THE TRANSFORMATION OF THE JAPANESE COMMERCIAL CODE AND ITS IMPACT ON THE JAPANESE ECONOMY

by

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ABSTRACT

The legal system is an essential basis of the society and economy of every country, and it changes continually in accordance with national social and economic situations.

The Japanese Commercial Code is no exception. One of the most significant and fundamental Japanese laws, it was enacted in 1899 as part of the modernization of Japanese society as the country moved away from a policy of seclusion followed by the old feudal government. The new Code was strongly affected by corporate laws in place at the time in Germany and France. However, as the balance of power in the world economy changed over the ensuing years, the Japanese Commercial Code and other corporate laws were influenced by American laws, and the nature of the Commercial Code was slowly transformed, especially following the Second World War and after the collapse of the so-called "bubble economy" in Japan.

In this thesis, I discuss the history of fundamental Japanese laws, the steps and players in the legislative process, and present details about the introduction of the share exchange system, which stimulated many more mergers and acquisitions in Japan. Then I analyze the economic impact of new legal procedures for M&As, including the share exchange system, and identify possible directions for Japanese corporate laws in the future.

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CHAPTER 1

INTRODUCTION

1.1 THESIS OBJECTIVE

Every country has its own history, culture, customs, and laws, each of which changes over time to reflect the country's unique social situations and legacies. In particular, the laws of each country reflect a variety of structures and characteristics.

The Japanese legal system has a two-millennium tradition that has existed since the earliest recorded Japanese history. At the same time, it has been continually affected by the legislation of other countries. Among many historical events, the most dramatic changes in Japanese laws occurred twice in modern Japanese history: at the beginning of the Meiji era and again after the Second World War. Today, a third wave seems to be manifesting itself as a result of the long-lasting economic hard times of the past several decades. In particular, the Japanese Commercial Code (*Shoho*), which governs Japanese economic activities, has been amended frequently and substantially in recent years.

Traditionally, government officials (especially those in the Ministry of Justice, which is responsible for the Commercial Code) and scholars believed that stability was critical to the judicial system. Thus, the Japanese government was reluctant to make changes to the Commercial Code despite urgent requests from industry for regulations that would adapt to the changing business environment. Finally, increasing demands to restore Japan's competitive position in world markets drove the government to optimize Japanese corporate

laws. Since 1997, revisions to the Commercial Code have been made almost every year until finally the code was entirely rebuilt in a new Code that was adopted in 2005.

In addition to regulatory changes, the nature of the Japanese legal system itself also changed. The Japanese Commercial Code was originally enacted in 1899. At that time, as legislation was being formulated following the feudal age of the Tokugawa dynasty, almost all Japanese statutes were modeled after either German or French laws, so the Japanese legal system had many characteristics found in continental laws. However, more recent amendments and newly enacted Japanese laws seem to be strongly affected by American laws, reflecting the economic power of the United States.

When managing today's modern corporations, legal issues surrounding companies cannot be ignored, nor can attention be paid only to accounting, finance, marketing, innovation, or other factors taught by most business schools. Corporate law is, of course, what companies are based on and what fundamentally governs the activities of most companies, and managers have to pay attention to legal issues.

In this thesis, I would like to introduce the historical perspectives regarding a series of amendments to the Japanese Commercial Code, and what that has meant for the social and economic environment in Japan. In particular, I will shed light on the introduction of the share exchange system, which was triggered when the ban on holding companies was lifted following amendment of the Anti-Monopoly Act in 1997, and which was primarily intended to facilitate transforming existing business entities to holding companies. I will also discuss the fact that the amendment activated a number of mergers and acquisitions, which led many Japanese companies to reorganize their corporate structure and helped the Japanese economy to recover from a deep depression. Finally, I will review the impact of the amendment on the

Commercial Code, and discuss recommendation for possible future revisions.

1.2 THESIS STRUCTURE

In Chapter 2, I will review the history of modern Japanese laws that affect Japanese companies and their economic activities. In particular, I will focus on the fundamental philosophy underlying this totally new legal system and where these statutes (including the Commercial Code and other fundamental laws) came from, in other words, which countries' laws affected the Japanese laws most.

In Chapter 3, two elements of great importance to the history of the Japanese Commercial Code will be briefly explained: procedures for enactment or amendment, and the players involved in amending the Commercial Code.

Chapter 4 is the core of the thesis. The introduction of the "share exchange system" is reviewed in detail—what triggered the system, its origins, processes, purposes, significance, legislative effects, and so on. This review will highlight characteristics of recent amendments to the Japanese Code, and discuss the impact of U.S. legislation on these amendments.

Following the detailed description of the share exchange system, Chapter 5 discusses its economic impact on the Japanese economy. The chapter also considers other related amendments to the Commercial Code and the recent trend of mergers and acquisitions in Japan.

Finally, I conclude the thesis (Chapter 6) by discussing the significance of recent revisions to the Commercial Code. I also give my perspectives and recommendations as to future directions for Japanese corporate laws.

CHAPTER 2

HISTORY AND CHARACTERISTICS OF THE JAPANESE COMMERCIAL CODE

2.1 INTRODUCTION

This chapter reviews the history of modern Japanese laws, including the Commercial Code. The aim is to illustrate how fundamental Japanese laws were formed and how foreign laws, especially German and French, affected the formation of Japanese laws. This will help readers understand the recent transition of the Japanese Commercial Code.

2.2 THE PRE-MEIJI ERA

In Japan, most historians agree that the private law system was not sufficiently developed prior to the Meiji era, which was the beginning of modernization. Although there were many laws enacted by the government during that time period (e.g., the Tokugawa shogunate [1603-1867]), most of them were criminal laws. Laws among merchants were highly developed, however, including bills and notes to regulate trade payments between merchants in Osaka (the center of Japanese economy at that time), Tokyo, and other major cities. This bills-and-notes system was quite sophisticated, and scholars praise it highly, noting that it compares favorably to European systems in use at the time (Fukushima, 1976).

Although these commercial transaction laws were effectively enforced, there were no organizational laws or legal systems for stock corporations or limited companies. All

merchants, from private concerns to large-scale traders, were operated personally and individually, with funds raised by the owners and/or their families (Fukushima, 1976). The legal environment for modern-day corporations did not fully appear until after the seclusion policy of the Japanese feudal government was abandoned.

2.3 MODERNIZATION OF THE JAPANESE LEGAL SYSTEM

The Japanese government was forced to open its doors to foreign countries in 1853 when it was threatened by American warships under the command of Commodore Matthew Perry (1794-1858) of the U.S. Navy, which led to the signing of the Convention of Kanagawa (*Nichi-Bei Washin Joyaku*) on March 31, 1854. In the treaty, the Japanese government agreed to open the Japanese ports of Shimoda and Hakodate to the United States for trading and to establish a permanent consul. Soon after this treaty, the Anglo-Japanese Friendship Treaty (*Nichi-Ei Washin Joyaku*), which had virtually the same content, was signed on October 14, 1854. Similar treaties were soon concluded with Russia and the Netherlands.

On July 29, 1858, the U.S. and Japan signed the Treaty of Amity and Commerce (*Nichi-bei Shuko Tsusho Joyaku*). The treaty granted:

(1) an exchange of diplomatic agents

(2) opening of additional ports (Kanagawa, Nagasaki, Niigata, and Hyogo) and markets (Edo [Tokyo] and Osaka) for international trade

(3) U.S. citizens the opportunity to live and trade in those ports

(4) fixed low customs duties subject to diplomatic control

(5) an extra-territoriality system that allowed foreign residents to apply their own laws in their own consular courts instead of Japanese laws and courts

At the same time, similar treaties were concluded with the Netherlands, Russia, Britain, and France. These treaties were signed under military pressure by the United States and European powers and were extremely unilateral and unequal. Therefore, the primary challenge to the new Japanese government under Emperor Meiji (1852-1912) after the Meiji Revolution in 1868 was to negotiate with Western countries to amend these treaties, take away the restrictions, and restore full sovereignty. However, the negotiations were not easy because in those days Western countries regarded countries not founded as a capitalistic economy as non-civilized and the West did not trust those countries as equal partners. A more modern legal system that included a Civil Code, Commercial Code, Criminal Code, and various procedural laws and appropriate enforcement organizations (i.e., a court system) was required in order for Japan to be regarded as a civilized country (Takano, 1985).

The primary reason why the Japanese government amended the treaties was to enact modern-style laws that were similar to Western countries, and to that end, in the 1870s the government sent diplomats to Europe and the United States to research related legal systems. At the same time, the government asked Rinsho Mitsukuri (1846-97) to translate relevant French laws because the French system was thought to be the most advanced legal system in the world. The French Criminal Law was translated in 1869, followed by the Civil Code, the Constitution, the Commercial Code, and procedural laws. Then Director General at the Ministry of Justice, Shimpei Eto (1834-74), told Mitsukuri not to be afraid if he made a mistake in translation, but also to speed up his work.[1] Catching up with the legal systems in Western countries was the most important matter for Eto and the Japanese government, even if the system was initially quite perfunctory. Eto is thought to have said: "Customs in Japan

[1] In fact, Mitsukuri recalled that there were many errors in the translations (Kawaguchi, 1998).

and those in European countries are, of course, different. However, when it comes to necessity of having a Civil Code, the situations are the same. Therefore, we have to enact our Civil Code based on the French Civil Code" (Hozumi, 1916). These translations of French laws did indeed form the basis of constructing and compiling fundamental new Japanese laws.

2.4 CREATING CIVIL LAWS AND OTHER FUNDAMENTAL LAWS

2.4.1 Civil Code (*Minpo*)

The Japanese government began to compile the Civil Code in 1871. The first draft was undertaken at the Department of State based on the Mitsukiri translations. The draft was amended several times[2] by the Department of State and the Ministry of Justice, but these drafts were not adopted due to objections by the then Minister of Justice, Takato Oki (1832-99), who insisted that translations of foreign countries' laws should not be allowed to govern Japanese citizens (Yamanaka, et al., 2002).

In 1880, after those preliminary drafts were abandoned, the Japanese Senate began to write a new draft. The drafting process was split into two parts: property rights and family relations. The property rights portion was directed by Gustave Emile Boissonade (1825-1910), a French legal scholar; the family rights part was directed by Rinsho Mitsukuri, Shiro Isobe, and Seiichiro Kurokawa, all Japanese legal professionals. The property rights part of the draft was finished in 1888, and the family relations part in 1890. Both parts of the Civil Code were passed by the Diet and enacted into law in 1890.

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[2] *Minpo Ketsugi* (1870), *Mikuni Minpo* (1870), *Kokoku Minpo Karikisoku* (1872), *Meiji 11 nen Minpo Soan* (1878)

It was Boissonade's basic idea that the Civil Code should not be just a translation of a foreign law, that Japanese customs should be carefully examined and adopted into the Code. Therefore, the Civil Code of 1890 had a mixture of the modern Western legal system and traditional Japanese conventions. It cannot be denied, however, that both the first draft and the Civil Code of 1890 were strongly affected by French laws.

After publicly announcing the Civil Code (and the Commercial Code of 1890, mentioned later in this section), political arguments began in the government and the Diet concerning both acts. Many politicians and legal scholars insisted that enforcement of both acts should be postponed for a several years until they could be reviewed thoroughly. This argument was initiated by Hogakushi Kai (an association of alumni from the Law School of Tokyo Imperial University) in its "Opinion for Compilation of Statutes" written in 1889. Most of the writers had studied English law, and they (and other law schools that taught mainly English law) were greatly concerned about basing Japanese laws on continental-law-oriented statutes (Kawaguchi, 1998).

Although supporters gave several reasons for postponement, most were not theoretically consistent but rather emotional and/or political (Fukushima, 1976). For example, Yatsuka Hozumi (1860-1912), a constitutional law professor at the Tokyo Imperial University, insisted that European laws reflecting Christian ideology and individualism were not suitable to Japanese society and families that were based on "ancestorism." He is famous for the phrase, "The Civil Law will ruin traditional Japanese loyalty and piety."

Among numerous reasons for postponement, it was pointed out that the different sources of both laws might create contradictions in actual economic and social operations. The first Commercial Code was derived from the German Commercial Code, while the Civil

Code of 1890 was strongly influenced by French laws. Theoretically, these different sources were not critical, but offering that reason was convincing to the general public. In the end, the decision to postpone enforcement of both the acts was made by the Diet, and a new Civil Code and Commercial Code ordered to be created yet again.

The new Civil Code (the Civil Code of 1896 and 1898) was drafted by three Japanese scholars: Nobushige Hozumi (1855-1926, an elder brother of Yatsuka Hozumi), Masaakira Tomii (1858-1935), and Kenjiro Ume (1860-1910). Hozumi and Tomii studied jurisprudence in Germany, while Ume acquired his research experience in France. As a result, the new draft was heavily influenced by German Civil Code (supported by Hozumi and Tomii), but French Civil Code (supported by Ume) and the old Civil Code also had some influence. Ume said people thought the new Civil Code was based only on German laws because they were similar in structure. He pointed out that at least half of the new Civil Code was related to the French Civil Code (Kawaguchi, 1998). The new Civil Code was promulgated and enforced in 1896 (property rights) and 1898 (family relations).

2.4.2 Commercial Code (*Shoho*)

Before the modernized Corporate Code was enacted in 2005, the Japanese Commercial Code consisted of four parts: general provisions, corporate organization provisions, commercial transaction provisions, and maritime commerce provisions. Among these provisions, the earliest draft covered corporate organization provisions. One reason for this was the need to found a capitalistic economy that would promote industry by encouraging the incorporation of large-scale companies (Yamanaka, et al., 2002).

Compilation of the corporate organization provisions was jointly started by the Ministry of Finance and the Home Ministry in 1874. The Home Ministry finished its compilation and submitted a draft of the Corporate Ordinance in 1875. However, this draft came under fire by both the Ministry of Justice and the Legislative Bureau in the Department of State and was eventually abandoned.

The next compilation of corporate code was undertaken in 1880. The Bureau of Corporate and Partnership Ordinance Review was set up in the Senate, and a new draft of the Corporate Ordinance was done by the Bureau in 1881. However, this draft too never saw the light of day. Strong opinions insisted that corporate provisions should be part of the commercial code and should not be enacted as an independent ordinance (Fukushima, 1976; Yamanaka, et al., 2002).

After the second draft failed, the government commissioned German legal scholar and economist, Hermann Roesler (1834-94), to undertake another draft. He came to Japan as an adviser on international law to the Ministry of Foreign Affairs, but he became involved in the compilation process of the Meiji Constitution with his knowledge of German state theory (*Staatslehre*). However, he was not a private-law scholar but his forte was public law. Therefore, his knowledge of commercial law was in fact doubtful, despite his efforts to investigate commercial legislation in several foreign countries (Fukushima, 1976). Furthermore, he thought Japanese customs were not valuable—in contrast with Boissonade who respected them to some extent. Roesler said:

> The Japanese Commercial Code should be harmonized with foreign commercial codes in order to achieve the equal position with trading countries all over the world. We have to adopt common principles that are accepted by civilized nations because most of the Japanese hereditary commercial customs are not inappropriate for that purpose. (Kawaguchi, 1998)

Roesler finished his comprehensive work (including not just corporate organization codes but also provisions concerning trademark, commercial bookkeeping, and commercial transaction.) based on the German Commercial Code (and some French bankruptcy laws) in 1884. The Diet passed a bill based on Roesler's draft, and the Commercial Code was promulgated in 1890 (see Figure 2.1).

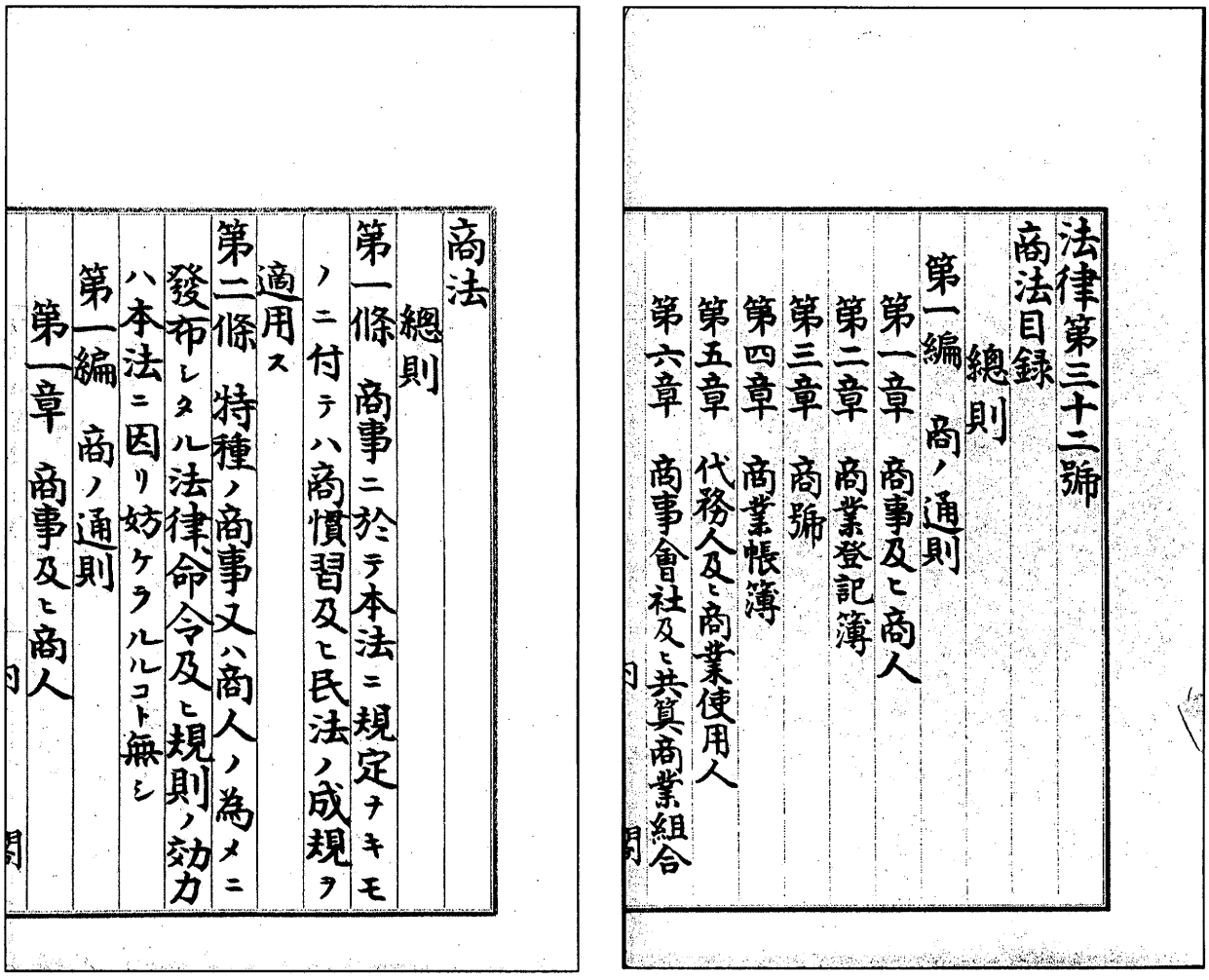

Fig. 2.1 The original document of the Commercial Code of 1890
(Left: Articles; Right: Table of Contents)

Source: National Archives of Japan

As mentioned earlier, political arguments concerning the Civil Code and the Commercial Code took place after they were publicly announced. Then enforcement of the Civil Code and most of the Commercial Code was postponed. Only the corporate organization provisions, the bills and notes provisions, and the bankruptcy provisions were enforced in the partial amendment of 1893 because of strong demand from business circles.

