Role and Function of Independent and Outside Directors in Japan: After the 2015 Amendment of the Companies Act and the Implementation of Japan's Corporate Governance Code

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I. INTRODUCTION

For a long time, the economic organization in Japan was considered to be on a "special trajectory"[1] based on its development and adherence to a "coordinated" market economy. This "coordinated" market economy rested on collaborative rather than competitive relationships between economic actors who tended to engage in non-market relationships and networks that overshadowed competitive market arrangements and formal contracting. [2] Due to this subscription to an idiosyncratic, collaborative rather than a full-fledged form of capitalism, Japan was regarded to have a "unique" corporate governance system denoted as being "markedly" different from the United States (U.S.)-style management model.[3] In this vein, in Japan, a corporation was perceived in its societal embeddedness, eclipsing the perspective of (short-term) profit maximization. An archetypal Japanese firm's – in short "J-firm's"[4] – corporate policy was orientated at (long-term) firm value and welfare maximization for a corporation and its stakeholders as a team,[5] revealing a commitment to a form of 'team-like'

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[1] Wolfgang Streeck, EXPLORATIONS INTO THE ORIGINS OF NONLIBERAL CAPITALISM IN GERMANY AND JAPAN, IN THE ORIGINS OF NONLIBERAL CAPITALISM: GERMANY AND JAPAN IN COMPARISON 4 (Wolfgang Streeck & Kozo Yamamura eds., 2001).

[2] Peter A. Hall & David Soskice, AN INTRODUCTION INTO THE VARIETIES OF CAPITALISM, IN VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 8, 19 (Peter A. Hall & David Soskice eds., 2001).

[3] Harald Baum, *Vergleichende Corporate Governance mit Japan*, 62 RABEL J. 739, 743 (1998).

[4] *See* Gregory Jackson & Hideaki Miyajima, INTRODUCTION: THE DIVERSITY AND CHANGE OF CORPORATE GOVERNANCE IN JAPAN, *in* CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY 1, 36 (Masahiko Aoki, Gregory Jackson & Hideaki Miyajima eds., 2007).

[5] *See* Henry Hansmann & Reinier Kraakman, *What is Corporate Law?* (Yale Law

corporate social responsibility. [6] Networks and interlocking between corporations resulted in the creation of a macro-level "corporate community" and micro-level conception of "companies as families." [7] Corporate monitoring was achieved through relational arrangements [8] between the stakeholders of a corporation buttressing contractual relations.[9] Societally predisposed strong stakeholder affiliation of corporations and orientation at the welfare of the overall economic system contributed to company law's role as a vehicle to align political and corporate policy between corporations and their stakeholders, rather than as a tool for investor-oriented monitoring of corporate management.

A. How Corporate Law Unfolded in Japan

Initially, Japanese company law absorbed ideas from legal theory and company laws of the United Kingdom (U.K.), France, and Germany in the wake of the Meiji era.[10] This reception occurred in the overall setting of Japan's adoption of Western thought promoted under the parole to approach, imbibe and digest Western knowledge, technology and science with the characteristic Japanese mentality (*wakon yousai*) [11] , and acceptance of Western researchers (*yougakusha*) into Japan.[12] Upon the enactment of the

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Sch. Ctr. for Law Econ. and Pub. Policy, Research, Working Paper No. 300, 2004) ("The underlying normative objective of corporate law is to aggregate welfare for society, shareholders and stakeholders equally."); Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1988 (2013).

[6] Kent Greenfield, *The Third Way: Beyond Shareholder or Board Primacy*, 37 SEATTLE U. L. REV. 749, 761-62 (2014) (muses on the concept of a corporation as a "team-like collective economic enterprise" relying on stakeholders' input to produce goods and services, thus contributing to the wealth of society. The "robust social obligation" that European states are attested to share and that root in cultural norms and law alike, might exist in Japan to a similar extent).

[7] Gen Goto, Recent Boardroom Reforms in Japan and Roles of Outside/Independent Directors 4 (unpublished manuscript) (on file with author).

[8] Masahiko Aoki, *Conclusion: Whither Japan's Corporate Governance? in* Aoki et al., *supra* note 4, at 438 (This earned Japan the characterization as relying on a "relational contingent governance").

[9] Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310-11 (1976).

[10] H. Takada & M. Yamamoto, *The "Roesler Model" Corporation*, 45 J. JAPAN L. 45, 46 (2018).

[11] The coinage of *wakon yousai* represents a modification of *wakon kansai* that denoting the reception and adoption of Chinese knowledge starting in 10th century Japan.

[12] GUNTRAM RAHN, RECHTSDENKEN UND RECHTSAUFFASSUNG IN JAPAN 65 (1990); Časlav Pejović, *Japanese Corporate Governance: Insights from the Unsuccessful Adoption of the American Model*, 3 YONSEI L. J. 191, 193 (2012); Ulrike Schaede, *Change and Continuity in Japanese Regulation*, 1 J. JAPAN L. 21, 25 (1996).

Japanese Commercial Code (*kyuu-shouhou*) in 1899, the corporate structure revolved around a *kansayaku*[13], which later evolved into a *kansayaku* board as the principal monitoring body, bearing a faint resemblance to the concept of a supervisory board.[14] In the period post-World War II, elements of U.S. corporate law were integrated into Japanese company law commencing with the amendment of the Japanese Commercial Code of 1950.[15] In the wake of the dissolution of *zaibatsu* [16] , the amendment focused on strengthening individual shareholder rights. Other fields of reform were reshuffle the balance of corporate powers between shareholders' meeting, board of directors and kansayaku, and devising means to attract capital investment as a form of corporate financing. [17] In the course of the amendment, the *kansayaku's* scope of competence was assimilated to that of a corporate auditor.[18] Subsequent reform trailed the footsteps of U.S. company law, primarily concentrating on efficient control of corporate management. In this vein, reform continuously sought to reinforce the monitoring component.[19] For this purpose, reform retracted the limitation

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[13] The paper adopts the recommendation issued by the Japan Audit & Supervisory Board Member's Association. The association advises to employ the term *kansayaku* instead of the widespread notions of statutory or corporate auditor, the main reason being that the scope of *kansayaku* does not run along the lines usually associated with auditors being of external or internal provenance. *See* Hiroyuki Kansaku & Kazuhiro Takei, *New Recommended English translation of "Kansayaku" and "Kansayaku-kai,"* http://www.kansa.or.jp/en/New_Recommended_English_translation_of_Kansayaku_and_Kansayaku-kai.pdf.

[14] Ronald J. Gilson & Curtis J. Milhaupt, *Choice as Regulatory Reform: The Case of Japanese Corporate Governance*, 53 AM. J. COMP. L. 343, 348 (2005); Curtis J. Milhaupt, *Historical Pathways of Reform: Foreign Law Transplants and Japanese Corporate Governance*, *in* CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES AND MARKETS IN EUROPE, JAPAN, AND THE US 53, 59 (Klaus J. Hopt et al. eds., 2006).

[15] Milhaupt, *supra* note 14, at 54; Hatsuru Morita, *Reforms of Japanese Corporate Law and Political Environment*, 37 J. JAPAN L. 25, 27 (2014).

[16] The term *zaibatsu* denotes huge business conglomerates that dominated and controlled the Japanese economy during the period that spans from the late Meiji period to the end of World War II. The Supreme Commander for Allied Powers initiated the dissolution *zaibatsu* in order to combat excessive concentration of economic power, *see* Thomas L. Blakemore & Makoto Yazawa, *Japanese Commercial Code Revisions Concerning Corporations*, 2 AM. J. COMP. L. 12, 13 (1953).

[17] *Id.* at 15-16.

[18] Eiji Takahashi, *Entwicklung und Hintergründe der Regelungen zur Corporate Governance in Japan mit einem Schwerpunkt auf der Reform von 2013*, 35 J. JAPAN L. 63, 66 (2013).

[19] *Id.*; Bruce E. Aronson, *Learning from Toyota's Troubles: The Debate on Board Oversight, Board Structure, and Director Independence in Japan*, 30 J. JAPAN L. 67, 76 (2010).

of the *kansayaku's* scope in 1974, consequentially shifting *kansayaku's* function towards the performance of legality checks over management whose members were assembled on a U.S.-style board of directors.[20] From the amendment of 1994 onward, the pronounced focus of company law reform has shifted to the promotion of economic growth. The formal influence of U.S. law can be traced in the current reform sweep dedicated – by the black letters of law – to an affirmative embrace of a more shareholder-oriented approach shaped after the management model under the U.S. and partially the U.K.[21] companylaw.[22]

Company law reform in Japan was essentially triggered by economic exigencies. The robust performance of the Japanese economy successfully prevented the rise of criticism until the 1990s when Japan started to face a serious economic headwind, before eventually succumbing and tumbling into recession in the aftermath of the burst of the bubble economy. The lingering recession and plummeting stock prices stirred external pressure to open markets, accompanied by internal pressure urging reform. [23] Under these exigent circumstances, Japan began to gradually reform its company law through nine revisions since 1990, [24] which culminated in the incisive amendment of 2003 ("2003 Amendment")[25] and the codification of comprehensive company law in the Companies Act ("CA") in 2005.[26] Legislative initiative attempted to combat the diagnosed structural crisis and "institutional fatigue" resulting from persisting

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[20] Eiji Takahashi, *Corporate Governance und die Reform des Gesellschaftsrechts in Japan*, 16 J. JAPAN L. 121, 135 (2003).

[21] The Global Financial Crisis of 2008 apparently led to a shift from the sole focus on independence towards expertise, *see* Guido Ferrarini & Marilena Filippelli, *Independent Directors and Controlling Shareholders Around the World* 7 (Eur. Corp. Governance Inst., Working Paper No. 258, 2014).

[22] Pejović, *supra* note 12, at 193; Hiroshi Oda, *Corporate Law Reform in Japan 2001/2002*, 14 J. JAPAN L. 5, 22 (2002).

[23] Harald Baum & Moritz Bllz, *Rechtsentwicklung, Rechtsmentalität, Rechtsumsetzung*, *in* HANDBUCH JAPANISCHES HANDELS- UND WIRTSCHAFTSRECHT 1, para. 63 (Harald Baum & Moritz Bllz eds., 2011); Motomi Hashimoto, *Commercial Code Revisions: Promoting the Evolution of Japanese Companies* 4 (Nomura Research Inst., Paper No. 48, 2002).

[24] *See* Hashimoto, *supra* note 23, at 2.

[25] Entering into effect as of 1 April 2003. The 2003 Amendment had a wide-ranging scope covering revisions concerning shares, auditing, the governing bodies of a stock corporation as well as regarding corporate governance of large public companies invigorating the *kansayaku* system and inaugurating the committee system.

[26] Kaisha-hou [Companies Act], Law No. 86 of 2005 (Japan); *see* Gilson & Milhaupt, *supra* note 14, at 352; Hiroshi Oda, *The Americanisation of Japanese Corporate Law?*, 69 RABEL J. 47, 53 (2005).

recession and the banking crisis of 1997/8.[27] Fuji Bank's refusal to bail out the broker Yamaichi Securities despite belonging to the same *keiretsu*[28] in autumn 1997 epitomized the relinquishment of long-cherished arrangements and tenets of the protective economic organization such as in this case the "no-fail" policy regarding financial institutions. [29] The first wave of reform prioritized the creation of a sound financial market as well as deregulation of anti-competitive barriers and market segmentation.[30]

A transition period of economic consolidation set in between 2002 and 2007, before Japan started to drift into a period of minimal economic growth. [31] By lapse of the third quarter of 2017, Japan's economy experienced growth for seven consecutive quarters, accounting for the longest streak for the past sixteen years. [32] In view of continuously navigating through economic doldrums and floundering firms, also corporate structures began to face scrutiny. A series of corporate scandals (*fushoji*), such as Toyota Motor Corporation's slow response to unintendedly accelerating vehicles and subsequent car recalls on the basis of quality and safety issues, precipitated a full-fledged corporate crisis in February 2010. In addition, Tokyo Electric Power Company's opaque, seemingly cumbersome decision-making in the wake of the Great Eastern Earthquake of March 11, 2011, and Olympus' accounting scandal that surfaced in late 2011 after hiding losses in an amount exceeding $ 1.5 billion incurred after the collapse of the bubble economy through sophisticated accounting schemes over the course of 20 years [33] sparked public

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[27] Nakatani Iwao, *A Design for Transforming the Japanese Economy*, 23 J. JAPANESE STUD., 399, 399 (1997) (For "exhaustion" as a type of institutional change denoting gradual breakdown and dilapidation); Wolfgang Streeck & Kathleen Thelen, *Introduction: Institutional Change in Advanced Political Economies*, *in* BEYOND CONTINUITY: INSTITUTIONAL CHANGE IN ADVANCED POLITICAL ECONOMIES 31 (2005).

[28] *Keiretsu* literally translates into series, sequence or succession. However, in the context of Japanese economy, the term refers to a group or conglomerate of companies linked by business relationships and cross-shareholdings [hereinafter *Keiretsu*].

