German and Asian Perspectives on Company Law

Edited by
HOLGER FLEISCHER, HIDEKI KANDA,
KON SIK KIM and PETER MÜLBERT

Max-Planck-Institut für ausländisches und internationales Privatrecht

Beiträge zum ausländischen und internationalen Privatrecht
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Mohr Siebeck

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Preface

This volume is based on presentations delivered at a conference held in May 2015 at the Max Planck Institute for Comparative and International Private Law in Hamburg. The symposium was organised to reinvigorate the scholarly exchange between company law academics in Germany, China, Japan and South Korea which can be traced back to the late 19th century. The organisers are convinced that this exchange will be very fruitful in solving the challenges for company and capital markets law in the 21st century. A follow-up conference has already taken place in Tokyo in March 2016.

We would like to thank all participants for their valuable and much appreciated contributions. Furthermore, we would also like to thank Jakob Hahn and Janina Jentz for their help in the editing process.

Hamburg, Tokyo, Seoul and Mainz
August 2016

Holger Fleischer
Hideki Kanda
Kon-Sik Kim
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Abbreviations

ADHGB	Allgemeines Deutsches Handelsgesetzbuch
AG	Aktiengesellschaft
AktG	Aktiengesetz
ALI	American Law Institute
ARUG	Gesetz zur Umsetzung der Aktionärsrechterichtlinie
Aufl.	Auflage
BAG	Bundesarbeitsgericht
BB	Betriebs-Berater
BEPS	Base erosion and profit shifting
BGB	Bürgerliches Gesetzbuch
BGH	Bundesgerichtshof
BGHSt	Entscheidungen des Bundesgerichtshofs in Strafsachen
BGHZ	Entscheidungen des Bundesgerichtshofs in Zivilsachen
BVI	Bundesverband Investment und Asset Management
CCZ	Corporate Compliance Zeitschrift
CEO	Chief Executive Officer
CGC	Corporate Governance Code
Cmnd	command papers 1956–1986
CMS	Controlling minority shareholders
CSR	Corporate Social Responsibility
CSRC	China Securities Regulatory Commission
DAX	Deutscher Aktienindex
DB	Der Betrieb
DGCK	Deutscher Corporate Governance Kodex
DGCL	Delaware General Corporation Law
DICJ	Deposit Insurance Corporation of Japan
DStR	Deutsches Steuerrecht
DT-AG	Deutsche Telekom AG
D&O	Directors and officers
EBOR	European Business Organization Law Review
ECFR	European Company and Financial Law Review
eG	eingetragene Genossenschaft
EU	European Union
EWIV	Europäische Wirtschaftliche Interessenvereinigung
FDI	Foreign direct investment
FIEA	Financial Instruments and Exchange Act
FRG	Federal Republic of Germany

FSA	Financial Services Agency
GAAP	United States Generally Accepted Accounting Principles
GbR	Gesellschaft bürgerlichen Rechts
GDP	Gross Domestic Product
GmbH	Gesellschaft mit beschränkter Haftung
GmbHG	Gesetz betreffend die Gesellschaften mit beschränkter Haftung
GmbHR	GmbH-Rundschau
HGB	Handelsgesetzbuch
HMC	Hyundai Motor Company
Hrsg.	Herausgeber
IFRS	International Financial Reporting Standards
JAL	Japan Air Lines
JASBA	Japan Audit and Supervisory Board Members Association
JCA	Japanese Company Act
JCGK	Japan Corporate Governance Code
JSC	Japan Stewardship Code
KAGB	Kapitalanlagegesetzbuch
KCC	Korean Commercial Code
KFTC	Korean Fair Trade Commission
KG	Kommanditgesellschaft
KGaA	Kommanditgesellschaft auf Aktien
KfW	Kreditanstalt für Wiederaufbau
KK	Kabushiki Kaisha
LAG	Landesarbeitsgericht
LG	Landgericht
LLC	Limited Liability Company
LLP	Limited Liability Partnership
M&A	Mergers & Acquisitions
MBC	Model Business Corporation Act
METI	Ministry of Economy, Trade and Industry
MitbestG	Mitbestimmungsgesetz
MNE	Multinational companies
MRFTA	Monopoly Regulation and Fair Trade Act
MOJ	Ministry of Justice
NaStraG	Gesetz zur Namensaktie und zur Erleichterung der Stimmrechtsausübung
NJW	Neue juristische Wochenschrift
NJW-RR	Neue juristische Wochenschrift Rechtsprechungs-Report
NZG	Neue Zeitschrift für Gesellschaftsrecht
OCC	Ordinary Corporate Conduct
OECD	Organisation for Economic Co-operation and Development

