2005

In the Shadow of Delaware?: The Rise of Hostile Takeovers in Japan

Curtis J. Milhaupt, *Columbia Law School*

ESSAY

IN THE SHADOW OF DELAWARE? THE RISE OF HOSTILE TAKEOVERS IN JAPAN

*Curtis J. Milhaupt**

Despite longstanding predictions to the contrary, hostile takeovers have arrived in Japan. This Essay explains why and explores the implications of this phenomenon, not only for Japanese corporate governance, but also for our understanding of corporate law development around the world today. Delaware law figures prominently in the recent Japanese events. A high-profile battle for corporate control has just generated a judicial standard for takeover defenses that might be called a Unocal *rule with Japanese characteristics. Meanwhile, ministry-endorsed takeover guidelines have been formulated that are heavily influenced by the familiar "threat" and "proportionality" tests under Delaware law, along with many of the doctrinal nuances following* Unocal.

At one level, these developments provide powerful support for convergence theories, illustrating the intellectual appeal of Delaware corporate law's shareholder-oriented model in the world today. But closer analysis suggests that a more complex process of selective adaptation is under way. The process suggests not so much a convergence of Japanese and Delaware law as a highly unpredictable telescoping and stacking of two decades of Delaware takeover jurisprudence onto existing Japanese institutions—a process whose important features are masked by the prevailing analytical constructs in the comparative corporate governance literature. Successful economies do not abandon their institutions for foreign models; they adapt features of other systems that offer the potential to address emergent shortcomings in their own systems. The true appeal of Delaware corporate law may reside in its suitability to this process of selective adaptation, rather than in its superior shareholder protections.

---

* Fuyo Professor of Law; Director, Center for Japanese Legal Studies; Chair, Transactional Studies Program, Columbia Law School. I thank Tomotaka Fujita, Hideki Kanda, Geoff Miller, Kenichi Osugi, Ed Rock, Mark West, and colleagues John Coffee, Merritt Fox, Ron Gilson, Jeff Gordon, Hugh Patrick, Katharina Pistor, and Charles Whitehead for comments and discussions on earlier drafts. The American Chamber of Commerce in Japan, the *Columbia Law Review*, the Federal Judicial Center Program on Law and Business, the Fourth Annual Asian Corporate Governance Conference in Seoul, the University of Michigan Law and Economics Workshop, the Research Institute of Economy, Trade and Industry, and the University of Tokyo Summer Program on Global Trends in Corporate Law provided stimulating environments in which to present this Essay. Nick Benes generously shared information and insights. Ko Wakabayashi provided excellent research assistance. Any shortcomings in the Essay remain despite this wealth of assistance, and the commentators listed above do not necessarily share my interpretations and conclusions. This Essay is dedicated to Hideki Kanda, my mentor and friend.

INTRODUCTION

The unthinkable has happened. Just a few years ago, it could confidently be asserted that "[t]here is no market for corporate control in Japan, and there is not likely to be one."[1] No conventional wisdom seemed more accurate and enduring than the disdain for U.S.-style hostile takeovers in Japan—the land of stable, friendly shareholders, expansive views of corporate purpose that go well beyond shareholder wealth maximization, and abiding social concern for the preservation of harmonious relationships. But things change, and predictions are risky. For the past year, Japan has been riveted by a series of contests for corporate control, featuring sharp-elbowed tactical maneuvering, strategic litigation, and creative use of corporate law to craft defensive measures. To be sure, the number of hostile deals to date is small. The significance of these transactions derives not from their prevalence but their mere existence and the potential changes they may bring about. Two of the recent deals have generated important judicial rulings.[2] Public discourse—down to the sports pages—has been filled with blow-by-blow accounts of the deals, along with corporate law arcana such as the intricacies of the poison pill.[3] Virtually every major actor in the Japanese political economy has mobilized to respond to this development.

Equally notably, a small state on the Eastern seaboard of the United States casts a long shadow over these developments. Perhaps predictably, perhaps not, Delaware's experience with takeovers looms large in the Japanese consciousness.[4] In a recent and high-profile case—a takeover attempt by an upstart internet service provider of a radio broadcasting firm affiliated with Japan's largest media conglomerate—both sides briefed the trial court, deciding whether to enjoin the target's defensive measure, on how the case would be resolved under *Unocal* and its progeny.[5] The trial court enjoined the defensive measure and the decision was affirmed on appeal. These rulings generated judicial standards for review of the most common defensive measure in Japan that would resonate well with the Delaware judiciary—a kind of *Unocal* rule with Japanese characteris-

1. Neil Fligstein, The Architecture of Markets: An Economic Sociology of Twenty-First-Century Capitalist Societies 187 (2001).

2. See infra text accompanying notes 70–73.

3. See Todd Zaun, Rebel Raider Takes Aim at Broadcast Giant in Japan, N.Y. Times, Mar. 24, 2005, at C9 (reporting on sensation created by recent takeover attempt).

4. Full disclosure: The author organized a Tokyo conference in 2003 entitled "Hostile M&A and the Poison Pill in Japan: Prospects and Policy," at which prominent academics and lawyers from both countries, a Delaware judge, and a Japanese shareholder activist discussed the U.S. experience with the poison pill and the possible lessons it offered for Japan. For conference proceedings, see Symposium, Poison Pill in Japan, 2004 Colum. Bus. L. Rev. 1 (2004).

5. See, e.g., Memorandum from John C. Coffee, Jr., Dir., Ctr. on Corporate Governance, Columbia Univ. Sch. of Law, to Tokyo Dist. Court, Civil Dep't No. 8 (Mar. 8, 2005) (on file with the *Columbia Law Review*) [hereinafter Coffee Opinion].

tics.[6] Meanwhile, Japan's Ministry of Economy, Trade and Industry (METI) formed a group of experts and business representatives to craft a governmental response to the rising tide of unsolicited bids. The group's report prominently noted that its purpose was "to begin developing a framework for fair and reasonable hostile takeover defensive measures that would enhance corporate and shareholder value based on Anglo-American measures that are accepted as a global standard."[7] The group conducted an in-depth investigation into U.S. takeover precedents and defensive techniques, and its report embraces Delaware takeover jurisprudence, including the "threat" and "proportionality" rules familiar to American corporate lawyers, in suggesting appropriate standards for Japan.[8] Based on this report, guidelines promulgated jointly by METI and the Ministry of Justice in May 2005 draw upon key principles in Delaware doctrine.[9] The shareholder rights plan, better known as the poison pill, symbol of U.S. hostile mergers and acquisitions (M&A) activity, is validated as a defensive measure by the report and the guidelines and appears to be on the verge of widespread adoption in Japan.

What happened? What are the implications of these developments? If, as now seems distinctly possible, the world's second largest economy is in the process of embracing hostile M&A (however reluctantly), and along with it the core of Delaware takeover jurisprudence, this develop-

6. See infra text accompanying notes 72–73. *Unocal* authorizes defensive measures in response to a threat to corporate policy and effectiveness, provided the response is proportionate to the threat. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954–55 (Del. 1985).

7. Kigyō Kachi Kenkyū Kai [Corporate Value Study Group], Tekitaiteki Baishū Bōeisaku (Kigyō Kachi Bōeisaku) no Seibi [Preparing Defensive Measures toward Hostile Takeovers (Measures to Defend Corporate Value)] 2 (Mar. 2005), available at http://www.meti.go.jp/committee/materials/downloadfiles/g50307a11j.pdf (on file with the *Columbia Law Review*) [hereinafter Corporate Value Study Group Report]. An English summary of the report is available. See METI: Corporate Value Study Group, Summary Outline of Discussion Points (Mar. 2005), available at www.meti.go.jp/english/information/downloadfiles/Corporate%20Value.pdf (on file with the *Columbia Law Review*).

8. Corporate Value Study Group Report, supra note 7, at 4, 10–11, 14–20, 33 (concluding, after extended discussion of the U.S. situation, that defensive measures recognized in U.S. and Europe can be introduced into Japan under existing corporate law).

9. See Keizai Sangyōshō [Ministry of Economy, Trade and Industry (METI)] & Hōmushō [Ministry of Justice], Kigyō Kachi, Kabunushi Kyōdō no Rieki no Kakuho Mata wa Kōjō no Tame no Baishū Bōeisaku ni Kansuru Shishin [Takeover Defense Guidelines for Protecting and Enhancing Corporate Value and the Common Interests of Shareholders] 3 (May 2005), available at http://www.meti.go.jp/press/20050527005/3-shishinn-honntai-set.pdf (on file with the *Columbia Law Review*) [hereinafter Takeover Guidelines] (explaining that guidelines are "modeled after typical defensive measures that have been developed elsewhere"). An English summary of the report is available. See METI & Ministry of Justice, Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholders' Common Interests (May 2005), available at http://www.meti.go.jp/policy/ economic_oganization/pdf/shishin_hontai.pdf (on file with the *Columbia Law Review*).

ment may represent an epochal moment for Japan and for the global standards movement in corporate governance.

In this Essay, I explore the emergence of hostile takeovers in Japan as a case study in market and legal development in a global era. In its ambitions, this Essay parallels work by prominent scholars who have sought to explain the rise of hostile M&A and related Delaware jurisprudence at a formative period of U.S. corporate law development, the 1980s.[10] Like those scholars, I "seek to understand the relationship between legal doctrine and the world of takeovers, and to assess the significance of corporate law from a broader perspective."[11] I do so, however, with a very different frame of reference—Japan in the 2000s. My task is complicated by the overlay of Delaware doctrine on a foreign legal and economic system. Discerning the significance of Japan's emerging takeover market and related legal developments requires nuanced comparative assessments of how legal standards and governance technologies whose evolution is deeply enmeshed with the U.S. political economy will operate in a very different institutional setting.

Beyond the intrinsic importance of this moment for Japanese corporate governance,[12] this phenomenon bears directly on the two major debates in comparative corporate governance literature today, which grapple intensely with the significance and evolution of corporate law in a global economy. One debate focuses on a provocative line of empirical research suggesting that differences in the "origin" and "quality" of corporate law among legal systems explain the diversity of corporate ownership structures and capital markets around the world.[13] A second line of debate asks whether corporate law and governance structures around the world are converging on a U.S. shareholder-oriented model.[14] The

10. See, e.g., Marcel Kahan & Edward B. Rock, How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law, 69 U. Chi. L. Rev. 871 (2002); Jonathan R. Macey & Geoffrey P. Miller, Toward an Interest-Group Theory of Delaware Corporate Law, 65 Tex. L. Rev. 469 (1987).

11. Kahan & Rock, supra note 10, at 872.

12. Given that the absence of a market for corporate control figures in virtually every academic account of corporate governance in Japan, see, e.g., Fligstein, supra note 1; J. Mark Ramseyer, Takeovers in Japan: Opportunism, Ideology and Corporate Control, 35 UCLA L. Rev. 1 (1987), the emergence of hostile takeovers may require substantial rethinking of the entire field.

13. The seminal articles in this line of literature are the following: Rafael La Porta et al., Law and Finance, 106 J. Pol. Econ. 1113 (1998) [hereinafter La Porta, Law and Finance] (providing extensive empirical evidence that common law ("English origin") systems have "higher quality" corporate law than civil law (particularly "French origin") systems, and that greater shareholder protections in the "better" corporate law system give rise to more dispersed share ownership structures and larger capital markets); Rafael La Porta et al., Legal Determinants of External Finance, 52 J. Fin. 1131 (1997) [hereinafter La Porta et al., Legal Determinants] (arguing that countries with "poorer" investor protections tend to have smaller capital markets).

14. Compare Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 Geo. L.J. 439 (2001) (arguing that corporate systems throughout the world are converging on single, shareholder-oriented model), with Lucian Ayre Bebchuk

events examined in this Essay prompt questions going to the heart of these debates: Is Delaware law becoming a "global" standard, and if so, what dynamics are pushing in that direction? Does the appeal of Delaware corporate law lie in its superior protections for shareholders, as the economic literature would suggest, or might the foreign gravitation to Delaware signal something broader and more ambiguous for the convergence hypothesis? How does "good" corporate law evolve anyway,[15] and perhaps even more saliently, can it be *imported* from abroad? This Essay cannot provide definitive answers to all these questions, of course. But Japan's recent experience with hostile takeovers provides unique insights into the significance and evolution of corporate governance in an era when law, like capital and information, can move around the world at great speed.

Part I of this Essay describes the rise of hostile M&A in Japan. It begins by providing brief factual sketches of several recent contests for control. It then explains the significance of these developments and the immense public fascination with the transactions as the product of several factors: the clash between old and new Japan, the novelty of the tactics employed by the bidders, and the concerns they sparked over the rise of "American-style" capitalism in Japan.

Part II contextualizes these deals by examining the corporate scene in Japan from the mid-1990s to the present. The rise of hostile M&A in Japan can be seen as the culmination of a process of interlinked market and corporate law developments over the past decade. On the market side are the rise of foreign institutional shareholders, steady declines in stable and cross-shareholding patterns, and a modest but potentially significant increase in the activism of Japanese institutional investors. The corporate law developments include substantial changes in board governance and incentive structures, major developments in the areas of directorial duties and personal liability, and expansions in organizational flexibility. Not unlike the United States in the mid-1980s, by the end of this period of substantial change, Japan's legal and market climate was conducive to hostile M&A, while relatively little attention had been paid to defensive measures available to target boards, setting the stage for the deal activity and defensive maneuvering currently underway.

In Part III, I step back to interpret these developments, using analytical perspectives that have proven powerful in understanding the evolution of Delaware corporate law. In brief, I argue that when markets changed in the 1990s, corporate law that was formerly irrelevant or com-

& Mark J. Roe, A Theory of Path Dependence in Corporate Ownership and Governance, 52 Stan. L. Rev. 127 (1999) (advancing theory of path dependence to explain differences among corporate systems and to argue why these differences may persist).

15. This question is just beginning to receive the attention it deserves. See Katharina Pistor et al., The Evolution of Corporate Law: A Cross-Country Comparison, 23 U. Pa. J. Int'l Econ. L. 791 (2002) (analyzing evolution of statutory corporate law in ten countries, and concluding that continuous evolution is the key to "good" corporate law).

plementary to presently waning Japanese economic institutions became problematic. Dissatisfied with the constraints imposed by law, market participants responded as they had in the United States two decades earlier: by pursuing legal strategies, adapting to governance or incentive structures outside the legal system, and making use of the new environment to push the edges of "acceptable" market conduct, thrusting novel transactions into the realm of contemplation, and in turn, raising new questions that the legal system had to answer. The parallels with Delaware in the 1980s are striking. In both systems, market and legal changes reverberated through the political economy, transforming existing corporate governance institutions and catalyzing further development of the corporate law. In contrast to developments in the United States, however, the changes in Japan involved large-scale transplantation of foreign legal technologies and standards.

Part IV explores the implications of the foregoing analysis. For Japan, the rise of hostile takeovers presages further acceleration in the reconfiguration of its postwar economic system. Among other possible changes, the judiciary is likely to take on a higher profile as arbiters of market conflict, and independent directors may assume a new role in structuring transactions and mediating between conflicting corporate constituencies. For comparative corporate law scholars, the Japanese events add an important piece of empirical evidence to the ongoing theoretical debates about convergence, stasis, and evolution in corporate law and governance structures.[16] At one level, the evidence provides powerful support for convergence theories, illustrating the intellectual appeal of the Delaware model in the world today. But further analysis suggests other possibilities, including a cryonic suspension of institutional transition if the poison pill proves too powerful a tool of managerial protection in Japan's nascent shareholder movement. In all likelihood, however, the transplantation of Delaware takeover jurisprudence and the poison pill will lead neither to strong convergence nor to path-dependent blockage of further reforms. Rather, preliminary evidence suggests that Delaware law will be adapted by the judiciary and other actors to suit local interests—indeed, a struggle for the "proper" interpretation of Delaware takeover jurisprudence in Japan is already taking shape. This struggle may well lead to a new governance regime, but its contours may look quite different from those in the United States.

