LEGAL CONTROLS ON CORPORATE MANAGEMENT IN JAPAN: COMPARISONS WITH COMMON LAW JURISDICTIONS

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We accept this thesis as conforming to the required standard.

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ABSTRACT

Corporate management involves various individuals, groups and organizations involved with corporations. Among them, in theory, the shareholders and directors play the critical roles in managing the corporations. Shareholders have the ultimate power in managing a corporation, and directors actually exercise these powers under the instruction of shareholders. Directors are also conferred with statutory powers to carry on the day-to-day business of their corporations. Between these two main actors within a corporation, conflicts sometimes arise. Thus, there is a need for corporate law whose functions include regulating how these powers ought to be exercised by them.

This thesis attempts to analyze the legal controls regulating shareholders and directors under Japanese corporate law, primarily by focusing on legal rules governing the general meeting, through which shareholders exercise their powers, and the legal duties of directors. Through the examination of such legal controls on the general meeting and directors, it is hoped that the role of corporate law in Japanese corporate society will be brought to light. To elucidate the Japanese legal system regulating corporate management, comparison will be made to relevant areas of the law in common law jurisdictions, in particular that of Canada.

This thesis also tries to shed some light on sociological peculiarities of Japanese society which may have influenced the present legal system affecting corporate management in Japan.
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INTRODUCTION

This thesis will analyze the Japanese corporate management system by looking at Japanese law, in particular the corporate laws of Japan. One of the primary objectives of this thesis will be to analyze how and to what extent the corporate laws of Japan have controlled or affected the behaviour of corporations and individuals involved with corporations in Japan. Some aspects to be looked at in this study include the ways in which the corporate laws have attempted to control the main actors of the corporations, and actual functioning of the laws and judicial responses to questions raised before them regarding corporate behaviour.

To answer the above questions, certain corporate organs will be looked at. When these areas are looked at in detail they should provide a better understanding to the questions posed. The areas to be looked at include: 1) the shareholders' general meeting (SGM), which is one of the two primary corporate organs and theoretically ought to have the ultimate power in managing the corporation; 2) the board of directors (BOD or the board) which is the other primary corporate organ that is conferred with the power to manage the corporation by statute or the SGM; and 3) directors comprising the BOD who, in fact, primarily exercise the powers of the corporation on a day to day basis. Among these subjects, this thesis will place emphasis on the legal rules and the actual functioning of the SGM as well as the legal duties of directors.

Through an examination of relevant legislation, cases, and actual practices of the above described organs a new dimension in the analysis of the legal controls over the Japanese corporate management system should be achieved. For a better understanding of Japanese law, comparisons will be drawn to Canadian and sometimes U.S. laws and practices. Through this comparison, similar and differing
attitudes of legislatures, judges, scholars and corporations themselves towards regulation in these jurisdictions will hopefully be clarified. Finally, based on factual similarities and disparities, I shall attempt to search out the factors which have led to such similarities or disparities in both jurisdictions. These may include cultural, historical, sociological, political or economical factors.

In Chapter I, the historical development of corporations and corporate law in Japan is briefly explained. Although Japanese corporations and corporate law have relatively short histories compared to the common law jurisdictions, it will be of useful to explain this historical background so as to better understand the character of the present Japanese corporation, its management system, and the corporate laws which attempt to regulate and control it. Unlike laws in common law jurisdiction, most laws in Japan, including corporate laws, were not originally created by the Japanese themselves. They were in great part adoptions, in whole or in part, of the laws of the developed nations of the time of their adoption. Furthermore, in the course of their transition, Japanese laws have been greatly influenced by the political and economic power of its Pacific neighbour - the United States. Therefore, the occurrence of conflicts between cultural norms may be viewed as a natural consequence. These differing norms owe their characters to hundreds of years of development in their respective jurisdictions, and in particular, with respect to Japan, to a complete immunity from the influence of foreign laws for centuries. This historical overview of Japanese corporate law will give some clue to the understanding of how, why, and from where the uniqueness of Japanese corporate law principles have emerged.

In Chapter II, how Japanese corporations are being managed in contemporary Japan will be looked at. Emphasis will be placed on characteristics unique to Japanese corporations in the management of business. The close relationships among corporations, the role of financial institutions, and the specifics of the labour
management system, are some of the factors which will be looked at to demonstrate
the peculiarities of Japanese corporate culture. Here, I will also examine some
peculiarly Japanese cultural aspects underlying various practices, and some economic
and political influences from both inside and outside of Japan which have affected
these practices. Of particular note-worthiness will be the recent economic situation
in Japan, along with the accompanying changes to established practices. Some
estimations about future developments will also be attempted.

In Chapter III, the role of the two primary corporate organs, the SGM and the
BOD, which tend to compete between themselves for controlling power in the
corporation, will be analyzed by focusing on the separation of ownership and control.
In Japan, as well as other capitalist countries, the separation of ownership and control
became conspicuous after the post-W.W.II period. Hence, directors have gained
more powers and abuse of these powers have become a more serious concern. The
role of the law in imposing strict duties on directors in the exercise of their powers
may have been derived from the phenomenon of separation of ownership and control
in corporate society.

