

## Reform After a Decade of the Companies Act: Why, How, and to Where?

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### I. INTRODUCTION

The current Companies Act was enacted in 2005 and entered into force on 1 May 2006 to replace the old corporate law provisions in the Commercial Code. In 2010, five years after the enactment, the Legislative Council started a review of the Act. The resulting Bill to amend the Companies Act was submitted to the Diet in December 2013 and is expected to be approved during the first half of 2014.

This article examines why and how the Companies Act is going to be revised now and what the future of Japanese corporate law will be after the Bill is approved. In doing so, the article will, in particular, consider the Bill’s continuity from, and novelty as compared with, the original Companies Act of 2005. The fact that the revision process commenced the year after the political turnover from the long-dominant Liberal Democratic Party (LDP) to the newly emerged Democratic Party of Japan (DPJ) might hint at discontinuity. However, the “Outline of the Revisions to the Corporate Law” (*Kaisei yōkō*)<sup>1</sup> published in August 2012, which the Bill traces almost word for word, did not meet any significant opposition even after the LDP returned to power later that year, except that the LDP members of the Diet added one provision (see IV below). Therefore, it may be

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1 The “Outline” is available on the website of the Ministry of Justice (in Japanese only). For its analysis in English, see G. GOTO, The Outline for the Companies Act Reform in Japan and Its Implications, in: *ZJapanR / J.Japan.L.* 35 (2013) 13. In German, E. TAKAHASHI, Entwicklung und Hintergründe der Regelungen zur Corporate Governance in Japan mit einem Schwerpunkt auf der Reform von 2013, in: *ZJapanR / J.Japan.L.* 35 (2013) 63.

misguided to simply assume that the swinging of power between the two political camps accompanies shifts in policies on corporate governance.

To make a more objective analysis, it is necessary to place the Bill in a series of developments affecting corporate governance. To this aim, this article first refers to the framework of political scientists to consider *why* the deliberations over the corporate law revision started (II). Then it examines *how* the Bill is going to improve the Companies Act, examining, among other issues, what types of problems it will address (III). Finally, it predicts *where* corporate law in Japan is heading by looking at the developments that have taken place since the Legislative Council concluded its deliberations (IV). The conclusion is that the Bill mainly complements the Companies Act by addressing many issues that the latter failed to address; in addition, as far as reforms of the board structure are concerned, it concludes that Japanese corporate law is making a moderate shift to a model emphasizing shareholders' interests (V).

## II. POLITICAL AND SOCIAL DRIVERS: WHY IT STARTED

As the framework for analyzing the relationship between the political powers and corporate law, Gourevitch and Singh advanced the patterns of coalition among the shareholders (investors), managers, and employees. According to their argument, the corporate governance in each jurisdiction varies depending on what coalition is formed and whether or not that coalition prevails over the other political groups.<sup>2</sup>

In Japan in 2010, when the government called the Committee on Corporate Law under the Legislative Council, the power appeared to be in the hands of the investors and employees. The Democratic Party of Japan (DPJ), the leading party in the governing coalition after achieving a landslide victory in the election the year before, had these two groups as their supporting basis. The DPJ was originally a party popular among urban voters, criticizing the clientelistic ties with the vested interests that the long-reigning Liberal Democratic Party (LDP) had formed.<sup>3</sup> It endorsed economic liberalism, which is attractive to global investors. On the other hand, from the early days of its formation, the DPJ was backed by labor unions.<sup>4</sup> The overall position of the DPJ had become center-left by the time it finally assumed power in 2009, promising during the election to enlarge the social insurance to cover any detriment the citizens might suffer from the liberalization that the LDP had advanced, in particular under Prime Minister Koizumi during

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2 P. GOUREVITCH / J. SHINN, *Political Power and Corporate Control*, (Princeton 2005) 57–67.

3 S. R. REED / E. SCHEINER / M. F. THIES, *The End of LDP Dominance and the Rise of Party-Oriented Politics in Japan*, in: *Journal of Japanese Studies* 38:2 (2012) 353, 366.

4 L. E. CARLILE, *The Labor Movement*, in: Gaunder (ed.), *The Routledge Handbook of Japanese Politics* (London et al. 2011) 162, 172. For the history of founding the DPJ, see P. KOLLNER, *The Democratic Party of Japan*, in: Gaunder (ed.), *supra*, 24, 25; J. A. A. STOCKWIN, *Governing Japan*, 4th ed. (Malden, Mass. 2008) 195.

the first few years of the twenty-first century.<sup>5</sup> As a policy suitable to its supporters, the DPJ attempted to conduct a reform of corporate governance to the benefit of investors and employees.

