 2.

will develop, as more cases are litigated, into a more fully developed Japanese jurisprudence of M&A and corporate governance.

In Livedoor, the Japanese courts, under intense national and international scrutiny, rendered a decision that upset the notion that corporate management had full discretion to select the merger partner of its choice. The fact that the Japanese courts played a pivotal role in a major M&A transaction was itself precedent-making. Just a few months earlier, MTFG-UFJ, though not directly litigated, had raised sensitivities about the conflicts of interest inherent in mergers between companies dominated by lifetime-employee inside directors. The Livedoor decision was poignant because it handed a victory to a brash upstart trying to crash the gates of a member of the corporate establishment. Given the facts of the case (not to mention that it was receiving as nearly much attention from the Financial Times as from the domestic Japanese press), however, any other result would have exposed Japan as seriously out of step with the corporate governance norms and jurisprudence of the community of advanced economies. Although Delaware cases are not explicitly cited in the Livedoor decisions, the inference is strong that the judges rendering the decisions were briefed on Delaware law, and applied a framework of analysis broadly consistent with Delaware law.

The legal issue in the Livedoor case was the validity of NBS issuing warrants (*shin kabu yoyaku ken*) to Fuji Television as a means of diluting the 38% shareholding Livedoor had accumulated in NBS. The Fuji Sankei group, through Fuji Television and other affiliates, controlled NBS. The price of the warrants and the exercise price was less than the market price of NBS stock and therefore favorable to Fuji Television. If Fuji Television exercised the warrants, Livedoor would be diluted down to 20%.

By any analysis, NBS's defensive issuance of warrants to a controlling shareholder to prevent another shareholder from gaining control invited skepticism, and would have received withering scrutiny from a Delaware court.[61] Among other damning factors, (a) the warrant scheme was adopted after Livedoor had actively begun its assault; (b) was approved by a board consisting entirely of inside directors; (c) the warrants were issued to a controlling shareholder; (d) at a discount from market price; and (e) NBS had no business need for the additional capital that would result if Fuji Television exercised the warrants.

Livedoor brought suit in Tokyo District Court to enjoin issuance of the stock acquisition rights, based on the prohibitions in Article 280 of the Commercial

61. US case law generally permits the issuance of stock to 'friendly' parties as a defensive measure (known as a 'white squire' defense), but subject to a set of conditions that were clearly breached in the NBS-Fuji case, including the conditions that (a) the transaction be approved by a majority of outside directors; (b) the issuance not be intended primarily to entrench incumbent management and (c) that the economic terms be at least as good as those offered by an outstanding tender offer. *See Shamrock Holdings Inc. v. Polaroid Corporation*, 559 A. 2d 278 (Del. Ch. Ct. 1989). Further, under New York Stock Exchange Rules (a) shareholder approval is required if 20% or more of a listed company's stock is offered to a party perceived as friendly to incumbent management and (b) a majority of directors are required to be independent in any event.

Code against the issuance of stock or stock warrants by means of 'an egregiously unfair method.'[62] The Tokyo District Court granted the injunction and the Tokyo High Court, on appeal, upheld it. The Tokyo District Court focused on the fact that the issuance of stock acquisition rights was made after a concrete hostile bid had been launched, was clearly motivated by incumbent management's desire to preserve itself in office, frustrated shareholder choice, and lacked any rational or independent economic purpose.[63] The Court wrote as follows:

> It is not in principle permissible for a board of directors to issue new shares, etc. for the main purpose of diluting the stake of a specific shareholder with whom the board is fighting over control of the company and thereby maintaining the current management's control of the company, as such acts mean that a board of directors, which is only an executing organ of a company, decides by itself who the company belongs to. The issuance of new shares, etc. should be permitted only in the cases where there is a special circumstance that would justify the issuance from the standpoint of protecting the interest of the company.[64]

On appeal the Tokyo High Court upheld the injunction stating:

