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Legally "Strong" Shareholders of Japan

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LEGALLY “STRONG” SHAREHOLDERS OF JAPAN

Gen Goto*

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Foreign investors often criticize Japanese corporations for not paying enough attention to the interests of their shareholders. It might surprise these critics, then, to learn that shareholders’ legal rights under the Japanese Companies Act are actually quite strong. Indeed, many of the rights that shareholders’ rights advocates often support, including shareholders’ power to alter a corporate charter without board consent, shareholders’ power to control dividend payments, majority voting for board elections, shareholders’ power to replace the board of directors, and shareholder access to a corporate ballot—all of which are strongly debated elsewhere—are already effective in Japan. Moreover, derivative suits are easily initiated and maintained. Shareholders of Japanese corporations are, therefore, in an arguably stronger position than those in, for example, the United States. Still, notwithstanding these Japanese statutory rights, foreign investors’ criticisms persist.

Two questions arise from this debate. First, why are shareholders of Japanese corporations unable to leverage their strong rights to force corporate management to prioritize shareholders’ interests? Alternatively, why are shareholder activists inactive in Japan? Second, if the existing shareholders’ rights are not actually used for activism, are they completely meaningless? Or, do they have alternative effects, whether positive or negative?

* Associate Professor, Graduate Schools for Law and Politics, University of Tokyo. This article is a revised version of the author’s presentation at the symposium “Corporate Law in Asia: Trends and Opportunities” held at University of Michigan Law School on February 21, 2014. The research for this article has been conducted while the author was a visiting scholar at East Asian Legal Studies of Harvard Law School.

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This article answers these questions by summarizing and categorizing the rights of shareholders of Japanese corporations into two characteristics. First, shareholders of Japanese corporations have strong class-based rights with respect to decision-making on a wide range of matters related to the corporation and ample opportunity to take an initiative. These rights might, in fact, be too strong, inducing managers to insulate themselves by engaging in so-called “cross-shareholding” (kabushiki mochiai) relationship, which in turn likely weakens the rights of other shareholders in practice. The lack of support provided to activist shareholders by other shareholders, especially those in these cross-shareholding relationships, is the primary cause of activist ineffectiveness in Japan. When cross-shareholdings are unwound, however, these shareholder rights function as a latent threat on managers, disciplining them. The keys to ensuring that class-based shareholder rights are meaningful are, thus, distribution of share ownership and restraint on management’s attempt to manipulate this distribution. Unfortunately, it is not easy to unwind already-established cross-shareholdings through regulatory intervention.

Second, shareholders also possess strong individual rights to raise issues with the corporation, either by asserting a shareholder proposal or filing a derivative suit, neither of which would the corporation disrupt for the interest of other shareholders. These rights, again, might be too strong, incentivizing individuals to take advantage of them in pursuit of personal goals, rather than for the good of the corporation. Yet, whether the use of these individual rights amounts to an abuse hinges on an evaluation of the benefits achieved, namely, the supply of diverse views through shareholder proposals and the deterrence effect of derivative suits. Possible future reforms to Japanese law ought to consider how to strike the right balance of power for shareholders of Japanese corporations.

I. INTRODUCTION

Foreign investors often criticize Japanese corporations for not paying enough attention to the interests of their shareholders.¹ It might surprise

1. For example, Asian Corporate Governance Association, an organization consisting primarily of institutional investors investing in Asian markets, has stated that “[i]mproved corporate governance is not a panacea for the problems of Japan’s stock markets or economy, but it will be an essential element in the rebuilding of confidence. . . . It is in Japan’s national interest, therefore, to converge towards global best practice in corporate governance” Indeed, “[f]airer treatment of shareholders is an integral part of this process. It is important to restore shareholders to their rightful, legal place as the owners of companies and to ensure that their interests are protected alongside other stakeholders.” ASIAN CORP. GOVERNANCE ASS’N, WHITE PAPER ON CORPORATE GOVERNANCE IN JAPAN 8 (2008), available at http://www.acga-asia.org/public/files/Japan%20WP_%20May2008.pdf.

Foreign investors are not the only ones to express this view. At a meeting of the Companies Act Subcommittee (*Kaisha Hosei Bukai*) of the Legislative Council (*Hosei Shingikai*), which was established in April 2010 for the revision of the Companies Act, representatives of two Japanese investors attributed the long-time underperformance of Japanese stock market to the insufficient protection of the interest of shareholders and called for stronger corporate governance. See HOSEI SHINGIKAI KAISHA HOSEI BUKAI, DAI 2 KAI KAIGI GIJIROKU [THE MINUTES OF THE 2ND MEETING] 2-6, 10-15 (2010), available at <http://www.moj.go.jp/content/000049083.pdf> (discussing the opinions of Mr. Daisuke Hamaguchi, executive director of fund management for Pension Fund Association, and Mr. Yoichiro Iwama, former president

these critics, then, to learn that shareholders’ legal rights under the Japanese Companies Act² (JCA) are actually quite strong.³ Indeed, many of the rights that shareholders’ rights advocates often support, including shareholders’ power to alter a corporate charter without board consent,⁴ shareholders’ power to control dividend payments,⁵ majority voting for board elections,⁶ shareholders’ power to replace the board of directors,⁷ and shareholder access to a corporate ballot⁸—all of which are strongly debated elsewhere—are already effective in Japan.⁹ Moreover, derivative suits are easily initiated and hard to dismiss. Shareholders of Japanese corporations, therefore, are arguably in a stronger position than those in, for example, the United States.¹⁰ Still, notwithstanding these Japanese statutory rights, foreign investors’ criticisms persist.

Two questions arise from this debate. First, why are shareholders of Japanese corporations unable to leverage their strong rights to force corporate management to prioritize shareholders’ interests? Alternatively, why are shareholder activists inactive in Japan? Second, if the existing shareholders’ rights under Japanese law are not actually used for activism, are they completely meaningless? Or, do they have alternative effects, whether positive or negative? These are important questions, not only for

of Tokio Marine Asset Management Company, Limited and the chairman of Japan Investment Advisors Association). For the result of the discussions in this Subcommittee, see Gen Goto, *The Outline for the Companies Act Reform in Japan and Its Implications*, 35 J. JAPANESE L. 13 (2013). The Reform Act of the Companies Act was enacted on June 20, 2014. For the texts of the Reform Act see *Cabinet Bill No. 22 for 185th Diet*, SHŪGIN SEITEI HÔRITSU, available at http://www.shugiin.go.jp/internet/itdb_gian.nsf/html/gian/honbun/houan/g18505022.htm (last visited Mar. 1, 2014).

2. Kaisha-ho [Companies Act], Law No. 86 of 2005 (Japan) [hereinafter JCA], available at http://www.cas.go.jp/jp/seisaku/hourei/data/CA1_4_2.pdf and http://www.cas.go.jp/jp/seisaku/hourei/data/CA5_8.pdf (English translation of JCA as of Dec. 15, 2006).

3. Japan has achieved high scores in recent research regarding corporate governance indices. See John Armour et al., *Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis*, 6 J. EMPIRICAL L. STUD. 343, 357 (2009) (Japan had the highest score for shareholder protection in 1996 and the fourth highest score in 2005, out of 20 countries studied); Holger Spamann, *The “Antidirector Rights Index” Revisited*, 23 REV. FIN. STUD. 467, 475 (2010) (Japan earned five out of six points, the highest score awarded in 1997 and second highest in 2005, both out of 46 countries).

4. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 865 (2005) [hereinafter Bebchuk, *Shareholder Power*].

5. *Id.* at 901-08.

6. Lucian Arye Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 701-04 (2007).

7. *Id.* at 700-01.

8. Lucian Arye Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43, 43 (2003).

9. See *infra*, Part II.

10. Japanese corporations are also well known for their stakeholder model with an emphasis on the interest of employees. Gregory Jackson & Hideaki Miyajima, *Introduction: The Diversity and Change of Corporate Governance in Japan*, in CORPORATE GOVERNANCE IN JAPAN 1, 4 (Masahiko Aoki et al. eds., 2007).

Japanese corporate law, but also for corporate law in countries like the U.S., where the implementation of strong shareholder rights is debated.¹¹

Part II of this Article examines in detail the strength of shareholder rights under Japanese law in comparison to shareholder rights in the U.S., particularly under Delaware law, and then summarizes and categorizes the characteristics of Japanese law into two groups: (i) strong class-based rights with respect to decision-making, and (ii) strong individual rights to raise derivative suits and shareholder proposals. Parts III and IV deal with the first characteristic. Part III briefly summarizes hedge fund activism in Japan and posits an explanation for the lack of support to activists from other shareholders, especially those in so-called “cross-shareholding” (*kabushiki mochiai*)¹² relationships. Part III then reviews empirical studies regarding the effects of hedge fund activism on certain corporations in Japan, analyzing the possibility and difficulty of regulating cross-shareholding relationships. The analysis suggests that shareholder rights would be strengthened if there were no restraints imposed by cross-shareholdings. Part IV considers the effect of shareholder rights when a corporation has fewer cross-shareholdings and is held largely by institutional investors. Finally, Part V analyzes the pros and cons of the second characteristic of Japanese law—shareholders’ strong individual rights, which are unaffected by cross-shareholdings.

II. SHAREHOLDER RIGHTS UNDER JAPANESE LAW

A. Overview

Shareholder rights can be divided into (i) the right to vote, (ii) the right to sue, and (iii) the right to sell.¹³ This Article focuses on the first two of

11. For an opposing view to the notion of shareholder empowerment, see, for example, William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653 (2010). For rejoinder, see Lucian A. Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013).

12. “Cross-shareholding,” which refers to the situation in which two corporations hold each other’s shares, is one of the characteristics of Japanese corporate governance. See Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions*, 25 DEL. J. CORP. L. 189, 210-11 (2000) (“The Japanese method of stabilizing management is through cross-shareholding. An implicit agreement is made between two companies to hold ownership in the other partners’ stock, usually around one percent by nonfinancial firms and up to five percent by banks. Each company makes the same type of implicit agreements with, for example, twenty companies. Consequently, a spider web of mutual stockholding among inside shareholders is created, thereby stabilizing majority stock ownership.”). In this article, however, the term cross-shareholding is used to include other forms of shareholding relationships that have a similar effect, such as circular shareholdings among three or more corporations or unilateral shareholding by a mutual insurance company. Cf. Akira Tokutsu, *Mochiai kabushiki no hoteki chi-i (I) [Legal Status of Crossly-held Shares (I)]*, 125 HOGAKU KYOKAI ZASSHI 455, 469 (2008) (stating that prior literature referring to cross-shareholding as the defining characteristic of Japanese share-ownership structure did not confine itself to literal mutual shareholding between two corporations).

13. WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, *COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION* 153 (4th ed. 2012).

those rights.¹⁴ The differences between U.S. corporate law, using Delaware law as its proxy, and Japanese corporate law can be categorized into four points. First, the range of matters that may be decided at shareholders’ meetings is broader in Japan than in the U.S. Second, shareholders’ influence on the core operations of shareholders’ meetings—the election and removal of directors—is stronger in Japan. Third, shareholders of Japanese corporations have a greater opportunity to affect corporate governance at shareholders’ meeting through shareholder proposals. And fourth, turning from the right to vote to the right to sue, derivative suits are more easily initiated and maintained in Japan. These are explained in greater detail in the following sections.¹⁵

B. Broader Power of Shareholder Meetings

As a civil law country, Japanese law mirrors continental European law in its grant of broad power to shareholders’ meetings, as compared to that supplied by Delaware law.¹⁶

1. Charter Amendments

The largest difference in shareholder rights under Japanese and U.S. law lies in the power to alter the fundamental structure of the corporation. U.S. corporations are governed by two constitutional documents, namely, the certificate or articles of incorporation and the bylaws, each with a different procedure for its amendment. Under Delaware law, any amendment to the certificate of incorporation must be proposed by the board of directors and voted on at a shareholders’ meeting.¹⁷ The board, thus, has a constructive veto power over amendments. Shareholders do have the power to amend a corporation’s bylaws, but likely share this power with the board. For example, if the certificate of incorporation permits, the board may amend the bylaws without shareholder approval.¹⁸

14. Regarding the right to sell, although free transferability of shares is a common feature of corporate laws in major jurisdictions, *see* REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 5 (2d ed. 2009), there are differences in approaches to hostile takeovers, where the right to sell closely relates to the right to vote. *See id.* at 233-56. This, however, is beyond the scope of this Article.

15. Application of the JCA differs according to the organizational structure of a corporation. *See* ICHIRO KAWAMOTO, YASUHIRO KAWAGUCHI & TAKAYUKI KIHIRA, *CORPORATIONS AND PARTNERSHIPS IN JAPAN* 214-18 (2012) (discussing variations in organizational structure). Descriptions of Japanese law in the following parts of this article are based on the rules applied to a public corporation (*kokai gaisha*), JCA art. 2(v), that adopts the structure of a corporation with a board of statutory auditors (*kansayakukai secchi gaisha*), JCA art. 2(x), which is the structure adopted by the great majority of listed corporations in Japan.

16. For comparison of Delaware law and those of continental European countries, *see* Sofie Cools, *The Real Difference in Corporate Law Between the United States and Continental Europe: Distribution of Powers*, 30 *DEL. J. CORP. L.* 697, 739-41 (2005).

17. *DEL. CODE ANN.* tit. 8, § 242(b)(1) (2011).

18. *Id.* § 109(a).

By contrast, Japanese corporations are governed by a charter alone. That is, there is no such distinction between certificates of incorporation and bylaws. Furthermore, the only procedure necessary for a charter amendment is an affirmative vote on a special resolution at a shareholders' meeting.¹⁹ Shareholders need not obtain board consent to amend a charter provision; rather, shareholders may amend the corporate charter unilaterally.

2. Decision on Ordinary Business Matters

The procedural differences regarding charter amendments inherently affects the board's power to make decisions on ordinary business matters, a power that belongs to the board as a default rule in both countries.²⁰ In Delaware, in order for the business and affairs of a corporation to be managed other than by the board, i.e. for this power to be reallocated to the shareholders, the certificate of incorporation must contain, or be amended to contain, such a provision,²¹ thereby making it impossible to deprive the board of its power against its will. In Japan, a charter provision granting shareholders the power to make decisions on ordinary business matters at shareholders' meetings²² can be introduced without consent of the board.