Unfortunately, the corporate organization provisions adopted permission principles for incorporation but did not have any merger procedures. These inflexible regulations soon became very inconvenient for expanding Japanese economic activities (Yamanaka, et al., 2002) (see Table 2.1).

Table 2.1 Incorporation and liquidation trends under the old Commercial Code

Year		Partnership Company	Limited Partnership Company	Joint Stock Company	Total
1893	Incorporation Liquidation	250 (15.6%) 13 (17.6%)	795 (49.6%) 61 (82.4%)	559 (34.9%) — (0.0%)	1,604 (100%) 74 (100%)
1894	Incorporation Liquidation	142 (7.4%) 32 (21.2%)	506 (26.4%) 97 (64.2%)	1,271 (66.2%) 22 (14.6%)	1,919 (100%) 151 (100%)
1895	Incorporation Liquidation	116 (10.0%) 36 (10.7%)	732 (63.3%) 260 (77.1%)	308 (26.6%) 42 (12.4%)	1,156 (100%) 337 (100%)
1896	Incorporation Liquidation	170 (8.4%) 52 (13.2%)	1,042 (51.2%) 271 (68.6%)	823 (40.4%) 72 (18.2%)	2,035 (100%) 395 (100%)
1897	Incorporation Liquidation	240 (9.0%) 58 (9.8%)	1,502 (56.6%) 275 (46.5%)	912 (34.4%) 259 (42.8%)	2,654 (100%) 592 (100%)
1898	Incorporation Liquidation	246 (10.3%) 58 (9.1%)	1,448 (61.0%) 414 (64.8%)	684 (28.8%) 167 (26.1%)	2,378 (100%) 639 (100%)

Source: Fukushima, 1976. Adapted by the author.

After postponement, a new draft of the Commercial Code was compiled by three Japanese scholars: Keijiro Okano, Kaoru Tanabe, and Ume (the same person who was involved in drafting the Civil Code). The three decided to compile a new draft, again based on the German Commercial Code, and that new Commercial Code was promulgated and enforced in 1899.

2.4.3 Other Fundamental Laws

The **Meiji Constitution** was compiled by four politicians (Hirobumi Ito, Kowashi Inoue, Miyuji Ito, and Kentaro Kaneko) based on suggestions and advice from two German legal scholars, Roesler and Albert Mosse. The Constitution was promulgated in 1889 and enforced in 1890. The Constitution itself was affected by the nature of the German constitution, and German-style interpretation theory became ascendant.

The **Civil Procedure Law** was compiled by a German scholar, Hermann Techow, and promulgated in 1890. In general, the law was derived from traditional German civil procedure law (Kaneko, 1992).

The first **Criminal Law** was compiled by Boissonade, largely based on French criminal laws and promulgated in 1880. The law was later amended in 1907 under the influence of German criminal law.

The first **Criminal Procedure Law** was also drafted by Boissonade based on French criminal procedure law and promulgated in 1880. The law was amended, and a new Criminal Procedure Law enacted in 1890. The second law inherited most of its provisions from the first law, but was amended under the influence of German laws.

2.4.4 Summary

Most fundamental Japanese laws, including the Commercial Code, were originally based on French or German laws. Afterward, most were amended under the influence of German laws. The reason for the strong influence of German laws was that the Japanese political direction was gradually oriented to the German constitutional monarchy system instead of the French democracy system. The French was believed by most Japanese politicians to be incompatible, or at least did not go well with the Japanese Emperor system (Yamanaka, et al., 2002).

In any case, it is clear that Japanese laws were greatly affected by continental laws and their interpretations (see Table 2.2).

Table 2.2 Japanese fundamental laws and their origins

	Enactment		**Amendment (or New Enactment)**	
	Year	**Influence**	**Year**	**Influence**
Constitution	1889	German Law	—	—
Civil Code	1890	French Law	1896 & 1898	German Law (partly French)
Commercial Code	1890	German Law	1899	German Law
Civil Procedure Law	1890	German Law	—	—
Criminal Law	1880	French Law	1907	German Law
Criminal Procedure Law	1880	French Law	1890	German Law

Source: the author

2.5 DIFFERENCES BETWEEN CONTINENTAL LAWS AND COMMON LAWS

Generally speaking, there are two major legal systems in the modern world. One is the common law system adopted by the United Kingdom and the United States. The other is the continental law (civil law) system based on ancient Roman civil law and used in France, Germany, Japan, and other countries (see Table 2.3).

Table 2.3 National legal systems

Common Law		**Civil Law (Continental Law)**	
Australia	Nigeria	Argentina	Indonesia
Bangladesh	Singapore	Austria	Iran
Canada	**United Kingdom**	Brazil	Italy
Ghana	**United States**	Chili	**Japan**
India	Zambia	China	Mexico
Israel		Egypt	Poland
Jamaica		Finland	South Korea
Kenya		**France**	Sweden
Malaysia		**Germany**	Tunisia
New Zealand		Greece	Venezuela

Source: Miller and Jentz, 2000. Adapted by the author.

In a civil law system, the primary source of law is statutory code, and case precedents are not judicially binding as they are in a common law system. Although judges in a civil law system often refer to previous decisions as sources of legal guidance, they are not bound by precedent; in other words, the doctrine of *stare decisis* does not apply (Miller and Jentz, 2000).

In a common law system, when a lawsuit is filed, judges analyze facts from related materials submitted to the court and try to find similar precedents and decisions. Although judges in continental law countries seek out the facts from evidence presented by both

plaintiffs and defendants (similar to common law countries), judges then try to find related provisions from a variety of statutes currently effective in the country. Next, judges interpret related abstract provisions so as to be consistent with other provisions and statutes. After these steps, judges apply these interpreted provisions to concrete facts and make a decision. Appellate courts and the Supreme Court will reverse lower courts' decisions if interpretation of provisions of the decision is contradictory to other provisions or laws. This is the main role of the higher court, although misidentification of facts can also be a reason for reversal in some situations. The Supreme Court of Japan does not open hearings to examine evidence for finding facts.

In general, judges in a common law system try to identify an appropriate and reasonable solution for the specific case facing them, by creating new theories, doctrines, and even substantial rules. On the contrary, judges in a continental law country attach importance to written statutes and their systematic consistency because consistency of laws is believed to lead to legal stability of economic and social activities. New statues or amendment to existing laws are usually necessary in order to adapt to a situation that was not envisioned in the existing statutes, and that cannot be coped with by interpretation. The continental law system is more conservative than a common law system from the viewpoint of dealing with unexpected situations (Fukuda, 2005).

2.6 THE NATURE OF THE JAPANESE COMMERCIAL CODE

The Commercial Code of 1899 had 689 articles and the following structure:

I. General Provisions
II. Companies
III. Commercial Transactions
IV. Bills and Notes

V. Maritime Commerce

This statute is still in force today, with the following major exceptions: the second chapter was deleted by enacting a new Corporate Code in 2005, and Chapter Four was deleted by spinning off two independent new laws: Bills Law in 1932 and Notes Law in 1933.

The act improved several weak points of the old code in response to strong demand from business circles. The basic characteristics and significance of the new Commercial Code were as follows:

1. ***Characteristics*** (especially as compared to common law)

(1) The permission principle for incorporation in the old Commercial Code was altered to the conformity principle.

(2) The "shareholders' meeting centrism," which meant that a shareholders' meeting had supreme power, was adopted.

(3) Directors (three or more) were to be elected in the shareholders' meeting.

(4) Management of the company was to be decided by a majority of the directors, and every director could represent the company.

(5) Auditors who were elected in the shareholders' meeting were to audit management of the directors and assets of the company, and no one could be both an auditor and a director (or a general manager) in the same company at the same time.

(6) All shares were to be par value stocks whose values were to be the same, and the capital of the company was to be calculated by multiplying the face value of the shares by the number of shares.

(7) The principle of maintaining capital and other principles concerning capital were strictly applied to protect creditors of the company, and stock repurchases were prohibited.

(8) Increasing or decreasing the capital was to be decided by a special majority vote in the shareholders' meeting.

2. Significance

(1) The fundamental legal regimes that regulated the Japanese economic activities were established.

(2) The adoption of the conformity principle enabled many private economic entities to transform easily into public corporations, especially stock corporations.

(3) Adding merger procedures encouraged mergers and consolidation of companies.

Although this Commercial Code experienced several amendments from that time on, the basic concepts and principles were maintained until after the Second World War.

2.7 AMENDMENTS TO THE COMMERCIAL CODE BEFORE WORLD WAR II

The first major amendment to the Commercial Code of 1899 was made in 1911. After the victory over Russia in 1905, and with rapid growth of the Japanese economy, business transactions became more complex, while consolidations increased. Victory raised Japan's position in the international community, which brought increasing amounts of foreign investments into Japanese companies. This expansion of the Japanese economy brought a

greater concentration of capital, and corporate stocks were distributed among a growing number of shareholders. This dilution of shares separated owners from management.

Due to these changes, certain inadequacies and defects gradually appeared in the Commercial Code. For example, a scandal involving bankruptcy, cooking the books, and bribery was caused by the CEO and directors of one of the largest sugar company, Dai Nippon Seito Corporation. Although one of the primary principles of the Commercial Code was that shareholders' meetings adequately controlled management, in fact the separation of ownership (shareholders) from management (directors) led to shareholder indifference to management, which reinforced management's power and sometimes led to abuses of power. This scandal raised the argument for an amendment to the Commercial Code concerning the need for a system of auditors and increased penalties for wrongdoing.

This amendment, which was promulgated in 1911, revised more than 200 articles. It had the following characteristics:

- Clarified merger procedures between different type of companies (for example, stock corporations and partnerships)
- Added procedures for issuing corporate bonds in foreign countries
- Clarified directors' responsibilities on civil law
- Added criminal penalty provisions for directors' abuse of power.

Although many revisions were made to this amendment (including boosting the authority of auditors, as suggested by the British Ambassador to Japan who was a shareholder of Dai Nippon Seito) to adjust to the changing economic situation surrounding Japanese companies, the fundamental nature of the Japanese Commercial Code as a continental law was maintained.

Subsequently, a similar amendment was made in 1938, which improved corporate governance and corporate finance.

2.8 AMENDMENTS TO THE COMMERCIAL CODE UNTIL 1995

2.8.1 1950s: Influence from U.S. laws

Following World War II, Japan was under the control of the Allied Powers (including the U.S., Britain, Soviet Union, France, and China). The U.S. took a leading role in the occupation, and General Douglas MacArthur (1880-1964) of the U.S. Army—the Supreme Commander for the Allied Powers (SCAP) in Japan—and his General Headquarters (GHQ) staff supervised policies in Occupied Japan.

The GHQ/SCAP policies were based on a document entitled "U.S. Initial Post-Surrender Policy for Japan" (SWNCC150/4/A), issued on September 21, 1945, by the State-War-Navy Coordinating Committee of the United States. It was followed, on November 3, 1945, by another document entitled the "Basic Initial Post-Surrender Directive to Supreme Commander for the Allied Powers for the Occupation and Control of Japan" (JCS1380/15) (see Table 2.4). According to these documents, the basic objectives of the occupation were as follows:

- abolition of militarism and ultra-nationalism
- disarmament and demilitarization of Japan, with continuing control over Japan's capacity to make war
- strengthening of democratic tendencies and processes in governmental, economic, and social institutions
- encouragement and support of liberal political tendencies in Japan.

Table 2.4 Initial policy of the United States for Occupied Japan

PART I - Ultimate Objectives
PART II - ALLIED AUTHORITY
1. Military Occupation
2. Relationship to Japanese Government
3. Publicity as to Policies
PART III - POLITICAL
1. Disarmament and Demilitarization
2. War Criminals
3. Encouragement of Desire for Individual Liberties and Democratic Processes
PART IV - ECONOMIC
1. Economic Demilitarization
2. Promotion of Democratic Forces
3. Resumption of Peaceful Economic Activity
4. Reparations and Restitution
5. Fiscal, Monetary, and Banking Policies
6. International Trade and Financial Relations
7. Japanese Property Located Abroad
8. Equality of Opportunity for Foreign Enterprise within Japan
9. Imperial Household Property

Source: Table of Contents of the SWNCC150/4/A. U.S. Initial Post-Surrender Policy for Japan.

To achieve these objectives, virtually every Japanese regime, including political, economic, and education systems, were thoroughly reviewed. For example, the Meiji Constitution, which had characteristics of a constitutional monarchy, was completely amended in November 1946 under the strong influence of GHQ/SCAP. (Due to these historical circumstances, whether the current Constitution was created by the Japanese people or forced on them by foreign countries (particularly the U.S.) is a delicate political issue even today. Some politicians in the Liberal Democratic Party insist on the latter opinion, and they have continually tried to reconstruct a Constitution written "solely by the Japanese.")

The so-called *Zaibatsu* (business conglomerates, or literally "financial cliques")—Mitsui, Mitsubishi, Sumitomo, Yasuda, and other corporate groups—were completely dismantled as a result of the Initial Policy, which stated that it should be the policy of the Supreme Commander to "favor a program for the dissolution of the large industrial and banking combinations which have exercised control of a great part of Japan's trade and industry." (SWNCC150/4/A) The United States and other Allied Powers countries believed that the *Zaibatsus* had actively cooperated with military policies in the pre-war period, and that they were the economic foundation of Japanese militarism.

In order to dismantle the *Zaibatsus* and prevent a revival of similar economic entities, GHQ/SCAP strongly suggested recommendations and new regulations to the Occupied Japanese government, including the following measures:

- Dissolution of holding companies of major *Zaibatsu* groups (Mitsui Honsha, Mitsubishi Honsha, Sumitomo Honsha, Yasuda Hozensha, and Fuji Sangyo) in September 1946.
- Enactment of the Act concerning Prohibition of Private Monopolization and Maintenance of Fair Trade (the Anti-Monopoly Act) in April 1947, which had a series of general competition policies including a ban on incorporation of or transformation into a holding company.
- Enactment of the Elimination of Excessive Concentration of Economic Power Act in December 1947, which subdivided other major *Zaibatsu* companies (as a result, 11 companies were divided).

As a matter of course, the Commercial Code was also targeted for review. As the *Zaibatsu* dismantlement progressed, GHQ/SCAP believed that the most problematic

characteristic of the Commercial Code (from the American, or common law point of view) was the weakness of shareholders' rights, which had led to situations where management had shareholders at its mercy. GHQ/SCAP requested that the Occupied Japanese government amend the Commercial Code to boost shareholders' rights, and concrete arguments in writing were made public, entitled the "Tentative Points for Agenda" (see Table 2.5).

Table 2.5 Request of GHQ/SCAP to the Japanese Government on January 31, 1949

SUBJECT: Tentative Points for Agenda:
I. 1. Stockholder's Right of Access to Books and Records
2. Transferability of Shares:
(Name Shares; Bearer Shares; Co-ownership; Transfer Books, etc.)
3. Voting Rights
(Voting trusts; voting lists; proxies, special classes of shares)
4. Increase in Capital
(Pre-emptive rights; etc.)
5. Minority Stockholders' Rights and Remedies
a. Ultra vires
b. Obligations of Officers and Directors
c. Auditors
d. Stock acquisitions
e. Mergers and consolidations
f. Court actions re wrongful acts
6. Articles of Incorporation—General Powers—Contents of Statement
7. By-laws
8. Investments
9. Directors and Officers
10. Annual Report
11. Amendment of Articles
12. Application of K. K. Provisions
13. Consideration for Non-par Shares
(Allocation; stated capital; paid-in surplus)
14. Subscriptions
15. Mergers and Consolidations
16. Meetings
II. Foreign Companies
(Branch offices; registration; doing business)

Source: Suzuki and Takeuchi, 1977.

The preliminary bill was discussed at the Legislative Council of the Ministry of Justice soon after the request was made, and all the requested points were included in the bill. This 1950 amendment was strongly influenced by GHQ/SCAP expectations, which had some of the typical features of common law, and the following characteristics:

- The concept of "shareholders' meeting centrism" was altered. Instead, the authority of shareholders' meetings was limited to items prescribed in the Commercial Code and the by-laws of the company, and shareholders' meeting were no longer almighty.
- The rights of shareholders were strengthened, including the right of shareholders to representation; the right to serve injunctions against directors' unlawful conduct; the right of each shareholder to inspect account books. Furthermore, shareholders who voted against company proposals could still make claims against the company for buying their shares at fair value.
- The board of directors system was introduced, and only representative directors selected from the board would represent the company.
- The board of directors would decide the management of the company and supervise the duties of directors.
- Auditors' authority was limited to auditing the books and accounting records.
- The authorized capital system was introduced; the board of directors would issue shares based on the decision of the board (not the shareholders' meeting) if total shares were within the authorized capital indicated in the company's by-laws.

Professor Takeo Suzuki (1905-95), who played a leading role in the group working on the amendment at the Legislative Council recollected the following:

> The Japanese Commercial Code had been based on continental laws (especially German) as "mother laws," and they had been accepted like the gospel truth. However, the American way of thinking was brought into the Commercial Code, and we had to take as fact that the German laws were not always the truth and that the experiment to absorb the most advanced legal system in the world had begun. We thought this amendment showed an example of a new type of law that was a mixture of the advantages of the German and the American legal systems. (Suzuki and Takeuchi, 1977, original in Japanese, translated by the author)

Indeed, various common law regulations were added to the Commercial Code,[3] and it became literally a mixture, to some extent. However, the fundamental concepts of the Commercial Code derived from continental laws, including the principle related to capital (for example, the ban on share repurchase) and the legal regime of corporate governance (for instance, the structure of legally required corporate organs) were not fundamentally changed.