At first sight, it might appear strange that the coalition of employees and investors was formed in Japan. Japanese corporate governance has long been portrayed as featuring employee participation in management, backed by the informally guaranteed lifelong employment and the practice of picking up executive directors from among the employees. However, lifelong employment continued shrinking gradually throughout the 1990s. While core employees are still tacitly guaranteed their jobs, such core employees have come to occupy an increasingly smaller part of the total workforce.<sup>6</sup> Therefore, the employees had good reasons to liaise with the investors to exercise discipline over the managers, which Gourevitch and Shinn suggest as one of the possibilities for the formation of the investor-employee coalition.<sup>7</sup>

Still, the employees stopped short of demanding higher returns to the shareholders as the beneficiaries of the pension funds. Though Japanese pension funds have become much more demanding than they used to be, they are yet to pursue the activist policies comparable to those of their foreign counterparts.<sup>8</sup> As a result, the corporate governance reform envisioned by the DPJ did not emphasize the monitoring of performance by the management, but the monitoring of compliance with laws and regulations. When the labor union proposed a system inspired by co-determination in Germany, it demanded that the representatives of employees sit on the board of statutory auditors (*kansa-yaku*) rather than the board of directors. Since statutory auditors are responsible only for monitoring compliance, the proposal revealed the lack of interest on the side of employees in improving the performance of Japanese companies.

After all, there appeared to be a gap between the investors wishing to advance the shareholder primacy model of corporate governance and the employees who still prefer stakeholder-centered corporate governance. It was thus no surprise that the coalition failed to prevail. The idea of having employee representatives on the board of statutory auditors was abandoned at an early stage of deliberations.<sup>9</sup> The proposal to introduce a mandatory requirement for the listed companies to nominate one or more independent

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5 F. MCCALL ROSENBLUTH / M. F. THIES, *Japan Transformed: Political Change and Economic Restructuring* (Princeton 2010) 191.

6 L. WOLFF, *The Death of Lifelong Employment in Japan?*, in: Nottage / Wolff / Anderson (eds.), *Corporate Governance in the 21st Century: Japan's Gradual Transformation* (Cheltenham 2008) 53; W. R. GARSIDE, *Japan's Great Stagnation* (Cheltenham 2012) 163.

7 GOUREVITCH / SHINN, *supra* note 2, 65, 211.

8 B. E. ARONSON, *A Japanese CalPERS or a New Model for Institutional Investor Activism? Japan's Pension Fund Association and the Emergence of Shareholder Activism in Japan*, in: *NYU Journal of Law and Business* 7 (2011) 571; J. BUCHANAN / D. HEESANG CHAI / S. DEAKIN, *Hedge Fund Activism in Japan* (Cambridge et al. 2012) 254–257.

9 GOTO, *supra* note 1, 30–31.

(or outside) directors was more seriously debated, but could not beat the resistance of the industry lobby. The compromise was the “comply-or-explain” duty: the Outline requires publicly traded companies to state in their annual reports why it was found unreasonable to nominate an outside director. There is no provision on this requirement in the Bill because the subject of annual reports is regulated by Ministerial Order and not by law, though the members of the Diet added a provision afterwards with substantially the same effect (discussed *infra*, in IV).

If the investor-employee coalition fails to prevail, the outcome will be the triumph of managerialism. However, this does not mean that no revision was found necessary. In fact, the Outline made various proposals for amendments to the Companies Act that have been incorporated into the Bill. This requires analyses of how, or in what respects, the Bill is going to improve corporate governance in Japan.