In addition to these two statutory corporate organs, the role of the other
statutory corporate organ, the auditor, and some customarily recognized groups which
play a significant role in Japanese corporations, will also be briefly explained in this
chapter. The auditor, a statutory required corporate organ, plays a monitoring role
on the BOD. Other individuals or groups are recognized by custom as legitimate
actors within the corporation. These groups, with their specific titles and ranks, are
generally composed of directors. The importance of these groups is that they have
influence over other directors. The existence of these groups along with the auditor
is one of the main differences in corporate structure between Japanese corporations
and those of Canadian and the American corporations. Although, because of the
limited scope of this thesis no detailed analysis of these organ or groups will be
undertaken, some light will be shed on how these organs or groups have affected the two primary corporate organs (the SGM and the BOD) in Japan.

In Chapter IV, the history of the SGM and the BOD under Japanese corporate law will be surveyed to give some background about these two statutory corporate organs. Through several amendments to Japanese law, the jurisdiction of the SGM and the BOD have been greatly altered. These amendments reflected the various social, political and economic situations of the time. This background will explain why these amendments were necessary and why the powers of the SGM and the BOD are now allocated under corporate law in Japan.

In Chapter V, the legal powers of the SGM, the corporate organ which ought to steer a corporation in its general direction and its actual workings and problems, will be examined. The legal role of the SGM under the Japanese law and its Canadian counterpart will be the first issue examined. Next, the actual functioning of the legal principles stipulated regarding the SGM in contemporary Japanese corporate society will be looked at. This chapter will show some startling factors which have hindered the realization of shareholder democracy in Japan. Certain groups of shareholders and directors have abused their role and failed to steer their corporations in the right direction. The Sōkai-ya, who are professional shareholders that extort from their corporations in various ways for their own purposes, is a typical example of one type of these groups. Although such notorious individuals have existed within corporations and interfered with normal corporate management, Japanese corporations have in fact achieved economic success. Questions about the desirability of their elimination will be discussed.

In Chapter VI, some aspects of the legal duties of directors under the Japanese corporate law will be analyzed in detail. Directors’ duties of care and skill and fiduciary obligations are the main duties which will be looked at. In this chapter,
some interesting similarities and disparities in the legal principles of these duties as portrayed under the corporate laws of Japan and Canada will be brought to light, along with some judicial attitudes toward these duties.

Finally, a conclusion, based on the analysis in the preceding chapters, will be presented. Whether the Japanese legal system has affected the actual practices of managing a corporation, and what has been and will be the role of the corporate laws in Japanese business society will be assessed.

It is hoped that this thesis will shed light on the mysterious ways of corporate management in Japan and the role of law in the Japanese business society. Any similarities and dissimilarities of law and its actual working in Japan and Canada or the United States are well grounded in the histories of the jurisdictions. A closer examination of the respective societies and their corresponding cultures would greatly add to an understanding of this and many other areas of the law. But this type of cultural and social analysis is not the main aim of this thesis. Rather, this thesis attempts to analyze the Japanese corporate culture and its underlying social norms by using the inductive method through legal analysis of Japanese corporate management. Hopefully those who look at Japan’s economic accomplishments with awe, will gain some enlightenment about this Japanese enigma.
The laws and the corresponding legal system in any jurisdictions is constantly evolving as the years advance. Through historical developments, these laws have developed into their own present styles. As such, corporate law in Japan has its own unique course of developments. It is the aim of this thesis to pursue how corporate law in Japan has attempted to control and regulate corporations as a whole and groups having interests in them, particularly shareholders and directors. The first step to be undertaken in this study is therefore a brief observance of the history of this area of Japanese law.

The present system of Japanese corporate law, particularly that which is embodied in the Japanese Commercial Code, is a relatively recent phenomenon to Japan. Observing the present corporate system of Japan, especially as laid down by the Japanese Commercial Code, one may be quick to conclude that it is the same as that of Western countries, however, this conclusion which may appear quite sound at first glance is quickly shown to be unreliable on closer inspection, especially an inspection which includes a look at the historical background of the Japanese legal system and its actual workings. This is the intention of this chapter. The areas to be looked at in this brief historical survey will include the history of Japanese commerce and commercial law to the present, the advent of corporate law in Japan and its

**Note:** In this thesis, all Japanese terms are written in italics. Titles of Japanese books, journals and articles are followed by brackets, "[ "]", enclosing their English translations.

1 Shōhō [The Commercial Code, Law No.48, March 9, 1899], amended as Law No.64, June 29, 1990.
development to the present day.