3. Dividends

The variation in the power to declare dividends is more apparent still. In Delaware, the decision to make dividend payments rests in the hands of the board, subject to any restrictions set forth in the certificate of incorporation.²³ The default rule in Japan is the opposite: a shareholder resolution is required to decide whether the corporation will pay dividends and, if so, their amount.²⁴ By way of charter amendment, however, shareholders can either grant this power to the board as well²⁵ or go further and divest themselves fully of this power, making the board solely responsible for any decisions about dividend payments.²⁶

19. JCA art. 466. A special resolution is made by a majority of two thirds or more of the votes of the shareholders present at the meeting, where the shareholders holding a majority of the votes of the shareholders entitled to exercise their votes at such shareholders' meeting are present. *See* JCA art. 309(2).

20. DEL. CODE ANN. tit. 8, § 141(a); JCA art. 362(2).

21. DEL. CODE ANN. tit. 8, § 141(a).

22. *See* JCA art. 295.

23. DEL. CODE ANN. tit. 8, § 170(a).

24. JCA art. 454(1). Shareholders can also make a proposal regarding the amount of dividends paid. *See infra* note 65 and accompanying texts.

25. JCA art. 459(1)(iv). This option is available only for a corporation that appoints an outside auditor and the term of directors of which is not over one year.

26. JCA art. 460(1). The eligibility standard is the same as in JCA article 459(1). It has been reported that, as of June 2006, which was the first annual shareholders' meeting season for Japanese listed corporations after JCA went into effect on May 1 of that year, 432 listed corporations have granted their boards of directors the power to decide on dividends, and 330 of those corporations have divested their shareholders' meetings of that power. *Kaisha*

4. Executive Compensation

The differences under U.S. and Japanese law with respect to the power to set executive compensation are rather subtle, particularly after the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act.²⁷ In the U.S., publicly traded corporations are now required to hold a non-binding shareholder vote at least once every three years to approve the compensation of the corporation’s CEO, CFO, and the three other most highly compensated executive officers (the so-called “Say on Pay”).²⁸

In comparison, shareholders’ power to set executive compensation is rather limited in Japan. Although the JCA stipulates that compensation of “directors shall be fixed by resolution of a shareholders’ meeting[.]”²⁹ case law has limited the scope of this shareholder right, such that these resolutions create only a ceiling on the maximum aggregate compensation for the corporation’s directors; the board may then divide this maximum aggregate compensation at its discretion.³⁰ In addition, once the maximum amount is set, a resolution of shareholders’ meeting is not necessary for as long as the actual compensation fits within the specified maximum.³¹ Moreover, there is no mandatory disclosure of individual compensation,³² except for directors of publicly traded corporations receiving compensation of 100 million JPY or more.³³

C. Greater Influence on Election and Removal of Directors

1. Election

To start, the standard for the election of directors is stricter in Japan, especially in uncontested elections. The default rule in Delaware is a plurality standard,³⁴ meaning that a candidate who receives more votes in her

ho kanren teikan henkou gian no jirei bunseki – Heisei 18 nen 6 gatsu sokai gaisha [Analysis of Proposals for Charter Amendments Regarding Companies-Act Related Matters – For Shareholders’ Meeting in June 2006], 272 *SIRYOBAN SHOJI HOMU* 56, 136 (2006). The total number of corporations that amended their charters in June 2006 to adjust to the new act was 2029. *Id.* at 56. No comprehensive data is available on the current status of all listed corporations on this matter.

27. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

28. 15 U.S.C. § 78n-1(a)(1) (2012).

29. JCA art. 361(1).

30. Saiko Saibansho [Sup. Ct.], Mar. 26, 1985, 1159 *HANREI JIHÔ* [HANJI] 150, 150.

31. Wataru Tanaka, *361 jyo [Article 361]*, in *KAISHAHO KONMENTARU DAI 8 KAN* [COMMENTARIES ON COMPANIES ACT, VOL. 8] 145, 162 (Seiichi Ochiai ed., 2009).

32. Kaishaho Seko Kisoku [Ministerial Ordinance for Implementation of Companies Act], Ministerial Ordinance No. 12 of 2006, art. 121, para. iii (Japan).

33. Kigyo naiyo to no kaiji ni kansuru naikaku furei [Cabinet Office Ordinance on Disclosure of Corporate Affairs], Cabinet Office Ordinance No. 5 of 1973 (Japan) (Form 2 (Precautions for Recording (57)a(d)) and Form 3-2 (Precautions for Recording (14))).

34. DEL. CODE ANN. tit. 8, § 216(3) (2011).

favor than any other individual competitor will be elected as a director. In uncontested elections, a candidate who runs unopposed will be elected, even if she receives only a single vote in her favor, because there is no other candidate who receives more votes. Shareholders may choose to adopt a majority standard³⁵ through a bylaw amendment,³⁶ which the board cannot further amend or repeal.³⁷

In Japan, the default rule for director elections is a majority standard, such that a candidate must receive the majority of votes cast in her favor, regardless of whether the election is contested or uncontested.³⁸ Thus, it is possible for shareholders to vote down a candidate proposed by the management without proposing their own candidate. Also, the majority of all voting rights entitled to vote must be present at the shareholders' meeting to represent a quorum.³⁹ The quorum itself may be lowered to one third by a charter provision, but the voting standard (i.e. majority versus plurality) can only be raised.⁴⁰

2. Removal

Standards relating to the removal of directors arguably have an even greater impact on shareholder rights than those governing their election. As a rule, shareholders of Delaware corporations are entitled to remove any particular director or the entire board, with or without cause, with the affirmative vote of a majority of shares entitled to vote.⁴¹ When the board is classified, however, removal is possible only for cause.⁴² Although the declassification of the boards of publicly traded corporations, especially those included in S&P 500 index, is becoming more common,⁴³ classification remains a hurdle for shareholders of corporations with classified boards.

35. Majority standard, which is the standard for all matters other than the election of directors in Delaware, means that "the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter" is necessary for the resolution of shareholders' meeting. *Id.* § 216(2).

36. For a discussion of the state of shareholder activism in favor of the majority standard and recent adoption of some form of that standard by listed corporations, see Fabrizio Ferri, 'Low-Cost' Shareholder Activism: A Review of the Evidence, in *RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW* 192, 199-200 (Claire A. Hill & Brett H. McDonnell eds., 2012).

37. DEL. CODE ANN. tit. 8, § 216 (2011).

38. JCA art. 341.

39. *Id.*

40. *Id.*

41. See DEL. CODE ANN. tit. 8, § 141(k).

42. *Id.* § 141(k)(1).

43. See LUCIAN BEBCHUK, SCOTT HIRST & JUNE RHEE, TOWARD BOARD DECLASSIFICATION IN 100 S&P 500 AND FORTUNE 500 COMPANIES: REPORT OF THE SRP FOR THE 2012 AND 2013 PROXY SEASON 9, 15 (2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2400652.

Japanese law is in sharp contrast to Delaware law. Shareholders of Japanese corporation can remove any director at any time by a majority of votes cast.⁴⁴ When there is no justifiable ground for such removal, the corporation must pay damages arising from the removal to the director,⁴⁵ but the removal itself stands. Because there is no exception to this rule, there is little use to classifying a board in Japan.⁴⁶

D. Greater Initiative at Shareholders’ Meetings

The greater power afforded shareholders of Japanese corporations under Japanese law is complemented by the greater opportunity for shareholders to raise shareholder initiatives, which typically take the form of proposals at shareholders’ meetings.⁴⁷

1. Shareholder Proposals and Proxy Access

a. U.S.

In the U.S., shareholder proposals made to listed corporations are regulated by federal Proxy Rules under Section 14(a) of Securities Exchange Act of 1934. According to Rule 14a-8, a shareholder who has continuously held at least \$2,000 in market value or one percent of the shares of a corporation for at least one year⁴⁸ may submit no more than one proposal for a particular shareholders’ meeting⁴⁹ to be included in the proxy statement

44. JCA art. 339(1); *id.* art. 341. The same quorum requirement as for the election of directors, i.e. the presence of the majority of all voting rights entitled to vote, applies here. *Id.* art. 341. Under the Japanese Commercial Code, the predecessor to the JCA, a special resolution with two-thirds majority of the votes cast was necessary to effectuate removal. *See* SHOHO [SHOHO] [COMM. C.] 1899, art. 257, paras. 1-2 (Japan).

45. JCA art. 339(2). The amount of this damage is normally the amount of compensation the director was entitled to receive during her term and at the end of her term had she not been removed. KENJIRO EGASHIRA, KABUSHIKI GAISHA HO [LAWS OF STOCK CORPORATIONS] 372 n.7 (4th ed. 2011). The term of a director is typically two years, unless shortened through a charter provision. *See* JCA art. 332(1).

46. Because the maximum term length for a director of a public corporation is two years, JCA art. 332(1), it is possible to classify the board into two groups by asking one half of directors to resign in the middle of their term and subsequently re-electing them, since a director elected to fill the vacancy of a resigned director is granted a full two-year term when no charter provision states otherwise. *See* Motohiro Sakaki, 332 *jyo* [Article 332], in KAISHAHO KONMENTARU DAI 7 KAN [COMMENTARIES ON COMPANIES ACT, VOL. 7] 452, 463 (Shinsaku Iwahara ed., 2013). Such practice is rarely, if ever, seen in Japan. Rather, it is customary to limit the term of the director elected to fill the vacancy to the remaining term of the resigned director or that of the other directors. *See, e.g.,* JAPAN TOBACCO, INC., TEIKAN [CHARTER] art.22(2), available at <http://www.jti.co.jp/investors/stock/articles/pdf/certificate.pdf> (last visited June 15, 2014).

47. *See* Cools, *supra* note 16, at 741 (noting the importance of the degree of shareholders’ initiative).

48. 17 C.F.R. § 240.14a-8(b)(1) (2014).

49. *Id.* § 240.14a-8(c).

of the corporation. The length of the proposal may not exceed 500 words.⁵⁰

Even when shareholder proposals meet the above requirements, the corporation can exclude them from the proxy statement on 13 separate grounds,⁵¹ many of which concern the subject matter of the proposal in question. Notably, directors may exclude proposals that pertain to the corporation's ordinary business operations,⁵² director elections,⁵³ and specific dividend payments.⁵⁴ Delaware corporations can also exclude, as improper under state law, shareholder proposals that would bind the corporation if approved by shareholders.⁵⁵ To avoid exclusion on this basis, shareholders of Delaware corporations often draft their proposals as recommendations or suggestions.⁵⁶ As such, the board may then ignore them, even if the proposals obtain a majority of votes in favor.

The extension of shareholder access to the corporate proxy process in relation to director elections has been on the forefront of the shareholder empowerment debate for the last decade.⁵⁷ The high watermark in recent years was the adoption of Rule 14a-11 by the SEC in August 2010.⁵⁸ This rule, adopted in accordance with the authority granted by Section 971(b) of the Dodd-Frank Act, required listed corporations to include in their proxy statements either one candidate or candidates for 25 percent of the board seats of the corporation, whichever was greater, nominated by any shareholder or group of shareholders that held more than three percent of the shares of the corporation for more than three years. In July 2011, however, this requirement was vacated by the Court of Appeals for the D.C. Circuit,⁵⁹ and the then-Chairwoman of the SEC, Mary Schapiro, stated in

50. *Id.* § 240.14a-8(d).

51. *Id.* § 240.14a-8(i).

52. *Id.* § 240.14a-8(i)(7).

53. *Id.* § 240.14a-8(i)(8) (a proposal relating to director elections could be excluded “[i]f the proposal: (i) [w]ould disqualify a nominee who is standing for election; (ii) [w]ould remove a director from office before his or her term expired; (iii) [q]uestions the competence, business judgment, or character of one or more nominees or directors; (iv) [s]eeks to include a specific individual in the company’s proxy materials for election to the board of directors; or (v) [o]therwise could affect the outcome of the upcoming election of directors.”).

54. 17 C.F.R. § 240.14a-8(i)(13).

55. *Id.* § 240.14a-8(i)(1); DEL. CODE ANN. tit. 8, § 141(a) (2011) (“[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors”); Ferri, *supra* note 36, at 203.

56. The Securities and Exchange Commission advises shareholders to do so. *See* 17 C.F.R. § 240.14a-8(i)(1) (Note to paragraph (i)(1)).

57. For a brief overview, see ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 13 at 200-02.

58. Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668 (Sept. 16, 2010) (to be codified at 17 C.F.R. pts. 200, 232, 240, 249).

59. *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1146 (D.C. Cir. 2011). The main ground for vacatur was the SEC’s failure to consider adequately the rule’s effect upon efficiency, competition, and capital formation.

a congressional hearing held on April 25, 2012, that the SEC would not propose a new proxy access rule.⁶⁰ The adoption of proxy access is thus left to each corporation via its bylaws.⁶¹

b. Japan

In sharp contrast yet again, Japanese law grants much greater proxy access to shareholder proposals.⁶² The shareholding amount threshold (the lesser of one percent of all voting rights or 300 voting rights) and the duration of such shareholding (six months or more) necessary to make a proposal are not very different from those in the U.S.⁶³ The stark difference lies instead in following two points. First, there is no restriction on the number of proposals that a shareholder can make.⁶⁴ Second, and more importantly, proxy access is granted to all proposals, so long as they are

60. *Oversight of the U.S. Securities and Exchange Commission, Hearing before the Subcomm. on Capital Mkts. and Gov't Sponsored Enters. of the H. Comm. on Fin. Services*, 112th Cong. 14 (2012), available at <http://financialservices.house.gov/uploadedfiles/112-119.pdf>.

61. Delaware law allows corporate bylaws to grant shareholders proxy access for nomination of director candidates. DEL. CODE ANN. tit. 8, § 112. 17 C.F.R. § 240.14a-8(i)(8) prohibits exclusion from the proxy statement of a shareholder proposal for such a bylaw amendment.

