Independent Directors in Japan

Changing Corporate Governance?

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I. Introduction
II. The Comparative Background: Independence as a Legal Transplant
   1. The Modern Corporation and the Agency Conflict
   2. The Rise of the Independent Director in the US
   3. Transplanting Independence: The European Experience
   4. The Independent Director as a Governance Tool
III. Traditional Japanese Corporate Governance: A Closed System
   1. The Insider Board
   2. Cross-shareholdings and the "Community Firm"
   3. The Burst of the Economic Bubble
IV. The Reforms of the 21st Century: Opening Up
   1. The Reform of 2001/2002
   2. The Reform of the Companies Act 2015
   3. The TSE Listing Rules and Japan's Corporate Governance Code
V. Changing Corporate Governance?
   1. Change in Form
   2. Preconditions for Substantial Change
   3. Legal Implementation of the Independent Director Mechanism
   4. The Definition of Independence
   5. The Function of Japan's Independent Directors
VI. Conclusion

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For a comprehensive comparative analysis on the topic of independent directors in Japan in German see T. SPIEGEL, Independent Directors in Japan. Japanische Corporate Governance und effektives Monitoring aus rechtsvergleichender Sicht (Tübingen 2017). Developments until the summer of 2018 have been taken into account in this article.

I. INTRODUCTION

The term corporate governance can be broadly defined as "the system by which companies are directed and controlled."[1] In recent years, the corporate governance of Japanese stock companies has undergone numerous extensive reforms.[2] They were triggered by the burst of the economic bubble at the beginning of the 1990s after an unprecedented economic upswing.[3] The subsequent, and arguably still continuing, phase of economic stagnation inspired the term "lost decade" – although "lost decades" seems more appropriate by now.

The changed economic situation has significantly influenced the aim and scope of the reforms. While past amendments had dealt with ensuring the legality of management's conduct of business (compliance), changes since the late 1990s have primarily aimed to promote the efficiency and economic viability of management's decision-making (performance).[4]

The most recent reforms on different regulatory levels in 2015 have to be seen in the context of *Abenomics*. This globally known term stands for Prime Minister Abe's plan for revitalizing the Japanese economy.[5] It com-

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1 See, e.g., K. J. HOPT, Comparative Corporate Governance: The State of the Art and International Regulation, American Journal of Comparative Law 59 (2011) 1, 6–7 with reference to the Cadbury Report of 1992. For an account of the emergence of the corporate governance discipline as a shift "from legal rules standing alone to legal rules interacting with non-legal corporate processes and institutions," see R. J. GILSON, From Corporate Law to Corporate Governance, in: Gordon/Ringe (eds.), The Oxford Handbook of Corporate Law and Governance (Oxford 2018) 3.

2 For an overview of recent reforms with a focus on outside and independent directors, see section IV below.

3 C.-C. LIN, The Japanese Independent Director Mechanism Revisited: The Corporate Law Setting, Current Status, and its Explanations, Temple International and Comparative Law Journal 24 (2010) 65, 76; H. KANSAKU/M. BÄLZ, § 3 – Gesellschaftsrecht, in: Baum/Bälz (eds.), Handbuch Japanisches Handels- und Wirtschaftsrecht (Köln 2011) 63, 78 para. 34.

4 M. MATSUNAKA, *Keiei-sha no monitaringu to bōdo no yakuwari: Torishimari yakkai no kata to keiei-sha no hyōka kinō* [Monitoring of Management and the Role of the Board: Different Types of Boards of Directors and the Function of Assessing Management], Hōritsu Jihō 86-3 (2014) 36, 37; regarding the objective of the most recent reform of company law, see S. SAKAMOTO (ed.), *Ichimon ittō. Heisei 26nen Kaisei Kaisha-hō* [The Reform of the Companies Act 2014. Questions and Answers] (Tōkyō 2014) 2.

5 In contrast, corporate scandals like the massive accounting fraud at Olympus, a maker of optics and reprography products, had no decisive influence on the discussions preceding the latest reform of the Companies Act. See G. GOTO, Recent Boardroom Reforms in Japan and the Roles of Outside/Independent Directors, in: Oda (ed.), Comparative Corporate Governance. The Case of Japan, ZJapanR/J.Japan.L.

prises three main pillars, or "arrows".[6] The first of these arrows is an aggressive monetary policy to drive up inflation through quantitative easing. The second arrow is a massive public stimulus package financed by debt. The third and final arrow comprises a multitude of structural reforms including an overhaul of public companies' corporate governance. At the core of this governance reform lies the strengthening of supervision of management by independent directors on companies' boards.

The independent director is by no means a Japanese invention. Board independence has its origins in the US. From there, it spread to the UK and all over the world, including to Asia, to become a standard tool of "good corporate governance."[7] This tool, however, stands in stark contrast to the post-war corporate governance of Japanese companies up until the reforms of the twenty-first century. The "traditional"[8] Japanese system can be characterized as a closed, insider-based system, to which independent supervision by outsiders – on the board and in general – is an alien concept.[9] This poses the question of how the independent director mechanism as a legal transplant[10] fits into the existing governance system and whether it can build on or even promote substantial change in corporate governance.

Special Issue 12 (2018) 33, 45–46; G. GOTO/M. MATSUNAKA/S. KOZUKA, Japan's Gradual Reception of Independent Directors: An Empirical and Political-Economic Analysis, in: Puchniak/Baum/Nottage (eds.), Independent Directors in Asia: A Historical, Contextual and Comparative Approach (Cambridge 2017) 135, 143.

6 For an explanation of Abenomics from a Western perspective, see "Japan and Abenomics: Once more with feeling," The Economist, 18 May 2013, Briefing section; "Abenomics picks up speed: The battle for Japan," The Economist, 28 June 2014, Asia section, and for a more recent evaluation "Abenomics. Overhyped, underappreciated," The Economist, 30 July 2016, Leaders section.

7 See section II below for a short analysis of the rise of the independent director in the West. Between 1993 and 2000, at least 189 countries took measures to strengthen the independence of directors on the board. K. UCHIDA, *Nihon kigyō no torishimari yakkai no shinka to kokusai-teki tokuchō* [The development of boards of Japanese companies and international characteristics], Shōji Hōmu 2007 (2013) 41, 41–42. For a comprehensive comparative study of the expansion of the independent director to Asia, including jurisdiction-specific analyses, see D. W. PUCHNIAK/H. BAUM/L. NOTTAGE (eds.), Independent Directors in Asia: A Historical, Contextual and Comparative Approach (Cambridge 2017).

8 In accordance with most of the literature on Japanese Corporate Governance, the term "traditional" is used to designate the corporate governance system of the post-war period and before the recent changes of the twenty-first century.

9 For an account of the traditional corporate governance system, see section III below.

10 The concept of legal transplant goes back to the debate between Alan Watson and Otto Kahn-Freund. See A. WATSON, Legal Transplants: An Approach to Comparative Law (Edinburgh 1974); O. KAHN-FREUND, On Uses and Misuses of Comparative Law, The Modern Law Review 37 (1974) 1.

From a comparative perspective, the current developments in Japan are particularly appealing in two regards. First, the focus on the independent director – for a long time praised as the magical solution for manifold corporate governance problems in the US –, has increasingly become the subject of hefty criticism, not least in its country of origin.[11] It is therefore all the more interesting to examine the late and rather cautious approach to board independence by Japan. Second, Japanese company law can be characterized as a mixed legal system with a history of legal transplants.[12] Modern Japanese company law was initially modeled after German law. Then, in the aftermath of World War II, the existing body of law came under the increasing influence of both US and UK law. At the same time, however, and contrary to popular perception, Japan never reverted to merely copying legal codes. The development can rather be described as a critical reception and adaption of foreign legal concepts.[13]

This article is structured as follows: Section II provides the comparative background necessary for understanding the independent director mechanism as a governance tool and for assessing its transplantation into the Japanese governance framework. Section III then explains the institutional framework as well as the characteristics of the traditional Japanese corporate governance system. In section IV we look at how this closed system has, at least on paper, been opened up by extensive reforms over the last two decades. Building on the previous findings, section V addresses the crucial question of whether recent reforms and the independent director in its current form have built on or can lead to substantial change in Japanese corporate governance. When attempting to answer this question and to assess the effects of the reforms enacted three and a half years ago, reactions to the reforms in practice have to be taken into account. Moreover, the Japanese legislature continues, albeit in a considerably less extensive fashion, to change legal rules and standards related to corporate governance. Section VI offers a conclusion.

11 See section II.2 below.

12 H. BAUM/E. TAKAHASHI, Commercial and Corporate Law in Japan: Legal and Economic Developments after 1868, in: Röhl (ed.), History of Japan Since 1868 (Leiden/Boston 2005) 330, 330–331; H. BAUM, Entstehung, Strukturen und Bedeutung des Handelsgesetzes – eine Einführung, in: Kliesow/Eisele/Bälz (eds.), Das Japanische Handelsgesetz (Köln et al. 2002) 1, 2–3.

13 See BAUM, *supra* note 12, 3.

II. THE COMPARATIVE BACKGROUND: INDEPENDENCE AS A LEGAL TRANSPLANT

When trying to better understand recent Japanese developments and to put them into context, it is necessary to first take a step back and take a look at both the roots of the corporate governance debate and the rise of the independent director in the West.[14]

1. The Modern Corporation and the Agency Conflict

The search for means to discipline the company's management dates back to the very beginning of the modern corporation.[15] Referring to the early British joint stock companies, Adam Smith stated in 1776 in his famous work on the wealth of nations:

> "The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own."[16]

With these simple words, writing in the eighteenth century, Smith described the basic cause for conflicts in the modern corporation with a board of directors: the separation of ownership and management.[17]

Over the course of the nineteenth century, the modern corporation became the dominant form for doing business in the UK as well as the US.[18] In their well-known book titled "The Modern Corporation,"[19] when analyzing this development, Adolf Berle and Gardiner Means came to a conclusion that laid the groundwork for the later corporate governance debate in the US. They found that the increasing number of shareholders and the increasing size of businesses had led to a de facto separation of not only

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14 For an in-depth analysis of the independent director's development in the West, see H. BAUM, The Rise of the Independent Director in the West: Understanding the Origins of Asia's Legal Transplants, in: Puchniak/Baum/Nottage (eds.), *supra* note 7, 21.

15 For a historical overview of the birth of the modern corporation, see J. D. COX/T. L. HAZEN, The Law of Corporations (3rd ed., St. Paul, MN 2010) vol. 1, 130–139 (UK and US) and, with a focus on the board of directors, Y. ZHAO, Corporate Governance and Directors' Independence (Alphen aan den Rijn 2011) 9–15 (UK); see also BAUM, *supra* note 14, 28–31.

16 A. SMITH, An Inquiry into the Nature and Causes of the Wealth of Nations (Oxford 1976, reprint 2004) vol. 2, 741.

17 See ZHAO, *supra* note 15, 15–16.

18 See COX/HAZEN, *supra* note 15, 129–130 and R. C. CLARK, Corporate Law (Boston/Toronto 1986) 1–4 (US); ZHAO, *supra* note, 15, 13–15 (UK).

19 A. A. BERLE/G. C. MEANS, The Modern Corporation and Private Property (New York/Chicago/Washington 1932).

ownership and management, but also ownership and control. As a consequence, in public companies the control of the company lay with the board of directors as a management body instead of the shareholders as owners.[20] The interests of management and shareholders, however, were not aligned but more often than not conflicting.[21]

Solving these conflicts of interest inherent to the basic structure of the stock corporation is one main task of company law.[22] The conflict between shareholders as a class and management, however, is characteristic only for companies with the widely dispersed ownership of the Berle-Means Corporation. In addition, two further general types of conflict can be distinguished.[23] In companies with the concentrated ownership structure that is commonly associated with continental and most Asian jurisdictions, the conflict lies between the majority shareholders and the minority shareholders. In these insider systems,[24] major shareholders with privileged knowledge assert their influence on the company through the board of directors. The third possible constellation is the conflict between the company and the shareholders on the one side and further stakeholders like creditors, employees and customers on the other.

What these so-called agency conflicts have in common is the dependency of one party's welfare (principal) on the acts of another party (agent). The asymmetry of information inherent in the delegation of functions to the agent hampers the principal's ability to monitor and provides incentives for the agent to act in his own best interest instead of the principal's.[25] To address the agency problems mentioned above, a basic set of strategies is regularly employed. One of these is the trusteeship strategy, with the independent director being the prime example of a trustee.[26]

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20 BERLE / MEANS, *supra* note 19, 68 ("In the corporate system, the "owner" of industrial wealth is left with a mere symbol of ownership while the power, the responsibility and the substance which have been an integral part of ownership in the past are being transferred to a separate group in whose hands lies control.").

21 BERLE / MEANS, *supra* note 19, 122.

22 J. ARMOUR et al., What Is Corporate Law?, in: Kraakman et al. (eds.), The Anatomy of Corporate Law (3rd ed., Oxford 2017) 1, 1–2.

23 For a concise introduction to the basic agency problems, see J. ARMOUR / H. HANSMANN / R. KRAAKMAN, Agency Problems and Legal Strategies, in: Armour et al. (eds.), *supra* note 22, 29, 29–30.

24 For a classification of insider and outsider systems, see, e.g., K. J. HOPT, Comparative Company Law, in: Reimann / Zimmermann (eds.), The Oxford Handbook of Comparative Law (Oxford 2006) 1161, 1166–1167; J. VON HEIN, Die Rezeption US-amerikanischen Gesellschaftsrechts in Deutschland (Tübingen 2008) 881–882.