[29] Baum, *supra* note 3, at 769.

[30] Hideki Kanda, *Globalization of Financial Markets and Financial Regulations in Japan*, 4 J. JAPAN L. 9, 10 (1998).

[31] The fact that the actual economic crisis that ensued the bubble burst and lasted through the 1990s, and economic stagnation through the 2000s is often contracted into the two lost decades (*ushinawareta nijuunen*) demonstrates that in the mind of Japanese people it was considered as one lingering economic crisis.

[32] Kikuo Iwata, Deputy Governor, Bank of Japan, Japan's Economy and Monetary Policy: Speech at a Meeting with Business Leaders in Oita 1 (Jan. 31, 2018) (transcript available at https://www.bis.org/review/r180201d.htm).

[33] Behind the scenes of a profitable company, Olympus's top management joined the ranks of other renowned companies that succeeded hiding operative losses such as Kanebo and Livedoor whose schemes were discovered in 2005 and 2006 respectively.

indignation and further fueled the corporate governance debate.[34] Although the muddles revealed shortcomings regarding internal information and compliance, regulators primarily intensified efforts to invigorate monitoring authority and ease directors' liability.[35] Corporate reform was directed at dismantling intra-company interlocking, enhancing management transparency, and raising competitiveness. This resulted in a balancing act between enhancing managerial flexibility and bolstering shareholder interests in order to attract foreign investment.[36] This approach blends in the overall narrative of "Abenomics"[37] to rekindle the flame of the Japanese economy through the attraction of foreign investment, eclipsing, nonetheless possibly aligning with, a motivation to (re)gain investors' confidence pursuant to the impact of the Global Financial Crisis of 2008.[38]

II. CONCEPTS OF A BOARD OF DIRECTORS AND INDEPENDENT BOARD MEMBERS

Board structure and composition are two pillars that contribute to reconciling the principal-agent conflict or ownership-control dichotomy inherent in a modern corporation. [39] Ownership interests are observed through monitoring and oversight over managers as the actual agents. Under a one-tier system, the spheres of management and monitoring are coupled on the individual board. Collectively, the board maps out the business

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Olympus devised sophisticated schemes in order to evade new accounting standards that grew stricter, filed inaccurate securities reports and did not inform its board of directors nor had the board means to access any relevant pieces of information. *See* Bruce E. Aronson, *The Olympus Scandal and Corporate Governance Reform: Can Japan Find a Middle Ground between the Board Monitoring Model and Management Model?*, 35 J. JAPAN L. 85, 87-88 (2013).

[34] *Id.* at 86; Aronson, *supra* note 19, at 67.

[35] Takahashi, *supra* note 18, at 63; Hashimoto, *supra* note 23, at 8.

[36] Keisuke Nitta, *Column 14: Will the Introduction of Independent Directors Make the Japanese Stock Market Attractive to Foreign Investors?*, RESEARCH INST. OF ECON., TRADE, & INDUS. (Apr. 7, 2009), https://www.rieti.go.jp/en/projects/cgp/columns/14.html.

[37] The term "Abenomics" is coined after Japan's Prime Minister Abe who promotes an ambitious economic revitalization policy as a cornerstone of his political program. The "Abenomics" is composed of three so-called arrows, namely expansive monetary policy, fiscal incentives and structural reform to address low profitability of capital hoarded by Japanese corporations, regain international competitiveness and improve internal corporate compliance systems.

[38] Souichirou Kozuka, Manabu Matsunaka & Gen Goto, *Japan's Gradual Reception of Independent Directors: An Empirical Political-Economic Analysis*, *in* INDEPENDENT DIRECTORS IN ASIA: A HISTORICAL, CONTEXTUAL AND COMPARATIVE APPROACH 135, 160-61 (Dan W. Puchniak et al. eds., 2017).

[39] *See* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 515 (1932).

strategy. In order to avoid blending of remits potentially giving rise to conflicts between management and monitoring functions of individual directors with directors monitoring also themselves and their very own business operations, there is commonly a division between executive and non-executive[40] directors. This division is maintained with the former being entrusted with management while being subject to oversight by the latter group. The effectiveness of the monitoring process is contingent upon the non-executive directors' integrity.[41]

Independent directors are envisaged to preemptively address the apprehension of bias abstract from concrete corporate decision-making.[42] On a global level, independent directors have established themselves as trustees of shareholders' interest that vouch for effective management control. [43] Board representation allows independent directors to review managerial decision-making in the interest of the enterprise by referring to the community of shareholders, investors, and other stakeholders.[44] Certain safeguards are necessary to ensure the personal independence of such directors to continuously warrant that they fulfill their monitoring tasks as objectively as necessary and possible, to prevent actions against shareholders' interest.[45] Despite definitions being far from converging, a common denominator can be identified in directors' financial independence based on their principal employment being external to the company. [46] Ideally, a definition further incorporates safeguards against potential foils such as *keiretsu* ties that could potentially (re)link external employment with the company. Hence, it is proffered that independent directors shall not have any business interests such as through links to major shareholders. The

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[40] *See* Donald C. Clarke, *Setting the Record Straight: Three Concepts of the Independent Director* 4 (George Washington Univ. Law Sch. Pub. Law & Legal Theory, Working Paper No. 199, 2006).

[41] Kozuka, Matsunaka & Goto, *supra* note 38, at 147.

[42] Michael Hoffmann-Becking, *Unabhängigkeit im Aufsichtsrat*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 801, 802 (2014) (Ger.); *see* Clarke, *supra* note 40, at 25 ("The quality of disinterestedness would refer to a particular conflict").

[43] John Armour, *Bank Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 1108, pt. 5 (Jeffrey N. Gordon & Wolf-Georg Ringe, eds. 2018).

[44] Hansmann & Kraakmann, *supra* note 5, at 12.

[45] Takuji Saito, *Why Outside Directors in Japan are Not Prevalent?*, RESEARCH INST. OF ECON., TRADE, & INDUS., (Sept. 2009), https://www.rieti.go.jp/en/rieti_report/110.html.

[46] Markus Roth, *Unabhängige Aufsichtsratsmitglieder*, 175 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT UND WIRTSCHAFTSRECHT [ZHR], 605, 620 (2011) (Ger.); Harald Baum, *The Rise of the Independent Director in the West: Understanding the Origins of Asia's Legal Transplants*, *in* INDEPENDENT DIRECTORS IN ASIA: A HISTORICAL, CONTEXTUAL AND COMPARATIVE APPROACH 26 (Dan W. Puchniak et al. eds., 2017).

formation of committees charged with pivotal monitoring tasks (nomination, remuneration, and audit) and a combination with a certain ratio of independent directors on these committees are alternative ways to accomplish effective monitoring.[47] Embedded in the global discourse on corporate governance, independent directors have become a cornerstone of recent corporate reform in Japan.

A. Variety of Independent Directors in Japan

When corporate reform regarding independent directors commenced after a period of resilience and defiance, statutory reform ran parallel to the initiatives of the ministry-associated Financial Service Agency ("FSA") and the private listing authority Tokyo Stock Exchange ("TSE").[48] This parallel, yet separate development is reflected in the status quo of corporate governance in Japan which rests on two columns, the recently amended CA and the novel Japanese Corporate Governance Code ("JCGC").

Essentially, the TSE's Corporate Governance Principles published in 1998 and revised in 2001 assumed the role of a forerunner. These principles contained recommendations for companies urging them to install "independent, non-executive directors" on their boards.[49] In 2009, the TSE required listed companies to integrate one independent, as opposed to a single outside *kansayaku* on the *kansayaku* board.[50] In the aftermath of the Olympus scandal in 2011, the TSE began to enforce its rules more thoroughly and henceforth required listed companies to adopt an individual independent director on their boards instead of an independent *kansayaku.*[51] The prior recommendation was escalated to a strong recommendation in February 2014. Drawing inspiration from the Organization for Economic Co-operation and Development ("OECD") Principles of Corporate Governance [52], a common forum of FSA and TSE [53] enacted the JCGC,

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[47] Philip Stiles, *Board Committees*, *in* THE OXFORD HANDBOOK OF CORPORATE GOVERNANCE 177, 181 (Mike Wright et al. eds., 2013).

[48] Dan W. Puchniak & Kon S. Kim, *Varieties of Independent Directors in Asia: A Taxonomy* 28 (Nat'l Univ. of Sing., Working Paper No. 001, 2017).

[49] Kozuka, Matsunaka & Goto, *supra* note 38, at 138 n.12.

[50] *See id.* at 136; Aronson, *supra* note 19, at 80 (That was a compromise at that time given that the TSE intended to incorporate one independent person on the board of directors).

[51] Kozuka, Matsunaka & Goto, *supra* note 38, at 141.

[52] The OECD Principles of Corporate Governance were first released in May 1999, revised in 2004 and 2015.

[53] *See* THE COUNCIL OF EXPERTS CONCERNING THE CORP. GOVERNANCE CODE, JAPAN'S CORPORATE GOVERNANCE CODE FINAL PROPOSAL 1, 2 (2015) (The JCGC was adopted through a government council called the Council of Experts Concerning the

effective as of June 2015 in an effort to pursue "sustainable corporate growth and increased corporate value over the mid- to long-term,"[54] and to overcome the undervaluation of Japanese companies due to a "governance discount" imposed by international investors for a perceived lack of transparency.[55] The authors have slightly adjusted the JCGC with effect as of June 1, 2018.

The JCGC includes two salient innovations. It stipulates (1) the duty to disclose cross-shareholdings to encourage (further) reduction of mutual cross-shareholding, [56] and (2) the appointment of two "independent" directors. [57] Conceptually, the TSE employs a "comply-or-explain" approach modelled after the U.K.'s former Combined Code that allows companies to derogate and opt not to comply with the rules[58] but compels them to justify such divergence. [59] An initiative to incorporate a sole independent director on the board of a listed company by virtue of the statutory amendment of the CA in 2015 ("2015 Amendment") [60] failed which demonstrates the different levels of impact of an eventually optional "comply-or-explain" rule in contrast to a binding statutory requirement.[61]

The JCGC surrenders the requirements for independent directors to each company's board discretion.[62] As for a benchmark, the JCGC refers to the security exchange's listing requirements that employ a general clause that requires companies to determine whether there is a potential conflict with shareholders' interests further specified by a list of persons not being eligible.[63] On a perspective plane, the JCGC promotes that at least a third

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Corporate Governance Code under the joint secretariat of FSA and TSE).

[54] *Id.* at 1.

[55] Nitta, *supra* note 36.

[56] JAPAN'S CORPORATE GOVERNANCE CODE § 1 princ. 1.4. (2018) [hereinafter JCGC].

[57] *Id.*, § 4 princ. 4.8; Curtis J. Milhaupt, *Evaluating Abe's Third Arrow: How Significant are Japan's Recent Corporate Governance Reforms?* 5 (Columbia Law and Econ., Working Paper No. 561, 2017).

[58] THE COUNCIL OF EXPERTS CONCERNING THE CORP. GOVERNANCE CODE, *supra* note 53, at 9.

[59] *See* Toshiaki Nakada & Thomas Witty, *New Rules on Corporate Governance in Japan*, 39 J. JAPAN L. 199, 206 (2015) (Comparing Section 24 number 1 Financial Instruments and the Exchange Act).

[60] Entering into effect as of May 1, 2015.

[61] Kozuka, Matsunaka & Goto, *supra* note 38, at 136.

[62] JCGC § 4 princ. 4.9.

[63] Goto, *supra* note 7 (refers to "Independent Directors" and may be read in conjunction with JCGC § 4 princ. 4.8 that slightly nebulously relates to sufficient qualities to ensure sustainable growth and increase of corporate value).

of directors on the board shall be independent, but it (still) accords the implementation to the individual company's discretion and evaluation of the specific circumstances. While initially appealing to companies to develop and submit a roadmap in the event of an affirmative decision, under the amended version, companies are now obliged to appoint a sufficient number of independent directors (Principle 4.8). Thus, despite raising the bar, at the same time there remains discretion and maneuverability for the companies.

Recent figures indicate a growing acceptance of this threshold among TSE-listed companies (28.2% for 2017). [64] The TSE encourages companies with a *kansayaku* board or a supervisory committee that do not have a majority of independent directors on their board of directors to more intensively involve independent directors by creating additional advisory committees for matters such as nomination and remuneration to which independent directors are envisaged to make a significant contribution. In essence, this approach is upheld under the amended JCGC (Supplementary Principle 4.10.1). Under the JCGC, independent directors are assigned a wide field of activity and equally expected to monitor management, provide advice on business policies, monitor conflicts of interest between company and management or controlling shareholders, and appropriately represent minority shareholders and other stakeholders.[65]

B. Outside Directors

The term "outside director" originates in the CA. By virtue of the 2015 Amendment, eligibility for a post as outside director has been limited to persons who "neither are executive director nor executive officer, nor employee, including manager, of such stock corporation or any of its subsidiaries, and who have neither served as executive director nor executive officer, nor as an employee, including manager, of such stock corporation or any of its subsidiaries."[66] Further barred are (1) directors or *kansayaku*, executive officers or employees, including managers of the company's parent company which extends to any controlling company, (2) executive directors or executive officers, or employees, including managers, of a subsidiary of the company's parent company, pertaining to other members of the company group on the same level as such corporation, (3) second-degree relatives or the spouse of directors or important employees, including managers, of such corporation, or of any natural person who controls the financial and business policies of such corporation (Article 2 xv lit. a) through e) CA). Additionally, a cooling-off period has been

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[64] TOKYO STOCK EXCHANGE, APPOINTMENT OF INDEPENDENT DIRECTORS, ESTABLISHMENT OF NOMINATION AND REMUNERATION COMMITTEES, AND DISCLOSURE OF SODANYAKU, KOMON ETC. 1, 5 (2018).