2.8.2 Amendments Until 1994

After the large-scale amendment in 1950, there were only relatively minor amendments until 1994, and the amendments basically concerned corporate governance: shareholders' rights were strengthened, and the audit system was enhanced. As the Japanese economy continued to recover from damage suffered during the Second World War, the regulations of the Commercial Code needed to be revised in order to adjust to the changing economic and social environment.

Both the amendment of 1974 and the one in 1981 were triggered by (again) corporate scandals. In 1965, Sanyo Special Steel Corporation, one of the largest specialty steel companies in Japan, applied for a Stock Company Reorganization and Rehabilitation Act, which meant substantial bankruptcy, with a total debt of about ¥50 billion ($140 million).

[3] Moreover, many provisions of the Securities and Exchange Law and the Anti-Monopoly Act, newly introduced after the Second World War, were substantially adopted from the same purpose regulations in the United States.

Soon after the bankruptcy, it was revealed that the CEO and directors of the company had window-dressed the accounts and distributed illegal dividends to shareholders and hidden bonuses to themselves. Although all the directors and auditors in the company knew this, no one took exception to those unlawful actions. In the end, the CEO and other directors were accused and found guilty of fraud, embezzlement, and violating the Commercial Code.

This case triggered public opinion to argue that the Commercial Code should have stricter regulations for overseeing directors, not only by internal auditors who were usually chosen by the CEO, but also by external accountants. As a result, the Commercial Code was amended and the Law for Special Provisions for the Commercial Code Concerning Audits, etc., of Joint Stock Companies for large-scale companies with introduction of obligation to be examined by certified public accountants was enacted in 1974. Similar cases concerning abuse of directors' power occurred again and again, even after this amendment, which caused problems and a demand for more authority given to auditors and shareholders in terms of monitoring directors. The Commercial Code and other related laws were revised again in 1981 (see Table 2.6 for amendments after 1981).

In general, amendments after 1950 were basically "symptomatic therapies." Although various prescriptions that were thought to be appropriate for dealing with changing circumstances and preventing corporate scandals were given to the Commercial Code, the fundamental principles remained unchanged. Despite Americanization of the Japanese Commercial Code, progress remained elusive and slow.

Table 2.6 Amendments from 1990-94 and trends in other regulations and industries

Year	Revisions of the Commercial Code	Trends in Other Regulations and Industries
1990	• Introduce a minimum capital requirement system • Deregulated the issuance of preferred stock • Abolished limits on the number of incorporators (seven or more) for establishing a corporation • Eliminated the requirement for examiners to inspect in-kind contributions to capital and asset acceptance at the time of incorporation • Simplified procedures for changing organizations, including joint-stock and limited companies • Separated procedures to incorporate profits available for dividends to capital from procedures relating to the issuance of new shares • Specified standards for setting aside reserves • Rationalized procedure for issuing preferred stock dividends	• Battle between Boone Pickens and Koito Manufacturing • US-Japan structural impediment talks • Court approval of Shuwa's lawsuit demanding that third-party allocation of new shares between Chujitsuya and Inageya be suspended (1989) • Revisions of the SEC Law (report on large securities holdings and reforms of the take-over bid system)
1993	• Introduced new systems for a board of statutory auditors and outside statutory auditor • Set a fixed fee of ¥8,200 for shareholder class-action lawsuits • Reduced the minimum number of shares owned by those entitled to demand to inspect accounting records (from 10% to 3%) • Abolished limits on amount of corporate bond issuance • Mandated the establishment of corporate bond management companies	• Enactment of the Financial System Reform Law (incorporating subsidiaries of banks, securities companies and trust banks) • MOF's guidelines on "the restart of capital increases by public offering at market price"
1994	• Deregulated limits on the repurchase of outstanding shares (approving the retirement of outstanding shares by profits and the transfer of such shares to employees)	• Asahi Breweries and Amway Japan use profits to retire outstanding shares (1995)

Source: Hashimoto, 2002. Adapted by the author.

CHAPTER 3

ENACTING NEW LAWS OR AMENDING THE JAPANESE COMMERCIAL CODE

3.1 INTRODUCTION

Creating or revising laws is neither an easy nor a simple process, as many stakeholders are eager to influence new legislation or deregulation. Indeed, recent changes in the Japanese Commercial Code were greatly affected by a Ministry in charge of industrial policy.

In this chapter, the legislative procedures and influential players of the amendment process are discussed with the goal of helping readers to understand how Japanese laws are enacted or amended, especially what made the Ministry change its attitude toward regulations that greatly affected the transition.

3.2 THE PROCESS FOR ENACTING AND AMENDING JAPANESE LAW

Under the Japanese parliamentary system, all amendments to existing laws as well as new enactments are handled by the National Diet, which consists of the House of Representatives (*Shugiin*) and the House of Councilors (*Sangiin*). Figure 3.1 illustrates the legislative process and how proposals (new and amendments) move from player to player.

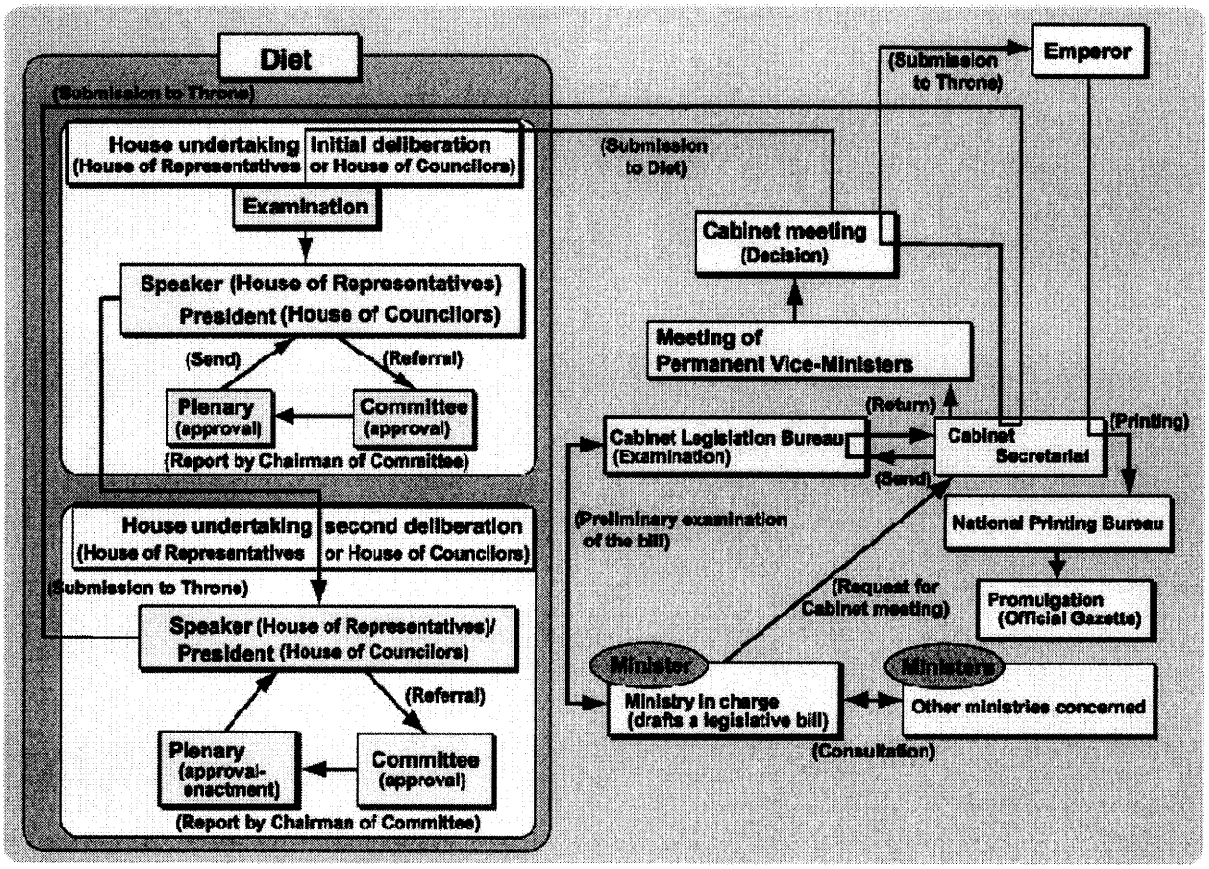

Fig. 3.1 The legislative process in Japan

Source: Cabinet Legislation Bureau, "The law-making process," <http://www.clb.go.jp/english/process.html>.

The Diet receives two kinds of bills in terms of the source of submission: bills from member(s) of the Diet (the House of Councilors or the House of Representatives), and bills from the Cabinet.

Article 41 of the current Constitution states: "The Diet shall be the highest organ of state power, and shall be the sole law-making organ of the State." It is generally understood that substantial law-making procedure that are supposed to be conducted exclusively by the Diet can be divided into four steps: origination, deliberation, decision, and promulgation (Ukai, 1956). Therefore, bills initiated by member(s) of the Diet are handled routinely. On the other hand, bills submitted by the Cabinet are generally based on Article 5 of the Cabinet

Law (not the Constitution), which states: "The Prime Minister, representing the Cabinet, shall submit Cabinet bills, budgets and other proposals to the Diet, and shall report to the Diet on general national affairs and foreign relations." In any case, both the organs, regardless of their legal basis (the Constitution or Cabinet Law), are legitimate and significant sources from the viewpoint of a parliamentary or representative democracy.

In reality, however, the number of bills submitted by member(s) of the Diet is considerably fewer than the number of bills submitted by the Cabinet. Moreover, the pass rate of Diet bills is extremely low (~16%) compared to the number of Cabinet bills passed (more than 90%) (see Table 3.1). This "rubber stamp" phenomenon is one of the most controversial problems of Japan's current political system; the Diet tends to pass virtually all bills proposed by the ministries rather than use government officials to form their own bills (Takami, 2003). Amendments to the Commercial Code are no exception. Almost all the amendments so far were planned and submitted by various ministerial and administrative organs.

Table 3.1 Comparison of bills from Diet members vs. the Cabinet (2000-06)

Diet Session	Bills submitted by Diet members			Bills submitted by Cabinet		
	Submitted	Passed	Pass Rate	Submitted	Passed	Pass Rate
165th Session in 2006	46	7 (28.0%)	15.2%	22	18 (72.0%)	81.8%
164th Session in 2006	72	14 (14.3%)	19.4%	94	84 (85.7%)	89.4%
163rd Session in 2005	28	7 (25.0%)	25.0%	24	21 (75.0%)	87.5%
161st Session in 2004	42	8 (25.0%)	19.0%	27	24 (75.5%)	88.9%
159th Session in 2004	84	15 (11.1%)	17.9%	127	120 (88.9%)	94.5%
157th Session in 2003	68	2 (22.2%)	2.9%	10	7 (77.8%)	70.0%
156th Session in 2003	114	16 (11.6%)	14.0%	126	122 (88.4%)	96.8%
155th Session in 2002	80	9 (10.3%)	11.3%	88	78 (89.7%)	88.6%
154th Session in 2002	115	16 (15.2%)	13.9%	106	89 (84.8%)	84.0%
153rd Session in 2001	76	13 (28.3%)	17.1%	35	33 (71.7%)	94.3%
151st Session in 2001	92	19 (17.0%)	20.7%	100	93 (83.0%)	93.0%
150th Session in 2000	45	12 (37.5%)	26.7%	21	20 (62.5%)	95.2%
Total	862	138 (16.3%)	16.0%	780	709 (83.7%)	90.9%

Source: Cabinet Legislation Bureau, <http://www.clb.go.jp/contents/all.html>, adapted by the author.

3.3 PLAYERS INVOLVED IN AMENDING THE COMMERCIAL CODE

The **Ministry of Justice**, responsible for administrative affairs concerning the Commercial Code and other related regulations, is the most important player involved in amending the law. Bills to amend the Commercial Code are generally drafted in the Ministry, proposed by the Ministry to a Cabinet Meeting that makes a decision, and then submitted to the Diet.

In the Ministry of Justice, the Counselor's Office in the Civil Affairs Bureau is responsible for affairs related to the Commercial Code, and most of the staff (including the Counselor who is chief of the group) are usually professional legal officials (prosecutors and judges) who have passed the Japanese National Bar Examination and are temporarily (normally a couple of years) transferred from the Public Prosecutors Office or one of the courts.

The Ministry of Justice does not consider the content of an amendment solely with its own bureaucrats. The **Commercial Code Committee** (replaced by the Corporate Code Committee in 2001) of the **Legislative Council** (which consists of scholars, lawyers, and industry representatives who are chosen by bureaucrats in the Ministry) had sufficient clout that almost all amendments before 1994 were made based on the decisions of the Committee. One reason why the Committee had such importance was because it was thought that fundamental laws like the Commercial Code were too complicated and influential to consider arguments from a ministry that might not have sufficient knowledge to make a proper decision. Still, the Committee was recently criticized for its slow deliberations; it was not unusual to take several years to finish drafting a single amendment.

The **Ministry of Economy, Trade and Industry** (METI, renamed from the Ministry of International Trade and Industry (MITI) in 2001) was also influential in make revisions to laws that affected industry. METI is (and MITI was) a huge administrative organ that consists of many bureaus that vary from regulating the toy industry to representing international trade (see Figure 3.2).

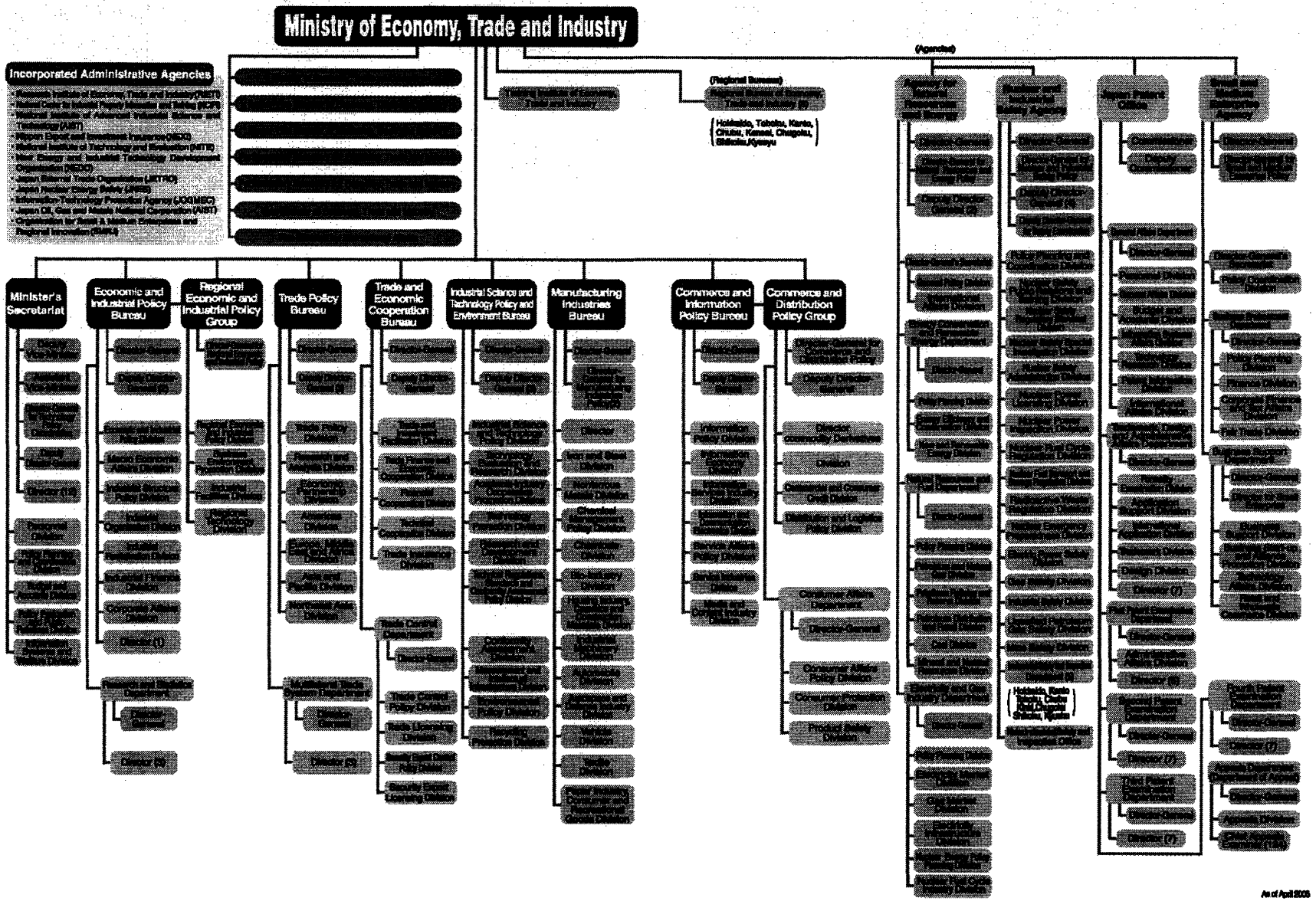

Fig. 3.2 Organizations of the Ministry of Economics, Trade and Industry

Source: "Introducing METI," METI, <http://www.meti.go.jp/english/aboutmeti/data/aOrganizatione/index.html >

There are generally two kinds of bureaus in the Ministry: (1) regulators for individual industries, and (2) horizontal policymakers. For example, the Manufacturing Industries Bureau is responsible for manufacturing industries including the automobile industry and the household appliance industry; the Trade Policy Bureau is in charge of planning Japanese trade policies including bilateral or multilateral diplomatic negotiations related to international trade.

The Ministry traditionally had strict policies as a regulator—controlling industry with various authorities of approval and permission and, in return, "protecting" from both general rules by other ministries that regulated horizontally and economic "intrusion" of foreign companies. For example, the Fair Trade Commission and its Anti-Monopoly Act were typical targets of MITI; the ministry enacted numerous exemptions from the Act by using its political clout in the government.[1] Moreover, at one time MITI guided its industries to create substantial cartels to help them recover from recessions—regardless of the Anti-Monopoly Act. The Ministry was famous for its aggressiveness and well known as the "notorious MITI."

