ABHANDLUNGEN

Corporate Law Reform in Japan 2001/2002
– Deregulation of Company Law ? –

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I. INTRODUCTION

Japanese company law is currently undergoing a major reform. Company law in Japan is primarily accommodated in the Commercial Code, which was enacted in 1899 based upon the German model. The company law part of the Code was later amended due to an influence from the US. There have been some 19 amendments during the last half century. In 2001/2002, there were four bills in a row for amendments to the Code, and related laws were endorsed by Parliament. The fact that such a wide range of amendments were adopted within little more than a year demonstrates the urgency felt by those who were involved in the process.

To be sure, in recent years, the reform of corporate law has not been limited to Japan. In the UK, after some celebrated corporate failures, the improvement of corporate governance came onto the agenda, culminating in the Corporate Law Review which started in 1998. In response to the conclusion of the Review, the UK government published a white paper entitled 'Modernising Company Law', with the view to totally amending the 1985 Companies Act.[1] In Germany, the *Aktiengesetz* has been amended several times since 1998 alone. The latest changes came in the form of the Transparency and Publicity Law, which came into force in 2002.[2] Changes have also taken place in France. In 2001, the Law on the *'Nouvelles Régulation Economique'* was enacted and incorporated in laws such as the *Code de Commerce*. This constitutes a comprehensive reform since 1966, and among other matters, it focusses on the improvement of corporate governance.[3] A reform is similarly under way in Italy.[4]

In Japan, the general background to the reform was the long-lasting recession which started after the collapse of the 'bubble economy' in 1990. Japan then experienced a major banking crisis in 1998 resulting in tax payers' money being injected into all banks. Still the economy does not seem to have recovered. Share prices remain low, at less than a quarter of the highest level achieved in 1989. In 2002 and 2003, the *Nikkei* average fell below 9,000 yen and the banks can barely meet the capital adequacy ratio set by the Bank of International Settlement.

In this continuing recession, companies felt that the rigid regulation of company law was making business overly difficult for them. Their view was that due to these regulations they were not allowed to do what their foreign competitors were allowed to do, and that they were therefore losing their competitive edge in the international market. The *Keidanren* (Japan Business Federation – now *Nippon Keidanren*) published recommendations for the reform of corporate law in October 2000. Five basic points were suggested:[5]

(1) the relaxation of the mandatory requirements of the law, shift to the law with an emphasis on the market and the ensurance of international competitiveness;
(2) the improvement of the legal system concerning the restructuring of businesses and organisations;
(3) the diversification and increased efficiency in corporate finance;
(4) the nurturing of new venture businesses;
(5) the introduction of communication technology.

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1 <*www.dti.gov.uk*>.

2 U. SEIBERT, Das „TransPuG“, in: Neue Zeitschrift für Gesellschaftsrecht 2002, 608-617. Corporate Governance Kodex – Endfassung, in: *ibid.,* 273 *et seq.*

3 R. STORP, Reform des Französischen Unternehmensrechts in Rahmen des Gesetzes über „Neue wirtschaftliche Regulierungen“ vom 15.5.2001, in: Recht der Internationalen Wirtschaft (2002) 409-417. See also P. OMAR, Company Law Reform in France: the Economic Imperative, in: European Business Law Review (March/April 2001) 76 *et seq.*

4 M. BUSE, Reform des italienischen Gesellschaftsrechts, in: Recht der internationalen Wirtschaft (2002) 677-679.

5 K. YOKÔ, The Role and Task of Corporate Legal Business in the 21st Century, Shôji Hômu, 1583 (2001) 74. Around the same time, a report prepared by an advisory council to the then MITI was published (Shôji Hômu 1581 (2000) 50-51).

One of the underlying ideas of these proposals was that the scope of mandatory provisions in company law should be reduced and companies should be assessed and directed by the market.[6]

This proposed shift from mandatory law to optional law was supported by the government which had embarked upon the course of deregulation under pressure from the US as well as the EU. The government's Council for Regulatory Reforms referred to the corporate law reform in the Three-Year Programme for Regulatory Reform, published in March 2001. Various measures were listed for the diversification of corporate finance and the ensurance of share liquidity. Furthermore, the system of corporate governance was to be reviewed from the viewpoint of the 'relaxation of the mandatory nature of the Commercial Code'.[7]

The perceived urgency of the reform of company law in the direction of freeing companies from company law 'regulations' was reflected in the legislative procedure. Previously, basic laws such as the Commercial Code, the Civil Code, and the Code of Civil Procedure had to be discussed by a special advisory body to the Minister of Justice – the Council for the Review of the Legal System (CRLS). This body was more or less dominated by lawyers and law professors and the industry had always criticised the CRLS for being too academic and too slow in responding to the needs of society. In 1997, for the first time, this body was bypassed in an amendment to the Commercial Code. This involved the relaxation of the regulations concerning the buy-back of shares in relation to stock options. In this instance, a bill for the amendment of the Commercial Code was prepared by the sub-committee on corporate law of the Legal Affairs Committee of Parliament and was finalised by the 'project team' of the ruling coalition.

The year 2001 marked an extraordinary year in the history of company law in that in total three bills amending the Commercial Code were submitted consecutively with all three being adopted. Two bills were prepared by the parliamentary members, while the third was prepared through the normal CRLS procedure. In 2002, another bill was submitted by the normal procedure. In fact, the two CRLS bills were part of the same legislative programme. A draft interim programme for the amendment was published in April 2001, but pressed by urgency the first part of the programme was submitted in 2001 and the remaining part in 2002.

There is a problem of transparency and openness in the parliamentary members' bill. Admittedly, the procedure at CRLS sometimes could be slow, and the industry has always viewed this institution as scholastic and out of touch with reality. However, the advantage of this system was that a wide range of interests could be represented in the process. The identified issues and the interim draft (sometimes its earlier version or outline) are published and public comments are solicited from various quarters. On the

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6 Y. NAKAMURA, Basic Viewpoints on the Total Reform of the Commercial Code: View of the Industry, in: Shôji Hômu 1574 (2000) 23.

7 Programme of March 30, 2001; *<www.moj.go.jp/PRESS/010330/010330.html>*.

basis of the outcome of this procedure, a draft law was then discussed and endorsed by the CRLS. Although its members were mostly legal academics or lawyers, through these measures diverse views, including the views of the industry, were accommodated. In contrast, in parliamentary members' bills, ironically, the scope of people whose views are heard does not seem to be wide enough. In fact, those amendments introduced by the parliament members' bill seem to reflect the long-standing demands of the industry, through *Keidanren*. However, it should be noted that *Keidanren* primarily represents the interests of the company management, but not those of the shareholders or the stakeholders, and company law would be distorted if only the interests of the industry were reflected.

In the following, some selected major changes introduced by the four bills of 2001 and 2002 will be examined and appraised.