25 ARMOUR / HANSMANN / KRAAKMAN, *supra* note 23, 29–30.

26 ARMOUR / HANSMANN / KRAAKMAN, *supra* note 23, 35–36. See *ibid*., 62–66 for a general illustration of the trusteeship strategy.

2. The Rise of the Independent Director in the US

During the 1970s and 80s, in the US the monitoring model based on the work of Melvin Eisenberg replaced the management model that had been dominant from the beginning of the modern corporation.[27] In fact, by that time the board had long since lost its function as management body. As in the UK, management had already been delegated to executive directors and had been taken from the board as a company organ.[28] The function of non-executive directors, who sat on the board for "non-managing purposes," remained vague.[29]

It was Eisenberg who then laid the foundation for a re-conceptualization of the board of directors. According to his monitoring model, the only viable function for the board was the monitoring of management. Effective monitoring, however, required that the directors be independent from management.[30] This change in the board's conception has been described as the "most significant corporate development in the last quarter century."[31]

The development of independent directors as trustees of the shareholders was driven by two other significant developments in the US.[32] First, shareholder wealth maximization became the primary corporate purpose and displaced broader stakeholder concerns. Directors related to management were thus seen as unsuited to ensure the primacy of shareholder interests. Second, the development and growth of capital markets enabled independent directors to assess the execution of management by using increasingly informative market indicators as well as relying on the service of securities analysts.

Today, US law mandates a majority of independent directors on companies' boards.[33] In fact, most of the directors are independent. In 2017, 85%

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27 BAUM, *supra* note 14, 35–38. For a critical in-depth discussion of the political debate surrounding Eisenberg's proposal see L. E. MITCHELL, The Trouble with Boards, in: Kieff/Paredes (eds.), Perspectives on Corporate Governance (Cambridge et al. 2010) 17, 34–53.

28 ZHAO, *supra* note 15, 16–17; see also BAUM, *supra* note 14, 32.

29 ZHAO, *supra* note, 15, 17–20; BAUM, *supra* note 14, 32–34.

30 M. A. EISENBERG, The Structure of the Corporation: A Legal Analysis (Boston et al. 1976) 162–170.

31 COX/HAZEN, *supra* note 15, 157.

32 These two factors are discussed in detail in J. N. GORDON, The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices, Stanford Law Review 59 (2007) 1465, 1469–1470 and 1510 et seq.

33 The monitoring model was in effect codified by the Sarbanes Oxley Act and Dodd-Franck Act; see S. M. BAINBRIDGE, Corporate Governance after the Financial Crisis (Oxford 2012) 59–61. For a description of the requirements of the NYSE and NASDAQ listing rules that implemented the statutory requirements of the Sarbanes Oxley Act, see COX/HAZEN, *supra* note 15, vol. 2, 25–41. Today, the requirement

of all directors met the legal independence criteria and 60% of the companies even had so-called super-majority independent boards, with the CEO being the only non-independent director.[34]

These numbers notwithstanding, it is noteworthy that the concept of an independent monitoring board has been increasingly criticized, including in the US. Criticism ranges from pointing out individual deficiencies of the current system to proposing that the monitoring board in itself was never designed to work.[35] What is more, in recent years a move from individual ownership to a re-concentration of institutional ownership has taken place.[36] Some observers see this development as causing a shift towards a shareholder-centric system. According to this view, managements' and shareholders' interests by now are mostly aligned; the agency conflict independent directors were meant to solve has therefore disappeared, while other stakeholders' interests need to be protected.[37]

The examination of the independent director mechanism's US origins leads to the following conclusions: It is tailored towards a one-tier board structure, it is directly linked to the shareholder value approach, and it is designed to solve the agency conflict between managers and shareholders as a class that is associated with widely-dispersed ownership.

3. *Transplanting Independence: The European Experience*

The UK took the lead in the European corporate governance movement and adopted the monitoring model following the Cadbury Report of 1992.[38] It was not until the beginning of the 21st century, however, that questions of

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of a majority of independent directors is found in NYSE Listed Company Manual Section 303A.01.

34 SPENCER STUART, 2017 Spencer Stuart U.S. Board Index, 8, available at *https://www.spencerstuart.com/research-and-insight/ssbi-2017*.

35 MITCHELL, *supra* note 27, 19 and 59 ("Building reform on this model is almost certain to fail."). For a critical evaluation of board independence after the financial crisis of 2007/2008, see W.-G. RINGE, Independent Directors: A Theoretical Framework, in: Puchniak / Baum / Nottage (eds.), *supra* note 7, 58. For a discussion of the criticism in the US and in general, see BAUM, *supra* note 14, 24–26 and 42–43; ZHAO, *supra* note 15, 139–164.

36 R. J. GILSON / J. N. GORDON, Agency Capitalism: Further Implications of Equity Intermediation, ECGI, Law Working Paper No. 239 (2014).

37 E. B. ROCK, Adapting to the New Shareholder-Centric Reality, University of Pennsylvania Law Review 161 (2013) 1907.

38 For an analysis of the development in the UK, where the monitoring model and independent directors met with an institutional setup different from the one in the US, see BAUM, *supra* note 14, 43–48; P. L. DAVIES, Corporate Boards in the United Kingdom, in: Davies et al. (eds.), *supra* note 47, 713, 716–719, 738–742; ZHAO, *supra* note 15, 29–35.

independent oversight were discussed on a European level. The European Union, allowing for some simplification, followed the UK's approach, but diverged from the concept of full harmonization of company law among its member states. In deviation from the US legislative approach, the focus shifted towards setting standards and promoting best practices via regulation through governance codices on a national level.[39] Today, the UK Code of Corporate Governance[40] has become the prototype of not only European, but worldwide corporate governance codices.[41]

The German Corporate Governance Code (GCGC),[42] first enacted in 2002, followed the UK example by adopting a "comply-or-explain" approach. The GCGC, however, is anchored in the German Stock Corporation Act instead of the stock exchange's listing rules.[43] Listed companies therefore have the statutory duty to disclose their compliance with the Code or explain to what extent and why they deviate from the Code's recommendations. Regarding board independence, the Code does not contain a fixed threshold, but rather calls for an "adequate number" of independent members on the supervisory board.[44]

This restrained requirement notwithstanding, some German observers have criticized independent directors as an unnecessary tool, arguing that the separation of management board *(Vorstand)* and supervisory board *(Aufsichtsrat)* renders independence requirements pointless.[45] While this criticism confuses functional separation with actual independence,[46] there is no denying that Germany is an example of a jurisdiction where the independent director as a transplant meets with a substantially different institutional framework compared to its US origin. Equally interesting for the purposes of this article is that the German framework shows certain similarities with the traditional Japanese system discussed in section III.

39 See P. C. LEYENS, Comply or Explain im Europäischen Privatrecht, Zeitschrift für Europäisches Privatrecht 2016, 388, 398–403; see also BAUM, *supra* note 14, 48–49.

40 The UK Corporate Governance Code, available at *https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code*.

41 See LEYENS, *supra* note 39, 390–391.

42 German Corporate Governance Code, as amended on 7 February 2017, available at *https://www.dcgk.de/en/code.html*.

43 § 161 Aktiengesetz [Stock Corporation Act], as last amended by Art. 9 of the Act of 17 July 2017 (Federal Law Gazette I, 2446).

44 No. 5.4.2 GCGC.

45 See, e.g., M. LUTTER, Vergleichende Corporate Governance – Die deutsche Sicht, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2001, 224, 226. Regarding criticism of the reception of US company law in general, see VON HEIN, *supra* note 24, 881–883 with further references.

46 VON HEIN, *supra* note 24, 896–897.

The two-tier structure with a separate supervisory board indeed contrasts with the one-tier structure of the US corporation, in which supervision has to be realized within one board of directors.[47] In addition, there are two further main differences. First, while the development of the independent monitoring board in the US is associated with the shareholder value approach, Germany is widely regarded as the pioneer of the stakeholder model.[48] Second, Germany has traditionally been associated with a concentrated ownership structure and described as an insider system.[49] This system, which is referred to as "Germany Inc." *(Deutschland AG),* developed after World War II and is characterized by the dominance of banks and major shareholders linked by cross-shareholdings.[50] The prevalent agency conflict has thus been between majority and minority shareholders.[51]

These differences in the governance framework warrant the question of whether and to what extent the implementation of board independence differs – or rather should differ – as well. Contrary to US law and following the Corporate Governance Code in the UK, for example, the definition of independence in the Code excludes relationships with a controlling shareholder or an enterprise associated with the controlling shareholder.[52] While this puts emphasis on the prevalent agency conflict, critics argue that the protection of minority shareholders is already ensured by a competing governance tool: German group law.[53]

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47 By introducing the supervisory board in the second half of the 19th century, Germany was arguably the first jurisdiction to establish a formalized separation between management and monitoring; see BAUM, *supra* note 14, 32 and 49. For an outline of the development of the Aufsichtsrat, see M. ROTH, Corporate Boards in Germany, in: Davies et al. (eds.), Boards in Law and Practice: A Comparative Analysis in Europe (Oxford 2013) 253, 276–278. For detailed information about the function of the Aufsichtsrat as company organ, see J. J. DU PLESSIS et al., German Corporate Governance in International and European Context (3rd ed., Berlin/Heidelberg 2017) 106–166.

48 See, e.g., ROTH, *supra* note 47, 262–263; cf. K. J. HOPT, The German Two-Tier Board: Experience, Theories, Reforms, in: Hopt et al. (eds.), Comparative Corporate Governance: The State of the Art and Emerging Research (Oxford 1998) 227, 230, 236–238.

49 VON HEIN, *supra* note 24, 882.

50 ROTH, *supra* note 47, 258. For an extensive study of "Germany Inc.," see W.-G. RINGE, Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG, American Journal of Comparative Law 63 (2015) 493, 495–502.

51 VON HEIN, *supra* note 24, 882; RINGE, *supra* note 50, 495–496.

52 No. 5.4.2 GCGC.

53 See, e.g., U. HÜFFER, Die Unabhängigkeit von Aufsichtsratsmitgliedern nach Ziffer 5.4.2 DCGK, Zeitschrift für Wirtschaftsrecht 2006, 637, 642.

What is more, the supervisory board, rather than serving as a monitor acting in the interests of minority shareholders, has in the past primarily fulfilled a network function.[54] Up until the 1990s, its members were all but independent from management and major shareholders.[55] Also, the German system of co-determination implies that only half of the members of the supervisory board can potentially be independent.[56] It thus renders the US practice of majority or even super-majority independent boards impossible.[57]

However, in recent years the institutional framework has been changing. For one, today the goal of corporate law is hotly debated in Germany and shareholder interests play an increasing role.[58] Moreover, as in the US, stakeholders' power relations might already have shifted. Starting in the 1990s, ownership structures have been changing and the closed system of a network of companies and banks has been eroding. Cross-shareholdings are on the decline and the banks have lost influence on the boards because of the increasing importance of the capital market.[59] Dispersed ownership and a high percentage of foreign investors now characterize at least the biggest German corporations.[60] Such fundamental conditions impacting the independent directors' role in corporate governance also have to be taken into account when assessing recent Japanese developments.

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54 See S. PRIGGE, A Survey of German Corporate Governance, in: Hopt et al. (eds.), *supra* note 48, 943, 960–961. Regarding the networks and their influence on the composition and function of the supervisory board, see HOPT, *supra* note 48, 233–235.

55 M. ROTH, Unabhängige Aufsichtsratsmitglieder, Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht 175 (2011) 605, 606; BAUM, *supra* note 14, 50–51; cf. VON HEIN, *supra* note 24, 882.

56 For an overview of the unique system of German co-determination see DU PLESSIS et al., *supra* note 47, 167–242. While the majority opinion in the literature seems to be that employee representatives cannot potentially be independent (see the references in note 55), most of the companies are of the opinion that they can, A. V. WERDER/K. DANILOV, Corporate Governance Report 2018: Kodexakzeptanz und Kodexanwendung, Der Betrieb 2018, 1997, 2004.

57 In practice, only some of the shareholder representatives are independent in most companies. 11.6% of companies aim for 100% of shareholder representatives to be independent and 36.6% aim for between 50 and 100%. See V. WERDER/DANILOV, *supra* note 55, 2004–2005.

58 ROTH, *supra* note 47, 332 with further references; see also G. BACHMANN, Corporate Governance nach der Finanzkrise, Die Aktiengesellschaft 2011, 181, 186.

59 See the in-depth analysis by RINGE, *supra* note 50, 508–526.

60 LEYENS, *supra* note 39, 393. Outside the DAX 30, however, family-owned companies are still predominant, ROTH, *supra* note 47, 259–260.

4. *The Independent Director as a Governance Tool*

The independent director has become a tool associated with good corporate governance worldwide. As this short comparative analysis has shown, however, there is not *one* type of independent director. It is rather a diverse and highly path-dependent corporate governance tool whose specific form varies depending on the vastly differing institutional frameworks.[61]

With these comparative findings in mind, we will now briefly turn to the traditional Japanese corporate governance system, which stands in contrast to the notion of outside, let alone independent, influence and shows some common features with the traditional German system.