> The main purpose of the issuance of stock acquisition rights NBS in the contest over control of the company was to dilute the stake of rights holders (i.e., Livedoor) who are pursuing a hostile takeover to gain controlling power and to secure a controlling interest in Fuji TV, which currently controls the management and has a substantial influence over the company.[65]

Livedoor, together with other recent less publicized cases in the same vein, establish the unsurprising proposition that the issuance of stock or warrants by a target to a controlling or friendly party as a means of diluting an unfriendly suitor are highly suspect.[66] The more detailed contours of this rule, for example a full fleshing out of the types of 'special circumstances' that would justify the issuance of stock or warrants to a white squire, have yet to be developed. Japanese court

62. Prior to *Livedoor*, Japanese courts had generally upheld the issuance of stock to friendly third parties as a defensive measure in the face of challenges under Article 280. *See* discussion of precedents in Y. Ota and S. Noda, '*Kigyo Bashu Boeisaku to Shite no Dai-san Wariate Zoshi to sono Mondaiten*' (Issues Involved in the Use of Stock Issuance to Third parties as a Takeover Defense') in Y. Ota and R. Nakaya, note 35, at 169–223.
63. These bases for the decision are broadly consistent with those that would have been given by a Delaware Court.
64. Decision of Tokyo District Court, March 11, 2005. *Shoji Homu* No. 1726 pp. 47 et seq.
65. Decision of Tokyo High Court, March 23, 2005. *Hanrei Times* No. 1173, May 1, 2005, pp. 125–153.
66. *CSK v. Bellsystem 24*, Tokyo District Court, July 30, 2004, *Hanrei Jiho* No. 1874, pp. 143–150, Tokyo High Court August 4, 2004, *Hanrei Times* No. 1184, pp. 154–155; Miyairi Bulb case Tokyo District Court, June 1, 2004 *Hanrei Jiho* No. 1873, pp. 159–162. The recent issuance of new stock by Hokuetsu Paper equivalent to a 24% ownership stake to a friendly Mitsubishi Corporation at a significantly below-market price, as a means of fending off an unwanted tender offer from Oji Paper, would seem to indicate that the Livedoor decision's long-term impact may be weak.

opinions, reflecting the Continental roots of Japanese jurisprudence, rarely specifically cite or distinguish other precedents and are typically short on explanations and reasons for the announced results. The Livedoor decision did send a clear warning that it was risky for a target to wait until an unfriendly bidder actually appeared and hope to keep the bidder at bay by issuing stock to a friendly insider. Livedoor caused every board of directors in Japan to begin studying defensive strategies that *would* work.[67]

4.5 The Poison Pill and Other Defensive Techniques – Overkill?

MTFG-UFJ, Livedoor and other contested front page M&A transactions persuaded the government and the business community that the time had come to establish a predictable set of rules. In particular, the question of permissible defensive tactics became highly urgent for many companies – somewhat incongruous in a country where a significant hostile deal has yet to be completed. Japan's lack of M&A experience and by extension lack of a body of M&A case law meant that there was a huge vacuum in meaningful rules. Rather than waiting for Japanese courts to define the rules piecemeal through adjudication of specific cases, the job of drafting the rules was delegated, in keeping with the normal practice, to a 'study group' or committee working under the auspices of the government. In 2004, the Ministry of Trade, Economy and Industry (METI) and the Ministry of Justice formed a 'Corporate Value Study Group' headed by Hideki Kanda, a University of Tokyo (Law Faculty) professor who has published extensively on corporate governance and corporation law both in Japan and in the U.S.

The 'Corporate Value Report'[68] issued by Kanda's study group forms a general set of guidelines and principles, largely derived from and consistent with Delaware law, that will likely serve as an important reference point for corporate governance and M&A in Japan for some time to come. In an ironic twist, after having left the U.S.-style corporate law bestowed upon Japan by the U.S. Occupation to gather dust for 50 years, Japan adopted the basic framework of the common law of American corporate governance and M&A virtually overnight.

