

## Revisions of Corporate Law

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### I. INTRODUCTION

Japanese Corporate Law<sup>1</sup> has been frequently revised during the last decade. In the face of such rapid change, a periodical report on substantial changes should be useful. The frequency of recent revisions necessitates an annual report.

This report consist of two parts, one outlining the achievements of the year, and a second part discussing the prospects for the coming year. For introductory purposes, however, the article will begin with a part on the current status of the Corporate Law. This is a historical introduction. Readers who are not interested in the historical background of the current provisions, may immediately proceed to the second part of the article.

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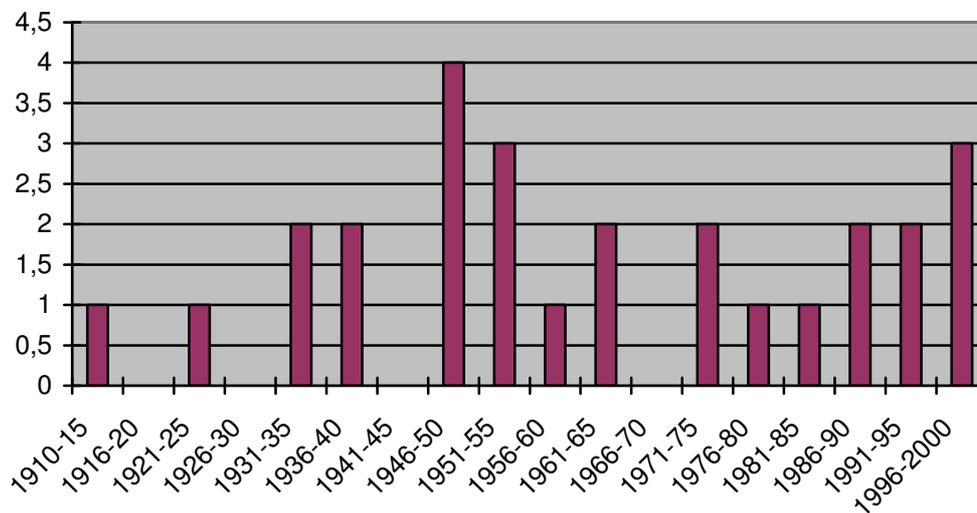
1 The rules of Japanese corporate law consist of Part II of the Commercial Code (*Shôhô*) and other related laws and regulations. Though Part II covers both the partnership type corporation and the joint-stock type corporation (*kabushiki kaisha*), this article will be developed on the latter type unless specifically mentioned. For the English titles of Acts, I follow as a rule H. ODA, *Japanese Law* (2nd ed. 1999).

## II. DEVELOPMENT OF CORPORATE LAW<sup>2</sup>

Is the recent rush to revise the law a mere temporary phenomenon or a structural and inevitable trend, which will become stronger in the future? Which powers are involved? A brief overview of the legislative process will be suggestive. The fifty years since World War II can be divided into three periods: The first period could be termed the time of reconstruction; the second the “good old days”; the third and last decade is the time of endless revisions. Below is a summary of the legislative activities and the parties involved, with an emphasis on the third period.

### 1. The First Period

The following chart shows that legislative activities were most frequent after the end of the War (1945).



It goes without saying that not all revisions were of equal importance. The highlight of the post-war revision was the revision in 1950 (in Japan commonly known as the Revision of the 25th year of the *Shōwa* Era [*Shōwa 25nen hō kaisei*])<sup>3</sup>. The intention of the U.S. government, announced via the General Headquarters, was implemented in various

<sup>2</sup> Cf. S. MORIMOTO, *Kaisha-hō kōgi* [Lectures on Corporate Law] (2001) 22-26.

<sup>3</sup> A mathematical genius is not required to convert between the western year and this traditional oriental year; as the first year of the *Shōwa* Era started in 1926 and ended in 1989, deduct/add 1925 (or 25 if focusing on the last two digits) from/to the western year. The same rule can be applied on the current *Heisei* Era the first year of which starts in 1989; just deduct/add 1988. However, many private and public institutions in Japan stop using the traditional calendar.

areas of law in order to encourage the leveling of wealth (*keizai minshu-ka*, democratization in terms of the economy). Although the antitrust law and the inheritance tax law targeted this goal most efficiently, the corporate law was also drastically changed.

It would be sensible to expect that the revised corporate law<sup>4</sup> and the securities law would have brought corporate governance and shareholders' control closer to its counterparts in the United States<sup>5</sup>. In reality, however, it failed to do so. A possible explanation for this is the dominance of commercial banks over the industries. Banking capital has affected industries, which primarily focused on managerial strategies and not on the best interests of shareholders<sup>6</sup>. It is beyond the scope of this article to scrutinize the differences between the U.S. and the Japanese systems. The point here is that the Japanese Corporate Law has had a fairly market-oriented framework. Should the framework be inactive and the market system and the structure of the corporate governance remain undeveloped, it is unlikely that Corporate Law revision is the only answer. External factors both in law and in the economy should be examined.

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4 The points of the revision of 1950 are as follows: the separation of ownership and management was realized through the establishment of the directorate; the shareholders' meeting elects the directors who form the board of directors which in turn elects the representative directors. Efficiency and legitimacy would be guaranteed by the resolution of the board for which each director is responsible. Meanwhile, supervisory rights of shareholders such as standing for a representative suit or for an injunction with regards to directors' acts were newly provided for.