III. TRADITIONAL JAPANESE CORPORATE GOVERNANCE: A CLOSED SYSTEM

The traditional organizational form of large public companies in Japan is the "company with a board of statutory auditors" *(kansa yakkai setchi kaisha)*. It developed in the aftermath of World War II when Japanese company law, which had previously been modeled after German law, came under the increasing influence of US law.[62]

1. *The Insider Board*

The Companies Act (CA)[63] provides that a company with a board of statutory auditors features three main company organs: the shareholders' meet-

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61 For an in-depth comparative analysis and conceptualization of the independent director, see SPIEGEL, *supra* note *, 5–73. Regarding the theory of path dependence, see the seminal work of M. J. ROE, Path Dependence, Political Options, and Governance Systems, in: Hopt/Wymeersch (eds.), Comparative Corporate Governance. Essays and Materials (Berlin/New York 1997) 165. See also GILSON, *supra* note 1, 9–10 on path dependence in corporate governance and H. BAUM, Zur Diskussion über vergleichende Corporate Governance mit Japan, Rabels Zeitschrift für ausländisches und internationales Privatrecht 62 (1998) 739, 756–758 regarding the relevance of path dependence in the Japanese context in particular.

62 For an account of the reforms from the 1950s until the 1980s, see BAUM/TAKAHASHI, *supra* note 12, 391–399. For an analysis of the genesis of modern corporate law in Japan up until the reception of US law in the 1950 revision, see H. TAKADA/M. YAMAMOTO, The "Roesler Model" Corporation. Roesler's Draft of the Japanese Commercial Code and the Roots of Japanese Corporate Governance, ZJapanR/J.Japan.L. 45 (2018) 45. For a short description of pre- and post-war developments up until the latest reform, see E. TAKAHASHI, Entwicklung und Hintergründe der Regelungen zur Corporate Governance in Japan mit einem Schwerpunkt auf der Reform von 2013, ZJapanR/J.Japan.L. 35 (2013) 63, 64–70 (article reprinted in: E. TAKAHASHI, Die Rezeption und Konvergenz des deutschen Handels- und Gesellschaftsrechts in Japan. Gesammelte Schriften (Baden-Baden 2017) 121).

ing, the board of directors and the board of statutory auditors. In addition, all large companies have to appoint accounting auditors.[64] While the accounting practice has been developing since the 1980s and legal requirements regarding the audit by accounting auditors have been tightened, their lack of contribution to uncovering wrongdoings has been continuously criticized.[65] Still, the recent discussion revolving around monitoring of management is clearly focused on the board of directors and the board of statutory auditors within the company.

The board of directors has a dual role to play.[66] It has to decide on the company's operations and to supervise the performance of duties by the individual directors. The supervision applies to the execution of the board's decisions by executive directors in particular.[67] Borrowing from the US terminology, this model can be described as a management model due to the extensive decision-making power of the board as a company organ.[68]

The board of statutory auditors and the individual statutory auditors are charged with supervising the performance of duties by the directors as well.[69] They are, however, limited to auditing the accounts as well as overseeing the legality of the directors' conduct.[70] What is more, in contrast to

63 *Kaisha-hō* [Companies Act], Law No. 86/2005, as amended by Law No. 45/2017.

64 The company organs and the requirements regarding their establishment are laid down in Artt. 295, 326–328 CA. The term "large company" is defined in Art. 2 no. 6 CA and depends on stated capital and liabilities.

65 See, e.g., H. KANDA, Trends in Japanese Corporate Governance, in: Hopt/ Wymeersch (eds.), *supra* note 61, 185, 187; O. KIRCHWEHM, Reformen der Corporate Governance in Japan und Deutschland. Eine gesellschaftsrechtliche Betrachtung (Frankfurt a.M. 2010) 198–200 and 231–232; cf. C. L. HEFTEL, Corporate Governance in Japan: The Position of Shareholders in Publicly Held Corporations, University of Hawaii Law Review 5 (1983) 135, 186–187.

66 I. KAWAMOTO, § 3 – Handels- und Gesellschaftsrecht, in: Baum/Drobnig (eds.), Japanisches Handels- und Wirtschaftsrecht (Berlin 1994) 47, 70, 73–74. Regarding the general allocation of responsibilities in the traditional organizational form, see H. KANDA, *Kaisha-hō* [Company Law] (20th ed., Tōkyō 2018) 178–181; K. EGASHIRA, *Kaisha-hō* [Company Law] (7th ed., Tōkyō 2017) 307–316; E. TAKAHASHI, *Kaisha-hō gaisetsu* [Overview of Company Law] (3rd ed., Tōkyō 2015) 102–108.

67 Artt. 362 (2) no. 1, 2 and 363 (1) CA.

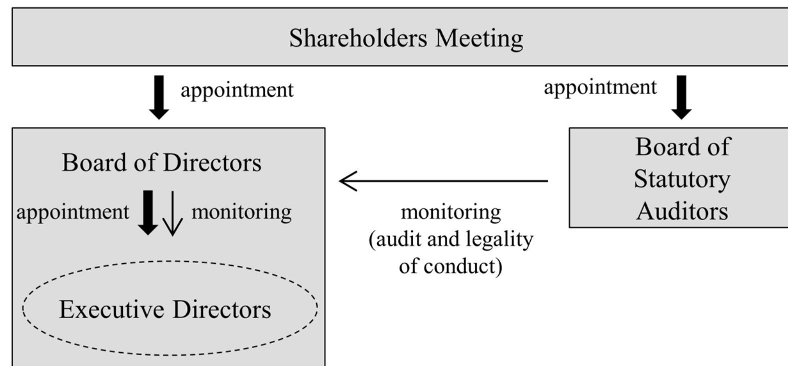
68 See, e.g., B. ARONSON, The Olympus Scandal and Corporate Governance Reform: Can Japan Find a Middle Ground between the Board Monitoring Model and Management Model?, ZJapanR/J.Japan.L. 35 (2013) 85, 85.

69 Art. 381 (1) CA. Half or more of the auditors on the board of statutory auditors must be outsiders, Art. 335 (3) CA.

70 The extent of the supervision by statutory auditors is a controversial topic, see MATSUNAKA, *supra* note 4, 39 with further references. The limitation described above, however, is in line with the prevailing view and practice. See, e.g., GOTO,

the German supervisory board, the board of statutory auditors does not appoint the directors.[71]

Diagram 1: Basic structure of a company with a board of statutory auditors



Until recently, the number of independent directors on the boards of directors of Japanese companies was negligible.[72] The boards were rather comprised of long-time employees who had risen through the ranks of the company and were largely shielded from any outside influence.[73] Independent or at least outside directors, who could more effectively have fulfilled the task of monitoring nominally assigned to the board, were missing.[74] Self-control of the board is further hampered by at least some large companies' practice of forming executive boards *(jōmu-kai)* within the board of direc-

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supra note 5, 35; GOTO / MATSUNAKA / KOZUKA, *supra* note 5, 135–136 n. 1; H. KANDA, Comparative Corporate Governance. Country Report: Japan, in: Hopt et al. (eds.), *supra* note 48, 921, 936.

71 Directors, like statutory auditors, are appointed by the shareholders' meeting directly, Art. 329 (1) CA. The *kansa yakkai* [board of statutory auditors] should therefore not be translated as supervisory board or *Aufsichtsrat*. Rather, the two concepts differ significantly. See T. YAMANAKA, Corporate Boards in Europe and Japan: Convergence and Divergence in Transition, European Business Organization Law Review 19 (2018) 503, 504.

72 Even in 2012, two thirds of companies listed on the Tokyo Stock Exchange had no independent directors at all, TSE-Listed Companies White Paper on Corporate Governance (White Paper) 2017, 84 chart 67. The biennial White Papers are available at *http://www.jpx.co.jp/english/equities/listing/cg/02.html*.

73 KANDA, *supra* note 65, 187; see also GOTO, *supra* note 5, 36; YAMANAKA, *supra* note 71, 511 and 517.

74 K. EGASHIRA, Commercial Law, Law in Japan 26 (2000) 50, 53–54.

tors. This leads to the most senior executives making the decisions instead of the whole board as a company organ.[75]

This closed system with an insider board tasked with the dual function of management and monitoring stands in stark contrast to the current monitoring model of US companies. To illuminate its development and characteristics, it is necessary to examine both post-war ownership structures and corporate culture.

2. Cross-shareholdings and the "Community Firm"

The post-war dissolution of the family-owned conglomerates *(zaibatsu)* of the pre-war era led to a temporary steep increase in the number of individual shareholders.[76] Former *zaibatsu* members, however, soon started to interlink themselves as companies by buying each other's shares in an effort to offer mutual protection. This development picked up speed after Japan joined the OECD in 1964, when the Japanese feared a "sellout" of their companies to foreign investors.[77] The strongest form of these mutual shareholdings are the horizontal cross-shareholdings in a group of companies *(keiretsu)*.[78] In these groups the companies as shareholders stay passive. They exercise their voting rights in the interests of the respective management, which leads to a de facto state of "companies owning themselves."[79]

Hence the plan intended by the occupying power's administration to replace a system dominated by family ownership with a system characterized by individual and institutional investors failed. The unintended develop-

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75 See I. KAWAMOTO/Y. KAWAGUCHI/T. KIHIRA, Corporations and Partnerships in Japan (Alphen aan den Rijn 2012) 252 para. 642, 264 para. 685; H. ODA, Corporate Governance in Japan: 1990–2016. The Changing Role of the Board of Directors, in: Oda (ed.), *supra* note 5, 7, 9, 15–16.

76 J. FRANKS/C. MAYER/H. MIYAJIMA, The Ownership of Japanese Corporations in the 20th Century, ECGI, Finance Working Paper No. 410 (2014) 1 and 12–13. Regarding the dissolution of the *zaibatsu* in general, see BAUM/TAKAHASHI, *supra* note 12, 383–387.

77 See T. EGUCHI, Management-shareholder relations in Japan: what's next after crossshareholdings?, in: Zen'ichi Shishido (ed.), Enterprise Law: Contracts, Markets, and Laws in the US and Japan (Cheltenham/Northampton 2014) 191, 199–200; H. BAUM, Marktzugang und Unternehmenserwerb in Japan. Recht und Realität am Beispiel des Erwerbs von Publikumsgesellschaften (Heidelberg 1995) 70–71; cf. BAUM/TAKAHASHI, *supra* note 12, 387, 390. Some observers see the re-emergence of cross-shareholdings rather as a result of the failed attempt to establish an outsider system of ownership due to a lack of institutional support for individual investors, FRANKS/MAYER/MIYAJIMA, *supra* note 76, 2 and 36–39.

78 BAUM/TAKAHASHI, *supra* note 12, 389–391; BAUM, *supra* note 77, 61, 63–71.

79 EGUCHI, *supra* note 77, 197–198; see also BAUM/TAKAHASHI, *supra* note 12, 390–391.

ment of cross-shareholdings rather led to a concentration of power in the boards of directors, the exclusion of outside influence, and therefore the establishment of a system dominated by insiders.[80]

Despite some apparent similarities, the structure of Japanese *keiretsu* is different to the traditional German cross-shareholdings.[81] In addition, while ownership in Japan was widely dispersed according to conventional measures, the nature of ownership changed along with the concentration of power in the boards.[82] The prevalent agency conflict between shareholders as a class and management was suppressed because management shielded itself from any supervision by shareholders as the actual owners of the company.

It is this foundation on which the Japanese "community firm"[83] associated with the larger companies is built. The inside focus of the board of directors is complemented by comparatively strong ties between the company and its employees. The concept of life-long employment and career advancement through seniority has a decisive influence on corporate culture.[84] By contrast, the external labor market is weak and mobility of labor between companies is limited.[85] These conditions promote the conception of the company as the property of its employees. Keeping the company as an organization in business is paramount, while shareholders' interests are of relatively little importance.[86]

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80 See FRANKS/MAYER/MIYAJIMA, *supra* note 79, 1–2; cf. GOTO, *supra* note 5, 36.

81 For example, in contrast to the large German web of cross-shareholdings, *keiretsu* are individual groups of companies; see RINGE, *supra* note 50, 498.

82 FRANKS/MAYER/MIYAJIMA, *supra* note 79, 7, 13, 15 and 21. By contrast, ownership in Germany was relatively concentrated overall. See G. FERRARINI/M. FILIPPELLI: Independent directors and controlling shareholders around the world, ECGI, Law Working Paper No. 258 (2014) 10–11.

83 J. BUCHANAN/D. H. CHAI/S. DEAKIN, Hedge Fund Activism in Japan: The Limits of Shareholder Primacy (Cambridge 2012) 297–304; see also GOTO, *supra* note 5, 35–36.

84 See BAUM, *supra* note 77, 81–82; GOTO, *supra* note 5, 35–36; Č. PEJOVIĆ, Reforms of Japanese Corporate Governance: Convergence in the Eye of the Beholder, ZJapanR/J.Japan.L. 35 (2013) 107, 114.

85 BUCHANAN/CHAI/DEAKIN, *supra* note 83, 303.

86 BUCHANAN/CHAI/DEAKIN, *supra* note 83, 297–300; see also BAUM, *supra* note 77, 83. Shareholders' meetings, for example, were of rather ceremonial nature, ODA, *supra* note 75, 14–15; E. TAKAHASHI, Unternehmensübernahmen in deutschem und japanischem Kontext, in: Assmann et al. (eds.), Markt und Staat in einer globalisierten Welt (Tübingen 2010) 67, 71 (article reprinted in: TAKAHASHI, *supra* note 62, 287).