OHG	Offene Handelsgesellschaft
OLG	Oberlandesgericht
PartG	Partnerschaftsgesellschaftsgesetz
PRC	People's Republic of China
RabelsZ	Rabels Zeitschrift für ausländisches und internationales Privatrecht
RCC	Resolution and Collection Corporation
RMB	Renminbi
ROE	Return on equity
ROHG	Reichsoberhandelsgericht
ROHGE	Entscheidungen des Reichsoberhandelsgerichts
SCE	Europäische Genossenschaft
SE	European Company
SEA	Securities and Exchange Act
SEC	Securities and Exchange Commission
SOEs	State-owned enterprises
SLC	Special Litigation Committees
SP	Steel Partners and its affiliates
SpruchG	Gesetz über gesellschaftsrechtliche Spruchverfahren
SR	Shareholder resolution
StGB	Strafgesetzbuch
TFEU	Treaty on the Functioning of the European Union
TSE	Tokyo Stock Exchange
UK	United Kingdom
UMAG	Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts
UmwG	Umwandlungsgesetz
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
VorstAG	Gesetz zur Angemessenheit der Vorstandsvergütung
VVaG	Versicherungsverein auf Gegenseitigkeit
WMF	Württembergische Metallwarenfabrik
WpHG	Wertpapierhandelsgesetz
WpÜG	Wertpapiererwerbs- und Übernahmegesetz
ZEuP	Zeitsdchrift für Europäisches Privatrecht
ZGR	Zeitschrift für Unternehmens- und Gesellschaftsrecht
ZHR	Zeitschrift für das gesamte Handels- und Wirtschaftsrecht
ZIP	Zeitschrift für Wirtschaftsrecht
ZJapanR	Zeitschrift für Japanisches Recht
ZPO	Zivilprozessordnung

Introduction

A Brief Guide to Japanese Company Law

Hideki Kanda

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I. Introduction

1. Organization Forms

In Japan, aside from sole proprietorships, businesses can be organized in one of six organizational, or legal, forms – *kumiai* (partnership), *tokumeikumiai* (limited partnership), *gomeigaisha* (incorporated partnership), *goshigaisha* (incorporated limited partnership), *godogaisha* (incorporated limited liability company) and *kabushikigaisha* (stock company).

Among these six forms, only the first two – namely, *kumiai* and *tokumeikumiai* – enjoy single-tiered income taxation, by which income tax is not imposed at the "entity" level and individual investors report their proportional share of the profits earned by the entity in their personal tax returns. However, *kumiai* does not offer limited liability to their investors, and while *tokumeikumiai* offers limited liability to investors, if the number of investors is ten or more, a withholding tax is imposed, making the *tokumeikumiai* form costly. For these reasons, *kumiai* and *tokumeikumiai* are unpopular for large businesses in Japan. The other four forms all have "legal personality" (some of which provide investors with limited liability and others do not) and are subject to "double" income taxation. While *gomeigaisha*, *goshigaisha* and *godogaisha* (collectively called "person companies") are given flexibility un-

der the Companies Act regarding their internal governance structure and related matters, they are unsuitable for raising a large amount of funds in capital markets. Thus, in Japanese practice, all major businesses take the *kabushikigaisha* (stock company) form, which is similar to a business corporation in the US, a public company in the UK, a German *Aktiengesellschaft*, and a French *société par action*.

As of the end of November 2014, there are about 3.4 million stock companies in Japan, but most of them are closely held companies, and the number of "large" companies (see below for definition) is estimated to be 9,000 to 10,000. There are about 3,600 publicly held companies listed on stock exchanges in Japan. As the largest stock exchange, Tokyo Stock Exchange ("TSE") has about 3,400 listed stock companies.

Table 1: Number of Companies as of the end of November 2014[1]

Stock companies (excluding special GmbH, see below)	
c: the amount of legal capital	
c < one million yen	116,713
one million yen ≤ c <10 million yen	566,299
10 million yen ≤ c < 100 million yen	1,049,174
100 million yen ≤ c < 1 billion yen	30,756
1 billion yen ≤ c	7,038
Total	1,769,980
Special GmbH[2]	1,642,039
Incorporated partnership *(gomeigaisha)*	17,887
Incorporated limited partnership *(goshigaisha)*	80,027
Incorporated limited liability company *(godogaisha)*	72,292
Total	3,582,225

2. *Company Law*

In Japan, the Companies Act of 2005 (effective from 1 May 2006) applies to *kabushikigaisha* (stock companies), *gomeigaisha*, *goshigaisha*, and *godogaisha*. The Companies Act provides for private law rules about stock companies and person companies. The Companies Act is a consolidation of the statutes that existed in 2005 in respect of company law rules governing stock companies and person companies in Japan. Until this consolidation, company law rules were codified primarily as part of the Commercial Code of 1899. Although Commercial Code is of German origin, many American rules for

[1] Source: Ministry of Justice.

[2] Before the Companies Act of 2005, these companies were the Japanese counterpart of German GmbH and governed by the Japanese GmbH Act of 1938. Under the Companies Act, which absorbed the Japanese GmbH Act, they are legally stock companies, but enjoy less stringent rules than other stock companies.

business corporations were transplanted after World War II. Today, the Companies Act also reflects numerous amendments to the Commercial Code made in the past decades, and represents the result of these historical developments in Japan. Thus, the Companies Act today exhibits its own, somewhat unique landscape.[3] In the following, this article will focus on stock companies.