### III. PROTECTING MINORITY SHAREHOLDERS UNDER THE JAPANESE CONTEXT: HOW THE LAW IS CHANGED

#### 1. “Agency Problems” of Corporate Law

In order to see what kind of problems the Bill will address, a theoretical framework for understanding corporate law is useful. As is well known, there are three types of conflicts of interest in the corporate law context, often described by borrowing the economics term “agency problems.” The first is the conflict between shareholders as owners of the corporation and the managers, which is the problem considered when the membership of the board is discussed. The second type of conflict is one between the majority and minority shareholders, or more generally, a part of the shareholders against the rest of shareholders. The third type of conflict is found between the corporation and the creditors and other stakeholders.<sup>10</sup>

The reform of corporate law since the end of 1990s, which finally culminated in the enactment of the Companies Act of 2005, was mostly concerned with the conflicts between the managers and (general) shareholders. On the one hand, the industry required that corporate law catch up with the developments of financial techniques and broaden the scope of financing measures available to the companies. The rules on financing are concerned with the agency problem of managers vis-à-vis the investors (shareholders) or financiers. On the other hand, the director’s liability has always been on the agenda. As the law on liability can be viewed as the mechanism to give right incentives to the managers, the reform made during this period was, after all, primarily concerned with the conflicts between managers and shareholders.

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10 R. KRAAKMAN et al., *The Anatomy of Corporate Law*, (2nd ed. Oxford 2009) 36.

## 2. Regulation over the Cash-Out (Squeeze-Out) of Minority Shareholders

In contrast, the revisions in the Bill of this time address the second type of conflict, namely the conflict between the majority and minority shareholders. First, the Bill proposes to introduce a procedure to be used when the majority shareholder intends to “cash-out” (squeeze-out with redemptions in cash) the minority shareholders. The procedure is available only to a “qualified controlling shareholder”, which is defined as a shareholder having ninety percent or more of the voting rights in the company. The majority shareholder is supposed to first make a tender offer and acquire most of the outstanding shares and then resort to this procedure to cash-out the remaining shareholders to complete the deal. Full disclosure is required in advance to give the objecting shareholder an opportunity to raise a suit for injunction. The injunction is granted when either the cash-out is made in contravention of any regulation or the conditions of acquisition, including the payment to be made, are extremely unfair. Unless the court orders the injunction, the acquisition is completed on the day provided for in the disclosure.

While creating a formal procedure for cash-out, the Bill also proposes that equivalent regulation be extended to two procedures that are utilized in practice for the purpose of cashing-out minority shareholders. One is conversion of common shares to the shares subject to wholly call (a class share that can be acquired by the company once the shareholders’ general meeting so determines by a qualified majority),<sup>11</sup> and the other is consolidation of shares.<sup>12</sup> These procedures, apart from their proper purposes, are often borrowed to conduct a de facto cash-out transaction. In both cases, it is possible to design a transaction in which the size of a share issued to shareholders after the transaction is so large that any minority shareholder is entitled to only a fraction of one share. In such a case, a share is auctioned or sold at a market price and the proportional payment is made to the minority shareholders as substitution of the fraction of a share that they are entitled to.<sup>13</sup> The result is exactly the same as the successful cash-out. The Bill requires disclosure in advance of these procedures and entitles the objecting shareholder to an injunction by the court when there is any contravention of regulations.

The proposed revisions are obviously intended to deter abusive cash-outs. Management buyouts accompanied by the later cash-out of objecting shareholders has become popular in recent years as a strategy for going private.<sup>14</sup> The phenomenon may be associated with the rush to create venture businesses in the early 2000s.<sup>15</sup> Backed by the policy to promote new entrants into the market, many venture businesses made initial

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11 Art. 171 Companies Act.

12 Art. 180 Companies Act.

13 Artt. 234, 235 Companies Act.

14 W. TANAKA, *Going Private and the Role of Courts: A Comparison of Delaware and Japan*, in: *UT Soft Law Review* 3 (2011) 12.

15 T. MATSUI, *Corporate Governance and Closely-Held Companies in Japan: The Untold Story*, in: *Nottage / Wolff / Anderson, supra note 6*, 108, 116 ff.

public offerings (IPOs) in the markets for emerging companies. Some of them continued growth after the IPO, but others were not so successful. After several years, the latter companies are now choosing to go private.

The cash-out transactions (conducted de facto by borrowing, in particular, the scheme of shares subject to wholly call) can become abusive if the company does not award sufficient compensations to the shareholders. In some cases, shareholders not satisfied with the whole transaction sought for the appraisal remedy before the court.<sup>16</sup> The management buyout is a transaction between the acquiring managers and the shareholders. However, the acquirer in the management buyouts conducted under such circumstances is usually the controlling shareholder that has remained as the manager after the IPO. Therefore, the conflict in actual situations exists more often than not between the controlling and minority shareholders. The amendments in the Bill are expected to mitigate such conflicts, providing for fairness to the minority shareholders.