II. 'DEREGULATION' OF COMPANY LAW

1. Total Liberalisation of Share Buy-Backs

The Liberalisation of the buy-back of shares has been on the reform agenda for some decades. The Law was fairly strict on this matter until 1994; share buy-backs were generally prohibited and allowed only on limited occasions. The industry has always wanted the liberalisation of share buy-backs for various reasons.

In 1994, share buy-backs were partly liberalised; the exceptions were expanded. Share buy-backs were allowed for the redemption of shares resourced from distributable profits. A resolution of the shareholders' meeting was required, and there was a numerical ceiling – 5% of the total issued shares.

A share buy-back was also thought to be a useful device to enable stock options. Stock options were not available in Japan at that time, but companies wanted to have this system so that they would be able to compete on an equal footing with US companies, particularly in the US. It was also thought to be an effective means to raise the morale of the employees and directors, and to ensure the employment of high quality personnel. It was discussed in 1993 on the occasion of the amendment of the Commercial Code, but despite a strong demand from the industry, it was concluded that such an introduction was premature. It was not until 1997 that the government decided to introduce the system, but, as mentioned above, before a cabinet bill was prepared, the parliamentary members' bill was submitted in 1997 and became law.

Under the 1997 system, share buy-backs in general were under restrictions concerning (1) purpose, (2) procedure, (3) method, (4) resources, (5) amount, and (6) period of holding.

Arguments against the buy-back of shares were:

(1) it may be tantamount to the return of the investment to the shareholders and will harm the creditors;
(2) it may be against the equality of shareholders, since a selected few shareholders are given an opportunity to have their shares purchased;
(3) if the company is allowed to hold its own shares, it may lead to market manipulation and/or insider trading;
(4) the system may be used by the management to maintain their position.

However, not all these arguments are valid. Concerning (1), if the buy-back is not resourced from the capital or capital reserve but from the distributable profit, it should not be a problem. In fact, even the *raison d'être* of the principle of the maintenance of capital is now being questioned. It should be added that a provisional law enabling the purchase of shares from the capital reserve was enacted also in 1997. This was intended to make good use of the capital reserve which Japanese companies had accumulated through the issue of new shares at market price during the 'bubble economy'. By the requirement of the Commercial Code, the difference between the market price and the par value had to be kept as a capital reserve. Regarding (2), provided that the shares are listed, if the shares are purchased through the market or by a take-over bid (TOB), it will not affect the equality of shareholders.

At least (1) and (2) were addressed in the 1994/1997 amendments. The 1997 amendment indeed provided that the share buy-back should be resourced from the distributable profit and that if there is a possibility that there is a deficiency in the distributable profit at the end of the financial year, stock options could not be granted. Shares were to be purchased either from the market or by TOB. It was prohibited to hold the shares indefinitely. Shares purchased had to be disposed of within 10 years if they were for stock options, and for redemption purposes, they had to be redeemed immediately.

Since 1997, a further liberalisation of the share buy-back was being pursued by the industry. There were several reasons for this. First, there was the facilitating of the reorganisation of companies. In 1998, the long prohibited holding-company system was liberalised, followed by the streamlining of the system of mergers. The system of share swaps and transfers as well as the system of splitting the company were introduced. For structural changes to the company, *e.g.* a shift to the holding company system or a split of the company, new shares may be needed. However, in terms of cost, it was thought that instead of issuing new shares, it would be less burdensome to use the shares held by the company itself and the dilution of the existing shareholders' shares could be avoided. Second, the stock option system using share buy-backs introduced in 1997 was thought by companies to be too rigid.

However, in addition to such arguments for the liberalisation of share buy-backs in general, the proposal for the introduction of the system of 'treasury stocks', which is fully liberalised in the US, came to gain support within the industry. The supporting arguments were:[8]

(1) it will facilitate the reorganisation of companies;
(2) it will work as a defence against hostile take-overs;
(3) it will facilitate the reduction of mutual shareholding while preventing the shares from being released in the market and resulting in low share prices;
(4) it will make the financial indexes such as PER better, since shares held by the company will not be counted.

The most pressing reason for this was the low level of share prices which has been hampering the Japanese economy for years. One of the reasons for this steady fall in share prices was thought be the selling of shares by companies which had hitherto been held mutually.

Since 1999, *Keidanren* had been campaigning for the liberalisation of treasury stocks as a measure to raise the share price level. In December 2000, the president of *Keidanren* formally requested the government to liberalise treasury stocks. This was taken up by the ruling Liberal Democratic Party and, in April 2001, the Council of Economic Ministers decided that in order to reinvigorate the stock market, treasury stocks should be legalised and the buy-back of shares should be further liberalised. The liberalisation of the treasury stock was made part of the 'emergency economic measures' announced in early 2001 by the government. A parliamentary members' bill (again by-passing the CRLS) was duly prepared by the ruling coalition, submitted to the Parliament in May and adopted in June.

The 2001 amendment was virtually revolutionary in that it not only completely liberalised share buy-backs, but also introduced treasury stocks.

While, before the amendment, for listed companies engaging in share buy-backs shares had to be purchased in the market or by TOB, now, with the amendment, in addition to these methods, their direct sale is allowed even for listed companies. A direct sale requires a qualified majority vote at the shareholders' meeting. Shareholders who wish to sell their shares are entitled to have their name added to the list.

Concerning the procedure, unless there is another provision in the law, a resolution of the annual shareholders' meeting is needed. The shareholders' meeting may decide on the classes, amount and the acquisition price of shares which it intends to purchase for the coming year.

8 YOKÔ (*supra* note 5) 33.

The sources of financing the share buy-back have also been liberalised. In addition to sourcing by distributable profits, the use of statutory reserves is allowed. In fact, since 1998, by virtue of the special measures law, capital reserves were allowed to be used as a source of finance. Previously, statutory reserves could be used only for covering the capital deficit and capitalisation. In 1998, as a provisional measure, it was allowed to finance share buy-backs from the capital reserve. Statutory reserves exceeding a quarter of the capital could be used for this purpose. This has become a permanent measure by the 2001 amendment to the Commercial Code. Furthermore, it was made possible not only to use the capital reserve, but the profit reserve. It should be added that in order to use the reserves for this purpose, a majority vote of the shareholders' meeting is required.

The restriction on the purposes of share buy-backs was removed. The ceiling on the amount of the share buy-back was abolished.

Finally, restrictions on the period of holding shares was totally removed, and thus, treasury stock was made possible in Japan.

Concerning treasury stocks, their original goal in the US was for healthy companies to invest in their own shares instead of those of other companies and to hold them. In the current state of the economy in Japan, it would be risky for companies suffering from low share prices to acquire and hold their own shares, since it would result in the deterioration of the financial state of the company, and eventually further affect the prices of theses shares. Furthermore, compared to the US, where there is a developed regulatory system of the stock market, the Japanese market has not reached that level. There is a possibility of market manipulation.[9]

To be sure, together with the amendments to the Commercial Code, the Securities and Exchange Law was amended. The buy-back of shares was added to the list of material facts regarding insider trading. The disclosure system regarding the share buy-back has also been strengthened. However, whether this is sufficient is questionable.