3. *The Burst of the Economic Bubble*

During times of high economic growth, the potential conflicts among the corporate stakeholders had not materialized mainly because shareholders profited from steadily rising share prices.[87] The burst of the economic bubble in the early 1990s and the subsequent economic downturn, however, led to questions about the viability of the current economic model.[88] In this context, "good corporate governance" came to be seen as a tool to ensure a healthy national economy.[89] Still, even after the reforms of the 1990s an economic recovery had failed to materialize.[90] This led to more fundamental reform efforts outside the scope of the current corporate organizational structure of the company with a board of statutory auditors.

IV. The Reforms of the 21st Century: Opening Up

With the reforms since the turn of the century, the Japanese legislature has slowly but persistently pushed for the adoption of a monitoring model and the proliferation of outside and increasingly independent directors.

1. *The Reform of 2001/2002*

The reform of 2001/2002 introduced a second organizational structure for stock companies, which was called a "company with committees" *(i'inkai setchi kaisha)*.[91] From then on, companies had the right to choose between two organizational models based on contrasting views of the role of the board of directors.[92] Necessarily, the allocation of responsibilities within the company is fundamentally different as well.[93]

While the traditional structure featuring a board of statutory auditors correlates with an insider-based management model, the second organizational

87 See H. MORITA, Reforms of Japanese Corporate Law and Political Environment, ZJapanR/J.Japan.L. 37 (2014) 25, 28; cf. TAKAHASHI, *supra* note 86, 70.

88 BAUM/TAKAHASHI, *supra* note 12, 400; see also ODA, *supra* note 75, 9–10.

89 MORITA, *supra* note 87, 28.

90 Regarding the reforms following the comprehensive revision of 1950 until the 1990s, see BAUM/TAKAHASHI, *supra* note 12, 396–400.

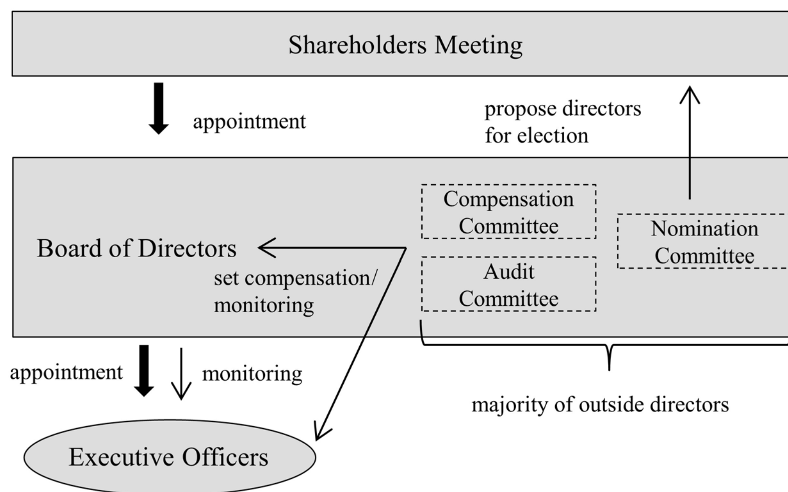
91 LIN, *supra* note 3, 89; KAWAMOTO/KAWAGUCHI/KIHIRA, *supra* note 75, 296 para. 799.

92 S. KOZUKA, Reform After a Decade of the Companies Act: Why, How, and to Where?, ZJapanR/J.Japan.L. 37 (2014) 39, 47; cf. ODA, *supra* note 75, 17.

93 For an overview of the general allocation of responsibilities, see KANDA, *supra* note 66, 253; EGASHIRA, *supra* note 66, 555–558; TAKAHASHI, *supra* note 66, 185–186.

structure is based on the monitoring model of US companies.[94] It is a one-tier system with one board of directors. Executive officers *(shikkō-yaku)* – who stand outside the board – execute the business of the company instead of executive directors.[95] The board's role is to supervise the performance of duties by the executive officers.[96] In addition, decisions on the company's operations can be delegated to the executive officers to a large extent.[97] The focus then shifts from a dual function of the board to a clearer separation of management and supervision.

Diagram 2: Basic structure of a company with committees



In a company with committees, there are no statutory auditors and there is therefore no board of statutory auditors. Instead, the board of directors has to form an audit committee and, in addition, a nominating and a compensation committee.[98] To enable effective monitoring, all committees must be comprised of a majority of *outside* though not necessarily *independent* directors.[99] The Japanese version of the monitoring model thus deviates from its US role model in its very form.

94 KOZUKA, *supra* note 92, 47.
95 Artt. 415, 418 (2) CA; see also Art. 416 (3) CA.
96 Art. 416 (1) CA.
97 Art. 416 (4) CA.
98 Art. 2 no. 12 CA.
99 Art. 400 (3) CA.

In the debate about corporate governance and effective monitoring, the terms outside and independent director are surprisingly often confused.[100] Yet – and in the Japanese context in particular – it is essential to clearly separate the two since they are *not* the same.[101] Allowing for some simplification, the term outside director denotes a non-executive director who, in addition, is not employed by the company and is therefore an outsider.[102] Independence, in the most general terms, in addition requires the director to "not [be] dependent on someone or something that is related to the company."[103] The exact definition of independence depends on the function the director is supposed to fulfill. In the case of monitoring, it is therefore determined by the prevalent agency conflict, that is, it depends on which stakeholder needs to be protected.[104]

Even though the committee structure did not require the appointment of independent directors and therefore allowed for potentially all directors to have financial and personal ties with management, it met with widespread disapproval in the business world.[105] It seemed to be in conflict with the traditional governance structures and their lack of any outside influence. More than a decade after its introduction, only a tiny fraction of companies had adopted the new organizational structure.[106] What is more, critics argue that the company with committees was used by at least some companies to strengthen ties with their subsidiaries and specifically to prevent any outsid-

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100 D. C. CLARKE, Three Concepts of the Independent Director, Delaware Journal of Corporate Law 32 (2007) 73, 78, 99; see also BAUM, *supra* note 14, 26–27. Y. MIWA/J. M. RAMSEYER, Who Appoints Them, What Do They Do? Evidence on Outside Directors from Japan, Journal of Economics & Management Strategy 14 (2005) 299, e.g., use data on outside directors to discuss the function of independent directors in Japan.

101 For a discussion of the current definition of outside and independent directors, see section V.4 below.

102 CLARKE, *supra* note 100, 99; BAUM, *supra* note 14, 26.

103 BAUM, *supra* note 14, 26.

104 BAUM, *supra* note 14, 24–26. Regarding possible criteria of independence as well as approaches to defining independence see RINGE, *supra* note 37, 70–73.

105 Already during the reform process itself, it was pressure from the business world that forced the reformers to make the new structure optional instead of mandatory. R. DORE, Insider Management and Board Reform: For Whose Benefit?, in: Aoki/Jackson/Miyajima (eds.), Corporate Governance in Japan: Institutional Change and Organizational Diversity (Oxford 2007) 370, 376–377. See also ODA, *supra* note 75, 18; LIN, *supra* note 3, 89.

106 On 14 July 2014, only 1.7% of companies listed on the Tokyo Stock Exchange were companies with committees, White Paper, *supra* note 72, 2015, 15. After the latest reform of 2015, the share increased slightly to 2% in 2016, White Paper, *supra* note 72, 2017, 67 chart 51.

er influence. The definition of outside directors in fact allowed for directors and employees of the parent company as well as representatives of major shareholders to be positioned on the committees of a subsidiary's board.[107]

The reform of 2005 introduced the Companies Act (CA)[108] but left the basic governance structure and the monitoring of management largely untouched.[109] Discussions of how to implement effective corporate governance then started anew in 2010.[110] The aim was to strengthen the trust of foreign investors and – once again – to revive the Japanese economy.[111] In contrast to earlier reforms, the focus was now solely on increasing companies' performance and shareholder value.[112] Foreign investors in particular had increasingly voiced their criticism and pointed out the insufficient monitoring of management from a shareholders' perspective.[113] The efforts resulted in, but did not stop at, a further reform of the Companies Act, which came into effect on 1 June 2015.

2. *The Reform of the Companies Act 2015*

With regards to corporate governance, the most recent reform of the Companies Act brought about three main changes.

First, the "company with an audit-plus committee" *(kansa tō i'in-kai setchi kaisha)* was introduced as a third organizational form.[114] The reason

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107 DORE, *supra* note 105, 375. Almost half of the listed companies that adopted the new structure in the first round of shareholders' meetings were subsidiaries of either Nomura or Hitachi, further relativizing the already low percentage of companies that switched. See also TAKAHASHI, *supra* note 62, 74–75; cf. P. LAWLEY, Panacea or placebo? An empirical analysis of the effect of the Japanese committee system corporate governance law reform, in: Nottage / Wolff / Anderson (eds.), Corporate Governance in the 21st Century: Japan's Gradual Transformation (Cheltenham / Northampton 2008) 129, 135.

108 See *supra* note 63. Until the introduction of the Companies Act, provisions relating to the various types of companies were spread across several laws. For an overview of the reform of 2005, see M. DERNAUER, Die japanische Gesellschaftsrechtsreform 2005/2006, ZJapanR / J.Japan.L. 20 (2005) 123.

109 M. MAEDA, *Kigyō tōchi* [Corporate Governance], Jurisuto 1472 (2014) 18, 24.

110 G. GOTO, The Outline for the Companies Act Reform in Japan and Its Implications, ZJapanR / J.Japan.L. 35 (2013) 13, 14–15; SAKAMOTO, *supra* note 4, 5.

111 SAKAMOTO, *supra* note 4, 2.

112 MATSUNAKA, *supra* note 4, 37; see also GOTO / MATSUNAKA / KOZUKA, *supra* note 5, 161.

113 S. IWAHARA, *Heisei 26-nen kaisha-hō kaisei no igi* [The Meaning of the Reform of the Companies Act 2014], Jurisuto 1472 (2014) 11, 11; N. YAMAMOTO, *Kaisha-hō kaisei no jitsumu ni kansuru eikyō. Dai-kaisha o chūshin to shite* [The Practical Implications of the Reform of the Companies Act: With a Focus on Large Companies], Hō no Shihai 176 (2015) 80, 80.

for introducing another structure was to improve the monitoring of executive directors compared to the traditional structure chosen by most companies.[115] It was meant to provide companies with the possibility of a "soft transition" to the monitoring model.

In contrast to the company with committees, the delegation of both the nomination and the compensation of directors to outsiders is therefore not mandatory.[116] There is just one committee with a majority of outside directors.[117] This committee mainly takes on the function of an audit committee, but to some extent is supposed to take on the functions of the other two committees as well. In order to fulfill this function, the audit-plus committee has the right to state its opinion on the nomination and compensation of directors at a shareholders' meeting.[118]

In companies with a small number of outside directors, the division of roles is similar to that of the traditional company with a board of statutory auditors. The situation changes when there is a majority of outside directors. In this case, the board can to a large extent delegate its decision-making power to the executive directors and concentrate on its monitoring function.[119]

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114 For an overview of other aspects of the reform not directly related to the board and corporate governance, see GOTO, *supra* note 110, 24–30; KOZUKA, *supra* note 92, 42–47. Regarding the general allocation of responsibilities in the new structure, see KANDA, *supra* note 66, 250–251; EGASHIRA, *supra* note 66, 581–584. For in-depth information about the new structure, see SAKAMOTO, *supra* note 4, 16–76.

115 YAMAMOTO, *supra* note 113, 81; cf. SAKAMOTO, *supra* note 4, 18–19.

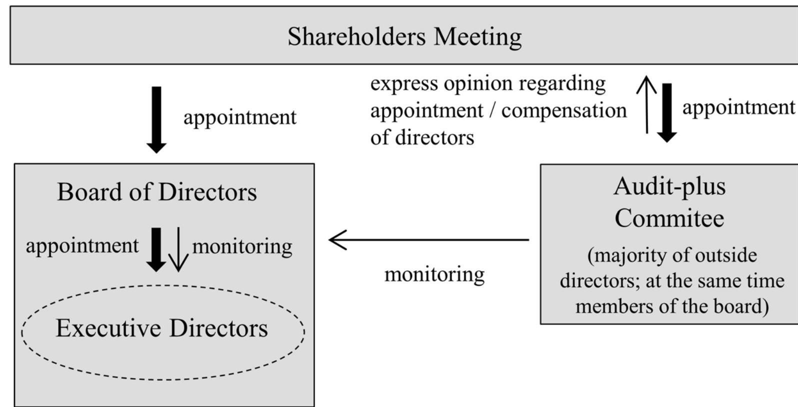
116 SAKAMOTO, *supra* note 4, 18–19.

117 Artt. 2 no. 11-2, 331 (6) CA. The members of the committee are elected directly by the shareholders' meeting and their compensation is determined separately from the other directors, Artt. 329 (2), 361 (2) CA. This is to strengthen the position of the committee in view of the lack of a nomination and compensation committee, GOTO, *supra* note 110, 24.

118 Artt. 342-2 (4), 361 (6) CA. See also GOTO, *supra* note 110, 23; MAEDA, *supra* note 109, 23. In the interim draft of the Companies Act revision, the committee was named "audit and supervisory committee" *(kansa kantoku i'in-kai)*. The name was later changed to *kansa tō i'in-kai,* which literally translates as "committee for audit etc." This was to indicate that the committee's function goes beyond the audit *(kansa),* but does not fully comprise the function of supervision *(kantoku)* because of the lack of decision rights regarding nomination and compensation. For some reason, the interim draft's wording was kept in the English translation of the Companies Act. To mimic the change in the Japanese wording, in this article the term "audit-plus committee" is used, following the example of GOTO, *supra* note 5.
The "company with committees" was in turn re-named to "company with, inter alia, a nomination committee" *(shimei i'in-kai tō setchi kaisha);* MAEDA, *supra* note 109, 22; SAKAMOTO, *supra* note 4, 21–23. For simplicity's sake, in this article the old name is used throughout.