The Corporate Value Report for all practical purposes now serves as a handbook for permissible defensive techniques and has been used by corporate Japan as such. The report is necessarily general in substance and stresses the following themes with respect to defensive measures:

– They should be disclosed and approved by shareholder vote
– They should be evaluated by reference to a 'corporate value standard'
– They should be in place *before* the hostile takeover materializes

67. An approving analysis of the court decisions in Livedoor form a significant part of the Corporate Value Report, discussed below.
68. Available at http://www.meti.go.jp/policy/economic_oganization/pdf/houkokusyo_hontai_eng.pdf.

– They should be removable by a shareholders vote; poison pills should be ‘chewable’
– Deference should be paid to the views of independent directors and outside professional advisors

In addition, a number of different official and quasi-official bodies have imposed limiting conditions and requirements on permissible defensive techniques. The Tokyo Stock Exchange, for example, has adopted disclosure as well as substantive requirements related to defensive techniques.[69] The Pension Fund Association has announced that it will vote against directors of companies that adopt poison pills without shareholder approval.[70] The new Company Law and the tender offer provisions of the Securities and Exchange Law contain new rules relating to permissible defensive measures. Suddenly, there is a great deal of official guidance on what to avoid when you want to design a bullet-proof poison pill.

With official guidance in place, starting in 2005, Japanese corporations and their advisors busily set about designing and deploying a variety of defensive mechanisms, including the poison pill. The following chart shows the range of techniques now in play.

Defensive Plans Proposed in 2005[71]

Type of defensive plan		*No. of companies proposing*	*Representative companies*
Poison Pill	Pre-warning	3	Toshiba, Panasonic
	Trust	2	Seino Transportation, e-access
	Board authority to change record date	1	Nireco
Issuance of Warrants to White Knight		1	TBS
Shelf registrations of additional shares		2	Fuji TV, Panasonic

69. Listing System Revision and the Adoption of Takeover Defense Measures (Draft Outline) dated November 22, 2005, available at http://www.tse.or.jp/english/news/2005/200511/051129_a.pdf (last accessed on September __, 2006), and Listing Rule Revision with regard to the Adoption of Takeover Defense Measures January 24, 2006, available at http://www.tse.or.jp/english/news/2006/200603/060324_a.pdf.
70. Yomiuri Shimbun, April 11, 2006, available at http://www.yomiuri.co.jp/atmoney/mnews/20060411mh06.htm.
71. Source: Yomiuri Shinbun, May 20, 2005, available at http://www.yomiuri.co.jp/atmoney/mnews/20050520mh06.htm.

Type of defensive plan		*No. of companies proposing*	*Representative companies*
Charter Amendments	Increase number of authorized shares	31	NEC, TV Tokyo, NTV
	Reduction of the number of directors	24	Yokogawa Electric, NTV
	Change of the record date	6	Sumitomo Metals, Sumitomo Electric
	Staggered boards	6	NTV, Nissin
	Supermajority vote for removal of directors	1	Denkikogyo
	Authorization of separate classes of stock	1	JAL
Cross-holding of stocks		7	Nippon Steel, Kobe Steel, Sumitomo Metal

Nippon Steel's 'state of the art' poison pill, developed by foreign advisors Lazard Freres and Sullivan & Cromwell, announced in March 2006, shows the direction Japanese corporations are heading.[72] Nippon Steel's poison pill bends over backwards to satisfy the letter of the conditions set forth in the Corporate Value Report. It is 'chewable'; it is being fully disclosed and submitted to a shareholder vote. The Nippon Steel plan requires a hostile bidder that tenders for or acquires a 15% or more share position to submit a comprehensive set of information about the bidder and its plans. Nippon Steel then has up to 30 weeks to study the information and decide whether the bid should be recommended to Nippon Steel's shareholders. The pill will be triggered if (a) management determines that the bidder is a 'greenmailer' or falls into other unacceptable categories deemed harmful to corporate value; (b) has not followed procedures and requirements dictated by Nippon Steel or (c) the Nippon Steel shareholders vote to activate the pill.[73]

The Nippon Steel pill, while meeting the formal conditions of the Corporate Value Report, presents a formidable obstacle by any measure to a would-be acquirer. The question presented by the Nippon Steel pill and others like it that will

72. 'Nippon Steel Announces the Adoption of Fair Rules for the Accquisition of Substantial Shareholdings', March 29, 2006, available at http://www0.nsc.co.jp/data/20060330115130.pdf (last accessed on September __, 2006).
73. *See* 'Nippon Steel Adopts 'Poison Pill' Defence', Financial Times, March 29, 2006.

surely follow, is whether in combination with other factors, such as residual stable shareholding, it effectively puts the company beyond reach and thereby defeats the very objective of 'corporate value' it is theoretically meant to promote.