### 3. *Injunction Against Fundamental Changes to the Corporation*

Another revision proposed by the Bill is to introduce injunction as a relief awarded to the complaining shareholder in case of a fundamental change to the corporate structure, namely merger, divestiture, “share exchange” (corporate restructuring to create a wholly owned subsidiary), and “share transfer” (creation of a parent company of which the originating company becomes a wholly owned subsidiary). The background situation is somewhat similar to the cash-out transaction. The opposing shareholder in a fundamental change can also avail himself or herself of the appraisal remedy and require the court to order the company to redeem the shares that he or she owns according to the evaluation that the court finds fair.<sup>17</sup> Like the appraisal cases in cash-out transactions, the number of disputes involving the exercise of appraisal right in fundamental changes is increasing.

Injunction could be a substitute to the appraisal remedy. When the result of evaluation by the court lacks predictability, it can be a better remedy, as it halts the process at an early stage. The appraisal right is exercised after the restructuring is completed and, for this reason, imposes unforeseeable costs at the time of completing the process on the companies conducting the fundamental change.<sup>18</sup>

However, the injunction proposed by the Bill is available only when there is a contravention of law or corporate charter and the shareholder incurs harm because of it. It is

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16 Art. 172 Companies Act. One of the best-known cases is *Rex Holding*. See M. SAITO, Case No. 28 (Supreme Court 29 May 2009), in: Bälz et al. (eds.), *Business Law in Japan – Cases and Comments* (Alphen aan den Rijn 2012) 299.

17 Artt. 785, 797, 806 Companies Act.

18 A. HOSHI, *Appraisal or Injunction?: Corporate Takeovers under Uncertain Valuation*, in: Shishido (ed.), *Enterprise Law: Contracts, Markets and Laws in the US and Japan* (Cheltenham, forthcoming in 2014).

understood from the deliberations at the Legislative Council that the amount of compensation given to the shareholder cannot be claimed as contravention of law, even if the court finds afterward that the amount was unfairly small.<sup>19</sup> Though it is obvious that the injunction is aimed at protecting the interests of the opposing minority shareholder from the majority's decision at the general assembly to conduct the fundamental change, how and to what extent it will improve the conflict is not clear.

#### 4. *Regulation over the Placement of Shares in a Large Amount*

The Bill also introduces the regulation over the placement of new shares in a large amount. Japanese corporate law authorizes the board of directors to issue new shares (or redistribute treasury stocks) up to the amount determined in the corporate charter. As this authorized amount can be as much as four times of the outstanding shares,<sup>20</sup> the management virtually has the discretionary power to affect the control of the company. Where the placement results in creating a controlling shareholder with more than half of the outstanding shares, the Bill requires disclosure of the identity of this new controlling shareholder. If other shareholders with ten percent or more of the voting rights notify the company of their objection within two weeks, the company must ask the general assembly to approve the placement.

On its face, the problem appears to lie in the power of the managers to affect changes in the control of the company through the issuance of shares. This has been the subject of controversy for many years in the context of takeovers, in which case the conflict between the manager and shareholders is at issue.<sup>21</sup> However, the background of the revision in the Bill was somewhat different. The chairman of the Legislative Council's Corporate Law Committee mentions the "dubious financing" cases after the global financial crisis. In those cases, the listed companies, again mostly newly created companies having made IPOs several years before, issued a large amount of shares to overseas equity funds. The identity of those funds that had acquired control of the issuing company was suspicious. Further, the financed money was soon lost from the issuing company, and reports of window dressing, insider trading, or distortions in trade in the market often surfaced.<sup>22</sup>

It appeared in those cases that the discretion of the managers in financing the company through the placement of new shares appeared to have been abused for the sake of the controlling shareholder. If such was the case, the intention of the new regulation over

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19 S. IWAHARA, 'Kaisha hōsei no minaoshi ni kansuru yōkōan' no kaisetsu [V] [Commentaries on the 'Draft Outline of the Revisions to Corporate Law', part five], in: Shōji Hōmu 1979 (2012) 4, 9.

20 Art. 113 (3) Companies Act.

21 See, for example, S. KOZUKA, Recent Developments in Takeover Law: Changes in Business Practices Meet Decade-Old Rule, in: ZJapanR / J.Japan.L. 21 (2006) 5.

22 S. IWAHARA, *Sōron* [General Part], in: Jurisuto 1439 (2012) 15–16.

the placement of shares is again mitigating the conflicts between the controlling and minority shareholders.