62. On the other hand, upon receipt of a shareholder proposal, the result is not terribly different from that in the U.S. Indeed, a corporation that receives a valid shareholder proposal no less than eight weeks before the day of the shareholders' meeting must similarly include a summary of the proposal in its notice of calling of shareholders' meeting. JCA arts. 305(1), 299(2)(3).

In addition, if the corporation permits its shareholders to exercise their voting rights in writing, which is mandatory when the number of shareholders is 1000 or more, *see* JCA arts. 298(1)(iii), 298(2) (this does not apply to a listed corporation soliciting proxies, which is rare. *See* KAWAMOTO, KAWAGUCHI & KIHARA, *supra* note 15, at 230-31; JCA art. 298(2) proviso), then the corporation must send a document to its shareholders stating (i) the matters of reference for the exercise of shareholder voting rights at the shareholders' meeting (reference document) and (ii) a document to be used by the shareholder to exercise the voting rights (voting form). JCA art. 301(1). The contents of these documents are prescribed by articles 65-66 and 73-94 of Ministerial Ordinance for Implementation of Companies Act. *See* Kaishaho Seko Kisoku [Ministerial Ordinance for Implementation of Companies Act], Ministerial Ordinance No. 12 of 2006, arts. 65-66, 73-94 (Japan). With regard to shareholder proposals, the reference document must include specific information about the shareholder proposals, such as the grounds for the proposal or the background of the candidate when the proposal is a nomination of a director. *Id.* arts. 93(1)(iii)-(iv), 74. The corporation can summarize the information provided by the proposing shareholders when they are too lengthy to include all of the proposals, and the voting form must provide a space for shareholders to express approval or disapproval to the proposal. *Id.* art. 66(1)(i).

63. JCA art. 303(2) (shareholding necessary to make a proposal to include a certain matter in the agenda of a shareholders' meeting); *id.* art. 305(1) (shareholding necessary to make a specific proposal on a certain agenda).

64. No article in JCA refers to the number of proposals permitted. Minoru Sawaguchi, *Kabunushi teianken no ima* [Shareholder's Proposal Right Today], 340 SRYOBAN SHOJI HOMU 18, 22 (2012). A recent judgment of the Tokyo High Court, however, acknowledged the possibility that shareholder proposals could be considered an abuse of right and, therefore, illegal when the number of proposals is too large, although the court declined to find abuse when a single shareholder had made 58 proposals. *See* Tokyo Koto Saibansho [Tokyo

comprised of matters rightfully to be decided at shareholders' meeting.⁶⁵ As discussed in Part II.B, the powers granted shareholders at shareholders' meetings is quite broad. For example, a proposal regarding specific decisions about the corporation's ordinary business operations will be permitted if it is conditioned on the approval of accompanying proposals for amendments to the charter to grant shareholders' meetings authority over such matters.⁶⁶ Furthermore, all director candidates nominated by shareholders must be included in the corporate proxy and ballot.⁶⁷ This requirement goes far beyond the now-vacated SEC Rule 14a-11. The only real exceptions to the broad Japanese proxy access are proposals in violation of law or charter provisions and proposals essentially identical to a proposal within the prior three years that received low affirmative votes (<ten percent).⁶⁸

2. Right to Call a Special Meeting

In keeping with the trend materializing, there is also a difference under U.S. and Japanese law with respect to a shareholder's right to call a special meeting. Under Delaware law, only the board of directors may call special meetings, unless either the certificate of incorporation or the bylaws grant such a right to shareholders.⁶⁹ In Japan, any shareholder holding three percent or more of the corporation's voting rights for six months or longer can demand that the directors call a special meeting.⁷⁰ When the board delays in doing so, the shareholder can obtain court permission to call the special meeting unilaterally.⁷¹ Because shareholders do not have to wait for annual meetings to hold a vote on their proposals, the value and protective purposes of a classified board are greatly diminished in Japan, while the value of a shareholder proposal is vastly increased.

High Ct.], May 31, 2012, 340 SIFYOBAN SHOJI HOMU [SHIFYOBAN SHOJI] 30; *see also infra* Part V.B, for issues arising from this point.

65. *See* EGASHIRA, *supra* note 45, at 309 (stating that corporation does not need to put a shareholder proposal regarding a matter that could not be decided at shareholders' meeting on agenda); *id.* at 310 n.4 (describing the U.S. rule as putting more restrictions on the subject matter of proposals compared to Japan).

66. Shoichi Aotake, 303 jyo [Article 303], in KAISHAHO KONMENTARU DAI 7 KAN [COMMENTARIES ON COMPANIES ACT, VOL. 7] 98, 101 (Shinsaku Iwahara ed., 2013).

67. For what a corporation should do when it receives a valid shareholder proposal, *see supra* note 62.

68. JCA art. 305(4).

69. DEL. CODE ANN. tit. 8, § 211(d) (2011). *But see* REVISED MODEL BUS. CORP. ACT § 7.02(a)(2) (2013) (granting the right to demand a special meeting to shareholders holding at least ten percent of all votes).

70. JCA art. 297(1).

71. *Id.* art. 297(4)(i).

E. *Greater Initiative in Derivative Suits*

1. U.S.

In principle, the decision to raise a claim on behalf of the corporation against a third party belongs to the board of directors.⁷² Shareholder derivative suits are permitted as an exception to this rule, however, since sometimes the board decision not to sue is biased and ought not be protected as a business judgment.⁷³ A typical case of this kind is one dealing with a claim against a director for liability arising from her breach of fiduciary duties.

U.S. law imposes the following requirements and restrictions on derivative suits, which are to be assessed on a case-by-case basis to determine whether the suit is truly in the best interest of the corporation:

First, a shareholder must make a pre-suit demand to the board of directors in order to let the board decide whether a suit is in the best interest of the corporation.⁷⁴ Only when the board’s refusal of the demand was wrongful or the demand requirement was excused due to its futility can a shareholder raise a derivative suit.⁷⁵

Second, even when the plaintiff shareholder passes the above hurdles and raises a derivative suit, the corporation may still seek its dismissal when a special litigation committee consisting of independent and disinterested directors makes a recommendation that the suit is not in the corporation’s best interest.⁷⁶ In Delaware, the court will then decide whether to follow this recommendation, pursuant to the standard established in *Zapata Corp. v. Maldonado*.⁷⁷

Third, there are two standing requirements, the purposes of which are to select a plaintiff who will carry out the derivative suit in conformity with the interest of the shareholders as a class. The contemporaneous ownership requirement dictates that the complaint “allege that the plaintiff was a shareholder or member at the time of the transaction complained of[.]”⁷⁸ The plaintiff must also “fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association.”⁷⁹ Courts consider any conflict of interest between the plaintiff and other shareholders, among other factors, in determining the adequacy of the named plaintiff.⁸⁰

72. See Del. Code Ann. tit. 8, § 141(a).

73. STEPHEN M. BAINBRIDGE, *CORPORATE LAW* 187 (2d ed. 2009).

74. FED. R. CIV. P. 23.1(b)(3); DEL. CH. CT. R. 23.1(a).

75. BAINBRIDGE, *supra* note 73, at 203-11.

76. *Id.* at 211-16.

77. *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981).

78. FED. R. CIV. P. 23.1(b)(1).

79. FED. R. CIV. P. 23.1(a). Rule 23.1(b) of the Delaware Court of Chancery includes more specific provisions restraining the receipt of compensation by the representative plaintiff, in lieu of the phrase cited in the text above. See DEL. CH. CT. R. 23.1(b).

80. BAINBRIDGE, *supra* note 73 at 199-201.

As long as these requirements are met, shareholders of American corporations can raise a derivative suit for claims on behalf of the corporation, including but not limited to claims against directors and officers for breaches of their fiduciary duties.⁸¹ In other words, derivative suits against directors and officers are addressed within the same framework as derivative suits for other claims.

2. Japan

Japanese law on shareholder derivative suits⁸² starts from the same point, that shareholder derivative suits are permitted as an exception to the general rule that the decision to raise a claim on behalf of the corporation belongs to the board of directors,⁸³ but then takes an approach that could be characterized as formalistic and categorical, as opposed to the substantive and case-by-case approach of the U.S.⁸⁴ The scope of the Japanese derivative suit is limited to those claims listed exhaustively by statute,⁸⁵ which the law regarded as claims that are especially likely to be under-enforced by corporate management.⁸⁶ Within this limited field, however, plaintiff shareholders face fewer restrictions.

First, although a shareholder seeking to file a derivative suit against a director must demand that the corporation sue the director in the first place,⁸⁷ the shareholder can bring a suit herself if the corporation does not sue the director within 60 days of that demand.⁸⁸ There is no need to establish that there was a wrongful refusal or that making the demand was futile.

81. *Id.* at 187 n.1.

82. See Hiroshi Oda, *Shareholder's Derivative Action in Japan*, 8 EUR. CO. & FIN. L. REV. 334, 341-47 (2011), for a more detailed description of Japanese law on derivative suits.

83. See *supra* notes 72-73 and accompanying texts.

84. Tomotaka Fujita, *Kabunushi daihyo soshō no gendaiteki tenkai* [*Development of Shareholder's Derivative Suit of Today*], in KAISHA JIKEN TETSUDUKIHO NO GENDAITEKI TENKAI [DEVELOPMENT OF THE LAW OF CIVIL PROCEDURE FOR CORPORATE LITIGATION OF TODAY] 41-44 (Shiro Kawashima & Masafumi Nakahigashi eds., 2013).

85. JCA art. 847(1) (listing the following claims: claims for the liability of an incorporator, director at incorporation, statutory auditor at incorporation, director, accounting advisor, statutory auditor, executive officer, accounting auditor or liquidator; claims for the return of the benefits set forth in Article 120(3); or claims for the payment under the provisions of Article 212(1) or Article 285(1)).

86. This does not mean that the list of Article 847(1) is perfect. There are other types of claims that are also very likely to be under-enforced but not included in this list, such as claims for liability of controlling shareholder or senior employees.

87. JCA art. 847(1).

88. *Id.* art. 847(3).

Second, once the plaintiff shareholder raises a derivative suit, a court cannot dismiss the suit with a reference to the decision of corporation’s special litigation committee.⁸⁹

Third, the only standing requirement for a plaintiff is the consecutive holding of at least one share⁹⁰ for the preceding six months or more.⁹¹ Since there is no contemporaneous ownership requirement, it is possible to purchase a share after one notices wrongdoing by a director and to raise a derivative suit six months thereafter. Additionally, there is no fair and adequate representation requirement; however, a derivative suit will be dismissed if the plaintiff’s purpose is to seek unlawful gains or inflict damage on the corporation.⁹²

Thus, derivative suits in Japan are both easier to initiate and harder to dismiss.

F. Summary

To summarize, the rights of shareholders of Japanese corporations are strong in two ways. First, as a class, shareholders have substantial ability and opportunity to influence corporate decision-making. Second, they also have strong individual rights to raise issues either via proposals or derivative suits.

Although shareholders of Japanese corporations lack some rights present under other countries’ corporate law scheme, such as class action for direct suits, it is fair to say that shareholders’ rights under Japanese law are among the strongest in the world.⁹³ The problem, then, is not the rights themselves, but what has been done with them.

89. Fujita, *supra* note 84, at 43-44 (stating that Japanese law does not have a system to allow the courts to dismiss derivative suits that are not in the interests of the corporation or shareholders as a class on a case-by-case basis).

90. In contrast, the standing requirement for multiple derivative suits, which is to be introduced by the Reform Act of the Companies Act, is set at one percent of the shares issued. For background on this reform, see Goto, *supra* note 1, at 35-36.

91. JCA art. 847(1).

92. *Id.*

93. In Continental European countries, shareholders enjoy strong class-based rights with respect to decision-making, *see* Cools, *supra* note 16 at 736-750, but shareholder derivative suits are limited. *See generally* Martin Gelter, *Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?*, 37 *BROOK. J. INT’L L.* 843 (2012). Similarly, in the U.K., shareholders have strong class-based rights with respect to decision-making, *see* Companies Act, 2006, c. 46, §§ 168, 303 (Eng.), but derivative suits require permission from the courts. *See id.* § 261(1). Permission must be refused when the court is satisfied that a person acting in accordance with the duty to promote the success of the company would not seek to continue the claim. *Id.* § 263(2)(a).

III. INACTIVE ACTIVISTS AND CROSS-SHAREHOLDINGS

A. *A Brief History of Hedge Fund Activism in Japan*

One type of investor that could leverage these strong shareholder rights is a hedge fund, as such funds often own large blocks of stock and are sophisticated enough to launch activism campaigns. In Japan, however, hedge fund activism⁹⁴ is rather infrequent today, though it experienced a short period of heightened activity in the early-to-mid 2000s.⁹⁵

Three hedge funds stood out during this period for their confrontational attitude against incumbent management teams: M&A Consulting (a.k.a. the Murakami Fund), Steel Partners Japan (SPJ), and The Children's Investment Fund (TCI).⁹⁶ Their tactics often involved making public requests for higher payouts via dividends or share repurchases or initiating tender offers against cash-rich corporations, which, too, often ended in some form of payout.⁹⁷ These techniques were quite successful at first.⁹⁸ The style of activism soon invoked strong opposition,⁹⁹ however, and later interventions by the hedge funds into corporation management, particularly those commenced by SPJ and TCI after late 2004, turned out to be unsuccessful.¹⁰⁰ For several years following the financial crisis of 2008, there was even a near-complete stoppage of hedge fund activism, stemming from a worldwide shortage of funds caused by the withdrawal of institutional investors.¹⁰¹

In recent years, U.S. activist hedge funds have returned to their previous level of activity;¹⁰² Japan has not seen the same rebound. Although at

94. Hedge fund activism is a kind of shareholder activism that purports to generate profit by changing the strategic or financial policies of the targeted corporation. BUCHANAN, DOMINIC HEESANG CHAI & SIMON DEAKIN, *HEDGE FUND ACTIVISM IN JAPAN – THE LIMITS OF SHAREHOLDER PRIMACY* 67-68 (2012). There are two other kinds of shareholder activism. One focuses on improvement of corporate governance. Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1042-44 (2007). The other focuses on promotion of social, political or environmental values. See, e.g., *infra* note 219 (derivative suits by NPO holding shares to correct illegal corporate activities); *infra* note 205 (shareholder proposal to abolish nuclear power plants by environmental activists holding shares of an electric power company).