5 Despite the power shift from the shareholders' meeting to the board of directors around 1950, the board of directors in Japan was unsuccessful in supervising management. It consequently required a series of reforms to improve corporate governance. The failure could be attributed to various factors: first, the board of auditors derived from German law and the board of directors derived from US law coexisted and confused the supervisory functions. Second, the members of the above boards were selected from employees dependent on the management. See Report by MIZUHO FINANCIAL GROUP RESEARCH CENTER <<http://dkb.co.jp/houjin/report/news/200011-2/2.html>>. Note that the difference in the use of the external directors between the United States and Japan is not a result of any difference in the law: even in the US, the adoption of external directors is not mandatory. It is reported that fifty years ago the CCS (Civil Communication Service), a subagent of the GHQ, emphasized vis-à-vis Japanese management the necessity of quality control and the adoption of external directors. As is well known, the former advice was adopted while the latter was neglected. See *GHP no keishō kara gojū-nen* [Fifty Years After the Warning by the GHQ] <<http://www.nikkei.co.jp/topic/tokushu2/eimi031121.html>>.

6 Due to inefficiencies and the lack of transparency, a large part of the population has long lost interest in the capital market. It is reported that there is a stunning gap of financial assets holding by the private sector. The United States, undoubtedly the most securities finance oriented country, marks nearly 80 % of securities holdings (of which the large majority consists of stocks and investment funds). The United Kingdom substantially follows the US example. The Japanese case is the opposite. Nearly 80 % of assets consist of bank (and other financial institute) deposits and bonds. Commercial banks are deeply involved in the sale of these assets. Stocks and investment funds occupy less than 20 %. Germany's position is somewhere in between: Although the importance of indirect finance is still remarkable (40 % for deposits and 20 % for bonds), stocks and investment funds exceed 20 %.

## 2. *The Second Period*

The chart suggests that there was a quiet period, starting in the late 1950s and ending in the 1980s. These thirty years largely overlap with the time of Japan's rapid economic expansion. Many factors have contributed to this long period of inactivity: Firstly, the United States did not yet regard Japan as a competitor and did not put pressure on Japan to examine her industrial structure. Secondly, the minimal availability of financial channels (indirect finance consisted of banks and postal savings) succeeded to transfer the limited savings to the industrial sector. The scarce capital was carefully distributed under the supervision of the Bank of Japan and the Industrial Bank of Japan. Some companies frustrated with this domestic scheme achieved a breakthrough on foreign markets<sup>7</sup>. When the national capital market was gradually relaxed later in this period, the issuance of corporate bonds was still kept under the strict control of the banks. Under these circumstances, a healthy growth of the domestic capital market could hardly be expected. The same is correct for the development of the finance-related corporate law.

Despite the general legislative inertia, this period is noteworthy for three reasons. First, two comprehensive revisions of corporate accounting and corporate governance occurred in 1974<sup>8</sup> and 1981<sup>9</sup>, respectively. Second, the related ministries (the Ministry of Justice with jurisdiction over commercial law in general and the Ministry of Finance<sup>10</sup> responsible for accounting related issues and disclosure) and related parties (industries, the Diet, the accountants' association, academics and so forth) were deeply used to the practices of this period (therefore, we have to discount the complaint against the recent inundation of legislation). They took years for research and debates (the official forum for this is the commercial law committee of the Legislative Advisory Council

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7 Kawasaki Steel Company, received a loan by private placement abroad in 1961 and continued its project. Another famous example is SONY which successfully listed their stocks (ADR) on the New York Stock Exchange in 1961. However, companies in need of relatively small funds often utilized the Swiss or London capital market.

8 The revision of 1974 is commonly known as *Shōwa 49nen kaisei* in Japan. This legislation was the response to a problematic window-dressing practice of a bankrupt steel company in 1965 (!). The German-originated accounting rules of the Japanese Commercial Code were bridged via the Japanese GAAP with the accounting rules of the Japanese securities law, which is highly influenced by US practice. The auditory system was also renovated with a hope to better address fraudulent acts by the directorate.

9 The revision of 1981, is commonly known as *Shōwa 56nen kaisei* in Japan. The effects of the legislation were twofold: first, the fortification of the power of auditors. Second, revisions related to the board of shareholders. The most famous among them is the penal sanction of company donations to the corporate Mafia (*sōkai-ya*) who otherwise would threaten the management by performing embarrassing activities at the shareholders' meeting. This has been and unfortunately still is one of the worst traditions of Japanese big companies.

10 Whose functions have been taken over by the Financial Service Agency (*Kin'yū-chō*) since 2001.

for the Ministry of Justice (*Hôsei shingi-kai shôhō bukai*), and they postponed decisions when the coincidence was unavailable. All this was possible because no one set an absolute goal or deadline. Third, the accumulated drafts since 1974 were compiled and published by the Ministry of Justice in 1986<sup>11</sup>. Without this publication, there would have been further delay in responding to the increasing legislative demands of the 1990s.

### 3. *The Third Period*

Legislators were as active as right after the war. The situation, however, was far more complicated.

#### a) *Overview*

Pressure for change originally came from external parties, especially from the United States. The US was eager to see an opening of the Japanese market in order to alleviate its trade deficit but became disinterested when its economy recovered in the 90s and Japan went into a recession. Gradually, however, there was internal pressure, too: In 1996, the Cabinet announced its decision to reform the financial system after the United Kingdom's 'Big Bang'. This resulted in continued legal reforms and in critical ministerial orders (*shôrei*) concerning securities including investment funds. The two largest legislative amendments were enacted in 1992 (*Heisei 4nen kaisei*) and 1997 (*Kin'yû shisutemu kaikaku-hô*) in banking (starting from the deregulation of banking but shifting to poorly managed financial institutions in general) and insurance. These were in turn extended to the related corporate law.