[65] JCGC § 4 princ. 4.7.

[66] Nakada & Witty, *supra* note 59, at 206.

included for certain former employees allowing their appointment as outside directors in the event that they did not entertain employment ties at any time within the ten-year period preceding the assumption of office.

C. Remaining Incongruence Between Independent and Outside Directors

The dichotomy of terminology between CA and JCGC potentially spurs confusion. A comparison between both sets of rules is further complicated by the fact that the statutory metric pertains to "outside directors" on committees, whereas the JCGC counts independent directors on the board as a whole. Despite the definition of independent directors being far from globally uniform,[67] such dichotomy within one jurisdiction naturally ushers the question as to which extent both concepts are congruent. However, both outside and independent director would equally qualify as the above-mentioned non-executive director.[68]

The current definition of an outside director continues to omit economic interests that originate outside of employment contracts but stems from affiliations with major business partners of the company and its subsidiaries. By virtue of the 2015 Amendment, however, such a loophole has been narrowed down considerably by the inclusion of other entities within a group company, namely parent company and subsidiaries of that parent being on the same level as the company concerned. Thus, the *keiretsu* ties that might give rise to loyalty between members of a *keiretsu* conglomerate have been further severed. Henceforth, the threat of potential controlling shareholders such as parent companies that seek to hold sway over their subsidiaries through proxies on their committees is effectively fended off.

However, the JCGC remains stricter than the CA due to the compulsory lack of business and trade relationships prescribed by the JCGC.[69] Nonetheless, as both outside and independent director appear to converge and qualify as non-executive directors, the paper will henceforth refer to independent directors, and only employ the term outside directors when relating to the term as it is employed by the statutory provisions.

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[67] Puchniak & Kim, *supra* note 48, at 3-4; Sanjai Bhagat & Bernard Black, *Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231, 238 (2002).

[68] Baum, *supra* note 46, at 26.

[69] *See generally* Hideki Kanda, *Western Versus Asian Laws on Corporate Governance: The Role of Enforcement in International Convergence*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2015); Kozuka, Matsunaka & Goto, *supra* note 38, at 138.

III. REGULATORY REQUIREMENTS STIPULATED IN THE COMPANIES ACT

Under the CA, companies can choose between three possible organizational forms resulting in disparate numbers of outside *kansayaku* and outside directors.

A. Company with Kansayaku

1. Statutory Layout

Japanese corporate governance used to revolve around a two-tier structure consisting of a board of directors with representative directors and a separate individual *kansayaku* before the latter was transformed into a *kansayaku* board. [70] The institution of *kansayaku* and its assigned competence had been the gateway for corporate governance reform indicated by the CA amendments dating from 1981, 1993 and 2001 that entailed an increase in numbers, the formation of a *kansayaku* board, full-time activity, an extension of the term of office, and outside company provenance.[71]

Currently, the *kansayaku* board consists of at least three *kansayaku* of which the majority is required to be of outside provenance.[72] Eligibility for a *kansayaku* post – regardless whether being outside company *kansayaku* or not – is tied to the absence of employment ties with the company or one of its subsidiaries concurrent with its term of office as *kansayaku*. [73] The mandatory full-time *kansayaku* [74] who is to become acquainted with business organization and envisioned to act as a contact point within a corporation is regarded as integral to achieve effective auditing.[75] Directors and *kansayaku* are equally subject to appointment and dismissal by the general meeting of shareholders.[76] The board of directors decides on certain fundamental matters defined by law or the articles of incorporation in plenary sitting. It also appoints at least one of its members as representative director (*daihyou torishimari-yaku*) who runs the

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[70] Aronson, *supra* note 19, at 76.

[71] Takahashi, *supra* note 18, at 66.

[72] Kaisha-hou [Companies Act], Law No. 86 of 2005, arts. 2(xvi), 335(3) (Japan).

[73] *Id*. art. 335(2).

[74] *Id.* art. 390(3).

[75] Goto, *supra* note 7, at 10-11 n.44.

[76] Kaisha-hou [Companies Act], Law No. 86 of 2005, arts. 347(2), 309(2)(vii) (Japan).

operations on a daily basis and is subject to monitoring by its peers on the board.[77]

2. Evaluation: Competence and Function

Kansayaku and the *kansayaku* board are furnished with authority to monitor and report whether management complies with applicable laws and to perform audits on directors' management activity.[78] *Kansayaku* oversee the performance of duty of all members of the board, including representative directors. To effectively fulfill their tasks, *kansayaku* attend board meetings, are granted access to relevant documents, can state their opinion, and request reports from directors concerning the company's operations. [79] Altogether, these are rights which they are encouraged to proactively exercise. [80] The rights to inspect and audit are individually bestowed on *kansayaku*, thus they do not depend on the delegation of authority from the *kansayaku* board.[81] Therein lies a structural difference in comparison to the committees entrusted with audits under the alternative governance structures.[82] The difference may derive its rationale from the fact that the majority of the committee members are outside directors deemed to sufficiently safeguard decision-making of the committees unaffected by managerial encroachment. [83] However, *kansayaku* lack directors' positions, and thus commensurate authority on the board. *Kansayaku* are divested of the authority to appoint and dismiss directors.[84] Corporate decision-making remains unimpaired with the board of directors. Therefore, the role of the *kansayaku* board is characterized as rather assuming "defensive functions."[85] Conceptually, the board of directors and the *kansayaku* board jointly fulfill the task of supervising management borne by the executive and representative directors.

3. Reception and Criticism

The institution of *kansayaku* has been criticized for being inefficient due to its lack of enforcement competence, specifically the absence of

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[77] *Id*. art. 362(2).

[78] *Id*. arts. 381(1), 374(1).

[79] *Id*. arts. 382-84.

[80] JCGC, § 4 princ. 4.4.

[81] Kaisha-hou [Companies Act], Law No. 86 of 2005, arts. 381(1-3), 390(2) (Japan).

[82] *Id*. arts. 399(3), 405(1).

[83] Goto, *supra* note 7, at 10-11 n.44.

[84] Takahashi, *supra* note 18, at 65.

[85] Goto, *supra* note 7, at 10-11 n.44.

voting rights on the board. *Kansayaku* are trapped between monitoring the performance of directors and lacking the authority to enforce their assessment. This deficit effectively bars *kansayaku* from any direct, potent influence on executive and representative directors whom they supervise, but who are appointed and dismissed by their peers on the board.[86] What is more, the very directors on the board are entrusted with the nomination of *kansayaku*, then submitted to the shareholders' general meeting. [87] This makes it evident why the role of *kansayaku* is perceived as being diminished to that of compliance officers – a role which does in effect not substantively exceed control of directors' fiduciary duties of care and loyalty[88] and is too narrow if projected against the foil of the initial concept.[89] Furthermore, despite the impression that the *kansayaku* models' inherent separation between board of directors and *kansayaku* board might serve as an antidote against entanglement with the management, practices such as inclusion into the internal promotion system appear to indicate the contrary. [90] Notwithstanding these shortcomings, the *kansayaku* model remains the most frequent corporate governance structure among TSE-listed companies accounting for a share of 73.3% as of July 31, 2018.[91]

B. Company with Three Committees

1. Statutory Layout

A three-committee-system was introduced as an alternative governance form by the 2003 Amendment. Under this governance form, corporations were enabled [92] to incorporate three committees within the board of directors instead of a *kansayaku* board by virtue of their articles of incorporation for the remits of audit, nomination, and remuneration.[93] Each committee is required to consist of at least three members of whom the majority must be outside directors. [94] The amendment was seen as an

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[86] Aronson, *supra* note 19, at 76; Aronson, *supra* note 33, at 98.

[87] Hashimoto, *supra* note 23, at 8.

[88] Kaisha-hou [Companies Act], Law No. 86 of 2005, arts. 355, 362(4) (Japan).

[89] Ronald Dore, *Insider Management and Board Reform: For Whose Benefit?*, *in* CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY 381, 384 (Masahiko Aoki, Gregory Jackson, Hideaki Miyajima eds. 2007).

[90] *Id*. at 381; Hashimoto, *supra* note 23, at 8.

[91] This quota corresponds with 2,637 out of 3,598 listed companies, *compare* TOKYO STOCK EXCHANGE, *supra* note 64, at 13.

[92] Gilson & Milhaupt, *supra* note 14, at 344.

[93] Kaisha-hou [Companies Act], Law No. 86 of 2005, arts. 327(4), 400, 404(2-3), 405 (Japan); *see* Kanda, *supra* note 30, at 11.

[94] *Id*. arts. 2(xv), 400(1-3).

attempt to approximate Japan's incumbent corporate governance regime to the U.S.-style monitoring model or adding such tint to it.[95]

The three-committee-system brings about a functional separation between the board and its committees that focus on the development of the business strategy and the monitoring process, and the execution of business that is entrusted to one or multiple executive officers (*shikkouyaku*). The board of directors appoints and dismisses *shikkouyaku* who are delegated daily business operation. [96] Hence, *shikkouyaku* in effect occupy a role tantamount to U.S.-style executive directors.[97] Notably, *shikkouyaku* can retain their seats on the board of directors, or quite the opposite, directors can retain their board position while concurrently acting as executive officer.[98] Similar to directors, *shikkouyaku* are subject to fiduciary duties and liable towards the company. [99] The board of directors effectively becomes a supervisory body if it decides to delegate the competence to execute business operation to *shikkouyaku* save for the non-transferable determination of the basic principles of management and decision-making.[100]

2. Evaluation: Competence and Function

The nomination committee submits proposals concerning appointment and dismissal of directors to the shareholders' general meeting. In contrast to *kansayaku*, all committee members are then subject to appointment and dismissal by the board. The remuneration committee determines compensation for each director as well as executive officer. The audit committee is entrusted with supervision of directors and executive officers as regards the legality and arguably, appropriateness of their actions including the authority to initiate lawsuits to pursue a director's or officer's liability for breach of fiduciary duty, thus assuming a role largely analogous to that of the *kansayaku*.[101] The existence of three committees with the prerequisite of a majority of outside directors suggests a high ratio of outside directors also on the board. But the math is not as easy because

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[95] Misao Tatsuta, *Ongoing Modernization of Japanese Company Law*, *in* CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE US 191, 203 (Klaus J. Hopt et al. eds., 2012); Kozuka, Matsunaka & Goto, *supra* note 38, at 135.

[96] Kaisha-hou [Companies Act], Law No. 86 of 2005, art. 402 (Japan); *see* Takahashi, *supra* note 20, at 135; Hashimoto, *supra* note 23, at 10-13.

[97] Kanda, *supra* note 30, at 11; Gilson & Milhaupt, *supra* note 14, at 353.

[98] Kaisha-hou [Companies Act], Law No. 86 of 2005, art. 402(6) (Japan).

[99] *Id*. art. 419(2) in conjunction with art. 355; *Id*. art. 423(1).

[100] *Id*. art. 416(4), 418; *see* Takahashi, *supra* note 18, at 67.

[101] Takahashi, *supra* note 20, at 136.

outside directors are permitted to occupy seats in several committees.[102] The pivotal improvement in comparison with the *kansayaku* model is that outside directors as committee members concurrently serve as board members with corresponding equal voting rights.

3. Reception and Criticism

Japanese companies have received the committee system unabatedly unwillingly. As of July 31, 2018 a mere 2% of TSE-listed companies have adopted the three-committee-structure.[103] While the audit committee resembles the former *kansayaku* board, the committees for nomination and remuneration represent two novelties. Beside the matter of how far or close to draw the circle around "outside directors" and consequently who to exclude from committee membership, the committees were met with skepticism due to the delegation of substantial authority to outside directors. Upon their adoption outside directors would decide on sensitive matters such as nomination and remuneration of directors and executive officers which were formerly determined by long-term employment mechanics and considered to fall in the realm of representative directors and company presidents. Under such circumstances, it was common practice to (re)appoint directors regardless of firm performance.[104] The very concept of outside directors' implying detachment from the company raised doubts in the business community of whether outside directors could act in a company's best interest. Concerns were voiced that intra-board solidarity and loyalty would be undermined and executive directors would be estranged from the board of directors.[105] In practice, outside directors were deployed to strengthen extant ties between companies contrary to their envisaged role.[106] Under the three-committee-system, a crucial shortcoming from the *kansayaku* system has been retained, namely that the people who are to supervise the directors are at the same time subject not only to the nomination, but even to the appointment by them.[107]

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[102] Kozuka, Matsunaka, & Goto, *supra* note 38, at 138; Peter Lawley, *Panacea or Placebo?* 9 ASIAN-PACIFIC L. & POL'Y J., 106, 111 (2007).