Stanford law professor Ronald Gilson argues persuasively that, putting aside other structural impediments to takeovers, Japan lacks the infrastructure to make the pill work in the way it is supposed to – as a lever to enable target management to ratchet up the price without taking the target out of play.[74] According to Gilson, Japan lacks three essential ingredients to make the pill work the way it does, or at least is supposed to, in the U.S.

First, Japan lacks independent directors. There is no requirement, as is the case for New York Stock Exchange listed companies, that a majority of directors be independent. Therefore, there will be an inevitable tendency for target management to want to protect itself.

Second, Japan lacks a judiciary and a legal culture that can police corporate activity, and apply vague standards such as 'fiduciary duty' or 'corporate value' to constantly evolving defensive techniques, on a case by case basis. In Gilson's view, if the poison pill works in America, it is because American courts have taken it upon themselves to actively define and apply the rules. The Japanese courts, by contrast, are not up to this task. One doubts whether a Japanese court, for example, would have the analytic grit or judicial assertiveness necessary to cut through the Nippon Steel pill and reach the conclusion that, despite meeting the facial requirements of the Corporate Value Report, on balance it failed to advance 'corporate value.'

Third, although shareholder composition in Japan is changing, Japan lacks the depth and breadth of institutional investors and professional fund managers that, in the U.S., serve as watch dogs and gadflies for the interests of the investing public as a whole.[75] Stable shareholders, who still represent over half of public share ownership, and silent, uninformed individual shareholders will tend to acquiesce to target management.

In an irony of unintended consequences, copying and pasting the formal features of foreign corporate governance and M&A onto the existing Japanese infrastructure may very well have provided Japanese management with a blueprint for building an impenetrable fortress.

4.6 Corporate Governance Law and Practice

Historically, Japanese boards have been composed almost entirely of company employee-managers. Becoming a department head (*bucho*) almost automatically ensured parallel promotion to the board of directors. This meant, for one, that Japanese boards tended to be large – in large companies as many as 20 or 30

74. Ronald J. Gilson, 'The Poison Pill in Japan: The Missing Infrastructure,' 2004 Colum. Bus. L. Rev. 21 (2004).
75. Gilson, note 74, at 37 *et seq*.

bucho. It also meant that the oversight and monitoring functions of the board were lost. Boards were composed of managers focused on the day-to-day problems of their own departments, not higher level corporate policy and strategy. Operating as a large committee of insiders, the board in effect combined the roles of judge and prosecutor, and failed to impose external, independent oversight and discipline on its own members.[76]

In the late 1990's, in response the same set of structural pressures that altered the rules and practice of M&A, public companies began to reorganize their boards so as to separate the oversight and monitoring functions from executive functions and day-to-day operations. Reflecting Japanese group-think, the adoption of board level reforms by a few prominent companies led to a large wave of companies following suit.

In 1997 Sony, a company that can barely be regarded as Japanese based on its share ownership (over half foreign) and geographical source of revenues, set the process in motion by reducing the number of directors, bringing in outside directors, and creating the position of 'executive officer.' Within a few years over 200 public companies spontaneously fell in line and adopted similar reforms, not because they were legally compelled to do so but, as it were, to keep up with the 'Jones'.'[77] By now, most public companies of any scale have reshaped their corporate governance architecture by some combination of (a) smaller boards; (b) executive officers; (c) adding two or three outside directors; or (d) instituting board committees.