119 Art. 399-13 (5) and (6) CA.

Diagram 3: Basic structure of a company with an audit-plus committee



The new organizational structure introduced in 2015 thus can be described as a hybrid form.[120] It allows companies to adopt either the management model or the monitoring model. The minimal requirements regarding outside directors are seen by the legislature as a starting point for moving towards a monitoring model with a majority of at least outside and possibly also independent directors.[121]

The second major aspect of the most recent reform of the Companies Act was the introduction of a comply-or-explain approach regarding the appointment of at least one outside director. Traditional companies with a board of statutory auditors that fail to appoint at least one outside director have to give an explanation for doing so in their annual business reports *(jigyō hōkoku)*.[122] The introduction of a legal obligation to appoint at least one outside director had lacked the support of the legislative council due to strong resistance by the business world.[123]

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120 KOZUKA, *supra* note 92, 47; see also MAEDA, *supra* note 109, 23.

121 GOTO, *supra* note 110, 23–24.

122 Art. 124 (2) and (3) *Kaisha-hō shikō kisoku* [Ordinance for Enforcement of the Companies Act], Ordinance of the Ministry of Justice No. 12/2006 as amended by Ordinance No. 5/2018. Moreover, an oral explanation in the shareholders' meeting is mandatory (Art. 327-2 CA), as is an explanation in the reference documents for the shareholders' meeting in cases where no nominee for election as director fulfills the requirements of an outside director (Art. 74-2 Ordinance for Enforcement of the Companies Act). Regarding the three modalities and their genesis during the reform process, see SAKAMOTO, *supra* note 4, 79–92.

123 See SAKAMOTO, *supra* note 4, 77–79. The Japan Business Federation *(Keidanren),* as in earlier reforms, was the main opponent; GOTO, *supra* note 110, 21.

Table 1: Management and monitoring in the Japanese stock company

	Company with board of statutory auditors	Company with committees	Company with audit-plus committee
Model	Management model	Monitoring model	Management model / monitoring model
Decisions on execution of operations of the company *(gyōmu shikkō no kettei)*	Board of directors; delegation to executive directors possible only to a very limited extent	Board of directors; delegation to executive officers possible to a large extent	Board of directors; delegation to executive directors possible to a large extent under certain conditions (majority of outside directors on the board or stipulation in articles of incorporation)
Execution of operations of the company *(gyōmu shikkō)*	Executive directors	Executive officers	Executive directors
Monitoring	Board of directors (dual function) and board of statutory auditors (the latter restricted to monitoring of legality of conduct)	Board of directors with audit committee, nomination committee, and compensation committee	Board of directors with audit-plus committee (right to state opinion on nomination and compensation of directors)

Third, the definition of outside directors was tightened, mainly in reaction to companies using the structure of a company with committees to secure control over their subsidiaries.[124]

3. *The TSE Listing Rules and Japan's Corporate Governance Code*

The reform of 2015 went beyond amendments to the Companies Act. Regulations regarding *independent* directors can now be found both in the listing regulations of the Tokyo Stock Exchange (TSE) and the Japanese version of a Corporate Governance Code.

Until the reform, the Securities Listing Regulations of the Tokyo Stock Exchange (TSE Listing Rules)[125] as a second regulatory level provided that

124 The definition of outside directors is found in Art. 2 no. 15 CA. Regarding the current definition of both outside and independent directors, see section V.4 below.

125 TSE Securities Listing Regulations (TSE Listing Rules) (as of 1 June 2018), available at *http://www.jpx.co.jp/english/rules-participants/rules/regulations/index.html*.

every listed company had to appoint either an independent director *or* an independent statutory auditor.[126] In addition to this obligation, the rules also contained a recommendation to appoint an independent director. This recommendation was now altered into a duty to "make efforts to secure" at least one independent director.[127] The definition of independence in the Listing Rules builds on the definition of outside directors in the Companies Act and, among other things, includes certain economic ties with the company as a negative criterion.[128]

Japan's Corporate Governance Code (JCGC),[129] which came into effect at the same time as the revised Companies Act in June 2015, represents the third regulatory level. As in Germany, the initiative behind this instrument of self-regulation has seen substantial state involvement.[130] Its proclaimed aim is to "achieve sustainable growth and increase corporate value over the mid- to long-term."[131] Following the now-ubiquitous UK example, it features a comply-or-explain approach that goes further with respect to outsider influence than the one found in the Companies Act. According to the Code, companies should appoint not one outside but at least two independent directors.[132] Companies that fail to comply have to explain their reasons for doing so in their corporate governance report.[133] This additional layer of regulation once again illustrates the legislature's urge for change.

V. CHANGING CORPORATE GOVERNANCE?

Our analysis so far has shown that the written rules governing the system by which Japanese companies are directed and controlled have seen numer-

126 Rule 436-2 TSE Listing Rules.

127 Rule 445-4 TSE Listing Rules. Regarding the development of the TSE Listing Rules with respect to independence requirements, see GOTO / MATSUNAKA / KOZUKA, *supra* note 5, 139–141.

128 Rule 436-2 TSE Listing Rules; Rule 211 (4) no. 6 and Rule 226 (4) no. 6 TSE Enforcement Rules for Securities Listing Regulations (as of 1 May 2018), available at *http://www.jpx.co.jp/english/rules-participants/rules/regulations/index.html*. For a more detailed analysis of the definitions of "outside" and "independent," see section V.4 below.

129 Japan's Corporate Governance Code: Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term, revised 1 June 2018, available at *https://www.jpx.co.jp/english/equities/listing/cg/*.

130 M. BÄLZ / M. PEIFER, Self-Regulation in Private Law in Japan and Germany, ZJapanR / J.Japan.L. Special Issue 10 (2018) 261, 276.

131 JCGC, 1 (preface).

132 Principle 4.8 JCGC. The Code refers to the TSE Listing Rules' definition of independence in Principle 4.7 n. 9 JCGC.

133 The comply-or-explain approach is anchored in Rule 436-3 TSE Listing Rules.

ous and far-reaching changes over the last two decades. But where do these developments leave us on the question of actual, substantial change?

While it should come as no surprise that there is no consensus among the relevant stakeholders about the best path forward for Japanese Corporate Governance, it is astonishing to see that assessments of past developments since the burst of the bubble are widely divergent as well.[134] Luke Nottage aptly describes the existing literature as "more likely to confuse than clarify."[135]

At least before the latest reforms, the majority of observers in both Western and Japanese literature took the view that Japanese corporate governance has seen gradual but noticeable change.[136] What follows is the question of whether change in this case equals Americanization. The probably prevalent view in this regard is that while seemingly adopting "global standards," legal transplants are adapted to the Japanese framework, thereby retaining the unique character of Japanese corporate governance.[137] As for the independent director mechanism, we have already seen in section II above that in fact there seems to be no global standard that goes beyond the notion of a certain number or share of board members that meets some form of independence criteria and is tasked with solving some form of agency problem.

It would of course be presumptuous to attempt to assess the present state of Japanese corporate governance comprehensively in this article. Rather, this section cautiously seeks to evaluate the current implementation of the independent director mechanism in the existing governance system from a comparative perspective.

1. Change in Form

When looking at the statistics of the TSE, recent reforms and the reform of 2015 in particular appear to have been highly successful in terms of promoting board independence. The new structure of a company with audit-plus committee is vastly better accepted than the company with committees

134 For an overview of the general corporate governance discussion and the various perspectives see L. NOTTAGE, Perspectives and approaches: a framework for comparing Japanese corporate governance, in: Nottage/Wolff/Anderson (eds.), *supra* note 107, 21. For various theoretical approaches to the comparative assessment of Japanese corporate governance see BAUM, *supra* note 61, 739 et seq.

135 NOTTAGE, *supra* note 134, 21.

136 NOTTAGE, *supra* note 134, 28–38 with further references.

137 NOTTAGE, *supra* note 134, 28–52 with further references; see also J. BUCHANAN/S. DEAKIN, Japan's Paradoxical Response to the New "Global Standard" in Corporate Governance, ZJapanR/J.Japan.L. 26 (2008) 59; D. W. PUCHNIAK, The 2002 Reform of the Management of Large Corporations in Japan: A Race to Somewhere?, Australian Journal of Asian Law 5 (2003) 42, 71.

introduced in 2002. Numerous publicly listed companies adapted their organizational structure during the first round of shareholders' meetings after the revised Companies Act came into effect.[138] While the traditional form of a company with board of statutory auditors is still dominant, today 24.7% of companies listed on the TSE take the form of the newly introduced hybrid structure.[139]

Table 2: The three organizational structures as percentages of the total number of companies listed on the TSE[140]

	2006	2008	2010	2012	2014	2016	2018
CBSA	97.5%	97.7%	97.8%	97.8%	98.3%	79.8%	73.3%
CC	2.5%	2.3%	2.2%	2.2%	1.7%	2%	2%
CAC	-	-	-	-	-	18.2%	24.7%

Abbreviations: CBSA = company with board of statutory auditors; CC = company with committees; CAC = company with audit-plus committee

Likewise, the percentage of companies with outside and independent directors on their boards has more than doubled over the last ten years, with the most drastic increase seen after the latest reform. Even more significantly, the share of outside and independent directors in the total number of directors on the boards has risen as well (see *table 3*).

At least in its form, Japanese corporate governance is on the move. On the face of the statistics, outside and independent directors have become increasingly influential on companies' boards. This development, however, should not be equated per se with substantial change in corporate practice. The number of directors meeting certain independence criteria in itself does not in any way guarantee that they perform the function intended by the legislature or play a meaningful role in the governance game at all. The use, or rather abuse, of the committee structure by parent companies to

138 Shortly after the revised Companies Act came into effect, the TSE expected 187 companies to change their organizational structure during the next shareholders' meeting. "*Yakuin-kai kansa kinō takameru* [Strengthening of monitoring function by boards of directors and statutory auditors]," Nihon Keizai Shinbun (Yūkan), 19 June 2015, 1.

139 TSE, Appointment of Independent Directors […] by TSE-Listed Companies (31 July 2018) 13, available at *https://www.jpx.co.jp/english/listing/others/ind-executive/index.html*.

140 TSE, *supra* note 139, 13; White Paper, *supra* note 72, 2017, 68 chart 51; 2015, 15 chart 15; 2013, 16 chart 14; 2011, 16 chart 15; 2009, 16 chart 15; 2007, 12 chart 17.

strengthen control over their subsidiaries is a shining example in the Japanese context.[141] The crucial question is therefore whether the insider system of the past is receptive to increasing outsider influence and whether the current implementation of the independent director fits the institutional framework or even has the potential for changing it.

Table 3: Increase in the number and proportion of outside and independent directors on the boards of companies listed on the TSE[142]

	2006	2008	2010	2012	2014	2016	2018
od ≥ 1	42.3%	45.4%	48.7%	54.7%	64.4%	95.8%	97.7%
od ≥ 2	-	-	23.8%	26.2%	27.1%	69.5%	79.9%
od ≥ 33%	-	-	10.7%	12.2%	13.4%	28.3%	38.1%
od ≥ 50%	-	-	1.9%	2.2%	2.6%	6.8%	5%
id ≥ 1	-	-	-	34.4%	46.7%	88.9%	93.6%
id ≥ 2	-	-	-	12.8%	13%	60.4%	71.8%
id ≥ 33%	-	-	-	4.4%	4.5%	19.4%	28.2%
id ≥ 50%	-	-	-	0.8%	0.8%	3.8%	2.7%

Abbreviations: od = outside director; id = independent director

2. *Preconditions for Substantial Change*

As noted above, the reform's goal of increasing companies' performance by increasing outsider influence and promoting shareholder interests stands in stark contrast to the corporate culture of the community firm, which is based on management's self-control and shielded from outside influence.

Professor Kenjirō Egashira, one of the most influential Japanese corporate law experts, has compellingly argued that corporate practice will not change unless this very foundation on which companies are based is shaken. What is necessary above all, he argues, is a change in the role played by shareholders as well as a change in the system of compensation and promo-

141 See section IV.1 above.

142 TSE, *supra* note 139, 5; TSE, Appointment of Independent Directors by TSE-Listed Companies [Final Figures] (27 July 2016) 5, available at *https://www.jpx.co.jp/english/listing/others/ind-executive/index.html;* White Paper, *supra* note 72, 2017, 84 charts 66 and 67; 2015, 24 charts 29 and 30; 2013, 25 chart 27; 2011, 19–20 chart 22; 2009, 19; 2007, 14.

tion of management that has so far been mainly characterized by the notion of life-long employment and seniority-based promotion.[143] Outside or independent directors, who are most often executive directors of other companies, could not be expected to strike at the foundation of the very structures in which they are based themselves.[144] According to Egashira, when it comes to corporate governance, reforms of the statutory framework alone are analogous to treating the symptoms of a disease instead of its true causes.[145]

There is, however, a certain probability that this traditional foundation will increasingly come under pressure from another angle. Not unlike developments in Germany,[146] Japan's shareholding structure has seen considerable change since the 1990s.[147] With the burst of the bubble and the beginning of a deep economic recession, companies and banks started to sell their shares in other companies.[148] The shares had no longer been profitable and the losses suffered – that is, the costs of cross-shareholdings – had to be disclosed after reforms in the regulation of banking and accounting had been implemented.[149] Thus, especially in large public companies, cross-shareholdings have been in decline for years.[150] At the same time, the proportion of foreign shareholders and especially foreign institutional shareholders of companies listed on the TSE has risen drastically. While in 1987 they accounted for only 4.1% of all shareholders, this number peaked at 31.7% in 2014 and now stands at 30.2%.[151]

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143 K. EGASHIRA, *Kaisha-hō kaisei ni yotte nihon no kaisha wa kawaranai* [Japanese Companies Won't Change Just Because of the Reform of the Companies Act], Hōritsu Jihō 86-11 (2014) 59, 60. A third element of the foundation is the role played by courts in evaluating the decisions of an independent board, see *ibid.,* 60. Cf. IWAHARA, *supra note* 113, 15, who presided over the legislative council of the latest reform and questions whether changes will happen within the current corporate culture; TAKADA / YAMAMOTO, *supra* note 62, 70–72.