The important dynamics at work in this Japanese experiment are masked by the prevailing analytical constructs in the comparative corporate governance literature. In practice, successful economies do not abandon their institutions for foreign models. Rather, foreign legal technologies are selectively adopted locally, then adapted by coalitions of market and governmental actors to suit their own interests. The poten-

16. For a range of perspectives on this debate, see generally Convergence and Persistence in Corporate Governance (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

tial to enhance shareholder protections is one motivation for the foreign borrowing, but many other motivations are also at work. The result is not so much a *convergence* of systems on the Anglo-American model as the unsettling *telescoping and stacking* of borrowed legal institutions on top of domestic governance structures. The true appeal of Delaware corporate law may be its suitability to this process of selective adaptation, rather than its superior protections for shareholders.

I. The Deals

The past few years have witnessed incidents of unsolicited M&A activity, which, although still small in number, are unprecedented in Japan. This Part describes the most important recent examples.[17] To a sophisticated American reader, these transactions may sound rather unremarkable, even prosaic, particularly as compared to U.S. deal activity in the 1980s. But each of these deals is steeped in a welter of facts and circumstances that add a distinctly local color and significance to the transactions. After sketching the essential facts, I will provide a sense of why these deals captured the public imagination and why they appear so important.

A. *UFJ-Sumitomo*

The first deal involves a contest for control involving UFJ Holdings, the holding company for various financial institutions, including UFJ Bank and UFJ Trust Bank (collectively, UFJ). In May 2004, UFJ signed a memorandum of agreement to sell UFJ Trust Bank, the crown jewel of the group, to Sumitomo Trust and its affiliated group, and to enter into a business alliance with the two groups. The agreement provided that Sumitomo Trust was to have the exclusive right to acquire UFJ Trust Bank during a two-year period, and contained a standard "no shop" provision prohibiting either party from engaging in consultations or providing information to any third party in connection with a transaction that could interfere with the deal contemplated by the memorandum. Moreover, the memorandum required each party to "negotiate in good faith any issue that is not established in this memorandum."[18] However, in July 2004, with management still searching for ways out of its financial problems, UFJ entered into talks with Mitsubishi Tokyo Financial Group (MTFG) for a transaction in which the latter would acquire all of UFJ's business operations, including UFJ Trust Bank. The merger would create the world's largest bank on an asset basis. In the weeks following the announcement, the stock price of Sumitomo Trust's parent corporation

17. For economy of exposition, I have pared the factual recounting of these bids to their essentials.

18. Sumitomo Shintaku Ginkō K.K. v. Yūefujeii Horudingusu K.K. (Sup. Ct., Aug. 30, 2004), excerpted in 1708 Shōji Hōmu 23, 24 (2004).

dropped 14%.[19] Sumitomo Trust immediately sued to enjoin the transaction on the basis of the memorandum of agreement. The litigation jeopardized the MTFG-UFJ merger because the Trust Bank was one of UFJ's only profitable operations; without it, UFJ's attractiveness to MTFG would decline significantly.

Sumitomo Trust obtained an injunction against the MTFG-UFJ negotiations in the District Court on the basis of its memorandum of agreement, but the High Court reversed.[20] Within hours of the High Court's ruling on August 11, 2004, the boards of MTFG and UFJ approved a merger of the two groups. Sumitomo Trust filed an appeal with the Supreme Court, and its parent company announced on August 24 that it had just approached the UFJ board with its own bid for UFJ. Using a tactic known in U.S. mergers and acquisitions parlance as a "bear hug," Sumitomo publicly announced the terms of the offer to put pressure on the UFJ board. Shortly thereafter, the Supreme Court affirmed the High Court ruling, and Sumitomo's judicial strategy reached a dead end. Sumitomo nonetheless persevered in its pursuit of UFJ for a time, publicly reserving the option to launch a hostile bid. The UFJ board, however, continued to negotiate toward a merger with MTFG, and took steps to insulate itself from a hostile tender offer by Sumitomo.[21]

Continuously spurned by the UFJ board, Sumitomo eventually gave up, though it filed a 100 billion yen (approximately $1 billion) lawsuit against UFJ seeking damages for breach of the memorandum of agreement. The MTFG-UFJ merger closed in the fall of 2005.

B. *Livedoor-Fuji TV*

The second deal involves a battle for control over Nippon Broadcasting System, Inc. (Nippon Broadcasting), part of the prominent Fuji Sankei media group. Nippon Broadcasting, a radio broadcaster, is a de facto subsidiary of Fuji Television Network, Inc. (Fuji TV), Japan's largest media company, and the virtual headquarters of the group. Somewhat anomalously, however, Nippon Broadcasting held 22.5% of the outstanding shares of Fuji TV, while Fuji TV held only 12.4% of Nippon Broadcasting's shares. In part to rectify that situation, on January 17, 2005, Fuji TV announced an all-cash offer for all of the outstanding shares of Nip-

19. Mark Saltzburg, Contest for Corporate Control Reveals Much about State of Shareholders' Rights in Japan, IRRC Corporate Governance Bulletin, June–Sept. 2004, at 14, 17.

20. Yūefujeii Horudingusu K.K. v. Sumitomo Shintaku Ginkō K.K. (Tokyo High Ct., Aug. 11, 2004), excerpted in 1708 Shōji Hōmu 23 (2004).

21. On September 10, 2004, UFJ Bank issued a new class of preferred shares to MTFG, giving it veto power over major business decisions by UFJ Bank. Scramble for UFJ, Sumitomo Mitsui Seen at Dead End, Nikkei Bus., Sept. 20, 2004, available at http://nikkeibp.jp/wcs /leaf/CID/onair/nbe/features/332662 (on file with the *Columbia Law Review*).

pon Broadcasting.[22] The bid was approved by the directors of Nippon Broadcasting, with the four board members affiliated with Fuji TV abstaining.

In the midst of the tender offer period, on February 8, 2005, an internet service provider called Livedoor (formerly called Livin' on the Edge) made the startling announcement that it had just acquired about 9.7 million shares, or 29.6%, of Nippon Broadcasting. In combination with shares owned previously, these purchases gave Livedoor 38% of the shares of Nippon Broadcasting. The share purchases, which were financed by an issuance of convertible bonds underwritten by U.S. investment bank Lehman Brothers, were made on an after-hours, off-exchange trading system operated by the Tokyo Stock Exchange.[23] On the same day, Livedoor informed Nippon Broadcasting of its intent to acquire all of its outstanding shares. Livedoor's CEO, a 32-year-old college dropout named Takafumi Horie, held a press conference to announce the expected synergies of turning Nippon Broadcasting's website into a portal site, and his desire to enter into a business cooperation agreement with the Fuji Sankei group.

In response, on February 23, 2005, Nippon Broadcasting announced that its board had decided to issue warrants to Fuji TV exercisable into 47.2 million shares of Nippon Broadcasting stock. If exercised, the warrants would give Fuji TV majority control and dilute Livedoor's stake to less than 20%. This type of warrant (known as *shin kabu yoyaku ken*), authorized in a 2002 Commercial Code amendment, allows directors to issue the instrument without shareholder approval at a price determined by the board.[24] The Nippon Broadcasting warrants were exercisable at 5,950 yen, the price offered in Fuji TV's tender offer. Nippon Broadcasting announced that the warrants were issued for the purpose of ensuring that it remained within the Fuji Sankei group, which would provide long-term benefits to its shareholders.

Livedoor then sued to enjoin the issuance of the warrants. The Tokyo District Court enjoined the warrant issuance as "grossly unfair," finding that its main purpose was to maintain control of the firm by incum-

22. The offer had a minimum share tender condition of the number of shares that, when added to shares already owned by Fuji TV, would give it just over 50%.

23. Livedoor's share purchases on the after-hours system fell outside a securities regulation requiring that any acquisition of one-third or more of the shares of a public company be made via a tender offer open to all shareholders. Shōken Torihiki Hō [Securities & Exchange Act], Law No. 25 of 1948, art. 27-2(1), translated in Securities and Exchange Law, Cabinet Order and Selected Ordinances: As in Effect April 1, 2001 (Capital Mkts. Research Inst. 2001). Until the Livedoor bid, this gap in the securities laws had received scant attention.

24. Shōhō [Commercial Code], Law No. 48 of 1899, arts. 280-19 to 280-39, translated in 2 EHS Law Bull. Series JA 143–54 (2004). The price determined by the board must be "fair." Id. art. 280-21(1), translated in 2 EHS Law Bull. Series JA 145 (2004).

bent management and affiliates of the Fuji Sankei group.[25] The High Court affirmed, albeit on somewhat different grounds.[26] In the face of these rulings, Nippon Broadcasting and Fuji TV abandoned the warrant issuance. Livedoor eventually obtained a majority of the shares of Nippon Broadcasting. Nippon Broadcasting's president announced his intent to resign, ostensibly to shoulder the blame for "failing to protect the company from a hostile bid."[27]

In the end, the contest for Nippon Broadcasting ended civilly. On April 18, 2005, Livedoor agreed to sell its Nippon Broadcasting shares to Fuji TV at 6,300 yen per share, about the average price it paid for the shares. In return, Fuji TV obtained a 12.5% stake in Livedoor for a capital infusion of approximately $440 million, and the three companies established a joint committee to explore related ventures.[28]

C. *Other Examples*

Other cases merit brief mention. Japan's series of hostile bids first began in January 2000, with an unsolicited tender offer by M&A Consulting, a Japanese takeover boutique, for Shoei Corporation, a company within the Fuyo (Fuji Bank) *keiretsu* corporate group.[29] M&A Consulting followed the same year with a proxy fight over dividend policies at a firm called Tokyo Style. Both attempts failed, at least in part because large shareholders friendly to management of the target firms provided unconditional support to the incumbents.

In December 2003, Steel Partners, a U.S. buyout fund, announced unsolicited bids for the shares of two relatively small public firms in which it had stakes of about 10%, Yushiro Chemical Industries and Soto. The two companies had similar financial profiles: Market prices of their stocks were less than net asset value per share, their balance sheets showed significant cash equivalents, and both companies had a history of paying low dividends. Steel Partners' bid represented approximately a 30% premium over the respective stock price of both target firms over

25. See Raibudoa K.K. v. Nippon Hōsō K.K., 1173 Hanrei Taimuzu 140, 141–42 (Tokyo D. Ct., Mar. 16, 2003).

26. See Nippon Hōsō K.K. v. Raibudoa K.K., 1173 Hanrei Taimuzu 125, 132–33 (Tokyo High Ct., Mar. 23, 2005); see also infra text accompanying note 73.

27. Nippon Hōsō: Kamebuchi Shachō no Tainin Nōkō ni Baishū Bōshi Dekizu Inseki [Nippon Broadcasting: Increased [Likelihood that] President Kamebuchi Will Resign for Failing to Prevent Takeover], Mainichi Shimbun, Apr. 9, 2005, available at http://www.mainichi-msn.co.jp/shakai/wadai/news/20050409k0000e040024000c.html (on file with the *Columbia Law Review*).

28. Fuji, Raibudoa to Wakai [Fuji and Livedoor Settle], Asahi Shimbun, Apr. 19, 2005, at I.

29. There were also two foreign bids in 2000: Britain's Cable & Wireless acquired Japanese telecom International Digital Communications (IDC) in an unsolicited bid after IDC had accepted a stock swap with Nippon Telephone and Telegraph Corp., and German pharmaceutical maker Boehringer Ingelheim made a successful unsolicited bid for a blocking stake in SS Pharmaceuticals.

the preceding month. Management of both Japanese firms immediately announced their opposition to the tender offers, and as a defensive measure, significantly changed their dividend policies. As a result, share price increased, and shareholders did not tender into the bids.

Most recently, in July 2005, Yumeshin Holdings launched a hostile tender offer for Japan Engineering Consultants. The target board took a number of defensive steps, including a stock split to exploit legal uncertainty over the bidder's ability to adjust its offer price in the midst of a tender offer and announcement of a warrant issuance designed to function like a poison pill. Yumeshin challenged the validity of these measures in court, but the offer failed in any event, because Japan Engineering's stock price rose substantially above Yumeshin's offer price, and few shareholders tendered into the bid.[30]

D. *Significance*

It would be difficult to overstate the attention these deals—particularly the Livedoor bid—received in Japan, despite their small numbers and the fact that none ended entirely successfully for the bidders. Without discounting the role of colorful facts in the prominence of these transactions,[31] these contests struck a deep chord in the Japanese consciousness—not only on a corporate level, but politically and socially as well. Several closely related factors help explain this phenomenon. First, these deals are an allegory on old versus new Japan. Livedoor is an internet firm run by a young college dropout in T-shirt and jeans, who had made a name, and a billion dollars, for himself buying up small technology companies. The target of his latest ambition was a radio broadcaster in a bloated media conglomerate, steered by starched-shirted sixty-somethings. UFJ, a large, weak bank formed through the merger of three smaller, weak banks, is quite literally a product of old Japan—a legacy of an era in which banks lent funds on the basis of relationships rather than financial analysis, and in which regulators quietly brokered mergers to re-equilibrate markets. M&A Consulting and Steel Partners, the bidders in the other transactions, represent a new breed of investor in Japanese markets—"vulture" and other strategic funds seeking to generate high financial returns by taking large stakes in distressed or undervalued firms.

Second, the market players in these deals used previously unheard-of tactics to achieve their objectives. M&A Consulting's use of the proxy fight, Sumitomo's bear hug, Livedoor's unsolicited bid, not to mention the strategic use of litigation in the contests for UFJ and Nippon Broad-

30. Michael Tsang & Eijiro Ueno, Japan Engineering Aims to Thwart Bid, Int'l Herald Trib., Aug. 1, 2005, at 15.

31. For example, in the midst of the contest for Nippon Broadcasting, several celebrities who appear on Fuji TV programs announced that they would resign rather than work for an enterprise controlled by Livedoor. Court Hands Victory to Livedoor, Japan Zone, Mar. 24, 2005, at http://www.japan-zone.com/news/archives/2005_03.shtml (on file with the *Columbia Law Review*).

casting, all marked major departures from the norm in the world of Japanese takeovers. As such, they generated a welter of controversy by creating the impression that a new brand of "American" capitalism was infiltrating Japan.[32] In the midst of Livedoor's hostile bid for Nippon Broadcasting, for example, Fuji TV's chairman remarked, "I wonder if this sort of thing is called American style. I don't know it because I'm Japanese."[33] More reflective commentators have questioned whether Japan is ready for the wholesale introduction of the U.S. system of corporate governance, with its extensive reliance on freedom of contract, robust capital markets, ex post judicial review, and private enforcement backed by a welter of incentives.[34] Some view hostile bids as part of the standard corporate governance tool kit, with potential to help revive the Japanese economy by moving assets to their most productive uses; others see an undesirable foreign practice that is inconsistent with Japanese sensibilities, and subject to exploitation in Japan's comparatively underdeveloped corporate and capital markets regime.[35]

Closely related to the impression made by the tactical novelty of these transactions is the larger sense (whether genuine or strategically motivated) that corporate Japan is now vulnerable to a wave of foreign acquisitions.[36] For years, a significant percentage of public firms in Japan

32. See, e.g., Jason Singer, With '80s Tactics, U.S. Fund Shakes Japan's Cozy Capitalism, Wall St. J., Apr. 15, 2004, at A1 (discussing New York investment fund's hostile takeover bids for two Japanese companies and noting that accompanying "uproar signals the arrival in Japan of American-style capitalism and the loud voice it gives shareholders").

33. Takuya Karube, Livedoor Ushers in Era of Hostile Takeover, Japan Today, Feb. 24, 2005, available at http://www.japantoday.com/e/?content=comment&id=731 (on file with the *Columbia Law Review*).