[103] This share corresponds with 71 out of 3,598 listed companies, *compare* TOKYO STOCK EXCHANGE, *supra* note 64, at 13.

[104] Takahashi, *supra* note 18, at 70.

[105] Dore, *supra* note 89, at 381.

[106] Takahashi, *supra* note 18, at 74.

[107] Aronson, *supra* note 19, at 76.

C. Company with Supervisory Committee

1. Statutory Layout

In the course of another amendment of the Companies Act entering into effect in 2015 ("2015 Amendment")[108], a third organizational form, the audit and supervisory committee ("Supervisory Committee") flanking the board of directors was adopted. The Supervisory Committee effectively substitutes the *kansayaku* board. Members of the Supervisory Committee, like members of the board of directors, are appointed and dismissed by the shareholders' general meeting. The requirement that a committee comprises at least three members of which the majority qualifies as outside director has been sustained.[109] As a safeguard to ensure the Supervisory Committee members' independence and remedy the shortcomings under previous models (i.e. the *kansayaku* model), nomination proposals submitted by the board of directors to the shareholders' general meeting are subject to the committee's consent. [110] Furthermore, the appointment of a committee member can only be revoked by a qualified majority of two-thirds of shareholders through the adoption of a resolution.[111] Thus, the Supervisory Committee's members position towards the board and the management has been thoroughly invigorated. The directors designated to form the board of directors and the non-executive directors as members of the Supervisory Committee are appointed separately.[112] This division is upheld with regard to remuneration. The shareholders' general meeting votes on committee members' and other directors' compensation separately to obviate any misgivings concerning potential economic entanglement.[113] The board of directors keeps the right to appoint executive officers and representative directors concomitant with the delegation of authority and responsibility for decision-making and daily operations. [114] At the same time, the 2015 Amendment retracts the novelty under the three-committee-system that

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[108] Which represents the first revision of the Companies Act enacted in 2005.The reform addressed matters in the fields of corporate governance and shares. The major topic was the promotion of outside directors as a vehicle to strengthen corporate governance in large public companies. *See* Companies Act *supra* note 26.

[109] Kaisha-hou [Companies Act], Law No. 86 of 2005, art. 331(6) (Japan).

[110] Nobuo Nakamura, *Amendment to the Company Law and Corporate Governance Reform of Listed Companies*, WASEDA UNIV. INST. OF COMPARATIVE LAW (Apr. 15, 2014), http://www.waseda.jp/hiken/en/jalaw_inf/topics2013/topic/002nakamura.html.

[111] Takahashi, *supra* note 18, at 77.

[112] Nakamura, *supra* note 110.

[113] *Id.*

[114] *Id.*

allowed a non-director to act as an executive officer. As encountered under the *kansayaku* system, all executive officers are concurrently members of theboard.

In contrast to statutory *shikkouyaku* whose appointment is imperative for companies opting for the three-committee-system [115], the adoption of informal, not statutory regulated *shikkouyakuin* or corporate executive officers[116] – tracing back to Sony's market-level innovation[117] inspired by U.S.-style corporate executive directors – is optional for companies with a *kansayaku* board or a Supervisory Committee aiming to streamline decision-making processes and business administration. [118] Despite being primarily dedicated to enhancing management flexibility, as a side effect *shikkouyakuin* contribute to separate executive management from the board for the benefit of effective monitoring.[119]

2. Evaluation: Competence and Function

From the angle of competence, the Supervisory Committee resembles the *kansayaku* board. Therefore, the option to adopt a Supervisory Committee can legitimately be considered an attempt to reconcile the conventional *kansayaku* model with a committee-type governance structure and might have been devised to inculcate change towards the internationally acclaimed monitoring model. Members of the Supervisory Committee are vested with seat and voice on the board, which heaves them into a position to share the monitoring of the executive directors with the collective board. Board membership implies that the committee members have access to board meetings, have a voting right on resolutions, and a say on the determination of management policies. The Supervisory Committee's competence extends to the shareholders' general meeting, where it can propose and submit motions regarding directors'

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[115] Kaisha-hou [Companies Act], Law No. 86 of 2005, art. 402(1) (Japan).

[116] The terminology draws upon the recommendation of John Buchanan & Simon Deakin, *In the Shadow of Corporate Governance Reform: Change and Continuity in Managerial Practice at Listed Companies in Japan*, *in* CORPORATE GOVERNANCE AND MANAGERIAL REFORM IN JAPAN 28, 36 n.3 (D. Hugh Whittaker & Simon Deakin eds., 2009). The authors distinguish between corporate executive officer as a translation for *shikkouyakuin* and executive officer reserved for *shikkouyaku*.

[117] Outside advisory boards and internal committees represent other market-level innovations. Franz Waldenberger, *Corporate Governance*, *in* ROUTLEDGE HANDBOOK OF JAPANESE BUSINESS AND MANAGEMENT 59, 67 (Parissa Haghirian ed., 2016).

[118] Milhaupt, *supra* note 14, at 62 (In 2009 almost half of the listed companies had adopted the executive officer system); *see* Christina Ahmadjian & Toru Yoshikawa, *Killing Two Birds with One Stone: Board Reforms in the Japanese Electronics Industry* 7 (Columbia Bus. Sch. Ctr. on Japanese Econ. & Bus., Working Paper No. 315, 2013).

[119] Ahmadjian & Yoshikawa, *supra* note 118, at 4, 11; Lawley, *supra* note 102, at 121.

appointment, dismissal, resignation, and compensation to a vote.[120] In order to effectively break the representative directors' monopoly as to personnel decisions, the introduction of veto right for committee members has been proffered. [121] If the majority of board members satisfies the criterion of outside directors, or in the event that it does not exceed half of the total number, and the articles of incorporation allows for such, the board of directors is permitted to delegate important decisions to certain executive, usually representative directors to the extent available under the three-committee-system. Members of the Supervisory Committee are barred from acting as representative or executive directors. [122] Enforcing a stricter separation between executive and non-executive directors as well as shifting executive decision-making from the board to those who are well versed with business engenders a clearer distinction between management and monitoring functions on the board equally beneficial for both. [123] However, the amendment continues to fall short to bolster up monitoring with a deeper involvement in the development of business strategy and planning.[124]

3. Reception and Criticism

The reception of the Supervisory Committee apparently progresses smoother than that of the three-committee-system. As of July 31, 2018, 24.7% of TSE-listed companies adopted the new model, [125] potentially benefitting from the fact that it has been perceived as a compromise between the two previous models.[126] The fact that the number of committees – thus of appointed outside directors – was trimmed down, and the possibility to withdraw nomination and compensation from the influence of outside directors engendered a solution ostensibly more tailored to Japanese corporations.[127] Granting outside directors board representation addresses the lack of influence of *kansayaku* on decision-making on the board as it bestows more weight and importance to concerns voiced by Supervisory Committee members during board meetings. The transition to board

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[120] Kaisha-hou [Companies Act], Law No. 86 of 2005, arts. 342-2(4), 361(6) (Japan); *see* Goto, *supra* note 7, at 10-11.

[121] Takahashi, *supra* note 18, at 78.

[122] Nakamura, *supra* note 110.

[123] *Id*.; Ahmadjian & Yoshikawa, *supra* note 118, at 11.

[124] Aronson, *supra* note 33, at 99.

[125] This quota corresponds with 890 out of 3,598 listed companies, *compare* TOKYO STOCK EXCHANGE, *supra* note 64, at 13.

[126] Goto, *supra* note 7, at 10.

[127] *Id.*

representation might have been facilitated by the fact that previously *kansayaku* attended board meetings with the right to make statements, a finding that unmasks lawmakers' step-by-step approach.[128]

D. Recent Trends – Towards Congruence of CA and JCGC?

In line with the incongruent terminology of CA and JCGC, the TSE distinguishes between both kinds of directors when compiling empirical data. When considering the corporations listed on the TSE's First Section, the top tier market segment that encompasses around 1,900 corporations, the share of corporations appointing at least one outside director leapt from 48.5% in 2010 to 98.8% in 2016.[129] When looking at all current TSE-listed corporations, the share of outside directors accounts for 97.7% as of July 2018.[130] Similarly, the figure for independent directors surged to 93.62%.[131] When examining the figure for the First Section[132] corporations that have appointed two or more independent directors, the share rose from 21.5% in 2014, thus prior to the 2015 Amendment, then to 79.7% in 2016, 88% in 2017 and 91.3% in 2018. [133] When taking a look at all TSE-listed corporations, beyond the aforementioned 93.6% that have appointed at least one independent director, 71.8% have incorporated two or more independent directors, and 28.2% have reached the threshold of one-third or more independent directors on their board with 2.7% having a majority of independent members on the board of directors.[134] In the overall context, TSE gauges an average total board size of 8.28 directors among which 2.04 qualify as independent and 2.34 as outside directors.[135] This implies that by adding on average less than one independent director (0.72) would result in a ratio of one-third (2.76) of independent directors on the boards equaling the JCGC's long-term goal.

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[128] Dore, *supra* note 89, at 377.

[129] TOKYO STOCK EXCHANGE, APPOINTMENT OF INDEPENDENT DIRECTORS BY TSE-LISTED COMPANIES 1, 6 (July 27, 2016).

[130] TOKYO STOCK EXCHANGE, *supra* note 64, at 5.

[131] *Id.*

[132] The TSE manages five markets, First Section, Second Section, Mothers, JASDAQ and TOKYO PRO Market. The top-tier and second-tier Japanese and foreign companies are listed in the First and Second Sections of the TSE. Large companies in terms of size and liquidity tend to be listed in the First Section, while medium-sized companies are listed in the Second Section. *See Overview of IPO*, JAPAN EXCH. GRP. (June 25, 2018), https://www.jpx.co.jp/english/equities/listing-on-tse/new/basic/index.html.

[133] TOKYO STOCK EXCHANGE, *supra* note 64, at 2; Goto, *supra* note 7, at 12-13.

[134] TOKYO STOCK EXCHANGE, *supra* note 64, at 5.

[135] *Id.*

These numbers reveal a considerable rising share of listed companies that embrace statutory and TSE requirements on a wide-scale. Pertaining to the minimum requirements, saturation can be legitimately assumed, however, with the caveat that the surveyed numbers reflect acceptance only among the top-tier corporations. It might be debatable whether reform is superficial or traditions' influence too steadfast since recent reform effort appears to be limited to the top-tier corporations. This tendency might adumbrate that the debate will also be one that will grapple with the degree of pervasiveness of reform. Against the background that foreign investors as one interest group pleading for corporate governance reform seem to concentrate their investment on the top-level companies, it might further be a question of relevance. Certain indents on the surface, however, stir hope that time has come that the current reform impetus will bear success. Despite their initial rejection of the statutorily imposed three-committee-model, TSE-listed companies have also begun to establish nomination (22.2%) and remuneration committees (24.7%) on a voluntary basis.[136] Interestingly, as of 2018, approximately half of the corporations listed on the TSE First Section (43.6%) opting for the discretionary [137] adoption of nomination (52.7%) or remuneration committees (51%) implement a majority of outside directors,[138] with each 43.9% proceeding even further by additionally appointing an outside director as chairman.[139]

IV. TOPOGRAPHY OF CORPORATE GOVERNANCE ORGANIZATION IN JAPAN

Independent directors as an institution are embedded in the overall web of corporate governance constituents like size and ownership structure of a firm [140] , financial system and capital market, human resource management, culture, and eventually law. These constituents interact, interdepend, and complement each other, thus potentially obstructing, overshadowing, or facilitating independent directors' intended objective and the impact hoped for.[141] As regards Japan, internal J-firm organization was for a long time dominated by institutions such the monolithic main bank environed by inter-corporate *keiretsu* ties as elements of a relational contingent governance regime under which external and internal monitoring

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[136] *Id*. at 12.

[137] JCGC, § 4 princ. 4.10.

[138] TOKYO STOCK EXCHANGE, *supra* note 64, at 7, 10.

[139] *Id*. at 8, 11.

[140] As regards size of a firm and ownership structure, the paper only considers what is defined as a large public company within the ambit of Kaisha-hou [Companies Act], Law No. 86 of 2005, art. 2(vi)(a-b) (Japan).