1. Prior to the Meiji Restoration (to 1868)

Japanese law has undergone several stages of historical development. In the eyes of one commentator, Japanese law "early stood under the influence of Chinese law but had gradually developed a body of indigenous laws and institutions, largely customary, prior to her reception of the more developed Occidental rules of law." It is therefore not surprising that commercial law has likewise followed a similar historical path of transition. Although Japanese corporate law in its modern sense did not exist until the first enactment of the Commercial Code of Japan in 1890, commercial law, including customary law which governed merchants and their commercial activities, was in existence in Japan prior to that time.

Japan emerged from feudalism, which took its most stable form in the Edo period, ending its policy of isolation. Japan's isolation policy, which lasted for over two centuries during the Edo Period until the Meiji Restoration, facilitated the developments of a Japanese indigenous legal system which was in most part customary, but simultaneously, hindered any foreign influences over the Japanese legal system. Japanese law took a grand step forward toward modernization with the

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3 For the history of commerce in Japan prior to the modern system (pre-Meiji era), see Toyoda, Takeshi, A History of Pre-Meiji Commerce in Japan (Tokyo, Kokusai Bunka Shinkôkai, 1969).


5 Law No.32, 1890. This law is generally referred to as "the Old Commercial Code," and was abolished in 1899 when the new law was promulgated; infra, see 3. The Enactment of the Old Commercial Code and the New Commercial Code (1890-1899) in this chapter.

6 The Tokugawa Shogunate established "Tokugawa feudalism" during the Edo era (1600-1868); see Norman, E. Herbert, Japan's Emergence as a Modern State (N.Y., Institute of Pacific Relations, 1940), at 11.

7 In 1640, the Tokugawa Shogunate banned all foreign trades except for trade with the Dutch and the Chinese which it strictly controlled. Thereafter, Japan kept its doors closed to foreign countries for over two centuries; Ibid, at 13.
abolition of the old shogunate\textsuperscript{8} social order which was based on feudalism, along with the abolition of its isolation policy\textsuperscript{9} at the time of the "Meiji Restoration"\textsuperscript{10} in 1868.

Commercial law, like other laws of Japan, grew out of pre-modern\textsuperscript{11} indigenous customary laws in Japan. Among these indigenous customary laws, however, commercial law appears to have been one of the least developed laws of Japan. This was primarily due to the "Rule-by-Status"\textsuperscript{12} concept of the pre-modern era (before the Meiji Restoration). This concept was a basic principle of Tokugawa Confucianism (the dominant philosophy influencing Japanese society at the time). According to Tokugawa confucianism, people were clearly distinguished and ranked according to their occupational status. Warriors and farmers comprised the dominant elite of the society at the time, while merchants\textsuperscript{13} were considered to be the occupants of the lowest rank.\textsuperscript{14} Because of this "Rule-by-Status" system merchants and their activities had been almost entirely ignored for a long time,\textsuperscript{15} and thus not surprisingly the development of commercial laws remained stagnant.

\textsuperscript{8} Tanaka, Hideo (ed.), \textit{The Japanese Legal System} (Tokyo, University of Tokyo Press, 1976), at 194.

\textsuperscript{9} The abolition of isolation policy will be discussed shortly; \textit{infra} note 22 and accompanying text.

\textsuperscript{10} In 1867, the Tokugawa Shogunate, which had controlled Japan both politically and militarily for over two hundred years, handed back its powers to the Japanese Emperor. In 1868, the "Meiji" era started. This revolution is called "The Meiji Restoration."; Noda, Yoshiyuki, \textit{Introduction to Japanese Law} (Angelo Trans, Tokyo, University of Tokyo Press, 1976), at 41 to 42.

\textsuperscript{11} Before the Meiji Restoration in 1868.

\textsuperscript{12} The Four statuses and their ranks from the top were: 1. \textit{Shi} (warriors); 2. \textit{Nô} (farmers); 3.\textit{Kô} (artisans); and 4. \textit{Shô} (merchants); Henderson, Dan Fenno, "Law and Political Modernization in Japan" in \textit{Political Development in Modern Japan} (New Jersey, Princeton University Press, 1968), at 392 to 396.

\textsuperscript{13} "The advent of merchants as a definite social class can be traced back no earlier than the Kamakura Period (1185-1333 A.D.)"; Takayanagi, \textit{supra} note 4, at xiii.

\textsuperscript{14} Clark describes "The merchants came last in the scheme of things because they neither governed nor produced wealth, but merely traded what other cultivated or made. Their place in society was the measure of an inferior though necessary role."; Clark, Rodney, \textit{The Japanese Company} (New Haven and London, Yale University Press, 1979), at 25.

\textsuperscript{15} Takayanagi, \textit{supra} note 4, at xi.
But the lights were not completely dimmed on this lowly group and merchants and their commercial activities did develop despite this unfavourable environment in Japan.

The family oriented enterprise had been the dominant form of merchant organization until "corporations" became legally recognized by the law in the late 19th century. As merchants' activities blossomed, they became more powerful and influential economically as well as politically, and these family enterprises formed groups to enjoy a monopoly and its privileges.