3. *Securities Regulation*

The Financial Instruments and Exchange Act of 1948 ("FIEA") applies to large publicly held companies.[4] The name of the Act was changed to its present name by the amendments in 2006 (effective from 30 September 2007), prior to which it was called the Securities and Exchange Act ("SEA"). The SEA was modeled on the US Securities Act of 1933 and Securities Exchange Act of 1934, but again reflects the unique historical developments in Japan in the past decades. The Act, therefore, has its own characteristics, and the substance of the rules in the Act is not identical to that in the United States. Firms whose shares are listed on the TSE are subject to the Companies Act, the Financial Instruments and Exchange Act, and the rules of the TSE.

Sometimes the Companies Act and the FIEA regulate the same matters. For instance, both Acts require public companies to prepare financial statements and have them audited by professional auditors. In usual practice, as far as annual financial statements are concerned, companies prepare those documents and have them audited at the same time, so as to satisfy the requirements under both Acts.

The Companies Act is a private law, enforced by the courts and there is no administrative branch or agency of government that enforces rules under the Companies Act. As an exception, public registry offices are understood to enforce the rules applied to matters that must be registered, but this is not discussed in this article. In contrast, the FIEA has an administrative body of government, the Financial Services Agency ("FSA"), and an enforcement body, the Securities and Exchange Surveillance Commission. The FIEA is also enforced by the courts.

The FIEA and regulations under the FIEA have been amended several times in recent years. For instance, the disclosure rules under the FIEA were amended in March 2010. The current rules under the regulation called *kaiji*

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[3] For a comprehensive explanation in English of company law in Japan, see KAWAMOTO/KAWAGUCHI/KIHARA, Corporations and Partnerships in Japan (Alphen aan den Rijn 2012). The English translations of major Japanese statutes are available at <http://www.japaneselawtranslation.go.jp/?re=02>.

[4] A company whose securities are listed on a stock exchange, traded "over the counter" or with 500 or more registered shareholders is subject to the periodic reporting requirements of the FIEA. A company that has made a public offering is also subject to the same reporting requirements.

naikaku furei promulgated by the FSA impose enhanced disclosure regarding corporate governance on reporting companies (which include all listed firms). In particular, reporting companies are now required to provide disclosure of the annual amount of executive compensation for each individual where the annual amount is 100 million yen or more.[5] They also are now required to provide disclosure of the result of voting at the resolutions of the shareholders' meeting.

4. *Stock Exchange Rules*

In the past, the TSE has been active in providing rules concerning corporate governance for listed companies.[6] In particular, on 24 August 2009, the TSE introduced a rule concerning the issuance of new stock to third parties requiring increased disclosure and explanations as to why the firm is making such issuance.[7] Also, on 30 December 2009, the TSE adopted a new rule requiring all listed firms to have at least one "independent" director or statutory auditor, whose name must be provided to the TSE every year.[8] The definition of "independent" under the TSE rule is stricter than the definition of "outside" under the Companies Act. In the latter, outside means lack of an employment or family relationship, whereas in the former, independent also requires, in addition to being an outsider required under the Companies Act, lack of business or trade relationship.[9]

From 1 June 2015, the Corporate Governance Code ("CGC") promulgated by the TSE applies to all listed firms on the TSE.[10] Other stock exchanges follow the TSE. The CGC consists of 5 fundamental principles, 30 principles and 38 supplemental principles. For firms listed on the "main market" of the TSE (about 2,400 firms listed on the First Section and Second Section of the TSE), all of these principles apply as a "comply or explain" norm, requiring companies to explain any non-compliance. For smaller-size firms listed on markets other than the main market (which consist of two markets called Mothers and JASDAQ), only the fundamental principles carry this "comply or explain" requirement.

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[5] See Disclosure Rules of the Financial Services Agency *(kaiji naikaku furei)* (March 2010).

[6] See generally Tokyo Stock Exchange, Improvements to the TSE Listing System, <http://www.jpx.co.jp/equities/improvements/general/index.html>.

[7] See Art. 432 of the TSE Listing Rules (effective from 24 August 2009).

[8] See Art. 436 para. 2 of the TSE Listing Rules (effective from 30 December 2009, amended on 30 June 2010).

[9] See TSE Guidelines on Listing III-(3)-2 (*jojokanri-to ni kansuru*-guidelines) (effective from 30 December 2009).

[10] <http://www.jpx.co.jp/equities/listing/cg/index.html>.

II. Board Structure

In Japan "large" and "public" stock companies must choose from among three alternative board structures. All firms listed on stock exchanges fall within this category. A "large" stock company is defined under the Companies Act as a stock company having either legal capital in the amount of 500 million Yen or more, or total debt (according to its balance sheet) in the amount of 20 billion Yen or more (Art. 2 no. 6 Companies Act). A "public" stock company is defined under the Companies Act as a stock company other than one where the transfer of any shares is restricted in the company's charter by making any proposed transfer subject to the company's approval (Art. 2, no. 5 Companies Act).