[141] Kanda, *supra* note 69, at 3.

were intertwined and whose actors shared information, responsibilities, and provided mutual help.[142]

A. Keiretsu

Organizational interlocking known as *keiretsu*, meaning the formation of economic literally chains or line-ups, [143] manifests in two forms: horizontal and vertical *keiretsu*.[144] While vertical *keiretsu* are being forged in the course of long-term exclusive manufacturer-supplier relationships[145], the notion of horizontal *keiretsu* refers to the formation of corporate groups (*kigyou shuudan*) usually concomitant with reciprocal, "political" cross-shareholding (*kabushiki mochiai*). [146] Such a corporate group or company network assembled around a main bank and a general trading company (*sougou shousha*) with its members aiming at long-term cooperation and mutual support.[147] The concept of *keiretsu* is broader than the term cross-shareholding. Cross-shareholding and (horizontal) *keiretsu*, however, typically crop up together. [148] Cross-shareholding portrays a constellation in which two or more corporations hold each other's shares leading to a "blending at the edges" of the individual firms.[149] By means of cross-shareholding, a pyramidal shareholding structure is emulated. Controlling interest in one or two key companies multiplies influence sufficient to gain effective control over a whole *keiretsu* conglomerate.[150] The gist of cross-shareholding is twofold: primarily, it forges mutual trust, [151] stability contributing to insulating management from market

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[142] Masahiko Aoki, *The Contingent Governance of Teams: Analysis of Institutional Complementarity*, 35 INT'L ECON. REV., 657, 672 (1994).

[143] Časlav Pejović, *Reforms of Japanese Corporate Governance: Convergence in the Eye of the Beholder*, 35 J. JAPAN L. 107, 111 (2013); *see also Keiretsu supra* note 28.

[144] Jackson & Miyajima, *supra* note 4, at 4.

[145] Franz Waldenberger, *Keiretsu*, *in* ROUTLEDGE HANDBOOK OF JAPANESE BUSINESS AND MANAGEMENT, *supra* note 117, at 40.

[146] Katsuki Aoki & Thomas T. Lennerfors, *Whither Japanese* Keiretsu*? The Transformation of Vertical* Keiretsu *in Toyota, Nissan and Honda: 1991 to 2011*, 19 ASIA PAC. BUS. REV. 70, 71 (2013); Jackson & Miyajima, *supra* note 4, at 3-4; SIMON LEARMOUNT, CORPORATE GOVERNANCE: WHAT CAN BE LEARNED FROM JAPAN? 56 (2002).

[147] Pejović, *supra* note 143, at 111; Waldenberger, *supra* note 117, at 36.

[148] *See Keiretsu supra* note 28.

[149] Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L. J. 871, 883 (1993).

[150] John O. Haley, *Japanese Perspective, Autonomous Firms, and the Aesthetic Function of Law*, *in* CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE US 205, 209 (Klaus J. Hopt et al. eds., 2012).

[151] Schaede, *supra* note 12, at 27. (casts a different light on keiretsu ties. From her

embroilments, and helping entrenched managers "to live the quiet life."[152] It also serves as a symbol of good relationship and conceptual foundation of a relational network, thus eschewing rather than building up a controlling position over other *keiretsu* members. [153] Despite a decrease of cross-shareholding after the banking crisis due to banks unwinding their equity positions, such development has evened out due to a non-negligible figure of firms continuing to commit to cross-shareholding.[154]

B. Main Bank

The main bank as the relational monitor at the heart of a *keiretsu* conglomerate and repository for insider information formed another major, if not the key actor under Japan's traditional corporate governance model.[155] As its principal actor, the main bank effectively sidelined other actors such as the board of directors, *kansayaku*, shareholders, and corporate law regulations. [156] The main bank rooted in the fact that corporate finance primarily relied on loans. Conceptually, external creditor monitoring was internalized through the main bank as lender and concurrently major shareholder. The main bank itself leaned on an implicit intra-bank arrangement under which monitoring of a specific company was delegated from the involved creditor banks to one principal bank among them.[157] The main bank's debt and equity position towards a corporation provided the bank with leverage to steer business strategy and lifted the bank into the position of a "self-interested manager."[158] The main bank was regarded as

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(historically founded) angle, they represent credible commitments to appease underlying mistrust.)

[152] Naoshi Ikeda, Kotaro Inoue & Sho Watanabe, *Enjoying the Quiet Life: Corporate Decision-Making by Entrenched Managers*, 47 J. JAPANESE & INT'L ECON. 55, 62 (2018).

[153] Yoshiro Miwa & Mark Ramseyer, *The Multiple Roles of Banks? Convenient Tales from Modern Japan*, *in* Hopt et al., *supra* note 14, at 527, 552; Gen Goto, *Legally "Strong" Shareholders of Japan*, 3 MICH. J. PRIVATE EQUITY & VENTURE CAP. L. 125, 126 (2014).

[154] Ikeda, Inoue & Watanabe, *supra* note 152, at 56.

[155] Aoki, *supra* note 8, at 429; Yasuhiro Arikawa & Hideaki Miyajima, *Relationship Banking in Post-Bubble Japan: Coexistence of Soft- and Hard-Budget Constraints*, *in* CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY (Masahiko Aoki et al. eds., 2007); Pejović, *supra* note 12, at 197.

[156] Milhaupt, *supra* note 14, at 56; Waldenberger, *supra* note 117, at 38.

[157] P. Sheard, *Reciprocal Delegated Monitoring in the Main Bank System*, 8 J. JAPAN & INT'L ECON., 1, 1 (1994).

[158] Dan W. Puchniak, *Perverse Rescue in the Lost Decade: Main Banks in the Post-Bubble Era*, *in* CORPORATE GOVERNANCE IN THE 21ST CENTURY: JAPAN'S GRADUAL TRANSFORMATION 81, 103 (Luke Nottage et al. eds., 2008); Pejović,

the driving force behind Japan's economic growth and as a significant contribution to Japan's competitive advantage.[159]

The main bank assumed a predominantly passive monitoring role, only springing into action in the event of a crisis bound by its implicit promise to restructure failing companies thus saving firm-specific assets instead of foreclosing loans prematurely and instead of propelling liquidation and thus further augmenting costs incurred through formal bankruptcy proceedings.[160] The main bank could substitute board members by proxies to orchestrate – with government patronage – "friendly" reshuffling of temporarily distressed firms, while subpar performing firms were liquidated so that despite the main bank's controlling position, a market shakeout eventually occurred. [161] The capacity to replace (not necessarily take over) senior management imitated an effectively absent takeover market.[162] A main bank could expect its clients not to extricate themselves upon financial recovery. [163] Government authorities' implicit promise to prevent bank failure ("no-fail policy") enabled the main bank's commitment to corporate monitoring. Adherence to this policy forged a triangular relationship between banks, corporations and government agencies,[164] but at the same time carried in it the seed of its decay.

Stricken by financial woes of the Banking Crisis of 1997/8, the main banks did not fully recuperate and were compelled to relinquish their position at the heart of a J-firm conglomerate. The erosion of the main bank's position marks a watershed development, dubbed as "collapse of financial communism," triggering financial and psychological shock waves catalyzing a loss of confidence in the Japanese financial system. [165] Deregulation and internationalization of financial markets caused a shift towards reliance on capital market and equity finance. [166] Internationalization pried open the limits of a self-contained, therefore

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supra note 143, at 113.

[159] *Id.* at 114.

[160] Dan W. Puchniak, Rethinking Corporate Governance: Valuable Lessons from Japan's Post-Bubble Era 117 (2008) (unpublished LL.D. dissertation, Kyushu University) (on file with author); Baum, *supra* note 3, at 747; Gilson & Roe, *supra* note 149, at 880.

[161] Arikawa & Miyajima, *supra* note 155, at 52; Aoki, *supra* note 142, at 671.

[162] Pejović, *supra* note 143, at 114; Miwa & Ramseyer, *supra* note 153, at 561.

[163] Aoki, *supra* note 142, at 671.

[164] Puchniak, *supra* note 158, at 116.

[165] Learmount, *supra* note 146, at 49.

[166] Milhaupt, *supra* note 14, at 57; Takeo Kikkawa, *Toward the Rebirth of the Japanese Economy and its Corporate System*, 17 JAPAN F. 87, 96 (2005).

controllable system and loosened the grip of the relational monitoring model assembled around the main bank on companies.[167]

C. Long-Term Employment

Human resource management played a significant role in the array of insider monitoring actors. [168] Irrespective of its actual dimension, [169] origin, and the widely-circulated narrative resorting to Confucian thought, the crucial fact is that the concept of long-term employment (*shuushin koyou*) transpired as the most rational economic – not codified, but institutionalized – choice for all involved actors.[170] Despite all perish songs intoned, the concept is still applicable to a non-negligible percentage of the overall workforce. [171] Conceptually, long-term employment relies on the implicit promise made by the employer to its employees of employment until the age of retirement under the condition that an economic crisis does not render layoffs unavoidable[172] in return for its employees' pledge not to abandon the company. [173] The concept was further fortified by the non-existence of a functioning external labor market, [174] "top-heavy"

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[167] *See* Wolf-Georg Ringe, *Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG* 26 (Univ. of Oxford Legal Research Paper Series, Paper No. 42, 2014) (for the erosion of bank-centered corporate governance in Germany).

[168] During the debates leading to the 2015 Amendment, labor unions motioned the installation of employee representation on the *kansayaku* board. However, this idea was dropped at an early stage of the deliberations. *See* Souichirou Kozuka, *Reform After a Decade of the Companies Act: Why, How, and to Where?* 37 J. JAPAN L. 39, 41 (2014); Morita, *supra* note 15, at 12.

[169] LEON WOLFF, THE DEATH OF LIFELONG EMPLOYMENT IN JAPAN? *in* CORPORATE GOVERNANCE IN THE 21ST CENTURY: JAPAN'S GRADUAL TRANSFORMATION 53 (Luke Nottage, Leon Wolff & Kent Anderson eds., 2008) (The phenomenon with its core elements accounts for approximately 20 percent of the workforce); For an overview of estimates, see Hiroshi Ono, *Lifetime Employment in Japan: Concepts and Measurements*, 24 J. JAPANESE & INT'L ECON. 1, 4 (2010).

[170] Pejović, *supra* note 143, at 115.

[171] Takashi Araki, *The Widening Gap Between Standard and Non-Standard Employees and the Role of Labor in Japan*, 8 U. TOKYO J. L. & POL., 3, 11-12. (2011); Junya Hamaaki, Masahiro Hori, Saeko Maeda & Keiko Murata, *Is the Japanese Employment System Degenerating?* 29 (Econ. & Soc. Research Inst. Discussion Paper Series, Paper No. 232, 2010).

[172] Fortified by the court's doctrine of abusive dismissal, see Gregory Jackson, *Employment Adjustment and Distributional Conflict in Japanese Firms*, *in* Aoki et al., *supra* note 4, at 290; Pejović, *supra* note 143, at 115.

[173] Pejović, *supra* note 12, at 209; Puchniak, *supra* note 158, at 120.

[174] Gregory Jackson, *The Origins of Nonliberal Corporate Governance in Germany and Japan*, *in* Streeck & Yamamura, *supra* note 1, at 138.

compensation, and a promotion system primarily based on seniority (*nenkou joretsu*).[175] Corporations were enabled to commit to their promise through the existence of main banks and stable shareholders that helped insulate them against financial turmoil.[176] However, even in the heydays of the Japanese economy, the benefits of long-term employment were reaped by only a share of core-workers in core-companies. This part of the workforce was insulated against their companies' economic embroilments. Economic pressures were vented at the expense of companies further down in the *keiretsu* pyramid and potentially non-long-term employees in those companies.[177]

Long-term employment incubated what is prevailingly portrayed as "internalism" or "corporate hegemony."[178] "Corporate hegemony" roots in the fact that promotion and remuneration are awarded commensurate with seniority leading to upper management levels being occupied by long-serving employees. This "corporate hegemony" reflects the key idea underlying long-term employment, to wit loyalty is rewarded by in-house career paths culminating in the prospect of being appointed as director.[179] Therefore, boards typically ended up being staffed with senior managers recruited from a company's major divisions.[180]

Board composition replicated the hierarchical structure within a firm.[181] There are typically four ranks below the president (*shachou*) –who usually is a representative director – ascending with seniority, namely ordinary director, regular director (*joumu*), special director (*senmu*) and vice-president. [182] Additionally, the prospect to retire as chairperson is attached to a director's position, projecting career horizons even further, beyond management positions (*kanrishoku*).[183] Such further deferred post-retirement career heights serve as additional performance checks beside reputational constraints.[184] The different levels of seniority among directors

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[175] Puchniak, *supra* note 158, at 120, 271, 278.

[176] *Id.* at 120.

[177] Baum, *supra* note 3, at 765.

[178] John Buchanan, *Japanese Corporate Governance and the Principle of "Internalism,"* 15 CORP. GOVERNANCE 27, 28 (2007).

[179] Ahmadjian & Yoshikawa, *supra* note 118, at 6.

[180] Milhaupt, *supra* note 14, at 58.

[181] Ahmadjian & Yoshikawa, *supra* note 118, at 6; Souichirou Kozuka, *Conclusions: Japan's Largest Corporations, Then and Now*, *in* Nottage et al., *supra* note 158, at 239.