There have been some valid arguments in favour of the liberalisation of share buy-backs, including share buy-backs to facilitate the reorganisation of companies which had just been made easier by earlier amendments to the Commercial Code. The stock option system under the 1997 amendment may have been too rigid. On the other hand, the argument in favour of further liberalisation in order to absorb shares released in the market by the dissolution of mutual shareholding and to raise the level of share prices was not tenable. The effect buy-backs would have on share prices has never been theoretically explained, although empirical studies in the US demonstrate that there are such general tendencies.[10] Even if such arguments in favour of liberalisation were valid, the 1997 amendments had already made it possible for companies to buy back shares

9 Shôji Hômu 1584 (2001) 54.

10 S. NOMURA, Liberalisation of Treasury Stocks, in: Jurisuto 1206 (2001) 102.

for the purpose of redemption of shares. It was even possible to finance the buy-back from the capital reserve. Therefore, there was no rationale for further liberalisation.

Furthermore, why the liberalisation of treasury stocks was needed was never explained in a persuasive manner. The argument that the liberalisation of the treasury stock would contribute to the reinvigoration of the stock market was met with scepticism even by people in the stock market.[11]

On the contrary, if one looks at foreign legislation, jurisdictions in which treasury stocks are fully liberalised are limited to some states in the US such as Delaware. The Second EU Company Directive generally prohibits share buy-backs, but provides for exceptions in a rather limited manner (Arts. 18-22). There is a numerical ceiling of 10% of the subscribed capital and shares acquired cannot be held by the company for more than 3 years, unless they account for more than 10% of the subscribed capital. To this extent, only treasury shares are allowed. EU member states have been fairly cautious regarding share buy-backs, not to mention treasury stocks.

The UK Companies Act allows share buy-backs, but it is subject to requirements as to the source, procedure and manner. The important point is that when shares are purchased, they must be treated as cancelled. There is no room for treasury stocks. The principal argument for retaining the ban on treasury stocks is said to be the potential for manipulating share prices.[12] It should be noted, however, that the UK government is planning to introduce a partial liberalisation of treasury stocks in June 2003, but only up to 10% of the share capital.

The German *Aktiengesetz*, which had a provision on the restriction of share buy-back similar to Japanese law, was amended in 1998 and share buy-backs were liberalised.[13] Stock options were also introduced on this occasion. Treasury stocks are allowed also to a certain extent in Germany. It is possible for the shareholders' meeting to authorise the company to purchase shares by specifying the maximum and minimum acquisition value and up to 10% of the share capital. The resolution is then valid for 18 months. Trading in its own shares is not included in the purposes of such buy-back. There is a general ceiling of 10% of the share capital along the line of the EU Directive. Thus, shares of up to 10% can be held indefinitely. However, in Germany, shares cannot be held for the purpose of 'trading in the shares'.

The latest amendment in Japan has gone further than the UK and German law in that there is no restriction as to the purpose and amount of the share buy-back, and that companies are allowed to hold their shares indefinitely as treasury stocks. In the absence of an efficient regulatory system in the securities market of the US level and in view of a

11 NOMURA (*supra* note 10) 107.

12 E. FERRAN, Corporate Law and Corporate Finance (Oxford 1999) 443-444.

13 T. GÜNTHER, Zulässigkeit des Rückkaufs eigener Aktien in den USA und Deutschland – vor und nach KonTraG, in: Recht der Internationalen Wirtschaft (1998) 337-344.

not too efficient corporate governance system, whether this was a right choice can be questioned.[14] Perhaps a further liberalisation of the share buy-back should have been distinguished from the problem of the liberalisation of treasury stocks. The former has some rationale, while the latter has not.

2. *Liberalisation of the Size of Shares*

a) *Abolition of Par Value Shares*

Before the 2001 reform, there were par value shares and non-par value shares. The latter were introduced into Japan in 1950, but until 2001, a great majority of Japanese companies issued par value shares. In 1981, the minimum par value of 50,000 yen was introduced. Until the 1950 amendment, the amount of capital was the par value multiplied by the number of issued shares. Since 1950, the requirement has been that in cases of par value shares, at least the par value multiplied by the number of issued shares had to be capitalised, while the remaining amount could be kept as a capital reserve. Therefore, the linkage between the par and the amount of capital was lost. The par merely showed that at least this amount multiplied by the number of shares was paid in at the time of establishment.[15] In reality, shares are now issued at market price and not at par value. There was no economic meaning for par value.[16]

As a result of the requirement that at least the par value multiplied by the number of issued shares had to be capitalised, it was understood that the amount of capital always had to exceed this amount during the existence of the company. It was also required that in order to split the shares, the value of the assets per share after the split had to be 50,000 yen or more. However, it turned out that for venture businesses with insufficient assets but high share prices, it was almost impossible to split the shares even if they wanted to do so in order to increase the liquidity of the shares, since the value of assets per share was less than 50,000 yen.

Another problem was the requirement that the issue price of shares had to be above the par. In the early 2000s, more than 100 listed companies' shares were below par. This requirement made it impossible for those companies to finance themselves.

The 2001 amendment totally abolished par value shares. Since the significance of par value has long been lost, there was not much controversy on this matter. The problem was more in the changes to the system of unit shares.

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14 See S. IWAHARA, Review and Perspective of the Reform of Company Law, in: Shôji Hômu 1569 (2000) 11.

15 M. TATSUTA, Corporate Law (8th edition, Tokyo 2001) 178.

16 K. EGASHIRA, Law on Joint Stock Companies and Limited Liability Companies (Tokyo 2001) 105-106.

b) Changes in the Unit Share System

As mentioned above, in 1981, the minimum par value for shares of 50,000 yen was introduced. Existing companies were not directly affected – the par value of the shares of those companies remained at 50 yen. As a transitional measure until companies consolidated the shares into a par value of 50,000 yen, companies were required to combine shares into one unit whose total par value would be 50,000 yen. Shares short of this unit were nevertheless granted rights, such as rights to dividends and liquidated assets. Although this was intended to be a merely transitory measure, most companies did not consolidate their shares, but resorted to this unit share system.

With the latest reform, as par value was abolished, there was no reason to maintain the 50,000 yen level. The previous system of unit shares as a transitory measure was replaced by a new permanent system. The new system is not compulsory, but most of the companies which had a unit share system are expected to convert to it.

A unit of shares does not have to be 50,000 yen any more; an amount is no longer set by law, but instead, left for the companies to determine. However, the number of shares combined into a unit cannot exceed 1,000 and also 0.5% of the total number of issued shares.

Under the new system, shareholders have one vote per one unit, not per share. This is a major change to the existing principle of one vote per share. Admittedly, the previous unit share system had the same effect, but it was at least a temporary measure. There are concerns that if companies are allowed to set the size of a unit more or less freely, this system may be abused against minority shareholders.[17]

Shareholders whose shares are less than a unit do not have minority shareholders' rights, since these rights are determined by the number of votes and not by the number of shares now. On the other hand, rights which are granted to a share, *e.g.* the right to a derivative action, still remain.