The first trade associations in Japanese history, called "Za," were analogous to the European Guilds of the Middle Ages. They came into existence as early as the 12th century, and continued to exist throughout the pre-modern era.\(^6\) "Za" consisted of merchants in the same line of business, and were managed by a council system through self-regulations called "Za-Hō (Rules of Za)."\(^7\) A relevant study shows that in the Tokugawa period (1603-1868), these associations were managed in a manner similar to present day corporations: the members of a "Za" held shares; officers were elected among its members; these officers managed the day to day business of the association; but important matters were decided by a general meeting of the "Za."\(^8\) However, since the "Za" were assemblies of merchants, as such cartel-like organizations, they were not corporation-like organizations in the present sense of corporation. The "Za" was more like a union of the present day.

Another association, called "toiya", which literally means wholesaler, consisted of merchants and carried on multiple businesses. These businesses included dealings

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\(^6\) In the Tokugawa period, these associations were called "kumi", "kumiai", or "nakama"; Takayanagi, supra note 4, at xv.

\(^7\) Shigematsu, Kazuyoshi, *Nihon Hōseishi [Japanese Legal History]* (Tokyo, Keibundō, 1987), at 88 to 90.

\(^8\) Takayanagi, *supra* note 4, at xv.
in land and marine transportation, hotel and warehouse businesses. The "toiya" developed since the 12th century throughout the pre-modern period and was operated in a monopoly type manner. It is particularly important to note that the toiya's marine business had greatly contributed to the development of Japanese maritime laws. Similarly, the advent of financial institutions can be traced back to the 12th century, though corporations in a modern sense did not exist before the Meiji Restoration, nor did corporate laws exist in the pre-modern period. This lack of the concept of the corporation or of corporate law in the modern sense was largely due, not only to the policies based on the feudalism of the pre-modern period, but also to Japan's isolation from all other nations up until the Meiji Restoration.

Japan's abolition of its isolation policy was a significant turning point. It signalled its stepping into a new and modern era and the emancipation of its people, making fertile the land for the successful cultivation of the beginning of modern and future Japanese corporate law. Thus not surprisingly, when the United States demanded that Japan open its doors, Japan suddenly realized that during the

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19 Maritime laws promulgated in the Edo period appear to be some of the few statutory commercial laws in Japan. Among them were Kaisen-Shikimoku [Code of 31 Articles relating to Navigation] and Kairo-Sho-Hatto [Regulations Relating to Sea Routs]; Takayanagi, supra note 4, at xxiv.

20 Takayanagi, supra note 4, at xix.

21 Tanaka, Seiji, Zentei Kaishahō Shōron (Jyōkan) [Study in Detail in Company Law, Vol.1 of 2] (Tokyo, Keisō Shobō, 1979), at 7.

22 American Commodore Perry with his crews of a worship, the Mississippi, arrived and anchored at Uraga in Japan on 8th July, 1853 "to induce the Japanese to resume intercourse with the outside world" with a letter from the American President, Tyler, to the Japanese Emperor. (Murdoch, James, A history of Japan, Vol.III The Tokugawa Epoch (London, Kegan Paul, Trench, Trubner & Co., Ltd., 1926), at 573 to 574) Though this negotiation was not quite successful, it has been widely recognized that it was the first step in getting Japan to reopen its doors to foreign countries. Perry visited Japan again the following year and after long negotiation a treaty was successfully drawn and signed by the representatives of Japan and the U.S.A. on 31st of March, 1854. The treaty included the following: "I. Peace and friendship between the two countries; II. Shimoda and Hakodate open to American ships, and necessary provisions to be supplied; III. Relief to shipwrecked people; IV. Americans to be free as in other countries, but amenable to just laws; V. Americans at Shimoda and Hakodate not to be subject to restrictions; free to go about within definite limits; VI. Careful deliberation in transacting business; VII. Trade in open ports subject to local regulations; VIII. Wood, water, coal, and provisions to be procured through Japanese officers only; IX. Most-favoured Nation clause; X. Most-favoured Nation clause; X."
period of its isolation it had deteriorated relative to the development of other nations. Japan could have rightly been referred to as the land of the "setting sun" for it had become inferior to western nations in many ways including its technology, military and its economy. Japan also realized that it was impossible to keep its doors closed any longer, and as soon as Japan opened its doors, the Japanese government faced serious problems due to the flood of new industrial and technological ideas and materials which swamped Japan. A new capitalist society was about to begin and Japan had no legal mechanism to deal with it. Thus a new but chaotic era commenced. This next section will deal with how order was attempted to be derived out of chaos.