34. See Tatsuo Uemura, Raibudoa tai Fuji Terebi: Shijō no Rūru wo Fumiarasu Mono wa Dare ka? [Livedoor v. Fuji TV: Who Will Trample the Market Rules?], Sekai, May 2005, at 58 (using *Livedoor* case to argue that Japan lacks enforcement and market infrastructure necessary to make introduction of U.S. system work properly).

35. Opinion surveys taken during the Livedoor-Fuji contest generally show support for Livedoor's Horie and his tactics as well as approval of the court decision invalidating Nippon Broadcasting's defensive warrant issuance. See 2005 Nen Tei Rei Yoron Chōsa, 3 Gatsu [March 2005 Public Opinion Survey] (Mar. 2005), available at http://www.ntv.co.jp/yoron/2005_03/200503/question.html (on file with the *Columbia Law Review*). But perhaps unsurprisingly, Horie received intense criticism among business and political leaders. For example, Hiroshi Okuda, the chairman of Keidanren (Federation of Economic Organizations)—Japan's big business lobby—and also head of Toyota, said of Horie, "He has been criticized by people in politics and business circles for having done something morally wrong, because it is the worst thing in Japanese society to think that if you have money, you can do anything." Takuya Karube, Young Gun Under Fire for Takeover Bid, Japan Times, Feb. 8, 2005, available at http://www.japantimes.co.jp/cgi-bin/getarticle.pl5?nb20050225a3.htm (on file with the *Columbia Law Review*); see also Uemura, supra note 34.

36. This perception is propagated even in official policy papers. See, e.g., Hōmushō Minji Kyōku [Ministry of Justice, Civil Affairs Department], Kigyō Baishū Bōeisaku ni Tsuite [On Corporate Takeover Defenses] 1 (undated policy outline) (justifying its policy initiative on the ground that "because of an increase in the desire of foreign firms to acquire Japanese companies . . . it is necessary to develop reasonable takeover defenses in

have traded below their asset values,[37] and the market capitalization of major Japanese firms is often only a fraction as large as that of their U.S. peers. This anxiety bubbled to the surface even during the Livedoor contest, though all the principal players were Japanese. Much critical attention in media and government circles was focused on Lehman Brothers' role in financing Livedoor's bid. Keidanren, a powerful big business lobby, issued policy papers calling for Japan's business community to devise measures to deter "foreign predators." In response to these anxieties, in the midst of the contest for Nippon Broadcasting, the Japanese government postponed a planned corporate law amendment that would permit foreign firms to do cross-border acquisitions in Japan using triangular mergers and stock swaps, even though hostile acquisitions are not feasible via this mechanism.[38] As Europe has illustrated in its ongoing and contentious debate over the Thirteenth Directive,[39] crafting an official response to hostile takeovers touches deep chords of nationalism, protectionism, and fear of the unknown. These forces are also at work in Japan.

Perhaps most importantly, these contests for control have brought Japanese corporate governance into uncharted territory. The emergence of a market for corporate control in Japan, if only nascent, has the potential to significantly change the incentive structure for Japanese managers. Surveys taken in the wake of the Livedoor bid indicate that managers at 70% of large Japanese firms are concerned about the "threat" of hostile takeovers.[40] Previously, Japanese managers had few direct incentives, short of financial crisis, to take major steps to enhance the value of their firms.[41] If they are no longer secure from the threat of hostile acquisition

---

order to cope with acquisitions that will have an adverse effect on regional employment and harm the interests of existing shareholders").

37. Indeed, lists of such firms appear occasionally in the business press. See, e.g., Masatoshi Kikuchi, TOB Sareyasui Kigyō 25sha [25 Firms Ripe for Takeover], Ekonomisuto, Mar. 14, 2000, at 60, 61.

38. The political dimensions of this action are readily apparent in the fact that the U.S. embassy in Tokyo spearheaded a public education campaign in Japan to combat the fear of foreign takeovers following the Livedoor bid. See Excerpts of Message from the U.S. Embassy in Tokyo, Japan, Foreign Direct Investment and Revitalizing Japan's Economy Through Mergers & Acquisitions (2005) (on file with the *Columbia Law Review*).

39. The Thirteenth Directive, which would have severely limited the ability of European firms to adopt defensive measures against hostile bids, failed to pass in 2001 after Germany withdrew its support out of concern for the vulnerability of German firms to foreign takeover. It was subsequently resuscitated, but only through inclusion of reciprocity provisions to allay protectionist concerns. Jeffrey N. Gordon, An American Perspective on Anti-Takeover Laws in the EU: The German Example, *in* Reforming Company and Takeover Law in Europe 541, 556 (Guido Ferrarini et al. eds., 2004).

40. See, e.g., Tekitaiteki Baishū, "Kyōi" 7 Wari [Seventy Percent [Perceive] "Threat" of Hostile Takeover], Asahi Shimbun, Apr. 30, 2005, at 1.

41. See Chuck Lucier et al., Why CEOs Fall: The Causes and Consequences of Turnover at the Top, Strategy + Bus., Third Quarter 2002, at 1, 13 (reprint 2002), available at http://extfile.bah.com/livelink/livelink/110173/?func=doc.Fetch&nodeid=110173 (on file with the *Columbia Law Review*) (showing that Japanese CEOs have "lowest proportions

or other unwelcome shareholder advances, they ignore shareholder returns at considerable peril to their own futures. Though the number of unsolicited bids is still very low by any measure and no bid thus far has been an unqualified success, the trend is upward, and it is not the number, but the existence, of hostile bids that matters from a corporate governance perspective.

II. The Deal Environment

Why has the phenomenon of hostile M&A begun to appear at this moment in Japanese economic history? Answering this question requires contextualizing the contests for control just described within broader market and legal changes in Japan over the past decade.

The rise of hostile M&A activity is part of a series of trends taking root in Japanese corporate governance, driven by deep structural changes in the economy following the bursting of Japan's bubble economy in 1990. These interrelated developments have combined to create a corporate governance environment that differs in significant respects from the one characterizing postwar Japan. First, the composition of shareholders, patterns of share ownership, and activism of shareholders in Japan have evolved substantially. Figure 1 shows several significant trends.[42] Shareholding by financial institutions has declined from almost 43% of market capitalization in the early 1990s to less than 35% as of 2004. More significantly, within this group, shareholding by commercial banks has declined precipitously, from almost 16% in 1992 to less than 6% in 2004. Corporate share ownership has declined from about 29% to about 22% over the same period. Significantly, these declines in Japanese institutional share ownership have been completely offset by increases in foreign ownership, which rose from about 6% of market capitalization in 1992 to almost 22% in 2004. Virtually all of these shares are held by foreign institutional investors, including CalPERS and other funds known for active engagement with the managements of their portfolio firms.

Equally importantly, shareholding patterns have changed. Time series data presented in Figure 2 show steep declines in cross-shareholding and stable shareholding between the early 1990s and 2002.[43] On a value

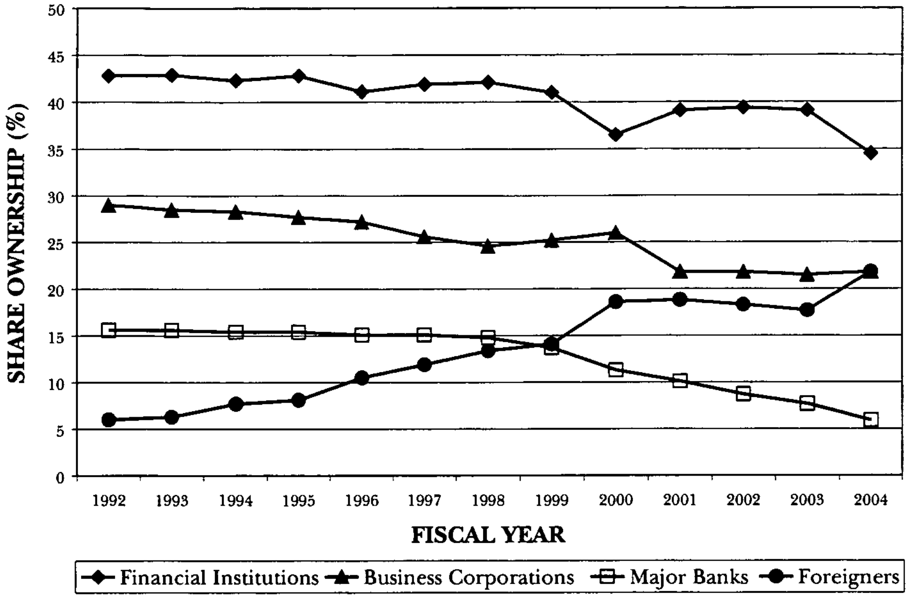
---

of merger-driven and performance-related departures; the smallest impact of CEO performance upon tenure; the oldest CEOs at ascension; and the least orientation toward shareholder returns" of CEOs in United States, Europe, and Asia/Pacific region).

42. Data in this figure are from Tokyo Stock Exch., Fact Book 2005, at 60 (2005), available at http://www.tse.or.jp/english/data/factbook/fact_book_2005.pdf (on file with the *Columbia Law Review*).

43. Data in this figure are from Fumio Kuroki, NLI Research, The Relationship of Companies and Banks as Cross-Shareholdings Unwind—Fiscal 2002 Cross-Shareholding Survey 6 & fig.3 (2003), available at http://www.nli-research.co.jp/eng/resea/econo/eco031118.pdf (on file with the *Columbia Law Review*). Recently, two scholars have argued that the patterns of stable and cross-shareholding (along with other institutions such as the main bank system and *keiretsu* corporate groups) thought to characterize postwar Japanese corporate governance are actually artifacts of data-mining and urban legend. See Yoshiro

FIGURE 1: SHARE OWNERSHIP BY MARKET VALUE



basis, the cross-shareholding ratio has declined by more than 10% over this period. The decline is attributable not only to unwinding of cross-shareholding arrangements, but also to the public listing of new companies that do not rely on long-term shareholding arrangements. The long-term shareholding ratio has declined by almost 20% over this period.

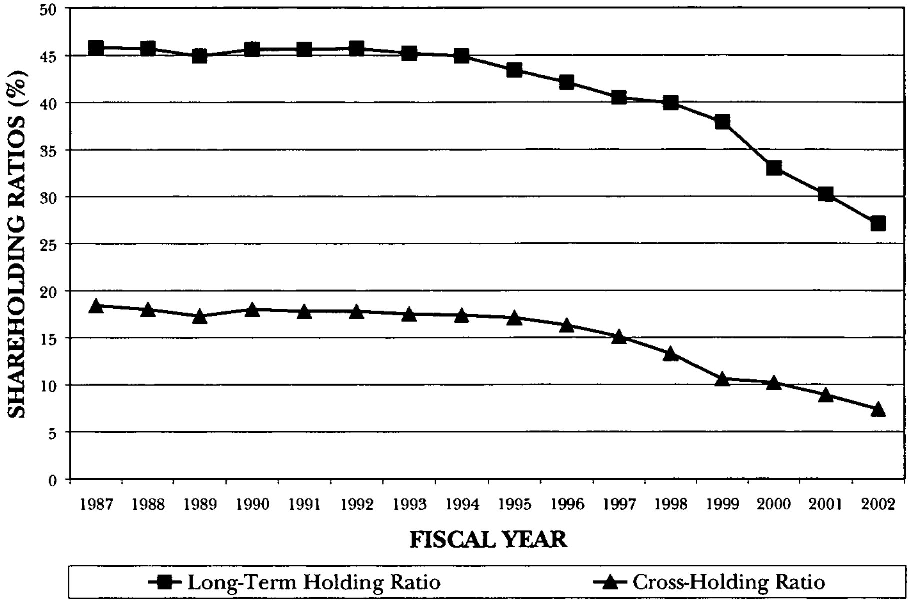
Japanese institutional investors and corporate shareholders have also become more activist, at least in comparison to the past. As recently as five years ago, banks, institutional investors, and stable corporate shareholders could be counted on to give unconditional support to management in the event an unwelcome bidder appeared.[44] That is no longer the case. Most visibly, several public retirement plan sponsors collectively managing over $1 trillion in assets have recently established proxy voting guidelines that emphasize corporate governance considerations, and have taken other steps to raise their profile vis-à-vis boards of directors.[45]

Miwa & J. Mark Ramseyer, The Myth of the Main Bank, 27 Law & Soc. Inquiry 401, 420–21 (2002). I address that argument elsewhere. See Curtis J. Milhaupt, On the (Fleeting) Existence of the Main Bank and Other Japanese Economic Institutions, 27 Law & Soc. Inquiry 425, 436 (2002) (arguing that Miwa and Ramseyer's theory "is not supported with compelling data and has little explanatory power with respect to changes in Japanese economic performance and organization over the past several decades").

44. Two hostile bids launched by a Japanese takeover boutique in 2000 failed in part for this reason. See supra text accompanying note 29.

45. For example, the Japanese Pension Fund Association (PFA), which directly oversees the management of substantial retirement assets and serves as the industry association for all pension fund managers, promulgated proxy voting principles in 2003 with recommendations on appropriate board size, separation of the offices of CEO and

FIGURE 2: CROSS-SHAREHOLDING AND LONG-TERM SHAREHOLDING RATIOS OF THE OVERALL MARKET



Adding momentum to this trend is the rising prospect of liability for failure to make decisions in the interests of shareholders.[46] It is no longer considered acceptable for the board of a large corporate or institutional investor to support incumbent management of a portfolio firm regardless of the financial consequences to their own shareholders.

Second, board structure and managerial incentives have been altered to the point that today two different board systems—colloquially, a "Japanese" board and a "U.S." board—compete within the economy. In an effort to enhance the effectiveness of the board, beginning in the mid-1990s many companies began to consider reducing the size of the board and including outside directors.[47] Of the firms reducing the size of the board, 80% scaled back to fewer than ten directors. About 25% of listed

Chairman, compensation practices, and other corporate governance issues. With respect to mergers and spinoffs, the guidelines recommend valuations by neutral and independent third parties. The PFA has also taken a lead in voting against or abstaining from proxy votes supported by management. See Tomomi Yano, Pension Fund Ass'n, Corporate Governance Activities of Pension Fund Association 10–15, at http://www.usajapan.org/PDF/TYano_1104.ppt (last visited Aug. 8, 2005) (on file with the *Columbia Law Review*). Proxy voting has become one of the major criteria by which plan sponsors select fund managers.

46. See infra text accompanying notes 53–56.

47. Survey data show an increase in firms displaying interest in reducing the number of directors, from 28.6% in 1998 to 46.2% in 2000. Tokyo Stock Exch., Survey on Listed Companies' Corporate Governance 2, 4, 7, 10 (Nov. 30, 2000), available at http://www.tse.or.jp/english/news/2001/200102/010221_a.pdf (on file with the *Columbia Law Review*).

firms have appointed outside directors to their boards, and the number continues to increase.[48] A major overhaul of the Commercial Code in 2002 allows firms to opt out of the traditional board structure featuring a "statutory auditor" in favor of a U.S.-style committee system for corporate governance.[49] In lieu of statutory auditors, firms can establish board committees for the audit, nomination, and compensation functions. A majority of the members of each committee must be outside directors. For firms choosing the committee system, a related amendment creates a formal distinction between directors, bearing oversight responsibility but not day-to-day managerial functions, and executive officers who actually run the firm.[50] These reforms are designed to strengthen the supervisory role of the board and to enhance the separation of monitoring and decisionmaking functions.

In line with these attempts to make management more responsive, executive compensation arrangements are being reformed. Traditional, seniority-based compensation is gradually giving way to performance-based pay arrangements. As of 2004, 46% of large firms either had already eliminated seniority-based pay for managers or planned to do so.[51] As a percentage of total compensation, variable pay (stock options, bonuses, and the like) increased from 21% to 33% from 1996 to 2003, and the portion of variable pay consisting of stock options went from zero to 20% over that period.[52] At least potentially, these reforms may make Japanese managers somewhat less resistant to unsolicited bids if they benefit

48. Hugh Patrick, Evolving Corporate Governance in Japan 25 (Ctr. on Japanese Econ. & Bus., Working Paper No. 220, 2004) (on file with the *Columbia Law Review*). It is important to note, however, that the definition of outside director in Japan is more expansive than that in the United States, encompassing directors affiliated with a parent firm or sibling subsidiary. See Shōhō [Commercial Code], Law No. 48 of 1899, art. 188, translated in 2 EHS Law Bull. Series JA 49–50 (2004).