However, after the collapse of the so-called "bubble economy" in 1990, MITI seemed to make an about-face with its macroeconomic policies. While protectionism was once useful and effective for fostering the immature Japanese economy after World War II, in the 1990s such protectionist actions would weaken the competitiveness of Japanese companies in today's borderless global economies. In fact, MITI took diametrically different actions, and began to take active leadership in planning a series of deregulation programs during the

[1] However, most exemptions were abolished during the deregulation movement (or "regulatory reform") of the 1990s.

Hashimoto[2] administration (1996-98) and thereafter. The Ministry itself abolished many regulations they had originally requested, in addition to pressing other ministries for deregulation.

MITI quickly took strong interest in general rules for corporate organization and corporate taxation that gave considerable influence to the activities and competitiveness of companies while aggressively giving voice to related ministries. Recently the Ministry has undertaken a variety of study groups on topics that essentially belong to other ministries' territories, including the Ministry of Justice and the Ministry of Finance. These study groups, like advisory councils in other ministries, usually consist of scholars and directors of major companies in Japan.

Among the Ministry bureaus, the Economic and Industrial Policy Bureau (formerly the Industrial Policy Bureau in MITI) is responsible for METI macroeconomic policy. The bureau has several divisions in charge of the Japanese corporate system, and the Industrial Organization Division (IOD) has taken the lead in advocating review of corporate organizational arguments including issues related to the Commercial Code and the Anti-Monopoly Act.

Kazuhiko Bando, former Director of IOD, talked about the characteristics of MITI industrial policy:

> Although there were many special regulations or treatments for specific industries in terms of legal systems or tax systems, people are becoming aware that these policies are out-of-date. . . . We have plenty of experience with discussing industrial policies with the United States, and today it is recognized that such government industrial policies as targeting and fostering specific industries have served their time. . . . We think that systems should be

[2] Then Prime Minister Ryutaro Hashimoto (1937-2006) was once the Minister of International Trade and Industry, and he had good relations with MITI bureaucrats. His father, Ryogo Hashimoto (1906-62), was a bureaucrat at the Ministry of Finance and among the members who drafted the first Anti-Monopoly Act in 1947 (thereafter he became a politician and the Minister of Health and Welfare).

> basically generalized. (MITI, 1998, original in Japanese, translated by the author)

The **Japan Federation of Economic Organizations** (JFEO) (renamed Japan Business Federation [JBF] following a merger with the Japan Federation of Employers' Associations in 2002) is also a stakeholder in legislating changes to the Commercial Code. While acting as a representative of large Japanese companies such as Toyota, Canon, and Nippon Steel, JFEO developed a variety of proposals and petitions concerning policies and regulations that it believed "adversely" affected economic activities.[3]

JFEO has had substantial participation in various legislation by sending its delegates from member companies to the Legislative Council at the Ministry of Justice. Furthermore, when JFEO does not think the official process is working well (for example, opposition from scholars or taking too much time for deliberations), it is not unusual that JFEO will work directly on politicians or other related ministries that are favorable to JFEO's opinions or proposals. In fact, since 1997 there have been many bills submitted by an individual politician and passed by the Diet (see Table 3.2). Those bills are usually initiated by JFEO petitions.

It is natural that **Politicians** should play a leading and central role in developing laws as members of the legislature. However, in reality they have made few contributions in terms of substantial content of laws. As mentioned earlier, the policies implemented by the Diet have been "rubber stamped" due to the limited investigational abilities of individual members of the Diet and little support from the Diet secretariat (the legal staff numbers only 70-80 people in each house, while thousands of bureaucrats propose policies in various fields)

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[3] JBF's membership of 1,662 is comprised of 1,351 companies, 130 industrial associations, and 47 regional economic organizations (as of June 2006).

(refer back to Table 3.1 for the current situation of bills submitted by Diet members and the Cabinet).

However, with strong support from industry (especially that of JFEO), several important revisions regarding deregulation of stock repurchase and reducing directors' liability, including setting a limit on shareholders' representation actions, have been made one after another recently.

Table 3.2 Recent revisions to corporate law (1)

Year	Main Issues	Remarks
1997 (1)	• Introduction of stock option system • Deregulation of stock repurchases (lifting the prohibition for purposes of a stock option plan) • Deregulation of stock repurchases (simplifying the procedure by which public corporations can repurchase shares from the market, or by way of a tender offer also known as a TOB)	Bill submitted by individual politician
1997 (2)	• Corporate restructuring (merger procedures)	Government-sponsored bill
1997 (3)	• Increasing penalties against company payments to corporate racketeers	Government-sponsored bill
1998	• Deregulation of stock repurchases (expanding available funds for a simplified procedure for public corporations)	Bill submitted by individual politician
1999	• Corporate restructuring: introduction of Share-to-Share Exchange and Share-transfer	Government-sponsored bill
2000	• Corporate restructuring: introduction of "demerger"	Government-sponsored bill
2001 (1)	• Deregulation of stock repurchase (completely abolishing prohibitions, lifting the ban on "treasury stock") • Deregulation of minimum size of shares • Simplifying procedures relating to reduction of statutory reserve fund	Bill submitted by individual politician
2001 (2)	• Authorizing electronic documentation of corporate information • Corporate finance (authorizing company to issue call options for its shares) • Simplifying procedures for stock options • Corporate finance (deregulation of issuance of various kinds of shares)	Government-sponsored bill
2001 (3)	• Corporate governance (authorizing limits on directors' liability) • Corporate governance (improving procedures for derivative actions)	Bill submitted by individual politician

Source: Fujita, 2004.

CHAPTER 4

INTRODUCING THE SHARE EXCHANGE SYSTEM TO THE JAPANESE COMMERCIAL CODE

4.1 INTRODUCTION

In this chapter, I discuss the story behind the introduction of the share exchange system to the Japanese Commercial Code. This amendment was the most important and influential change in the Commercial Code in several decades, and came about largely because of American corporate laws. This chapter details what caused the Japanese government to adopt this peculiarly American system and how the most recent transition of the Commercial Code was in fact triggered by the share exchange system.

4.2 ECONOMIC OVERVIEW

4.2.1 Economic Situation in the 1990s

Following the collapse of the Bubble Economy in 1990, the Japanese economy experienced an unprecedented and lengthy recession. Real economic growth dropped to 1.6%, compared to 3.8% enjoyed during the 1980s. Stock prices also were in the doldrums (see Figure 4.1). During the recession period, large-scale remedial policies—both monetary and fiscal—were exercised in order to avoid deflation; near-term interest rates decreased to almost zero, and Japan's financial deficit was the highest among major

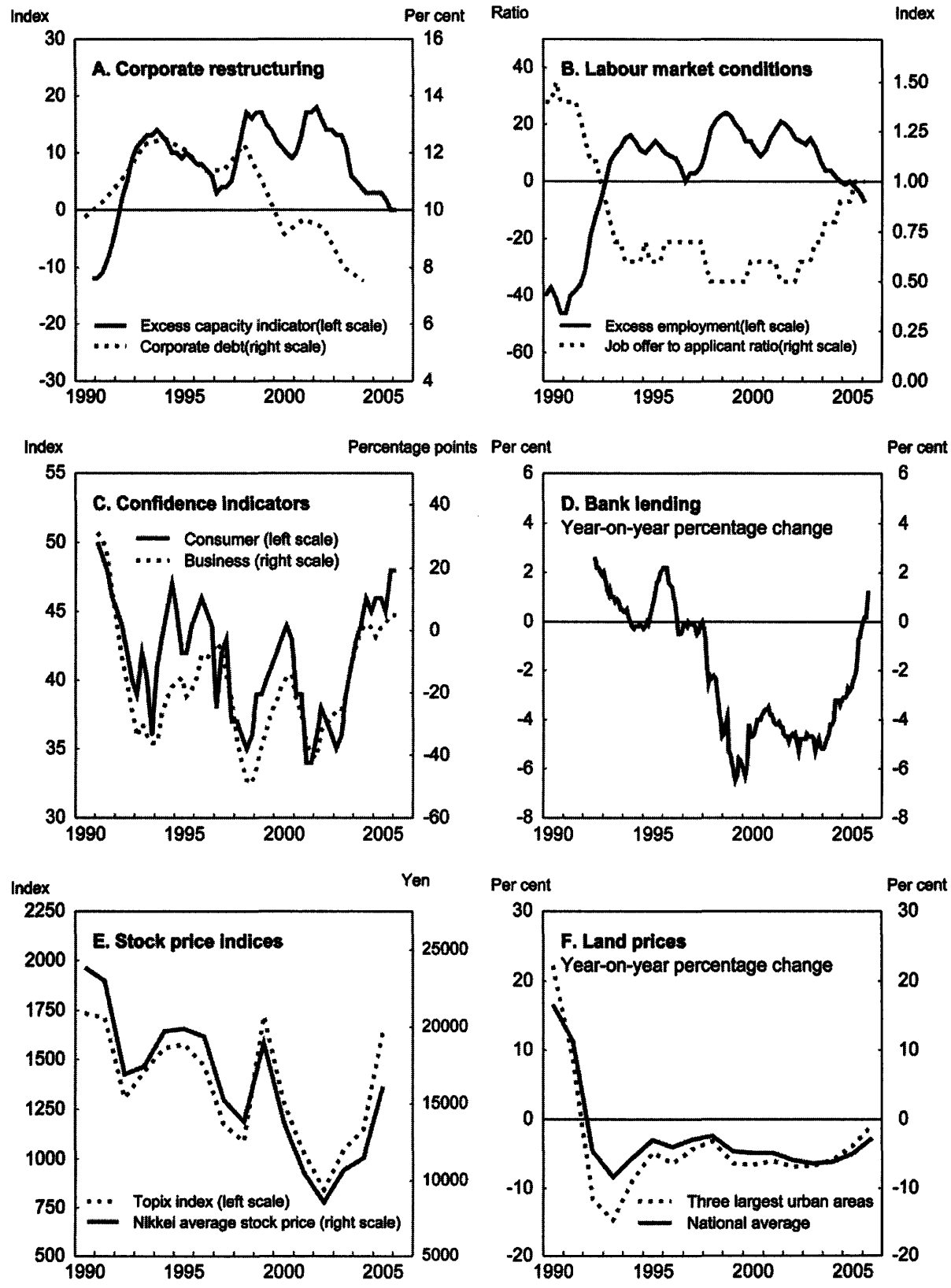

Fig. 4.1 Trends in the Japanese economy after 1990

Source: OECD. Economic Survey of Japan 2006.

developed countries. The recession continued for almost ten years, despite various fiscal measures, and in Japan this period is often referred to as "the lost decade."

Meanwhile, the global economy itself was changing dramatically. The market economy began to expand with the end of the Cold War era, and Asian countries such as China and South Korea were rapidly becoming strong economic forces. In these circumstances, Japanese companies were fighting for their survival. In particular, global companies were seeking the best platform for their activities, which often meant transferring their business bases, including production and even their headquarters, to countries that offered the most favorable economic environment. For them, the era of "companies choose their countries" seemed to have arrived.

The Japanese government was keenly aware of these changes in the business environment and sought various measures to increase the competitiveness of Japanese companies and, ultimately, to make the Japanese system attractive to any business entity, whether domestic or international.

4.2.2 Lifting the Ban on Holding Companies

As noted in Chapter 2, GHQ/SCAP of Occupied Japan dismantled the *zaibatsu* groups to prevent them from becoming similar economic entities in the future. Among a series of new laws for that purpose was the Anti-Monopoly Act, which prohibited the incorporation of holding companies. The original Anti-Monopoly Act (before the 1949 amendment) was one of the strictest competition laws in the world, even compared to its

"mother law"—U.S. antitrust laws. The original law prohibited not only holding companies (Article 9) but also prohibited the acquisition of other companies' shares (Article 10).[1]

Although both articles were amended, and the restriction on acquiring and holding shares was deregulated in 1949, the ban on pure holding companies[2] remained. There were several movements to lift this ban following the end of occupation, especially around 1965 and again in 1987 (MITI, 1995). However, these efforts accomplished little because the arguments for lifting the ban on holding companies were neither clear nor persuasive to the public.

A third movement began in 1992. One of the most influential Japanese business groups, the Japan Association of Corporate Executives (*Keizaidoyukai*), proposed a review of the Act. Subsequently, JFEO came up with similar suggestions in 1993 and 1994 (JFEO, 1993, 1994). These proposals emphasized the following points:

- the positive effects to be gained by making the most of the holding company systems in Europe and the United States
- the need to harmonize with foreign regulations that allowed holding companies
- Japanese companies would have an alternative for rationalizing management and enhancing competitiveness by adding flexibility to restructuring their corporate organizations.

Although these reasons were not much different from earlier arguments, the proposals seemed more convincing given the lengthy recession.

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[1] This regulation did not apply to financial companies such as banks and insurance companies.

[2] There were two kinds of holding companies under the earlier Anti-Monopoly Law regulations: pure holding companies and business holding companies. The former represented holding companies whose principal objectives were domination over other companies; the latter were all other holding companies other than pure holding companies.

Following these proposals from two non-government organizations, MITI began to discuss possible review of the Anti-Monopoly Law, and the Industrial Policy Bureau Study Group for Corporate Legislation was founded in November 1994. The study group consisted of famous legal scholars (for example, Professor Mitsuo Matsushita, a former member of the Appellate Body in the World Trade Organization, who was chairperson of the study group), lawyers, and directors of major Japanese companies (for instance, Toyota, Sony, Nippon Steel, and Mitsubishi Chemical). Vigorous meetings were held about twice a month, and the Group's final report was published in February 1995 (MITI, 1995).

In its final report, the Study Group explained the merits of introducing a holding company system, as follows:

1. Realize efficient corporate organizations to cope with diversification and multi-nationalization
   (1) Separate strategic group corporation management and operational management
   (2) Smooth personnel and labor management
   (3) Promote venture businesses and corporate ventures
2. Harmonize with other international legal systems
3. Corporate integration without organizational and personnel frictions.

These merits were similar to those found in previous proposals from financial entities, and the conclusion was also substantially the same—lift the ban on (pure) holding companies as soon as possible. However, transforming the private organizations' proposal to a public (governmental) recommendation brought significant differences from the original proposal, and the movement gradually spread throughout government. MITI aggressively coordinated

with the Fair Trade Commission and related politicians, especially the Liberal Democratic Party. Complete deregulation concerning holding companies was realized finally accomplished in 1997, and holding companies were once again allowed after being prohibited for 50 years.

The most remarkable characteristics of this amendment process were the heavy involvement of MITI. As mentioned earlier, MITI was aware of policy limitations for specific industries, so it became actively involved in the review process of other Ministry acts that regulate horizontally throughout many industries. Moreover, even if the ministry responsible for a certain regulation was reluctant to reconsider, MITI would aggressively press other ministries to convince them of the necessity for revision.

4.2.3 MITI's Growing Influence

As happened in the Anti-Monopoly Act, the Commercial Code also became a target for MITI. Recovering from the ongoing recession was the most urgent matter for the Japanese government. For that reason, making it possible for companies to reorganize their corporate structure flexibly was, at least from MITI's viewpoint, the most effective and sustainable way to regain the competitiveness of Japanese companies.

MITI began by encouraging the Ministry of Justice to review the Commercial Code to ensure that the language for merger procedures was "user-friendly." Although the Ministry of Justice and the Legislative Council had already put merger procedures on the agenda, MITI requested them to make the procedures more flexible and easier to use.

In order to gain support from legal scholars and industry, in 1995 MITI also set up a study group[3] to develop proposals for revising merger procedures, and the final report of the study group was published in July 1996[4] (MITI, 1996). The report sent a strong message to the Ministry of Justice from the viewpoint of practical business and, moreover, in a political context. Although MITI had no legal authority to revise the Commercial Code, the Ministry of Justice could not ignore these strong voices from industry, and MITI's tremendous clout in the political world. Indeed, the Ministry of Justice had far few connections with influential politicians compared to MITI.

The bill to revise merger procedures was passed by the Diet in 1997 with provisions that were generally satisfactory to both MITI and to industry. This amendment was a milestone for MITI, giving it considerable experience with the process for amending the Commercial Code, and becoming involved in the review process of the act.

4.3 THE NEED FOR NEW LEGISLATION

When the ban on holding companies was lifted in 1997, the Commercial Code did not have any procedures in place for creating holding companies. Theoretically, companies could set up holding companies in two ways. These two methods were called *Nukegara Hoshiki* (Empty Shell) and *Baishu Hoshiki* (Purchase Plan). However, both methods had defects (see Fujita, 1996; MITI, 1998; etc.).

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[3] MITI also invited officials from the Ministry of Justice who were in charge of the Commercial Code to join the study group meetings. MITI's intention was to add legitimacy to the study group. The Ministry of Justice agreed to send a deputy director-level person as an observer.

[4] The study group also surveyed industries' needs for "corporate separation" and argued for spin-offs, split-offs, and split-ups—referring to the American legal system for corporate separation. This final report became one of the most influential triggers for the 2000 amendment.

4.3.1 *Nukegara Hoshiki* (Empty Shell) Method

The first method involved:

- creating new companies (see Companies B, C, D in Figure 4.2)
- disposing of the existing company's (Company A's) businesses to the new companies (Company B, C, D) which were now wholly owned subsidiaries of Company A.

This method for establishing holding companies was called the "Empty Shell" method because a company that wanted to be a holding company would dispose of all its businesses to subsidiaries, thus becoming a shell organization without business operating divisions.

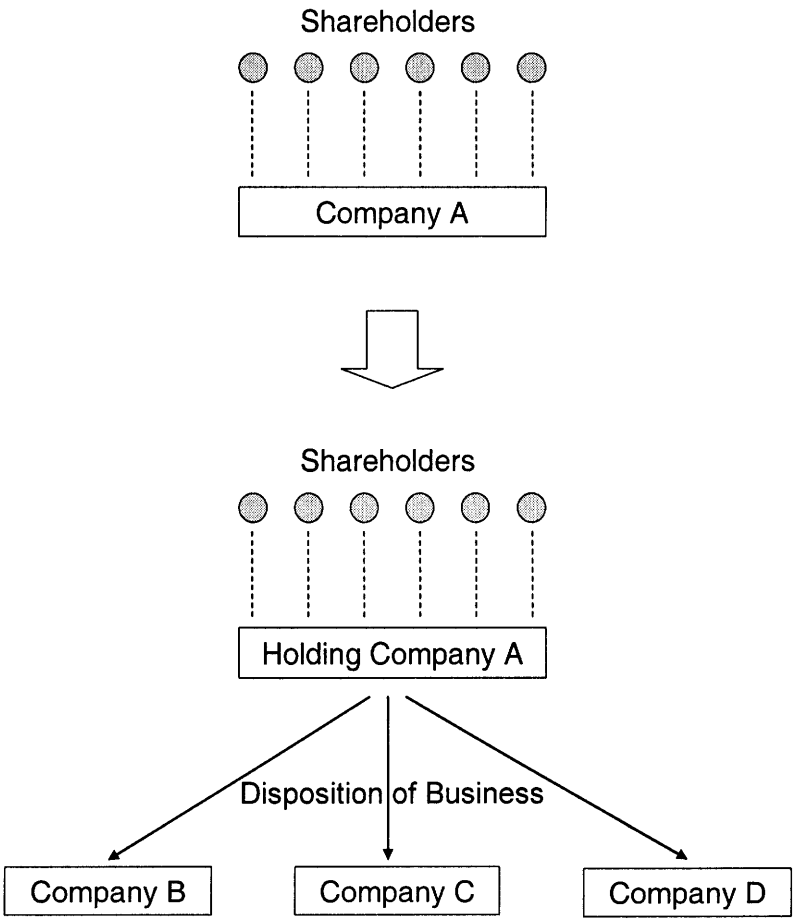

Fig. 4.2 Illustration of *Nukegara Hoshiki* method

Source: MITI, 1998. Adapted by the author.