95. For a thorough description of the rise and fall of hedge fund activism in Japan, see BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 153-293.

96. See *id.* at 154, 173-74, 180-82 (describing the funds mentioned).

97. *Id.* at 154-57, 174-77, 182-83.

98. *Id.* at 158-62, 175, 209.

99. *Id.* at 289-93 (depicting attempts, coined as “quiet” activism, of foreign hedge funds to avoid such criticism and opposition by refraining from making public challenges to management).

100. *Id.* at 209.

101. BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 180.

102. See John J. Madden, *The Evolving Direction and Increasing Influence of Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 23, 2013, 9:18 AM), <http://blogs.law.harvard.edu/corpgov/2013/12/23/the-evolving-direction-and-increasing-influence-of-shareholder-activism/>; Martin Lipton, *Dealing with Activist Hedge Funds*, HARV.

least two cases of hedge fund activism were reported in 2013¹⁰³—TCI’s intervention against Japan Tobacco¹⁰⁴ and Third Point’s intervention against Sony¹⁰⁵—confrontational activism is still rare. Whether this trend will continue is difficult to predict at the moment.

L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Nov. 21, 2013, 12:24 PM), <http://blogs.law.harvard.edu/corpgov/2013/11/21/dealing-with-activist-hedge-funds-2/>.

103. Although the conflict between Cerberus and Seibu Holdings, Inc. attracted ample public attention in the first half of 2013, this conflict was different from ordinary hedge fund activism: Seibu was a non-listed corporation at that time; Cerberus was originally a friendly, large shareholder holding 32 percent of Seibu’s shares; and Cerberus supported Seibu’s recovery after it was delisted from the Tokyo Stock Exchange for misstatements regarding shareholdings of the founder’s family. Since Seibu was a delisted corporation, the holding ratio of other institutional investors was presumably low. A conflict arose when Cerberus opposed management’s early application for re-listing, since it would not produce enough return for Cerberus to exit. In turn, Cerberus is said to have proposed the abolition of unprofitable railroad routes and the sale of a professional baseball team in order to raise Seibu’s share price. Although Cerberus itself denied making these proposals, this invited strong opposition from Seibu’s management and (mostly negative) public attention. Cerberus’ attempted tender offer to raise its stake to 45 percent and proxy fight for director seats both eventually failed. Despite the initial expectation that this ongoing conflict would end with Cerberus’s exit upon Seibu’s re-listing, which occurred on April 23, 2014, Cerberus still holds Seibu shares as of June 2014, choosing not to sell because of the low IPO price. Ritsuko Ando, *Cerberus Pulls Out of Seibu IPO as Price Slashed*, REUTERS (Apr. 9, 2014, 8:21 AM), <http://www.reuters.com/article/2014/04/09/us-seibu-hldg-ipo-idUSBREA380WG20140409>.

104. Since June 2011, just after the Eastern Japan Great Earthquake, TCI has been requesting higher payouts from Japan Tobacco. BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 287-89. Indeed, TCI made shareholder proposals at the annual meetings in 2012 and 2013, though both proposals were ultimately rejected. See JAPAN TOBACCO, INC., RINJI HOKOKUSHO [EXTRAORDINARY REPORT] (2012), available at http://www.jti.co.jp/investors/securities_report/pdf/rinji20120627.pdf; JAPAN TOBACCO, INC., RINJI HOKOKUSHO [EXTRAORDINARY REPORT] (2013), available at http://www.jti.co.jp/investors/securities_report/pdf/rinji20130624.pdf. JT, nonetheless, has increased its payouts to shareholders. See *Japan Tobacco: Turning Over a New Leaf*, THE ECONOMIST (Mar. 2, 2013), <http://www.economist.com/news/business/21572778-activist-hedge-fund-helps-light-up-old-gasper-turning-over-new-leaf>. Further, in 2013, the Japanese Government decreased its shareholding of JT from 50.01 percent to 33.35 percent in order to meet its expenditure needs after the earthquake. *Id.*; see also JAPAN TOBACCO, INC., DAI 28 KI YUKA SHOKEN HOKOKUSHO [ANNUAL REPORT FOR THE 28TH BUSINESS YEAR] 35, 56 (2013), available at http://www.jti.co.jp/investors/securities_report/pdf/f.s.20130621.pdf. Such reduction of governmental shareholding was also a part of TCI’s request. BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 288.

105. Third Point requested that Sony Corporation, which is well-known for adopting an American-style corporate governance, list its entertainment division and restructure its electronics division. Letter of Daniel S. Loeb, Chief Exec. Officer, Third Point LLC, to Kazuo Hirai, President and Chief Exec. Officer, Sony Corp. (May 14, 2013), available at <http://online.wsj.com/public/resources/documents/ThirdPointLettertoSony.pdf>. Although Sony rejected the request for partial listing of its entertainment division, the corporation did begin to provide additional information on its entertainment division, announce that it would sell its personal computer business, and restructure its TV business. Press Release, Sony Corp., Sony Corporation Sends Letter to Third Point (Aug. 6, 2013), <http://www.sony.net/SonyInfo/News/Press/201308/13-091E/>; Press Release, Sony Corp., Sony Announces Plans to Address Reform of PC and TV Businesses (Feb. 6, 2014), <http://www.sony.net/SonyInfo/News/Press/201402/14-0206E/>. One might conclude that this is a partial response to Third Point’s request. Third Point was not listed among the 10 largest shareholders of Sony as of December 31, 2013, but Third Point might still hold its investment through swap arrangements. See Kana

B. *The Cause of Failure: Cross-Shareholding*

Putting aside the possibility of future developments, hedge fund activism seems to have largely failed as a sustainable investment strategy thus far.¹⁰⁶ This is due, in part, to strong resistance from the incumbent management teams of targeted corporations.¹⁰⁷ But, why couldn't this resistance be countered by the strong legal rights of shareholders of Japanese corporations?

The answer is simple. In order to use these rights, activist hedge funds, who rarely own a controlling stake by themselves, needed to obtain sufficient support from other shareholders.¹⁰⁸ The ultimate cause of the failure of activist hedge funds in Japan is the lack of this support,¹⁰⁹ which is more readily available for activists in the U.S.

One particular subset of shareholders that perpetually show no support for these activists are those in cross-shareholding relationships.¹¹⁰ Cross-shareholders consist of banks, insurance companies, and other business companies that are typically engaged in some sort of business transaction with the issuer corporation. Because their interest is in maintaining this business relationship, rather than dividends and capital gains,¹¹¹ they generally support the incumbent management from whom they earn business, rather than activist shareholders.

Even individual shareholders that have no such relationship with the corporation sometimes deny their support to hedge funds. A famous example is the Bulldog Sauce case,¹¹² in which almost all shareholders other than SPJ approved a defensive maneuver against a hostile tender offer with a premium¹¹³, even though implementing that defensive plan came at a substantial cost to these same shareholders.¹¹⁴ Since it was financially

Inagaki & Juliet Chung, *Dan Loeb's Third Point Drops Out of Sony's Top 10 Biggest Holders*, WALL ST. J. (Feb. 18, 2014, 12:35 PM), <http://blogs.wsj.com/moneybeat/2014/02/18/dan-loeb-third-point-drops-out-of-sonys-top-10-biggest-holders/>. It is of great interest whether Third Point will take further action at Sony's 2014 annual shareholders meeting.

106. BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 307.

107. *Id.* at 298-300.

108. Kahan & Rock, *supra* note 94, at 1088-89.

109. BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 252.

110. For definition of "cross-shareholding" in this Article, see *supra* note 12.

111. *Id.* (regarding shareholding by life insurance companies). See also *infra* note 155-159 and accompanying texts (discussing rationales of cross-shareholding in Japan).

112. Saikō Saibansho [Sup. Ct.] Aug. 7, 2007, 61 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 2215 (Japan), discussed in Hiroshi Oda, Comment, in BUSINESS LAW IN JAPAN – CASES AND COMMENTS – INTELLECTUAL PROPERTY, CIVIL, COMMERCIAL AND INTERNATIONAL PRIVATE LAW 323 (Moritz Bälz et al. eds., 2012).

113. The shareholder meeting of Bulldog Sauce approved the defensive plan by 88.7 percent of the voting rights present at the meeting and by 83.4 percent of all voting rights, whereas SPJ claimed to hold about 10.5 percent. Saikō Saibansho [Sup. Ct.] Aug. 7, 2007, 61 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 2221, 2228 (Japan).

114. *Id.* at 2221-22. The defense plan diluted the position of SPJ—the hostile bidder in this case—by allocating share options, which could be exercised to receive three new shares

irrational for individual shareholders to approve this defensive plan, it seems logical to conclude that they had strong sympathy for the targeted corporation and antipathy to the hostile bidder.¹¹⁵ In other words, shareholder hostility towards activist hedge funds is not always guaranteed; rather, it seems to depend on how a hedge fund behaves publicly.¹¹⁶

In their reflections on the issue, Buchanan, Chai & Deakin have asserted that neither domestic nor foreign institutional investors have always supported activists,¹¹⁷ yet failed to specify cases in which foreign investors denied their support.¹¹⁸ Such a denial might occur when, for example, an activist hedge fund requests higher dividends.¹¹⁹ However, this kind of opposition is not unreasonable, compared to the adoption of the defensive plan in the Bull-Dog Sauce case, since investors might reasonably disagree as to their projections on the amount of free cash flow and the investment opportunities of the targeted corporation.¹²⁰

per share, to each existing share, *including* those held by SPJ, but prohibiting SPJ from exercising these options. SPJ was financially compensated for this loss by the repurchase of its options by the corporation. *Id.* Thus, the non-SPJ shareholders not only eliminated their opportunity to receive the premium offered by SPJ, but also had to bear the cost of this compensation to SPJ.

115. Wataru Tanaka, *Kabushiki hoyu kozo to kaisha-ho – Bunsan hoyu no jyojyo gaisha no jirenma wo koete* [Share-Ownership Structure and Corporate Law – Beyond the “Dilemma of Dispersedly-Held Listed Corporations”], 2007 SHOJI HOMU 30, 39 n.18 (2013); see also Peng Xu & Wataru Tanaka, *Baishu boeisaku in za shado obu kabushiki mochiai – jirei kenkyu* [Takeover Defense in the Shadow of Cross-Shareholdings – A Case Study], 1885 SHOJI HOMU 4, 10-13 (2009).

116. Joseph Chang, *Shareholder activism in Japan on the rise, but change will be difficult*, ICIS CHEM. BUS. (Nov. 5, 2007), <http://www.icis.com/resources/news/2007/11/05/9075289/shareholder-activism-in-japan-on-the-rise-but-change-will-be-difficult/> (reporting that Warren Lichtenstein, CEO of Steel Partners, stated at a press conference in Tokyo that his intent was to “educate” and “enlighten” Japanese corporate managers); see also BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 274-76, 281 (describing popular media coverage in Japan, which was often negative). *But see* Loeb, *supra* note 105, at 1 (Third Point is seemingly trying to avoid this antipathy by emphasizing that their proposals to Sony are based on “a spirit of partnership”).

117. BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 280, 311.

118. *Id.* at 257-59 (raising only examples of support by foreign investors); see also *id.* at 255-57 (citing a general concern by Japanese fund managers with regard to the excessiveness of SPJ and an implied preference for the autonomy of the board of directors on dividend payments).

119. Compare JAPAN TOBACCO, INC., ANNUAL SHAREHOLDERS’ MEETING 3 (2013), available at http://www.jti.co.jp/investors/securities_report/pdf/rinji20130624.pdf (TCI’s proposal for higher dividends and share repurchases obtained only 20 percent to 22 percent of the votes cast), with JAPAN TOBACCO, INC., ANNUAL REPORT 2013 (2013), available at http://www.jt.com/investors/results/annual_report/pdf/annual2013_E_all.pdf (showing that 33.5 percent of the outstanding shares were held by foreign institutions).

120. For example, it has been reported that Institutional Shareholders Services has recommended that shareholders of Apple, Inc. vote against the proposal for a \$50 billion share repurchase by Carl Icahn. David Benoit, *Apple Gets Backing Against Icahn Proposal - Proxy Adviser ISS Recommends Against Investor’s Stock-Buyback Resolution*, WALL ST. J. (Feb. 9, 2014, 6:41 PM), <http://online.wsj.com/news/articles/SB10001424052702303874504579373443507730608>; see also Nickolay Gantchev, *The Costs of Shareholder Activism: Evidence from a*

The following sections will focus on cross-shareholdings as the main cause of hedge fund activism failure.

C. Unwinding Cross-Shareholding

1. General Trend

Is cross-shareholding a problem in Japan? Graph 1¹²¹ below shows the share-ownership distribution by investor category of all listed corporations in Japan on an aggregate basis over time.

The three categories of investors on the left side of each row, namely, non-financial business corporations, banks, and insurers, are “insider shareholders” that tend to support the incumbent management. These investors can be approximated to shareholders in a cross-shareholding relationship. The three categories on the far right side of the graph, namely, individuals, foreigners, and trust banks,¹²² are “outsider shareholders” that may support activist hedge funds.

Sequential Decision Model, 107 J. FIN. ECON. 610, 620 (2013) (reporting relatively low rate of success of activism—including in those corporations that hedge funds exited before going into proxy fights—when hedge funds demand higher dividends).

121. Graph 1 is based on data from the Tokyo Stock Exchange. See TOKYO STOCK EXCHANGE, 2012 SHAREOWNERSHIP SURVEY, SHARE DISTRIBUTION SURVEY § 2-5, <http://www.tse.or.jp/english/market/data/shareownership/b7gje60000003t0u-att/2-5.xls> (last visited Feb. 28, 2014).