One of the reasons for the introduction of the new system of unit shares combined with the abolition of par value was the perceived need for reinvigorating the stock market, particularly by soliciting individual investors into the market. Currently, the percentage of individuals among the investors is in decline, and it was thought to be beneficial to encourage investors, if companies were allowed to determine the minimum size of investment themselves, rather than have it determined by an across-the-board regulation.

3. Pre-emption Rights for New Shares

'Pre-emption rights for new shares' is a new concept introduced by the 2001 amendments. It is defined, by the amended Commercial Code, as a right which entitles the

17 M. KISHIDA, Reform of the System of Shares and Treasury Stocks (Tokyo 2001) 102-105.

holder to require the company to issue new shares or to transfer to him the company's shares which it holds. It should be noted that this concept appeared in the Draft Interim Programme for the Amendment of the Commercial Code published in April 2001 as the 'right to subscribe to newly issued shares', and that it appeared as pre-emption rights only in the Draft Programme for the Amendment published in August of the same year.[18]

To be sure, there were pre-emption rights for new shares under the Code before the amendments in the form of stock option, convertible bonds and warrant bonds. They were regarded as something similar to the issuing of shares at an especially advantageous price to those other than existing shareholders and were strictly regulated and only allowed as exceptions in the above three instances. It was thought that while debt finance could be left to private autonomy, equity finance should be regulated in a stricter fashion. However, in recent years, the demarcation between debt finance and equity finance has become blurred.[19]

By the 2001 amendment, a comprehensive concept of pre-emption rights for new shares was introduced and extensive liberalisation took place. This new concept covers the above three instances, but extends beyond them. Pre-emption rights for new shares do not need to be combined with bonds. It is now possible to grant pre-emptive rights for new shares on their own as well as in combination with other financial products, and thus, means of corporate finance will be further diversified. This amendment is regarded to have represented significant deregulation and the widening of private autonomy in corporate finance.[20]

The amendment has acknowledged the value of pre-emption rights for new shares *per se*, which had hitherto been regarded as an attachment to the shares. This is symbolised by the fact that the amended Code introduced the concept of the 'issue price' of pre-emption rights. If pre-emption rights are not issued at a fair price, it requires a qualified majority vote of the shareholders' meeting.

Pre-emption rights for new shares are issued by a decision of the board of directors, unless the articles of incorporation provide otherwise. An important exception is that if they are issued to those other than shareholders at an especially advantageous price, a qualified majority vote of the shareholders' meeting is required. The current value of pre-emption rights for new shares is expected to be determined by using some existing economic models.

Under the new concept of the pre-emption rights for new shares, the existing warrant bonds and convertible bonds were re-categorised. Warrant bonds in which the option for new shares could be separated are now characterised as bonds and pre-emption

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18 Shôji Hômu 1593 (2001) 9.

19 F. ENDO / YOSHIKAWA, The Creation of Call Option for New Shares, in: Shôji Hômu 1627 (2002) 18-19.

20 IBID, 19.

rights for new shares issued simultaneously and, therefore, there is no specific provision in addition to provisions on pre-emption rights. Inseparable type warrant bonds and convertible bonds are characterised as bonds with pre-emption rights for new shares. As for convertible bonds, they are also characterised as bonds with pre-emption rights for new shares in which the pre-emption right is not assignable, the issue price of the bond and the payable amount at the time of the call are the same amount. When the pre-emption right is exercised, the bond is always redeemed, and this amount is paid for the exercised of the option.

Under the new system, stock options are characterised as a gratuitous issue of pre-emption rights for new shares. In fact, stock options were totally liberalised by this amendment by qualifying them as pre-emption rights. In addition to granting stock option to directors and employees, it is even possible to allocate pre-emption rights to shareholders as a 'poison pill' against take-overs.[21]

Previously, there were various restrictions on stock option such as:

(1) the scope of those entitled to receive stock options was limited to directors and employees of the issuing company;
(2) there was a maximum limit of 10 years on calling the option;
(3) there was a numerical ceiling to stock options, *i.e.,* 10% of the total number of issued shares;
(4) the names of the beneficiaries had to be specified for the resolution by the shareholders' meeting;
(5) a justifiable reason was needed for stock options.

The above were all removed as a result of the latest amendments. There is no specific provision on stock options in the Commercial Code any more; they are now fully covered by the general provisions on pre-emption rights for new shares.

It has been a long-standing demand of the industry to enable stock options to be issued to people such as directors of the subsidiary. Now it is possible to issue them to any person, including trading partners and consultants. Although the Interim Programme on the Amendment of the Commercial Code prepared by the CRLS had required a 'justifiable ground' to grant stock option, this was removed in the Law.[22]

On the other hand, a stock option is still subject to a qualified majority vote of the shareholders. In fact, in most jurisdictions, a shareholders' approval is needed for stock options. In the UK, by virtue of the listing rules, in listed companies such schemes are subject to approval by shareholders.[23] Even in the US, the same applies to shares traded on a major stock exchange.[24]

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21 A. OTSUKA, Use of the Amendments of the Commercial Code concerning the System of Shares as Means of Defending Companies from Take-Over, in: Shôji Hômu 1618 (2002) 27-28.

22 Shôji Hômu (*supra* note 18) 11.

23 B. CHEFFIN / R. THOMAS, Should Shareholders have a Greater Say over Executive Pay?:

This almost total liberalisation in Japan seems to be at odds with the global tendency to strengthen control over executive pay[25] and should be contrasted with the approach of German and Austrian Law. In Germany, stock options were introduced by the *KonTraGesetz* 1998, but still in a limited manner.[26] On the other hand, Austria enacted a Law on Stock Options in 2001, which has gone further than German law in this respect. However, in order to grant stock options, either the approval of the *Aufsichtsrat* or the shareholders' meeting, depending on the resources, is required.[27] Also in the UK, stock options are under various restrictions, not by the Companies Act, but by the Listing Rules and other self-regulatory instruments.

4. New Classes of Shares

Under the pervious arrangement, non-voting shares were not regarded as a separate class of shares. The only type of preference shares was shares with preferential status in payment of dividends and participation in the liquidated assets. Only those preference shares could be non-voting, and the votes could be restored in cases of default in preferential payment of dividends. Thus, shares could be either voting or non-voting, but there was nothing in between.

By the 2001 amendment, companies have come to be allowed to issue different classes of shares; in addition to preference shares in payment of dividends and liquidated assets, there can be shares such as those with a preferential right in a share buy-back or in the redemption of shares from distributable profits.

Furthermore, changes include:

(1) non-voting shares were made a class of share of their own;
(2) shares with limited voting rights were introduced (votes are not given to a certain scope of matters);
(3) there is no provision on the restoration of voting rights even in cases of default by the issuer; this is to be left for the articles of incorporation to determine;
(4) the ceiling of the number of non-voting shares was increased from one third to one half of the total number of issued shares.

Learning from the US Experience, in: Journal of Corporate Law Studies, December 2001, 287.