In 2002, the Commercial Code was amended to formalize the governance structures already being adopted voluntarily by many large companies and to give large corporations the choice of adopting a committee format in place of the board of statutory audit.[78] Companies electing the committee format were required to establish committees of the board for audit, nomination and compensation. Each committee was required to have at least three members, a majority of whom are 'outside' directors. Electing firms must appoint also officers, including at least one 'representative officer' with CEO-like functions and authority. The new Company Law, which came into effect in May 2006, and completely rewrites the corporations section of the old Commercial Code, carries forward the Commercial Code's menu of corporate governance organizational choices.[79]

The Japanese corporation statute formalizes what Japanese companies were beginning to do anyway. The quality and discipline of corporate governance in Japan have doubtless greatly improved from the days when a board meeting was essentially

76. *See* James C. Abegglen and George Stalk, Jr. *Kaisha: The Japanese Corporation* (Kodansha, 1985).
77. Curtis Milhaupt, 'A Lost Decade for Japanese Corporate Governance Reform? Working Paper' (2004) available at http://swopec.hhs.se/eijswp/papers/eijswp0202.pdf; Zenichi Shishido, Changes in Japanese Corporate Law and Governance: Revisiting the Convergence Debate, University of California, Berkeley, Working Paper available at http://repositories.cdlib.org/cgi/viewcontent.cgi.
78. *See* Chapter 3.
79. *Id.*

an informal council of *bucho*. Stricter disclosure requirements and the higher potential for shareholder derivative suits have worked in parallel to focus the attention of management and make it more difficult to sweep unpleasant problems under the rug. The presence of two or three outside directors in the board room serves at least a chaperone function, inhibiting crude deviation from accepted norms.

At the same time, despite these improvements, the overriding reality remains that Japanese boards are dominated by lifetime manager-employees, and will most likely be so for many years to come. Inviting a few distinguished professors, lawyers or business leaders to sit in on formal board meetings as outside directors is one thing; completely surrendering oversight and policy-setting authority to a committee of strangers is another matter entirely. The same mentality that supports lifetime employment resists ceding control to a majority of independent directors. Until the underlying psychology and anthropology of Japan change, Japanese corporate governance will be played in a key and style different from that in the U.S. and Europe, and convergence of the corporate governance systems will be incomplete. In Japan, the boundaries between and among the oversight and monitoring functions, management and executive functions, and ownership will continue to be in softer focus than in the U.S. and Europe for some time to come.

4.7 The Arrests of Horie and Murakami, Selective Enforcement and the Rule of Law

The recent arrests of Takafumi Horie of Livedoor and Yoshiaki Murakami of the Murakami Funds, two of the most visible practitioners of Japanese M&A, raise fascinating questions about the role of law itself in the market for corporate control in Japan. [80]

As suggested earlier, the legal framework governing M&A – and much else – is full of holes, and enforcement has been spotty. Vague rules and spotty enforcement have been a natural – perhaps even necessary – part of the Japanese way of life and business. Lack of clear rules forces businesses to engage in a dynamic and ongoing process of gathering information from each other and from the regulatory agencies to find out – and agree on – what the 'real' rules are.[81] Vague rules are an adhesive in a conformist and authority-respecting society. They magnify the power of the regulator. The natural Japanese response to vague rules is not 'Let's see what we can get away with' but 'Let's see what everyone else is doing.'

Horie and Murakami were mavericks not only in trying to take control of member companies of the Japanese establishment, but also in operating at the edge

80. Horie was arrested in January 2006, for allegedly false and misleading financial information issued by Livedoor unrelated to and pre-dating Livedoor's bid for NBS. Horie has yet to be charged with any wrongdoing related to the NBS bid. Murakami was arrested in June 2006, for insider trading related to the NBS transaction. The charge is that he bought NBS stock with non-public knowledge that Horie was intending to take over NBS.