However, business disposition as defined in the Commercial Code was not originally intended to be used for this type of corporate reorganization. Therefore, the following points are examples of shortcomings or problems for those who wanted to create holding companies:

- Investigation by an inspector, appointed by a court, was required to dispose of a business. However, it was not unusual for the investigation to take a couple months, and it was unpredictable.
- Business disposition was not treated as a corporate organizational action by the Commercial Code. Therefore, obligations could not be transferred as a package, and companies had to meet transfer requirements for every single asset or property.
- Existing businesses would be operated by different corporate entities, and additional licenses or approvals might be required by regulators in Japan and abroad.
- Disposition would be accompanied by a large amount of taxes (e.g., real estate acquisition tax, registration fee for real estate, securities trading tax, etc.).

4.3.2 *Baishu Hoshiki* (Purchase Plan) Method

The second method was simpler, as follows:

- Incorporate a new company as a holding company (see Company B in Figure 4.3).
- The new company (Company B) would purchase shares of the existing company (Company A).

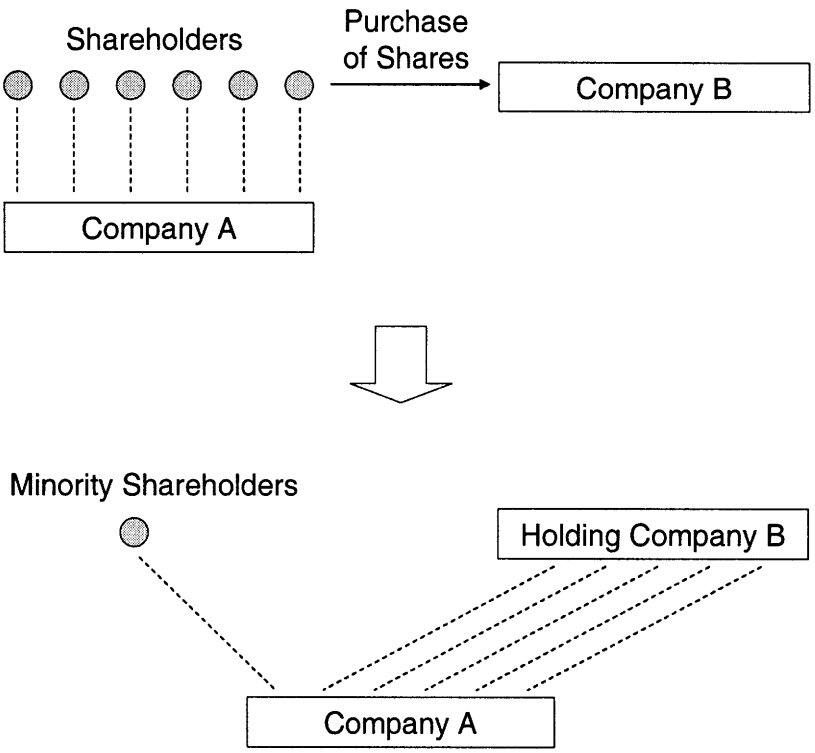

Fig. 4.3 Illustration of the *Baishu Hoshiki* method

Source: MITI, 1998. Adapted by the author.

The Purchase Plan method did not have the problems that were inherent in the Empty Shell method:

- The Purchase method did not involve disposing of business(es). Therefore, an inspector's investigation was not required.
- The legal corporate entities that operated their businesses were the same throughout the process of creating holding companies. Therefore, additional approvals or licenses were not required.

However, this method also had some shortcomings:

- Acceptance of an offer to purchase shares was solely dependent on the shareholders' free will. Therefore, the company could not predict whether the purchase would be successful or not.

- Even if the purchase was successful, there was the possibility that minor shareholders would remain. The existence of minor shareholders could hinder the smooth management of subsidiaries under the holding company.
- A large amount of financing was required for the purchase. It was neither efficient nor practical that huge funds were required just for reorganization.
- Shareholders who sold their shares to the future holding company have to pay taxes on their profits that were calculated by subtracting the original purchase price from the selling price to the company. This made shareholders reluctant to sell their shares.

Although the third problem could be avoided by using the future holding company's stock instead of cash, the first and second points were critical for most companies that hoped to become holding companies at the time.

Each method for creating holding companies had its own defects, although it was not impossible to use either method. Most businesses thought the Empty Shell method was practical if the disposition of businesses was treated as a corporate organizational action under the Commercial Code. However, that would require a thorough review of related provisions in the Commercial Code to ensure consistency between the new treatment and the existing system. This kind of review would take a long time, and industries could not wait for that.

The most critical problem with the Purchase Plan method was the possibility of remaining minor shareholders. If companies could force shareholders to exchange their

shares for something with virtually the same value (e.g., securities), this method could be a promising way to create holding companies.

However, the Japanese Commercial Code traditionally views shareholders as essential constituents of a company, so shareholders could not be squeezed out against their will. German law (the "mother law" of the Japanese Commercial Code) had no provisions concerning expulsion of a company member. They could be expelled only when *magna culpa* conditions existed, and a court permit was required for expulsion (Nakahigashi, 1999). Consequently, the Japanese Commercial Code also did not have provisions for expelling shareholders in joint stock corporations. It would require a drastic change in the ideology that determined the nature of shareholders in order to introduce the Purchase Plan method.

4.4 INTRODUCTION OF THE SHARE EXCHANGE SYSTEM

When the ad hoc consulting agency published its final report in 1995, MITI was not fully aware of the problems discussed in Section 4.3. The final report stated that it *might* be necessary to consider introducing a corporate separation system to the Commercial Code in order to create holding companies (MITI, 1995). However, that point was presented as an additional note, rather than a strong proposal or recommendation.

The final report mainly emphasized that no urgent problems or concerns over shareholders' rights would occur by lifting the ban on holding companies. This implied that MITI thought the Anti-Monopoly Act should be reviewed as soon as possible without thorough consideration of the issues in the Commercial Code. At that time, MITI was afraid long delays might occur if there were broad issues for discussion.[5]

[5] In the Japanese bureaucrat's world, this is a typical way of ignoring problems: point out arguments and at the same time regard them as intermediate or long-range issues.

After the Anti-Monopoly Act was amended in 1997, many companies made plans to adopt the holding company system. But as they began to think about the specific steps for transition, they gradually realized there were many difficulties in creating holding companies given the existing provisions of the Commercial Code.

In comparison, the reorganization of Nippon Telegraph and Telephone Corporation (NTT), Japan's largest telecommunication company, encountered few problems. The reorganization was scheduled in 1999 by the government as the first major transition to a holding company system. Although the reorganization was designed to use the Empty Shell model, no problems came to the surface. Because NTT was virtually a stated-owned company and incorporated by a special act,[6] the government amended the act to facilitate the reorganization, and most of the problems in the Commercial Code and the tax laws were solved by legislation. No other companies would have received similar benefits.

Some companies that were planning to introduce the holding company system tried to convince the related ministries that additional review of the Commercial Code and the tax laws would be necessary to ensure a smooth transition to holding companies.

4.4.1 Set up a New Study Group[7]

The Industrial Organization Division (IOD) of the Industrial Policy Bureau, which was responsible for corporate organizational policies at MITI and was the most influential driving force for lifting the ban against holding companies, received petitions from many

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[6] The Nippon Telegraph and Telephone Corporation Law (renamed afterward to the Law concerning Nippon Telegraph and Telephone Corporation, etc. by the amendment in 1997 for the reorganization of NTT)

[7] The following details were derived from interviews with officials at MITI. Their names must remain anonymous for reasons of confidentiality.

companies and business circles. In the beginning, the IOD had no specific ideas as to directions of review, but it was becoming aware of the need.

In 1997, a general manager of one of the largest banks in Japan visited the IOD and presented a unique idea—the share exchange system, which was, according to his explanation, widely adopted by many states in the United States. Although he had already called on the Ministry of Finance, he did not get a promising answer. So the bank petitioned other ministries that showed an interest in a new method for creating holding companies. MITI was the first target of the bank.

Creating a holding company using the share exchange system involves the following steps:

- Incorporate a new company to be a holding company (see Company B in Figure 4.4)
- Sign a share exchange contract (between Company A and Company B)
- Transfer all of Company A's shares from the previous shareholders to the new Company B
- Issue shares of the new company (Company B) to previous shareholders of the older company (Company A).

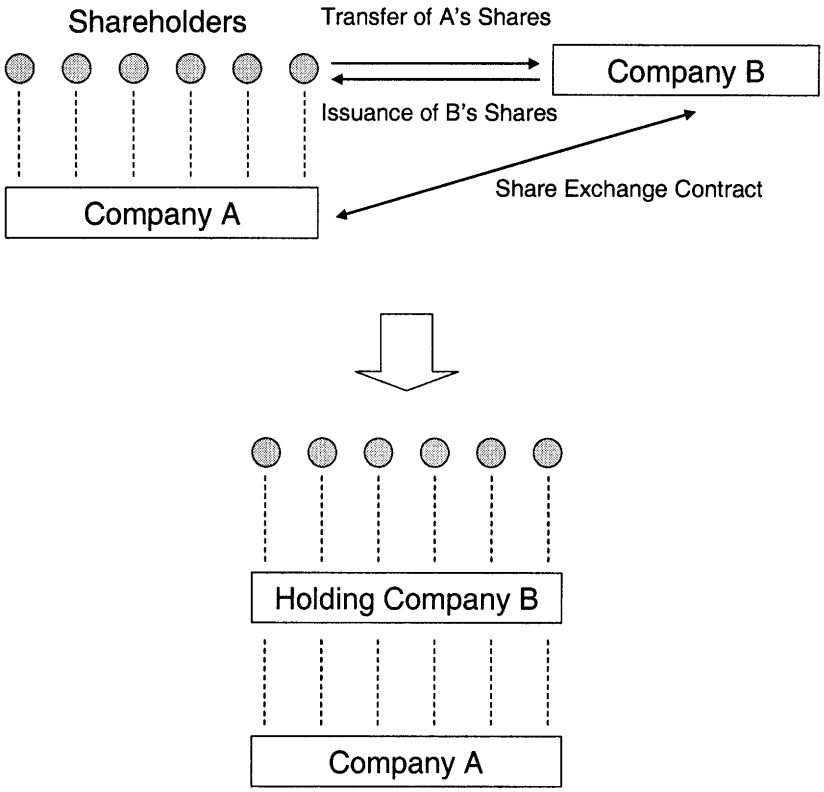

Fig. 4.4 Creating a holding company using the share exchange system

Source: MITI, 1998. Adapted by the author.

The share exchange system was relatively unknown to the Japanese, even to scholars of commercial laws in Japan; naturally, the division also did not know anything about the system when the bank made its presentation. There was really only one paper[8] that referred to this peculiarly American system. It was written by Masafumi Nakahigashi, an associate professor at Nagoya University, who had been a visiting scholar at the University of California, Berkeley in 1992-93.

As described earlier, an advisory council formed in each ministry played a major role in the Japanese lawmaking process. Although the council's final report was normally drafted

[8] Masafumi Nakahigashi, "Amerikahojo no sankakugappei to kabushikikokan [Triangular Merger and Share Exchange in American Laws]," *Chukyo Hogaku,* vol. 29. no. 2 (1994): 1-54. Although one or two other papers mention the share exchange system, they just refer to Nakahigashi's paper.

by the council secretariat, bureaucrats in the secretariat generally respected the theories and ideas of the members. As far as the legislation was concerned, whether a scholar was a member of the related advisory council or not made a big difference in terms of influence on policies of the ministry. And most members of advisory councils were often professors at the University of Tokyo. Therefore, Nakahigashi's paper, which proposed the introduction of the share exchange system to the Japanese Commercial Code, did not become the focus of attention from the political point of view regardless of whether the paper had any academic value or not.

Nevertheless, the Industrial Organization Division decided to explore the possibility of adopting the share exchange system into the Commercial Code. In July 1997, soon after the presentation, MITI set up a new study group to look into how to create a holding company. Although Nakahigashi was not a member of the study group, his paper had a significant effect on the arguments in the study group.[9]

4.4.2 Study Group Discussions

From the beginning, the group focused on the feasibility of introducing the share exchange system to the Commercial Code. While all industry members completely supported the proposal, the scholar members were not unanimous. At the first meeting, one scholar insisted that the mandatory share exchange was a breach of shareholders' property rights, which were secured by the Constitution.[10]

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[9] Why MITI did not invite Nakahigashi to join the study group is not clear. While members of advisory councils were often professors at the University of Tokyo, it was not unusual that members of lower-level study groups or working groups were from other universities or colleges. In fact, in this study group none of the scholars, including the chairperson, were professors at the University of Tokyo.

[10] This remark can be found in the official minutes of the study group distributed during the second meeting on September 18, 1997. It shows that no members, including scholars, agreed with this opinion.

The controversy arose fundamentally from different views on the nature of shareholders. In addition, from the law and economics points of view, the argument might be paraphrased into a more general question: Which is more preferable for securing shareholders' property rights—the so-called property rules or the liability rules? (Calabresi and Melamed, 1972). If one believes shareholders are entitled to be essential members, and their rights cannot be encroached (which implies that property rules should be applied), mandatory exchange of shares becomes a breach of constitutional rights and should not be allowed. On the contrary, if one believes that stocks are just securities that enable one to receive some value from a specific company (which is consistent with liability rules), even a mandatory share exchange could be allowed if the value of each share is essentially equal.

These law and economics viewpoints are particularly popular in the United States and should not be easily expanded to analyzing legal differences between countries. However, traditional German origin theories, which were adapted for Japan, often prefer property rules; in contrast, the recent liberalization of the Commercial Code (strongly affected by American legislation) is rather consistent with liability rules. We can see some transition from continental laws to common laws here.

In any case, the opposition platform, based on a conservative view of shareholders' rights, was not backed by any of the other members. They did not think the introduction of a share exchange system to the Japanese Commercial Code caused any constitutional issues. The discussion focused again on specific procedures and requirements of the share exchange system for creating holding companies. After six meetings, in February 1998, the study group

announced its final report, which included the detailed model bill for the amendment to the Commercial Code.[11]

4.5 THE FINAL REPORT OF THE MITI STUDY GROUP

The final report of the study group was structured as follows. First, the final report analyzed the pros and cons of each existing method for creating holding companies and explored related legislation in a few foreign countries (the United States, Britain, and Germany), searching for the most effective and efficient methods for Japan. Second, the report noted how shareholders' rights were affected by transforming into a holding company and it examined the validity for boosting those rights. Finally, the report recommended immediate introduction of the share exchange system to the Commercial Code.

The first chapter of the report, which examines five foreign systems, contains the key logic for revising the Commercial Code (and is most relevant to this thesis):

- American systems
  - Triangular merger
  - Share exchange
- British systems
  - Scheme of arrangement
  - Compulsory acquisition
- German system
  - *Eingliederung* (Integration)

Among these five systems, the final report concluded that the British systems and the German system were not appropriate due to their excessively severe requirements. The final

[11] The final report titled "*Mochikabu kaisha wo meguru Shoho jono shomondai [Issues of the Commercial Code Concerning Holding Companies]*" was published by MITI in April 1998.

report subsequently evaluated the remaining two systems: triangular merger and share exchange.

4.5.1 Triangular Merger

A triangular merger is a uniquely American system, as is the share exchange system. Figure 4.5 illustrates the creation of a holding company utilizing the triangular merger, [12] which includes the following stages:

- Incorporate both a new company as the holding company, and its subsidiary (see Company B [the future holding company] and Company C [the future business operating company under the holding company] in the figure).
- Merge the existing company (Company A) and the newly founded business operating company (Company C).
- Issue shares of the new company (Company B) to the previous shareholders of the original company (Company A) as compensation for the merger.

[12] The following description outlines a "reverse" triangular merger. The other option, in which the existing company (Company B in Fig. 4.5) is to be dissolved, is called a "forward" triangular merger. Both methods are allowed in all states' laws in the US (MITI, 1998; Nakahigashi, 1999).