[182] Puchniak, *supra* note 158, at 275.

[183] *Id.*; Dore, *supra* note 89, at 391.

[184] Dore, *supra* note 89, at 391; Waldenberger, *supra* note 117, at 62.

are mirrored in the degrees of influence in institutionalized informal decision-making processes. Presidents of the members of a *keiretsu* conglomerate convene informally (*shachou-kai*).[185] On the company level, a company's *shachou* confers with *semnu* and vice-president – jointly forming the *joumu-kai* – about business strategy.[186] The board of directors is then left to disseminate the internally binding *joumu-kai* decisions.[187]

The prospect of promotion as a reward for ability, the accumulation of company-specific knowledge, as well as loyalty to the company causes that employees perceive their individual personal welfare to be concatenated with their company's economic well-being. Lifetime employment aligns a corporation's economic welfare with its employees' individual welfare. Employees gain additional motivation from the negative prospect of being dispatched to peripheral sectors of their firm, as well as through the social hardship looming if their firm fails.[188] Effectively, long-term employees through security of employment, wages, and promotion participate in the corporation's welfare, thus becoming a company's quasi-owners. Firm-specific education fosters the creation of firm-specific skills, strengthening the ties between employer and employees and increasing a company's opportunities to redeploy employees through internal rotation schemes, but simultaneously "trapping" employees in a specific firm due to their education and training being tailored to their specific company or *keiretsu*.[189] Thus, an inextricable tie between employees' (including managers') financial future and a company's economic performance is spun.

Long-term employment was conducive to a corporate governance system that relies on contractual governance and organizational cross-monitoring through peer review to curb managerial freedom by compelling managers to a company's welfare.[190] Upon attaining a director's post, directors are encouraged by their own careers to ensure that the following generations can likewise enjoy lifetime in-house careers.[191] Younger

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[185] Časlav Pejović, *Japanese Corporate Governance: Behind Legal Norms*, 29 PENN ST. INT'L L. REV. 483, 504 (2011).

[186] Dore, *supra* note 89, at 374.

[187] *Id.*; Pejović, *supra* note 185, at 505.

[188] Wolff, *supra* note 169, at 60 (In this context the findings of Weber are interesting who states that the sanctioning of violations of social norms by social boycott might prove to be more effective than sanctions imposed by legal norms); MAX WEBER, WIRTSCHAFT UND GESELLSCHAFT 17 (1922).

[189] Wolff, *supra* note 169, at 60; Pejović, *supra* note 185, at 505; Jackson, *supra* note 172, at 282.

[190] Gilson & Roe, *supra* note 149, at 874, 885.

[191] Waldenberger, *supra* note 117, at 59, 61.

employees are prompted to monitor the board due to their very own career prospects being contingent upon the company's performance.[192] However, the absence of lateral exit opportunities extends to executive levels and disincentivizes managers to put shareholder rights into practice against peer managers within a *keiretsu* conglomerate, but rather induces them to maintain the status quo in their common best interest.[193] Therefore, long-term employment buttresses the internal monitoring scheme through career employees and long-term business orientation eclipsing shareholders' interest in short-term dividends for the benefit of job security. Long-term employment epitomizes a corporate philosophy that builds upon investment in human capital for the sake of returns on human capital.[194]

D. Closing of Ranks Between Government and Business

Business and governmental policy in Japan seem to go hand in hand. One major reason for this interlocking can be traced back to the concept of "developmental state" as which Japan has been characterized and which refers to a state's principal role in devising macroeconomic industrial policy and industrial organization in late twentieth century in East Asia.[195] The growth of the J-firm that drew upon a government supporting the main bank system[196] and condoning – if not facilitating[197] – the formation of *keiretsu* corporate groups through cross-shareholding and informal ties can be seen as a product of such philosophy. The system revolving around the J-firm was designed to observe fair competition in the domestic market and to be competitive on the global scale. [198] The orchestration of bank-driven reallocation of capital through friendly mergers between firms subsequent to the banking crisis can be regarded as a prime example of a developmental state's commitment. [199] Government involvement in Japan specifically refers to the Ministry of Finance and the Ministry of Economy, Trade and Industry's ("METI," formerly the Ministry of International Trade and Industry, MITI) role, earning Japan the reputation of being a "government

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[192] *Id*. at 62; Dore, *supra* note 89, at 371.

[193] Haley, *supra* note 150, at 210.

[194] *Id*.; Waldenberger, *supra* note 117, at 61.

[195] Pejović, *supra* note 143, at 116; Paul Krugman, *The Myth of Asia's Miracle*, 73 FOREIGN AFF. 62, 76 (1994).

[196] For example, by legislation, that effectively obstructs new entrants into the banking system, *see* Arikawa & Miyajima, *supra* note 155, at 51.

[197] See for example the historical amendment of the Antimonopoly Act in the 1950s which (re)allowed cross-shareholding.

[198] Pejović, *supra* note 143, at 116.

[199] Puchniak, *supra* note 158, at 105.

of administration" rather than of law.[200] The developmental state entails cooperation and group orientation within the framework of a concerted economy that relies on a network of mutual relationships and trust, thus encouraging the formation of a collaborative, communitarian capitalism. However, recent developments indicate authorities' awareness to vacate their position for the sake of a "participatory market economy" that rests on transparent rules, giving way to a law-oriented approach.[201]

Cohesion based on institutional links was reinforced by personal ties. Executives in the areas of politics and business were likewise perceived to be recruited from a pool of elites. Moreover, such elites appeared to be able to switch freely between both areas – a tendency epitomized by the institution of *amakudari*, literally meaning "descent from heaven." In general, the term *amakudari* refers to an unwritten, however, institutionalized re-employment scheme to accommodate high-level bureaucrats in private and public companies that furnish them with sinecures.[202] In one of its guises[203] – the one that is deemed solely relevant in the context of this paper – the *amakudari* system offers public officers who have reached the statutory retirement age of sixty or a dead-end in their potentially life-time ministerial career, the opportunity to acquire a position on the board of directors or as *kansayaku*. Other career paths could see former bureaucrats operate "public corporations" or "intermediary firms," meaning entities funded by private monies that serve public, such as regulatory, purposes.[204] In their various capacities, *amakudari* aid public authorities to ensure the implementation of their regulations through decentralized monitoring,[205] and dissemination of administrative guidance, thus contributing to a "government-business-consensus."[206] As contact points for consultation and cooperation, *amakudari* foster information exchange and coordinated policy-making, thus contributing to the stability of the overall system.[207]

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[200] Pejović, *supra* note 143, at 117.

[201] The Justice System Reform Council, *Recommendations of the Justice System Reform Council* ch. 1 (2001); Leon Wolff, Luke Nottage & Kent Anderson, *Introduction: Who Rules Japan?* 3 (Sydney Law Sch., Research Paper No. 15/10, 2015).

[202] RICHARD COLIGNON & CHIKAKO USUI, AMAKUDARI: THE HIDDEN FABRIC OF JAPAN'S ECONOMY 2, 5 (2003).

[203] *Id*. at 11; Colin P. A. Jones, *Amakudari and Japanese Law*, 22 MICH. ST. INT'L L. REV. 879, 882 (2014).

[204] Schaede, *supra* note 12, at 26.

[205] Pejović, *supra* note 12, at 201.

[206] CHALMERS JOHNSON, JAPAN: WHO GOVERNS? THE RISE OF THE DEVELOPMENTAL STATE 141 (1996).

[207] COLIGNON & USUI, *supra* note 202, at 7; Jones, *supra* note 203, at 880.

The developmental state and the *amakudari* system are both manifestations of the concept of inter-institutional and business cooperation for the best outcome for every actor, [208] their robustness earning this triumvirate the title "iron triangle."[209] On the other hand, the prospect of attaining a propitious position as *amakudari* adds a personal interest to civil servants' perspective that might imbue their decision-making, shying away from decisions that could jeopardize their potential future career as *amakudari*, making government authorities susceptible to lobbying. [210] Collusion might just prove to be the reverse side of a coin's obverse called corporation. Unbiased supervision may be legitimately questioned if regulators and the regulated are intertwined. Despite the overall tendency that adherence to bureau-pluralism in general and to the *amakudari* system specifically is on the wane, which can partly be ascribed to regulatory reform,[211] it is still common to allocate advisory positions to *amakudari*.[212]

E. The Relevance of Non-Legal Rules

Social phenomena require a holistic view because social science fields are interrelated.[213] An observation cannot be exclusively imputed to one field of social science. In this vein, law only represents a sector of the whole. Equally, norms are no prerogative of law but likewise occur in non-legal realms. Formal law and "informal" social norms mutually affect each other.[214] These general findings become evident in Japanese corporate law. Its status quo developed its peculiarities despite being formally – by the black letter law – oriented at U.S. corporate law throughout the last decades. As an explanation for this apparent paradox, it has been put forward that law only prescribes formal rules in whose margin the actors supposedly operate, however, the law does not necessarily reflect the rules the actors

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[208] COLIGNON & USUI, *supra* note 202, at 5.

[209] Tetsuji Okazaki, *The Government-Firm Relationship in Postwar Japan: The Success and Failure of Bureau Pluralism*, *in* RETHINKING THE EAST ASIAN MIRACLE 323, 323 (Joseph E. Stiglitz & Shahid Yusuf eds., 2001).

[210] Pejović, *supra* note 143, at 117.

[211] Exemplified by the metamorphosis of the FSA from an institutional agent of bureau-pluralism to a regulator in a relationship at arms length with the regulated companies. *See* Aoki, *supra* note 8, at 447.

[212] *Id*. at 446; Jones, *supra* note 203, at 890, 892.

[213] JOSEPH A. SCHUMPETER, THEORIE DER WIRTSCHAFTLICHEN ENTWICKLUNG 1 (1911).

[214] Phillip Lipton, *The Evolution of the English Joint Stock Company to 1800: An Institutional Perspective* 8 (Monash Univ. Dep't of Bus. Law & Taxation, Research Paper No. 19, 2016).

choose to abide.[215] This concept might hold a grain of truth with respect to Japan. Harkening back to Confucian thought, society continues to define itself by balance and harmony rather than difference. Hence, the legal system is only invoked in cases of distress. [216] Institutions like *keiretsu*, long-term employment, and the main bank system rely on informal agreements between the involved parties and illustrate that extra-legal foundations assume an influential role in the field of corporate governance.[217] The pertinent rules constitute a somehow parallel regime that actors can opt to resort to, a regime that in practice can sometimes overshadow statutory law rendering it ineffective. The interpretation of legal concepts such as good faith and fiduciary duty by Japanese courts unveils how social thought winds its way into contractual relationships.[218] Similarly, Japanese corporate governance can be construed as a complex system of multiple (social) constraints of various actors and interest groups, however, resting on an intact legal framework. [219] Corporate governance actors have concertedly and in their common best interest developed a system which they deem to be economically efficient within their environment.[220] This system might not be based on, nor reflected by laws. The evolution of this idiosyncrasy might become clearer if legal norms are viewed as having been transplanted on a bedrock of extant social, non-legal norms, compelling the transplanted legal norms to attune to impact and importance of non-legal rules rooted in social customs in Japan.[221]

1. Difference Between Law and Practice Reflects the Way Things are Done

The characteristics of the J-firm reflect societal concepts of community[222] and cooperation[223] in the sense that all actors of the corporate governance team strive for the best result of all team members revealing the extent and impact of social norms. However, it is not that social norms single-handedly craft or shape institutions, but it is rather interest groups

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[215] Aoki, *supra* note 8, at 434.

[216] *See* NIKLAS LUHMANN, DAS RECHT DER GESELLSCHAFT 167 n.5 (1993).

[217] Pejović, *supra* note 12, at 204.

[218] Curtis J. Milhaupt, *A Relational Theory of Japanese Corporate Governance*, 37 HARV. INT'L L.J. 3, 40 (1996).

[219] *Id*. at 21.

[220] Pejović, *supra* note 12, at 204.

[221] Pejović, *supra* note 143, at 120.

[222] JOHN O. HALEY, THE SPIRIT OF JAPANESE LAW 14 (1998).