49. Law for Special Exceptions to the Commercial Code Concerning Audit, etc. of Kabushiki-Kaisha [Joint Stock Companies], Law No. 22 of 1974, art. 21-5 to 21-39, translated in 2 EHS Bull. Series JAA 17–41 (2004). Statutory auditors (*kansayaku*) comprise a board parallel to the board of directors, and are responsible for overseeing the directors' compliance with law and the corporation's certificate of incorporation. They have the right to investigate the corporation's books and affairs and to demand that directors cease unlawful activity. See Shōhō [Commercial Code], arts. 273–280, translated in 2 EHS Law Bull. Series JA 130–54 (2004).

50. See Law for Special Exceptions to the Commercial Code Concerning Audit, etc. of Kabushiki-Kaisha [Joint Stock Companies], arts. 21-5, 21-15, translated in 2 EHS Law Bull. Series JAA 20, 30 (2004). Previously, there was no legal distinction between directors and officers, although beginning in the late 1990s companies began to informally make the distinction by creating an executive officer (*shikkō yakuin*) position for executives who did not simultaneously serve on the board.

51. Keisho Komoto, NLI Research, Companies Make Progress in Reforming Employment and Wage Systems—February 2004 Nissay Business Conditions Survey 9 fig.8 (May 2004), available at http://crystal.nli-research.co.jp/eng/resea/econo/eco040512.pdf (on file with the *Columbia Law Review*).

52. Towers Perrin, Worldwide Total Remuneration Report 2003–2004, at 26 (2003) (on file with the *Columbia Law Review*).

directly from resulting share price increases. Thus far, however, Japanese executive compensation arrangements do not contain lucrative change-of-control provisions common in the United States.

Finally, the legal environment for director decisionmaking has changed, placing directors under considerably greater scrutiny from shareholders and courts. In the past several years, Japanese courts have rendered decisions with striking parallels to important Delaware court decisions. Greater resort to shareholder derivative litigation since the early 1990s has created new law clarifying the legal responsibilities of directors to their firms.[53] A good example of this process is the shareholder litigation involving Daiwa Bank. In that case, shareholders of the bank derivatively sued eleven current and former directors for failing to detect and accurately report to U.S. authorities massive unauthorized trading in the bank's New York branch that ultimately resulted in almost $1.5 billion in losses and fines. The directors, heeding an informal Ministry of Finance indication that disclosure of the losses to the Federal Reserve would be untimely given instability in the Japanese financial system, filed a misleading report with the U.S. banking regulators, a violation of U.S. federal law. The Osaka District Court held the defendants liable for breach of duty and ordered them to pay $775 million in damages.[54] The court dismissed the argument that the Ministry of Finance's informal guidance should insulate the directors from liability. The court remarked that the "defendant [directors] persisted in following local rules that apply only in Japan, despite the fact that the Japanese economy has expanded on a global scale."[55] In finding the directors liable for failing to establish a risk management system designed to detect employee misconduct, the case has obvious parallels to the *Caremark* decision of the Delaware Chancery Court.[56]

To sum up, the market environment for Japanese corporate governance as well as the corporate law itself have changed significantly over the past ten years. In the fundamental areas of board structure, directorial duties and personal liability, executive compensation, and organizational flexibility, both statutory and case law have changed markedly, paving the way for new types of transactions in Japan. While these legal develop-

53. See Mark D. West, Why Shareholders Sue: The Evidence from Japan, 30 J. Legal Stud. 351, 356 & tbl.1 (documenting dramatic increase in shareholder litigation in 1990s).

54. See Nishimura v. Abekawa (The Daiwa Bank Case), 1573 Shōji Hōmu 4, 4 (Osaka D. Ct., Sept. 20, 2000).

55. Id. at 46.

56. See In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) ("[A] director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system . . . exists, and that failure to do so under some circumstances may . . . render a director liable for losses caused by non-compliance with applicable legal standards."). For a discussion of the parallels to Delaware case law, see Bruce E. Aronson, Reconsidering the Importance of Law in Japanese Corporate Governance: Evidence from the Daiwa Bank Shareholder Derivative Case, 36 Cornell Int'l L.J. 11, 33–36 (2003).

ments in themselves are not sufficient to drive merger activity, they have altered the incentive environment for transfers of corporate control, facilitating deals motivated by Japan's new economic realities.

Also significant, however, is what did not change in this period. While the market and legal developments just described created a climate much more conducive to transfers of corporate assets, including potentially through unsolicited bids, virtually no attention was paid to the development of new defensive mechanisms to replace the gradually dwindling postwar tactics of cross-shareholding arrangements and business alliances. Thus, as Japan entered the 2000s, changes in the environment left managers rather exposed—not unlike their American counterparts in the mid-1980s. Not surprisingly, contests for corporate control emerged in both environments.

III. Legal Strategies and Adaptation

As we have seen, substantial market shifts and large-scale legal development occurred over the course of a decade, in a country commonly portrayed as slow to change,[57] culminating in a series of hostile bids that would have seemed unthinkable a short time ago. But these developments were not random or completely exogenous, any more than the rise of hostile M&A and related jurisprudence in the United States was a random or exogenous event. In this Part, I uncover the underlying dynamics that propelled Japan to this remarkable moment in its economic and institutional development, drawing parallels to events in the United States two decades earlier.

To help interpret the changes in Japan, I consciously draw on analytical templates that have proven powerful in understanding the development of Delaware takeover jurisprudence. For example, in the Delaware context, Professors Marcel Kahan and Edward Rock have argued that market participants dissatisfied with the state of the law can pursue three different strategies: They can seek to change the law through the legislative or judicial process; they can opt out of the disfavored legal regime either by changing a company's organic governance documents or by reincorporating in another jurisdiction; or they can adapt by changing governance or incentive structures external to the legal regime, such as board structure or compensation.[58] In an early and influential article, Professors Jonathan Macey and Geoffrey Miller argued that "Delaware law reflects an internal equilibrium among competing interest groups."[59] That is, Delaware corporate law, prominently including its takeover law,

57. See, e.g., Asia's So Slow Express, Economist, Nov. 4, 2000, at 75 (describing economic recovery in Japan as a "long slog"); Edward J. Lincoln, Arthritic Japan: The Slow Pace of Economic Reform 1 (Japan Policy Research Inst., Working Paper No. 81, Oct. 2001) (on file with the *Columbia Law Review*) (concluding that Japan's "economic system is not changing very much").

58. Kahan & Rock, supra note 10, at 887–93.

59. Macey & Miller, supra note 10, at 509.

can be best understood as the outcome of political bargaining among interest groups, including managers, shareholders, corporate advisors, and state legislators. Combining these approaches, the evolution of corporate law can be seen as a product of strategic adaptation to new market realities, shaped by interest-group dynamics. This analytical approach is not system-specific, and it provides a powerful way of viewing the past decade of corporate law development in Japan.

A. *Legal Strategies*

As is apparent from the preceding discussion, legal strategies focused on the corporate law became prevalent in Japan over the past decade as one way of dealing with Japan's economic problems, leading to an almost annual series of amendments to the Commercial Code. These amendments lifted restrictions on equity finance and stock options, relaxed a ban on holding companies, streamlined merger procedures, and expanded shareholder monitoring mechanisms such as the derivative suit. The accelerated pace and expanded scope of corporate law amendments represent a major departure from past practice, in which amendments were made at a highly deliberate pace and were typically driven by scandals or other exogenous shocks, rather than by organized interests or government actors pursuing responses to the exigencies of the market.[60]

The move to legal strategies follows the simple logic of the political economy. In the postwar high-growth period fueled by bank loans and retained earnings, Code restrictions on equity finance techniques, stock options, and organizational form had little impact on Japanese economic activity. Indeed, the Code's relatively mechanical, rule-oriented approach may have actually complemented Japan's small judiciary and accounting profession.[61] However, as the economy stalled in the 1990s and

60. Mark D. West, The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States, 150 U. Pa. L. Rev. 527, 587–88 (2001) [hereinafter West, Puzzling Divergence] ("[C]orporate law development proceeded not in accordance with a broad plan, either of government, managers, investors, or any other interest group. . . . Instead, development in Japan is best described as slow and reactionary to various exogenous phenomena.").

61. Hideki Kanda & Tomotaka Fujita, Kabushiki Kaisha Hō no Tokushitsu, Tayōsei, Henka [Features, Variety, and Evolution of Stock Corporation Statutes], *in* Kaisha Hō no Keizaigaku [Economic Analysis of Corporate Law] 453, 470–75 (Yoshiro Miwa et al. eds., 1998). By contrast, in the United States, flexible and permissive corporate laws complement a fairly robust financial disclosure regime and an expansive legal system, featuring a large legal profession, a judiciary comfortable with the application of broad standards as opposed to narrow rules, and a procedural environment replete with procedural mechanisms to promote private litigation as a tool of enforcement. See, e.g., William Chandler III & Leo E. Strine, Jr., The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State, 152 U. Pa. L. Rev. 953, 976 (2003) ("Delaware takes an enabling approach, which broadly empowers corporate boards acting in conformity with their fiduciary duties to cause their corporations to engage in virtually any lawful activity subject to compliance with relatively flexible statutory constraints.").

many corporations were in need of restructuring, market participants recognized that the Code's constraints were blocking needed reforms. Since then, the business community, working through its political allies in the ruling Liberal Democratic Party, has had a much larger voice in the corporate law reform process. Stock options are the first illustration of the move to legal strategies. The success of Silicon Valley's venture capital industry drew envious glances from the Japanese, whose own venture capital market was inhibited by a variety of legal rigidities.[62] For example, Commercial Code restrictions made the issuance of stock options impossible as a practical matter. This limitation prompted an unprecedented reform of the Commercial Code in 1997 to liberalize the stock option regime—unprecedented because, for the first time in postwar history, an amendment was initiated by politicians rather than bureaucrats working through the Legislative Reform Council, as the business community prevailed upon Diet members to bypass the traditional, ponderous amendment process.[63]

Simultaneously, some market actors adapted informally to perceived deficiencies in the legal regime. In 1997, Sony started a trend by drastically reducing the size of its board and creating the position of executive officer, which was not recognized in the Commercial Code. These moves were intended to increase the functionality of the board as a monitoring and strategic decisionmaking organ. These changes also had an important strategic legal consequence: Because the position of executive officer was entirely informal, individuals holding that position were not proper defendants of shareholder derivative litigation. Thus, Sony's move was highly instrumental in that it shielded an important class of managers from legal liability. This innovation was quickly mimicked by hundreds of other firms.[64] Eventually the position of executive officer was codified in the corporate law, and executive officers became subject to derivative suits.

As the discussion of Sony suggests, as in the United States, some market actors in Japan opted out of the disfavored regime. However, strategies based on opting out unfold differently in the Japanese context because Japan has a unitary corporate law structure. Thus, unlike the situation in the United States, it is not possible to reincorporate in a jurisdiction with more favorable rules. Other scholars have suggested that the

62. Curtis J. Milhaupt, The Market for Innovation in the United States and Japan: Venture Capital and the Comparative Corporate Governance Debate, 91 Nw. U. L. Rev. 865, 880–90 (1997).

63. Hideki Kanda, Understanding Recent Trends Regarding the Liability of Managers and Directors in Japanese Corporate Law, J. Japanese L., vol. 9, No. 17, 2004, at 29, 32–33, available at http://www.law.usyd.edu.au/anjel/documents/ZJapanR/ZJapanR_17_07_Kanda.pdf (on file with the *Columbia Law Review*).

64. See Curtis J. Milhaupt, Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance, 149 U. Pa. L. Rev. 2083, 2117 & n.117 (2001) (stating that 179 firms adopted the executive officer system within two years of Sony's initiative).

monopoly on corporate charters causes the process of corporate law reform in Japan to differ from that in the United States, where competition for charters promotes swift, endogenously induced reform.[65] However, the 2002 reform giving Japanese firms the option of retaining their traditional board structure or switching to a U.S.-style board with independent committees can be understood as an adaptive response to the *inability* to opt out of the unitary regime. Japanese firms cannot reincorporate from one prefecture to another, but they can now obtain some measure of choice by selecting the board structure deemed to best suit the firm's characteristics.[66] To the extent that Japanese firms now have a choice of board structure, Japan has introduced a measure of quasi-jurisdictional charter competition into its corporate law.

The result of the decade's amendments is a much more flexible, deal-friendly corporate law. Merger activity of all kinds has increased significantly in Japan over the past ten years. For example, the number of mergers and acquisitions increased from about 500 per year in the 1990s to 2,211 in 2004.[67] Japanese merger activity was approximately 0.4% of GDP in 1990. By 2002, it was 5.5% of GDP.[68] Economic necessity ultimately drove both the legal changes and the increased merger activity, but these data indicate that Japanese market actors responded predictably and significantly to adjustments in their institutional environment.

B. *Court Action*

More transactions, some of which were promoted by actors such as Livedoor's Horie, who pushed the envelope of accepted market conduct, created new opportunities to pursue legal strategies through the courts. We have already seen an important byproduct of the dramatic increase in derivative litigation in Japan over the past decade—the creation of judicial rulings amplifying the duties of directors. Litigation initiated by bidders frustrated by a target management's defensive measures was not completely unknown in Japan. However, the standard that emerged from the sparse litigation—that a share issuance to a white knight may be set aside as "grossly unfair" if the primary purpose of the issuance is dilu-

---

65. West, Puzzling Divergence, supra note 60, at 589–91.

66. Ronald J. Gilson & Curtis J. Milhaupt, Choice as Regulatory Reform: The Case of Japanese Corporate Governance, 53 Am. J. Comp. L. (forthcoming 2005) (manuscript on file with the *Columbia Law Review*), available at http://ssrn.com/abstract=537843.

67. Kigyō Kachi Kenkyū Kai [Corporate Value Study Group], Kigyō Kachi Hōkoku Sho [Corporate Value Report] 13 (May 2005), available at http://www.meti.go.jp/press/20050527005/3-houkokusho-honntai-set.pdf (on file with the *Columbia Law Review*) [hereinafter Corporate Value Report].

68. Curtis J. Milhaupt & Mark D. West, Institutional Change and M&A in Japan, *in* Global Markets, Domestic Institutions 295, 316 (Curtis J. Milhaupt ed., 2003) [hereinafter Global Markets].

tion of the bidder's stake in the target[69]—did not constitute a particularly complete or instructive body of takeover jurisprudence. With so few deals, the courts had little opportunity, or need, to flesh out the standards governing these transactions.

This situation has begun to change. Sumitomo's bid for UFJ and Livedoor's bid for Nippon Broadcasting have generated important pieces of the emerging body of Japanese takeover jurisprudence. As noted above, Sumitomo Trust sought a temporary restraining order on the basis of its memorandum of understanding with UFJ. The District Court granted the order, but the High Court reversed on the ground that the "bond of trust between Sumitomo Trust and UFJ was already destroyed, and so it is impossible to expect that they will continue to negotiate in good faith towards conclusion of a definitive agreement."[70] The Supreme Court affirmed, on narrower grounds. It held that a temporary restraining order was not appropriate because monetary damages could adequately compensate Sumitomo Trust for any harm it sustained in connection with the loss of the possibility, which the court found to be fairly small, of reaching a final agreement with UFJ.[71] Also noteworthy about this case is what the courts did *not* decide. None of the three opinions generated in the case grappled with the corporate law issue of the duties of UFJ directors in deciding between the MTFG and Sumitomo bids.