### 5. *Ensuring the Proper Management of a Group Company*

The three items of revision discussed above are all concerned with changes in the structure or control of the corporation. It is the situation where the conflict between the controlling and minority shareholders becomes most crucial. However, the conflict among the shareholders also matters in the ongoing operation of a company. In particular, the fact that many listed companies in Japan form corporate groups creating subsidiaries as a tool to enter into new markets<sup>23</sup> often complicates the problem.

The Legislative Council spent many hours discussing the problem that occurs when the subsidiary is a listed company. Some argued that the parent company, still holding control of the subsidiary, could exploit it to the detriment of its minority shareholders, which may be called tunneling in some jurisdictions. However, the idea of imposing liability on the parent company vis-à-vis the subsidiary when they enter into a transaction on terms unfavorable to the subsidiary was not supported, not least because there was no consensus on whether such tunneling in fact exists or not.<sup>24</sup> Further, even if introduced, such a general standard would cause a heavy burden on the courts that would examine the economic benefits of the transaction within the corporate group. As the benefits and harms within a group can take various forms – long-term or short-term, direct or indirect – the court would have difficulty in affirming the detriment suffered by the subsidiary other than in an extreme case of obvious fraud.

Rather, the Bill expanded the scope of liability to be pursued by the derivative action and opened the way for shareholders with one-hundredth of the outstanding stocks or voting rights, whichever is smaller, to raise a derivative suit against the directors and officers of an important, wholly-owned subsidiary. In Japan, minority shareholders frequently use the derivative action to pursue the liability of managers. In theory, it is a mechanism to strengthen the enforcement of the directors' liability and solve the conflict between the shareholders as a whole and the managers. However, the controlling shareholder has other much less costly means to discipline managers. For example, it can vote at the general assembly and displace an unsatisfactory manager. Therefore, in reality, the derivative suit is often used by the minority shareholders for the sake of advocating their interests against a decision made by the management and supported by the majority.<sup>25</sup>

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23 T. KIKUTANI / H. ITOH / O. HAYASHIDA, *Business Portfolio Restructuring of Japanese Firms in the 1990s: Entry and Exit Analysis*, in: Aoki / Jackson / Miyajima (eds.), *Corporate Governance in Japan* (Oxford 2007) 227, at 228–229.

24 GOTO, *supra* note 1, 31.

25 M. NAKAHIGASHI / D. W. PUCHNIAK, *Land of Rising Derivative Action: Revisiting Irrationality to Understand Japan's Unreluctant Shareholder Litigant*, in: Puchniak / Baum / Ewing-Chow (eds.), *The Derivative Action in Asia* (Cambridge 2012) 128.



Thus, this revision of the derivative suit, placed in its actual context, also has the effect of mitigating the conflict between the controlling and minority shareholders.

#### IV. PROGRESS ON THE REFORMS IN THE BOARDROOM

Another major item of revision in the Bill is the addition of a third option for the governance structure of large, public companies. Since the 2002 amendments to the then Commercial Code entered into force the next year, large, public companies in Japan have had two options: whether to maintain the traditional two-board system with the statutory auditors forming their own board besides the board of directors, or to have no statutory auditor and create within the board of directors three committees dominated by outside directors, respectively in charge of nomination, audit, and remuneration. The third option to be added by the Bill requires the company to set up only the “audit and supervision committee” dominated by outside directors, and to have no statutory auditor.

The currently available two options are based on totally different ideas about the role of the board. The traditional option assumes that the board of directors is mostly composed of executive directors. The Companies Act indeed requires the board of directors in such companies to make important business decisions,<sup>26</sup> and the statutory auditors monitor compliance with laws and regulations by the directors and employees. The committee system option, on the other hand, closely copies the practice of the monitoring board in the United States and allows the board of directors to entrust the operations to the executive officers.<sup>27</sup> The board of directors is charged with the responsibility of making basic policy decisions as well as monitoring the executive officers.

Compared with these two options, the idea behind the new option is not clear. The power of the audit and supervision committee is, after all, limited to the audit. Unlike the committee-system option, neither the succession of the CEO (nomination) nor the determination on the managers’ pay (remuneration) will be in the hands of outside directors. However, unlike statutory auditors in the traditional option, members of the audit and supervision committee are on the board of directors, which is responsible for monitoring the executive directors and sharing the power of turning an executive director into a non-executive director or vice versa with peer members of the board. Further, the Bill allows the board of directors in a company choosing the third option to delegate important operational decisions to executive directors, if the majority of the whole board (as opposed to solely the audit and supervision committee) is occupied by outside directors. The models of executive board and monitoring board seem to be merged to produce a hybrid.<sup>28</sup>

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26 Art. 362 (4) Companies Act.