24 IBID., 300.

25 IBID., 277 *et seq.*

26 KontraG is the abbreviation for "Gesetz zur Kontrolle und Transparenz im Unternehmensbereich"; a critical analysis is found in M. ADAMS, Aktienoptionspläne und Vorstandsvergütungen, in: Zeitschrift für Wirtschaftsrecht [ZIP] (2002) 1342-1343.

27 S. WEBER, Aktienoptionen nach dem österreichischen Aktienoptionsgesetz, in: Wertpapiermitteilungen (2002) 368.

Details of the content of each class of share to be provided by the articles of incorporation underwent some changes too. The background to this was the possibility of introducing tracking stocks. Tracking stocks are linked to the performance of a specific division or a subsidiary of the issuing company, *i.e.* the dividend and the liquidated assets are indexed to the performance of a division or a subsidiary. They are fairly common in the US. It was not entirely clear whether tracking stocks could be issued under the Code before the amendment, but there was a Japanese company which actually issued tracking stocks. By the 2001 amendment, the requirement concerning entry into the articles of incorporation was relaxed; instead of providing for the maximum amount of dividend to be paid, it is sufficient to provide for the gist of the criteria for determining the dividend, and thus, tracking stocks which do not specify the maximum amount of dividends are officially made available to companies.

The above changes were intended to give more alternatives to companies in corporate finance. The idea was that

(1) by allowing non-voting shares, those investors who are not interested in voting may be attracted, particularly with the relatively low issue price as compared to the voting shares;
(2) companies do not need to worry about the quorum of the shareholders' meeting and reduce the management cost of shares, and above all;
(3) the incumbent management can seek finance without endangering their position.[28]

The introduction of shares with no vote seems to be different from the European approach which guarantees the shareholders effective voting rights by granting them votes equivalent to their investment.[29]

Concerning shares with limited voting rights, the veto rights of holders of a specific class of shares have been expanded. Such veto rights existed prior to the amendments, when the rights of a particular class of shareholders were at risk, *e.g.* when the amendment to the articles of incorporation would affect the interests of these classes of shareholders. After the 2001 amendments, it is now possible, by the articles of incorporation, to require all or part of the matters subject to the decision of the board or the resolution of the shareholders' meeting, an additional resolution of the shareholders of a particular class. This means that on certain matters, a specific class of shareholders have the right of veto. In fact, such veto rights given to a specific category of shareholders have been practiced via shareholders' agreements when investing in venture businesses by venture

28 MAEDA (ed.), Shôji Hômu 1623 (2002) 9-10.
29 A. POUTIANEN, Shareholders and Corporate Governance: the Principle of One Share – One Vote, in: European Business Law Review (March/April 2001) 77.

capitals. However, these agreements had some weaknesses in their enforcement, and it was felt that these matters should be covered by company law.[30] It should be noted here that the new system is now applicable not only to venture businesses, but companies in general.

Another novelty is the introduction of the compulsory conversion of preference shares to ordinary shares by the initiative of the company. In practice, there is a need for such conversion without the consent of the shareholders, and various means were used to achieve a similar goal despite the absence of an explicit provision in the Commercial Code. Under the 2001 amendment, by the articles of incorporation, it has become possible to convert preference shares into ordinary shares by a decision of the board. On the other hand, the former convertible shares, which enabled shares to be converted on the initiative of the shareholder, were renamed as options to convert.

There was a follow-up amendment in this respect in 2002. Shares which entitled the holder to appoint and dismiss directors and auditors were introduced. The amount of shares without the right to appoint directors should not exceed one half of the issued shares. In companies where this type of shares are issued, the appointment of directors is effected by the meeting of shareholders of this particular class, and the ordinary procedure of the appointment of shareholders is not applicable. Dismissal of directors is also effected by the qualified majority vote of the meeting of these shareholders, and not by the general shareholders' meeting.

This new system only applies to closed companies. Again, a similar goal could be achieved by shareholders' agreement, but the problem lay with its enforcement, and therefore, a legislative measure was needed.

III. CORPORATE GOVERNANCE

1. Liability of Directors

In the past, directors who acted against the law or articles of incorporation were seldom held liable by the company. At the most, they were forced to resign. Despite the introduction of the system of derivative action in 1950, shareholders were not active in pursuing the liability of directors. The 1993 amendment to the Commercial Code made derivative action easier, particularly by reducing the stamp duty for the action.

Already from the early 1990s, the number of derivative actions was on the increase, reflecting the rather imprudent management of listed companies in the 1980s during the 'bubble economy', which, after the burst of the bubble, left the companies in a bad state. Since 1993, the number of derivative actions further increased. The amount of

30 H. NAGATA ET AL., Liberalisation of Classes of Shares and related Changes to the System, in: Shôji Hômu 1630 (2002) 32-33.

damages claimed increased as well; it was not uncommon for directors to be sued for billions of yen.[31]

The industry was particularly concerned that the reinforced derivative action might have a chilling effect on the management and prevent them from taking 'bold investment decisions'. After all, in hindsight, many business decisions may be regarded as reckless. Directors feared that they might be held liable for something they had done in the interests of the company but which, in the end, went wrong. In the United States where derivative action is common, there is a rule called 'business judgment rule' which exempts the liability of directors who acted in good faith and prudently. In Japan, although this rule has been referred to in some lower court judgments, it is yet to become a firmly established rule.

The ruling party and the *Keidanren* have been working on the reform of the system since 1997.[32] A programme for the amendment to the Commercial Code on corporate governance primarily focusing on the liability of directors was published in 1999. Finally, a parliament members' bill was submitted to Parliament in 2001 and became law. The bill was ostensibly intended to 'strengthen the function of auditors, facilitating the limitation of the liability of directors, and the rationalisation of derivative action in order to ensure the effectiveness of corporate governance',[33] but the main thrust was in the limitation of the liability of directors.

The immediate cause which triggered the submission of this bill was the District Court judgment in 2000 on the *Daiwa* Bank case. In this particular case, the court ordered 10 directors to pay between 70 million to 530 million US dollars (the damage had been incurred in US dollars) each. This judgment was somewhat controversial, since the standard of care required of directors seemed to have been too high, being determined with hindsight, and the scope of the damage was determined in an excessively broad way.[34] Although this was an exceptional case – there have not been so many cases where the plaintiff won in a derivative action, and the amount of compensation was less than 130 million yen[35]– this case seemed to have poured oil over the flame, *i.e.* the move for limiting liability of directors.

The parliamentary members' bill has addressed this issue, but not necessarily in an adequate form. The core of the bill is the limitation of directors' liability and the rationalisation of derivative action. The bill was adopted by Parliament in November 2001.

31 H. ODA, Recent Developments in Corporate Governance in Japan, in: Zeitschrift für Japanisches Recht 10 (2000) 187.

32 Summary of the Proposal for the Amendment of the Commercial Code concerning Corporate Governance, in: Shôji Hômu 1468 (1997) 27.

