

LUKE NOTTAGE / LEON WOLFF / KENT ANDERSON (eds.),

Corporate Governance in the 21st Century
Japan's Gradual Transformation

Corporations, Globalisation and the Law Series

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Since the so-called lost decade of the 1990s, Japan has witnessed massive reforms of corporate and commercial law culminating in the new Company Law of 2005. At the same time the debate on Japanese corporate governance, both in Japan and abroad, has intensified and become richer and more complex. The volume, edited by three leading experts on Japanese law in Australia, *Luke Nottage*, *Leon Wolff* and *Kent Anderson*, takes stock of these developments. Among the contributors are academics and legal practitioners from Australia, Japan, New Zealand, the United States and Canada. Some chapters originally stem from presentations given at the annual conferences of the Australian Network for Japanese Law (ANJeL), which was co-founded by the three editors.

The book offers the reader a rich variety of analyses of various key topics of Japanese corporate governance. It covers issues of board structure (including the rarely covered aspect of close corporations) and hostile takeovers, i.e., internal and external monitoring mechanisms. Furthermore, the volume takes into account the important de facto roles ascribed in Japanese corporate governance to a wide range of stakeholders. It also explores the implications of lifelong employment and looks into certain main banks' behavior during the economic slump of the 1990s. Finally it contributes to the debate, notably in *Luke Nottage's* opening chapter, by structuring the complex discussion on Japanese corporate governance while at the same time providing a highly useful framework for future comparison.

In their introduction, the editors outline the broader setting of corporate law reform connecting the volume's topic to the ongoing judicial reform as well as to broader theories of socio-economic change. They identify gradualism and the method of layering as characteristic features of the Japanese reform process. Critically reflecting on the claim that Japan's corporate and securities law is rapidly converging towards the market-driven "American" model, the editors summarize as the overall thesis of their book that Japanese corporate governance is currently undergoing a significant gradual transformation. By this they mean that, on the one hand, the comprehensive reforms of statutory rules are indeed transforming Japanese "law in action", while on the other, as

opposed to some predictions, what can be observed is a gradual change rather than radical upheaval. In other words, for the time being the results of this transformation can be expected to bear distinct Japanese features.

Luke Nottage's opening chapter, written with an admirably circumspect view of the subject, critically evaluates the burgeoning literature on Japanese corporate governance and develops a framework for future comparison. In a first step, assessing change versus continuity in Japanese corporate governance, he distinguishes four camps of commentators: The first two consist of those who take the view that overall there is little change. Those in the first camp, communitarians like Haley, argue that this is because cultural patterns such as key employment practices persist. Others like Ramseyer, from a rational choice perspective, deny that they see substantial changes towards a more market-driven economy, because in their view Japanese society has always been fundamentally driven by market forces. The commentators in the third camp and those in the fourth camp agree that there is significant change indeed. While the former, in particular influential voices in the financial press, speak of dramatic change and rapid convergence towards shareholder primacy and market solutions, the latter take a more guarded position. Nottage, as one will expect from the above (and his earlier publications), settles in the fourth camp. He recognizes that shareholders have assumed a more central position, but stresses that the shifts observed remain ambiguous in various respects. He outlines that in the relevant literature this fourth approach is supported by the majority of the authors.

In a second step, Nottage identifies what he calls "five ways forward": Future research on Japanese corporate governance should (1) consciously choose the historical frame of reference, (2) carefully choose the countries compared, (3) bear in mind that fundamental changes in black-letter law do not necessarily entail significant changes of the law viewed in a broader socio-economic context, (4) be reflective and explicit about normative preferences underlying empirical observations, and (5) focus less on outcomes and more on processes. All this is, of course, much easier said than done. Still, naming these aims clearly in face of an often amorphous debate deserves credit as such.

In the first contribution on specific governance issues, *Leon Wolff* examines the thesis of an alleged death of lifelong employment in Japan. While not being the first to do so, he correctly points out that this practice applies only to a minority of Japanese employees. Wolff proposes to understand lifelong employment primarily as a political compromise and an invented tradition. As such it is sustained by a regulatory framework of "flexicurity", meaning a combination of flexibility of working practices and security of employment. According to Wolff, Japanese employment patterns are indeed undergoing significant changes. He emphasizes that empirical data do not, however, evidence convergence to a market-based, dismissal-at-will system any time soon. Rather, he predicts, we shall observe an intensification of the regulatory modes of "flexicurity", which might well lead to a crisis in the labor-management nexus in Japan.

Dan W. Puchniak considers the role of the main bank in Japanese corporate governance. Based on case studies, he decidedly rejects the free-market theory advocated by Ramseyer and Miwa according to which the famous main bank is nothing more than a myth. As evidence Puchniak points to the lending practices of main banks and the important role played by them in the rescue of ailing group companies during the 1990s. In essence, Puchniak argues that Ramseyer and Miwa neglect the unique environment of Japanese firms. Not being shy of replying to the radical rational approach put forward by Ramseyer and Miwa in an equally pronounced language, he argues that such main bank behavior may be driven by perverse institutional incentives (instead of optimal efficiency), though this is not at all mythical. Puchniak even finds evidence that the importance of the main banks for corporate governance has increased in the post-bubble era.