The underlying principles of these new laws are deregulation, the introduction of rules based on market mechanisms and the enhancement of competition. The establishment of the notion of self-liability (*jiko seki'nin*) as the ethics of the market in lieu of paternalistic interference, namely, the anterior prohibition of certain conduct and the posterior rescue operations to recover losses. It should be noted that these principles are often neglected or attacked by the lobbies of the industry. This is particularly true for the reactions by interested parties who believe that those changes were too drastic or untimely. As these lobbies are increasingly successful in realizing their views, some of the recent legislation is hardly in line with the above-mentioned principles<sup>12</sup>.

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11 HÔMU-SHÔ MINJI-KYOKU SANJIKAN-SHITSU [Chamber of Councilor, Civil Bureau of the Ministry of Justice], *Shôhō yûgen kaisha-hô kaisei shian* [Draft for the Revisions of the Commercial Code and the Law of Certain Companies with Limited Responsibilities] (May 1986) has served as an agenda for debate. The full text of the draft is available e.g. at *Shôji Hômu* 1076 (1986) at 11-28.

12 The motives of some were explained as the relief of financial institutions in crisis. Especially after the successive falls of banks and securities firms after 1997, the artificial lift of the stock price and the capital ratio by means of the accounting rule change (admission of the reevaluation of real estates) or the relaxation of the acquisition of own stocks.

b) *New Parties to Initiate Legislation*

During the first and second period, the leading legislative authorities were the Ministry of Justice (*Hômu-shô*) for corporate law, and the Ministry of Finance (*Ôkura-shô*, in 2001 divided and reorganized as *Kin'yû-chô*) for finance and accounting related laws. In order to achieve specific political goals (*seisaku rippô*), other institutions and groups joined them in initiating legislation<sup>13</sup>. First, the Ministry of International Trade and Industry (*Tsûshô sangyô-shô*, in 2001 enlarged and renamed as *Keizai sangyô-shô*), which has jurisdiction over the economic activities of the private sector, lately announced its policy on corporate legislation<sup>14</sup>. Second, bills were repeatedly submitted by members of parliament (*gi'in rippô*) since 1997. Bills concerning commercial law had long been prepared and submitted exclusively by bureaucrats due to the very limited number of lawyers in the Diet. Since representatives and their political parties have realized the value of law making, this genre of bills will increase in the future. Third, some of the major economic organizations are active in an attempt to counter-attack the menace of derivative suits. Among them is the Federation of Economic Organizations (*Keidanren*) that expressed a plan to introduce a bill concerning the limitation of derivative suits in 2001<sup>15</sup>. The conventional initiator of legislation, the Ministry of Justice, might be required to consider these proposals or even to collaborate with them.

c) *Revisions During the Last Decade*<sup>16</sup>

Generally speaking, the revisions can be divided into three groups: those related to corporate governance, to corporate finance (including the accounting and the capital adequacy issue) and to corporate restructuring. To the first group belong the enlarge-

13 MORIMOTO (*supra* note 2) at 25.

14 *21 seiki no kigyô keiei no tame no kaisha hôsei no seibi* [The Alignment of Corporate Legislation for the Corporate Management of the 21st Century] (Dec. 8, 2000) <[www.meti.go.jp/kohosys/press/0001166/0/1208kigyô.html](http://www.meti.go.jp/kohosys/press/0001166/0/1208kigyô.html)> released under the name SANGYÔ KÔZÔ SHINGI-KAI SÔGÔ BUKAI SHIN SEICHÔ SEISAKU SHÔ IINKAI KIGYÔ HÔSEI BUNKA-KAI [Corporate Legislation Division of the New Development Strategy Commission of the General Committee of the Commission for the Industrial Structure], formerly simply known as the commercial law study group (*Shôhô kenkyû-kai*)

15 KEIDANREN, *Shôhô kaisei he no teigen* [Some proposals for the commercial law reform] <[www.keidanren.or.jp](http://www.keidanren.or.jp)>. Also see K. YOKO'Ô, *Keizai kai kara mita kigyô hôsei no tenkai: Shôji Hômu* 1583 (2001) at 73. The *Keidanren*'s interests are a) the limitation of the corporate manager's liability up to the salary for two years in the articles of association of the corporation; b) the clarification of the corporation's power to intervene in the suit where one of its director is a defendant; c) the limitation of standing for the derivative suit plaintiff to those who were already shareholders when the disputed incidence occurred.

16 M. TATSUTA, *Kaisha-hô* [Corporate Law] (8th ed. 2001) is a highly recommendable textbook due to its high quality description and frequent revisions. It presents new and old numbers of statutes since the revision of 1997, which are functionally classified and in accordance with the page numbers for the comments at xi-xvii (appendix).

ment of the power of the corporate audit in 1993 and 1999 (which appears ineffective and requires a fundamental change); a facilitation of derivative suits, especially in terms of the costs of trial in 1993<sup>17</sup> (which drastically increased corporate suits, and undoubtedly is one of the most serious threats to corporate managers); the drafting of rules for stock options in 1997 (this was also the first case of a bill submitted by a parliamentarian); the strengthening of the punishment of the corporate Mafia in 1997. The second group involves the reform for the standard bond issue on the domestic market in 1993; the alleviation of the acquisition and cancellation of own shares in 1994 and 1997 (a special law<sup>18</sup> valid until 2002 permits the use of capital surplus for this operation. All of these bills were introduced by parliamentarians); the more market-based valuation of financial instruments in 1999. The final group of revisions includes a clarification of rules concerning corporate mergers in 1997; a new law on corporate stock exchanges for setting up a parent company in 1999; a law on the corporate division in 2000, the details of which will be given in part two.