33 Shôji Hômu 1596 (2001) 4.

34 See S. IWAHARA, The Judgment of the First Instance Court in the Daiwa Bank Derivative Action and the Reform of the Derivative Action; Part 2, in: Shôji Hômu 1577 (2000) 6-10. W. TANAKA, Alleviation of the Liability of Directors and Derivative Action, in: Jurisuto 1220 (2002) 32.

35 S. IWAHARA, Shareholder's Derivative Action, in: Jurisuto 1206 (2001) 123.

Directors' liability can now be subject to limitation, but only when the director has acted in good faith and without gross negligence. Eligible acts are those against law or ordinance, or articles of incorporation. Acts such as the payment of unlawful dividends, payment of unlawful benefit to specific shareholders, extending loans to other directors, and transactions in conflict of interests are not covered.

The liability of directors can be alleviated by the articles of incorporation or by an *ad hoc* resolution of the shareholders' meeting. If the articles of incorporation so provide, the board, by taking into consideration the grounds of liability, circumstances of performance of duties by the director, and other factors, may discharge the liability of the director down to an amount calculated by the annual income multiplied by the number of years. The consent of all the auditors is needed.

The maximum amount of compensation payable depends upon whether the director is a representative director, an ordinary director, or an external director. The ceiling is 6 years' income for representative directors, 4 years' income for ordinary directors, and 2 years' income for external directors. 'Income' in this context means not only remuneration as a director, but other payment for the carrying out of business, including the payment as an employee if the director combines his position with that of an employee (which is common in Japan). Income from the exercise of stock options would also be included.

Shareholders have the right to veto the decision of the board in this respect. If the board has made a decision to discharge the liability, it must be publicised, or notified to shareholders. Shareholders are entitled to object to this decision within a month. If shareholders with 3% or more of the vote object, discharge cannot take place.

Ad hoc and *ex post* discharge by the resolution of the shareholders' meeting is also available. A qualified majority vote is needed, and auditors' consent is required for the board to make this proposal to the shareholders.

The system of derivative action itself has been streamlined by the 2001 amendment. Most importantly, the 1993 amendment had failed to address possible settlements between the parties in a derivative action. The problem was that since derivative actions are initiated by a shareholder *vis à vis* directors and do not directly involve the company, it was questionable whether the parties were entitled to settle the dispute between themselves. Besides, there was an explicit provision in the Commercial Code which required the consent of all shareholders in discharging the liability of the director. In practice, settlement was common, but invariably with the unofficial participation of the company. In many cases where the claimed amount was extremely high, the parties settled at a much lower level of compensation. Nevertheless, the ambiguity of the legal basis remained, and a legislative measure in this respect was thought to be desirable.

By the 2001 amendment, the application of the provision which requires the consent of all shareholders for discharging director's liability was made inapplicable as far as settlement was concerned. Furthermore, in cases of settlement between the parties, the court is now required to notify the company of the content of the settlement. Unless the company objects to the settlement within 2 weeks of the notification the settlement may go ahead.

An important omission in rationalising the system of derivative action is related to holding-companies. The problem arises when a derivative action is brought against a company, and then this company comes under the umbrella of a holding-company group. In such cases, the holding-company becomes the sole shareholder of the company whose director is sued, and the shareholder-plaintiff will become the shareholder of the holding-company. His standing to sue is lost, since he is no longer a shareholder of the company whose director is being sued. This was one of the reasons why, in the above *Daiwa* Bank case, the plaintiff settled the case despite winning an enormous amount of compensation in the first instance. The Bank was due to be re-organised into a holding group and the plaintiff would have lost his standing, had he not settled. A further legislative measure is needed here.

As a trade-off for alleviating the liability of directors by the November amendment, the system of auditors has been further strengthened in the parliamentary members' bill and was adopted.

2. *The Reform of the Board System*

Japan had introduced the system of the board of directors from some US states in 1950, but since then, the situation has changed significantly in the US. There, the majority of board members are externals. According to a survey in the US, in 1997, the mean number of inside directors of S & P 500 firms had dropped from three to two, and 56% of these firms had only one or two inside directors.[36] In 1998, the average number of board members was 11, of which only 2 were insiders.[37] Thus, the board plays a supervisory role, while the actual business is carried out by executive officers, who are supervised by the board.

In the UK, the Combined Code requires that for public companies, one-third of directors should be non-executive.[38] It should be noted that in countries with a single-tier system such as France, Belgium, and Spain in Europe, at least among the listed companies, there is a trend to split the executive (*Geschäftsführung*) and the supervisory functions.[39]

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36 S. BHAGAT / B. BLACK, "The Non-Correlation Between Board Independence and Long-Term Firm Performance, in: The Journal of Corporation Law (2002) 238.

37 M. GOLDMAN / E. FILLIBEN, Corporate Governance: Current Trends and Likely Developments for the Twenty-First Century, in: Delaware Journal of Corporate Law 25, (2000) 699-700.

38 FERRAN (*supra* note 12) 208.

39 C. TEICHMANN, Corporate Governance in Europa, in: Zeitschrift für Unternehmens- und Gesellschaftsrecht [ZGR] 30 (2001) 668.

In Japan, this was not the case. The board is dominanted by insiders. 42.3% of companies have external directors, but the average number of external directors in such companies is 2.7.[40] On the other hand, Japan does not have the system of the *Aufsichtsrat* (two tier board system). Thus, the Japanese system of the board is unique, despite its US origin.

Until the late 1990s, the size of the board in Japanese companies was fairly large. It was not uncommon for a company to have more than 40 board members. However, if the size of a collective body is this big, a meaningful discussion cannot be expected. Therefore, companies set up an inner cabinet which was called '*jômu-kai* (managing directors' meeting)' or '*keiei-iinkai* (management council)', which met more frequently than the board itself. There was no legal basis for it and, therefore, the decision made by these bodies had to be ratified by the board.

A more recent phenomenon is the reform of the board system in line with the US model, converting it into a supervisory body and creating executive officers. This was initiated by *SONY* in 1998, and many companies actually followed this by introducing executive officers. However, the core of this reform, *i.e.,* the reconsideration of the role of the board and the separation of management and implementation were not widely accepted even by those companies which introduced executive officers.

The 2002 amendments to the Commercial Code have taken up both alternatives. Both alternatives are applicable, as a rule, to large companies which the Special Measures Law for the Audit of Large Companies apply, *i.e.,* these are the companies with either a capital of over half a billion yen or a debt of over 20 billion yen.

a) Committee for Significant Assets

Large companies which (1) have more than 10 directors, and (2) of which more than one is external, may set up a committee for significant assets by the article of incorporation or the decision of the board. This committee comprises more than three directors selected by the board and determines matters which are entrusted by the board. It is subordinate to the board.

This is intended to make the decision-making of companies with a large number of directors more timely. However, matters which are listed in the Code to be delegated to this committee do not necessarily seem to be what the present informal 'management councils' are handling on a regular basis. Rather, they are limited in scope and of a more traditional nature, which companies very rarely face.[41] Whether this new arrangement will make the decision-making of companies timely in general is doubtful.