In the *Livedoor* litigation, the court was forced to decide a question at the heart of any takeover law: When is it permissible for a target's board to erect a virtually impenetrable barrier to an unsolicited bid? The District Court enjoined Nippon Broadcasting's warrant issuance as "grossly unfair" and the High Court affirmed,[72] enunciating the following rule:

> In principle, where a contest for corporate control has emerged, it constitutes a grossly unfair issuance (Commercial Code arts. 280-39(4), 280-10) to issue warrants, the primary purpose of which is for existing management or a specific shareholder who exercises actual influence over management to maintain control, by diluting the holdings of another shareholder who has made a hostile bid. . . . However, where the hostile bidder (1) simply intends to make a target company or its affiliates repurchase the shares for a premium after the stock price increases (is

69. See Shūwa K.K. v. K.K. Chūjitsuya, 1317 Hanrei Jihō 28, 32 (Tokyo D. Ct., July 25, 1989); see also Shōhō [Commercial Code], Law No. 48 of 1899, art. 280-10, translated in 2 EHS Law Bull. Series JA 140 (2004).

70. Yūefujeii Horudingusu K.K. v. Sumitomo Shintaku Ginkō K.K. (Tokyo High Ct., Aug. 11, 2004), excerpted in 1708 Shōji Hōmu 23, 23 (2004).

71. Sumitomo Shintaku Ginkō K.K. v. Yūefujeii Horudingusu K.K. (Sup. Ct., Aug. 30, 2004), excerpted in 1708 Shōji Hōmu 23, 24 (2004). Sumitomo Trust subsequently filed suit against UFJ, seeking 100 billion yen (approximately $1 billion) in damages for breach of contract. If at First You Don't Succeed . . . : Sumitomo Trust Still Not Done Suing UFJ, Asahi Shimbun, Oct. 29, 2004, available at http://www.asahi.com/english/business/TKY200410290128.html (on file with the *Columbia Law Review*).

72. See Nippon Hōsō K.K. v. Raibudoa K.K., 1173 Hanrei Taimuzu 125 (Tokyo High Ct., Mar. 23, 2005).

> engaged in so-called greenmail), (2) intends to transfer intellectual property, know-how, corporate secrets, key business transactions or customers, which are vital for the management of the company, to the bidder or its affiliates (is engaged in "scorched earth" policies), (3) has acquired shares so that after acquiring control, the bidder can use the target's assets to secure or pay off bidder's debts or those of related companies, or (4) obtains temporary control of management to sell off assets not directly related to the core business, such as real estate or securities, in order to pay a one-time dividend from the proceeds, or to sell off the stock after having driven up the stock price due to the high dividend—in other words, where there is an abusive motive of exploiting the target, then the hostile bidder need not be protected as a shareholder, and because it is clear that the interests of other shareholders will be harmed if the bidder is left to its own devices, issuance of warrants whose primary purpose is to preserve or protect management's control rights may be permitted to the extent the means of resistance are recognized as necessary and appropriate.[73]

Finding insufficient evidence that any of these abusive motives were present in Livedoor's bid, the High Court concluded that Nippon Broadcasting's board had issued the warrants with the primary purpose of preserving management's control. Accordingly, the court enjoined the issuance.

Note the *Unocal*-like qualities of the rule set out by the High Court, with its implicit threat analysis and proportionality requirement. This may not be coincidental. The courts in this case had been briefed on how the issue would be resolved under Delaware law, and the recent takeover contests in Japan generated a large body of academic commentary on how a *Revlon* or *Unocal* rule in Japan would have applied in the cases.[74]

As in the United States, judicial decisions clarifying directors' legal duties reverberate through the political economy, at times provoking countermoves by threatened groups. A close parallel to the famous *Van*

---

73. Id. at 132–33. Note the parallel to the early *Cheff* case in Delaware, in which the court's first attempt to fashion a rule on defensive measures turned on an assessment of motives. See Cheff v. Mathes, 199 A.2d 548, 556 (Del. 1964). In Delaware, the difficulty of discerning good from bad motives led to the development of the *Unocal* test, with its elliptical incorporation of *Cheff*'s inquiry into the threat posed by the bid. See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953–54 (Del. 1985) (citing *Cheff* for proposition that "in the acquisition of its shares a Delaware corporation may deal selectively with its stockholders, provided the directors have not acted out of a sole or primary purpose to entrench themselves in office").

74. See, e.g., Coffee Opinion, supra note 5. The Takeover Guidelines, supra note 9, which contain an elaborate discussion of Delaware standards, were also provided in draft form to the *Livedoor* court. Interview with Satoshi Kusakabe, Dir., Econ. & Indus. Policy Bureau, METI, in N.Y., N.Y. (May 6, 2005). (Mr. Kusakabe was the chief METI official overseeing the preparation of the Takeover Guidelines.)

Gorkom case[75] and its aftermath is apparent in the business community's reaction to the *Daiwa* case, discussed above,[76] imposing draconian personal liability on directors for breach of duty of care for failure to institute internal controls to detect unauthorized trading losses.[77] In the United States, the *Van Gorkom* case was effectively overruled by the Delaware legislature through the enactment of Section 102(b)(7), which allows firms to eliminate personal directorial liability for breach of the duty of care.[78] Similarly, within a year after the *Daiwa* case was decided, Japan amended its Commercial Code to permit firms to cap the personal liability of directors by shareholder vote to a multiple of their annual salary, subject to exceptions for intentional misconduct or gross negligence.[79] Thus, legislatures in both countries quickly mobilized responses to overturn judicial precedent viewed as dangerous to their business communities.

C. *Ministry Takeover Guidelines*

Closely related to the formation of judge-made rules on permissible responses to hostile bids in the *Livedoor* case is the formation of takeover guidelines jointly endorsed by METI and the Ministry of Justice, a process that was undertaken at a feverish pace from August 2004 to May 2005. As cross-shareholding declined precipitously and "in light of concerns about the steady rise of hostile bids," METI established a Corporate Value Study Group composed of legal experts and business representatives to consider an appropriate policy response to hostile takeover activity.[80] The Study Group's work was based on four basic principles: enhancement of corporate value, global standards, no discrimination between foreign and Japanese firms, and expansion of choice.[81] The Study Group's report, issued in March 2005 in the midst of the *Livedoor* controversy, followed

75. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (holding that board of directors acted with gross negligence in approving sale of corporation without adequately informing themselves about the transaction).

76. See supra notes 54–55 and accompanying text.

77. The *Daiwa* case was ultimately settled during the appeals process. Even here, we find legal strategy at work. The plaintiffs—wildly successful at the trial court level—settled for a tiny fraction of the district court's damage award when Daiwa began to reorganize itself as a holding company. This change in organizational structure, according to a contemporaneous judicial decision, extinguishes the right of shareholders to sue derivatively, because they are no longer shareholders of the original corporation, but of the holding company. Aronson, supra note 56, at 42–43 & n.130.

78. Del. Code Ann. tit. 8, § 102(b)(7) (2001).

79. Shōhō [Commercial Code], Law No. 48 of 1899, art. 266(7)–(23), translated in 2 EHS Law Bull. Series JA 121–26 (2004). In capping liability at a multiple of directors' salary upon a shareholder vote, Japan actually adopted an approach similar to that recommended by the American Law Institute rather than that taken by the Delaware legislature. See 2 Am. Law Inst., Principles of Corporate Governance: Analysis and Recommendations § 7.19 (1992).

80. Corporate Value Study Group Report, supra note 7, at 2.

81. Id.

extensive research and consultations with experts regarding Anglo-American takeover defenses and legal precedents.

The report is remarkable for its approval of Delaware takeover jurisprudence.[82] The report begins by noting that no Western country completely lacks defensive measures, because reasonable defensive measures can enhance corporate and shareholder returns.[83] It then provides an exhaustive analysis of Delaware's experience with defensive measures, in particular the poison pill, focusing on the *Unocal* rule and its progeny. *Unocal* authorizes defensive measures in response to a threat to corporate policy and effectiveness, provided the response is proportionate to the threat.[84] The report also suggests incorporation of doctrinal refinements made in the wake of *Unocal*. For example, the report approvingly echoes the *Blasius* requirement that a defensive measure interfering with the shareholder franchise receive strict judicial scrutiny,[85] and emphasizes, as a line of Delaware cases beginning with *Unitrin*[86] has done, that the key inquiry is whether, in spite of the defensive measures, shareholders retain a realistic possibility of unseating the incumbent directors in a proxy contest. Finally, the report discusses incorporation of a *Revlon*-like rule[87] requiring the board to shift from defenders of the corporate bastion to auctioneers seeking the highest price once the board has reached a decision to sell the firm.[88]

The report notes that the establishment of defensive measures in Japan has been hampered by uncertainty over their legal effect, a paucity of precedents and experience, and a lack of consensus on what constitutes

82. My discussions with members of the Study Group suggest that the transplantation of Delaware principles into the Takeover Guidelines was unintentional, in the sense that the Group's objective was not to endorse a particular country's takeover law as appropriate for Japan. Rather, the objective was to identify the best standards by which to distinguish corporate value-enhancing from value-destroying bids. Features of UK and EU takeover law were also carefully considered. However, Delaware takeover doctrine emerged from this process as a superior means of accomplishing that objective in the eyes of most, though not necessarily all, members of the Study Group.

83. Corporate Value Study Group Report, supra note 7, at 9.

84. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

85. Blasius Indus. Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

86. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995).

87. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

88. Corporate Value Study Group Report, supra note 7, at 14–17. Ultimately, the Study Group advised against direct transplantation of the *Revlon* rule in change-of-control situations because of uncertainty, even in the United States, over the situations that trigger *Revlon* duties. Yasushi Hatakeyama, Remarks at the Seminar on New Hostile Takeover Guidelines in Japan (June 13, 2005). On the vagueness of Delaware takeover standards, see infra text accompanying notes 137–138. Nonetheless, a version of the *Revlon* rule is reflected in the Takeover Guidelines, which emphasize directors' fiduciary duty to evaluate competing proposals and to refrain from implementing defensive measures that deprive shareholders of the opportunity to consider competing proposals. See Takeover Guidelines, supra note 9, at 5 n.2.

reasonable defensive measures.[89] It then favorably cites an opinion of the Ministry of Justice that "[i]f adjusted for Japanese circumstances, most defensive measures recognized in the U.S. and Europe can also be implemented in Japan."[90] Specifically, the report concludes that warrants (*shin kabu yoyaku ken*) of the type Nippon Broadcasting tried to issue discriminately to Fuji TV can be used to implement a shareholder rights plan (poison pill). Again drawing heavily on Delaware jurisprudence, the report discusses ways to ensure and enhance the reasonableness of defensive measures, including retaining the ability to replace the board through a proxy contest, participation of independent directors and advisors in the formulation of defensive measures, the use of "chewable pills," and shareholder approval.[91] In short, the report represents a major endorsement of Delaware takeover jurisprudence in the formulation of Japanese policy, down to doctrinal nuances such as disallowance of dead hand pills.[92] Based in part on the Study Group's report, Takeover Guidelines were jointly issued by METI and the Ministry of Justice in May 2005. The Takeover Guidelines are "modeled after typical defensive measures that have been developed elsewhere,"[93] and reflect the influence of Delaware jurisprudence, although they place more emphasis on shareholder approval of defensive measures as a means of ensuring fairness than does Delaware doctrine.[94]

* * *

Note the broad parallels to the United States in the 1980s, and the common logic of the political economy that drove the reform process in both countries. As Ronald Gilson has noted, a "corporate governance system's development is driven, domino-like, by the linking of complementary institutions."[95] In both countries, structural rigidities in the economy, along with inefficient corporate structures, led mature firms to waste free cash flow. Market change caused a rethinking of corporate governance institutions and exposed problems in the corporate law. Ac-

89. Corporate Value Study Group Report, supra note 7, at 18.

90. Id. at 19.

91. Id. at 24–29. A "chewable pill" is automatically cancelled if an unsolicited bid meets criteria specified when the pill is adopted.

92. Id. at 24. The report does recognize the need for certain additional steps to make the U.S. measures fair and effective, such as establishing proper disclosure rules and considering how to involve truly independent third parties in the decision to implement and maintain a defensive measure. The report also notes that existing Japanese law offers more flexibility to shareholders in that staggered boards are not used because directors' terms are limited to one to two years, and there is no restriction on removing directors midterm. Therefore, the report recommends departing from Delaware law by not introducing a staggered board. Id.

93. Takeover Guidelines, supra note 9, at 3.

94. Id. at 6–14.

95. Ronald J. Gilson, Globalizing Corporate Governance: Convergence of Form or Function, 49 Am. J. Comp. L. 329, 335 (2001) [hereinafter Gilson, Globalizing Corporate Governance].

tors responded with legal strategies and informal adaptations, and by exercising choice. Complementarities emerged among these responses. Over time, a new set of corporate governance institutions took shape. In both systems, hostile takeovers helped catalyze these dynamics, in part because they brought new players and new legal technologies into the system. This is not meant to directly equate any features of the two systems, least of all Japan's incipient market for corporate control and the booming U.S. takeover market of the 1980s. It is simply to note how basic economic and legal dynamics driving Japan's corporate reform process over the past decade mirror the U.S. experience of two decades ago, and to highlight the role of hostile takeovers as a uniquely galvanizing force in these processes. This basic model of corporate law and governance change appears to have universal qualities.

IV. Implications: Delaware's Shadow

The analytical narrative has delivered us to the present, rather remarkable moment, when Japan has just incorporated major principles of Delaware takeover jurisprudence along with the poison pill into its own system—albeit indirectly in the form of nonbinding guidelines—as a means of dealing with the emergence of hostile takeovers. In this Part, I provide a preliminary roadmap for understanding the implications of these events. As a guide to this process, I draw on analytical constructs that are now well engrained in the comparative corporate governance literature. As we will see, while the literature is helpful in mapping the possible implications for Japan, the rubrics it emphasizes mask important features of the Japanese developments. Working through the implications for Japan in this way thus also provides an opportunity to offer some comments on the state of the comparative corporate governance literature itself.

As noted in the Introduction, two fascinating literatures in comparative corporate governance have emerged over the past decade that have a direct bearing on the phenomena at issue here. The first asks whether corporate governance structures among the world's major economic systems are converging, particularly on a U.S.-style, shareholder-oriented model. At one end of the debate is a strong-form convergence theory articulated most forcefully by Henry Hansmann and Reinier Kraakman in their provocative essay, *The End of History for Corporate Law.*[96] They argue that ideological convergence on the supremacy of the shareholder-oriented model, which in their view has already occurred, is inducing similar rules of corporate law and practice around the world, including similar approaches to mergers and acquisitions. At the other end of the spectrum are scholars, including most prominently Lucian Bebchuk and Mark Roe, who argue that path dependencies based on efficiencies and

96. Hansmann & Kraakman, supra note 14, at 439.

rent seeking will slow corporate change and block convergence.[97] Despite the theoretical gridlock, the debate has led to the development of a useful rubric for approaching the convergence question. It is now commonplace for scholars to distinguish formal convergence of laws from functional convergence in the operation of corporate practices.[98] The distinction attempts to capture the truism that identical formal rules in different legal systems do not ensure functional equivalence in the operation of those systems.

The second debate, initiated by economists in what is known as the "law and finance literature," seeks to identify the causal antecedents of effective capital markets and high-growth economies. The central explanation in this influential body of literature, supported by numerous empirical studies, is the quality of shareholder protections provided by a country's corporate law. The quality of a country's corporate law seems, in turn, to depend on the historical origin of its legal system. Common law systems appear to provide better investor protections than civil law—particularly French civil law—systems. It is plausible that as a result, the Anglo-American economies have larger capital markets and faster economic growth than economies supported by European civil law.[99] The genius of Delaware law—the best of the best—shines bright in the wake of this literature. Not surprisingly, commentators are beginning to explore ways to adapt features of Delaware law to foreign systems.[100]

With this conceptual background in mind, consider the significance of Japan's recent turn to hostile takeovers and Delaware corporate law.