[223] Pejović, *supra* note 12, at 204.

dynamics that determine social patterns and courses of operations.[224] Social norms may facilitate and expedite the acceptance of institutions if they reflect settled paths and procedures.[225] In this vein, the modes of economic decision-making (management) and governance (monitoring) have been harmonized under Japan's corporate governance system. Cross-shareholding and long-term employment emerged and remain in effect because they have established themselves as integral parts of the most effective governance mode, as they coincide with the traditional way of doing business in Japan. [226] Pragmatism supersedes adherence to principles. [227] Long-term orientation has been distilled as the common denominator of institutions and relationships brought forth by the Japanese corporate governance system.[228]

2. Extra-Legal Foundations

In this context, it might be worth dwelling upon the alignment of corporate governance mechanisms with social norms that might account for the high degree of identification companies achieve with their employees. The fact that employees perceive the company as a family might havebeen smoothened by the fact that social – which means in this context family – norms likewise apply to them. Social norms catalyzed the acceptance of long-term employment created through informal consensus between employers and employees. The juxtaposition of home (*ie*) and company (*kaisha*) demonstrates that association with the company bears resemblance with the conception of *ie*, articulated in the expression "my company" (*uchi no kaisha*) in consonance with my home (*uchi*). Although the relationship between employer and employee is endorsed by an employment contract, this contract does not include an explicit clause pertaining to interminability, as it would infringe statutory provisions.[229] Instead, virtual interminability is achieved through non-contractual factors such as reputation and implicit collusive arrangements regarding hiring practice between firms, and eventually backed by jurisprudence.[230]

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[224] Pejović, *supra* note 143, at 124; Curtis J. Milhaupt, *Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance*, 149 U. PA. L. REV. 2083, 2124 (2001).

[225] Pejović, *supra* note 12, at 206.

[226] *Id.* at 207.

[227] Schaede, *supra* note 12, at 26.

[228] Pejović, *supra* note 143, at 126.

[229] Hideshi Itoh, *Japanese Human Resource Management from the Viewpoint of Incentive Theory*, *in* THE JAPANESE FIRM: SOURCE OF COMPETITIVE STRENGTH 233, 235 (Masahiko Aoki & Ronald Dore eds., 1994).

[230] *Id.* at 235, 249.

Rooted in the concepts of *giri* and *sasshi*,[231] a high degree of social accountability exists in Japan that percolates into legal concepts such as fiduciary duties and the long-term orientation of relationships.[232] Fiduciary duties are not limited to those directors owe towards their company and essentially its shareholders, but can be identified between all employees and company, and also between stakeholders and their company and are tantamount to ties between family or team members. [233] The acknowledgment that to push back the scope of *giri* is a prerequisite to warrant successful implementation of legal reform reveals the lingering permeation of corporate institutions with social norms.[234]

3. Social Norms as Pacemaker for Effect of Legal Reforms

This phenomenon might explain the purported resilience of Japan's corporate governance system. Social norms require more time to adapt to change than legal reform.[235] The divergence between brisk legal reform and gradually changing social norms and standards weakens the support social norms can provide for institutions molded by interest group consensus. Changes imposed by laws and regulations cannot prompt a rapid reorientation of institutions and patterns firmly entrenched in society. Social engineering requires being addressed with the same vigor as legal reform.[236] Society and its norms do not match the speed lawmakers wish to achieve. However, society's transformation under the exposure to globalization and the gradual adoption of Western values by Japanese changes the way of

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[231] *Giri* denotes the concept of moral obligation or loyalty, while *sasshi* embodies a concept of empathy. Rooting in communication patterns and describing social sensitivity and receptiveness, *sasshi* further has a normative dimension, namely the expectation of a party of the *sasshi* of its counterparty. Based on *sasshi* a party knows how to fulfill a *giri*. Compliance with the *giri* is secured through the fact that non-compliance would evoke social sanction. However, addressing the other party with an explicit demand to do or not do something would militate against the normative expectation of society. *Sasshi* and *giri* determine social interaction and overshadow the impact of legal claims. *See* RAHN, *supra* note 12, at 48.

[232] *Id*.; Outside the Japanese setting, Greenfield, *supra* note 6, at 763 explores how management's fiduciary duties towards stakeholders contribute to long-term benefits of corporate management through trust- and team-building with its stakeholders.

[233] Takaya Seki & Thomas Clarke, *The Evolution of Corporate Governance in Japan: The Continuing Relevance of Berle and Means*, 37 SEATTLE U. L. REV. 717, 747 (2014).

[234] ZENTARŌ KITAGAWA, REZEPTION UND FORTBILDUNG DES EUROPÄISCHEN ZIVILRECHTS IN JAPAN 162 (1970).

[235] Gilson & Milhaupt, *supra* note 14, at 346 (who apply Newton's First Law of Motion to this context).

[236] Milhaupt, *supra* note 218, at 2124.

thinking and doing things.[237] Individual-oriented thinking supplants group-oriented values, thus triggering an erosion of institutions that rest on group cohesion such as long-term employment.[238] The high degree of interrelation of industrial organization as a whole contributes to the fact that the system itself seems to be at rest – if one likes to stick with the model of Newton's First Law of Motion.[239] Profound systematic changes – if they are truly desired – need a fair amount of time to become effective.

V. TOWARDS A CONCLUSION

Corporate law provides a variety of legal entities for the organization of economic activity. Under the umbrella of a stock corporation as the prevailing form of enterprise in Japan,[240] owners, i.e. shareholders, delegate execution of business to directors while retaining residual control and information rights. Dispersed ownership precipitates rational apathy to enforce control rights. Independent directors being detached from the management are conceptualized to fill in the gap and monitor effective management. The elements of corporate law that Japan absorbed into its idiosyncratic system performed well for a long time. The Japanese "traditional" model did not necessarily imply that shareholders were disadvantaged or even expropriated, on the contrary as ultimate owners they benefitted through rising stock prices and dividends.[241] What is more, *keiretsu* shareholders generally have an interest in "their" robust company's economic performance. After this system came to an abrupt halt from the 1990s onwards, a re-orientation towards shareholder value dawned, because owners, especially international shareholders, could no longer be appeased through dividends. [242] Realignment on a shareholder-oriented system was identified as the way showing forward. [243] Assigning

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[237] Pejović, *supra* note 12, at 208.

[238] *Id.*

[239] Sir Isaac Newton postulated three laws of motion as the basis of classical mechanics in his work *Philosophiae Naturalis Principia Mathematica* first published in 1687. The first law deals with the phenomenon of inertia as the tendency of an object to maintain its very own velocity, unless a force acts on the object.

[240] With 2,490,479 stock corporations accounting for share of 94.3 per cent in 2015. *see* KOKUZEICHOU, Heisei 27 Nendo bun Kaisha Hyouhon Chousa Kekka (Mar. 2017) (Japan).

[241] Takahashi, *supra* note 18, at 73.

[242] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, YALE LAW SCH. PROGRAM FOR STUDIES IN LAW, ECON. & PUB. POLICY, Research Paper No. 235, 11, 16 2000) (who suggest that global competition and internationally acting shareholder-oriented institutions urge countries to remove comparatively dis-advantageous legal frameworks).

[243] Aronson, *supra* note 19, at 75.

independent directors a key role provoked that from the beginning the question of convergence on global standards hovered over reform given the global promotion of independent directors.[244] However, even considering the furthest reaching – non-statutory listing – requirement stipulated by the JCGC, Japan (two independent directors) is lagging behind the demand to compel companies to appoint a minimum of three independent directors uttered by the Asian Corporate Governance Association in the interest of institutional investors in May 2008. [245] Against the foil of increasing numbers of independent directors throughout Asia,[246] Japan remains – also in this domain – an island.[247]

Notwithstanding the seemingly belated advent of the transplant of independent directors coupled with resilience, recent reform might have been a wake-up call raising awareness for stronger recognition of shareholders' interests.[248] Might regulators resort to their box of tricks or not, shifting the narrative of policy reasoning under the 2015 Amendment from effective monitoring to counsel and growth stimulation proved to be agreeable to Japanese business, because it blends in with recent novelties like *shikkouyakuin* who have been acclaimed as remedies to address cumbersome decision-making and enhance transparency rather than from the angle to amplify shareholders' voice.[249] There is certain legitimacy to a careful approach given the fact that a shareholder-oriented approach might not be beneficial against the backdrop of a consensus-oriented society reflected by close bonds within the corporate family, between companies and their employees as a source of self-development and personal commitment. [250] The current gap between a model that fully embraces shareholder value and Japan might stand to reason against the background of path dependence. Independent directors represent an element alien to the very nature of corporate governance in Japan. There appears to remain the conventional understanding in Japan that "good" corporate governance is achieved through internal and relational monitoring mechanisms. [251]

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[244] Convergence solely denotes the shrinking gap between various corporate governance systems. Oda, *supra* note 26, at 52. *See also* Buchanan & Deakin, *supra* note 116, at 34, who legitimately question the existence of such standards.

[245] ASIAN CORPORATE GOVERNANCE ASSOCIATION, WHITE PAPER ON CORPORATE GOVERNANCE IN JAPAN 5, 21 (2008).

[246] Puchniak & Kim, *supra* note 48, at 1.

[247] For the concept of Japan as an island and its social dimensions, *see* DAVID PILLING, BENDING ADVERSITY: JAPAN AND THE ART OF SURVIVAL (2014).

[248] Dore, *supra* note 89, at 371; Lawley, *supra* note 102, at 134

[249] Dore, *supra* note 89, at 381.

[250] Takahashi, *supra* note 18, at 74.

[251] Aoki, *supra* note 8, at 438.

Keiretsu and long-term employment seem not to be perfectly compatible with a governance model leaning on external monitoring. Accordingly, independent directors and the Supervisory Committee are viewed as institutions that should guide rather than rein in and replace management. Therefore, the challenge will be to take the plunge towards external monitoring while retaining valuable elements of internal linkage.[252] The 2003 Amendment might prove to have paved the way for further, more pervasive reforms of the corporate governance system.

A. Towards True Independence?

By virtue of statutory reform, lawmakers undertook efforts to secure the independence of outside directors by significantly confining the scope of eligible persons. This reinforcement narrows down maneuverability for corporations to not appoint truly outside directors. Liberation from ties with subsidiaries and parent companies is vital to forestall an affiliation of outside directors with *keiretsu* members, and conducive to effective monitoring for the benefit of all stakeholders – shareholders among them. Having further severed family ties by virtue of the 2015 Amendment, attention might turn towards management's "friends and well-wishers"[253] conjuring up the conundrum of where to draw a line which makes it safe to presume absence of conflict of interest on this side of such supposed line. However, on this side of the such supposed line, the definition of outside directors is currently far from exhausting its endogenous potential due to the persistent ignorance of business interest leaving outside directors vulnerable to links with horizontal *keiretsu* members. The inauguration of independent directors through the JCGC poses another sequel to the liberation of the former *kansayaku* whose position has been gradually extracted from *keiretsu* fangs, most recently through conferral of board access on outside directors as committee members. A follow-up question relates to the pool of individuals qualifying as independent directors.[254]

B. "Democratic" Election Process for Outside Directors?

The conventional balance of powers between governing bodies of a corporation assigns authority to appoint independent directors to the shareholders' general meeting. The power to submit nomination proposal falls within the scope of the board of directors. Given the strategic momentum inherent in nomination proposals, it seems worth considering the integration of shareholders and other stakeholders at the proposal stage rather than yielding such competence to proxies of the board. The aim to install truly independent directors on the board can be attained if the interest groups can articulate their views and say during the nomination process. It

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[252] *Id*. at 439.

[253] Dore, *supra* note 89, at 390.

[254] Milhaupt, *supra* note 14, at 63.

would further contribute to a balanced exercise of influence on the whole nomination process, because stakeholders and shareholders would concurrently present their views on the nomination committee, rather than separately through the board of directors (stake- and shareholders) – where shareholders' interest is barely represented in Japanese corporations – and shareholders' general meeting (shareholders). At first glance, chances of acceptance and approval in Japan appear to be dim given the recent virtual rejection of the three-committee-model based on the outlook to surrender nomination rights moored in the managerial realm to an outsider-dominated committee. On the other hand, Japanese companies started to adopt nomination committees on a voluntary basis.

C. Prospective Role(s)

The traditional train of thought envisions independent directors balancing the interests at stake in a corporation by supervising and reining in management. Additionally, independent directors are expected to engage in advising and networking. In Japan, legal compliance remains the overarching priority. Statutory reform and JCGC alike do not seem to shake the foundation of independent directors assuming defensive roles as compliance officers and advisors.[255] Incorporating a competence to oversee "formulation and implementation of business strategy" [256] appears to be tantamount to a breach with the incumbent system. However, monitoring is conceptually not limited to ex-post review but includes ex-ante determination of business strategy as a form of preventive oversight.[257] If extended too far, however, such competence can entangle independent directors in managerial task, rendering it difficult to regard them as vigilant wardens of shareholders' interest any longer.[258] Resorting to the analogy of constitutional law, monitoring and management form separate branches whose distinctive duties must be observed in order to preserve an effective system of checks and balances as the basis for accountability, legitimacy, transparency, and credibility.[259]

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[255] JAPAN'S CORPORATE GOVERNANCE CODE, §4 princ. 4.7 (Japan).

[256] Aronson, *supra* note 33, at 99.

[257] Baum, *supra* note 46, at 50.

[258] Saito, *supra* note 45; *see generally* Takashi Araki, *Changing Employment Practices, Corporate Governance, and the Role of Labor Law in Japan*, 28 COMP. LAB. L. & POL'Y J. (2007).

[259] Stephen M. Bainbridge, *The Board of Directors*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 7 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2015).