*d) Perspectives for the Future*

Among these pieces of legislation, those in the second (corporate finance) and the third (corporate restructuring) lines are of a relatively technical nature. Besides, they are mostly developed by adopting US law. Thus, it is fair to expect that Japan would try to catch up with a delay of 50 years. A stronger growing domestic market may be required for this, but this is not merely a question of commercial law.

The first group of corporate governance legislation<sup>19</sup> is more problematic. As was mentioned above, the Japanese corporate law inherited a US framework, but this framework was rejected and substituted with a system which better fits the actual organization of society. Given the fact that the Japanese society highly values harmonious peace at the sacrifice of individual interests of a member, it is no wonder that the model based on the separation of powers (the triangle system of board, shareholders and auditors) has failed. Further, in view of the importance of continued and close relationships, it is natural that the Japanese are not keen on accounting and disclosure practices. Some of these cultural characteristics may disappear as a result of learning processes, but others may be profoundly rooted. It will be interesting to see whether the Japanese people will discard their cultural characteristics to resolve the current problems.

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17 Art. 267, para. 4 *Shôhô* (Commercial Code); Art. 4, para. 2 *Minji soshô hiyô tô ni kansuru hôritsu* (Law on the Cost for Civil Procedures) (L. 1971 No. 40).

18 *Kabushiki no shôkyaku tetsuzuki ni kansuru shôhô no tokurei ni kansuru hôritsu* (Law on the Procedure of Stock Cancellation by other means than those Provided for in the Commercial Code) (L. 1997 No. 55).

19 For this issue, H. ODA, Recent Development of Corporate Governance in Japan: ZJapanR 10 (2000) at 187 should be referred to.

### III. ACHIEVEMENT OF THE YEAR 2000: THE NEW LAW ON CORPORATE DIVISIONS (*KAISHA BUNKATSU*)

#### 1. Overview

As the same volume of this journal includes two articles (in German) on Corporate Divisions in Japan (a general introduction by M. Hayakawa who is one of the authorities in this area, and a comparison between the German and Japanese systems by L. Ködderitzsch), the author would like to avoid repetition and confines herself to a functional description of the new law with an emphasis on the main points of the revision, the improvements in comparison with the former system, some examples of utilization, and finally to typical questions on the construction of the new law<sup>20</sup>.

Generally speaking, the new law was modelled after the European system which constructs the corporate division parallel to corporate merger<sup>21</sup>. Despite the trend of importing US law, it is very different from the US system which is based on an understanding of corporate division as a combination of a contribution in kind (*genbutsu shusshi*) and the distribution of new stocks to former shareholders<sup>22</sup>.

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20 Essential references for the new law include: K. HARADA, *Kaisha bunkatsu hôsei no sôsetsu ni tsuite* [On the Establishment of Corporate Division Rules]: *Shôji Hômu* 1563 (2000) 4-13, 1565 (2000) 4-23, 1565 (2000) 4-14 (semi-official commentary by the Ministry of Justice); K. HARADA, *Heisei 12nen kaisei shôhō, kaisha bunkatsu ichimon ittō* [Commercial Law Revision of the year 2000 – The Law on Corporate Divisions Q&A] (2000) (an essential commentary in a Q&A series for new commercial law authored by the legislator and published by the editor of *Shôji Hômu*). H. MAEDA, *Shôhō tō no ichibu wo kaisei suru hôritsu an yōkō no kaisetsu* [Explanation of the Outline of the Draft of the Law on the Partial Revision of the Commercial Code]: *Shôji Hômu* 1553 (2000) 4, 1554 (2000) 4, 1555 (2000) 4 (unofficial commentary by the chair of the *Hôsei shingi-kai* [Legislative Advisory Council for the Ministry of Justice]); K. TAKEI/M. HIRABAYASHI, *Kaisha bunkatsu no jitsumu* [The Practice of Corporate Divisions] (2000) (the most widely distributed book on this issue written by experienced practitioners); TATSUTA (*supra* note 16) at 376-836.

21 Both transfer rights and duties in a comprehensive manner. However, only by way of division is it possible to transfer only a part of the entire business of a company. Further, the dividing company would not disappear even after transferring the business. Also, a dividing company itself rather than its shareholders can acquire the newly issued stocks. TAKEI (*supra* note 20) at 40.

22 For an introduction in Japanese to the current legislation concerning corporate restructuring in Germany, see T. OGAKI, *Doitsu ni okeru kaisha hō tō no kaisei dôkō: Shôji Hômu* 1568 (2000) 58. Details of the German rules on corporate divisions are introduced in M. HAYAKAWA, *Doitsu ni okeru kaisha bunkatsu kisei*: vol. 48 *Dôshisha Hôgaku* 5 (1997) at 94-186. A close comparison of the German and the Japanese rules will show that the Japanese rule is constructed on the basis of the European system but with modifications modeled after the US system. A good observation of the historical development in the United States is given by TAKEI (*supra* note 20) at 195-262. According to Takei, corporate division is a favored tool by management for the dissolution of inefficient conglomerates constructed during the sixties and seventies. The characteristics of the U.S. system are that the gradual separation of business is possible; between the two extremes, namely the public offering of the subsidiary and the use of tracking stock, there are various methods for the

## 2. *The New Law from the Viewpoint of Legal Practice*

### a) *Main Features of the New Law and Ameliorations*

The first purpose of this law is to revise the Commercial Code to incorporate rules for corporate division. Secondly, the aim of the revision is to provide adjustments for some of the consequential frictions<sup>23</sup>. Promulgated on 31 May 2000 and effective since 1 April 2001, this new law was welcomed by the business world after the series of revisions starting in 1997.