2. The Meiji Restoration to the Enactment of the Old Commercial Code (1868-1890)

After the collapse of the Tokugawa Shogunate, the ultimate and most urgent task for the new government was to build Japan up to an equal footing with its western counterparts. For example, Japan realized how dangerous and humiliating it was not to have a sufficient knowledge of western legal systems. This was quite apparent to the new government and evidenced from the fact that bilateral treaties such as the U.S.-Japan Commercial Treaty signed by the Tokugawa Shogunate at the end of the Tokugawa period, without any western legal study being undertaken, "turned out to be extremely prejudicial to Japan." It was also of critical importance for the new government to establish a new set of laws as quickly as

American ships restricted to Shimoda and Hakodate except when under stress of weather; XI. U.S. consuls or agents permitted to reside at Shimoda; XII. Ratification to be exchanged within eighteen months." (Murdoch, ibid, at 605); see Kinoshita, Yataro, The Past and Present of Japanese Commerce (New York, Ph.D paper in the Faculty of Political Science of Columbia University, 1902), at 89 to 99; Murdoch, ibid, at 569 to 662 Chapter XVI. The Reopening of Japan; Kashima, Morinosuke, Nihon Gaikōshi 1. Bakumatsu Gaikōshi [Japanese Diplomatic History 1. Diplomatic history in the late shogunate era] (Japan, Kashima Heiwa Kenkyūsho, 1970), at 3 to 10.

23 Ibid.

24 Tanaka, Hideo, supra note 8, at 199.
possible which could govern the new capitalist society. The easiest and quickest way for the Japanese government to facilitate this situation was to simply adopt in whole or in part the laws of advanced capitalist nations such as Britain, France, Germany, and the U.S.A. In the early years of this period, French law had a dominant influence on the laws of Japan. As time passed, however, from around 1880, German law took predominance. With German law having prominence, or being the law of the day, the first Commercial Code was enacted in 1890. This marked the commencement of modern day corporate law in the history of Japan. It should be noted however that corporation-like organizations had already began to surface before this first Commercial Code came in force.

After the doors to Japan, due to the constant prying from outsiders for numerous decades, were finally levered open, foreign trade swept over the tiny isle like water which had finally found relief and taken its natural course. At this point, the Japanese government put its mind to the immediate task of forming corporations with sufficient capital and organizational powers to match their western trading partners. Thus, the Japanese government incorporated several semi-governmental companies which included several Tsūshō-Kaisha [Trading Companies], Kawase-

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25 Noda, supra note 10, at 42.

26 It is said that the common law system was not adopted because at the time "the common law system appears too complicated.", and "France was the country with the most sophisticated and complete codification of laws and Code Napoléon, which had a far-reaching impact on European and American nations through the first half of the 19th century."; Tanaka, Hideo, supra note 8, at 200.

27 Noda states that "As I see it from the viewpoint of characterology, Japanese people have an affinity for the German Geist (spirit) which values Gemüt (mind or emotion), rather than the French esprit (spirit), which prizes précision (precision)." (translation mine); Noda, supra note 10, at 204.

28 Supra note 4.


30 8 Trading companies were incorporated in 1869; Tamaki, Hajime, Gendai Nihon Sangyō Hattatsu-shi XXXIX, Sōron Jyō- [History of Industrial Developments in Modern Japan: General Remarks -Vol.1-] (Tokyo, Gendai Nihon Sangyō Hattatsu-shi Kenkyūkai, 1967), at 20.
Kaisha [Trust Companies],\textsuperscript{31} national banks,\textsuperscript{32} railway companies, mine companies and cotton mills. This incorporation process was repeated in a trial and error fashion and, despite some failures, around 1878, Japan experienced the first real corporate boom in its history. The number of national banks peaked to 151 by the end of 1880, while 207 private banks were incorporated by the end of 1883.\textsuperscript{33} However, due largely to the very unstable economic situation and insufficient know-how to manage these corporations, this corporate boom was short lived. The real corporate boom occurred some years later, between 1886 to 1889, when the Japanese Government privatized its major mining and manufacturing companies. With the gradual penetration of knowledge about the corporation into the Japanese psyche it was inevitable that this second corporate boom would be a grand success, as it actually turned out to be.\textsuperscript{34}

At this time corporate law was still in its infancy and these corporations were regulated under ad hoc regulations (specific laws promulgated for licensing of specific corporations).\textsuperscript{35} As such, these laws were rather administrative in nature.\textsuperscript{36} The law concerning bills of exchange and promissory notes\textsuperscript{37} was probably the only true private law enacted at the time and not merely administrative like the others.

\textsuperscript{31} These companies were established at the same time as Trading Companies. See \textit{ibid.}

\textsuperscript{32} Four Notional Banks were founded between 1873 to 1874, but they lasted only about three years. See Tamaki, \textit{supra} nota 30, at 32 to 39.


\textsuperscript{34} Takayanagi, \textit{supra} note 4, at 31 to 39.

\textsuperscript{35} Among these laws were, regulations concerning the establishment of national banks [\textit{Proclamation No.349 of the 5th year of Meiji} (1872) and \textit{Proclamation No.106 of the 9th year of Meiji} (1878)], regulations concerning the Bank of Japan [\textit{Proclamation No.21 of the 15th year of Meiji} (1882)], and regulations concerning private railways [\textit{Imperial Ordinance No.12 of the 20th year of Meiji} (1887)]; Takayanagi, \textit{supra} note 4, at xxix to xxx (note 13).