A. *Delaware and the Future of Japanese Corporate Governance*

1. *Strong-Form Convergence.* — In order to motivate the analysis, recall the immediate consequence of the developments to date: a high degree of tension in the political economy fostered by anxiety over the emergence of new players and tactics perceived as deeply threatening to existing institutions.[101] These tensions make further legal and market

---

97. Bebchuk & Roe, supra note 14, at 129–32.

98. See Gilson, Globalizing Corporate Governance, supra note 95, at 336–37.

99. See, e.g., La Porta, Law and Finance, supra note 13, at 1151–52 (empirically associating "better" corporate law protections for minority shareholders in common law systems with more dispersed shareholding and larger capital markets as compared to civil law systems); La Porta et al., Legal Determinants, supra note 13, at 1132, 1149 (concluding that "civil law, and particularly French civil law, countries, have both the weakest investor protections and the least developed capital markets, especially as compared to common law countries"); Paul G. Mahoney, The Common Law and Economic Growth: Hayek Might Be Right, 30 J. Legal Stud. 503, 505, 515 (2001) (empirically associating common law systems with higher rates of GDP growth than civil law systems from 1960–1992).

100. For example, commentators have suggested that Delaware might set up a court in leading European and Asian cities. See Jens Dammann & Henry Hansmann, Extraterritorial Courts for Corporate Law 4 (Feb. 2004) (unpublished manuscript, on file with the *Columbia Law Review*).

101. See supra Part I.D.

change inevitable. For example, adoption of the Takeover Guidelines will necessitate yet another round of amendments to the corporate and securities laws, at the very least to ensure that disclosure of takeover defenses is adequate, tender offer rules are functional, and that there are no mechanical inconsistencies between the existing corporate law structures and the implementation of defensive mechanisms contemplated by the Takeover Guidelines. Indeed, the Corporate Value Study Group Report itself anticipates this necessity.[102] The Tokyo Stock Exchange has announced that it will alter its listing requirements, and a major pension fund association has already changed its proxy voting guidelines, in both cases to incorporate the principles of the Guidelines.[103] Thus, the Takeover Guidelines, though technically nonbinding, are poised to have an immediate effect on Japan's institutional environment for corporate governance. The question is how actors will respond to all of these new developments.

Proliferation of the Takeover Guidelines has already had two immediate consequences, both with parallels in the U.S. experience. The first is a wave of adoptions of (or at least keen interest in) the poison pill in the Japanese market,[104] as firms avail themselves of a powerful defensive measure that has been "officially" sanctioned by two prominent ministries. The second is pressure for legislative protection against hostile takeovers, fomented by managers and politicians dissatisfied with the adequacy of the defensive measures contemplated by the Takeover Guidelines.[105] Indeed, a corporate governance committee of Japan's ruling

102. See Corporate Value Study Group Report, supra note 7, at 6.

103. Id. at 16, Supplemental Explanation 1. The Pension Fund Association has announced four basic standards regarding the introduction of shareholder rights plans: (1) management must adequately explain how they improve shareholder value; (2) shareholder approval; (3) independent directors, in reliance on transparent principles, must make decisions on employing, maintaining, or redeeming a plan in the face of an offer; and (4) rights plans must be limited in duration and subject to reauthorization by shareholders. Kōsei Nenkin Kikin Rengō Kai [Pension Fund Association], Kigyō Baishū Bōeisaku ni Kansuru Kabunushi Giketsuken Kōshi no Handan Kijun [Standards for Exercising Shareholder Voting Rights Related to Corporate Takeovers] 1 (2005) (on file with the *Columbia Law Review*).

104. See Andrew Morse, Poison Pills Emerge in Japan, Wall St. J., Apr. 11, 2005, at C18 (reporting growing interest in poison pill). By early June 2005, nine Japanese firms had adopted some version of a shareholder rights plan in the immediate wake of the Livedoor contest and promulgation of the Takeover Guidelines. Goldman Sachs, Japan Strategy Flash, May 27, 2005, at 4–5 (on file with the *Columbia Law Review*). During the June 2005 annual shareholders meeting season, eight firms sought approval for some form of a shareholder rights plan. Of these, six were structured in ways most closely resembling U.S.-style poison pills. See Hiroshi Mitoma & Yuko Tamai, Rokugatsu Sōkai Kaisha ni okeru Kigyō Baishū Bōeisaku no Dōnyū to Sono Arikata [Defensive Measures Introduced at June Shareholders' Meetings and Their Characteristics], 1737 Shōji Hōmu 30, 31 & tbl.1 (2005). Many more companies are actively considering introduction of such plans.

105. Rent-seeking responses to the exogenous shock of hostile takeovers are highly predictable. See generally Mancur Olson, The Logic of Collective Action (1971) (providing classic account of interest group behavior).

Liberal Democratic Party is studying the moratorium and "other constituency statutes" enacted in the United States at the behest of managers in the 1980s as possible models for Japan.[106]

The convergence literature is useful in understanding the possible implications of these developments for Japanese corporate governance. First, consider the possibility of strong-form convergence. If Japan follows Delaware, its reform trajectory is clear. The number of independent directors serving on boards should increase, and independent directors may come to play a more pivotal role in structuring and negotiating acquisitions, as this will enhance the probability that a court, deciding ex post, will find the installation or retention of a poison pill to be a fair and proportionate response to an unsolicited bid. In related fashion, there could be a spike in adoptions of the U.S.-style board committee system, which provides a structure suited to action by independent committees, which have played a large role in Delaware takeover jurisprudence. Thus, one possible consequence of the rise of hostile takeovers is that independent directors will take on a much higher profile in Japanese corporate governance, particularly as arbiters of newly competing constituencies (shareholders, managers, and employees) in a world of contests for control.[107]

106. Attention among Japanese political and business leaders has focused on Delaware's so-called moratorium statute, section 203. See Del. Code Ann. tit. 8, § 203 (2001 & Supp. 2004) (imposing restrictions on certain business combinations following acquisition of large block of stock). "Other constituency statutes" expanding the scope of managerial discretion in the face of a takeover bid are also receiving attention. See, e.g., 15 Pa. Cons. Stat. Ann. § 1715 (West 1995) (allowing board of directors to consider effects of any action on all groups affected by such action, and not requiring consideration of any group's interests to be controlling). Thus far, however, passage of such statutes is not at the forefront of the Liberal Democratic Party's policy agenda relating to takeovers. See Jiyū Minshutō Sōgo Keizai Chōsakai [Liberal Democratic Party General Economic Investigation Committee], Kigyō Tōji ni Kansuru Iinkai [Committee on Corporate Governance], Kōsei na M&A Rūru ni Kansuru Teigen [Proposal on Fair M&A Rules], 1738 Shōji Hōmu 42 (2005) [hereinafter LDP Proposal] (listing priorities for legal reform related to M&A, but omitting mention of moratorium statute or other protective measures).

107. Exactly what constitutes independence in the Japanese context is now the subject of substantial debate. The corporate law does not require the presence of independent directors on corporate boards, and there is no formal definition of independence in any regulation or judicial ruling. Rather, the corporate law refers to "outside" (*shagai*) directors, the definition of which is broad enough to include directors from a parent company or sibling subsidiary. Shōhō [Commercial Code], Law No. 48 of 1899, art. 188, translated in 2 EHS Law Bull. Series JA 49–50 (2004). The Takeover Guidelines finessed this issue by referring to the useful role that "independent outside directors" (*dokuritsu shagai torishimariyaku*) can play in enhancing the reasonableness of a defensive measure. See Takeover Guidelines, supra note 9, at 17. In the wake of the Guidelines, there is a movement to define independence. See Maboshii Hanrei Shishin Kyūzo [Rushing to Create Guidelines [Due to] Sparse Precedent], Asahi Shimbun, June 10, 2005, at 1. The Japan Association of Corporate Directors has proposed that independent directors be mandatory for all listed companies. Independent Directors Needed to Avoid Poison Pill

These adaptive responses by corporate management would likely trigger strategic countermoves by other market actors. The widespread existence of poison pills could invite increased use of the proxy fight, heretofore little used in Japan, as a means of unseating incumbent management and thereby removing defensive measures. Proxy fights are potentially a more potent weapon against the pill in Japan than in the United States because staggering the board is not feasible under Japanese corporate law, and directors can be removed without cause.[108] Thus, it is possible to replace a majority of the board in a single election, and thereby redeem a pill standing in the way of an acquisition. Perhaps most importantly, recent Japanese experience suggests that the incidence of corporate litigation may increase significantly as market actors test the validity of defensive measures. Indeed, Japan's first poison pill was immediately tested in the courts by a foreign institutional shareholder.[109] The generation of corporate law doctrine would accelerate as courts are confronted with a myriad of new questions resulting from steady market innovations at the margins of existing legal rules.[110] This would mark a

---

Abuse: Biz Group, Nikkei Net Interactive, June 18, 2005 (on file with the *Columbia Law Review*).

108. Cf. Lucian Ayre Bebchuk et al., The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy, 54 Stan. L. Rev. 887, 925–33 (2002) (demonstrating potency of poison pill in combination with staggered board). Under present conditions, however, it may be unrealistic to place much confidence in the proxy process as a check on defensive measures. Many observers believe that the Japanese proxy process is plagued by practical problems such as short deadlines, untimely distribution of documents among custodian layers, and a concentration of annual shareholders meetings on a single date. See, e.g., Am. Chamber of Commerce in Japan, Comments on the *Ronten Kokai* of the Corporate Value Study Group 5 (May 2005).

109. It flunked the test. David Ibison, Court Prohibits Nireco 'Poison Pill,' Fin. Times, June 3, 2005, at 20. Significantly, the court expressly drew on the just-issued Takeover Guidelines in striking down the pill. A problematic feature of the pill was that rights were issued only to shareholders of record as of a certain date. Shareholders who obtained shares after the record date would thus suffer dilution of their shares upon exercise of the rights, even if they were not the hostile acquirer. The court ruled that the rights plan imposed a threat of serious harm even to current shareholders, whose shares might decline precipitously in value due to this feature. Shin Kabu Yoyaku Ken Hakkō Sashidome Karishōbun Meirei Moshitate Jiken [Provisional Order Enjoining Issuance of Warrants], 1734 Shōji Hōmu 37, 45 (Tokyo D. Ct., June 1, 2005). In a portion of the opinion that may prove highly influential, the court also ruled that rights plans should in principle be approved by shareholders, and that where such approval is impractical, the board must create a mechanism to ensure that the plan reflects the will of the shareholders. Id. at 43. The court found the mechanism employed by Nireco—guidelines delegating questions regarding deployment and redemption of the pill to a special committee of independent directors whose decisions would be "fully respected" by the board—to be too vague and uncertain to adequately ensure that the will of shareholders would be protected. Id. at 44. In so ruling, the court appeared to impose more stringent requirements for introduction of a rights plan than those contemplated by the Guidelines.

110. As the Delaware Chancery Court put it, "Since the 1980s, [corporate takeover law], largely judge made, has been racing to keep abreast of the ever-evolving and novel tactical and strategic developments so characteristic of this important area of economic endeavor . . . ." Carmody v. Toll Bros., 723 A.2d 1180, 1185 (Del. Ch. 1998).

major departure from the past, in which a dearth of novel transactions stifled any significant role for ex post judicial review of fundamental corporate issues.

In this scenario, the Japanese legal system, featuring a new degree of mutability and susceptibility to shareholder monitoring, becomes supercharged by changes in the surrounding capital markets and distribution of shareholders.[111] Substantive change is brought about by dynamics external to formal corporate governance institutions, as actors such as Livedoor's Horie promote the erosion of corporate norms that stigmatize redeployment of corporate assets to higher value uses as signaling failure or social disharmony. Ultimately, the ensuing transformations force senior managers to abandon their attachment to existing institutions. As recounted by Ronald Gilson, this is essentially the story of the United States in the 1980s. Similar developments outside the formal corporate governance framework created forces for change so powerful that those favoring existing institutions, particularly senior management, could not contain them. The result was a dramatic transformation in American corporate governance from a system that served largely to protect value-destroying decisions by insular groups of senior executives to a model whose attributes "animated international reform proposals."[112]

To date, developments in Japan provide powerful—even astonishing—evidence in support of the strong convergence theory. One way to interpret these developments is that intellectual convergence on the shareholder-oriented model, propelled by novel transactions driven by overriding concern for financial returns, is gradually breaking down resistance to change, and inexorably drawing Japan's corporate governance institutions closer to those of the United States. Indeed, the Japanese situation appears to be playing out in much the way that Professors Hansmann and Kraakman have suggested: "As shareholding patterns become more homogeneous (as we expect they will), and as corporate cultures everywhere become more accommodating of takeovers (as it seems destined to), takeovers presumably will become much more common in Europe, Japan and elsewhere."[113] As this Essay has shown, thus far, Delaware's experience has proven highly salient to Japan. If the pattern holds, Japan is on the threshold of convergence with Delaware corporate rules and practices.

2. *Cryonic Suspension.* — But the convergence literature also suggests a cautionary note to this conclusion: Formal convergence does not imply functional convergence. Continued movement into the strong convergence scenario of the kind I have just outlined rests on two related as-

111. Cf. Ronald J. Gilson, Catalyzing Corporate Governance: The Evolution of the U.S. System in the 1980s, at 8–16 (Aug. 5, 2005) (unpublished manuscript, on file with the *Columbia Law Review*) (tracing similar changes in surrounding capital markets and shareholder distribution during 1980s in the United States).

112. Id. at 7.

113. Hansmann & Kraakman, supra note 14, at 457–58.

sumptions: First, that Japanese gravitation toward hostile takeovers and Delaware takeover standards actually reflects ideological convergence on the shareholder-primacy principle, at least by groups powerful enough to break down adherence to existing institutions by incumbents. Second, that Japanese adoption of Delaware takeover jurisprudence, whatever its motivations, will result in convergence on Delaware takeover *practice.* Upon closer inspection, neither assumption may be valid.

Consider why Japan transplanted Delaware takeover jurisprudence. The first step in the process, at least implicitly, was rejection of an "indigenous" response to hostile takeovers in favor of "global" standards. An indigenous response could have provided robust protections to non-shareholder constituencies, particularly employees, who have been a primary focus of Japanese management in the postwar period. A powerful precedent for such an approach exists in the German Takeover Code, which permits adoption of any defenses, essentially without limitation, as long as they are approved by a majority of the supervisory board (*Aufsichtsrat*), half of whose members represent labor.[114] The Corporate Value Study Group's implicit rejection of the German approach is even more salient given that Japanese corporate law was originally modeled after the German Commercial Code—Japan's corporate law is classified as being of German civil law origin in the law and finance literature—and the two countries shared considerable institutional and social affinities in the postwar period.

As with most foreign legal transplants, the decision to adopt a "global" standard rather than to formulate an indigenous response is fairly easy to justify on practical grounds.[115] Time was of the essence, at least if one credits the argument that market developments left Japanese firms unduly vulnerable to unsolicited takeovers, particularly via potentially coercive bids. Moreover, given the legal uncertainty about the validity of defenses and the lack of experience with such measures, the transaction-cost environment for the adoption of defensive measures was very high. As the Corporate Value Study Group repeatedly emphasized, these

114. The German Takeover Code offers substantially more protection to target management than is available under Delaware law. The supervisory board can sell off pieces of the firm to prevent its acquisition (no *Revlon* rule) and there is no requirement that defensive steps approved by the supervisory board be reasonable in relation to the threat posed by an offer (no *Unocal* rule). Christian Kirchner & Richard W. Painter, Takeover Defenses Under Delaware Law, the Proposed Thirteenth EU Directive and the New German Takeover Law, 50 Am. J. Comp. L. 451, 468 (2002); see also Gordon, supra note 39, at 556.