Three alternatives are (i) two boards, (ii) one board and one committee, and (iii) one board and three committees. Until the amendments in 2014, the Companies Act permitted a choice between a two-board company and a one-board and three-committee company. The former *(kansayakukai secchi gaisha),* requires a board of directors and a board of statutory auditors, while the latter *(shimei iinkaito secchi gaisha),* has no statutory auditors and the board of directors is required to have three committees – a nominating committee, an audit committee and a compensation committee (Art. 400–Art. 417 Companies Act). This latter form was introduced by the amendments to the Commercial Code in 2002 (effective from 1 April 2003), and more than half of the members of each committee must be "outside" directors. For two-board companies, at least half of the members of the board of statutory auditors must be "outside" statutory auditors, but the board of directors does not have to have outside directors. In practice, the level of uptake shows that one-board and three-committee companies are not popular. Only 1.7% of the listed firms on the TSE as of 14 July 2014 are one-board and three-committee companies.[11]

A brief further note on two-board companies may be worthwhile, because statutory auditors are not well-known outside Japan. The Companies Act begins with the familiar position that shareholders are the owners of a stock company. A shareholders' meeting elects directors, and makes decisions about "fundamental changes" to the company, such as a merger, a sale of a substantial part or all the firm's assets, and any amendments to the firm's charter. For a two-board company, there must be at least three directors. Directors are elected at the shareholders' meeting, and form the board of directors. The board elects representative directors, the Japanese counterparts of US officers or executives. There must be at least one representative director. Representative directors and executive directors manage the company, running its day-to-day activities. The Companies Act requires that the board of

[11] See TSE-Listed Companies White Paper on Corporate Governance 2015 (March 2015).

directors make important corporate decisions and supervise management. Each director, as a member of the board, owes a duty of care and loyalty to the company. The director's liability to the company may be enforced by shareholders through a derivative action. Shareholders have rights similar to those of other countries, such as the right to make proposals, the right to ask questions to directors and statutory auditors (although the Companies Act calls this the director's or auditor's "duty to explain"), and the right to examine the company's books and records.

A two-board company must have a *kansayaku*, often (somewhat misleadingly) translated as a statutory auditor.[12] Statutory auditors are elected at the shareholders' meeting, and do not have to be an accountant or other professional. A "large" company (see above for definition) must have at least three statutory auditors, and at least half of them must be "outside" statutory auditors. An auditor is "outside" where he or she does not, and in some cases did not in the past ten years, serve as a director or employee of the company or its parent or subsidiary (Art. 2 no. 16 Companies Act). In a large company, there must be at least one full-time auditor.

In addition, a large company must have an accounting auditor *(kaikeikansanin),* who must be a certified public accountant or certified auditing firm. An accounting auditor is elected at the shareholders' meeting, and is responsible for auditing the company's financial statements annually before they are submitted to the annual shareholders' meeting, where the audit opinion is also submitted. In contrast, a statutory auditor is responsible for overseeing the activities of management. This is understood to mean confirming the legality of management activities. The Companies Act requires collaboration between accounting auditors and statutory auditors, providing complex rules, the details of which are beyond the scope of this article.

A two-board company may elect an outside director, although this election is not mandatory. A director is "outside" where he or she is not, and in some cases was not in the past ten years, an executive director or employee of the company or its parent or subsidiary (Art. 2 no. 15 Companies Act).

There are two recent trends in this area. First, as noted below, the TSE today requires listed firms to have at least one "independent" director or auditor, and the TSE adopts a policy that encourages all listed firms to have independent directors.

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[12] The Japan Audit and Supervisory Board Members Association (JASBA) *(Nihon Kansayaku Kyokai)* recommends that *kansayaku* be translated into English as audit and supervisory board member and *kansayaku-kai* be translated as audit and supervisory board. See JASBA, New Recommended English Translation for *Kansayaku* and *Kansayaku-kai* (October 2012), available at <http://www.kansa.or.jp/en/ns121023.pdf>. I am sticking to the traditional translation in this article and am using "statutory auditor" and the "board of statutory auditors".

Second, the Companies Act was amended in 2014 (effective from 1 May 2015). The amendments introduced a new rule by which if reporting companies (to which the FIEA applies) are two-board companies, they must have an outside director as a comply or explain norm. Specifically, all two-board reporting companies without an outside director must explain why at the annual shareholder's meeting (Art. 327 para. 2 Companies Act). In addition, under the rule of the Ministry of Justice ("MOJ"), such explanation must be made in the annual business report *(jigyo hokoku),* and in the materials in connection with the election proposals of directors at the shareholders' meeting *(kabunushi-sokai sanko-shorui).* In this respect, it is interesting to note that the Legislative Council of the MOJ also made a strong request to stock exchanges that they encourage listed firms to have outside directors.[13]

Note also that the Corporate Governance Code mentioned above includes a principle (Principle 4.8 of the Code) providing that listed firms (on the main market, see above) must have at least two outside directors as a comply or explain norm.

The 2014 amendments to the Companies Act introduced a third option for structuring the board – the one-board and one-committee structure. Companies in this new type are called *"kansato-iinkai secchi geisha".* In such companies there are no statutory auditors and the majority of the committee members must be outside directors (Art. 399 para. 2–Art. 399 para. 14 Companies Act). This one-board and one-committee structure is intended to encourage listed firms with the two-board structure to move to that structure and thereby have outside directors.