\textsuperscript{36} Takayanagi, \textit{supra} note 4, at xxx.

\textsuperscript{37} \textit{Proclamation No.57 of the 15th year of Meiji} (1882).

The first Japanese Commercial Code, commonly known as the Old Commercial Code, was drafted by a German legal advisor to the Ministry of Justice in Japan, and promulgated in 1890. It is interesting to note that despite the strong inclination toward favouring German law at the time, this Old Commercial Code was a mixture of the laws of several European states, including France, Germany, and Great Britain.

The Old Commercial Code, though containing provisions pertaining to companies, remained partial to the old rule of licensing for incorporations instead of adopting a registration system. For several reasons, this Old Commercial Code was soon abolished, and in 1899 a so-called New Commercial Code was promulgated. Unlike the Old Commercial Code, this New Commercial Code undoubtedly reflected the Japanese scholars inclination and admiration toward German laws at the time. The New Code almost entirely eliminated any French and English influence which had been felt in the Old Code; this further spurred on the

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38 Hermann Roester of Hanover, Germany.

39 Law No.32, 1890. History of the Japanese Commercial Law prior to this first Commercial Code, see Takayanagi, supra note 4, at IV to XXX.

40 "The reason why the Old Commercial Code was not patterned exclusively upon the German Commercial Code is generally ascribed to the fact that Herr Roester, though a German by nationality, had an antipathy to the policies of the Prussian Government and that he was thoroughly conversant with the laws of England and France."; Takayanagi, supra note 4, at xxxi (note (17)).

41 Tanaka, Seiji, supra note 21, at 8.

42 The Old Civil Code and Commercial Code which were copied from foreign laws were strongly criticized as being incongruous with Japanese custom. Thus, the enforcement of the Old Commercial Code was postponed several times. Although a part of the Code came to the enforcement on July 1, 1893, the entire Code came into force only one year prior to the enactment of the New Commercial Code; Takayanagi, supra note 4, at xxxi to xxxiv.

German law boom among legal scholars and law students of the day.\textsuperscript{44}

This New Commercial Code in 1899 was for the most part based on the German Commercial Code of 1861, which in turn became the origin of the present Commercial Code. The New Commercial Code made it relatively easy for the first time for private individuals to form and manage corporations.\textsuperscript{45} It regulated, though in a different way from the present Code, the fundamental functions and principles of corporations including regulations regarding incorporation, shares, the shareholders' general meetings, directors and dissolution.

4. Amendments to the New Commercial Code

Since the enactment of the New Commercial Code, the Code has been amended several times to adapt to the changing reality of the Japanese situation.\textsuperscript{46}

In 1911, the Commercial Code was amended,\textsuperscript{47} however, its substantial nature remained unchanged. Subsequent amendments in 1938\textsuperscript{48} to the Code changed its provisions regarding companies.\textsuperscript{49} The amendments were made largely due to the rapid change in the economic situation which was stimulated by closer ties to Anglo-American companies.

After World War II, due to the American influence in Japan, the Japanese Commercial Code was altered\textsuperscript{50} to embody, or one may even say, to epitomize

\textsuperscript{44} The myth that "any law other than German law is not a law" was predominant at this time; Tanaka, Hideo, \textit{supra} note 8, at 208 to 209.

\textsuperscript{45} Clark, Rodney, \textit{supra} note 14, at 33.

\textsuperscript{46} A detailed discussion on the amendments of the Code will be made in a later chapter. See Chapter IV. The Historical Transition of SGM and BOD under the Commercial Code.

\textsuperscript{47} \textit{The Commercial Code}, amended as Law No.73, May 3, 1911.

\textsuperscript{48} \textit{The Commercial Code}, amended as Law No.72, April 5, 1938.

\textsuperscript{49} Tanaka, \textit{supra} note 21, at 16.

\textsuperscript{50} \textit{The Commercial Code}, amended as Law No.167, May 10, 1950.
Anglo-American commercial law concepts.\textsuperscript{51} It is therefore not surprising to find the present similarities between Japanese corporate law and its Anglo-American counterpart.\textsuperscript{52} However, the present Commercial Code is not wholly in line with the scheme of American corporate law, which evolved from the common law tradition. It still contains the original framework of corporate law based on the Old German Commercial Code. Nevertheless the Code is far from being within the regime of the present German Commercial Code, since the Old German Code, which had been the mother law of the original Japanese Commercial Code, was in great part altered in 1937 by the German authorities. It would be fair to say that the present Japanese Commercial Code has a unique character; its taste being derived from ingredients which are primarily of a mixture of German and American corporate commercial laws.