115. This is not to discount the desire to adopt a transparent rule that would put all players on equal footing. Interviews with participants in the METI process suggest a genuine concern that to do otherwise would put Japan out of step with global markets and create a unique set of rules that would not be understandable to outsiders, ultimately harming Japanese firms, shareholders, and other constituencies. Telephone Interview with Yasushi Hatakeyama, Managing Director, Lazard Freres (Apr. 10, 2005) (on file with the *Columbia Law Review*). (Mr. Hatakeyama was an outside advisor to the Corporate Value Study Group.)

factors prevented the formation of market consensus on what constitutes fair and enforceable measures. In such an environment, adoption of a respected, market-tested foreign code or practice may have been viewed as the only viable response. Notably, the process followed in this episode—forming a committee of experts under the auspices of an influential ministry to study foreign systems and recommend a solution to a Japanese policy problem—has a long history in Japan.

But why Delaware? The law and finance literature might suggest that the choice reflects the acknowledged superiority of Delaware law in protecting shareholders. But another Anglo-American-based "global" standard was available in the form of the British City Code on Takeovers and Mergers.[116] The City Code has served as the model for the takeover codes of several other countries, including some in Asia.[117] The City Code represents a very different approach to takeovers than Delaware law, mandating "strict neutrality" of target boards in the face of a takeover bid, and prohibiting directors from installing defensive measures without shareholder approval.[118] In return for board neutrality, takeover bids are regulated, principally through a mandatory offer rule, to prevent unfair or coercive tactics.[119] A Takeover Panel composed of experts engages in a variety of interpretive and disciplinary activities designed to enhance compliance with the Code. Arguably, the City Code represents a more attractive candidate for transplant into Japan than Delaware takeover law. Its relatively straightforward rules are much simpler to replicate and enforce than a complex body of foreign judicial doctrine. And the quasi-administrative role of the Takeover Panel is more consistent with traditional Japanese approaches to economic regulation than Delaware's court-centric approach. Moreover, one facet of existing Japanese tender offer procedures is borrowed from the City Code.[120]

---

116. Panel on Takeovers and Mergers, The City Code on Takeovers and Mergers (2005), available at http://www.thetakeoverpanel.org.uk/code/code.pdf (on file with the *Columbia Law Review*) [hereinafter City Code].

117. Malaysia and Singapore have takeover laws based on the City Code. Mark Gillen & Pittman Potter, The Convergence of Securities Laws and Implications for Developing Securities Markets, 24 N.C. J. Int'l L. & Com. Reg. 83, 91 (1998). Note that the legal systems of both these countries have strong affinities with the U.K. legal system.

118. City Code, supra note 116, at gen. princ. 7 (prohibiting target company's board, after receiving offer, from taking any action "in relation to the affairs of the company, without the approval of the shareholders in general meeting, which could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits").

119. Id. at rule 9.1 (requiring that shareholder crossing 30% voting rights threshold extend offers to all outstanding classes of shares).

120. Japan's Securities Exchange Act requires that an off-exchange offer, the acceptance of which would result in the acquisition of more than 33.3% of the target's shares, be made through a tender offer open to all shareholders. Shōken Torihiki Hō [Securities Exchange Act], Law No. 25 of 1948, art. 27-2(1)[4], translated in Securities and Exchange Law, Cabinet Order and Selected Ordinances: As in Effect April 1, 2001 (Capital Mkts. Research Inst. 2001). In contrast to the mandatory bid rule of the City

Without discounting the role that the comparative intellectual appeal of Delaware law played in the decision to embrace Delaware jurisprudence over the City Code,[121] several other factors appear to have influenced the choice. As with any transplant, familiarity with the foreign law among the experts responsible for interpreting and enforcing it appears to have played a role in the adoption of the Takeover Guidelines.[122] Delaware corporate law is familiar to many Japanese lawyers, economic bureaucrats, and judges, many of whom have studied in U.S. law schools. More specifically, at least one-third of the Corporate Value Study Group's members have extensive exposure to Delaware corporate law.[123] The City Code is far less familiar to the Japanese legal community. At the same time, implementing a mandatory bid rule was perceived as disadvantageous because it would prevent potentially efficient partial bids, and would require major changes to the tender offer provisions of the securities law, which may have been politically problematic.[124] Perhaps most importantly for the ministries endorsing the Takeover Guidelines and the political constituencies to which they respond, Delaware takeover jurisprudence is more protective of management than the City Code. Adoption of the City Code, therefore, would have run counter to the strong tradition of concern for nonshareholder constituencies in Japan, and exacerbated fears of a wave of foreign takeovers of Japanese firms. The Corporate Value Study Group expressly cited alleviation of this fear as a reason for formulating the Guidelines.[125] The failure of the European Union's Thirteenth Company Law Directive on Takeovers (which was closely based on the City Code) is an indication of the controversial na-

---

Code, however, the offer does not have to be for all outstanding shares. Nonetheless, the City Code was the model for this provision. See Milhaupt & West, supra note 68, at 306.

121. On the intellectual appeal of Delaware law, see infra text accompanying notes 147–149. Several members of the Corporate Value Study Group indicated that the flexibility of Delaware takeover law, which allows courts to distinguish between value-enhancing and value-destroying bids, was preferred over the comparatively more rigid City Code rules.

122. See David Berkowitz et al., The Transplant Effect, 51 Am. J. Comp. L. 163, 189 (2003) (finding that legal transplants are more likely to be successful where "the population is already familiar with the basic principles of [the] laws").

123. Seven of the twenty-one members are either corporate lawyers or corporate law scholars.

124. The Securities Exchange Act is the province of the Financial Services Agency, not METI or the Ministry of Justice. Policy coordination among the three organizations can be difficult. The Liberal Democratic Party has proposed studying the enactment of a mandatory bid rule in Japan. See LDP Proposal, supra note 106, at 44. Note the potential hazards of this type of piecemeal reform: The mandatory bid rule is designed to complement the board neutrality principle, not a powerful defensive measure like the poison pill (and indeed the poison pill is not used in the United Kingdom). Japan's Takeover Guidelines clearly reject the board neutrality principle and endorse the poison pill. Adding a mandatory bid rule in addition to the defenses already contemplated by the Takeover Guidelines would thus create a far stronger defensive environment than exists either in the United Kingdom or the United States.

125. See Corporate Value Report, supra note 67, at 15.

ture of a decidedly shareholder-oriented approach to hostile bids,[126] and may have at least subconsciously sounded a cautionary note for Japanese policy planners. Thus, Delaware takeover law provided the METI and Ministry of Justice planners with the best of all possible worlds: a familiar and politically attainable "global" standard that is simultaneously somewhat protective of management.[127]

Adoption of Delaware standards and validation of the poison pill in the Takeover Guidelines also has fascinating parallels to the interest-group explanation for the development of Delaware law provided by Macey and Miller.[128] The enormous potential business opportunity presented by METI's undertaking was not lost on the lawyers and financial advisors (both Japanese and American) directly involved in the process of formulating and promoting the Takeover Guidelines. Selection of the City Code approach would have sharply limited the role of U.S. advisors in Japanese contests for corporate control and elevated the position of U.K. firms in what promises to be a large new market for legal services in Japan. Japan's transplantation of Delaware takeover jurisprudence, by contrast, is a potential bonanza for U.S. firms. Literally overnight, a new market of more than three thousand public companies has been created for the poison pill, a sophisticated piece of legal technology developed and market tested in the United States. While the U.S. version of the poison pill cannot be adopted as is under Japanese corporate law, the accumulated experience of U.S. law firms with hostile takeovers and defensive measures will be highly attractive to Japanese corporations now that Japan's institutional environment for takeovers has taken on a distinctly U.S. cast. For elite Japanese corporate lawyers as well, most of whom received graduate legal education in the United States and are members of the New York or California bars, the transplantation of Delaware takeover law, particularly the need to adapt the poison pill to the domestic legal regime, presents a substantial new business opportunity.[129] In fact, major Japanese law firms quickly began marketing their own signature poison pills, utilizing different structures designed to overcome technical hurdles presented by Japanese corporate law.

---

126. See Gordon, supra note 39 (using Germany as example of hostility towards European Union's Thirteenth Directive); Kirchner & Painter, supra note 114 (explaining Thirteenth Directive and potential alternatives).

127. Some involved in the METI process also argue that the Delaware approach is more consistent with Japan's deregulatory movement because an essential corollary to the board neutrality principle under the City Code is the regulation of bids to protect shareholders from unfair or coercive offers. METI supposedly preferred the system of market ordering made possible through the board's gatekeeping function under Delaware law. Interview with Satoshi Kusakabe, supra note 74. This argument, however, overlooks the regulatory aspects of court-centered ex post review of takeover defenses, as well as the elaborate regulation of the tender offer process under the U.S. securities laws.

128. See supra text accompanying note 59.

129. See, e.g., Katsukyō "Dokuyaku Bijinesu" [Rapidly Developing "Poison Business"], Asahi Shimbun, June 8, 2005, at 9 (reporting on marketing efforts by lawyers and financial advisors rushing to fill demand for defensive measures created by Livedoor contest).

The point is not that METI caved in to special interests or that the selection of Delaware law was a disingenuous cover for protectionism. The point is simply that Japan's gravitation toward Delaware takeover law is the product of multiple motivations and, as such, is highly ambiguous with regard to the signal it sends about ideological convergence on the shareholder primacy norm.[130] In that sense, the takeover developments are similar to several other corporate reforms in Japan over the past decade, which outwardly enhance the ability of shareholders to monitor management, but may actually increase agency slack in the absence of complementary reforms such as the emergence of truly independent directors and robust judicial review.[131]

From this perspective, particularly one informed by path-dependency-based skepticism about convergence, it is possible to envision a very different set of implications for Japan. Current developments may not trigger adaptive and strategic responses that supercharge Japan's corporate governance institutions. To the contrary, the Takeover Guidelines may simply increase managerial entrenchment. By validating adoption of the poison pill, the Takeover Guidelines may simply lock insular boards in place and provide a perfect substitute for the disappearing institution of cross-shareholding.[132] As scholars have pointed out, to the extent that the poison pill has worked in the United States as a negotiating tool for the benefit of shareholders rather than simply as a means of blocking bids that threaten incumbent managers, it has worked because of the surrounding infrastructure of independent directors, judges capable of discerning proper from improper motivations for adoption of a pill, and capital market pressure.[133] If much of this infrastructure is missing in

130. Some commentators do not read Delaware law as unambiguously supporting the shareholder primacy norm even in the United States. See, e.g., Stephen M. Bainbridge, Director Primacy in Corporate Takeovers: Preliminary Reflections, 55 Stan. L. Rev. 791, 798–813 (2002) (arguing that director primacy explains Delaware takeover jurisprudence better than does shareholder primacy).

131. Curtis J. Milhaupt, A Lost Decade for Japanese Corporate Governance Reform?: What's Changed, What Hasn't, and Why, *in* Institutional Change in Japan (Magnus Blomström & Sumner La Croix eds., forthcoming 2006).

132. This outcome is the early prediction of some analysts. See Morse, supra note 104 (reporting concerns that Japanese managers, "infatuated with the notion of protecting themselves even before they have learned how to address the needs of shareholders," may use poison pills to hurt long-term value of Japanese firms). Many foreigu market players in Japan share this pessimistic view of the Takeover Guidelines. However, for a sanguine view by prominent analysts, see Naoki Kamiyama & Robert A. Feldman, No Need for Pessimism on Poison Pills, Morgan Stanley Strategy and Economics, June 21, 2005, at 2 (on file with the *Columbia Law Review*) (concluding that Takeover Guidelines have usefully absorbed Delaware doctrine, institutional investors will not agree to excessive defensive measures, and courts will favor shareholders).

133. E.g., Ronald J. Gilson, The Poison Pill in Japan: The Missing Infrastructure, 2004 Colum. Bus. L. Rev. 21, 33–40 (2004). Of course, this puts to one side the more fundamental questions of whether the courts are the proper arbiters of contests for corporate control and, even if so, whether existing Delaware takeover doctrine maximizes shareholder value. These questions are longstanding and contentious issues in the United

Japan—and it is certainly possible to identify important gaps in the infrastructure as of this writing[134]—the pill may freeze market actors in their tracks. Indeed, Jeff Gordon has suggested that this may be the consequence of Germany's Takeover Code.[135] In this path-dependency scenario, adoption of Delaware takeover law *reinforces* rather than transforms the existing institutional set up.

3. *Selective Adaptation and the Struggle to Interpret "Delaware" Law.* — Yet in all likelihood, neither the strong convergence nor the cryonic suspension effects of the pill outlined in the scenarios above will come to pass in precisely this fashion. This follows from a basic truth: We simply do not know how Delaware takeover jurisprudence and the poison pill will operate in Japan. Legal transplants are always tenuous experiments, and this particular transplant may be especially unpredictable. Japan has borrowed, not a single legal rule or procedural mechanism, but a complex body of common law principles and a sophisticated legal technology in the form of the shareholder rights plan, which evolved through an iterative process of strategic and adaptive responses over two decades in tandem with market developments.[136] The Takeover Guidelines, by contrast, are the result of a rapid, top-down process of law reform. The consequences of this experiment grow even harder to discern considering that Delaware takeover jurisprudence, consisting of loosely defined, fact-intensive standards, is indeterminate even on home soil.[137] If Delaware

---

States. For a summary of the major positions in this debate, see Kahan & Rock, supra note 10. If Delaware doctrine is itself suboptimal, even perfect replication of the Delaware doctrine in Japan would not constitute the optimal response to this policy issue.

134. Five examples stand out: (1) It is not possible under current Japanese law to make a tender offer conditional on redemption or invalidation of a poison pill. Thus, if a bidder fails to unseat an incumbent board in a proxy contest waged parallel to the tender offer (and thus cannot cause the poison pill to be redeemed) but obtains shares in the tender offer sufficient to trigger the poison pill, the bidder will suffer massive dilution of its ownership in the target. The risk of this outcome will significantly deter hostile bids. (2) The viability of the proxy process is undermined by a variety of logistical problems, and it has never been successfully used to unseat incumbent management. (3) Weak disclosure requirements and a tradition of deference to management may reduce the effectiveness of shareholder approval of defensive measures as a robust check on managerial entrenchment. (4) Japan lacks a tradition of (or legal requirements for) a higb degree of directorial independence. (5) Disadvantageous tax treatment of exchange offers makes it problematic to use bidder's securities as merger consideration, severely limiting the types of deals that are feasible. Reforms to the tender offer process to permit conditioning an offer on redemption of the pill are already contemplated. See LDP Proposal, supra note 106, at 43.

135. See Gordon, supra note 39, at 550–51.

136. For an outline of the process (for the benefit of a Japanese audience) from the perspective of a Delaware Chancery Court judge, see William B. Cbandler III, Hostile M&A and the Poison Pill in Japan: A Judicial Perspective, 2004 Colum. Bus. L. Rev. 45 (2004).

137. See, e.g., Ehud Kamar, A Regulatory Competition Theory of Indeterminacy in Corporate Law, 98 Colum. L. Rev. 1908, 1915–18 (1998) (arguing that *Unocal* test and related takeover doctrines are indeterminate because Delaware courts rely heavily on flexible standards and avoid devices that could render application of standards more predictable).

law in the hands of the *Delaware* judiciary represents one of "the more extreme forms of unpredictable ex post decisionmaking,"[138] application of those same open-textured standards by *Japanese* judges, operating with different professional training in a different social and economic climate, is likely to be all the more unpredictable.[139] At a minimum, Japanese judges can be expected to demonstrate heightened concern for takeovers that pose a threat to stable employment, given the relatively illiquid labor market and tradition of judicial activism to protect workers against discharge. Delaware law may look quite different in Tokyo than in Wilmington.