III. Groups of Companies

There are few statutory rules governing groups of companies in Japan, and general company law rules apply to them. This is closer to the situation in the US, rather than in Germany.

One of the statutory rules governing groups of stock companies is the rule on mutual stock holding. If Company A holds 25% or more of Company B's shares, Company B is prohibited from voting on the share(s) in Company A that B owns. In practice, this rule seldom applies. In a typical "cross holding" situation, using the above hypothetical, Company B owns 100% to 1% of

[13] Legislative Council of the Ministry of Justice, Main Points for the Reform of Corporate Law (7 September 2012), available at <http://www.moj.go.jp/content/000102013.pdf> (in Japanese). On the date the bill was submitted to the Diet, the TSE made an announcement to that effect. See Tokyo Stock Exchange, Revisions to Listing Rules concerning Securing Highly Independent Outside Directors (29 November 2013), available at <http://www.tse.or.jp/rules/comment/b7gje600000186jz-att/131129_01e.pdf>.

Company A's shares, but Company A owns less than 25% of B's shares. Also, the situation where A owns B, B owns C, and C owns A is a popular, means of circumventing the voting restriction rule. In addition, with narrow exceptions, subsidiaries are prohibited from acquiring the shares of the parent company, a rule extending the regulation of share repurchase. Where subsidiaries hold the parent's shares as an exception, they do not have voting rights.

For accounting and disclosure purposes, as will be discussed later, the FIEA requires reporting companies (see above) to prepare and disclose financial statements on a consolidated basis four times a year. The Companies Act requires the same, but annually.

The 2014 amendments to the Companies Act introduced certain new rules. First, for public companies, a large-scale stock issuance that would create a controlling shareholding (that is, a majority holding of voting stocks) requires the approval of the shareholders' meeting (Art. 206 para. 2 Companies Act). The technical operation of this new rule is complicated and not discussed here.

Second, in parent-subsidiary situations, a so-called multi-layer shareholder derivative action was introduced under limited circumstances. Under the new regime, where a director of a subsidiary owes liability to the subsidiary, a shareholder of its 100% parent company (if he or she has one percent or more of the voting shares for six months or otherwise satisfies specified conditions) is given the right to sue the director of the subsidiary in the form of a derivative action (if the subsidiary is large enough to account for more than twenty percent of the parent's balance sheet or otherwise satisfies specified conditions) (Art. 847 para. 3 Companies Act).

IV. Recent Issues and Empirical Studies

1. Defensive Measures against Hostile Takeovers

The area of takeover defenses is complicated in respect to the law's coverage. The FIEA regulates tender offer processes, while most of the defense measures raise legal issues under the Companies Act, not the FIEA. In this sense, the distinction between the FIEA and the Companies Act roughly corresponds to that between the federal (and state) securities law and state corporate law in the United States. It is interesting to note that the validity of some of the defenses was challenged before the courts. In those cases the relevant issues were those under the Companies Act, not the FIEA.[14] In fact, the current tender offer regulation under the FIEA permits the target company to

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[14] See generally K. OSUGI, Transplanting Poison Pills in Foreign Soil: Japan's Experiment, in: Kanda/Kim/Milhaupt (eds.), Transforming Corporate Governance in East Asia (London et al. 2008) 36.

adopt a defense action even after the commencement of a tender offer by a hostile bidder. Thus, as in Delaware, case law under the Companies Act shapes the landscape, although the substance of the case law is not identical between Delaware and Japan.

In a well-known case, in May 2007, Steel Partners, a US buy-out fund, commenced a hostile tender offer for all outstanding stocks of Bulldog Sauce, a Worchester sauce producer and a listed company on the TSE. Bulldog Sauce did not have any "pre-bid" defense plan. As a post-bid defense, the board of directors of Bulldog Sauce intended to issue stock warrants to all shareholders, including Steel Partners and its affiliates (collectively "SP"), with the condition that SP could not exercise the warrants. The warrants had a redemption feature, by which warrant holders other than SP would receive common stocks in exchange for turning the warrants into the company, whereas SP would receive cash. Thus, the scheme was structured as a scheme to dilute SP's voting right without imposing an economic loss on SP ("economic" does not include the value of the voting right). The Bulldog board introduced the proposal at the annual shareholders' meeting on 24 June 2007, and shareholders holding more than eighty percent of the total stocks approved the plan. SP sued to enjoin the issuance of the warrants. The Tokyo District Court held on 28 June 2007, that the scheme was valid. The decision was affirmed by the Tokyo High Court on 9 July 2007, and then by the Supreme Court on 7 August 2007. The relevant issues were decided under the Companies Act, and not the FIEA.[15]

Also, a number of public firms in Japan have one of the two types of "pre-bid" defense plans. Of the 3,414 firms listed on the TSE on 14 July 2014, 497 (14.6%) have pre-bid defense plans.[16]

Pre-bid defense plans take two forms. The first is a typical trust based scheme, where the firm issues stock warrants to a trust bank with designating shareholders as beneficiaries of the trust. A hostile bid triggers the defense plan, and the trust bank transfers the warrants to the shareholders. The warrants have a discriminatory feature and the bidder has no right to exercise them, as the terms and conditions of the warrants usually provide that the warrants cannot be exercised by shareholders who own twenty percent or

[15] See C. J. MILHAUPT, In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan, 105 Columbia Law Review (2005) 2171. See also J.B. JACOBS, Implementing Japan's New Anti-takeover Defense Guidelines, Part II: The Role of Courts as Expositor and Monitor of the Rules of the Takeover Game, 3 University of Tokyo Journal of Law and Politics (2006) 102; H. KANDA, Takeover Defenses and the Role of Law: A Japanese Perspective, in: Tison et al. (eds.), Perspectives in Company Law and Financial Regulation (Cambridge 2009) 413.