27 Art. 416 (4) Companies Act.

28 The possibility of a hybrid model is suggested by B. ARONSON, *The Olympus Scandal and Corporate Governance Reform: Can Japan Find a Middle Ground Between the Board Monitoring Model and Management Model?*, in: *UCLA Pacific Basin Law Journal* 30 (2012) 93.

Like the option of committee system introduced in 2002, the creation of the third option may be a political compromise.<sup>29</sup> It offers a model of corporate governance without statutory auditors, whose usefulness is often questioned by foreign institutional investors,<sup>30</sup> and equipped with outside directors. It is indeed an option perhaps more palatable to the existing Japanese companies, as the limited responsibility of the audit and supervision committee enables the incumbent statutory auditors to be “upgraded” to members of the committee, thereby converting outside statutory auditors to outside directors. Still, this model is not imposed even on listed companies, reflecting the outcome of deliberations over the mandatory requirement of independent directors.

There is, however, also a difference from the compromise in 2002. This time, the political pressure is exercised in a way that might affect the choice among the options. The politicians of the LDP, now back in power, stepped in after the Outline was published and added a provision to the Bill that requires a listed company with no outside director to explain why nominating an outside director is not appropriate at the general shareholders’ meeting. Thus, the “comply-or-explain” rule is finally codified in the statute. Its practical effect will be all the more significant because Japanese companies are extremely sensitive about the general shareholders’ meeting.

Further, even after the Bill was completed and submitted to the Diet, the politicians did not stop exerting pressure. The LDP is reportedly preparing a corporate governance code that will make it virtually mandatory to nominate one or more outside directors.<sup>31</sup> Once such a code is edited and implemented, the listed companies will find it hardly possible to remain without an outside director.

The LDP has long been considered generous to industry preferences. Therefore, the fact that they are taking the initiative to put pressure on listed companies appears to be a surprising shift. It might be interpreted as revenge for the Japan Business Federation that quickly disconnected its old ties with the LDP and reverted to a neutral position once the DPJ came to power in 2009. However, by the beginning of the 2010s it has become obvious that the Japanese economy, now caught up with the emerging economy of China after having suffered two decades of economic downturn, needs to be reinvigorated by

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29 For the background of the 2002 reform, R. J. GILSON / C. J. MILHAUPT, Choice as Regulatory Reform: The Case of Japanese Corporate Governance, in: *The American Journal of Comparative Law* 53 (2005) 343, 354.

30 See, for example, ASIAN CORPORATE GOVERNANCE ASSOCIATION, The Roles and Functions of Kansayaku Boards Compared to Audit Committees, October 2013, [http://www.acga-asia.org/public/files/ACGA\\_Paper\\_Kansayaku\\_Audit\\_Committees\\_October\\_2013\\_English\\_Final.pdf](http://www.acga-asia.org/public/files/ACGA_Paper_Kansayaku_Audit_Committees_October_2013_English_Final.pdf).

31 “Abe Plans Japan Inc. Governance Code to Boost Growth, LDP Says”, <http://www.bloomberg.com/news/2014-02-28/abe-plans-japan-inc-governance-code-to-boost-growth-ldp-says.html>; “Abe Rewrites Rules to Rouse Japan With Governance Revamp”, <http://www.bloomberg.com/news/2014-04-09/abe-rewrites-rules-to-rouse-japan-with-governance-revamp.html>.

inviting investment from the global capital market. Whatever the preference of the existing business interests, the economic policy to be pursued is clear.

## V. CONCLUSION

It is true that the deliberations on the corporate law revision started after the DPJ-led coalition government was formed following the election in 2009. From their political position, exerting some discipline over managers in the interest of shareholders (investors) and employees made sense. However, these two groups of stakeholders had rather opposite interests in whether or not to pursue the shareholder primacy model. As a result, the politically motivated revision did not produce as significant an outcome as expected.