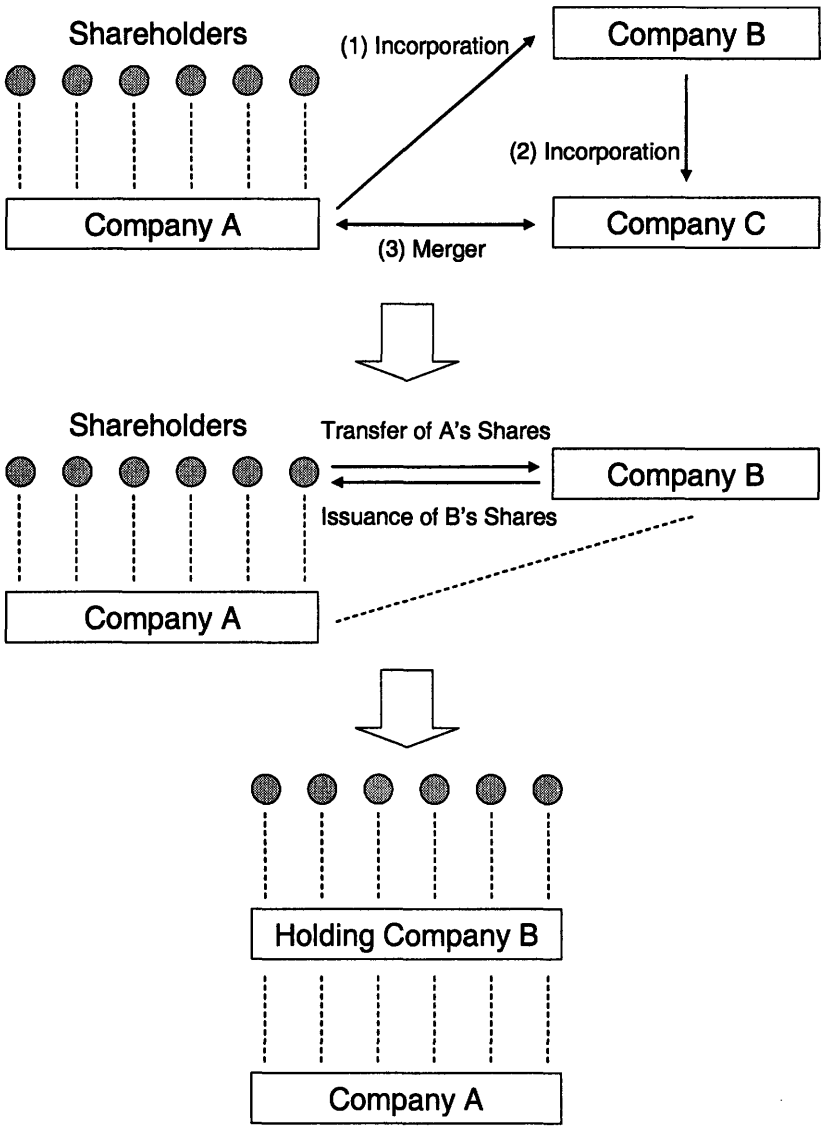


Fig. 4.5 Creating a holding company using the triangular merger

Source: MITI, 1998. Adapted by the author.

The triangular merger was enabled by allowing the use of cash or other considerations for a merger. This was first done via an amendment of the New York Business Corporation Law in 1961, while Delaware state law added similar provisions in 1967. Subsequently, the Model Business Corporation Act, introduced by the American Bar Association in 1969, included deregulation provisions, and corporation laws in other states followed that model in relaxing their restrictions of consideration for mergers (Nakahigashi,

1999). The Model Business Corporation Act, which was most recently revised in June 2005, defined this point as follows:

> **§11.02. MERGER**
> (c) The plan of merger must include:
> (3) the manner and basis of converting the shares of each merging domestic or foreign business corporation and eligible interests of each merging domestic or foreign eligible entity into shares or other securities, eligible interests, obligations, rights to acquire shares, other securities or eligible interests, cash, other property, or any combination of the foregoing;

Note that, based on this Article, companies can use not only survivor's shares but virtually anything of value as consideration for mergers. This enabled companies in the United State to utilize triangular mergers to form holding companies—a flexibility that did not exist in the civil law of other countries such as Germany, France, and Japan.

In Japan, the Japanese Commercial Code in those days prohibited (or was interpreted as prohibiting) the following actions that were thought to be indispensable to the use of triangular mergers:

- Possession of the parent company's shares by its subsidiary
- Using shares other than survivor's shares or cash as consideration for a merger.

These two restrictions prevented companies in Japan from conducting any kinds of triangular mergers.

4.5.2 Share Exchange

The share exchange, described briefly in the last section, was originally added to the New Jersey Statutes in 1967, and was also included in the Model Business Corporation Act in 1976. The system became gradually widespread among the other states' laws.[13]

According to American Bar Association comments about the Act, one of the objectives of this system is the following:

> It is often desirable to structure a corporate combination so that the separate existence of one or more parties to the combination does not cease although another corporation or other entity obtains ownership of the shares or interests of those parties. This objective is often particularly important in the formation of insurance and bank holding companies, but is not limited to those contexts. In the absence of the procedure authorized in section 11.03 [SHARE EXCHANGE], this kind of result often can be accomplished only by a reverse triangular merger, which involves the formation by a corporation, A, of a new subsidiary, followed by a merger of that subsidiary into another party to the merger, B, effected through the exchange of A's securities for securities of B. Section 11.03 authorizes a more straightforward procedure to accomplish the same result. (Emphasis added by the author) (ABA, 2005)

Due to this historical background, countries other than the United States that had no similar provisions for triangular merger also did not have the share exchange system.

4.5.3 Study Group Conclusions

After exploring the laws enacted in various other countries, the final report concluded that the introduction of a share exchange system was the most effective way to facilitate the creation of holding companies. As the ABA commented about the Model Business Corporation Act, the share exchange system is more straightforward. In addition, it did not require making exceptions to the principles for considerations in merger procedures. Most

[13] According to the Model Business Corporation Act annotated (3rd ed.), 43 states' laws had adopted the share exchange system by 1995.

members of the study group thought there was no need to change traditional principles just to facilitate its objective—making the creation of holding companies easier—and that the more the amendment remained fundamental, the fewer objections there would be among people, and especially in discussions in the Diet.

The most interesting and significant point in the study group's report was that very few members had a negative view of this uniquely American system, and they thought adoption of the share exchange system would not cause any inconsistencies with the existing German-based codes.

4.6 REALIZATION OF THE AMENDMENT

After announcing its final report, MITI began to negotiate with related government ministries, especially the Ministry of Justice and its advisory council. As MITI did when its first study group was held in 1995-96, the ministry invited an official from the Ministry of Justice to this study group as an observer and several unofficial discussions were held between the two ministries. Moreover, MITI knew that the Ministry of Justice was fully aware of the aggressive desire of politicians in LDP to revise the Commercial Code, which was vividly demonstrated in the amendment processes in 1997 and 1998 for deregulating stock repurchase. Therefore, the Ministry could not ignore the political powers of MITI and JFEO, which strongly supported the introduction of the share exchange system. If the Ministry rejected the idea, JFEO would aggressively lobby the politicians, and MITI would wheel and deal behind the scenes.

Other ministries in the government paid little attention to the share exchange system. Although most of industries under their authority (for example, the financial industry under

the Ministry of Finance and the pharmaceutical industry under the Ministry of Health and Welfare) had an interest in the share exchange system, those ministries did not have to do anything because MITI had taken the lead in introducing a system that would affect all industries by amending the Commercial Code, rather than creating special-purpose laws for only the industries under MITI. Furthermore, introduction of the share exchange system did not step on the toes of these ministries, which was the most important concern for the ministries.

Therefore, it was not difficult to coordinate the various government entities. The Three-Year Program for Promoting Deregulation, which would facilitate the entire regulatory reform plan, was decided by the Cabinet on March 31, 1998. It included plans "to consider the share exchange system for making possible to facilitate transforming existing companies into holding companies, to publicize the intermediate result of the consideration by the first half of FY 1998, and to take necessary measures after forming a conclusion as soon as possible."

Thereafter, the Legislative Council at the Ministry of Justice submitted its final report, which contained the outline of a bill adding the share exchange system to the Commercial Code on February 16, 1999.

Furthermore, the proposed plan in the final report, which included introduction of the share exchange system, was somewhat extended in comparison with the recommendation of the study group at MITI. The reason for this was that the chairperson of the Commercial Code Committee under the Legislative Council insisted that a more straightforward way to create a new holding company should be included, in addition to introducing the share exchange system, and there were no objections among the committee members.

The newly proposed procedure was called the *share transfer system*, and the stages for creating a holding company utilizing the share transfer system were the following:

- Planning to incorporate a new company as a holding company (see Company B in Figure 4.6)
- Endorsement of the share transfer plan by a shareholders' meeting at the company (Company A)
- Transfer all shares (Company A's shares) from the previous shareholders to the new company (Company B)

This procedure cannot be found in any commercial codes or corporate acts in any other country, including the United States. The Japanese Commercial Code was taking a big step forward.

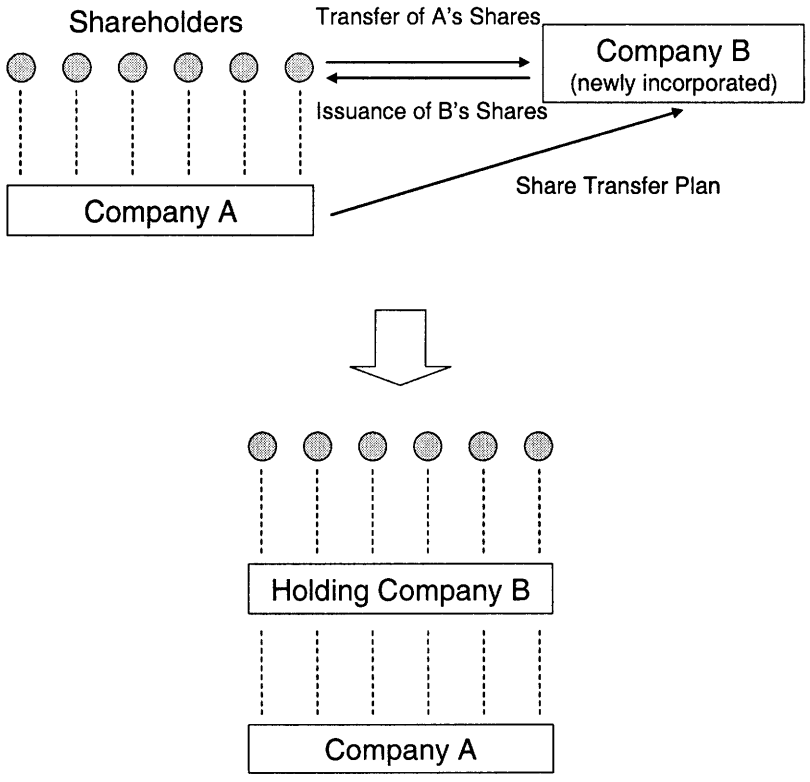


Fig. 4.6 Creating a holding company using the share transfer system

Source: MITI, 1998. Adapted by the author.

The Ministry of Justice drew up a bill to amend the Commercial Code based on the final report of the council, and submitted it to the Diet on March 10, 1999. Subsequently, the Diet passed the bill on August 9, 1999. This dramatic change to one of the most traditional and fundamental laws, only came about after nearly two years of consideration once MITI set up the study group in July 1997. The relatively speedy delivery of this amendment by the Cabinet had never been seen before in Japan, and was marvelous considering that the Japanese people were previously totally unfamiliar with the share exchange system.

4.7 CONCLUSION

It was a symbol of the times that the introduction of the share exchange system to the Japanese Commercial Code was led by MITI, which had transformed itself from "notorious MITI" to the moving spirit that aggressively promoted deregulation in a wide range of fields. MITI believed that competition, not protection, would give Japanese companies greater competitiveness and economic power, and that the government should adopt policies that would basically allows companies to be free in their economic activities unless specific problems arose. The ministry took the lead in reforming the Japanese regulatory systems from prior restrictions to *ex post facto* countermeasures.

In terms of their commercial codes or corporate laws, continental laws historically adopted strict restrictions, while American laws allowed companies to be relatively free, with flexibility of mergers as a typical example. The Ministry of Justice and some conservative scholars tended to think that strict regulations were necessary to protect company stakeholders. One reason for this tendency was traditional beliefs derived from German laws that had dominated policies in Japan. Traditional council members also thought that old

corporate scandals supported the need for such regulations as well. Furthermore, they believed that fundamental laws like the Commercial Code should be "stable" in order to ensure people's trust in the legislation; they thought that complete coordination with related laws should be required, which that would take a long time to achieve.

Despite these leanings, MITI believed that imposing strict administrative restrictions was already out-of-date, and that the government should introduce best practices from other countries. The ministry thought the first priority should be flexibility for solving the problems facing Japanese society.

As a result, systems in the United States (whose economic powers could not be denied by anyone) were the most influential models for the ministry. Introduction of the share exchange system became the first step for MITI and, from that time on, MITI (and its successor, METI) were actively involved in revising the Commercial Code, believing that preparing as many choices as possible in the corporate law and letting companies choose freely from them would maximize corporate vitality and the Japanese economy as a whole. The lengthy depression following the collapse of the Bubble Economy pushed from behind, while the urgent voices of politicians and industries overcame the concerns of some conservative scholars.

This was the beginning of the metamorphosis of the Japanese Commercial Code.

CHAPTER 5

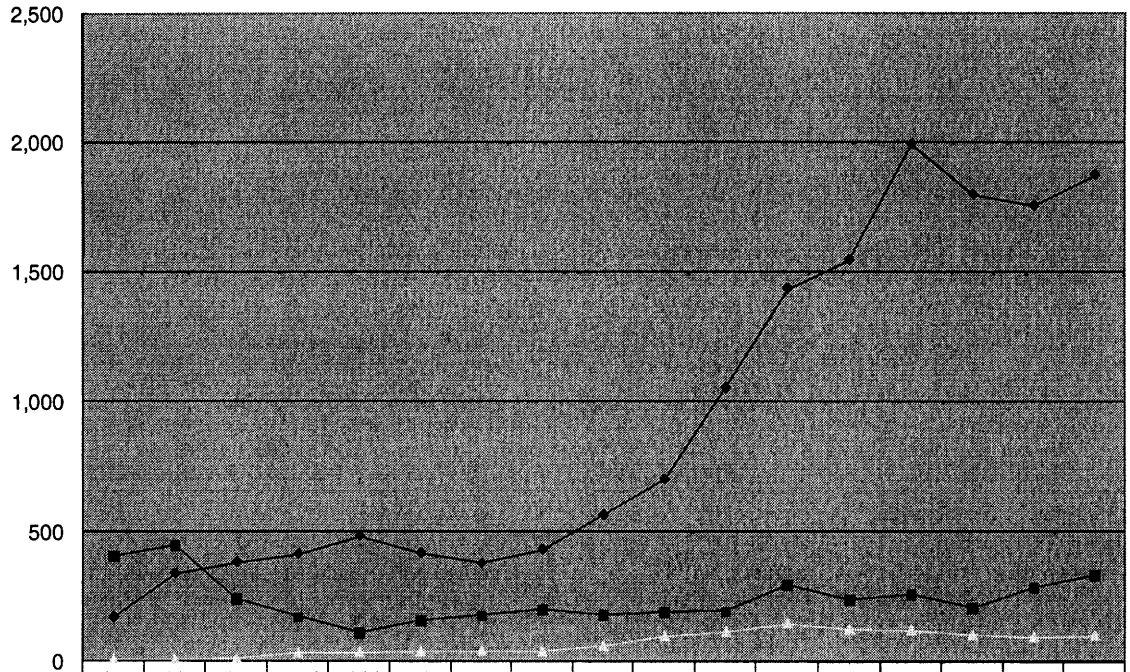
THE ECONOMIC IMPACT OF AMENDMENTS TO THE JAPANESE COMMERCIAL CODE

5.1 INTRODUCTION

It would, of course, be meaningless to amend the Commercial Code to improve the environment for corporate activities if the new systems introduced by amendments were never used. This chapter discusses the economic impacts of the amendments in recent years.

5.2 IMPACT ON MERGERS AND ACQUISITIONS

According to recent statistics, the number of mergers and acquisitions (M&As) in Japan increased dramatically after the adoption of the amendment in 1999 (see Figure 5.1).



	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
IN-IN	172	341	385	417	486	421	381	433	567	703	1,05	1,43	1,54	1,99	1,79	1,75	1,87
IN-OUT	408	450	246	174	112	159	179	203	182	192	194	298	239	260	209	286	333
OUT-IN	10	9	12	33	36	38	42	38	60	97	115	146	125	121	102	95	101

Fig. 5.1 Trends of M&As in recent years

Note: Figures include IN-IN type mergers (M&A between Japanese companies); IN-OUT type (M&A of a foreign company by a Japanese company), and OUT-IN type (M&A of a Japanese company by a foreign company)

Source: Nomura Securities, 2006.

As the figure shows, the total number of M&As was consistently below 1,000 until 1998, but beginning in 1999, the situation changed dramatically. The IN-IN type of M&As increased significantly, and in early 2000s, had almost tripled compared with the 1990s. The number of OUT-IN type of M&As also grew steadily, while the IN-OUT type of M&As decreased during the recession.

Generally speaking, the motives for M&As are economies of scale, economies of vertical integration, and other purposes, as shown in Table 5.1.

Table 5.1 Motives for mergers and acquisitions

Motives	Example
1. Economies of Scale	Chevron & Texaco, HP & Compaq
2. Economies of Vertical Integration	
3. Complementary Resources	Utah Power & PacifiCorp
4. Surplus Funds	
5. Eliminating Inefficiencies	Martin & McConnell
6. Industry Consolidation	Banking Industry in U.S.A., U.K., and Japan
(7. To Diversify [*benefits are dubious*])	
(8. Increasing Earnings per Share [*benefits are dubious*])	
(9. Lower Financing Costs [*benefits are dubious*])	

Source: Brealey, Myers, and Allen, 2006. Adapted by the author.

Considering these motives, recent trends in Japanese M&As can be explained by the following:

- Foreign investors became aware that Japanese companies were relatively undervalued due to the Japanese people's pessimistic view of the future during the recession. Thus, Japanese companies were good bargains. Example: the purchase of the bankrupt Long-Term Credit Bank of Japan by the American private equity firm Ripplewood Holdings.
- On the other hand, Japanese companies were less willing to invest in foreign countries due to a lack of funds, although they had aggressively bought assets or companies abroad during the Bubble Economy, aiming for economies of scale or vertical integration. Example: the acquisition of CBS and Columbia Pictures Entertainment by Sony.
- During this period, Japanese companies were especially motivated by a desire to

eliminate inefficiencies in order to survive the lengthy recession. So they were forced to reorganize not only their group companies but also other companies with which they had no business relationship or capital affiliation within their industries.