[16] See TSE-Listed Companies White Paper on Corporate Governance 2015 (March 2015).

more of the firm's outstanding stocks.[17] This plan is not popular today. The second, more popular, plan is called the advance-warning plan. This plan varies from company to company but generally involves a mechanism of the board, sometimes with the approval of the shareholders' meeting, making a public announcement that if a shareholder attempts to increase its stake to twenty percent or more of the firm's outstanding stocks, that shareholder is first required to disclose and explain their intent for the shares in accordance with the details specified in the announcement. If the shareholder does not answer these questions or the target board thinks the shareholder's explanation is unsatisfactory, then a defense measure would be triggered. Typically, the defense measure involves issuing stock warrants to all shareholders; however, the shareholder having twenty percent or more cannot exercise the warrants, instead warrants are redeemed at a fair price at the option of the company. Thus, typically, a warrant issuance has the effect of "cashing out" the hostile bidder.[18]

Thus, the Companies Act is important for critical issues in the area of hostile takeovers and defenses, and the courts play an important role in applying the relevant rules under the Companies Act. The Tokyo Stock Exchange also plays an important role in shaping the landscape in this area, since such issues are not directly regulated by the FIEA, and thus there is no room for their enforcement by the FSA.

As noted above, beginning in 2005, some listed firms adopted pre-bid defense plans against hostile takeovers, in the form of advance warning defense plans noted above, and there is an empirical study showing a positive correlation between firms that adopted defense plans in 2005 and firms that showed poor economic performance.[19] The authors report that there is no such correlation for firms that adopted defense plans in 2006.[20] Causality is not entirely clear for firms that adopted defense plans in 2005: it is not certain whether the adoption of defense plans led to poor performance. It may be that firms with poor performance tend to expose themselves to hostile bids and thus introduced defense plans.

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[17] See KANDA, *supra* note 15, 419.

[18] Note, however, that after the report by the Corporate Value Study Group (at the Ministry of Economy, Trade and Industry on 30 June 2008) took a general position against paying compensation to hostile bidders for the economic loss they may suffer when the defense action is triggered, advance warning plans generally do not provide such payment.

[19] See S. HIROSE/T. FUJITA/N. YANAGAWA, *Baishuboeisaku no Gyosekijoho Koka – 2005 nen Donyu Jirei no Bunseki* [Information Effects of Performance by the Adoption of Takeover Defenses: An Analysis of Cases in 2005], Junkan shōji hōmu 1826 (2008) 4.

[20] See *id.*

2. Outside Directors

As was noted above, under the current Companies Act in Japan, outside directors are not required for "two-board companies", which is the most popular board structure among listed firms in Japan. In fact, 98.3% of the listed firms on the TSE as of 14 July 2014, are two-board companies, and the remaining 1.7% are "one-board and three-committee companies."[21]

The TSE-Listed Companies White Paper on Corporate Governance 2015 ("TSE White Paper") reports on all firms listed on the TSE as of 14 July 2014. As of that date, 1,814 are listed on the First Section, 545 are on the Second Section, 194 on Mothers and 861 on JASDAQ. Therefore, in total, 3,414 firms are listed on the TSE ("TSE-listed companies").[22]

The overall average number of directors per TSE-listed company was 7.50 persons. There are 7 companies that have more than 20 directors, and all of these companies have outside directors. On the other hand, 946 companies have up to 5 directors. In 11 companies (0.3% of two-board companies), the number of statutory auditors *(kansayaku)* exceeds the number of directors; 146 companies (4.3% of two-board companies) have equal numbers of directors and statutory auditors; and, in 425 companies (12.7% of two-board companies), the number of directors exceeds the number of statutory auditors by only one person.

Companies that have appointed outside directors accounted for 64.4% or nearly two-thirds of TSE-listed companies. Among two-board companies alone, the percentage is 63.8%.

Of the two-board companies, 25.9% (or 40.2% of two-board companies that appointed outside directors) have multiple outside directors. On the other hand, companies that appointed multiple "independent" directors accounted for only 12.0%.

The average number of outside directors per company was 1.1 for TSE-listed companies. For two-board companies, the average number of outside directors was 1.04, exceeding one for the first time. For one-board and three-committee companies, it was 4.7.

Of the 3,761 outside directors appointed by the 2,200 TSE-listed companies that appointed outside directors, the TSE was notified of 2,303 (61.2%) outside directors that were also independent directors.