81. *See* John Owen Haley, Authority Without Power: Law and the Japanese Paradox 139–68 (1991).

of the legal envelope. They exploited the indeterminacy of Japanese securities law, and worked on the assumption that what was not explicitly forbidden was permitted. One example of this pattern was Horie's use of the definitional loophole in the regulations that had the inadvertent effect of exempting off-market transactions from the tender offer rules.[82] By acquiring NBS shares in the overnight market, Horie avoided having to make a tender offer, and related disclosure, to all NBS shareholders. With this tactic he was able to catch the market and NBS off guard and create consternation when he called a press conference to announce that he had acquired 38% of NBS. Most Japanese companies were aware of the loophole, but rarely used it. The consensus was that it was an inadvertent loophole, and that using it was contrary to the real spirit of meaning of the tender offer rules. When Horie did use it, he looked like a rogue. The authorities quickly closed the loophole. Because Horie was technically within the letter of the law the authorities were unable to bring charges against him on this front, but his stretching of the rules invited the authorities to look at Horie and his activities more closely.

The investigation that started as a result of the eyebrows raised by Horie's tactics in Livedoor-NBS ended up netting not only Horie but Murakami as well. The investigation confirmed market rumors that Murakami and Horie had been working in concert, starting in late 2004, to acquire a position in NBS. Initially, Murakami had independently accumulated a position in NBS, which he offered to Horie. Horie agreed to buy Murakami's block and also started buying NBS shares in the overnight market. Murakami continued to buy NBS shares with the understanding that he would flip them to Horie. The fact that the two were working in concert was not disclosed to the market, and enabled them to conceal from the market the fact that they were accumulating a controlling block. To the market, it looked as though Murakami was accumulating NBS stock for his own account, when in fact he had already agreed to sell out to Murakami.[83]

The Financial Services Agency, Japan's bank, insurance and securities regulator, and prosecutors began a wide-ranging investigation of Horie and Murakami. Ultimately the infractions that netted Horie were not directly related to NBS. Horie was arrested for false and misleading financial reporting and disclosure that took place well before the NBS bid. One assumes that the authorities would have preferred to nail Horie for misdeeds in connection with NBS, but could not find anything that would stick. Murakami was arrested and admitted guilt for 'insider trading' related to NBS – i.e., he bought NBS stock with the non-public knowledge that Horie was also buying with a view to acquiring control.

It is hard to avoid the impression that the arrests of Horie and Murakami amount to selective enforcement of malleable rules designed to send a message. The conduct for which the two were arrested, in various forms, has been widespread. Market manipulation and insider trading are still common in the Japanese stock market, but,

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82. *See* Minutes of General Planning Division, Financial Services Agency, March 3, 2005, available at at http://www.fsa.go.jp/singi/singi_kinyu/gijiroku/kinyu/dai1/20050303_roku.html.

83. *See* Yomiuri Shimbun, June 12, 2006, available at http://job.yomiuri.co.jp/news/jo_ne_06061213.cfm.

so far, rarely prosecuted and punished. The practical meaning of 'market manipulation' and 'insider trading', inherently vague and general to begin with, remains especially elusive in Japan.[84] Specific rules implementing the concepts require constant redefinition and updating as human ingenuity spawns new forms of manipulation not anticipated by the existing rules. Compounding matters, targets of enforcement actions have rarely thought it worthwhile to defend themselves in court.[85] As a result, Japanese courts have not played a significant role in generating a well-defined jurisprudence governing conduct in the securities markets.[86]

In the wake of the Horie and Murakami arrests, the Financial Services Agency and prosecutors now appear to have embarked on a crackdown against a range of perceived market abuses. Cyclical 'crackdowns' of this sort are the classic method the authorities have historically used to redefine the gross boundaries of acceptable behavior. A crackdown naturally results in a reduction of driving speeds across the population. But regulating by means of cyclical crackdowns without defining the rules with greater precision at the outset – by keeping the regulated population guessing, as it were – is a crude substitute for the Rule of Law.