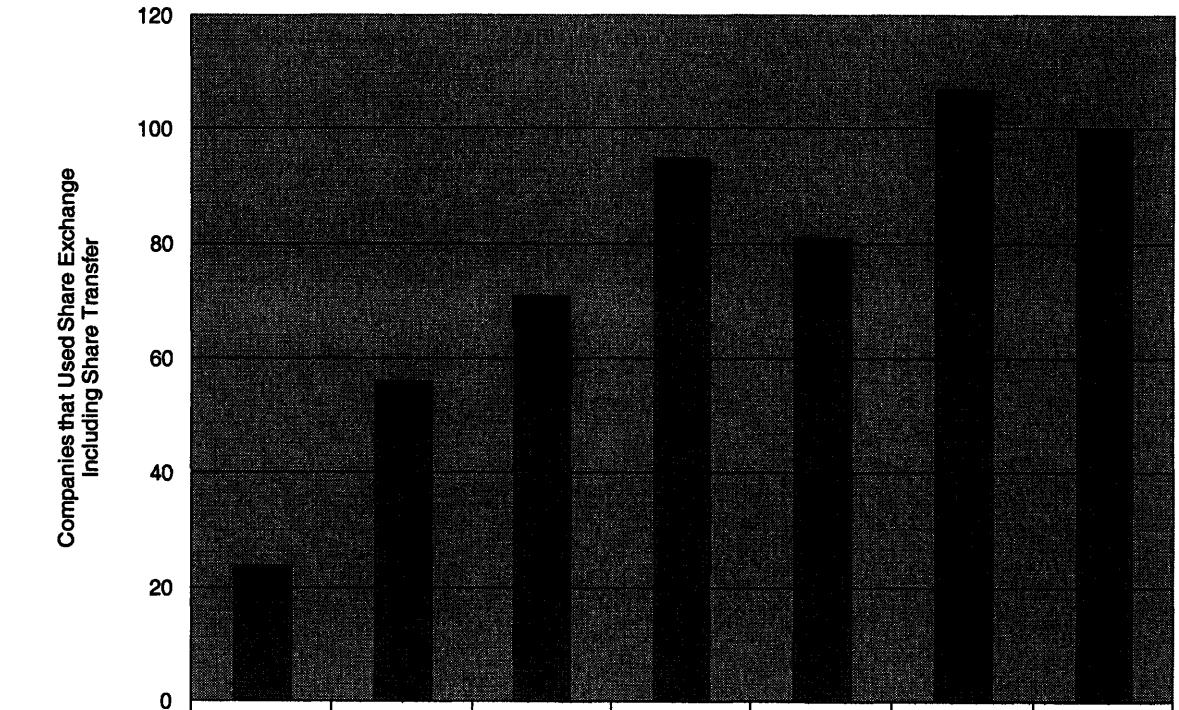
And indeed, the last one was precisely the aim of the Japanese government: to promote these reorganizations in order to restore competitiveness to Japanese companies. Lifting the ban on holding companies occurred in 1997, and soon thereafter the share exchange system (including the share transfer system), which would help facilitate creation of holding companies, was introduced in 1999.

As the statistics in Figure 5.1 show, although the number of M&As did not increase much after amendment of the Anti-Monopoly Act, the number increased dramatically following introduction of the new share exchange and share transfer systems into the Commercial Code. However, the Japanese government did not take into account the OUT-IN type of M&As at that time. These new systems were implemented as procedures in the Commercial Code that did not apply to foreign companies. Therefore, the introduction of the share exchange system did not affect the number of M&As by foreign companies.

Furthermore, the share exchange system was not designed merely to create holding companies. The amended Commercial Code said simply that "a company may effect a share exchange to become a company . . . that owns the total number of the issued shares of another company" (Article 352 of the Commercial Code). Therefore, any company could make plans for a share exchange not just to create holding companies but also to acquire other companies using the acquirer's shares. Soon companies were using their shares like "currency" for M&As—and to legally squeeze out their minority shareholders. For instance, NTT, which had little experience in international communication services, wanted to acquire

International Digital Communication Corporation (IDC), one of the largest international telecommunication operators in Japan, in the spring of 1999, by using the forthcoming share exchange system.[1] This attempt did not succeed because the British competitor, Cable and Wireless (C&W), had threatened "political problems" between governments as part of their negotiations. However, most executives and employees in IDC had hoped to be acquired by a Japanese company, especially NTT, with which IDC historically had a close relationship since its founding. Despite NTT's failure to acquire IDC, the attempt symbolized the new era of M&As in Japan: Japanese companies could acquire other companies without raising large amounts of money, something U.S. companies had been able to do for some time. With these benefits, the use of the share exchange system increased steadily after the 1999 amendment (see Figure 5.2).

[1] Nihon Keizai Shinbun reported NTT's attempt in an article titled "*IDC baishu, kabushiki koukan wo katsuyo. NTT, C&W ni taiko.[NTT, confronting C&W, attempts to utilize share exchange system to acquire IDC],* " April 15, 1999.



	1999	2000	2001	2002	2003	2004	2005
Share Transfer	6	10	18	11	13	6	13
Share Exchange	18	46	53	84	68	101	87

Fig. 5.2 Growth of share exchange and share transfer

Source: Nomura Securities, 2006. Adapted by the author.

The Japanese government continued to review corporate organization regulations even after the introduction of the share exchange system because the goal of the government, especially METI, was to give companies as many alternatives as possible for corporate reorganization. As a part of this move, corporate separation procedures, including spin-offs, split-offs, and split-ups, were introduced in 2000 to solve the problems of the *Nukegara Hoshiki* (Empty Shell) method. Figure 5.3 shows trends in corporate separations.

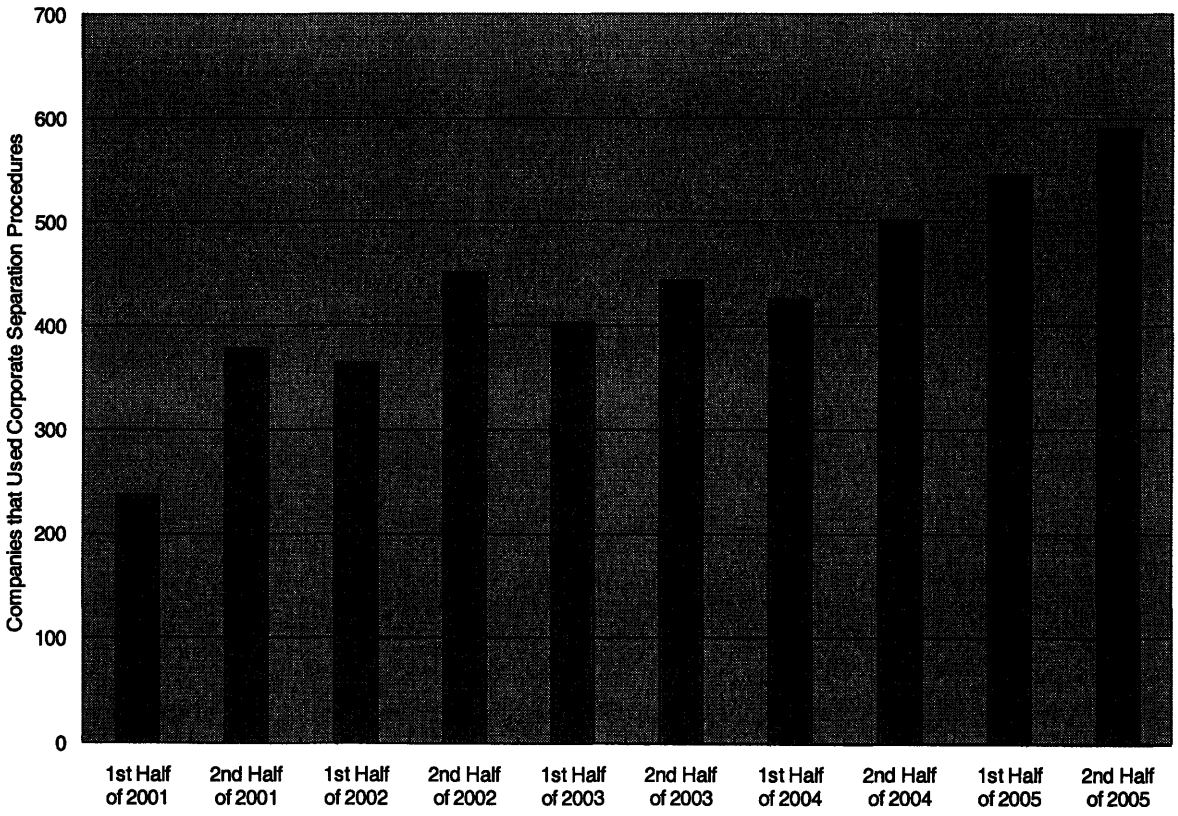


Fig. 5.3 Trends in corporate separation

Source: Tokyo Shoko Research, 2006. Adapted by the author.

During studies that sought methods for creating holding companies, it was believed that the introduction of a corporate separation procedure would take a long time due to conservatism in the Ministry of Justice and the Legislative Council. This anticipated tardiness was one reason why the share exchange system, which was accepted with little controversy compared to the corporate separation procedure, was the first priority. However, their wariness of the revision of the Commercial Code was completely changed through 1999 amendment process, and this led to the swift introduction of the corporate separation procedure. It took only one year to add a totally new corporate reorganization procedure to the Commercial Code—a speed that was almost impossible before.

In the most optimized organizational form, companies have various legal tools to maximize their economic powers via a series of structural reforms that began with the introduction of the share exchange. Although the utilization rate of the share exchange system in terms of total number of M&As is not so high, this can be explained by the fact that companies can freely choose the form and procedure for reorganization from a wide range of choices that were further widened by the share exchange system and other newly introduced procedures triggered by it. The dramatic increase of M&As after 1999 was brought about by this "liberalization" of corporate organization legislation.

5.3 ECONOMIC IMPACT OF MERGERS AND ACQUISITIONS

As mentioned in the last section, the procedures for corporate reorganization worked quite well and led to the sustainable growth of M&As in Japan. The Evaluation Report on Structural Reform by the Cabinet Office, dated November 2003, assessed the situation with regard to revival of the Japanese companies' vital powers:

> **Reform in the corporate related systems is generating effects**
>
> It is getting easier for companies to carry out reorganization thanks to improvement in systems concerning business and organizational reform; in fact, reorganization utilizing these systems is increasing.
>
> Companies that experienced business reorganization show improvement in profitability and high productivity. (Cabinet Office, 2003, original in Japanese, translated by the author)

It is hard to determine the economic effect of recent M&As in Japan quantitatively. Still, some analyses are available (e.g., Economic and Research Institute, 2006; Ochiai, 2006).

ABeam M&A Consulting (2006) is another of this kind of analysis, and its report described the effect as follows:

> As a result [of the survey], it was verified that the enterprise value premium had increased to 104.8 points one year after M&As, and to 116.1 points three year after. The reason for this was that companies had significantly reduced their costs and improved their profitability by stocking jointly with their investors and by restructuring aggressively spurred by M&As. . . .
>
> M&As in Japan have created synergy and increased the enterprise value premium of the targeted companies by cooperation between the investors and the targeted companies. Based on the results of this quantitative verification, it is apparent that M&As in Japan have been somewhat successful, but there is still room for improvement. (Original in Japanese, translated by the author) (see Fig. 5.4 for and illustration)

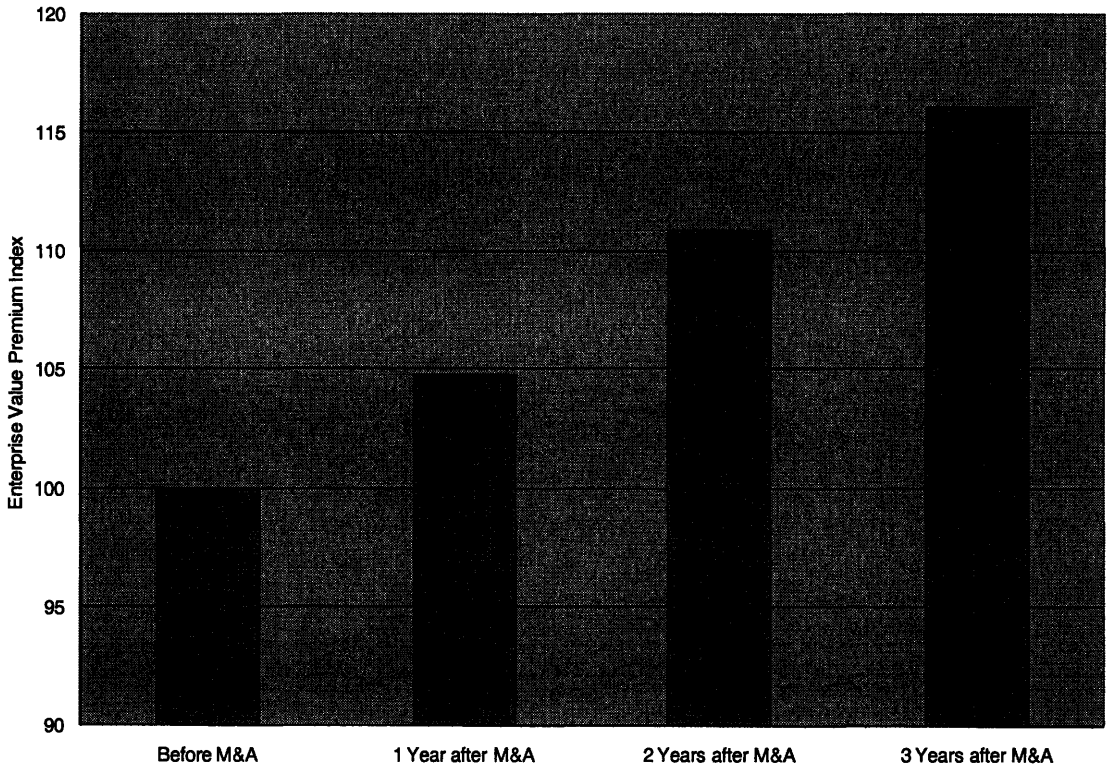


Fig. 5.4 Economic impact of mergers and acquisitions

Source: ABeam M&A Consulting, 2006.

Of course, it cannot be said that all M&As in Japan were successful or that every company in every industry should plan a consolidation. Moreover, some M&As might actually cause losses for the participating companies. For example, it is often pointed out that cultural differences among the employees in the consolidated companies might cause problems, and that such inharmony could cause inefficiency. However, these studies show that, on average, M&As bring statistically significant improvements to companies.[2]

5.4 CONCLUSION

The number of M&As in Japan has grown steadily following a series of regulatory reforms. In particular, the IN-IN type of M&As, which utilize the newly introduced procedures, have increased dramatically. Although there are no statistics that analyze only the effects of the share exchange system, several quantitative studies show that recent M&As has definitely brought positive impacts to consolidated companies.

Of course, it must be said that neither current regulations nor corporate systems are ideal. There are still plenty of problems to be addressed that will encourage further M&As. For example, a study group of M&A issues was established in December 2004 in the Economic and Research Institute of the Cabinet Office to research and make recommendations for promoting further development of M&As in Japan.

The study group published a series of its recommendation reports, one of which provided the following points:

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[2] Some people might say that the improvements shown in the survey could also happen in companies that did not engage in M&As. However, a government report showed that the Return On Assets (ROA) of companies that had conducted M&As was significantly higher than those that had not conducted M&As. (Cabinet Office, 2003).

1. Corporate management
   (1) "Integration" and "Fusion" of management
   (2) Non-disjunction between ownership and management, and between owner and employees
   (3) Corporate governance
   (4) Organizational culture and conflict of interest
2. Corporate value
3. Control of corporation
4. Defense policy for hostile take-over bids
5. Professionals for M&A
6. Human capital (human relations)
7. Corporate laws, tax systems, and securities laws
8. Regional vitalization
9. Cross-border M&A and legal systems in foreign countries
10. Business revitalization and bankruptcy laws
11. Anti-Monopoly Act
12. Accounting standards

Source: Economic and Research Institute, 2006.

Clearly, issues of corporate laws that regulate domestic companies are no longer a high priority because it is commonly recognized that corporate laws have been rationalized by the series of amendments. Instead, issues in cross-border M&A (numbers 9 through 12 in the above list) are attracting attention because of the sluggish growth of OUT-IN type M&As (refer back to Figure 5.1). The government has now begun to give particular attention to the economic benefits not only of internal (domestic) revitalization by M&As, but also the benefits of foreign capital investment. This tendency again initiated further Americanization of the corporate laws.

CHAPTER 6

TOWARD THE NEXT GENERATION OF CORPORATE LAWS

6.1 FURTHER AMERICANIZATION OF THE COMMERCIAL CODE

The Japanese Commercial Code has its origins in continental laws, primarily German laws, whose strong influence continued for more than 50 years. In Chapter 2, I discussed how the Japanese Commercial Code was also influenced by common laws, especially American laws, following the end of World War II. The first wave of changes came right after the war when Occupied Japan was forced to put American-style regulations into its previously continental-law-based legislation. However, Americanization of the Commercial Code made only slow progress until the collapse of the Bubble Economy in 1990, although amendments in the first wave were substantial and widespread.

Chapter 4 covered the introduction of the share exchange system, which was significantly affected by the similar U.S. system. The amendment not only created new ways for incorporation of holding companies and for M&As but also triggered a second wave of Americanization in the Commercial Code.

Although MITI (and its successor METI), as a whole, had no intention of explicitly Americanizing Japan's corporate laws, in the end the revisions that incorporated aspects of foreign legislation had the characteristics of U.S. legislation. A series of further revisions in the corporate laws were conducted under the strong influence of METI, which aggressively

sought to identify the best practices for making Japanese companies more competitive and the fastest ways to recover from the serious and lengthy recession (see Table 6.1)

Table 6.1 Recent revisions to corporate law (2)

Year	Main Issues	Remarks
2002	• Corporate governance (creation of "Company with Committees," modeled on American corporate governance system) • Corporate governance (creation of "Important Asset Committee") • Corporate governance (relaxing the requirement for super majority voting at shareholders' meetings) • Corporate governance/corporate finance (introduction of class voting for management elections) • Introduction of registration system for lost securities • Simplifying procedures for "In-kind Capital Contributions" • Simplifying reduction procedure for legal capital and a mandatory statutory reserve fund	Government-sponsored Bill
2003	• Deregulation of stock repurchase (simplified procedure for public corporations to repurchase shares from the market, or by way of a tender offer often referred as a TOB)	Bill submitted by individual politician
2004	• Dematerialization of corporate securities • Electronic public notice system	Government-sponsored Bill
2005	• Enactment of the Corporate Code and repeal of Chapter 2 of the Commercial Code	Government-sponsored Bill

Source: Fujita, 2004. Adapted by the author.

6.1.1 New Corporate Governance Structure

An example of revisions driven by METI can be seen in the Japanese corporate governance structure, which experienced a significant change with the 2002 amendment that was triggered by METI's final report of the Industrial Structure Council. This revision, which

brought major changes, especially to publicly listed companies, was "not a refinement of the existing corporate governance structure. Rather, it [was] the introduction of a new structure based on a completely different philosophy" (Fujita, 2004).

Traditionally, the corporate governance structure in the Japanese Commercial Code had been limited to the "company-with-auditors system." In this system, representative directors, including the CEO[1], are chosen by the board of directors from all the directors in the company. The board of directors, whose members are to be elected by the shareholders' meeting, monitors the CEO's (representative directors') managerial activities, and auditors inspect accounts and operations (see Figure 6.1).