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40 Shôji Hômu 1632 (2002) 58.

41 T. SUENAGA, Reforms related to Large Companies concerning Company Bodies, in: Jurisuto 1229 (2002) 27.

b) Companies with Committees within the Board

The reform of the system of corporate bodies has been under discussion in Japan for some time.

The Draft Interim Programme for the Amendment of the Commercial Code which was published in April 2001 introduced a new concept of companies with committees within the board to be applicable to large companies.[42] This is clearly based upon the US system of boards. It is intended to strengthen the supervisory function of the board by separating if from business execution, facilitating speedy decision-makings by delegating power to officers, and to make the board more independent by introducing external directors.[43] This part of the Interim Programme was enacted in 2001 as an amendment to the Special Measures Law on Audit of Large Companies.

Under the new arrangement, companies, once they have opted for this system, are obliged to have three committees plus the system of officers (*shikkô-yaku*). These committees are: (1) a nomination committee; (2) an audit committee; and (3) a remuneration committee. These three must be created as a set; companies cannot set up one or two of them alone, or ignore the system of officers.

Committee members are appointed by the board. Each committee comprises directors, but what is important is that a majority of committee members must be external. In the case of the audit committee, the officers, managers, or employees of the company or its subsidiaries cannot be members.

Under this system, the board determines the basic strategy of the company and supervises the execution of business by directors and officers. Matters such as the determination of the contents of the proposals to be submitted to the shareholders' meeting (except, *e.g.,* the appointment and dismissal of directors), the approval of concurrent business or business in conflict with the company by directors, and the convocation of the shareholders' meeting are still left to the board. However, significant power has shifted from the board to these committees, which are dominated by outsiders.

This system is accompanied by the introduction of the system of officers. In these companies, instead of representative directors and executive directors, officers are entrusted to execute the business of the company. They also take decisions on matters entrusted by the board. Officers are appointed and dismissed by the board. The term of an officer is one year, the same as that of directors. It should be noted that officers may combine their position with that of a director, although it is not desirable from the viewpoint of the separation of business execution and supervision. The company must appoint a representative officer.

These officers (*shikkô-yaku*) should be distinguished from executive officers (*shikkô-yakuin*), who had been introduced in practice in the past 3-4 years. The latter are in

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42 Interim Programme, in: Shôji Hômu 1593 (2001) 18-19.
43 MAEDA (*supra* note 28) 14.

most cases employees who are entrusted to implement the management decisions of the board and still do not have any legal basis. The underlying idea was to separate executive decision-making and implementation; executive officers were to implement the decisions of the board. However, this idea was not fully implemented, since the board, in most companies, still remained a body which makes decisions on business execution. In some cases, the introduction of executive officers was an outcome resulting from the reduction in the number of directors. Those people who had been directors, or who would have been made a director, were made executive officers. A majority of executive officers were at the same time senior employees.

Those companies with committees are not allowed to have auditors; they are replaced by the audit committee within the board.[44]

Initially, this type of corporate structure was intended to be mandatory for all listed companies, but there was strong opposition from the industry. The argument was that the system of corporate governance should not be 'moulded' in a single pattern in order to ensure successful management. The choice of corporate bodies should be made by the management in accordance with its type of business and business models.[45] In the end, the system was made optional. This, however, is not unprecedented. Italian law offers companies three alternatives regarding the structure of the governing bodies.[46]

There was also a proposal to make external directors mandatory; this was accommodated in the interim programme, but was strongly opposed by the industry, *e.g.* by *Keidanren* on the ground that (i) this should be left to the discretion of companies; (ii) the number of external auditors had just been increased (in 2001) and therefore, there was no need for further addition.[47] On the other hand, the US government, in its comments on the Interim Programme, pointed out that making one external director mandatory was rather modest and doubted the effectiveness of such a measure.[48]

There were some doubts about the suitability of the direct transplant of the US system into Japan. A study of the US system suggested that the increase of external directors might lead to the conversion of the board into a body used merely for the ratification of executive decisions rather than a monitoring system, as is the case with the US system.[49] After all, the US board or audit committee is not as powerful as one might think. Despite the independent board, a majority of directors are dependent on the CEO for their position.[50] In the US, boards, especially those dominated by outsiders,

44 Executive Officers and Officers, in: Shôji Hômu No.1619 (2002) 50.

45 Y. NAKAMURA, Preface, in: Id. (ed.), Handbook on the Amended Commercial Code from the Viewpoint of Company Management (Tokyo 2002).

46 BUSE (*supra* note 4) 678.

47 Analysis of the Comments by Various Bodies on the Major Review of Company Law (Tokyo 2001) 353.

48 IBID., 182.

49 K. TAKEI, The Reality of the US Board and the Problems of Its Introduction into Japan, in: Shôji Hômu 1505 (1998) 81-82.

50 J. VON HEIN, Die Rolle des US-amerikanischen CEO gegenüber dem Board of Directors im

sometimes do remove top managers after poor performance, but a true performance disaster is required before they act.[51]

Whether this system of companies with committees within the board would be accepted by companies is not clear. At the moment, there are not so many companies which would opt for this system straight away. In the survey by *Nikkei,* only 0.8% of the respondent companies replied that they would introduce this system. No company intended to establish a committee for significant assets.[52] Views which cast doubt on the Anglo-American system of corporate governance are not uncommon, particularly since the interest of stakeholders other than the shareholders is likely to carry less weight there.[53] However, some major companies are introducing this system at their June 2003 AGM.

IV. OTHER CHANGES

1. Introduction of Communication Technology in Corporate Matters

The introduction of communication technology in corporate matters had been envisaged for some time. For example, the Report of the Committee on the Industrial Structure of METI referred to this in 2000. The November 2001 amendments to the Code were a major step towards this direction. The announcement of the shareholders' meeting can now be sent out to shareholders in an 'electromagnetic' form, but this is subject to shareholders' consent. Shareholders can also exercise their rights in this manner.

Some documents of the company can now be prepared and kept in an electronic-magnetic form. The minutes of the shareholders' meeting and the board meeting can be prepared in this manner and signed electronically by the relevant persons. A list of shareholders can also be made and kept in this way.

The amended Code also allows the balance sheet, profit and loss accounts and business reports to be prepared in an electronic format. These documents are made available to shareholders in the same form.

2. The Accounting System

A new provision relating to the accounting system was introduced by the November amendments. This provision merely states that the assets which are to be entered in the books of accounts are to be valued in accordance with the Ordinance of the Ministry of

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Lichte neuerer Entwicklungen, in: Recht der internationalen Wirtschaft (2002) 508. See also BHAGAT / BLACK (*supra* note 36) 235.

51 A. SHLEIFER / R. VISHNY, A Survey of Corporate Governance, in: The Journal of Finance (1997) 751.

52 *Nikkei*, June 20, 2002.