122. Shareholding by trust banks consists of shareholding for beneficiaries, such as investment trusts (mutual funds), private pension trusts, and other domestic investment funds, and shareholding for trust banks’ own account. Although the exact proportion of these two categories are unknown, it is reasonable to assume that the ratio of shares held for trust banks’ own account has been considerably low in recent years, since the restrictions on share-

The percentage shareholding held by insider shareholders, which was as high as 61.8 percent in 1986, has decreased to 31.2 percent in 2012. Cross-shareholdings are being unwound. The largest period of decline took place in the late 1990’s, caused mainly by the banking crisis of 1997-1998 and subsequent regulation¹²³ forcing banks to sell their shares of other corporations.¹²⁴ Insurers that were in a similar distressed situation also sold their shares,¹²⁵ although they were not subject to the regulation noted above.

Correspondingly, the ratio of outsider shareholders has increased to 65.9 percent as of 2012. Greater holdings by foreign investors and trust banks are the cause of trend. Although, by appearances, the unwinding of cross-shareholdings seems to have stopped or largely slowed since 2005,¹²⁶ the other side of the coin is that cross-shareholdings simply no longer seem commonplace.

2. Diversified Unwinding

The above observation, however, is based on the aggregate data of all listed corporations, calculated from market share price, the upshot of which is that Graph 1 tends to over-emphasize the figures of corporations with large market capitalizations. Research on a corporation-to-corporation basis has shown that there is diversification between large corporations and small and medium corporations with respect to the degree of cross-shareholding unwinding. There are several reasons for this.

First, when banks were forced to sell their shares of other corporations, they began with those of corporations with larger market capitalization and higher market valuation,¹²⁷ refraining when possible from selling

holdings by banks, *see infra* note 119, apply only to the shares held for trust banks’ own account. Ginko to no kabushiki to no hoyu no seigen to ni kansuru naikaku furei [Cabinet Office Ordinance on Restriction of Shareholdings by Banks], Cabinet Office Ordinance No. 4 of 2002, art. 2, para. 1, subpara. ii.

123. Ginko to no kabushiki to no hoyu no seigen to ni kansuru horitsu [Act on Restriction of Shareholdings by Banks], Law No. 131 of 2001, art. 3, para. 1 (Japan) (prohibiting banks from holding shares of other corporations in excess of the bank’s capital).

124. Hideaki Miyajima & Fumiaki Kuroki, *The Unwinding of C-Shareholding in Japan: Causes, Effects, and Implications*, in CORPORATE GOVERNANCE IN JAPAN 79, 90-91 (Masahiko Aoki et al. eds., 2007).

125. *Id.* at 90.

126. Hideaki Miyajima, Takuji Saito, Peng Xu, Wataru Tanaka & Ryo Ogawa, *Nihon-gata koporeto gabanansu ha dokohe mukaunoka (jyo)* - “Nihon kigyo no koporeto gabanansu ni kansuru anketo” chosa kara yomitoku [*Quo Vadis Japanese Corporate Governance? – Analyzing the Results of “Questionnaire on Corporate Governance of Japanese Corporations” (1 of 2)*], 2008 SHOJI HOMU 4, 9 (2013).

127. Miyajima & Kuroki, *supra* note 124 at 99, 102. It is also worth noting that corporations that had their shares sold by banks tended to sell the shares of those banks within the same or following year. *Id.* at 104. This tendency towards reciprocal share selling explains another finding by Miyajima: that the unwinding of cross-shareholdings took place primarily between banks and non-financial business corporations and less so among non-financial business corporations, since non-financial business corporations did not face the regulatory pres-

shares of corporations that were dependent on them for borrowing, especially those in main-bank relationships.¹²⁸

Second, foreign investors tend to prefer to invest in larger corporations with higher ratios of overseas sales and higher return on assets, presumably because they are more familiar with them, thereby replacing banks as shareholders of such corporations.¹²⁹ This movement is slower in small and medium corporations, where no such preference is apparent.

Third, after 2005, there was a limited revival of cross-shareholding among non-financial business companies. The stunted return of cross-shareholding was especially pronounced among cash-rich corporations that were targeted by activist hedge funds.¹³⁰

The data indicate that the unwinding of cross-shareholding and the increase of foreign investment is taking place primarily in large public corporations, while small and medium-sized listed corporations still seem to have a relatively high ratio of cross-shareholdings and lower percentage of shareholding by foreign investors.¹³¹ And, since activist hedge funds tend to target smaller corporations in which less cash is needed to obtain a considerable stake,¹³² the impact of cross-shareholding on hedge fund activism is still quite large.

sure to sell other corporations' shares that banks did. Hideaki Miyajima & Keisuke Nitta, *Kabushiki shoyu kozo no tayoka to sono kiketsu – Kabushiki mochiai no kaisyō / “fukkatsu” to kaigai toshika no yakuwari* [Diversification of Share-Ownership Structure and its Consequences / Unwinding and “Revival” of Cross-Shareholdings and the Role of Foreign Investors], in *NIHON NO KIGYO TOCHI* [CORPORATE GOVERNANCE IN JAPAN] 105, 120-21 (Hideaki Miyajima ed., 2011); *supra* note 123-124 and accompanying texts.

128. Miyajima & Kuroki, *supra* note 124 at 102. A “main bank,” which is another characteristic of Japanese corporate governance, is the largest single lender to a corporation and often one of its principal shareholders. From such a relationship, a main bank is expected, at least traditionally, to monitor the borrower corporation's management and to provide assistance in case the corporation becomes financially troubled. CURTIS J. MILHAUPT & MARK D. WEST, *ECONOMIC ORGANIZATIONS AND CORPORATE GOVERNANCE IN JAPAN: THE IMPACT OF FORMAL AND INFORMAL RULES* 13 (2004). The behavior mentioned in the text could be considered an attempt to avoid giving the market a negative impression that a corporation is being abandoned, even by its main bank. Miyajima & Nitta, *supra* note 127, at 122.

129. Miyajima & Nitta, *supra* note 127, at 135; *see also* Miyajima & Kuroki, *supra* note 124, at 86-88.

130. *Id.* at 117, 125-30; *see also* Xu & Tanaka, *supra* note 115, at 8-10 (describing Bull-Dog Sauce's attempt to strengthen cross-shareholdings).

131. Tanaka, *supra* note 115, at 31-32.

132. Kotaro Inoue & Hideaki Kato, *Akuthibisuto fando no kozai* [Merits and Demerits of Activist Funds], 58 *KEIZAI KENKYU* 203, 207-08 (2007). Buchanan, Chai & Deakin report that corporations targeted by confrontational hedge funds had “higher market capitalization than their peers,” BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 197, but these “peers” are chosen from corporations in the same industry type with closest total assets and book-to-market ratio. *Id.* at 193.

D. Effects of Hedge Fund Activism on Japanese Targets

Should cross-shareholding be regulated in order to increase hedge fund activism in Japan? The answer to this question depends on the effect of activism on the firm value of targeted corporations. Although empirical research on this point, especially on the long-term effects of activism, is relatively scarce in Japan,¹³³ a small number of existing studies have found positive effects.

1. Inoue & Kato¹³⁴

By examining the stock market return of corporations targeted by activist hedge funds during 2000-2006,¹³⁵ Inoue & Kato sought to determine whether activist hedge funds increase shareholder value by disciplining targeted corporations, or whether they simply make profits from exiting quickly after increasing the targeted corporation's share price.¹³⁶

The authors found that the cumulative abnormal return (CAR)¹³⁷ upon activist hedge funds' acquisition of more than five percent of the shares was positive and statistically significant.¹³⁸ For the cases in which activists have exited, corporations targeted by activists other than Murakami Fund experienced significantly positive CAR for the entirety of the activist investment period.¹³⁹ On the other hand, the targets of

133. For empirical studies about the effects of hedge fund activism in the U.S., see, for example, LUCIAN A. BEBCHUK, ALON BRAV & WEI JIANG, *THE LONG-TERM EFFECTS OF HEDGE FUND ACTIVISM* (2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2291577, and Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729 (2008). For refutation of the first article, see Martin Lipton, *Empiricism and Experience; Activism and Short-Termism; the Real World of Business*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 28, 2013, 9:40 AM), <http://blogs.law.harvard.edu/corpgov/2013/10/28/empiricism-and-experience-activism-and-short-termism-the-real-world-of-business/>.

134. Inoue & Kato, *supra* note 132.

135. This method is similar to the one employed in Brav, Jiang, Partnoy & Thomas, *supra* note 133, at 1755-57, 1760-62.

136. Inoue & Kato, *supra* note 132, at 205-06.

137. CAR, which is a metric often used in financial studies to measure the effect of a certain event to the shareholder value of a corporation, is the sum of the differences between the actual performance of the share of that corporation and the expected return from that share in the absence of the event in question. See RONALD J. GILSON & BERNARD S. BLACK, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 193-204 (2d ed. 1995). In this research by Inoue & Kato, however, CAR was calculated as the sum of the differences between the actual performance of the shares of the targeted corporations and those of matched non-targeted corporations selected by industry type and size of market capitalization, since it was difficult to obtain sufficient data from the period unaffected by the activists' purchase to calculate reliable expected returns of the shares of targeted corporations. This difficulty was caused by the fact that most of these targeted corporations had smaller market capitalizations and were not traded frequently. Inoue & Kato, *supra* note 132, at 207; see also *id.* at 210, 215 n.9.

138. *Id.* at 210-11.

139. *Id.* at 211.

Murakami Fund, which tended to exit its investments in the relatively short period of just over one year,¹⁴⁰ experienced negative CAR during the investment period, though these findings were not statistically significant.¹⁴¹ Finally, there was no apparent significant negative CAR around, or for 100 days after, the exits of the activists studied.¹⁴²

The fact that the initial positive CAR did not reverse suggests that these activists have, in fact, created some value for shareholders.¹⁴³

2. Buchanan, Chai & Deakin¹⁴⁴

The more recent study by Buchanan, Chai & Deakin focused on the ex post effects (i.e., 1 and 2 years later) of hedge fund activism on targeted corporations as of December 31, 2007,¹⁴⁵ the date the authors regard as the peak of hedge fund activism in Japan.¹⁴⁶ They divided their samples into two categories: targets of confrontational activists (i.e., SPJ and TCI) and those of non-confrontational activists.¹⁴⁷ The focus here is on the former.

In comparison to matched corporations selected by industry type, amount of total assets, and book-to-market ratio,¹⁴⁸ corporations targeted by confrontational activists experienced a greater increase in ROA from 2007 to 2009, which was statistically significant at a ten percent level.¹⁴⁹ The higher increase of ROA achieved by these activist targets was caused, presumably, by a statistically significant increase in dividend payments by these corporations, using their cash reserves.¹⁵⁰ Although the level of significance is low, this result suggests the positive contribution of hedge fund activism to decreasing the agency costs of free cash flow.

At the same time, corporations targeted by confrontational activists experienced a larger decline of Tobin's q than their matched counterparts in both 2008 and 2009.¹⁵¹ Buchanan, Chai & Deakin themselves interpret

140. *Id.* at 209.

141. *Id.* at 211.

142. Inoue & Kato, *supra* note 132, at 211.

143. *Id.* at 212-13 (denying the possibility that activists other than Murakami Fund are just good at picking undervalued shares).

144. BUCHANAN, CHAI & DEAKIN, *supra* note 94.

145. *Id.* at 325-30 tbl.A.3 (listing the corporations studied).

146. *Id.* at 166 (focusing the research on this point in time excluded the corporations targeted by Murakami Fund, which terminated its investment activities in late 2006 following the arrest of its CEO).

147. *Id.* at 192.

148. *Id.* at 193.

149. *Id.* at 199-203 (also showing no significant effect on ROE in 2009, nor on ROA or ROE in 2008).

150. BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 204. If the higher increase of ROA was caused by the increase of profits, then not only ROA but also Tobin's q should have increased, which is not observed. *See infra* text accompanying note 151.

151. *Id.* at 199. Tobin's q, which is a metric often used in financial studies to measure current and future profitability of a firm, is the ratio of the market value of a firm to the

this as a negative response of the stock market to confrontational hedge fund activism.¹⁵² In my view, however, this larger decline of Tobin’s *q* for activist targets was caused by the larger drop in share prices experienced by these corporations during this period. This relatively larger decrease in share price was, in turn, the result of having had higher than average share prices in December 2007 in anticipation of further hedge fund activist intervention being wiped away by the 2008 financial crisis. Thus, the decline of Tobin’s *q* should not imply negative effects of hedge fund activism on the target’s firm value.

E. Regulating Cross-Shareholding

Although one should be careful to derive a definite conclusion from limited empirical research, it may not be unfair to assume from the discussion above that hedge fund activism does have some positive effects on the firm value. The next step is to find a workable regulation of cross-shareholding, which is not an easy task, as explained in the following section.

1. Prohibition

One option would be to create an outright prohibition on cross-shareholding. Besides the possibility of circumvention,¹⁵³ such regulation might well also face considerable opposition.¹⁵⁴ Indeed, cross-shareholding is regarded as a useful method of strengthening mutual trust between business partners in the Japanese business community.

A popular explanation of how the practice works goes as follows¹⁵⁵: Corporation A commits not to betray its business partner, Corporation B,

replacement cost of its assets. See Gary Smith, *Tobin’s q*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS (Steven N. Durlauf & Lawrence E. Blume eds., 2008). In the research by Buchanan, Chai & Deakin, Tobin’s *q* is defined as: (equity market value + book value of total liabilities excluding shareholders’ equity)/(equity book value + book value of total liabilities excluding shareholders’ equity). BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 196.

152. *Id.* at 204. This interpretation seems to correlate with their contention that domestic and foreign institutional investors did not always support hedge fund activists, *see supra* note 117 and accompanying text, and also with their final intention of presenting a Japanese “community firm” model that “focus[es] on the organisational sustainability of the underlying business of the company” as an opposing idea contrasting the shareholder primacy model. BUCHANAN, CHAI & DEAKIN, *supra* note 94, at 324.

153. For example, it is easy to evade the prohibition against literal cross-shareholding between two corporations by circular-shareholding between three corporations. Prohibition against circular-shareholding might not be easy to enforce when the circle expands to include more corporations.

154. The Act on Restriction of Shareholdings by Banks of 2001, which had a considerable impact on the unwinding of cross-shareholdings by banks, *see supra* notes 123-124 and accompanying texts, was introduced in an extraordinary situation of banking crisis. Furthermore, the main purpose of this act was to ensure the financial soundness of banks. As such, the act permits cross-shareholdings, as long as the amount of cross-shareholding is below the threshold. It would be difficult to justify similar regulation against cross-shareholding for corporations in general.