Of all listed companies, 2,058 companies, or 60.3%, have at least two independent directors and/or statutory auditors. Where a company has multiple outside directors and/or statutory auditors who satisfy the independence criteria, it is at the company's discretion whether to notify the TSE of all of them

[21] See TSE-Listed Companies White Paper on Corporate Governance 2015 (March 2015).

[22] The following text draws on the TSE-Listed Companies White Paper on Corporate Governance 2015 (March 2015).

or only of selected members who are considered appropriate. Therefore, compliance only requires a company to notify the TSE of only one of their independent directors or statutory auditors, but a significant number of companies have notified the TSE of multiple persons.

On aggregate, the TSE was notified of 7,526 independent directors and/or statutory auditors, of which 7,330 were in two-board companies, and 196 in one-board and three committee companies. The average number of independent directors and statutory auditors per listed company is 2.20 persons: 2.18 persons in two-board companies and 3.44 persons in one-board and three committee companies.

An analysis of the average number of independent directors or statutory auditors by market division reveals the greatest number of designations came from TSE First Section companies (average 2.62 persons), followed by Mothers (1.95 persons), the TSE Second Section (1.7 persons), and JASDAQ companies (1.7 persons).

Of the listed companies that have independent directors and/or statutory auditors, only 329 companies (9.6%) notified the TSE of outside directors, with 272 of those companies being two-board companies. On the other hand, 1,818 companies (53.1%) only notified the TSE of outside statutory auditors, while 1,267 companies (37.1%) notified them of at least one outside director and one outside statutory auditor.

Out of all independent directors and statutory auditors, 2,303 persons (30.6% of all independent directors and statutory auditors) are outside directors, and 5,223 persons (69.4%) are outside statutory auditors. Of the outside directors and statutory auditors reported to the TSE, 61.2% outside directors were independent, while independent statutory auditors accounted for 63.1%.

Whether outside directors play a positive role in corporate governance has been much debated, and several empirical studies on the subject have been conducted. As to whether there are correlations between having outside directors and firm performance, the results of those studies are split.[23]

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[23] Compare Y. MIWA/J. M. RAMSEYER, Who Appoints Them, What Do They Do? Evidence on Outside Directors from Japan, 14Journal of Economics and Management Strategy (2005) 299 with K. UCHIDA, *Torishimariyakukai Koseihenka no Ketteiyoin to Kigyo Performance eno Eikyo* [The Determinants of the Ratio of Outside Directors and Firm Performance], Securities Analysts Journal 50 (2012) 8; T. SAITO, *Nihon Kigyo niyoru Shagaitorishimariyaku no Donyu no Ketteiyoin to Sono Koka* [The Determinants and the Effects of Having Outside Directors in Japanese Firms], in: Miyajima (ed.), Corporate Governance in Japan – Toward Redesigning Corporate Governance and the Recovery of Competitiveness *(Nihon no Kigyo Tochi - Sono Saisekkei to Kyosoryoku no Kaifuku ni Mukete)* (Tokyo 2011) 181; H. MIYAJIMA/R. OGAWA, *Nihon Kigyo no Torishimariyakukaikosei no Henka o Ikani Rikaisuruka* [How to Understand the Change in the Composition of the Board of Directors in Japan], Junkan shōji hōmu 1973 (2012) 81.

It is interesting to note, however, that empirical studies in recent years have tried to examine the determinants of board composition, seeking to identify factors that may affect optimal board structure. The hypothesis is that more diversified firms with more branches need directors with different backgrounds and expertise, and firms requiring special knowledge and skills need a greater number of inside directors. While recent empirical studies concerning independent directors in the United States imply a situation consistent with this hypothesis, empirical studies concerning outside directors in Japan imply the opposite.[24]

3. *Listing of Subsidiaries*

While most listed firms on the TSE do not have parent companies, some of them do. The TSE White Paper 2015 reports that among TSE-listed companies, 629 companies have controlling shareholders, accounting for 18.4% of all listed companies. Of these, 61.8% (11.4% overall) have parent companies, with 83.5% (9.5% overall) being listed companies[25] while 38.2% (7% overall) have controlling shareholders other than a parent company. In terms of market division, 8.9% of TSE First Section companies have parent companies. This is relatively low compared to the high levels shown in the TSE Second Section 14.7%, Mothers 11.9%, and JASDAQ 14.4%. The same trend can be seen when looking at the total percentage of companies with controlling shareholders other than a parent company. In the TSE First Section, the percentage of companies with controlling shareholders is 12.7%, comparatively lower than the higher levels shown in the TSE Second Section 20.6%, Mothers 29.9%, and JASDAQ 26.6%.

Out of TSE-listed companies whose largest shareholder's ownership ratio is 50% or above, 293 companies do not have a parent company. By market division, they comprise 117 TSE First Section companies (6.4% of this market division), 56 TSE Second Section companies (11.7%), 28 Mothers companies (14.4%), and 92 JASDAQ companies (10.7%). This indicates that there are many companies with company founders and other individuals as controlling shareholders in the market divisions, other than the TSE First Section.