53 H. NAKAGAWA, Expectation on Corporate Governance suitable for Japanese Companies, in: Shôji Hômu 1598 (2001) 5-6.

Justice. This, however, represents a very significant change. Before the amendments, the method of valuation was provided by the Commercial Code itself. The provisions in the Code regarding accounting were fairly scarce, and details were left to the 'fair accounting practice' which was to be taken into account. By delegating the power of setting accounting standards to ministerial ordinances instead of covering them in the Code, it is now possible to adjust the Japanese standards to the rapidly developing international standards without much delay.

The Japanese system of accounting, particularly the way assets were valued, was rather different from international standards. There have been instances where a Japanese company, which was listed in Japan and the US, reported totally different results in the same accounting year – profits in Japan and loss in the US.

In recent years, there has been a drive towards the harmonisation of accounting standards in the light of the globalisation of the economy. In Japan, this has been accelerated by the collapse of some banks, securities companies and insurance companies in 1997/1998, where lax accounting contributed to their collapse. The valuation of shares by current value was introduced for the banks first, and to other companies in 2002. A new public interest organisation whose task is to set accounting standards was set up in 2001 in order to bring the standards closer to the International Accounting Standards.

3. Foreign Companies

The Commercial Code has some provisions applicable to foreign companies, *i.e.* companies established in accordance with laws other than Japanese Law. One of the requirements for foreign companies to do business in Japan on a continuous basis was that they had to appoint a representative and open an office in Japan. This arrangement was intended for the protection of creditors in Japan and also for making it easier for courts to acknowledge jurisdiction over these companies. However, the effectiveness of these provisions was often questioned.

The Interim Programme introduced a provision which removed the obligation to open an office, but instead, imposed unlimited liability on the representative in Japan jointly and severally with the foreign company in cases where the company's assets in Japan were insufficient to meet the claims. This idea of imposing unlimited liability came under criticism and was eventually dropped.[54] Instead, creditors are now entitled to object to the resignation of all representatives in Japan, and in such cases foreign companies must pay the debts or place a deposit. However, whether this arrangement would have any meaning is questionable.[55]

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54 NAKAMURA (*supra* note 45) 312-313.

55 M. KONDO / M. SHITANI, New Corporation Law II (Tokyo 2002) 379-380.

The requirement of opening an office was removed. On the other hand, foreign companies are now required to appoint a representative in Japan, to register this person and to make a public announcement if they intend to do business on a continuous basis. Furthermore, these companies are under an obligation to publicise their balance sheet or its equivalent after its approval by the general shareholders' meeting. The trade name also must be registered.

Another problem concerning foreign companies was the applicability of the share swap system as a means of M & A which was introduced by the amendment to the Commercial Code in 2000. The swapping of shares in a Japanese company with those of a foreign company is currently not allowed. This makes the take-over of Japanese companies by foreign companies more difficult and was regarded as a 'trade barrier' by foreign countries. The Ministry of Economy, Trade and Industry reached an agreement with the Ministry of Justice to amend the Industry Restoration Law without awaiting amendments to the Commercial Code, allowing foreign companies to swap shares with a Japanese company.[56]

V. CONCLUDING REMARKS

According to the officials of the Ministry of Justice, the reforms of company law in 2001/2002 were aimed at:

(1) ensuring effective corporate governance;
(2) the introduction of communication technology;
(3) the improvement and diversification of the means of corporate finance;
(4) the facilitation of internationalisation of corporate activities.

In reality, the main thread of the reform was the 'deregulation' of company law. This was the policy of the government which was reflected in the successive programmes for regulatory reforms prepared in the 1990s. Just to mention some outcomes of deregulation, the buy-back of shares was fully liberalised together with treasury stocks, restrictions on stock option have been widely removed, various new classes of shares were created, and tracking stocks have become officially possible. Most of these measures had been proposed by the industry for some years, and some of them even went beyond industry's demands. Some measures were part of the general economic package in pursuit of the recovery of the economy. The extent of deregulation by far surpasses that in the UK and Europe, and is matched only in the US. For companies to

56 *Nikkei*, September 13, 2002.

compete on an equal footing, it was natural that the system needed to align itself with the least regulated system. This was indeed the desire of the industry in Japan.

What should not be forgotten is that deregulation increases the responsibility and accountability of companies. Companies are given a free hand but are also expected to use their power in a prudent way. Otherwise they will have to face the consequences. For this reason, a proper system of corporate governance is needed. In the US, there is a fairly developed system of corporate governance with outsiders being dominant. Although this system is not fail-safe and there have been some celebrated cases such as the fall of *Enron* and *WorldCom*, there is much to learn from this system. The UK has a similarly advanced system, while Germany has been making efforts to improve the *Aufsichtsrat*. If one is to talk about global convergence, probably the clear tendency is towards the enhanced separation of management and supervision. Whether or not the system of corporate governance is one tier or two tiers, this is clearly the case.[57] Japan has finally started moving towards this direction, but the pace is slow. Japanese companies are now given an alternative to introduce a US-type board structure. However, this is not mandatory. Despite extensive deregulation most companies may retain their corporate governance structure, at least for the time being.

If company law reform is in the first place regarded as a means to facilitate economic recovery, it is only natural that the aspect of discipline and accountability was to be given only secondary place in the latest reforms. The latest reforms in Japan started with generally acceptable goals, such as the diversification of corporate finance, facilitating globalisation, and increasing the effectiveness of corporate governance. However, although various positive changes have been made, it cannot be denied that they were overshadowed by the poor economic state of the country. Overall, the balance of freedom and discipline was largely tilted towards the former. This does not seem to coincide with the recent move in Europe and US towards stricter regulations on corporate behaviour.

ZUSAMMENFASSUNG

In den Jahren 2001/2002 wurde in Japan die umfassendste Novellierung des Gesellschaftsrechts seit einem halben Jahrhundert in Angriff genommen. Diese Reform war Teil der grundlegenden „regulatorischen Erneuerung“, die die japanische Industrie seit langem anstrebt. Allerdings war sie während ihrer Umsetzung von der sich verstärkenden Rezession in Japan überschattet.

Wichtigstes Ziel der Novelle war eine weitreichende Liberalisierung des Gesellschaftsrechts. So wurden etwa die Beschränkungen für Aktienrückkäufe weitgehend auf-

57 C. TEICHMANN (*supra* note 39) 668.

gehoben, „treasury stocks" eingeführt, die Regulierung der Aktienoptionen wesentlich gelockert und verschiedene neue Aktiengattungen eingeführt. Zugleich wurde der Umfang der Organhaftung beschränkt. Für große Gesellschaften wurde ein alternatives Corporate Governance-System eingeführt, das nach US-amerikanischem Vorbild die Bildung von Ausschüssen innerhalb des Verwaltungsrates vorsieht. Insgesamt hat die Reform ein größeres Maß an Flexibilität für die Unternehmen gebracht. Sie dürfte nach Ansicht des Verfassers allerdings nicht ausreichen, um sicherzustellen, daß die neuen Freiräume stets verantwortungsvoll genutzt werden.

(Die Redaktion)