What then has been achieved<sup>24</sup>? First, a business (*eigyô*) can now be entirely transferred (*hokatsu shôkei*) to another<sup>25</sup>. Under the former system, the automatic transfer of rights and obligations was unavailable and thus, necessitated a specific agreement with creditors or contract partners in the context of the business transfer (*eigyô jôto*).

Second, the legitimacy of the personal type division (*jinteki bunkatsu*, in which new stocks are distributed to the shareholders of the dividing company) was confirmed. This is a progress but it is definitely necessary to clarify that the recognition of the capital gain is deferrable for those shareholders. It is reported that the Ministry of Finance is considering a tax reform for corporate restructuring in general, with a view to generally admit a deference provided that there is continued control over the transferred business<sup>26</sup>. Though it is not illegal to distribute new stocks as dividend<sup>27</sup>, it is risky to exercise this without a specific guide for the exemption. Interestingly, the clarification of

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separation. Another characteristic is that the economic substance is prioritized and that regarding the contractual balancing, large flexibility is admitted.

23 Relevant provisions are: 1) Modification of the stock options rules in line with the new corporate division rules; 2) Exceptional rules for small-scale transfers of businesses; 3) Prohibition of benefits offered by subsidiaries concerning the use of the shareholder's voting rights. See HARADA, *Heisei 12nen kaisei shôhō* (*supra* note 20) at Q1.

24 See TAKEI (*supra* note 20) at 4-6.

25 Preparation of legal documents (*bunkatsu keikaku-sho* in the case of a division by way of establishing a new corporation (Art. 374) or *bunkatsu keiyaku-sho* in case of division by way of absorption by an existing company (Art. 374-17)) are required. Also, the perfection of rights toward third parties (e.g., registration for real estate under the Japanese Civil Code) is still required. Cf. TAKEI (*supra* note 20) at 89.

26 *Kaisha bunkatsu gappei tō no kigyō soshiki saihensei ni kakaru zeisei no kihonteki kangaekata* [Principles for the Taxation Concerning the Corporate Restructuring such as Divisions and Mergers] <[http://www.mof.go.jp/shingikai/zeicho/siryō/a02kai\\_2.htm](http://www.mof.go.jp/shingikai/zeicho/siryō/a02kai_2.htm)>. As a rule, the same treatment is adequate when there is no substantial economic change through the asset transfer. Thus, in the context of restructuring, the deference of capital gain or loss is adequate in cases in which there is a continuing control over the transferred assets (at the company level) or a continuing investment substance (at the shareholder level). [Supplement to this article in May 2001: A bill concerning this issue has been submitted to the Diet in February and is effective since April 1, 2001. For more details, see *Heisei 13nen do zeisei kaisei hō wo kokugi ni teishutsu: Shōji Hōmu* 1586, p. 47 (brief notes); *Shōji Hōmu* 1591 (2001) 14 (bill text).]

27 MAEDA (*supra* note 20) *Shōji Hōmu* 1553 at 6.

the scope of admissible dividends in terms of personal type division is a point that the commercial law legislators intentionally abstained from<sup>28</sup>.

Third, such business transfer is exempted from the asset examination procedure (*kensa*) conducted by a comptroller appointed by the court<sup>29</sup>. This *kensa* procedure by a comptroller, a requirement for various types of irregular incorporation (Artt. 173, 246, 280-8), is feared by practitioners because of the unpredictable time frame and cost factor.

Fourth, the transfer of accounting items such as earned surplus or reserves was enabled. Similarly, the transfer of licenses or approvals for the business is simplified.

There is no free lunch, though. First, the definition of “business transfer” is relatively restrictive so as not to allow tax evasion or damage to the creditor’s interests. Second, as a rule, a larger majority is required for approval at the shareholders’ meeting (Arts. 374 para. 1, 374-17. The conditions for such a special resolution [*tokubetsu ketsugi*] are given in Art. 343. For an exemption, see Art. 374-6). Further, opposing shareholders are granted an appraisal right (Artt. 374-3, 374-31 para. 5), as they are in the case of a resolution on a merger. Third, for the protection of creditors, disclosure and a limited level of creditors’ engagement are required<sup>30</sup>.

b) *Examples of Utilization*<sup>31</sup>

Most importantly, the transfer by way of division of a comprehensive business division (or even a company as a whole) and the restructuring is now possible in a more efficient manner. This can be applied especially for the restructuring of subsidiaries of a holding company. In a special occasion where unanimous approval is required (this typically happens with closed corporations), a thorough restructuring such as a dissolution of a joint venture is possible, since a disproportional share distribution (*hi-anbun*) is allowed.

Other types of restructuring that were common even under the former system, may also benefit from the new rules. A transfer of a business division to a subsidiary (known as *bunsha*) will be exempted from the *kensa* procedure and will have more simplified

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28 MAEDA (*supra* note 20) *Shôji Hômu* 1553 at 6; HARADA, *Heisei 12nen kaisei shôhō* (*supra* note 20) at Q13.

29 How is the fulfillment of capital requirements guaranteed? A combination of disclosure and the possibility for creditors to file an objection are to serve as a substitute. In the United States where a similar creditor protection system is unknown, a professional opinion concerning the value of positive and negative assets and the sufficiency of these assets in comparison with the capital increase (known as solvency opinion) is required; TAKEI (*supra* note 20) at 86, 222-230; HARADA, *Heisei 12nen kaisei shôhō* (*supra* note 20) at Q18.

30 This was critical particularly in case of the division without a distribution to shareholders (*butteki bunkatsu*). Cf. TAKEI (*supra* note 20) at 96-97.