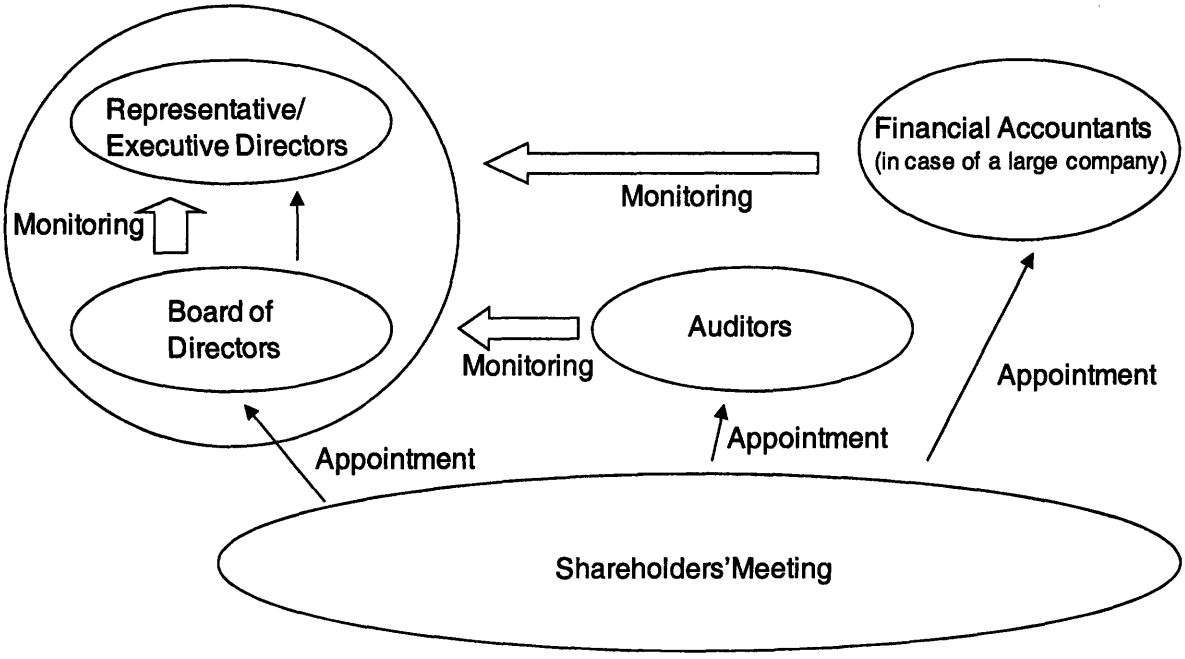

Fig. 6.1 Traditional governance structure (company-with-auditors system)

Source: Fujita, 2004.

[1] In Japanese corporate law, "CEO" is not a legal term. The Commercial Code defines only representative directors who represent a company, and these representative directors are not restricted to one person; each representative directors can represent the company independent from other representative directors.

However, people are becoming aware that auditors and directors, who are elected by the shareholders' meeting, are in reality chosen by the CEO, and therefore it may be difficult for them to exhibit differing opinions from the CEO who chose them for the job. Some investors believe these issues lead to insufficient monitoring of operations by the officers and sometimes even to corporate scandals.

METI insisted that an alternative system should be prepared for companies that wanted to show more effective corporate governance to outside people, including foreign institutional investors (METI, 2001). As a result of discussions and coordination inside the government, especially between METI and the Ministry of Justice, the "company-with-committees system" was added to the Commercial Code, and this amendment paved the way for companies to choose their governance system from these two alternatives (see Figure 6.2).

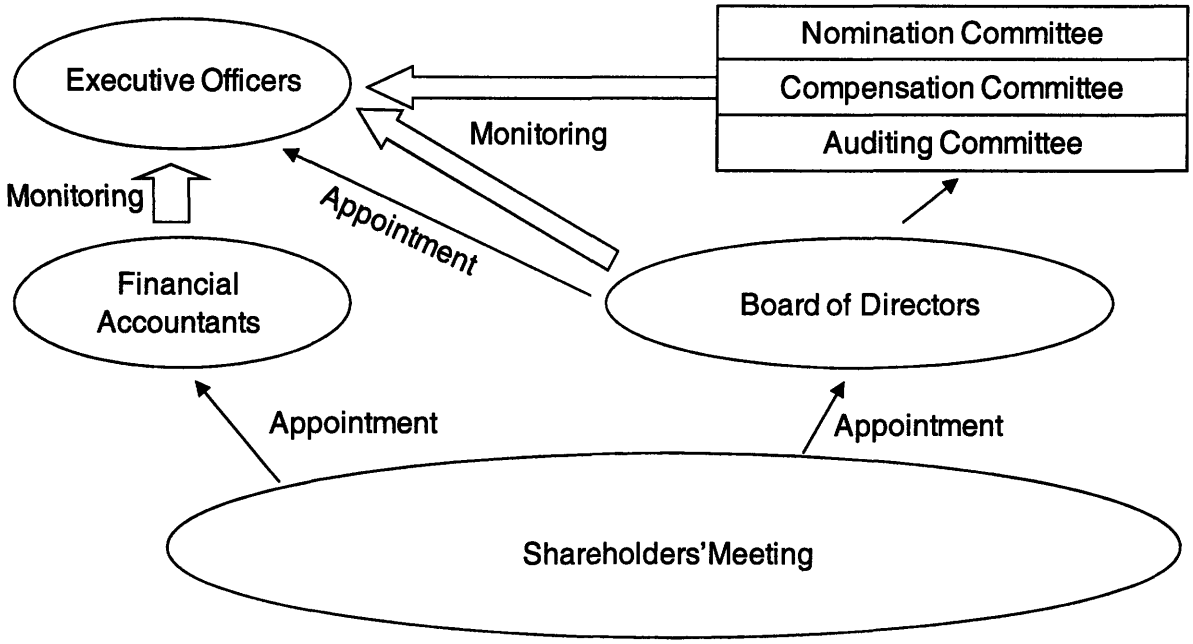

Fig. 6.2 Company-with-committees system

Source: Fujita, 2004.

During discussions at the Industrial Structure Council, MITI surveyed corporate governance systems worldwide, and the final Council report was greatly influenced by thriving economic situation in the United States and its corporate governance structure. It can be said that this company-with-committees system was basically based on (or was an imitation of) the similar system in the U.S. laws.

6.1.2 Considerations Used in Mergers

Another example can be found in the enactment of the Corporate Code of 2005, a sweeping revision of the corporate regulation portion of the existing Commercial Code. This enactment was intended to make Japanese corporate laws completely up-to-date by examining every single article to determine if it needed revision in light of current economic and/or social conditions surrounding Japanese companies and their stakeholders.

As mentioned earlier, using shares other than the survivor's or cash as consideration for a merger was prohibited by the Commercial Code.[2] However, this restriction against considerations was removed by the new Corporate Code in response to urgent requests from industry. This deregulation, one of the most substantial and influential revisions among the recent corporate reorganization rules, was triggered by a JBF[3] opinion that insisted on the following: "In order to promote corporate reorganizations smoothly, it is effective to make considerations for mergers flexible. More flexibility in considerations for mergers should be admitted. . . ." (original in Japanese, translated by the author).[4]

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[2] Although some theories insist that the articles related to mergers should not be interpreted as prohibiting cash-out mergers, these arguments were generally not supported by most scholars.

[3] JFEO was renamed the Japan Business Federation (JBF) following a merger with the Japan Federation of Employers' Associations in 2002

[4] JBF, "*Kaishaho kaisei he no teigen [Proposal for Amendments to Corporate Laws],*" October 21, 2003.

This assertion was widely supported by most of the ministries, including METI. As mentioned in Chapter 5, the Japanese government also realized that promoting cross-border M&As should have a higher priority in order to encourage investment from foreign countries and cautious Japanese investors, and to save companies with their own competencies because of a shortage of capital.

In those days, the OUT-IN type of M&As in Japan was completely inactive, while the IN-IN type continued to grow steadily (refer back to Figure 5.1). Foreign companies could not use legal tools for M&As (merger, share exchange, etc.) defined in the Japanese Commercial Code because the law did not apply to foreign entities. For them, the only way to acquire Japanese companies was by purchasing shares with cash or other equivalents accepted by the sellers. As a result, foreign direct investment (FDI) in Japan was at a remarkably low level compared to that of other countries—far below 10%, while most developed countries received around 25% investment from foreign countries (see Figure 6.3). However, flexibility in acceptable considerations would enable foreign companies to use the triangular merger by using their subsidiaries in Japan to acquire Japanese companies.

However, JBF made an abrupt change on this significant policy change soon after the bill was submitted to the Diet. I will discuss this sudden change later in this chapter.

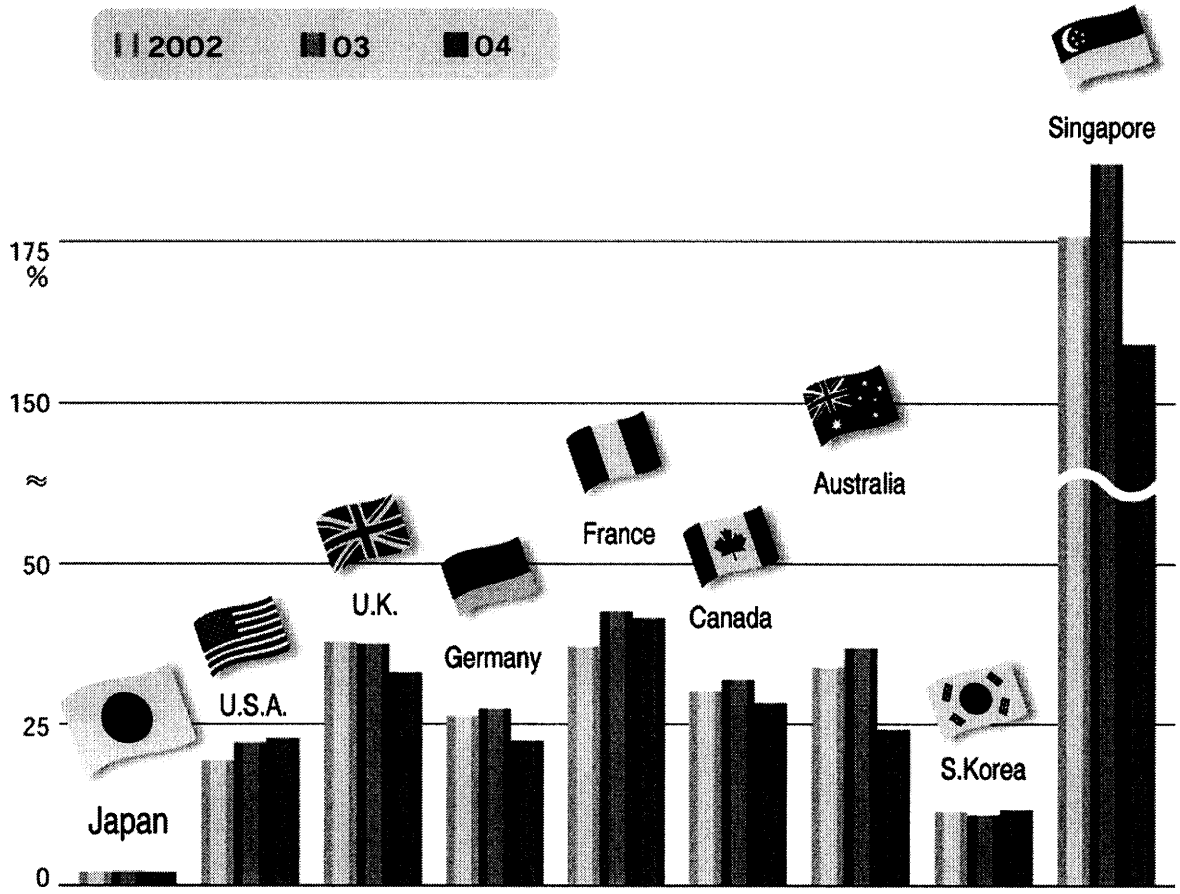

Fig. 6.3 Foreign direct investment stock (investment-to-GNP ratio)

Source: Shiota, 2007.

6.2 PERSPECTIVES AND RECOMMENDATION FOR THE FUTURE

6.2.1 Domestic Amendments

Thus far I have reviewed the history of amendments to the Japanese Commercial Code, especially those in recent years, and their impacts on corporate activities and efficient management of companies. The Japanese Commercial Code and other fundamental laws adapted a variety of systems from other countries including France, Germany, and the United States. These imported systems worked well with existing Japanese traditions. Gradually, however, the nature of Japanese laws shifted from the continental law system to a more

common-law-oriented system that reflected the current balance of power in the world economy.

However, the revisions so far basically focused only on Japanese economic entities and paid little attention to cross-border activities, essentially leaving that area to interpretations of international private law. Therefore, there have been many issues to be resolved in order to successfully promote foreign direct investment in Japan.

6.2.2 Partial Postponement of the Corporate Code

As a part of the movement to improve the environment and make it more conducive to international economic activities, legal restrictions that had impeded cross-border M&As were removed during the sweeping 2005 revisions of the Commercial Code. The strict restrictions regarding considerations for mergers, which made it difficult for foreign entities to acquire Japanese companies because huge amounts of money were required to purchase stocks, were removed. Most people believed that flexibility in considerations for mergers was necessary for revitalizing Japanese companies. This new flexibility would accelerate foreign investment, and in turn the know-how acquired from successful foreign organizations would be helpful for companies that had lost their competitive edge in the global market.

As noted in the last section, JBF also insisted on this flexibility. However, once the bill for the new Corporate Code was submitted, many members of JBF companies suddenly changed their minds, fearing that their own companies might be acquired by foreign companies if this deregulation was implemented. JBF began to petition Diet members to remove all articles related to flexibility of considerations for mergers, which might enable foreign companies to merge with or acquire Japanese companies through a triangular merger.

Although JBF's request was not met granted, some provisions concerning considerations for mergers were postponed for one year, to give companies time to prepare the necessary counter-measures in case of hostile takeovers. This action revealed the continuing conservatism of Japanese companies despite the government-wide move to promote FDI.

After making the decision to postpone, many discussions as to the pros and cons of foreign countries using triangle mergers took place among the related agencies and parties. JBF continued to request that the government and politicians adopt stringent regulations for triangular mergers by foreign companies, arguing that confidential know-how and corporate secrets of Japanese companies would be diffused if triangular mergers were easily conducted, and such diffusion would erode Japan's national interests. In March 2007, the Japanese government and LDP decided to refuse JBF's request. However, they also decided to begin a study concerning how to balance openness to foreign capital with ensuring national interests (i.e., national security, etc.).

6.2.3 Recommendations for the Future

Recent amendments to the Japanese Commercial Code involved deregulation and giving as much freedom of choice as possible to companies. This also meant that the government would not intervene in the activities of private economic entities unless concrete harmful effects were likely to happen.

It is my opinion that it would be beneficial to make a transition from prior control to *ex post* regulation, and to critically evaluate a series of amendments after rationalization of the merger procedure in 1997.

I have some concerns about JBF's apparent cowardice in being unwilling to open the channels to foreign capital; also its enormous political influence, which ultimately leads in a more conservative direction. There is no doubt that certain information should remain confidential so that state secrets are not leaked to foreign entities. However, such regulations should not be included as part of general purpose laws such as the Corporate Code, because issues of national security are highly political and can cause distortion in a free economy. There would be some risk if arguments in LDP concerning triangular mergers mentioned issues of national security in the context of future reviews of the Corporate Code.

I recommend that, insofar as possible, the Corporate Code should be independent from political matters. It should be continually reviewed so that it offers as many choices as possible to private economic entities to ensure market mechanisms and to promote competition, not only between domestic companies but also among multinational enterprises. From this perspective, corporate reorganization procedures have been well organized as a result of recent amendments in terms of domestic activities. However, cross-border reorganization rules, and many corporate governance issues, remain for consideration as they have been given the highest priority in response to requests from industries.

Finding the balance between a degree of freedom in corporate management and the interests of stakeholders (especially minor shareholders) is a problem that can be argued eternally, and simple answers that apply to all circumstances all the time will be impossible to find. We should continue to seek out undiscovered frontiers of best practice from all over the globe.

6.3 CONCLUSION

Every country has its own history, culture, customs, and so on. Its legal system, including its laws and legislative theories, reflect (or should reflect) the historical background and current circumstances of the country. And best practices in one country have been, in many cases, emulated by other countries, until the new practices and the existing system blend into a new tradition. As world markets grow increasingly closer together, the legal systems of its countries are becoming more and more harmonized; differences between continental laws and common laws are shrinking, and various treaties continue to promote convergence. Countries that care little about interacting with other areas will become isolated from cross-border transactions due to trade barriers caused by differences in legislation. Every country must pay attention to and learn from other countries' legal systems, especially those of the most developed countries that have shown themselves to be successful within the changing current world economy.

Japan has a long history of importing almost everything from all over the globe and fusing it with native Japanese traditions: ancient civilization; culture (including Chinese characters by which Japanese people write their own language); religion (Confucianism, Taoism, and Buddhism); political systems from China; the modern tactics of war and Christianity from Portugal in the sixteenth century; modern science and technologies from the Netherlands (in the Edo era), Britain, France, Germany, and America (from the Meiji era on). Laws and legal system are no exceptions. And while I have focused on the history of modern Japanese corporate laws, Japan's legal system has always sought to adopt the most developed systems from abroad and make them become inherent to Japan.

When I think about the characteristics of law in other countries, I recall the following anecdote:

> Some students were given assignments to write reports on elephants.
> An American student went to a zoo, observed elephants carefully, and wrote a report titled, "The Profitability of Breeding Elephants."
> A German student went to a library (not a zoo), read thousands of books thoroughly, and wrote a report titled "The Nature of Elephants."
> A Japanese student also went to a library, also read thousands of books thoroughly, and wrote a report titled "German Theories Concerning the Nature of Elephants.

This anecdote characterizes the history of Japanese laws well. Although it might be necessary to change the last title to "Adapting the American Elephant Business in Japan" (taking into account recent trends in Japan), we must not forget that the Japanese style is not solely imitation of someone else's ideas – or laws – or elephants. I believe that the recent changes in the Japanese Commercial Code are typical examples of the beneficial effects of assimilating a "melting pot" of laws, and I am certain the end result will be a great model for every legal system around the world.

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