Rather, many of the proposed revisions address issues that the reform culminating in the Companies Act of 2005 has not focused centrally, namely the conflict between the controlling and minority shareholders. After the Companies Act was in force, this corresponded to the rise in the number of cases of such a conflict, in particular in newly founded companies that made an IPO. The governance of group companies was also discussed, and a limited revision in expanding the scope of targets in derivative suits is included in the Bill.

It is already anticipated that the conclusion of deliberations at the Legislative Council will cease the transformation of corporate governance, even for a while. The first step has already been taken by LDP members of the Diet who are now back in power, by adding a provision to the Bill that requires “comply or explain (at the general shareholders’ assembly)” with regard to the nomination of outside directors. The next one will come with the codification of the corporate governance code, which will further narrow the room for listed companies to remain turned away from the investors’ demand for independent directors. The political will appears to appreciate the necessity of appealing to the global capital market.

The revision, after all, will prove to be timely. Whether with large, globally known companies or in newly founded companies after an IPO, the Japanese economy needs to please investors. This means that corporate governance in Japan will come to accept the shareholder primacy model, even if gradually and preferring a hybrid approach. The politics in the Diet do not form economic policy in general, or corporate governance policy in particular. Rather, the context of the global economy conditions the politics on corporate governance.

## SUMMARY

*A bill to amend the Companies Act is now pending before the Diet. This is the first reform since its enactment in 2005. It is the outcome of deliberations that commenced the year following the DPJ’s ascension to power in 2009. However, their attempt to impose the*

*mandatory requirement of nominating at least one outside director in public companies failed, not least because their supporting groups – including the employees – did not appreciate the shareholder primacy model of corporate governance. Instead, the Legislative Council adopted many items of reform that may be effective in addressing the conflicts (agency problem) between the controlling and minority shareholders. Such conflicts emerged as a serious problem when several of the newly established companies failed to grow after their initial public offerings and exploited the general shareholders. Interestingly, after the Legislative Council concluded its deliberations, the LDP, which had returned to power in the meantime, exerted political pressure to include a provision requiring public companies to give “reasons for not nominating independent directors” at the general shareholders’ meeting. The LDP even announced its intent to continue corporate governance discussions by drafting a corporate governance code. These developments might imply that the amendments of 2014 do not stand alone, but instead constitute a step in the Japanese economy’s process of meeting the demands of the capital market.*

#### ZUSAMMENFASSUNG

*Der Gesetzentwurf zur erstmaligen Reform des Gesellschaftsgesetzes seit dessen Verabschiedung 2005 wurde mittlerweile ins Parlament eingebracht. Er ist das Ergebnis von Beratungen, die im Jahr nach der Machtergreifung durch die DPJ 2009 begannen. Der Versuch, Publikumsgesellschaften die Besetzung des Boards mit mindestens einem unabhängigen Direktor zwingend vorzuschreiben, scheiterte nicht zuletzt daran, dass die Unterstützerguppen – einschließlich der Arbeitnehmer – den Ansatz der Priorisierung von Anlegerinteressen in der Corporate Governance nicht teilten. Stattdessen hat der Gesetzgebungsrat zahlreiche Änderungen beschlossen, die zur Lösung der Konflikte (Prinzipal-Agenten-Problem) zwischen Mehrheits- und Minderheitsaktionären beitragen könnten. Derartige Konflikte wurden zu einem gravierenden Problem, als mehrere neu gegründete Unternehmen nach ihrem Börsengang nicht weiter wuchsen und die Publikumsanleger ausbeuteten. Interessanterweise übte die LDP, die in der Zwischenzeit wieder an die Macht gelangt war, nachdem der Gesetzgebungsrat seine Beratungen abgeschlossen hatte, politischen Druck aus, in den Entwurf eine Regelung aufzunehmen, welche die Unternehmen verpflichtet, in der Hauptversammlung „Gründe dafür zu nennen, dass keine unabhängigen Direktoren benannt wurden.“ Darüber hinaus äußerte die LDP sogar die Absicht, die Diskussionen zur Corporate Governance durch die Erstellung eines Corporate Governance-Kodex fortzusetzen. Diese Entwicklungen könnten darauf hinweisen, dass die Änderungen aus 2014 nicht isoliert zu betrachten sind, sondern einen Schritt auf dem Weg der japanischen Wirtschaft mit dem Ziel darstellen, die Anforderungen des Kapitalmarkts zu erfüllen.*

*(Die Redaktion)*

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The Bill to amend the Companies Act was approved by the Japanese Diet on 20. June 2014.

*(The Editors)*