144 K. EGASHIRA, *supra* note 143, 65.

145 K. EGASHIRA, *supra* note 143, 65.

146 See section II.3 above.

147 See GOTO / MATSUNAKA / KOZUKA, *supra* note 5, 147–150 for a short summary of the transition of the share-ownership distribution.

148 EGUCHI, *supra* note 77, 191 and 200; ODA, *supra* note 75, 9–12.

149 See EGUCHI, *supra* note 77, 191 and 200; ODA, *supra* note 75, 11–12; TAKAHASHI, *supra* note 86, 76.

150 G. GOTO, Legally "Strong" Shareholders of Japan, Michigan Journal of Private Equity & Venture Capital Law 3 (2014) 125, 145–146. Professor Kozuka argues that cross-shareholding among the largest companies has all but disappeared; S. KOZUKA, Conclusions: Japan's largest corporations, then and now, in: Nottage / Wolff / Anderson (eds.), *supra* note 107, 228, 234.

151 TSE, 2017 Share Ownership Survey, 4 table 3, available at *https://www.jpx.co.jp/english/markets/statistics-equities/examination/01.html*.

All in all this development marks a decline in the percentage of shares held by insider owners and a rise in the importance of outsider owners with purely financial interests.[152] To some extent, a return to the pre-World War II situation is apparent.[153] In contrast to then, however, today there are no major shareholders and ownership is even more widely dispersed. The focus is therefore shifting towards the agency conflict between shareholders as a class and management.

Nevertheless, it has to be noted that both the decline of cross-shareholdings and the increase in foreign shareholdings are taking place primarily in large public companies and less so in the much bigger number of small and medium-sized companies.[154] A recent study is indicative of the persistent corporate culture at the beginning of the twenty-first century. It has shown that interventions by activist hedge funds in Japan have not led to enduring changes in corporate governance and have seen hostile reactions, especially from Japanese investors.[155]

A departure from the status quo, therefore, seems to require shareholders in general – both foreign and domestic – to take a more active stance.[156] In particular, the comply-or-explain approach adopted by the revised Companies Act and the Code calls for shareholders to evaluate management's conduct and the companies' corporate governance. The increasingly important institutional investors in particular, however, hold relatively small stakes in individual companies. In the US context they have been described as "rationally reticent," since they themselves rarely exert active influence on the companies.[157] To push these investors towards a more active role in improving the investee companies' corporate value, the Japanese version of

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152 GOTO, *supra* note 150, 144–145; FRANKS/MAYER/MIYAJIMA, *supra* note 76, 3, 10–11, 46–47; GOTO/MATSUNAKA/KOZUKA, *supra* note 5, 149. As a result, it has to some degree come to a stimulation of the market for corporate control as well as several takeover attempts, H. BAUM,/M. SAITŌ, § 7 – Übernahmerecht, in: Baum/Bälz (eds.), *supra* note 3, 323–329 para. 10–28.

153 In the first half of the 20th century ownership in Japan was, the presence of *zaibatsu* notwithstanding, relatively dispersed and characterized by a high percentage of outsider owners, FRANKS/MAYER/MIYAJIMA, *supra* note 76, 13–15

154 GOTO, *supra* note 150, 146; GOTO/MATSUNAKA/KOZUKA, *supra* note 5, 149–150. See also White Paper, *supra* note 72, 2017, 6 and 7 charts 7 and 8.

155 J. BUCHANAN/D. H. CHAI/S. DEAKIN, Unexpected Corporate Outcomes from Hedge Fund Activism in Japan, ECGI, Law Working Paper No. 383 (2018).

156 S. IWAHARA et al., *Kaisei kaisha-hō no igi to kongo no kadai (ge)* [Meaning of the Reform of the Companies Act and Future Challenges (Part 2)], Shōji Hōmu 2042 (2014) 4, 17–18 (contribution to the discussion by Professor Egashira and consent of Professor Iwahara).

157 GOTO, *supra* note 150, 154. The term is used in the US by GILSON/GORDON, *supra* note 36, 16–17.

a Stewardship Code was enacted in February 2014 and revised in May 2017.[158] These developments reflect the legislature's aim to not only promote shareholder interests, but also follow the UK's example of calling for shareholders' engagement in corporate governance.[159]

At least to some extent, the development of the shareholder structure and pressure by foreign investors in particular are beginning to influence corporate culture and practice. Shareholders have begun to openly criticize management, to question management decisions, and to make active use of their voting rights. Some companies themselves have started to actively seek dialogue with their shareholders.[160] At the same time, enduring economic pressure means that the principles of life-long employment and seniority no longer apply in absolute terms.[161] The number of part-time workers is increasing and performance-based remuneration and promotion are on the rise.[162] This development is in line with the dominant view that the traditional characteristics of Japanese corporate governance are not carved in stone.[163] They fit well with the consensus- and group-oriented Japanese culture, but were predominantly driven by the power relations of stakeholders and economic necessities after World War II.[164]

To summarize, some signs of the traditional insider system beginning to erode can be seen. At least for larger companies, the dissolution of cross-shareholdings and the rise of foreign ownership are clearly visible. In conjunction with the extensive reforms of recent years, these developments have the potential to bring about changes to corporate culture and practice over the medium to long term and open up companies to outsider influence.[165] This leads us to the question of whether and to what extent the current implementation of the independent director mechanism is in line with proclaimed legislative goals and favors substantial change to corporate governance.

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158 Japan's Stewardship Code: To promote sustainable growth of companies through investment and dialogue, revised 29 May 2017, available at *https://www.fsa.go.jp/en/refer/councils/stewardship/20170529.html*.

159 See M. YUFU, *Kōporēto gabanansu kōdo ni tsuite* [About the Corporate Governance Code], Shōji Hōmu 2068 (2015) 4, 7. Regarding the shareholder engagement model and stewardship in the UK, see DAVIES, *supra* note 38, 714–716, 752–758.

160 EGUCHI, *supra* note 77, 200–201.

161 Č. PEJOVIĆ, Changes in Long-term Employment and Their Impact on the Japanese Economic Model: Challenges and Dilemmas, ZJapanR / J.Japan.L. 37 (2014) 51, 59–62.

162 PEJOVIĆ, *supra* note 84, 132–133.

163 See TAKAHASHI, *supra* note 86, 69–71 with further references also regarding opposing views.

164 PEJOVIĆ, *supra* note 84, 114 and 124–126 with further references.

165 Cf. IWAHARA, *supra note* 113, 14–15 and 17.

3. *Legal Implementation of the Independent Director Mechanism*

Japan is an outlier among Asia's leading economies as it is still not mandatory for listed companies to appoint even one independent director.[166] Technically there is not even an obligation to appoint one single outside director since adopting one of the committee-type organizational structures is optional. Still, the push for higher numbers of outside and independent directors on three regulatory levels – the Companies Act, the TSE Listing Rules and the Corporate Governance Code – is readily apparent.[167]

Whereas in the US, the UK, and Germany, there is one organizational structure for public companies and independence requirements are mostly either found in the listing rules or a corporate governance code, the Japanese system has grown quite complex. It has developed into a challenging regulatory jungle of three organizational structures, three main regulatory levels differentiating between outside and independent directors (but also outside and independent statutory auditors), overlapping requirements of both mandatory and non-compulsory provisions, and the current handling of the definition of independence. It also has terms that are easy to confuse but in no way synonymous.[168]

This complexity is to some extent the result of the political dynamics behind the reforms.[169] On the one hand, it contradicts the notion of shareholder engagement characterized by an active assessment of governance structures and a conscientious exercise of voting rights. This is especially true for individual shareholders, but also for foreign investors unfamiliar with ever-changing Japanese corporate governance. On the other hand, the numerous options enable companies to adapt their corporate governance to their individual needs and also let the legislature assess the different reactions in corporate practice over time. The comply-or-explain approach and the distinction between outside and independent directors make it possible for companies to take incremental steps and open up to outside influence cautiously and gradually. The new type of a company with an audit-plus

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166 D. W. PUCHNIAK/K. S. KIM, Varieties of Independent Directors in Asia: A Taxonomy, in: Puchniak/Baum/Nottage (eds.), *supra* note 7, 89, 107.

167 See sections IV.2 and 3 above.

168 For an in-depth analysis of the legal implementation of outside and independent directors, including sanctions on the different regulatory levels, see SPIEGEL, *supra* note ∗, 197–217.

169 For an analysis of these dynamics, see GOTO/MATSUNAKA/KOZUKA, *supra* note 5, 160–171. In light of the protracted discussions during the drafting of the Companies Act revision, the speed with which the government pushed through the Corporate Governance Code with increased requirements regarding even independent directors seems particularly astonishing.

committee especially allows for a smooth transition between management and monitoring model.

Critics will argue that companies may have a choice between the organizational forms, but that the choice of whether or not to appoint outside or independent directors is in fact quite limited. Under the Companies Act's comply-or-explain approach, companies cannot merely argue why it is not beneficial, but have to explain why it would be detrimental to appoint even one single outside director. Understandably, the number of listed companies with no outside directors has fallen to almost two percent.[170] This outcome may have been further facilitated by the fact that an ancillary clause in the reform act contained the obligation for the legislature to evaluate the reform two years after its enactment. The clause demands that the necessary further steps be taken, explicitly including the possibility of making the introduction of outside directors mandatory.[171]

Likewise, the rate of compliance with the Code is extremely high, with 88.9% of listed companies complying with at least 90% of the Code's provisions. Compliance with Principle 4.8, which asks companies to appoint at least two independent directors, stands at 84.76%.[172] In practice, the regulations seem to have an almost binding character, which contradicts the basic idea of a comply-or-explain approach: companies have every right to deviate from the code if they explain to the shareholders why they prefer to do so.[173] A similar trend can be seen in Germany, where the Corporate Governance Code has come to be treated by many as quasi law.[174] A similarly high compliance rate has already sparked off discussion about the need for a "culture of deviation" *(Abweichungskultur)*.[175]

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170 See section V.1 table 3 above. Regarding the difficulties for companies to find suitable explanations, see S. IWAHARA et al., *Kaisei kaisha-hō no igi to kongo no kadai (jō)* [Meaning of the Reform of the Companies Act and Future Challenges (Part 1)], Shōji Hōmu 2040 (2014) 6, 10 and 16 (contribution to the discussion by Mr. Sakamoto); EGASHIRA, *supra* note 143, 61.

171 SAKAMOTO, *supra* note 4, 12–13.

172 TSE, How Listed Companies Have Addressed Japan's Corporate Governance Code (5 September 2017) 3, available at *https://www.jpx.co.jp/english/equities/listing/cg/*.

173 Regarding the need for shareholders to accept explanations and for companies to provide sufficient justification for their decisions, see YUFU, *supra* note 159, 9.

174 BACHMANN, *supra* note 58, 191–192. There are even legal commentaries on the code, one of them being T. KREMER et al. (eds.), Deutscher Corporate Governance Kodex. Kommentar (7th ed., München 2018).

175 See paragraph 10 sentence 4 of the preamble of the GCGC. See also G. BACHMANN, Überlegungen zur Reform der Kodex-Regulierung, in: Krieger/Lutter/Schmidt (eds.), Festschrift für Michael Hoffmann-Becking zum 70. Geburtstag (München 2013) 75, 82–84.

The high rate of compliance notwithstanding, the number of companies where at least one third or even half of the board's directors are outside or independent is relatively low.[176] This cautious and gradual approach to independence by both the legislature and the business world, however, should not be prejudged too hastily. First, as noted above, the sole focus on independence on the board of directors has received increasing criticism internationally. While empirical studies of Japan paint a slightly more positive picture than studies in the US, there is still no convincing evidence of whether – and to what extent – all companies profit from more independence on their boards, or if not all do, precisely which companies do.[177] Super-majority independent boards are still the norm in the US, but the focus in the UK has already shifted towards an "appropriate balance of skills, experience, independence and knowledge of the company."[178] Second, the question of what proportion of outside or independent directors is needed depends on the precise function intended for these directors.[179]

4. *The Definition of Independence*

Another important aspect of the implementation of the independent director mechanism is the definition of independence. It is also directly linked to the function intended for the directors and in its current form adds to the level of complexity of the corporate governance system.[180]

While companies with a board of statutory auditors have to explain their decision if they choose not to appoint a single outside director, companies that opt for one of the two committee structures must have a majority of outside directors on their committees.[181] The definition of outside directors is found in Art. 2 no. 15 CA. Until the latest reform of the Companies Act in 2015, it focused on employment relationships with the company or a subsidiary.