31 TAKEI (*supra* note 20) at 21-40. (Supplement of May 2001: A. TOKI ET AL., *Kigyô saihei no subete* [Comprehensive Study on Corporate Restructuring]: *Bessatsu Shôji Hômu* 240 (May 2001) includes comprehensive information from the viewpoint of expert practitioners applying the new law.)

procedures for the incorporation and the issuance of new stocks. If shareholders agree, the shares of the subsidiary can be distributed to the shareholders of the parent. Similarly, joint venture or business co-operations are among those companies that can take advantage of the new regulations.

One has to take note that the division is inadequate for establishing a holding system by transferring businesses to newly established subsidiaries. Preserving privileges such as licenses and avoiding the procedure for the creditors' protection is possible by simply utilizing the stock exchange rules established in 1999 (Arts. 352-363).

*c) Remaining Questions*

During the research for this part of the article, the author frequently wondered whether such an approach would have been possible ten years ago: So many critical points are left unresolved hoping that other people will be able to solve them. As a matter of fact, it is reported that the government is planning to increase the number of lawyers three-fold<sup>32</sup>. There is some irony in this situation, because the reason why the business world pressed for this legislation were the ambiguities especially of the *kensa* procedure and the consequential costs. With the new rules, business people will still face a number of difficult issues. The following are some examples of expected problems.

First, due to the ambiguities of critical terms (e.g., the definition of business, the necessary and/or admissible terms in the documents for the divisional procedure) and their construction (e.g., the requirement for a disproportional distribution of new shares), law suits for the declaration of nullity of the division (Arts. 374-12, 374-28) are to be expected.

Second and most importantly, the rules for tax accounting<sup>33</sup> are not yet determined. Practitioners can ask the National Tax Administrative Agency for opinions. In particular practitioners may want to transfer the annual net loss (*kurikoshi kesson kin*) to the new income statement, although the chances for this to be allowed are slim. One

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32 The governmental committee presented a specific number as a goal. In 2004, a new educational system will be introduced. The bar exam will be made easier so that the majority of graduates of law schools can pass it. Approximately 3000 candidates are likely to pass which is three times the current number. The total number of lawyers (app. 50,000 in year 2018) will increase by two and a half. *Hôsû zôin goman'nin, hôka daigaku-in, 2004nen ni kaikô – shihô kaikaku shin saishû iken gen'an* [Final Draft for the Advisory Opinion of the Committee for the Reform of the Judicial System]: *Nikkei Times* (morning edition) May 12, 2001, p. 1. The introduction of the new educational system, coupled with plans for privatization, would greatly change legal education in Japan. Precisely speaking, the mainstream seeks the shift to so-called *dokuritsu gyôsei hôjin*, independent administrative juridical persons, i.e. universities which can determine and manage their own budget.

33 TAKEI (*supra* note 20) at 172-77. Japanese GAAP do not have comprehensive rules for corporate restructuring and thus, the practice follows the tax accounting rules. Most of the problems occur with the use of book values. [Supplement of May 2001: See the supplement to note 26 of this article. The new law clarified many important issues.]

possible reason for this prudent attitude is the example of serious tax evasion through the corporate division in the United States.

Finally, there are open questions concerning labor law. It is not surprising that the parties opposing the legislation were concerned with the status of employees during the procedure of reconstructing. As the restructuring involves by definition the possibility of a lay-off, what the Diet could do is to make an incidental resolution (*futai ketsugi*) to confirm the general rules concerning the legal termination of employment relationships<sup>34</sup>. Increased redundancies in less competitive industries would, however, lead to more law suits against the dividing company.

#### IV. PROSPECTS FOR THE YEAR 2001

##### 1. *Comprehensive Approach*

In September 2000, the Ministry of Justice officially announced a very broad legislative plan drafted by the commercial law committee of the Legislative Advisory Council of the Ministry of Justice (*Hôsei shingi-kai shôhō bukai*)<sup>35</sup>. As was mentioned above in the part on the Second Period, this is a procedure with a long tradition, but with the current changes in the environment the final outcome is unpredictable. A good summary for an earlier version of this far-reaching plan was already published in this journal<sup>36</sup>. Also, in October 2000, the Japan Association of Private Law (*Shihō gakkai*), the biggest and apparently most prestigious association for legal studies in Japan, held a conference on the reform of the corporate law<sup>37</sup>. It is reported that bills by Diet members (*gi'in rippō*) on the restriction of directors' liabilities in cases of derivative suits (compensation amount of up to two years' income of a director) are under preparation and scheduled to be submitted in 2001<sup>38</sup>. The *Nikkei Times* reported that the committee

34 M. IWADA, *Kaisha bunkatsu ni yoru rôdô keiyaku shôkei-hô no jitsumu: Rôdô Hanrei 792* (2001) 149-155 (continued). A separate law (*Kaisha no bunkatsu ni tomonau rôdô keiyaku no shôkei tô ni kansuru hôritsu* [Law on the Successions of Employment Contracts in the Occasion of Corporate Division] was introduced in April 2000 to confirm these points. For more details for this law, see N. ARAKI, *Gappei, eigyô jôto, kaisha bunkatsu to rôdô kankei: Jurisuto* 1182 (2000) 16. Cf. also TAKEI (*supra* note 20) at 46-47; HARADA, *Heisei 12nen kaisei shôhō* (*supra* note 20) at Q34.

35 *Kôgô no shôhō kaisei ni tsuite* [Upon the Future Reform of the Commercial Law] (Sept. 6, 2000) <<http://moj.go.jp/MINJI/minji27.html>>. Why they packed up all the issues in one plan is unclear, particularly when there is no practical relationship between them.

36 H. ODA, *Forthcoming Legislation: ZJapanR 9* (2000) 161-162; H. ODA, *Forthcoming Legislation: ZJapanR 10* (2000) 219-220.