As Japanese ties with the U.S.A. have become stronger and much more intimate than those with any single European country, Japanese corporate laws, along with other laws of Japan, have inevitably undergone a metamorphosis to produce a unique creature resembling its American counterparts more closely than any other.

\textsuperscript{51} In 1950, after World War II, the Japanese Commercial Code was amended under the instruction of the SCAP (The Supreme Commander for the Allied Powers); this amendment was the most significant amendment to the Japanese Commercial Code in history. Through this amendment, the Japanese Commercial Code, which up to this point had been based on an European continental model, largely adapted American corporation laws; the Illinois Business Corporations Act of 1947 and other corporate statutes of some states including New York, Massachusetts, Ohio, Michigan and California were frequently referred to as a guide in the course of drafting of the amendment; For details of this amendment, see Salwin, Lester N, "The New Commercial Code of Japan: Symbol of Gradual Progress Toward Democratic Japan" in \textit{The Georgetown Law Journal}, Vol.150, 1962), at 478.

\textsuperscript{52} "The Anglo-American corporate law was developed over several centuries via a system which included that which is presently known as the Common Law." In England, and in those parts of the world where the English legal tradition has been received, the characteristic type of law is common law, as contrasted with statute law." Twining, William (ed.), \textit{Legal Theory and Common Law} (Oxford, Basil Blackwell, 1986), at 8; For a detailed discussion on the history of company law in England where the common law originated, see Gower, L.C.B., \textit{Gower's Principles of Modern Company Law (5th ed.)} (London, Stevens & Sons, 1992), at 3 to 54.
5. Present Corporations and Corporate Law in Japan

This metamorphosis marks a specific point in the history of Japanese law. The laws controlling corporations have now reached their most sophisticated form. Today, the laws controlling corporations are diversified and include corporate law, economic law, administrative law, tax law, labour law, civil law, and constitutional law. Needless to say, however, the area of law which most directly regulates and controls corporations is corporate law itself.

Presently, the term "corporate laws of Japan" generally refers to two separate laws whose application depends on the type of corporations which they are to govern. The two laws are Book II of the Commercial Code of Japan and [Private Company Law].

These two statutes recognize four types of companies: 1) the Gomei-Kaisha (Commercial Partnership); 2) the Goshi-Kaisha (Limited Partnership); 3) the Kabushiki-Kaisha (Limited Company); and 4) the

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53 The Japanese Commercial Code was most recently amended in June 29, 1990, and was promulgated as The Commercial Code, Law No.48, March 9, 1899, as amended as Law No.64, June 29, 1990. Here in after, "The Japanese Commercial Code" and "articles", unless otherwise indicated, refer to this Law and its articles: For the English translation of The 1990 Japanese Commercial Code, see "The Commercial Code of Japan" in EHS Law Bulletin Series. (Tokyo, Eibun-Horei-Sha Inc., 1990-current): In fact, this is the translation of the 1981 Commercial Code. But, since the articles referred to in this paper were not, unless indicated, amended in 1990, and these articles are the same as that of the 1981 Commercial Code, this translation can be used as the translation of the 1990 Commercial Code. Unless otherwise indicated, all translations of provisions of the Code in this thesis are cited from this EHS translation. Some of this translation leave much to be desired.

54 The Private Company Law, Law No.74, April 5, 1938, amended as Law, No.64, June 29, 1990. For English translation of Private Company Law, see "Private Company Law" in EHS Law Bulletin Series (Tokyo, Eibun-Horei-Sha Inc.).

55 For the detail concerning the four types of company, see Kitagawa, Zentaro, Doing Business in Japan (New York, Matthew Bender, 1982), Sec.7.03[1].


57 Translation by EHS Law Bulletin Series.

58 Supra, note 53, III. Goshi-Kaisha.

59 Supra, note 54.
Yūgen-Kaisha$^{62}$ (Private Company$^{63}$).

The first three types of corporations are regulated under the Commercial Code and the last one is regulated under the Yūgen Kaisha Hō or the Private Company Law. The Commercial Partnership$^{64}$ and the Limited Partnership$^{65}$ are very similar to the general partnership$^{66}$ and the limited partnership,$^{67}$ respectively, of Canadian jurisdictions.

The third type of company, the limited company, is a company which is similar to a company incorporated under Canadian company law.$^{68}$ It consists of shareholders whose liability is limited.

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$^{60}$ Supra, note 53: IV. Kabushiki-Kaisha.

$^{61}$ Supra, note 54.

$^{62}$ Private Company Law.

$^{63}$ Supra, note 54.

$^{64}$ Under the Japanese Commercial Code, this type of company consists of members with unlimited liability. (The Japanese Commercial Code, art.80). Each member is jointly and severally liable to creditors of the company, and may manage and represent the company (The Japanese Commercial Code, art.70, 76). To resolve fundamental matters of the company including transferring shares, the unanimous consent of all the members of the company is required (The Japanese Commercial Code, arts.72, 73, 74). Kitagawa, supra note 55, at Sec.7.03[1][a].