To make monitoring more effective, it has now been tightened to include certain relationships with parent and sister companies as well as certain

176 See section V.1 table 3 above.

177 For a meta-analysis of the existing empirical studies, see GOTO/MATSUNAKA/KOZUKA, *supra* note 5, 151–150; SPIEGEL, *supra* note *, 181–190.

178 B.1 Main Principle, The UK Corporate Governance Code, *supra* note 40. Regarding the shift of focus, see also BAUM, *supra* note 14, 45–46; M. T. MOORE, United Kingdom: The scope and dynamics of corporate governance regulation, in: Fleckner/Hopt (eds.), Comparative Corporate Governance: A Functional and International Analysis (Cambridge 2013) 913, 923–925.

179 See section V.5 below.

180 For an in-depth analysis of the definition of outside and independent directors in Japan, see SPIEGEL, *supra* note *, 217–228.

181 See section IV.1 and 2 above.

personal ties with the company or its management. The changes are especially aimed at ending some companies' practice of strengthening their influence on subsidiaries by appointing their representatives to the boards of subsidiaries.[182] Through these recent changes, the Japanese version of an outside director has further closed the gap with the international standard of an independent director.[183]

At the same time, however, the definition has been broadened. In the past, former executive directors and employees of the company or one of its subsidiaries were excluded from the position of outside director. Now, the revised Companies Act has parted with this strict approach. The legislature has introduced a cooling-off period of 10 years, which is supposed to make it easier for companies to find suitable candidates.[184] Thus, while the requirements have been tightened at one end, they have been loosened at the other. It should be mentioned, though, that in Germany members of the management board were legally permitted to transition seamlessly to the supervisory board until 2009, when a cooling-off period of only two years was introduced.[185]

From a comparative view, there is one aspect that seems even more important than the introduction of a transition period. It is the fact that one element that is commonly seen as a prerequisite for independence is still left out of the Japanese definition of an outside director: a lack of economic ties with the company or its management.[186] This element is only covered in the definition of independent directors in the Listing Rules. The pertinent provision takes the Companies Act's definition of outside directors as a starting point and additionally requires that the person in question be unlikely to have conflicts of interest with general shareholders.[187] The En-

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182 SAKAMOTO, *supra* note 4, 104–106; YAMAMOTO, *supra* note 113, 84. Regarding this practice, see section IV.1 above.

183 See GOTO, *supra* note 110, 20–21. For a chart showing the requirements after the latest reform, see SAKAMOTO, *supra* note 4, 95.

184 Art. 2 no. 15 lit. a) CA. Regarding this amendment, see MAEDA, *supra* note 109, 22; GOTO, *supra* note 110, 21 n. 47. For a chart showing the different scenarios under the new provision, see SAKAMOTO, *supra* note 4, 103.

185 K. J. HOPT, The German Law of and Experience with the Supervisory Board, ECGI, Law Working Paper No. 305 (2016) 11; LEYENS, *supra* note 39, 404.

186 See GOTO/MATSUNAKA/KOZUKA, *supra* note 5, 143; GOTO, *supra* note 110, 20–21. Personal and financial ties to the respective monitoring object are the two main aspects of independence. Interview by the author with Professor Hideki Kanda at the University of Tokyo on 2 July 2015; cf. L. ENRIQUES et al., The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies, in: Kraakman et al. (eds.), *supra* note 22, 79, 85.

187 Rule 436-2 TSE Listing Rules. The JCGC refers to the definition of independence in the Listing Rules, Principle 4.7 n. 9 JCGC.

forcement Rules for Securities Listing Regulations of the TSE (TSE Enforcement Rules)[188] provide a list of negative criteria – including certain economic ties with the company – that generally speak against the independence of the respective person.[189]

Another element that is lacking in the definition of outside directors, but – as in Germany – included in the definition of independence is ties to major shareholders. The list of negative criteria includes being a major shareholder or, in cases where the shareholder is a legal entity, a person who executes or executed its business. The regulations of the TSE in conjunction with the Financial Products and Exchange Act define a major shareholder as a shareholder holding at least 10% of the voting rights.[190] What follows is that this negative criterion does not cover the cross-shareholdings that are still relatively common for small and medium-sized companies. The interlinked companies hold reciprocal shares that are significantly lower than 10%, meaning that their representatives can be considered independent.[191]

While the requirements for outside and independent directors were modified during the last round of reforms, the handling of the negative criteria listed in the TSE's regulations has been changed as well. It is the very nature of the comply-or-explain approach that it requires companies to give an explanation if they choose to deviate from the Code's requirements. In view of this, it seems surprising that the reform does away with the need for an explanation in cases where a negative criterion is met by a director who is declared independent by the board. Companies therefore only have to disclose the fact that a criterion is met and can then state that they comply with the requirement of the Code to appoint at least two independent directors.[192]

188 See *supra* note 128.

189 Rule 211 (4) no. 6 and Rule 226 (4) no. 6 TSE Enforcement Rules.

190 Rule 2 (2) no. 13-3 TSE Enforcement Rules, Rule 402 no. 2 lit. b) TSE Listing Rules, Art. 163 (1) *Kin'yū shōhin torihiki-hō* [Financial Products and Exchange Act], Law No. 25/1948, revised through Law No. 65/2006 as amended by Law No. 63/2015.

191 Regarding the practice of cross-shareholding, see sections III.2 and V.2 above.

192 For an explanation of the old and the new approach, see T. SATŌ, *Kōporēto gabanansu kōdo no sakutei ni shitagau jōjō seido no seibi no gaiyō* [Overview of the Revision of the Stock Exchange System Resulting from the Preparation of the Corporate Governance Code], Shōji Hōmu 2065 (2015) 57, 62–64. For a chart juxtaposing the old and new regulations, see *ibid*. as well as TSE, Development of Listing Rules for the Implementation of the Corporate Governance Code (24 February 2015) 8, available at *https://www.jpx.co.jp/english/rules-participants/public-comment/detail/d01/20150224-01.html*.

The argument that this change of procedure is intended to alleviate companies' concerns about a negative assessment of the market and that the concept of disclosure follows the comply-or-explain approach is, in my view, contradictory.[193] Rather, it is necessary for deviations not only to be disclosed, but also justified so that shareholders can make a well-founded assessment. As a consequence of the changes, in 2016 the share of managing directors of business partners was 26.2% of all independent directors without the companies having to justify why these persons should nevertheless be deemed independent.[194]

The dualism of outside and independent directors as well as the combination of a positive and a more general definition supplemented by a list of negative criteria further adds to the complexity of the governance system described above. In addition, companies can deviate from the list of negative criteria without explaining their decision and are even encouraged to set their own independence standards based on the standard set out in the regulations of the TSE.[195] This situation is exacerbated by frequent changes caused by several reforms that have shifted requirements between the different regulatory levels. In fact, one of the TSE's charts illustrating the independence requirements is, in my understanding, not compliant with the respective provisions in the TSE Listing Rules.[196]

The answers to both the question of who should be declared independent and the question of how many outside or independent directors are needed ultimately depend on the function intended for these directors.

5. *The Function of Japan's Independent Directors*

The declared aim of the last round of reforms was to boost the performance of Japanese companies and, more specifically, to improve the monitoring of management's performance.[197] The intended function for outside and inde-

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193 Regarding the reasoning behind the modifications, see SATŌ, *supra* note 192, 62–63; cf. TSE, *supra* note 192, 3.

194 White Paper, *supra* note 72, 2017, 92 chart 79. Only for 60.4% of independent directors no relationship contained in the list of negative criteria was disclosed.

195 Regarding the development of individual standards, see Principle 4.9 JCGC; see also SATŌ, *supra* note 192, 62–63.

196 TSE, *supra* note 192, 8. For example, the chart marks current executives of major clients as "not independent" instead of "disclose." Such business relations, however, are not covered by the definition of outside directors in the Companies Act, but are only included in the list of negative criteria for independence in the TSE Listing Rules. This means that companies can simply disclose the relationship and appoint the person as independent director.

197 See sections IV.2 and 3 above.

pendent directors, however, is not clearly laid out on any of the three regulatory levels and is still under discussion.

a) *Evidence on the Three Regulatory Levels*

While the Companies Act contains provisions regarding the tasks of the committees in the two newer organizational structures, the outside directors' role within these committees as well as their role as individuals on the board as a company organ remains vague.[198] Under the Companies Act, all members of the board of directors have the same rights and duties regardless of whether they are outside directors or not.

The TSE Listing Rules offer hardly any indication as to the directors' functions. The Corporate Governance Code, while more specific, contains only a very broad description of the function of independent – not outside – directors: In addition to monitoring the management, they are supposed to give advice, monitor conflict of interest transactions and also represent the views of minority shareholders and other stakeholders.[199]

This is not to say that other jurisdictions that have received the independent director mechanism have precise regulations in that respect.[200] In Germany, for example, the Code provides no detailed description of the function of independent supervisory board members either. However, the case of Japan is special because of its complexity and the diversity of regulatory approaches. By contrast, German law only features one organizational structure with a two-tier board model. Here independence is supposed to strengthen the monitoring of the supervisory board, the function of which as a counterpart to the management board is clearly defined and substantiated by court rulings.[201]

b) *From the "If" to the "How"*

The mere introduction of some form of independence requirements may paint a picture of effective political governance in reaction to the economic malaise and it may to some extent boost the confidence of domestic and

198 Regarding the authority and operations of the committees, see Artt. 399-2 to 399-12 and 404 to 414 CA.

199 Principle 4.7 JCGC.

200 See, e.g., M. GUTIÉRREZ/M. SÁEZ, Deconstructing Independent Directors, Journal of Corporate Law Studies 13 (2013) 63, 67, stating that legislators are "very vague as to the task they are supposed to carry out."

201 See section II.3 above. Nevertheless, the function of the supervisory board is of course also subject to change and constantly under discussion. For an up-to-date account of the function, see DU PLESSIS et al., *supra* note 47, 133–53.

especially foreign investors.[202] Reducing the independent director to a mere signal of "good corporate governance," however, cannot be the basis for substantial change.[203] While the signaling function may have played an important role during the reforms, it is certainly not an end in itself.

Still, the debate in Japan – as in other jurisdictions – has primarily focused on the question of whether and, if so, in what numbers outside and independent directors should be mandatory on the boards of listed companies. In comparison, the specific functions intended for these directors, as well as their implementation in practice, have figured too briefly in the debate.[204]

In particular, it remains to be clarified whether functions differ depending on the chosen organizational structure and the role of the board of directors in general.[205] In clarifying this, other framework conditions – ownership structure, corporate culture, and competing governance mechanisms – need to be taken into account.

This article will now briefly – and in an exemplary and in no way exhaustive fashion – address some aspects of the function of outside and independent directors that might need further discussion.[206]

c) *Independence as Foreign Body or Elementary Component*

To begin with, it is necessary to understand the fundamentally different starting points of the three organizational structures. In traditional companies with a board of statutory auditors, outside and independent directors are foreign bodies within a board of directors made up of insiders and entrusted with management decisions.[207] By contrast, in the company with committees they are an elementary component of the board, which is supposed to act as a monitoring body. Not only do the executive officers *(shikkō-yaku)* outside the board execute the business of the company, but decision-making power can be delegated to them to a large extent.[208] The new

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202 Foreign investors' lack of confidence was the second driving force behind the reforms in addition to the low-performing Japanese economy, GOTO/MATSUNAKA/KOZUKA, *supra* note 5, 161.

203 K. EGASHIRA, *supra* note 143, 61–62. Signaling good corporate governance was an important reason for adopting independent directors in other Asian jurisdictions, PUCHNIAK/KIM, *supra* note 166, 112–113.

204 For an analysis of recent discussion focusing on the roles expected to be performed by outside and independent directors, see GOTO, *supra* note 5, 47–51.

205 See MATSUNAKA, *supra* note 4, 38 with a focus on performance monitoring.

206 For a more comprehensive account of possible functions of Japan's independent directors, see SPIEGEL, *supra* note ∗, 228–262.

207 See section III.1 above.

208 See section IV.1 above.

organizational structure with an audit-plus committee can be seen as a hybrid approaching either the management or the monitoring model, depending on the number of outside and independent directors on the board.[209]

d) The Functions in Theory and Practice

When talking about the function primarily intended by the legislature – performance monitoring – it is noteworthy that the number of companies where at least a third or even half or more of the directors on the board are outside or independent is rather low.[210]

In the traditional structure of a company with a board of statutory auditors, where there are no committees, a small minority of outside or independent directors might not have any influence on the decisions of the board.[211] Even if there is a majority of outside directors, the decision-making power cannot be delegated to the executive directors as it is possible in the committee structures. This restricts the board to its dual function of management and monitoring regardless of the number of outsiders on the board.[212]

Even in a company with committees, though, a clear separation of management and monitoring is hindered by the fact that directors are allowed to simultaneously act as executive officers.[213] These are the very persons that not only execute the decisions of the board, but can also be tasked with decision-making itself and are supposed to be monitored by the board.

In the new type of a company with an audit-plus committee, decision-making powers can be delegated to executive directors under certain circumstances, especially if at least half of the directors are outside directors.[214] In practice, however, most of the companies that chose the new structure have only two or three outsiders and even fewer independent directors on their boards.[215] This suggests that at least in most of these companies, like in the traditional structure, the board still fulfills a dual function, which prevents a clearer separation of management and monitoring.

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209 See section IV.2 above.

210 The numbers for outside directors are 38.1% (at least one third outside) and 5% (at least half outside) and for independent directors 28.2% (at least one third independent) and 2.7% (at least half independent). See section V.1 table 3 above.