37 For the discussion papers, see *Nihon Shihō Gakkai, Shihō 63* (April 2001).

38 Drafts published by a team of the Liberal Democratic Party (*Jimintō*) and of the *Kômeitō* were published (*Kigyô tôchi ni kansuru shôhō tô no kaisei an yôkô: Shôji Hômu 1524* (1999) 37 and *Kigyô tôchi ni kansuru shôhō tô no rippô-an: Shôji Hômu 1589* (2001) 45). Additionally, it is reported that the *Jimintō* drafted a bill to be submitted in the current

participants from academies, who were worried that the director's liability will be inadequately alleviated, were reluctant to approve the bill for restricting the rules on derivative suits<sup>39</sup>. Finally, on 18 April 2001, the *Hōsei shingi-kai*, the Legislative Advisory Council for the Ministry of Justice, announced a proposal for the prospected reform and requested public comments until the end of May 2001<sup>40</sup>. The prospective bills are to be submitted in 2002 (except for the year 2001 bills pertaining to the stock option (Item 5) and the use of electronic methods to summon shareholders for meetings (Items 24-26)). The proposal consists of four columns: 1) Reforms aiming at effective corporate governance, particularly in areas such as rules relating to organization, disclosure of the corporate information, and necessary adjustments for rules on stock options; 2) Applying the system to the current status of information technology, especially to utilize electronic methods (PC and the Internet) for corporate documents and shareholders' meetings; 3) To facilitate corporate finance, especially to avoid rigid restrictive requirements; 4) To supervise rules with foreign companies, particularly by paying attention to the interests of Japanese nationals. However, the proposed text consisting of 28 items is divided as follows: a) Equities (Items 1-8); b) Corporate organs (Items 9-19); c) Accounting and Disclosures (Items 20-22) ; d) Miscellaneous (Items 23-28).

## 2. Summary of the Proposal of April 2001<sup>41</sup>

Issues here are broad and prospects are unstable. Some proposals are very old, repeated almost over a generation, and will perhaps not be realized soon. The proposal mixes large with small issues. Brainstorming effects are perhaps expected. It is possible that issues not covered here will become important new legislation. By the same token, issues discussed here could finally be disregarded and remain unrealized.

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session to activate the securities market by way of a liberalization of holding treasury stocks and the shortening of the procedural period for the issue of new stock from four to two weeks by abolishing the board's decision on the concrete issuing price. *Kabu hakkō nishūkan de tetsuzuki* [Stock issue will need only two weeks]: *Nikkei Times* (morning edition) May 16, 2001, p. 1. Further, the *Jimintō's* committee for taxation system research (*Zeisei chōsa-kai*) announced its intention to take measures for stimulating the securities market by a partial exemption from the capital gain taxation. *Aki no kokkai de hōan shori* [Tax bill is for the next session] Id.

39 *Kigyō tōchi tōmei sei wo yōkyū*: *Nikkei Times* (morning edition) May 4, 2001, p. 5.

40 As is stated in the first chapter of this article, this is the most orthodox and authoritative procedure and the plan proposed here used to be almost decisive. However, this time the proposal is highly tentative in nature. It is characteristic that it substantially includes the draft published by parliamentarians (*gi'in rippō an*) or organizations representing the industry. It is fair to judge that this proposal is a critical, if not decisive, milestone for the reform.

41 For the text of the proposal, see HÔMU-SHÔ MINJI-KYOKU SANJI-KAN SHITSU, *Shōhō tō no ichibu wo kaisei suru hōritsu-an yōkō chūkan shian* [Intermediate Draft on the Outline of a Law Revising the Commercial Code]: *Shōji Hōmu* 1593 (2001) 28-51. For the official comment on the proposal, see ID. at 5-27.

a) *Equities*

The official commentary further divides this topic into six categories: i) Relaxation of rules concerning the authorized shares (maximum number of shares a company may legally create) and the adjustment of requirements for the new stock issue in a limited context; ii) Classes of shares. As the practice necessitates a freer hand with the use of new type securities such as tracking stocks, and an increased freedom of contract among shareholders, the power of articles of association to delineate the contents of each class will be increased; iii) Issue of subscription rights (partly to be codified in 2001). At first this aims at reorganizing the existing rules on preemptive rights in general and on warrants and stock options. Proposals for more drastic changes are also presented; iv) Selective adoption of the dematerialization of corporate securities. This is to allow the corporation to utilize the book-entry system and to save the expense and time for the material certificates; v) an amelioration of the current invalidation system for lost or stolen stocks; vi) Empowering the company to dispose of anonymous stocks.

Item ii) (class of stocks) may lead to a real chaos, particularly because the current system admittedly offers very limited choices on the long run. One should empower minority shareholders to negotiate and pay attention to the experience of European countries, which lately allowed the creation of various stocks.