Evidence of this is already apparent in the Tokyo High Court's *Livedoor* opinion. The opinion plainly resonates with *Unocal*'s determination that a threat to the firm can justify a proportionate defensive response by management. Similarly, as in *Unocal*, despite concerns about conflicts of interest in change-of-control situations, the court implicitly positions the board as the appropriate organ to initially evaluate the threat to corporate value posed by a hostile bid, and suggests that there must be broad latitude to consider the issue from "mid- and long-term perspectives relating to developments in the economy, society, culture, and technology, etc.," subject ultimately to the "business judgment and evaluation of shareholders and the stock market."[140] Yet the court goes far beyond what is necessary to decide the case in enumerating situations that would justify management's (virtually preclusive) massively dilutive issuance of warrants to a friendly shareholder in the face of a hostile bid. The court indicates that an abusive motive justifying such a response would include a bidder's intent to pledge assets of the target as collateral for debts of the acquirer or to sell target assets to pay down those debts.[141] Note that, taken literally, this dictum would effectively preclude leveraged buyouts; although it is unclear whether the court intended to fashion such a sweeping rule.[142] In short, the High Court's decision could be the foundation for development of a *Unocal* rule with Japanese

138. Hansmann & Kraakman, supra note 14, at 459.

139. Even U.S. lawyers disagree over how Delaware takeover standards would apply to actual Japanese transactions. Compare Stephen Givens, Derawea-shū Saikōsai de Attara, Konkai UFJ Hōrudingusugawa ga Totta Gappei Tōgō Bōshisaku in Taishite, Dono Yō na Shihō Handan wo Kudashita de arō ka? [What Judicial Decision Would Have Been Handed Down if the Defensive Measures Adopted by UFJ Holdings Were Before the Delaware Supreme Court?], 32 Kokusai Shōji Hōmu 1295, 1315 (2004) (arguing that *Revlon* duties would apply to the UFJ board), with Robert G. DeLaMater, Director Fiduciary Duties in the Context of M&A Transactions: Relevance of U.S. Experience in Japan 8 & n.19 (Mar. 9, 2005) (unpublished manuscript, on file with the *Columbia Law Review*) (arguing *Revlon* duties would not apply).

140. Nippon Hōsō K.K. v. Raibudoa K.K., 1173 Hanrei Taimuzu 125, 132 (Tokyo High Ct., Mar. 23, 2005).

141. Id. at 133.

142. Kenichi Osugi, *Livedoor vs. NBS* Case: Recent Judicial Decisions on a Hostile Takeover Battle in Japan and their Implications 5 & n.11 (May 20, 2005) (unpublished manuscript, on file with the *Columbia Law Review*).

characteristics—preventing egregious entrenchment attempts by incumbent management, but sanctioning airtight defenses to protect a range of corporate interests that appear very broad from a U.S. perspective.

As with any transplant, Japanese actors can be expected to adapt Delaware law principles reflected in the Takeover Guidelines to suit their own interests, and the law is malleable enough to accommodate strategic use by both managers and shareholders. This phenomenon is neither unusual nor necessarily negative, but it is noteworthy. Anecdotal evidence already suggests that, even before the ink is dry on the Report and Takeover Guidelines, the transplanted standards are being given different interpretations, depending on the interests of the interpreter. One commentator, for example, warns that if American concepts such as the *Revlon* rule and the fiduciary out gain currency in Japan, they will enable foreign firms to "intrude" on mergers between Japanese firms.[143] Seeking to expand the market for the poison pill in the immediate wake of the *Livedoor* ruling, some Japanese lawyers promoted the view—certainly not consistent with Delaware law—that preplanned defenses would not have to be subsequently reviewed for reasonableness in the face of an unsolicited offer. U.S. legal and financial advisors—argnably big winners in the evolution of Delaware corporate law[144]—actively promoted the Takeover Guidelines as the optimal way to fill the "void" in Japanese law exposed by the recent hostile bids.[145] In this regard, METI's role in spearheading the formulation of guidelines that led to Japan's embrace of Delaware is also noteworthy. While METI's initiative is consistent with its involvement in other corporate governance reforms in recent years, METI is arguably not the most appropriate agency to formulate a coordinated response to hostile takeovers. It has no formal jurisdiction over the corporate or securities laws, and other governmental actors such as the Financial Supervisory Agency and the Securities Exchange Surveillance Commission (a rough analogue to the SEC) seem more appropriately situated to formulate a governmental response to this policy issue. But METI is close to the corporate sector, which obviously has a direct stake in the approved defenses to hostile bids. By responding rapidly with nonbinding guidelines crafted under its auspices, in contrast to a legislative response over which it may have had little control or lasting role, METI deftly ensured that it would be at the center of future developments in this important area of economic policy. Significantly however, thus far the Japanese courts seem inclined to stake out a central role for themselves as arbiters of contests for control—not unlike the Delaware courts.

143. Hiroshi Mitoma, Gaishi ni yoru Nihon Kigyō no Baishū to Taiyōsaku [Foreign Acquisitions of Japanese Firms and a Policy Response], 1731 Shōji Hōmu 43, 45 & fig.3 (2005).

144. See Macey & Miller, supra note 10, at 514–22.

145. Interview with representatives of Lazard Freres and Sullivan & Cromwell, in N.Y., N.Y. (May 6, 2005).

This struggle for interpretive control over "Delaware" law in Japan does not clearly reflect either the embrace of the shareholder-oriented model predicted by strong convergence theories and the law and finance literature, or the path-dependency-driven blockage of institutional change predicted by convergence skeptics. Rather, it reflects a continuation of the process of corporate law evolution highlighted throughout this Essay—strategic adaptation to new market realities. The end result of this process in Japan cannot be predicted today, but new corporate governance institutions that depart markedly from the postwar institutions are plainly under construction. To cite just two examples, the courts now constitute an important new player in Japanese corporate governance, and concepts such as "corporate value," "independent directors," and "shareholders as ultimate owners of the corporation" loosed in the current debate over defensive measures appear to be taking on a life of their own, altering the way market actors and judges respond to a range of issues outside the takeover context.

B. *Implications of Japan's Experience for the Comparative Corporate Governance Literature*

Scholars have made major advances in understanding both the impact of globalization on corporate governance and the significance of corporate law to variations in economic structures and success around the world. Yet collectively, the convergence and law and finance literatures still offer a rather anemic account of how corporate law evolves and why it matters to economic success. The Japanese experience offers a new perspective on these issues.

1. *Delaware's (Ambiguous) Intellectual Appeal as a Force for Convergence.* — Japan's new Takeover Guidelines, along with recent amendments to the Commercial Code promoting organizational flexibility and freedom of choice in board structures, clearly reflect in part the powerful intellectual appeal of Delaware corporate law around the world today. The major features of Delaware corporate law—its flexible, enabling structure promoting freedom of contract among corporate constituencies, the prevalence of broad standards over detailed rules, and the protection of shareholders by a sophisticated judiciary policing the boundaries of directorial conduct ex post with an eye toward the incentive effects of their decisions on other corporate actors—have become the ideal features of a corporate law regime in the eyes of many commentators.[146]

146. See, e.g., John C. Coffee, Jr., The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control, 111 Yale L.J. 1, 60–64 (2001) (hypothesizing that flexible role of the common law judge plays important part in protecting investors); Luca Enriques, Off the Books but on the Record: Evidence from Italy on the Relevance of Judges to the Quality of Corporate Law, *in* Global Markets, supra note 68, at 257, 262–64, 270–81 (measuring quality of Italian corporate law judging against standards arguably describing features of Delaware judiciary); Katharina Pistor & Chenggang Xu, Fiduciary Duty in Transitional Civil Law Jurisdictions: Lessons from the

The Japanese case suggests, however, that Delaware's intellectual appeal does not reside exclusively in its shareholder primacy, as Hansmann and Kraakman's ideological-convergence hypothesis would suggest, or in its superior shareholder protections, as the law and finance literature would imply. Rather, in addition to the prosaic but significant impact of increasing familiarity with Delaware corporate law around the world,[147] the deeper appeal seems to spring from its elastic quality, which is well suited to interest-group balancing, its deregulatory emphasis on freedom of choice and facilitation of transactions, and the way in which judicial application of broad fiduciary duties deftly regulates potentially problematic conduct by encouraging disclosure and procedural integrity.[148] These features make Delaware corporate law ideally suited for global markets, which thrive on transparency, flexibility, and equality of access and treatment. This is not to deny Delaware law's protection of shareholder interests. But what is most intriguing about Japan's embrace of Delaware takeover jurisprudence and the poison pill is the very real possibility, sketched out above, that Delaware law can be adapted to suit rather different interests than it does in the United States. The very elasticity and visceral emphasis on fairness that make Delaware jurisprudence appealing globally may ensure that it will produce different results in different jurisdictions. Convergence on Delaware law as a global standard may thus support continuing diversity of priorities within the expansive rubric of enhancing corporate value.

Japan's use of Delaware corporate law in shaping its approach to takeovers invites further reflection on the distinction now prevalent in the literature between formal and functional convergence. For all its analytical power, this dichotomy is conceptually somewhat misleading. "Formal convergence" suggests that borrowed rules *replace* local rules. Yet history provides few examples of successful economies voluntarily overwriting vast tracts of their laws with foreign transplants. Rather, foreign-law borrowing tends to be highly piecemeal and selective. Moreover, the dichotomy is false to the extent it implies a lack of interaction between transplanted rules and local practices. The Japanese case suggests that a more informative analytical construct for thinking about the process by which foreign legal knowledge is incorporated into local regimes is *institution telescoping and stacking.* In practice, borrowed rules

Incomplete Law Theory, *in* Global Markets, supra note 68, at 77, 77–78 (arguing that broad fiduciary duties and enabling nature of Delaware law are important to its success).

147. Note the cross-border parallel to the network-effects explanation for the prevalence of Delaware charters in the United States. See Michael Klausner, Corporations, Corporate Law, and Networks of Contracts, 81 Va. L. Rev. 757, 843–47 (1995).

148. See, e.g., Melvin Aron Eisenberg, The Architecture of American Corporate Law: Facilitation and Regulation 19–23 (Mar. 14, 2005) (unpublished manuscript, on file with the *Columbia Law Review*) ("Delaware statutory corporate law is terrific at facilitating corporate transactions and conduct . . . . [T]he Delaware courts . . . have developed an extremely rich body of judge-made law concerning fiduciary duties of directors and officers.").

(and the home-country experience surrounding their formation and interpretation) are telescoped into a convenient or politically palatable package and stacked atop existing institutions in the host country. Only through repeated strategic and adaptive responses by local actors are the new rules and the old institutions eventually welded together into something functionally operative. By that point, the result is inevitably distinct from both the borrowed rule as it operated in the home country and the pre-existing institution in the host country. Telescoping and stacking may be mechanisms of convergence, but that is not the inevitable outcome of the process. The Japanese case indicates not so much a formal or functional *convergence* of Japanese and Delaware corporate law as an unpredictable telescoping and stacking of two decades of Delaware judicial doctrine on top of existing Japanese institutions. The phenomenon is not new—the entire history of foreign law adaptation in Japan (and perhaps foreign borrowing generally) bears these characteristics.[149] But the dichotomous convergence debate (in the literature, systems are either said to be converging on a single model or not), and the formal-versus-functional rubric mask important features of the process of reform in Japan.

2. *Corporate Law as a Focal Point for Institutional Transformation.* — A final point relates to the role of corporate law in successful economies, the subject of much theorizing in the wake of the law and finance literature. The implication widely drawn from this literature is that corporate law "matters"—and matters almost exclusively—for the protections it provides to minority shareholders.[150] Yet given the ambignities we have just seen with regard to Delaware corporate law on this point, the Japanese case, particularly when examined side-by-side with Delaware's own experience in the 1980s, actually suggests a quite different role for corporate law in successful economies.

At key moments in the institutional transformation of the world's two largest economies, the corporate law became the focal point for a highly iterative process of market innovation and strategic legal response.[151] The process involved an array of actors seeking to create or

149. Several commentators on earlier drafts suggested that telescoping and stacking also describe the unpredictable process by which new doctrines and practices are selectively assimilated into religions.

150. See Brian R. Cheffins, Does Law Matter? The Separation of Ownership and Control in the United Kingdom, 30 J. Legal Stud. 459, 462 (2001) ("A series of empirical studies have given the 'law matters' story a powerful boost . . . . The message suggested by these results is that ownership concentration is a consequence of poor legal protection of minority shareholders." (internal citation omitted)). The accuracy of this message is subject to dispute, as Cheffin's own analysis and that of other scholars indicates. See id. at 465. Accurate or not, however, the law and finance literature has occupied a large space in comparative corporate governance scholarship over the past decade, leading to a measure of fixation on corporate law's role in protecting minority investors to the exclusion of other possible roles.

151. On focal points, see Thomas C. Schelling, The Strategy of Conflict 54–58, 111–13 (1980).

adapt to new rules in the pursuit of their respective interests. At pivotal moments in the process, market entrepreneurs such as the hostile bidders at the center of this Essay pushed the envelope of accepted conduct, forcing the legal system to respond anew, triggering yet another round of accommodating reactions. This process was repeated until all major actors internalized a relatively stable new set of expectations about how the world works, and a new system of corporate governance took shape that better fit the new market realities. This process came to rest in the United States, relatively speaking, with the Delaware Supreme Court's approval of the "just say no" defense and the acceptance by all relevant actors of the pill in its current form.[152] In Japan, the process of internalizing a significant new set of judicial rulings, new legal technologies such as rights plans, and nonbinding guidelines supplementing the formal corporate and securities laws has just begun. Yet already, market expectations about what constitutes a reasonable reaction to a hostile bid and the proper role of boards, shareholders, and other actors in erecting defensive measures have been affected. Japan will find its own equilibrium point in this process of shifting expectations as it fits Delaware takeover jurisprudence to the dictates of its own political economy.

Thus, in both systems, corporate law has crucially served to coordinate the expectations of market participants during phases of institutional transition.[153] This role for corporate law has been largely overlooked in the comparative corporate governance literature, which has become fixated on minority shareholder protections.[154] Returning to the discussion of convergence, gravitation toward Delaware corporate law may signal recognition in other countries, at least implicitly, that its main features are well suited to playing this central role in efficient economic adaptation. Serving as a focal point for market and institutional change may in fact be one of the most important ways in which corporate law matters to successful economies.

CONCLUSION

This Essay has analyzed a series of recent contests for corporate control in Japan and the development of a policy response to the emergence of hostile M&A in that country. The analysis has emphasized parallels with the Delaware experience, particularly the uniquely catalyzing effect of hostile M&A on corporate law development. In the Japan of the 2000s as in the United States of the 1980s, corporate law—whatever its significance as a device to protect shareholders—became the focal point for institutional transformation in the economy. In a rather remarkable de-

152. See Kahan & Rock, supra note 10, at 877–87.

153. For a discussion of the role of securities law as a focal point for market transition in developing economies, see Robert B. Ahdieh, Law's Signal: A Cueing Theory of Law in Market Transition, 77 S. Cal. L. Rev. 215 (2004).

154. For brief mention of corporate law as focal point, see Klausner, supra note 147, at 800–01.

velopment, Delaware's takeover experience has become particularly salient to Japan, as influential ministries have recently endorsed the poison pill along with significant principles of Delaware takeover jurisprudence.

The outcome of this experiment in foreign law transplantation is uncertain, because the process is only now approaching a climax. The convergence and law and finance literatures in comparative corporate governance provide powerful analytical frameworks for understanding the Japanese developments and their possible implications for the future. At the same time, however, these literatures may deflect attention from the iterative process of selective borrowing and strategic adaptation—what I have called institution telescoping and stacking—that characterizes foreign law transplantation and corporate reform in Japan, and probably elsewhere. This process, which is heavily colored by interest-group dynamics, may often serve as the mechanism of convergence, but that outcome is not inevitable: Ultimately, the new institutions may bear only passing resemblance to the foreign models on which they are based. Regardless of the precise path of future changes initiated by the rise of hostile takeovers in Japan, this episode bears watching as a remarkable example of the transplantation of foreign institutions, and potentially as a watershed moment in the evolution of corporate law and governance in the world's second largest economy.