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[24] On this point, see T. FUJITA, Corporate Governance and the Rule of Soft Law, 5 UT Soft Law Review (2013) 9. For the studies in the United States, see, for example, J. S. LINCK/J. M. NETTER/T. YANG, The Determinants of Board Structure, 87 Journal of Financial Economics (2008) 308; K. LEHN/S. PATRO/M. ZHAO, Determinants of the Size and Structure of Corporate Boards: 1935–2000, 38 Financial Management (2009) 747; L. A. BEBCHUK/M. S. WEISBACH, The State of Corporate Governance Research, 23 Review of Financial Studies (2010) 939.

[25] The following text draws on the TSE-Listed Companies White Paper on Corporate Governance 2015 (March 2015).

TSE-listed companies that have controlling shareholders provided explanations on their guidelines for protecting minority shareholder interests.

Approaches to the specific descriptions are categorized into two types: (i) those that describe their policies for transaction conditions; and (ii) those that refer to their procedures for transactions with the controlling shareholders.

(i) 268 companies (or 42.6% of TSE-listed companies with controlling shareholders) described their policies for transaction conditions. They typically referred to policies that stipulate that transactions with the controlling shareholder are to be carried out in a fair and equitable manner, as in those with other business partners, taking into account the terms of such contacts and market prices, to prevent transactions that adversely affect minority shareholder interests (156 companies). Some companies stated that while they do not have business relationships with their controlling shareholders at the moment, they would adopt the above-mentioned policy for future transactions. Other companies referred to the control function of outside directors or statutory auditors, or putting the details of transactions up for internal approval and circulating the information internally. Furthermore, there were companies that stated that, as a matter of policy, they did not, in principle, conduct any transactions with their controlling shareholder in the first place.

(ii) 365 companies (58%) referred to procedures for transactions with the controlling shareholders. Specifically, the procedures described include: asking the opinion of independent directors or statutory auditors, other than those from the parent company to provide more objective decision-making in order to prevent any transaction that benefits the parent company but undermines the interests of minority shareholders; decisions being made in consultation with external specialists, when necessary, to ensure that the transaction terms in question are reasonable and appropriate; and, in contrast to ordinary transactions, requiring a resolution of the board, regardless of the transaction amount in question. As guidelines on protecting minority shareholder interests, some companies involve their own (not the parent company's) board in separate discussions and decisions on matters concerning the transaction, such as the appropriateness of the terms and making independent executive decisions. These companies are expected to provide greater detail demonstrating that directors under the parent companies' influence can make a fair decision. Other procedures include stipulating rules on internal procedures relating to decision-making on the transaction terms to ensure the appropriateness of transactions, and appropriate auditing by statutory auditors or the operations audit group, etc.

In addition to the above-mentioned approaches (i) and (ii), where a controlling shareholder assumes the role of director, company rules such as its code of ethics prohibit such a director from conducting conflict of interest transactions, which cause or may cause conflicts between the director's interests and the company's interests. There are certain companies that specifical-

ly include prohibition on unfairly favorable or unfavorable transactions compared with transactions with third parties, or transactions for the purpose of transferring profits, or losses or risks in their rules as policies to protect minority shareholders.

Finally, recent empirical studies tend to indicate that the economic performance of those listed subsidiaries is not consistently worse than other listed firms.[26]

4. Shareholder Activism

Whether shareholder activism plays a positive role in corporate governance is also a topic that has been much debated worldwide. There are empirical studies about the Japanese situation on this topic, and their implications seem somewhat unclear.[27]

In practice, many institutions have registered with the FSA as institutions implementing the Japanese Stewardship Code, which was promulgated in February 2014.[28] Many institutions also have internal policy guidelines on voting. Similarly, voting advisory institutions such as ISS and Glass Lewis also provide policy guidelines.[29]

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[26] See H. MIYAJIMA/K. NITTA/Z. SHISHIDO, *Oyako Jojo no Keizai Bunseki* [An Economic Analysis of Parent and Subsidiary Listings], in: Miyajima (ed.), *Nihon no Kigyo Tochi – Sono Saisekkei to Kyosoryoku no Kaifuku ni Mukete* [Corporate Governance in Japan – Toward Redesigning Corporate Governance and the Recovery of Competitiveness] (Tokyo 2011) 289.

[27] See Y. HAMAO/K. KUTSUNA/P. P. MATOS, US-Style Investor Activism in Japan: The First Ten Years, Marshall School of Business, Working Paper No. FBE 06-10 (2010). See also J. BUCHANAN/D. H. CHAI/S. DEAKIN, Hedge Fund Activism in Japan – The Limits of Shareholder Primacy (Cambridge 2012).

[28] <http://www.fsa.go.jp/status/stewardship/index.html/>.

[29] For ISS, see <http://www.issgovernance.com/file/policy/2016-asia-pacific-policy-updates.pdf> (in English) and <https://www.issgovernance.com/file/policy/2015japanvotingguidelines-japanese.pdf> (in Japanese). For Glass Lewis, see <http://www.glasslewis.com/assets/uploads/2015/12/2016_GUIDELINES_Japan.pdf> (in English).