155. Tokutsu, *supra* note 12, at 508-15.

by holding shares of Corporation B, because betrayal damages Corporation A's own assets through the decline of the share value of Corporation B. Further, by letting Corporation B hold Corporation A's shares, Corporation A exposes itself to retaliation via Corporation B's voting rights.

Logically, this explanation is unpersuasive. First, since Corporation A is holding only a fraction of the shares of Corporation B, Corporation A suffers only a fraction of any damage suffered by Corporation B. This would likely not be a sufficient incentive for Corporation A to refrain from betraying Corporation B.¹⁵⁶ Second, the effect of Corporation B's retaliatory voting would be limited if the amount of shares held by each corporation is not very large, which usually is the case.¹⁵⁷

If, however, there is a strong norm among Japanese business people that one should not betray a business partner with whom she is in a cross-shareholding relationship, then one's reputation would be seriously damaged if she were to do so.¹⁵⁸ Here, cross-shareholding functions as a symbol of mutual trust, which should not be ruined. In this sense, cross-shareholding, as a method of strengthening mutual trust between business partners, is rather self-enforcing.¹⁵⁹

To accommodate this rationale, one might consider prohibiting cross-shareholdings between corporations that do not have a business relationship, which, without the impetus of an existing business relationship, can be seen as nothing more than managerial entrenchment, while still permitting cross-shareholdings between corporations that do have a business relationship. This type of regulation, however, might lead corporations to create unnecessary business relationships in order to engage in cross-shareholdings, causing added inefficiency.

156. Major trust banks in Japan have recently introduced new products called "trusts for unwinding cross-shareholding" (*mochiai kaisho shintaku*), in which a settlor corporation entrusts the shares of other corporations to the trustee bank and sells away its beneficiary interest, while preserving the right to direct the trustee bank regarding how to vote these shares. This enables the settlor corporation to get rid of the financial risk from holding shares of other corporations, while maintaining the power to exercise voting rights. See Masakazu Shirai, *Mochiai kaisho shintaku wo meguru kaisyaho jyo no mondai* [*Corporate-Law Problems Regarding the Trust for Unwinding Cross-Shareholding*], 76 HOGAKU 491, 493-96 (2012). The invention of such a product also suggests that the popular explanation discussed in the texts above, which depends on such financial risk, was not reflecting reality.

157. For example, no single shareholder of Bull-Dog Sauce—which is understood to have strengthened its cross-shareholding relationships in order to resist activism by SPJ, see Xu & Tanaka, *supra* note 115, at 8-10—holds more than five percent of its shares. BULL-DOG SAUCE CO., DAI 88 KI YUKA SHOKEN HOKOKUSHO [ANNUAL REPORT FOR THE 88TH BUSINESS YEAR] 23 (2013), available at https://www.bulldog.co.jp/company/pdf/130626_IR1.pdf.

158. This logic would apply only among those that share the same culture regarding this norm. For the tendency of young corporations, see *infra* note 160.

159. Although an interesting research topic, how this idea developed in Japan is beyond the scope of this article.

Thus, any outright prohibition of cross-shareholding seems to be an unrealistic solution at present.¹⁶⁰

2. Liability

The second alternative cross-shareholding regulatory scheme is to impose liability on the directors of corporations holding shares of other corporations,¹⁶¹ either for buying those shares or, alternatively, for not selling them at a premium.

Given the rationale of cross-shareholdings described in the prior section, however, these investment decisions could well be protected as legitimate business decisions intended to strengthen business partnerships.¹⁶² This argument could, of course, be challenged by asserting that the direc-

160. This situation might change if, in the future, fewer corporations view cross-shareholding as a method of strengthening business partnerships. In this regard, there is an interesting finding that the ratio of corporations listed in emerging secondary markets (e.g., JASDAQ and Mothers) that reported cross-shareholding relationships with other non-financial business corporations or financial institutions was smaller in comparison with those listed in the traditional secondary markets (e.g., 1st and 2nd sections of Tokyo Stock Exchange). Miyajima, Saito, Xu, Tanaka & Ogawa, *supra* note 126, at 8-9. This suggests that those rather young corporations are less likely to follow traditional business customs regarding cross-shareholdings.

161. Another possibility is to use JCA Article 120(1), which prohibits corporations from “giv[ing] property benefits to any person regarding the exercise of shareholders’ rights.” Although the original intention of this prohibition is to eliminate the source of money of corporate racketeers (*sokaiya*), its scope is prescribed in a broad manner, and transactions between corporations in cross-shareholding relationships can be interpreted as providing benefits to each other’s shareholders through transactions consummated on the grounds of being a friendly shareholder to its management. This interpretation is rather unpopular, however, since a violation of Article 120(1) gives rise not only to civil liability for directors in the amount of the benefit given in violation, *see* JCA art. 120(4), but also to criminal liability for directors and employees who participated in the violation of imprisonment of up to 3 years or a fine of up to ¥3 million. JCA art. 970(1). Criminal liability is a necessary measure to tackle corporate racketeering, but it is not a suitable measure for restricting cross-shareholdings. *See* Takahito Kato, *Rieki kyoyo kinshi kitei to kabushiki mochiai – Kabunushi no insenthibu kozo no kanten kara [Prohibition of Giving Benefits on Exercise of Shareholder’s Right and Cross-Shareholdings – From the Viewpoint of Shareholder’s Incentive]*, in KIGYOHO KAIKAKU NO RONRI – INSENTHIBU SISUTEMU NO SEIDO SEKKEI [THE THEORY OF ENTERPRISE LAW REFORM – DESIGNING INCENTIVE SYSTEM] 227, 244 (Zen-ichi Shishido ed., 2011) (arguing for restrictive interpretation of JCA art. 120 in relation to cross-shareholdings); Akira Morita, *120 jyo [Article 120]*, in KAISHAHO KONMENTARU DAI 3 KAN [COMMENTARIES ON THE COMPANIES ACT, VOL.3] 239, 253-54 (Tomonobu Yamashita ed., 2013) (same).

162. *See, e.g.*, Tokyo Chiho Saibansho [Tokyo Dist. Ct.], Apr. 13, 2006, 1226 HANREI TAIMUZU [HANTA] 192, *aff’d*, Tokyo Koto Saibansho [Tokyo High Ct.], Oct. 25, 2006, 274 SIRYOBAN SHOJI HOMU [SHIRYOBAN SHOJI] 245. In this case, shareholders of Tokyo Electric Power Company (TEPCO) filed a derivative suit against TEPCO directors, claiming that the directors had breached their duties of care and loyalty by affirmatively responding to a tender offer by Fuji Television (FTV) for shares of Nippon Broadcasting (NB), when the market price of NB shares was higher than the tender price in anticipation of a hostile takeover by another party. The Tokyo District Court denied the liability of the directors, holding that their decision—which was made in order to maintain good business relationship with a huge media group including FTV and NB—was not extremely unreasonable.

tors' true intent was mutual managerial entrenchment and that the business judgment rule should not apply because of a conflict of interest, but it may be difficult to prove this unsavory intent if there exists an actual business relationship.

3. Disclosure

Eliminating the alternatives leaves disclosure as the only realistic regulatory method, which was introduced by Japanese Financial Services Agency in 2010.

Under the disclosure requirements, listed corporations holding shares of other corporations for any strategic purpose, such as strengthening the business relationship, must disclose these holdings in their annual reports, including both the number of such other corporations¹⁶³ and the aggregate book value of those corporations' shares.¹⁶⁴ In addition, corporations are required to make individual disclosures of the corporate name, number of shares held, book value, and a detailed description of the purpose of the holding for each of the top 30 other such corporations.¹⁶⁵

The idea behind this disclosure requirement is to provide investors with information on the corporation's use of its funds for cross-shareholdings,¹⁶⁶ thereby incentivizing those investors to monitor the corporations and encourage them to use their funds efficiently. Disclosure would, thus, be an effective means of using investor pressure to deter corporations from engaging in managerial entrenchment through cross-shareholding.

For managers of corporations that are already insulated from shareholder pressure by cross-shareholdings, however, the effectiveness of this measure will be limited.¹⁶⁷

163. Kigyo naiyo to no kaiji ni kansuru naikaku furei [Cabinet Office Ordinance on Disclosure of Corporate Affairs], Cabinet Office Ordinance No. 5 of 1973 (Japan) (Form 2 (Precautions for Recording (57)a(d)) and Form 3-2 (Precautions for Recording (14))).

164. *Id.*

165. *Id.* The top 30 is determined by the book value of the shares of these corporations on the latest balance sheet of the disclosing corporation. *Id.* If there is a corporation that is not included in the top 30, but the book value of its shares on the latest and preceding year's balance sheet of the disclosing corporation exceeds one percent of the stated capital, then disclosure of that shareholding is also required. *Id.*

166. Listed corporations are also required to disclose information regarding shares held solely for the purpose of investment. The information required is: aggregate book value (for the latest and the preceding business year), aggregate amount of dividends received, aggregate profit/loss from trading, and aggregate profit/loss from appraisal (for the latest business year). *Id.*

167. The text above does not imply that the disclosure requirement is completely meaningless. Indeed, such disclosure would engender a negative valuation by the capital markets of corporations holding a large sum of other corporations' shares. However, if these corporations are insulated by cross-shareholdings, they may not care much about their reputation in the capital market.

F. Summary

To summarize, the practice of cross-shareholding, which is still present in small and medium-sized corporations, has effectively diminished the strength of shareholders’ class-based rights, thereby making hedge fund activism difficult in Japan. For some corporations, cross-shareholdings have even been strengthened for fear of activists.¹⁶⁸ In other words, the distribution of decision-making power between shareholders and management is affecting the ownership structure.¹⁶⁹ Once the current management becomes insulated by cross-shareholding, it is not easy to unwind by regulatory intervention.

In the U.S., cross-shareholding is not common among public corporations. However, if a shareholder empowerment movement gains momentum and shareholder rights are further strengthened, then it is not impossible that, in the future, managers may try to insulate themselves from the increased pressures of shareholders by manipulating the corporate ownership structure.

Proponents of shareholder empowerment might contend that this is an undesirable reaction that should be regulated.¹⁷⁰ In the U.S., management’s decisions to buy shares of other corporations in order to form cross-shareholding relationships would not necessarily be protected as a valid business judgment, because the Japanese rationale for cross-shareholding, i.e. as a method of strengthening mutual trust between business partners, would not apply. Such conduct may be a valid source of a derivative suit for shareholders. It would be difficult, however, to detect such activities without disclosure.¹⁷¹ In this regard, introduction of detailed dis-

168. Interestingly, the fear of shareholder power also played a large role in the formation of cross-shareholding relationships, especially in the mid 1960’s to early 1970’s, when Japanese corporations feared takeover by foreign investors as Japan gradually permitted foreign direct investment, a consequence of OECD membership in 1964. Tokutsu, *supra* note 12, at 483. For more on the process of the formation of cross-shareholding relationship after World War II, see *id.* at 479-85, and Miyajima & Kuroki, *supra* note 124, at 83-85; see also Curtis J. Milhaupt & Mark D. West, *Institutional Change and M&A in Japan: Diversity through Deals*, in *GLOBAL MARKETS, DOMESTIC INSTITUTIONS: CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS* 295, 307 (Curtis J. Milhaupt ed. 2003) (asserting that the ambiguity of rules regarding takeover defenses caused Japanese managers to resort to cross-shareholding).

169. This relationship between the decision rights of shareholders and the ownership structure was first illustrated by Cools, *supra* note 16 at 755-60. The difference between the Continental European countries that Cools discussed and Japan is that the strong power of shareholders led to the dominance of controlling shareholders in the former, whereas it has led to cross-shareholding relationships in the latter. This difference could be attributed to the compulsory dispersion of share-ownership of major Japanese corporations after World War II, which was a part of the U.S. occupational policy. Tokutsu, *supra* note 12, at 479-81. Formation of cross-shareholding relationship was a reaction to this situation, rather than a voluntary decision of entrepreneurs to go public. Cools, *supra* note 16, at 755.

170. From their opponent’s viewpoint, this could be considered a second-best solution, although it is inefficient.

171. It is possible to obtain correct information by way of discovery in a derivative suit, but it is costly.

closure for shareholdings of other corporations would be useful, and effective even in the U.S.

IV. EFFECT OF NON-ACTIVIST INSTITUTIONAL INVESTORS

The findings of Part III regarding the effect of cross-shareholdings on the class-based rights of shareholders suggest that these rights would be more meaningful in corporations with a lower degree of cross-shareholding, as in large listed corporations, where foreign and domestic institutional investors are more prevalent.¹⁷² Part IV examines the effect of shareholding by non-activist institutional investors, such as pension funds, mutual funds, trust banks, and investment advisors.¹⁷³

A. “Rationally Reticent” Institutional Investors

As Ronald Gilson and Jeffrey Gordon have recently emphasized, non-activist institutional investors are “rationally reticent.”¹⁷⁴ They rarely make a proposal or start a proxy fight themselves because these institutional investors or their portfolio managers, who compete amongst themselves, do not have an incentive to incur costs for actions that would benefit their competitors.¹⁷⁵ If other shareholders assume these costs, however, then the non-activist investors will respond to these activists when they find their argument compelling,¹⁷⁶ either by voting against management’s proposal or by voting for the activist’s proposal.¹⁷⁷ Also, institutional investors that have no business relationship with

172. See *supra* Part III.C.

173. Life insurers, which are one of the major institutional investors, are not listed in the text because they have been traditionally considered to be a part of cross-shareholdings relationships.

174. Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 867 (2013). In this regard, Japan has recently followed the U.K. by introducing “Japan’s Stewardship Code” to encourage institutional investors to “enhance the medium- to long-term investment return for their clients and beneficiaries . . . by improving and fostering the investee companies’ corporate value and sustainable growth through constructive engagement . . . based on in-depth knowledge of the companies and their business environment.” COUNCIL OF EXPERTS CONCERNING THE JAPANESE VERSION OF THE STEWARDSHIP CODE, JAPAN’S STEWARDSHIP CODE 1 (2014), available at <http://www.fsa.go.jp/news/25/singi/20140227-2/05.pdf>.