D. A Numbers Game?

Independent directors' effectiveness is a critical matter that is related to number and composition. The number of independent directors has evolved into a crucial qualitative governance indicator cherished by proxy advisory firms and international investors.[260] Even so, the mere counting of independent directors as a key metric runs the risk to impede the view on independent directors' material role under a corporate governance regime[261] and to encourage window-dressing ostentatiously put forward to lull international investors rather than to promote substantive change. [262] Instances such as the Olympus scandal in 2011 and Global Financial Crisis of 2008 illustrate that super-majority boards rather advance information control and manipulation by the remaining sole executive director on whom independent directors rely on for access to strategic soft and inside information as the prerequisite for performing monitoring, advisory, and network tasks.[263]

Proponents that favor a certain level of competence over one-sided emphasis on independence (re)gained ground in response to the Global Financial Crisis of 2008.[264] In Japan, where business relationships rely on long-term orientation and trust building, the presence of too many independent directors may cause adverse effects and even go so far as to daunt (domestic) investment into firms.

Independent directors are only one piece of the greater puzzle. Mixed boards comprising independent and company-affiliated directors representing an appropriate balance of expertise and detachment may hold the key to this matter. [265] Independence in conjunction with expertise bestows credibility and trustworthiness on directors' decisions. [266] Nonetheless, not all kinds of expertise need to be present at board level, but can also be acquired through external counsel. Potentially, the debate might

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[260] Ronald Masulis, Christian Ruzzier, Sheng Xiao & Shan Zhao, *Do Independent Expert Directors Matter?* 2, 3 (Munich Pers. RePEc Archive, Paper No. 68200, 2012); TRACY GOPAL, JAPAN: A CLOSER LOOK AT GOVERNANCE REFORMS fig.3 (2015).

[261] Puchniak & Kim, *supra* note 48, at 5.

[262] *Id*. at 17 specifically for Singapore; Baum, *supra* note 46, at 42.

[263] Baum, *supra* note 46, at 27, 40; Masulis et al., *supra* note 260, at 8.

[264] *See* THE WALKER REVIEW OF CORP. GOVERNANCE OF UK BANKING INDUS., A REVIEW OF CORPORATE GOVERNANCE IN UK BANKS AND OTHER FINANCIAL INDUSTRY ENTITIES (2009), http://webarchive.nationalarchives.gov.uk/+/www.hm-treasury.gov.uk/d/walker_review_261109.pdf, for a prominent example.

[265] Bhagat & Black, *supra* note 67, at 264; EUROPEAN MODEL COMPANY ACT § 5.1 (EUR. MODEL CO. ACT GRP. 2015); U.K. Corporate Governance Code 2016, § B.1 (U.K.).

[266] Lipton, *supra* note 214, at 18.

benefit from a more refined differentiation between various kinds of independence.

Independent and insider directors represent two opposing ends of a spectrum determined by the degree of detachment or affiliation to a corporation. However, a corporation is embedded in a certain industry branch that entails that, between firm-specific knowledge and a lack thereof, a middle ground in the form of domain-specific or industry-specific knowledge yawns. [267] Directors with industry-specific knowledge can mitigate information asymmetry between management and independent directors, supplement firm-specific knowledge, balance information access and protect minority shareholders.[268] Their expertise makes them equally effective for counseling and monitoring.[269]

Similarly, "grey directors" – directors that still entertain a material relationship with the corporation – could compensate for lack of information and network access due to their constructive understanding of a company's complexity of business, and their seniority be conducive to voice grievances and enforce decisions on the board.[270] Transplanting this concept to Japan could mean that "grey directors" or directors with industry-specific knowledge advise management that is concurrently supervised by truly independent directors who, in turn, receive information input from grey or industry-educated directors.

However, "grey directors" are prone to "stakeholder tunneling" abetting transfer out of a company to controlling shareholder, [271] a worrisome tendency against the background of lingering stakeholder impact on corporations in Japan. Equally, an industry with a high ratio of interlocking might render it difficult to procure directors that combine independence with industry-specific knowledge. On a perspective plane, the extant full-time *kansayaku* or independent directors could link information access due to long-term tenure and growing expertise with objective as possible inspection of the management.[272]

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[267] Suzanne Le Mire, *Independent Directors: Partnering Expertise With Independence*, 16 J. CORP. L. STUD. 1, 9, 25 (2015); Masulis et al., *supra* note 260, at 3.

[268] Le Mire, *supra* note 267, at 18; MINISTRY OF ECON, TRADE & INDUS., THE CORPORATE GOVERNANCE STUDY GROUP REPORT (2009).

[269] Masulis et al., *supra* note 260, at 9.

[270] Lawley, *supra* note 102, at 116 n.57.

[271] *Id.* at 115; Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Tunneling*, 90 AM. ECON. REV. 22, 22 (2000).

[272] Goto, *supra* note 7, at 10 n.44.

E. Thoughts on Independence as Pivotal Criterion?

It might be worth considering whether independence is the appropriate criterion for determining suitability and aptitude of monitoring agents. Conflict of interest is commonly reduced to the absence of an economic interest. Social elements such as friendship, social life ties, or shared corporate philosophy have apparently been widely disregarded.[273] Furthermore, entanglement arises from the dynamics of human relationships. Initial independence might erode during tenure with a company, independent directors can be 'seized' and eventually pulled towards the corporation.[274] Affiliation decreases with time and absence of ties. For that reason, the introduction of a cooling-off period under the 2015 Amendment might prove a prescient addition. The quality of detachment on a stand-alone basis is likely insufficient. Moreover, the absence of relational ties also entails less knowledge, incentive to act, as well as authority towards the management.[275] Impartiality, trustworthiness and "the capacity to act as a disinterested trustee of outsiders" have been proffered as alternative criteria.[276] Authority can be created by number or social and occupational standing. A high share of independent directors on the board lends independent directors' opinion weight and makes enforcement of decisions more likely, thus effectively breaking into management's entrenchment and protection by the "corporate community."[277] Furthermore, numbers prevent outsiders from being captured by the board despite true independence being a defense in its own right. The limitation of the pool of potentially independent directors might conjure up the matter of interlocking through boards. However, the pool's size can be regulated by the requirements for independent directors – such as the cooling-off period – and the preferable ratio.

F. In Spite of Everything, Reform has Taken Roots

Corporate governance represents a facet of an economic system. An economic system forms a part of social life in general that is largely structured by non-legal, social norms. People grow into these norms through

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[273] Ferrarini & Flippelli, *supra* note 21, at 6, 8; María Gutiérrez Urtiaga & Maribel Saez, *Deconstructing Independent Directors* 20 (Eur. Corp. Governance Inst., Working Paper No. 186, 2012).

[274] Le Mire, *supra* note 267, at 15; *European Commission Recommendation on the Role of Non-Executive or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board*, at annex II, para. 1(h) (Feb. 15, 2005), https://eur-lex.europa.eu/eli/reco/2005/162/oj.

[275] Le Mire, *supra* note 267 at 16; Gutiérrez & Saez, supra note 273, at 21.

[276] Gutiérrez & Saez, *supra* note 273, at 20.

[277] Goto, *supra* note 7, at 18-19.

education and socialization. If therefore the social consensus remains to conduct business and monitoring in the way they are habitually done, changes will remain superficial. However, culture is something in flux, and it does not determine a legal system single-handedly, nor is a legal system immune to change. [278] Path dependence may cause reform to require a longer time to take effect because self-reinforcing effects contribute to the inertia of a system. Economic choices might be superimposed or "overlayered" by cultural acquisitions resulting in a system that does not succumb to an economic rationale.[279] Legal transplants are confronted with the extant institutions embedded in a system of "institutional complementaries," but at the same time, they trigger the conversion of institutions through redeployment and reorientation.[280] Acculturation to the peculiar cultural circumstances requires time and elasticity of both the transplant and the system, qualities the legal community in Japan has proven to dispose of.[281] Markets and path-dependent institutions move at different speeds. [282] Reciprocal influence might entail that a legal transplant is implemented in a way distinct from the initial design without necessarily diminishing its effects, but tailoring it to its surroundings.[283]

Optimism for a continuation of recent liberation tendencies can be drawn from the observation that Japan is steering towards a "hybrid model" in terms of corporate governance combining successful idiosyncratic components with new elements [284] – mirroring the idea of "institutional

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[278] Moritz Bllz, *Wider den Exotismus? Zur Bedeutung der Kultur für das Verständnis des modernen japanischen Rechts*, 25 J. JAPAN L., 153, 159 (2008).

[279] *Compare id.* at 156, 158. (Exigencies might result from at first glance remote factors moored in idiosyncrasies of the overall socio-economic system. In Germany, the prospect of funding exigencies of the state-run pension system ensuing demographic developments precipitated the promotion of shareholder capitalism out of the need for private retirement arrangements that accelerated liberalization of the corporate governance system); *see* Jeffrey N. Gordon, *The International Relations Wedge in the Corporate Convergence Debate*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 161, 171 (Jeffrey N. Gordon & Mark J. Roe eds., 2004); Product liability might be able to assume a similar role in Japan, *see* Milhaupt, *supra* note 14, at 61.

[280] Nakatani, *supra* note 27, at 414; Aoki, *supra* note 142, at 657; WOLFGANG STREECK & KATHLEEN THELEN, BEYOND CONTINUITY: INSTITUTIONAL CHANGE IN ADVANCED POLITICAL ECONOMIES 31 (Wolfgang Streeck & Kathleen Thelen eds., 2005).

[281] Pejović, *supra* note 185, at 500, 520; BÄLZ, *supra* note 278, at 162.

[282] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights 873* (Columbia Univ. Sch. of Law, Working Paper No. 438, 2013).

[283] Jackson & Miyajima, *supra* note 4, at 2.

[284] *Id.* at 6; Aronson, *supra* note 33, at 87

layering." [285] Although voices alleging that reform will not bring about significant change[286] resonate and should not be disregarded, the policy of incremental change seems to indicate otherwise and foster sustainable change. The introduction of an initially small number of independent directors did justice to the inertia – in the sense of Newton's First Law of Motion – of the interdependent institutional network as a whole.[287] It should further be kept in mind that thorough legal reform has only recently been pursued. Therefore, reform can still be regarded as a "work in progress," meaning that reforms' implications are yet to unfold entirely.[288] Exposure triggered by the adoption of the three-committee-system by very few companies might have nonetheless stirred other companies' managers' and presidents' conscience.[289] Given the inherent internal monitoring structure of Japanese corporate governance, it would probably put too much strain on the system to demand the immediate introduction of a majority of independent directors on the board of directors. Given the widespread appointment of one or two independent director does not seem to hurt companies (any longer), it would be interesting on a perspective plane to see how companies accommodate if the requirement were lifted and whether the threshold of acceptance could be pushed forward.

Imitation of successful pioneers – such as Sony in the case of *shikkouyakuin* – might contribute to a wider acceptance and dissemination of committees staffed with independent directors, thus a form of institutional isomorphism. [290] Companies with a higher ratio of foreign shareholding appear to have embarked on a more shareholder-oriented approach, while traditional companies usually with lower foreign ownership rates retain traditional governance features, displaying certain degrees of path dependence and system flexibility at the same time.[291] This Janus-faced[292] constellation might herald awakening of the whole system.

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[285] STREECK & THELEN, *supra* note 280, at 31.

[286] HALEY, *supra* note 222, at 5, 13.

[287] Sandra Dow, Jean McGuire & Toru Yoshikawa, *Disaggregating the Group Effect: Vertical and Horizontal Keiretsu in Changing Economic Times*, 28 ASIA PACIFIC J. MGMT. 299, 304 (2011).

[288] Eric A. Feldman, *Legal Reform in Contemporary Japan*, 25 J. JAPAN L. 5, 6 (2008).

[289] Dore, *supra* note 89, at 383. For the phenomenon of "institutional isomorphism," *see* Paul J. DiMaggio & Walter W. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 AM. SOC. REV. 147, 149 (1983).

[290] DiMaggio & Powell, *supra* note 289, at 149.

[291] Waldenberger, *supra* note 117, at 69.

[292] This metaphor draws on the god Janus from Roman mythology. As the god of beginnings and passages, time and transition, Janus was commonly depicted as having two

However, the trigger for Japanese companies acting on the international stage might be their two-sided exposure to both global corporate governance standards and foreign investors. Nonetheless, 'grassroots initiatives' unveil a general willingness to let independent directors participate in ex-ante managerial control. This accomplishment might serve as the stepping stone for the widespread adoption of independent directors. However, it might very well be that this wind of change is not pervasive and only shakes the top-tier, while the lower echelons remain unshaken.

The current incremental reform approach reveals how switching between soft and binding regulation is employed for the sake of eschewing overt controversy in Japan. Furthermore, it reflects a compromise building process found symptomatic for Japan, also with respect to rulemaking.[293] Incremental reform with both sides – authorities and business – negotiating and gradually ceding ground to each other appears to be the way things are and can be successfully done in Japan.

faces looking in opposite directions.

[293] Kanda, *supra* note 30, at 15.