Trying to regulate Japan's securities markets in the 21st Century by means of old fashioned 'administrative guidance' invites unpleasant risks. The investor population, a third of which is now foreign, is too large, diverse and vocal. The lack of predictability and transparency invites international criticism and ultimately hinders the international competitiveness and attractiveness of the Japanese securities markets. Not least, it invites a crisis of legitimacy. In the immediate aftermath of Murakami's arrest, there has been public confusion about the actual substance of the charges against him. Was he guilty of technical violations or did he commit what should be regarded as morally reprehensible crimes? The confusion simmers without resolution because the authorities fail public to articulate a philosophical framework or clear legal justification for what they are doing. Japan still has not been given satisfying answers to the question, 'What did the arrests of Horie and Murakami actually mean?'

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84. Rumblings have emerged in Japanese blogs and press that, based on the facts presented, there is no legal basis to convict Murakami of insider trading. Article 166 of the Securities Transactions Law, the insider trading prohibition, is by its terms limited to 'insiders' of the company whose shares are being traded on the basis of non-public information. Murakami was not in any sense an 'insider' of NBS. If Murakami is to be convicted, prosecutors will have to rely on much vaguer provisions of the Securities Transaction Law, such as Article 157, which contains a broad and general prohibition against trading by 'illegitimate means' (*fusei no shudan*'). *See* 'Murakami 'Muzai' e no Daigyakuten' (The Big Reversal: Murakami 'Not Guilty') AERA, June 19, 2006.
85. Murakami initially admitted guilt but has apparently reconsidered his position and appears to be ready to mount a vigorous defense. The case, if litigated, will be significant whatever the ultimate result.
86. The Japanese Federation of Business Associations (Keidanren) has called for clarification of the many ambiguities contained in Article 166 of the Securities Transactions Law. *Insaida Torihiki Kisei no Meikakuka ni Kansuru Teigon* ('Demand for Greater Clarity in Insider Regulation'), December 16, 2003, available at http://www.keidanren.or.jp/japanese/policy/2003/124.html.

5. CONCLUSION

The law and practice of corporate governance and M&A in Japan have evolved rapidly in the period following the collapse of the Bubble Economy, in tandem with dramatic transformations in the larger ecology of Japanese institutions and values. Globalization, of the securities markets in particular, has been a major driver of change. Japan's corporate governance system (and, as a corollary, its M&A practices and rules) are approaching convergence with their counterparts in the U.S. and Europe. But convergence is not complete, and will remain incomplete so long as the key features of Japanese culture, psychology and anthropology remain recognizably and distinctively Japanese.

There are three primary impediments to total convergence, and all reflect fundamentally Japanese attributes.

First, group-focused loyalties and identities, and psychological attachments of employees to the company in particular, will postpone for sometime the implementation of boards composed of a majority of outside directors. Japan is not yet prepared to treat employees as a collection of free agents, or to surrender corporate oversight and policy to outsiders. The same factors will tend to inhibit mergers in the first place: the personnel issues involved merging employees from different companies into a single organization remain daunting.

Second, stable shareholding patterns, while weakening, will not disappear for some time. Lobbying and jawboning by institutional investors and their professional managers will put increasing pressure on management to maximize corporate value and performance. But the extended family of stable shareholders will continue to insulate management, to some extent, from relentless worry about quarter-to-quarter earnings and the company's stock price. Quite apart from the array of poison pills and other imposing defensive measures now being adopted by corporate Japan, stable shareholding will serve to minimize the number of successful hostile bids.

Third, the Japanese judiciary, unlike the American courts, is unprepared to serve as rule-maker and arbiter in this field. As the experience in the U.S. has shown, abstract principles and standards such as 'fiduciary duty,' 'corporate value,' 'disclosure,' and 'market manipulation' are not self-defining – the devil is in the details. The common law tradition of the U.S. has been well-adapted to applying general standards to constantly evolving techniques and technology. Japan lacks both an active judiciary and a common law tradition. The FSA and other regulatory agencies can fill the gap to some extent through rule-making and consistent, transparent enforcement. For the foreseeable future, however, rules will continue to be vaguer and enforcement less consistent and predictable than in the other advanced economies. This, in turn, will cloud the legitimacy of M&A practice in Japan, and hostile M&A practice in particular.