175. Gilson & Gordon, *supra* note 174 at 889-95.

176. *Id.* at 896-97.

177. Since 2010, mutual funds, trust banks and investment advisors have been disclosing how they voted on different categories of proposals on an aggregate basis as their self-regulation. See Yuki Kimura, *Kikan toshika no giketsuken koshi kekka kaiji to kongo no kadai* [Disclosure of the Voting Records of Institutional Investors and Their Future Task], KIGYO KAIKEI, February, 2011, at 113, 113-14. For example, in 2013, these investors on average voted against 65.3 percent of management’s proposals for takeover defense and 42.7 percent of those relating to directors’ compensation upon their retirement. Naoyoshi Ema, *Kikan toshika ni yoru giketsuken koshi no jyokyo – 2013 nen no kabunushi sokai wo furikaette* [The State of Exercise of Voting Rights by Institutional Investors – Looking Back on Shareholders’

the corporation in which they have invested would be more likely to tender their shares in hostile takeovers, if the premium offered is high enough. Thus, the more the shares of a corporation held by institutional investors, the more likely an activist initiative on that corporation is to succeed.¹⁷⁸

To be sure, corporations with a high ratio of institutional investors are typically large corporations,¹⁷⁹ and these large corporations are less likely to be targeted by activists.¹⁸⁰ But this fact does not mean that an activist campaign against a large corporation is impossible. Take Third Point’s attack on Sony, for example.¹⁸¹ The mere possibility of such activism constitutes a latent threat against the management of corporations that are largely held by institutional investors and has an inherently disciplinary effect on management, at least theoretically. But is this true in practice?

B. Effect of Shareholdings by Institutional Investors

Hideaki Miyajima and his colleagues have found strong, though not conclusive, evidence of the effects that institutional shareholding has on corporations. According to their research based on samples of non-financial business corporations listed in the first sections of Tokyo, Osaka and Nagoya Stock Exchanges from 1991–2008, the increase of ROA of a corporation over a one-year period was higher when foreign investors held more shares of that corporation at the beginning of that year.¹⁸² This result was statistically significant at a one percent level.¹⁸³ Similar results

Meeting in 2013], 2019 SHOJI HOMU 27, 32 (2013). These votes “against” are not necessarily made in response to activism.

In regard to shareholder proposals, however, this disclosure is not currently as informative, because different types of shareholder proposals (e.g., proposal to abolish nuclear power plants, proposal requesting disclosure of the compensation of individual directors, and proposal requesting higher dividends) are not distinguished. Accordingly, the data shows that institutional investors vote against shareholder proposals in more than 90 percent of cases on average. *Id.* at 31, 34.

On this point, disclosure of voting results for each proposal by listed corporations—required since 2010, see Kigyo naiyo to no kaiji ni kansuru naikaku furei [Cabinet Office Ordinance on Disclosure of Corporate Affairs], Cabinet Office Ordinance No. 5 of 1973, art. 19, para. 2 (Japan)—would be useful. For example, in the 2013 annual shareholders’ meeting of HOYA Corporation, a shareholder proposal for disclosure of individual director compensation received 39.55 percent of votes in support. See HOYA CORP., NOTICE OF THE RESULTS OF THE 75TH ORDINARY GENERAL MEETING OF SHAREHOLDERS 3 (2013), available at http://v4.eir-parts.net/v4Contents/View.aspx?template=ir_material&sid=24266&code=7741.

178. For example, Aderans Corporation, against which SPJ succeeded in preventing the re-election of the incumbent president and electing its own nominee, had relatively low degree of cross-shareholdings. Xu & Tanaka, *supra* note 115, at 13-14.

179. See *supra* note 131 and accompanying text.

180. See *supra* note 132 and accompanying text.

181. See *supra* note 105 and accompanying text.

182. Miyajima & Nitta, *supra* note 127 at 139-40 & n.38. (finding that the effect of a general trend of increased foreign investors is controlled by including year dummies).

183. Miyajima & Nitta, *supra* note 127, at 141.

have been found for the holding ratio of domestic institutional investors, but not for the holding ratio of banks and insurers.¹⁸⁴

These findings are not the result of a preference by foreign investors¹⁸⁵ for corporations with high ROA at the outset.¹⁸⁶ Whether this correlation is the result of a disciplinary effect of foreign and domestic institutional investors on management or simply evidence of investment savvy that enables the institutional investors to correctly predict which corporations will increase their ROA in the coming year, however, remains to be seen.

There is no ground, at the moment, for excluding the latter alternative.¹⁸⁷ Indeed, institutional investors are sophisticated investors, so there is little wonder if they are able to systematically invest in growing corporations. Even so, the linkage between institutional investing skill and their holding ratio in a corporation is not intuitively clear,¹⁸⁸ because passive index funds, which are not actively managed, account for a considerable part of high holding ratios of foreign and domestic institutional investors. A better proxy for their investing talent, and therefore better proof in favor of the investment savvy theory, might be, for example, the number of institutional investors that actively included a corporation into their portfolios, though it may be difficult to obtain credible information on this point.

On the other hand, because the two alternatives presented are not mutually exclusive and there is similarly no ground on which to exclude the former alternative, connecting a high holding ratio of foreign investors with the disciplinary effect is also theoretically plausible. In fact, given the uncertainties of the investment theory, it may not be at all irrational to assume that disciplinary effect of institutional investors on management has at least partly contributed to the results above. Here, the strong class-based rights of shareholders under Japanese law have an indirect positive effect through a latent threat of hedge fund activism, even though it is still rare.

184. Hideaki Miyajima & Takaaki Hoda, Toshi shutai betsu meigara sentaku kijyun to gabanansu koka wo tsujita kigyō pafomansu heno eikyo [Portfolio Selection Standards of Different Types of Investors and Their Influence on Firm Performance through Governance Effect] 19-20, 38 (2014) (unpublished manuscript) (on file with author).

185. See *supra* note 129 and accompanying texts.

186. Miyajima & Nitta, *supra* note 127, at 139. The effect of ROA at the end of previous period is also controlled by including this as one of independent variables, which also had positive effect on the increase of ROA with one percent-level statistic significance. *Id.* at 141.

187. Tanaka, *supra* note 115, at 37.

188. This does not mean that there is no linkage. It is possible that the holding ratio of institutional investors at a certain corporation is high because many institutional investors predicted that the ROA of that corporation would increase. Thus, the latter alternative in the text cannot be excluded.

V. PROPOSALS AND SUITS BY INDIVIDUALS

This Article now turns to the second characteristic of Japanese law, the strong individual rights of shareholders and their ability to raise issues with the corporation.

In the U.S., there are many restrictions on shareholder proposals and derivative suits to protect director and management business decisions from excessive intervention by individual shareholders.¹⁸⁹ Conversely, such restrictions are relatively rare in Japan, making it easier for individual shareholders to carry out their own views on corporate governance through a shareholder proposal or derivative suit.

What is the effect of this difference? The interests of individual shareholders exercising their rights could deviate from the interests of shareholders generally. It is, thus, possible that individuals could abuse their rights for their personal interest. It is also possible for the actions of these individuals to produce positive effects for the corporation by overcoming the collective action problem innate to public corporations. The rest of Part V analyzes shareholder proposals and derivative suits in Japan from these alternative viewpoints.

A. *Letting Proponents Express Their Views*

1. SHAREHOLDER PROPOSALS BY INDIVIDUALS IN JAPAN

The shareholder proposal, which enhances the strong class-based rights of shareholders with respect to decision-making, is also a powerful tool through which individuals can express their views to other shareholders. Three distinct features of Japanese law contribute to the force of shareholder proposals. First, although not exercisable by an owner of a single share, the threshold shareholding for submitting a shareholder proposal is relatively low: one percent of all voting rights or 300 voting rights.¹⁹⁰ The latter absolute standard allows individuals with a sufficient (though relatively insignificant) stake in the corporation to make a proposal against even a large corporation. Second, there is no limit on the number of proposals that a shareholder can make to a corporation in a year.¹⁹¹ Third, a shareholder may make a proposal regarding the corporation's ordinary business operations if it is conditioned on the approval of an accompanying proposal for a charter amendment granting the shareholders' meetings authority over such matters.¹⁹²

Traditionally, shareholder proposals have been made by groups of individuals in pursuit of a political or social agenda regarding the business of the corporation. An example of this kind concerns a proposal by environ-

189. See *supra* notes 48-61 and accompanying text (shareholder proposals); *supra* notes 72-81 and accompanying text (derivative suits).

190. See *supra* note 63 and accompanying text.

191. See *supra* note 64 and accompanying text.

192. See *supra* note 66 and accompanying text.

mental activists against electric power companies to abolish nuclear power plants.¹⁹³ The primary purpose of this type of activist shareholder is, presumably, to express her views to management and other shareholders in an effort to achieve change, rather than monetary profit from the investment in shares.

Recently, a different type of shareholder proposal by individuals has been reported. In 2012, a single shareholder of Nomura Holdings, Inc. made 100 proposals for its annual shareholders' meeting, which were reduced to 18 in the corporate proxy statement after screening by the corporation.¹⁹⁴ The contents of these proposals were in many cases absurd and humiliating,¹⁹⁵ and they attracted public attention. In yet another example, a single shareholder of HOYA Corporation made a substantial number of proposals since 2010, including 117 proposals in 2010, 68 proposals in 2011, and 58 proposals in 2012.¹⁹⁶ This phenomenon has been regarded as an abuse of shareholder's rights by practitioners and has led to a call for law reform, particularly with respect to the total number of proposals that can be made by a single shareholder.¹⁹⁷

2. *Costs and Benefits of Proposals by Individuals*

Before considering such reform, the costs and benefits of the current shareholder proposal regime should be analyzed.

193. Toshikazu Nakanishi, *Kabunushi sokai [Shareholders' Meeting]*, in KABUSHIKI GAISHAHO TAIKEI [TREATISE ON LAWS OF STOCK CORPORATIONS] 219, 233 (Kenjiro Egashira ed., 2013).

194. The excluded proposals were presumably those that were not formulated as charter amendments to fit within the power of shareholders' meeting. Sawaguchi, *supra* note 64, at 22.

195. For English translations of the proposals ultimately included in the corporate proxy, see Nomura Holdings, Inc., Report of Foreign Private Issuer Pursuant to Rule 13a-16 or 15d-16 of the Securities Exchange Act of 1934 (Form 6-K) 14-20 (June 1, 2012) [hereinafter Nomura 6-K], available at <http://www.nomuraholdings.com/investor/library/sec/6k/120601/120601.pdf>. The most infamous proposal, which was referred to but not included formally in the corporate proxy, was to change the corporate name from "Nomura Holdings" to "Yasai Holdings." *Id.* "Yasai" is the Japanese word for vegetables, and the Chinese character for "ya" in "yasai" is the same with the one used for "no" in "Nomura."

196. Tokyo Koto Saibansho [Tokyo High Ct.], May 31, 2012, 340 SIRYOBAN SHOJI HOMU [SHIRYOBAN SHOJI] 31. HOYA did not include all of these shareholder proposals in either the agendas of its shareholders' meetings or the notices for them, ultimately permitting only 15 proposals in 2010, 20 proposals in 2011, and none in 2012. This led to a series of lawsuits by the proposing shareholder. Sawaguchi, *supra* note 64, at 23-24. Notices for HOYA's annual shareholders' meetings during the relevant period are available at *Shareholders Meeting*, HOYA, <http://www.hoya.co.jp/english/investor/meeting.html> (last visited 2014/06/11). For a list of shareholder proposals made in advance of the 2012 annual meeting—all of which HOYA rejected—see Sawaguchi, *supra* note 64, at 28-29. In contrast to the Nomura shareholder proposals, the HOYA shareholder proposals were mostly governance-related. See, e.g., HOYA CORP., NOTICE OF THE RESULTS OF THE 73RD ORDINARY GENERAL MEETING OF SHAREHOLDERS (2011), available at http://v4.eir-parts.net/v4Contents/View.aspx?template=ir_material&sid=24259&code=7741.

197. Sawaguchi, *supra* note 64, at 26; Nakanishi, *supra* note 193, at 236.

The costs are quite clear. With each proposal comes an increase in actual expenses to be incurred by the corporation, e.g., to send potentially lengthy proxy statements to shareholders,¹⁹⁸ and the opportunity cost of using resources that could be expended more efficiently to respond to these proposals.¹⁹⁹

In contrast, the benefit is more difficult to evaluate. Although the great majority of proposals made by individuals are very unlikely to be adopted, this improbability was anticipated from the outset.²⁰⁰ Shareholder proposals were introduced by the reform of the Commercial Code in 1981, at which time corporate racketeers (*sokaiya*) were rampant.²⁰¹ According to the drafter of the 1981 reform, the shareholder proposal was a remedy intended to make shareholders’ meetings accessible to ordinary people by promoting communication among shareholders and with management, who was expected to respond sincerely to proposals, despite their potential absurdity.²⁰²

The rationale underlying the 1981 reform may not apply directly to today’s shareholders’ meetings, which are generally thought to be conducted sincerely, without the presence of corporate racketeers.²⁰³ Nevertheless, the focal point of the reform can be paraphrased in modern wording: shareholder proposals by individual shareholders may provide diverse views that might be beneficial to some extent. For example, the inane proposals against Nomura Holdings were, in part, sarcastic criticism of an underperforming management team,²⁰⁴ and the proponent shareholder arguably succeeded in gaining public attention with this criticism. Likewise, with the benefit of hindsight from the Eastern Japan Great Earthquake on March 11, 2011, and the subsequent meltdown at the Fukushima Nuclear Power Plant, shareholder proposals to Tokyo Electric Power Company by environmental activists²⁰⁵ pointed to a risk that could

198. Although marginal cost for including another shareholder proposal may not be large, it may theoretically become very large in the aggregate.

199. See Bebchuk, *Shareholder Power*, *supra* note 4, at 879.

200. Nakanishi, *supra* note 193, at 233.

201. Sawaguchi, *supra* note 64, at 26. For corporate racketeers, see Mark D. West, *Information, Institutions, and Extortions in Japan and the United States: Making Sense of Sokaiya Racketeers*, 93 NW. U. L. REV. 767 (1999).