b) *Corporate Organs*

The official commentary further divides this into eleven sections: vii) Advancing the deadline for the exercise of shareholders' rights to propose a subject for resolution and/or to convene a special shareholders' meeting; viii) The relaxation of the requirement for special resolutions at shareholders' meetings (Art. 343); ix) Exemption from the resolution at shareholders' meeting in the case of transfer of stocks by a parent company; x) Simplification of the summons procedure of shareholders' meeting and directors' meeting, especially the permission to use documents for resolution; xi) New rules for the disclosure of compensations for directors, especially those pegged to a certain index; xii) Clarifying the scope of a possible transfer of power from the directors' board to a managerial subcommittee (*keiei i'inkai*). As the directors' board of a big company may not be able to immediately respond to business necessities, this type of subcommittee, commonly known as *jômu-kai* is widely adopted but its legitimacy and the admissible scope of delegation remains unclear; xiii) Obligatory appointment of external directors in large companies as defined by the *Shôhô tokurei hô* (Law on Special Measures to the Commercial Code on Audit and Related Matters; L. 22 of 1974); xiv) Expansion of the application of rules (including those provided in Item xvi) for large companies defined by the above Law of 1974 to smaller companies which are audited by a public auditor (*kaikai kansa-nin*) and have more than one hundred million yen capital; xv) To legislate for the standing of the public auditor as a defendant of the derivative suit; xvi) Adjustment of the rules concerning the decision for the allocation

of net profit. This is critical with a large company under the Law of 1974, since the directors' board can make a decision without the approval of shareholders, provided that auditors express their unqualified approval; xvii) Introduction of regulatory committees (*kakushu i'inkai*) and the executive directorate (*shikkô yaku*) system with large companies under the Law of 1974.

Again, this is a mixture of large and small issues. It is safe to say that items xiii) and xvii) are most interesting. It is suggested that the alleviation of the director's responsibility in the current law is necessary for the external director. Item xvii) has a twofold effect: Admitting an effective directory organization on the one hand, and requiring multiple controlling organizations (auditing committee, nominating committee and the compensation committee, each with three or more members, the majority of which should be external directors) on the other hand (abandoning the current corporate audit system). This is based on the understanding that the current directors' board fails both in efficient management and control. The proposal suggests that a choice between the new and the current system should be allowed. Where the former is selected, then this should be provided in the articles of association.

*c) Accounting and disclosures*

The official commentary further divides this into three sections: xviii) Enlargement of the scope covered by ministerial order (*shôrei*) instead of law, especially with the evaluation of assets and the calculation of the net profit distributable to shareholders (*haitô kanô rieki*). Generally speaking, the accounting rules under the Securities Law (*Shôken torihiki-hô*) and Rules are catching up with international standards (including the disclosure of consolidation). However, since the Commercial Code is dragging behind, it is expected that areas within the scope of the Commercial Code would be restricted to basic principles; xix) For large companies defined by the Law of 1974, accounting documents (*keisan shorui*) required by the Commercial Code should be prepared on a consolidated basis. What is critical here again is to adjust to the rules of the Securities Law where the consolidated basis accounting is adopted as a rule. Simultaneously, the scope of rights, duties and responsibilities of audits should be adjusted in a way suitable for the conduct of audit of subsidiaries; xx) Disclosure of the accounting documents. The amelioration of the disclosure of corporate documents has been officially demanded since 1962 (!). The use of electronic methods is suggested in the proposal.

*d) Miscellaneous*

The official commentary further divides this into four sections: xxi) New evaluation system for assets as an object of bulk transfer. For reasons why the current evaluation system named *kensa* is disliked, please refer to part two of this article on corporate division; xxii) Digitalization of corporate management in general; xxiii) Streamlining and

clarification of the capital reduction procedure. The current provision is insufficient from the view of disclosure and protection of creditors; xxiv) Allowing foreign companies which conduct a permanent based business in Japan to hold a Japanese agency as its representative instead of the currently required business branch (*eigyô-sho*).

Item xxii) merits a further scrutiny: The commentary on the proposals classifies this in two: the issue of preparation of corporate documents by electronic methods and the issue of communication by electronic methods. The first issue will create difficulties in the sense that parties opposed to the legislator will stress the necessity of protection of those without an access to electronic facilities<sup>42</sup>. The second issue, titled Electronic Publications and others by Stock Companies involves two matters. The first is the utilization of electronic means for transmissions by the company such as the public notice (*kôkoku*) required by law, or a contact made with each shareholder such as an invitation to shareholders' meeting. The other matter is the transmission in opposite direction: Provided that this is resolved by the directors' board, electronic voting in addition to the conventional method may be admitted. This e-vote, once realized, might have a revolutionary power for corporate governance. Unless the resolution of the shareholders' meeting acquires independence from the directorate<sup>43</sup>, the management will remain under the control of an incumbent board. Since the uselessness of participation by external parties is historically demonstrated as related elsewhere in this article and the experience with the legislation rush of the last decade demonstrates that the law of 1993 concerning the cost of trial is not popular with management, it is time for legislators to abandon the conventional scheme and substitute it with new methods based on new technologies<sup>44</sup>.

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42 Unless the use of these new methods is admitted on a sufficiently large scale, the introduction will increase expenses for the company. It is hard to judge to what extent shareholders have access to electronic methods. In Japan, the use of Internet by private persons is not as common as in the United States. On the contrary, the use of cellular phones with a picture transferring function (called 'i-mode') is very common. With this function, investors cannot only receive investment data but also place a transaction order on a 24 hour basis. See <[www.dokomo-kansai.co.jp/mova/i\\_mode/menu/trade/index.html](http://www.dokomo-kansai.co.jp/mova/i_mode/menu/trade/index.html)> (a homepage of the Kansai division of NTT company). Unfortunately however, for the time being, this i-mode is unable to load a document large enough for corporate disclosure.

43 As to how management can achieve a majority by means of proxy or voting in writing, see H. ODA (*supra* note 1) 238-39. For listed companies at least, dissident large shareholders can hardly succeed in collecting the necessary votes.

44 As many shareholders record and control their shares on the computer account furnished by various organizations (e.g., <<http://www.nomura.co.jp/hometrader/index.html>>), and experience indicates that people are willing to utilize the net to express their complaints, this may bring a revolutionary change for corporate governance. The ratio of PC holders among shareholders is expected to be much higher than the national average. Indeed, the proposal of 2001 itself suggests the introduction of voting through the net.