Tomoyo Matsui turns to corporate governance in Japan's close corporations. If one considers the fact that in Japan as in most other countries the overwhelming majority of companies are non-listed small and medium-size enterprises (SME) this contribution deserves particular praise for taking up an aspect often forgotten in the debate, at least outside Japan. The contribution outlines the flexible menu of governance structures offered to close corporations under the new Company Law. The new rules enable shareholders of existing SMEs to better tailor governance rules to their needs. In addition, the Company Act attracts corporate newcomers to the SME sector. Matsui points out that the judicial doctrine on resolving shareholder conflicts within close corporations has by and large remained unchanged. This is remarkable, as the new Company Law, by removing most of the former mandatory rules stipulated so far by the Commercial Code, is likely to raise new types of shareholder oppression issues. Matsui speculates that takeover jurisprudence might influence the oppression doctrine for smaller companies in the future.

Peter Lawley's chapter addresses board structure. He focuses on the adoption of the committee-structure by large corporations. The option to replace the traditional statutory auditor board structure by a US-style committee system board structure was first introduced for large Japanese companies by an amendment to the Commercial Code in 2002. It later found its way into the new Company Law. The most important characteristic of this system is that a majority of the members of each committee must be so-called outside directors. Lawley's analysis shows that so far, in practice, few Japanese companies have adopted the new structure. Still there are more cases than predicted prior to the reform, including quite a few high-profile companies. Lawley then provides a detailed analysis of data collected in 2006 by way of interviews he conducted with professionals. Interestingly, judged by the available empirical data, such adoption does not have a net positive or negative effect on the corporation's performance, even though it is perceived to be a stronger and more transparent corporate governance structure. Lawley nicely summarizes these findings by calling the committee structure a "placebo" for corporate governance and corporate performance vows.

From an Australian practitioner's point of view *Geread Dooley* turns to defensive measures against hostile takeovers in Japan, which is one of the most hotly debated points in the corporate governance discussion. He compares the legal infrastructure for hostile takeovers that has been evolving in Japan since the Livedoor case to Australia's takeover landscape. Dooley makes the innovative proposal to establish a specialized tribunal outside the regular Japanese court system inspired by the Takeover Panel in Australia and adapted to Japanese needs. With regard to adequately policing poison pill defenses he argues that introducing such a stream-lined and market-sensitive dispute resolution body could help to make up for deficiencies he perceives with regard to shareholders, independent directors and courts in Japan.

Mitsuhiro Kamiya and *Tokutaka Ito* have both been involved as *bengoshi* in several of the major Japanese takeover cases in recent years. Based on their experience they compare the emerging Japanese takeover law to the elaborate Delaware case law. After outlining the development prior to the Japanese Supreme Court's Bulldog Sauce decision in 2007, they give a detailed analysis of this much-discussed case. They demonstrate that the decision marks a certain deviation from the rapid adoption of Delaware takeover law in Japan observed in the past few years. Furthermore, they take a rather skeptical stance on the role ascribed by the Supreme Court to the target company's shareholder meeting. They wonder why a shareholder resolution should be regarded as an important factor for assessing the validity of defensive measures considering the fact that shareholders could just as well simply refuse to tender their shares. Convincingly, they also point to the potential for greenmailing created by the Court's approach. In light of the lack of "real" independent directors and a revival of cross-shareholdings the authors see serious problems ahead for the development of hostile takeovers in Japan.

As part of the broader context of hostile takeovers and corporate restructuring, a critical assessment of Japanese policy on foreign direct investment (FDI) is at the center of the chapter by *Christopher Pokarier*. He asks why despite formal liberalization FDI growth in Japan still clearly lags portfolio investment from abroad and by far falls short of publicly proclaimed government targets. Testing various political explanations, he finds a perceived threat by FDI and a complex policy mixture. Factors impeding more rapid growth of FDI include defensive measures against foreign hostile takeover bids as well as an expansion of "at the gate" screening and restrictions in relation to sensitive sectors such as airports. To be fair, with regard to the latter, one might add that, Germany, for instance, has also recently extended the authority to screen major investments by non-EU investors in German companies. In this case the perceived threat particularly referred to the investment activity of sovereign wealth funds.

In the concluding chapter *Sôichirô Kozuka* looks at Japan's largest corporations and how their structure has evolved over the last 20 years. He finds that most blue-chip companies of the peak days of the Japanese economy in the late 1980s are still major companies two decades later. At the same time, certain legal reforms such as lifting the ban on pure holding companies and liberalizing rules on restructuring and divestitures,

have contributed to creating a greater diversity among Japanese largest companies. By contrast, the impact of other reforms, e.g., the introduction of the aforementioned committee system, so far has proved rather limited. He thus concludes, in line with the book's other contributions, that changes in law affect, and are affected by, the economic, political and social environment, but that no simple trends in terms of changes or developments can be identified. Everything is changing gradually and in ambiguous directions, which does not exclude the possibility of incremental changes eventually adding up to a large shift. Compared with the ambitious claim of rapid convergence touched upon at the beginning of the book this may sound like a rather disenchanting conclusion; still it has the great advantage of being consistent with reality.

Overall, this book fulfills its promise to offer fresh and up-to-date perspectives on the developments in Japanese corporate governance in every respect. Among the extensive literature on Japanese corporate governance this is an essential book for anybody seriously interested in the field.

Moritz Bälz