202. Sawaguchi, *supra* note 64, at 26 (citing TAKEO INABA, KAISEI KAISHAHO [CORPORATE LAW REFORM] 131 (1982)).

203. *Id.*; Nakanishi, *supra* note 193, at 236.

204. For example, the proposal to change the corporate name to “Yasai [Vegetable] Holdings” seems to criticize Nomura’s expansion into the agriculture business, which is apparently not a core business for a financial group. See *Nomura Agri Planning & Advisory Co., Ltd.*, NOMURA HOLDINGS, <http://www.nomuraholdings.com/company/group/napa/> (last visited Apr. 14, 2014); see also Nomura 6-K, *supra* note 195, at 18 (Proposal 13, suggesting that Nomura’s agricultural ventures are unprofitable).

205. For example, at the annual shareholders’ meeting in 2009, Nuclear Phase-out TEPCO Shareholder Movement (*datsu-genpatsu Toden kabunushi undo*), a group of environmental activists holding shares of TEPCO, made a shareholder proposal to decommission nuclear reactors at Fukushima First Nuclear Power Plant on the grounds that they were very

seriously affect the economic viability and value of the corporation, not to mention the broader Japanese economy.

The possible benefits of diversity of opinion derived from individual shareholder proposals, does not necessarily mean that these proposals worth their cost. Although it may be easier to attract the attention of management when these views are delivered as shareholder proposals, they can also be expressed through other media, including, but not limited to, the Internet. If management were adequately pressured to consider the long-term interests of shareholders, then it would take these diverse views into consideration to the extent that they affect such interests, regardless of their delivery method.²⁰⁶

Whether the condition of investor pressure on management is met depends on the ownership structure of a corporation. Thus, as a rule to be applied universally, a workable middle ground might be to introduce certain restrictions on shareholder initiatives to save corporations from undue burdens caused by insincere proposals while preserving some room for individual viewpoints. In doing so, it is also important not to over-restrict the introduction of proposals by hedge fund activists.

3. Possible Reform

The first alternative is to introduce a limit on the contents of shareholder proposals in order to exclude those that are blatantly absurd, such as the ones made to Nomura Holdings. This solution gives rise to substantial uncertainty, however. If no governmental agency will issue a no-action letter on the matter,²⁰⁷ then corporations are unclear²⁰⁸ as to where the boundaries of absurdity lie. A prohibition of proposals regarding ordinary

old reactors built when the Regulatory Guide for Aseismic Design did not exist. *Tokyo Denryoku dai 85-kai teiji kabunushi sokai kyodo kabunushi teian gian 2009* [Joint Shareholder Proposal for the 85th TEPCO Annual Shareholders' Meeting on 2009], NUCLEAR PHASE-OUT TEPCO SHAREHOLDER MOVEMENT (Mar. 22, 2009, 6:56 PM), <http://todenkabu.blog3.fc2.com/blog-entry-104.html>. This proposal did not mention the risk of tsunami caused by an earthquake.

206. Of course, this does not mean that the management should or would follow these views.

207. Because shareholder proposals are in the realm of the Companies Act, which is under the jurisdiction of Ministry of Justice, the Financial Services Agency is unable to issue no-action letters. The Ministry of Justice, on the other hand, is generally reluctant to intervene in individual cases.

208. When a corporation rejects a legal shareholder proposal, the rejection might affect the validity of other closely related resolutions. See Nakanishi, *supra* note 193, at 234-35. This possibility may not be very high, but practitioners would dislike any amount of uncertainty. See Wataru Tanaka, Gen Goto, Kenji Hasegawa & Yusuke Ishii, *Kaisha hosei no kongo no tenbo to kadai (zadankai)* [Prospects and Problems of Corporate Law for Future (Roundtable Discussion)], 2000 SHOJI HOMU 70, 94 (2013) (remark by Ishii).

business matters or those for charter amendments, for example, would almost certainly be over-reaching.²⁰⁹

A second alternative is to raise the threshold for exercising the proposal right. In particular, abolishing the absolute standard of 300 voting rights would largely eliminate proposals by individuals at large corporations.²¹⁰ However, by simply raising the threshold, shareholders beyond that threshold would still be able to make an unlimited number of proposals.

The third alternative—to limit the number of proposals available to each individual shareholder or group of shareholders at each shareholders’ meeting—seems to be most promising at the moment. But the question here is, how many is appropriate? The U.S. rule of limitation to one proposal per meeting would be too restrictive in Japan, since at least two proposals are necessary to remove incumbent directors and nominate new directors²¹¹ or to amend a charter provision and take action based on that amendment. While there is no definitive answer to this question, somewhere between two to five proposals per shareholder or group of shareholders seems to be both logical and plausible.²¹²

B. Deferring to “Irrational” Decisions to Sue

1. Negative and Positive Effects of Derivative Suits

The cost to a corporation of individual shareholders exercising their rights might be greater in the case of derivative suits than shareholder proposals. Directors and officers might become distracted from daily business operations because of their need to respond to the suit. Announcement of the filing of a suit may also cause reputational harm for the corporation. When balanced, these negative impacts on firm value could well be larger than a shareholder’s expected compensation from the defendants, since there are inherent uncertainties regarding probability of winning and amount collectable.

The net present value of a suit against a director who allegedly breached her duty at the time of filing might be negative in many cases.²¹³

209. For example, proposals for the disposition of certain unprofitable business or a charter amendment governing the disclosure of compensation of individual directors should not be excluded per se.

210. See Sawaguchi, *supra* note 64, at 26 (noting that the absolute standard enables a considerable number of shareholders to make a proposal).

211. A proposal for the nomination of multiple directors should be counted as one proposal, as should a proposal for the removal of multiple directors.

212. The number five as maximum is derived by adding two for removal and nomination, two for decision based on charter amendment and one for dividends. Wataru Tanaka suggests limiting the number of proposals to three. See Tanaka, Goto, Hasegawa & Ishii, *supra* note 208, at 93.

213. Empirical evidence on this point is not clear. Two event studies on Japanese listed corporations found no statistically significant results on share price for filing of a derivative suit. Dan W. Puchniak & Masafumi Nakahigashi, *Japan’s Love for Derivative Actions: Irrational Behavior and Non-Economic Motives as Rational Explanations for Shareholder Litiga-*

As such, it would be rational for the corporation not to sue. This is precisely the reason why U.S. law respects the board's decision not to sue, as long as there is no conflict of interest. From this viewpoint, then, the filing of a derivative suit that causes damage to the corporation is irrational, and some might regard this as an abuse of right.

Such an accusation might be unfair, however, when the ex ante effect of a derivative suit is taken into consideration. The specter of a derivative suit is one means of deterring directors from breaching their fiduciary duties, but this function will be diminished if those directors know at the time of their breach that their wrongdoings are unlikely to be punished.²¹⁴ By allowing shareholders to raise and maintain derivative suits, regardless of the board's opposition,²¹⁵ Japanese law reinforces the deterrence effect ex ante.

One concern regarding the Japanese derivative suit regime is the potential for over-deterrence. For example, directors may refrain from taking risks that would be beneficial to shareholders in order to minimize their possibility of being sued. If this occurs, then the pendulum has swung too far and the overall effect of derivative suits may turn out to be negative.

2. Possible Reform

Recently, Tomotaka Fujita reviewed the structural differences between derivative suits under Japanese and American law and suggested reform to enable courts to effectively dismiss derivative suits that are not in the interests of the corporation or shareholders as a class on a case-by-case basis.²¹⁶ There are two problems to be considered in this regard.

The first is precisely how to evaluate the general deterrence (and over-deterrence) effect of the current regime and the likely consequence of the proposed reform on these effects.²¹⁷ Although direct measurement may be difficult, if not impossible, the classification of derivative suits by (i) the

tion, 45 VAND. J. TRANSNAT'L L. 1, 41-42, 73 (2012); Mark D. West, *Why Shareholders Sue: Evidence from Japan*, 30 J. LEGAL STUD. 351, 359 (2001). Although the studies stress that no significant positive effect was found, Puchiniak & Nakahigashi, *supra* at 42; West, *supra* at 359, which was important to their argument regarding plaintiffs' motives, it is equally important here that a significant negative result was not found, either. Nevertheless, another finding of Puchiniak & Nakahigashi, that the settlement of derivative suits have significant positive result, Puchiniak & Nakahigashi, *supra* at 42, 74, suggests that the benefit of coming out of a derivative suit (and the cost of staying in it) are substantial.

214. Fujita, *supra* note 84, at 58 n.53 (citing DOUGLAS BAIRD, ROBERT H. GERTNER & RANDAL C. PICKER, *GAME THEORY AND THE LAW* 117 (1994)).

215. See *supra* Part II.E.2.

216. Fujita, *supra* note 84, at 42-44, 58-59.

217. *Id.* at 58 n.53 ("It is difficult to deny the possibility that a large number of the derivative suits that have been filed are undesirable and should be dismissed at an early state (even when taking the general deterrence effect of derivative suits into consideration)."). Likewise, while mentioning the possibility that the disciplinary effect of derivative suits might be diminished if it becomes the standard not to file a suit when the expected return from that suit is negative, the author stresses that this possibility is a theoretical one, implying that it may not be a reality. *Id.*

types of plaintiffs²¹⁸ and (ii) the types of actions accused—such as violation of laws, transactions in conflict of interests, failure of business judgments—would be useful in conducting an indirect approach to evaluation by analyzing the incentives of plaintiffs and the effect of derivative suits on the decisions of the management.²¹⁹

Finally, the problem of how to design restrictions on derivative suits, if any were to be introduced, must be addressed. The natural candidate from Fujita’s proposal is the introduction of a system similar to the special litigation committee utilized in the U.S.,²²⁰ but, again, some concerns have been raised about the practicability and appropriateness of this tool in Japan, where the appointment of independent directors is still relatively low²²¹ and judicial scrutiny to the degree required in the U.S. exceedingly costly.²²² Ultimately, the search for a workable measure is left as a future task.

VI. CONCLUSION

The rights of shareholders of Japanese corporations are strong – perhaps too strong, at least legally. First, they have strong class-based rights with respect to decision-making on a wide range of matters related to the corporation and ample opportunity to take an initiative. The power of the shareholder class might actually induce managers to insulate themselves by engaging in cross-shareholding, thereby weakening the rights of other shareholders in practice. When cross-shareholdings are unwound, however, these shareholder rights function as a latent threat on managers, disciplining them. The key to ensuring that class-based shareholder rights are meaningful is, thus, the distribution of share ownership and restraint on management’s attempts to manipulate this distribution. Unfortunately, it is not easy to unwind already-established cross-shareholdings through regulatory interventions.²²³

218. See Puchiniak & Nakahigashi, *supra* note 213, at 52-64.

219. For example, derivative suits raised by attorneys of a non-profit organization called *Kabunushi Onbuzuman* (Shareholders Ombudsman), which aims to “correct illegal activities by firms and promote sound firm activities[.]” see, e.g., *Kabunushi Onbuzuman, Kabunushi onbuzuman no annai* [Information on Shareholders Ombudsman], SAKURA (Aug. 24, 2006), <http://kabuombu2.sakura.ne.jp/archives/guidance.html>, account for a large part of derivative suits after 1993. Puchniak & Nakahigashi, *supra* note 213, at 55. These derivative suits presumably focus on liability of directors for violation of laws rather than liability for poor business judgment, where over-deterrence would be more problematic. See Tanaka, Goto, Hasegawa & Ishii, *supra* note 212, at 93 (the deterrent effect of derivative suits seems to be present for violation of laws and transactions in conflict of interests; remark by Tanaka).

220. Another alternative is to require a certain amount of equity, for example one percent, to raise a derivative suit. For deterrence purposes, however, this may be overkill. See *id.*

221. Fujita, *supra* note 84, at 59 n.56.

222. Tanaka, Goto, Hasegawa & Ishii, *supra* note 212, at 93 (remark by Tanaka).

223. One might consider switching to the director primacy model of the U.S. to weaken the rights of shareholders and induce the unwinding of cross-shareholdings. In order to step in this direction, however, enforcement by the courts of fiduciary duties would be necessary

Second, shareholders also possess strong individual rights to raise issues with the corporation, either by asserting a shareholder proposal or filing a derivative suit, neither of which would be disrupted by the corporation for the interest of other shareholders. These rights, again, might be too strong, incentivizing individuals to take advantage of them in pursuit of personal goals, rather than for the good of the corporation. Yet, whether the use of these individual shareholder rights amounts to an abuse hinges on an evaluation of the benefits achieved, namely, the supply of diverse views through shareholder proposals and the deterrence effect of derivative suits on management overreaching. Possible future reforms to Japanese law ought to consider how to strike the right balance of power for shareholders of Japanese corporations.

as a substitute for strong rights of shareholders, especially in M&As and takeovers. Unfortunately, this enforcement is underdeveloped in Japan at the moment, making it an unrealistic option to weaken the class-based rights of shareholders. See MASAKAZU SHIRAI, YUKOTEKI BAISHU NO BAKEN NI OKERU TORISHIMARIYAKU NI TAISURU KIRITSU [CONTROLLING TARGET DIRECTORS IN FRIENDLY MERGERS AND ACQUISITIONS] 160-62 (2013); see also Takaaki Eguchi, *Kabushiki gaisha no sihai wo meguru keieisyō to kabunushi tonō aidano chikara kankei – Kakkoku hikaku to nihon no kabushiki mochiai heno shisa* [Balance of Power Regarding the Control of Corporation between Management and Shareholders – Comparative Analysis and Implications to Cross-Shareholdings in Japan], in KIGYOH KAIKAKU NO RONRI – INSENTIBU SISUTEMU NO SEIDO SEKKEI [THE THEORY OF ENTERPRISE LAW REFORM – DESIGNING INCENTIVE SYSTEM] 206, 208-09, 220-23 (Zen-ichi Shishido ed., 2011) (the U.S. director primacy model is an appealing, but unrealistic, alternative for Japan to adopt as the mechanism to retain management autonomy when cross-shareholdings are further unwound).