211 Cf. GOTO, *supra* note 5, 46.

212 See YAMANAKA, *supra* note 71, 507 and 523. Another factor is the establishment of so-called executive boards *(jōmu-kai)* within the boards of directors. See section III.1 above.

213 Art. 402 (6) CA. Even a majority or all of the executive directors could potentially be executive officers at the same time. Moreover, there are no provisions regarding the proportion of outside directors on the board.

214 See section IV.2 above.

215 White Paper, *supra* note 72, 2017, 85 chart 68.

What is more, another factor inducing companies to change to the new organizational form might have been the committee's power to consent to conflict of interest transactions. This consent renders the legal presumption of a negligent breach of duty by the directors involved in the transaction inapplicable.[216] Since the directors giving their consent do not even have to be independent, they are allowed to have economic ties to the persons involved in the transaction.

Corporate scandals like the ones at Olympus (2011), Toshiba (2015) and Mitsubishi (2016) show that there might be room for improvement in compliance monitoring as the second major aspect of monitoring.[217] In the traditional organizational structure, it is carried out by the board of statutory auditors. This poses two questions for the adoption of independent directors. First, it needs to be seen in what way the audit committee and the audit-plus committee can help to improve compliance monitoring in comparison to statutory auditors, considering the lack of any further qualification requirements. Second, in companies with a board of statutory auditors, the division of roles between outside or independent directors and the board of statutory auditors as a competing governance tool regarding questions of compliance needs to be clarified.[218]

Regardless of the organizational form, the question arises as to in whose interests the monitoring function should be carried out, that is, the question of the prevalent agency conflict.[219] In most major Asian economies, as opposed to the US as the country of origin, independent directors are supposed to monitor controlling shareholders to protect minority shareholders.[220] In contrast, in Japan outside directors can be both major shareholders

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216 Art. 423 (4) CA.

217 Regarding these scandals, see "Corporate Governance in Japan: A revolution in the making," The Economist, 3 May 2014, Business section and ARONSON, *supra* note 68, 85–96 (Olympus); "Toshiba's accounts: A load of tosh," The Economist, 25 July 2015, Business section (Toshiba); "Car emissions: Exhaustive analysis," The Economist, 30 April 2016, Business section (Mitsubishi).

218 FERRARINI / FILIPPELLI, *supra* note 82, 15; LIN, *supra* note 3, 94. China, where independent directors are expected to act as complimentary monitors to the supervisory board, faces a similar question. See XIN TANG, Independent Directors in China. Facts and Reform Proposals, in Puchniak / Baum / Nottage (eds.), *supra* note 7, 208, 224–225.

219 A related and similarly important question is how outside or independent directors can be best incentivized to efficiently and diligently perform their duties. For an interesting functional approach to independence, see RINGE, *supra* note 35, 79–88, who proposes to combine independence with dependence on the party whose interests need to be protected.

220 PUCHNIAK / KIM, *supra* note 166, 111–112. Some commentators are highly critical of independent directors' ability and incentives to control insiders, particularly in

and executives of major shareholders. Only the definition of independence excludes such relationships.[221]

The lack of focus on the protection of minority shareholders seems plausible if we consider that today the shareholder structure in Japan is widely dispersed and characterized by the absence of major shareholders.[222] However, while cross-shareholdings have all but disappeared from the largest companies, they are still common for small to medium companies and obscure the agency conflict between shareholders as a class and management.[223] A possible function for outside directors that was not intended by the legislature and has so far been largely overlooked could thus be to reinforce old intercompany links while at the same time signaling good corporate governance.[224] This network function was characteristic for the boards of companies in a *keiretsu* and members of the supervisory board during the era of the Deutschland AG in Germany as well.[225] Representatives of interlinked companies can even sit on the boards as independent directors as these companies are not major shareholders under the current definition because of their relatively small share sizes.[226] The relationship does not even have to be disclosed unless another of the negative criteria in the stock exchange's regulations is met.

Another possible function, which is both in line with the overall aim of boosting performance and also mentioned in the Code, is an advisory function. While in the US the focus is on containing excessive risk-taking by executives, in Japan there is often criticism of a lack of innovative strength and willingness to take risks.[227] This is somewhat similar to the situation in the UK, where at the beginning of the 1970s non-executive and later also

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jurisdictions where the agency conflict is between controlling and minority shareholders. See, e.g., GUTIÉRREZ/SÁEZ, *supra* note 200, 63 et seq.

221 See section V.4 above.

222 See section V.2 above.

223 Regarding the evasion of supervision by shareholders through cross-shareholdings, see section III.1 above.

224 Cf. PUCHNIAK/KIM, *supra* note 166, 116 and DORE, *supra* note 105, 382–383 regarding the situation before recent changes to the definition of outside directors.

225 Regarding the situation in the *keiretsu,* see section III.2 above, and regarding the network function and the Deutschland AG, see PRIGGE, *supra* note 54, 960–961. For an analysis of the connection between the networks and the composition and function of the management and the supervisory board, see HOPT, *supra* note 48, 233–235

226 See section V.4 above.

227 YUFU, *supra* note 159, 8; H. KANSAKU, *Kōporēto gabanansu kōdo no hōsei-teki kentō. Hikaku-hō no kanten kara* [A Legal Analysis of the Corporate Governance Code. From a Comparative Perspective], Shōji Hōmu 2068 (2015) 13, 14–15.

outside directors were predominantly supposed to contribute their experience as well as bring innovative and fresh ideas to the board.[228]

For this function, actual independence from management or controlling shareholders might not even be a necessity.[229] A precondition for these directors to be effective, though, is that they are taken seriously by the board. On the one hand, for advice to have any impact, it requires a willingness to cooperate. On the other hand, a willingness to cooperate can be enforced if a minimum number of outside or independent directors have the necessary leverage to exercise a supervisory function. The German understanding of the supervisory board's function[230] and the discussions in the UK about independent directors' contribution to the board's decision-making[231] show that an advisory function may not exist independently of a monitoring function; it can rather be understood as ex-ante monitoring.

The new structure of a company with an audit-plus committee represents an interesting, mediatory approach in this respect. It allows the advice of outside or independent directors to be combined with the empowerment of shareholders through the right of the committee to state its opinion on matters of compensation and nomination of directors. The management first receives input from outsiders. Then, if the shareholders informed by the committee are dissatisfied with the management, it is up to them as owners of the company to make active use of their right to vote. They determine the remuneration of directors and have the option to reject election proposals by the board. In comparison to the company with committees, both the advisory function and the role of shareholders as owners of the company are emphasized.

VI. CONCLUSION

The study of recent developments in Japan confirms the findings of the comparative analysis of board independence as a legal transplant at the beginning of this article: There is not *one* type of independent director. It is rather a diverse governance tool with a wide range of distinctive features that speak against the notion of a mere adoption of US standards.[232] On a

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228 ZHAO, *supra* note 15, 29–35. What is different, though, is that in the UK the initiative for the introduction of these directors came from the companies.

229 See GUTIÉRREZ / SÁEZ, *supra* note 200, 68.

230 HOPT, *supra* note 185, 2 and 12. The connection between an advisory and a monitoring function is also acknowledged by case law; see Bundesgerichtshof (Federal Court of Justice), decision of 25 March 1991 – II ZR 188/89, BGHZ 114, 127, 129–130.

231 DAVIES, *supra* note 38, 740–741.

232 SPIEGEL, *supra* note ∗, 68; cf. BAUM, *supra* note 14, 55–56.

broader scale, the independent director is arguably an example of a legal transplant that, despite convergence in certain aspects, for now contradicts the prediction of the "end of history for corporate law."[233]

While it is to be expected that the Japanese legislature will refrain from further extensive changes to the basic corporate governance structure in the foreseeable future, the revisions of 2015 were seen as just the beginning of efforts to improve Japanese corporate governance.[234] Since then the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code has already published several statements,[235] and both the Corporate Governance Code and the Stewardship Code have been published in revised editions.[236] In addition, the Minister of Justice consulted the Legislative Council in February 2017, regarding a further revision of the Companies Act.[237] While the resulting interim draft published in February 2018 has its focus on other items, it also deals with outside directors and explicitly considers the introduction of a mandatory appointment of one outside director for all listed companies.[238]

A further shift of focus in the discussion from the "if" to the "how" of board independence seems to be even more important than the question of an eventual mandatory appointment. The effects of the numerous changes in recent years need to be evaluated, and further efforts should be accom-

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233 See S. KOZUKA/L. NOTTAGE, Independent Directors in Asia: Theoretical Lessons and Practical Implications, in: Puchniak/Baum/Nottage (eds.), *supra* note 7, 468, 472–474. The chapter concludes the volume's analysis of the proliferation of the independent director in Asia. The authors follow the notion that "legal transplantation is actually a process by which elements and concepts of a legal system are decontextualised […] and then reassembled by the importing jurisdiction without much interest in how they functioned in the original jurisdiction," *ibid*., 476–481.

234 Minutes of the First Council of the "Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code," 1, available at *https://www.jpx.co.jp/english/equities/listing/cg/*.

235 The statements are available at *https://www.jpx.co.jp/english/equities/listing/cg/*.

236 For example, in the revised version of the JCGC, Principle 4.1 has been rephrased and amended by Supplementary Principles to further promote the dissolution of cross-shareholdings. See the revised Code with track changes, available at *https://www.jpx.co.jp/english/rules-participants/public-comment/detail/d01/e20180330-01.html*.

237 Consultation No. 104, *Kaisha hōsei (kigyō tōchi tō kankei) no minaoshi ni tsuite* [On the Reform of the Companies Act (Corporate Governance and Other Issues)], available at *http://www.moj.go.jp/content/001216452.pdf*.

238 *Kaisha hōsei (kigyō tōchi tō kankei) no minaoshi ni kansuru chūkan shian* [Interim Draft concerning the Reform of the Companies Act (Corporate Governance and Other Issues)], 11, available at *http://www.moj.go.jp/shingi1/shingi04900348.html*. A reference translation of the interim draft is available at *https://www.jpx.co.jp/english/news/1020/20180314-01.html*.

panied by extensive empirical studies. There remain numerous open questions, some of which have been identified in this article. These need to be seen against the background of a changing institutional framework and mainly concern the legal implementation of independence, the definition of independence and especially the precise function intended for independent directors.[239]

These and similar questions do not only arise in the Japanese context. They are common to many other jurisdictions that have transplanted board independence and struggle with making effective use of independent directors and finding the right balance between independence and other qualifications. In Germany, to give an example, a more fundamental revision of the Code is currently under discussion. Among other items, the agenda also includes a new examination of board independence and a clarification of the definition of independence.[240]

Japan took a cautious and gradual approach towards board independence in the light of increasing global criticism of a sole focus on independent directors. Nonetheless, the latest round of reforms and changes in the shareholder structure has put heavy pressure on companies. In combination, they have the potential to bring about not only change in form, but change in substance. The next few years will show whether Japan can build on the foundation that has already been laid and increase companies' profitability by opening them up to outsider influence and making effective use of independent directors.

SUMMARY

Effective monitoring of management is at the core of the corporate governance debate. One tool to compensate for existing monitoring deficits is the independent director. While board independence is a global standard of "good corporate governance," it has increasingly become the subject of hefty criticism, not least in the US as its country of origin. In contrast, the reception of the independent director in Japan has only recently picked up speed against the background of Abenomics, a plan for revitalizing the Japanese economy.

This article examines the question of how the independent director as a legal transplant fits into the corporate governance system in Japan, which has so far been largely isolated from outsider influence. The study begins by providing the comparative background necessary for understanding recent Japanese devel-

239 See section V.3 to V.5 above.

240 Regierungskommission Deutscher Corporate Governance Kodex, press release of 22 June 2017 (in German), available at *https://dcgk.de/de/presse.html*.

opments. It then examines the institutional framework and characteristics of traditional Japanese corporate governance before discussing the opening of the closed system through the reforms of the twenty-first century, including those of 2015. Finally, it explores the crucial question of whether these reforms and the independent director in its current form can build on or bring about substantial change to Japanese corporate governance.

ZUSAMMENFASSUNG

Die effektive Überwachung der Geschäftsführung ist eine der Kernfragen der Corporate-Governance-Debatte. Ein Instrument zum Ausgleich bestehender Überwachungsdefizite ist der unabhängige Direktor. Er gehört weltweit zum Standard „guter Corporate Governance", ist jedoch zunehmend in die Kritik geraten. Seine Rezeption in Japan hat demgegenüber erst in jüngerer Vergangenheit vor dem Hintergrund des Wirtschaftsprogramms Abenomics an Fahrt aufgenommen.

Dieser Beitrag geht der Frage nach, wie sich der unabhängige Direktor als legal transplant in das bislang weitgehend vor unternehmensexternem Einfluss abgeschottete System der Corporate Governance in Japan einfügt. Die Untersuchung beginnt mit einer Analyse des für das Verständnis der japanischen Entwicklungen notwendigen rechtsvergleichenden Hintergrunds. Im Anschluss werden die strukturellen Rahmenbedingungen und Charakteristika der traditionellen japanischen Corporate Governance beleuchtet, bevor auf die Öffnung des abgeschlossenen Systems durch die Reformen des 21. Jahrhunderts einschließlich der Reformen des Jahres 2015 eingegangen wird. Am Schluss steht eine Untersuchung der entscheidenden Frage, ob die genannten Reformen und der unabhängige Direktor in seiner derzeitigen Form auf einen substantiellen Wandel der Corporate Governance aufbauen oder einen solchen bewirken können.