$^{65}$ This type of company consists of two classes of members: members with unlimited liability and members with limited liability (The Commercial Code, art.146). Only the former have the power to manage and represent the company (The Commercial Code, arts.151, 156); to resolve the fundamental matters of the company the unanimous consent of members of both classes is required. In short, though this type of company is managed by members with unlimited liability, it is possible for the company to collect its capital from individuals with limited liability, whose only purpose is to gain from the distribution of the profits made by the company.


$^{67}$ Partnerships Act (ibid); Simmonds, supra note 66, at 88 to 92; Hadden, Tom, Forbes, Robert E., and Simmons, Ralph L., Canadian Business Organization Law (Toronto, Butterworth & Co. Ltd., 1984).

$^{68}$ Canadian Business Corporations Act, R.S.C.1985 (CBCA) and provincial company act including British Columbia Company Act, R.S.B.C.1979 (BCCA).
The fourth type of company is called the *Yūgen-Kaisha*, which translates as a private company,\(^{69}\) a limited liability company,\(^ {70}\) or a company with limited responsibility\(^ {71}\). This type of company, for the most part, is the same as the above mentioned limited company\(^ {72}\) but for a few specific differences. The major difference between the limited company and the private company is that, the statutory requirements as to the latter are more flexible and less stringent than that of the former. It can be said that a private company is a limited company in miniature,\(^ {73}\) since a private company may only consist of less than fifty members who have invested money in the company.\(^ {74}\)

Though each of these four types of companies has its own distinctive characteristics, and each may be successfully utilized to carry on business, the limited company is the dominant form of company in Japan, as it is in most other developed countries.\(^ {75}\)

Under the modern capitalist economy, it is generally recognized that the centralization of capital is the most important factor for the constant and smooth development of business.\(^ {76}\) To realize this purpose, a company limited by shares, namely a limited company, is the most suitable and sophisticated form of company.

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\(^{69}\) *Supra*, note 54.

\(^{70}\) Translation by Kitagawa, *supra* note 55.

\(^{71}\) Translation by Hōmushō Keijikyoku Gaikokuhō Kenkyūsho [Research and Training Institute of Criminal Affairs Bureau, Ministry of Justice] (Tokyo, Commercial Law Centre Inc., 1990).

\(^{72}\) Kitagawa, *supra* note 55, at Sec.7.03[1][d].

\(^{73}\) *Ibid*.

\(^{74}\) Private Company Law, art.8.

\(^{75}\) Kitazawa, Masayoshi, *Kaishahō (Shinpan): Gendai Hōritsu-gaku Zenshū 18* [Company Law (New edition): Series of Contemporary Jurisprudence Vol.18], at 29 to 30; Kitagawa, *supra* note 55, at Sec.7.03[1][d].

\(^{76}\) Kawamoto, Ichirō, *Gendai Kaishahō (Shintei Dai 1-pan) [Contemporary Company Law (New Edition-1)]* (Tokyo, Shōji Hōmu Kenkyūkai, 1980).
under Japanese law.\textsuperscript{77}

Both the Japanese corporate laws and corporations which did not exist prior to just over one hundred years ago, have now reached an apex in their stage of maturity. At this time, as has been seen in the most advanced nations, disparity between law and its actual working appears to be expanding. In the next chapter, how Japanese corporations are functioning in contemporary Japan regardless of the governing law will be examined, followed by an analysis of legal controls over corporations and corporate management.

\textsuperscript{77} Kitazawa, \textit{Kaishahô}, supra note 75, at 45.
For people living in modern capitalist economies, corporations are a fundamental factor of their lives. Corporations provide wages directly to their employees and indirectly to many others; corporations supply the commodities for consumers; and Corporations are the instruments to gain investment profits. Individuals who invest in corporations receive a distribution of their profits.

Additionally, corporations constitute the financial base of states and are closely intertwined with their politics. It would not be considered an exaggeration, to say, that corporations control the economy of states and the life of individuals within them. In other words, to understand corporations and their management system in a particular jurisdiction, it is necessary to carefully observe the economy and other related factors relevant to the corporations in the jurisdiction.

Thus, in this chapter we will look at the present situations surrounding corporations for a better understanding of the legal framework of corporate management in Japan.

1. Background - The Japanese Economy

It has been argued by many economists and other Japanologists that Japanese capitalism differs greatly from its Western counterparts and in particular, the U.S.A. Heterogeneous Japanese capitalism is typically described as company-

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oriented capitalism as compared to the consumer-oriented capitalism of the West.\textsuperscript{79} The following four distinct corporate management practices have been said to be responsible for the uniqueness of Japanese capitalism: 1) the long-range planning practices of Japanese corporations; 2) the labour management system; 3) the interlocking relationship among corporations; and 4) the intimate relationship between corporations and the Japanese government.\textsuperscript{80}

There is no doubt that this Japanese style of corporate management has contributed to Japan's modern economic prosperity. However, as the Japanese economy has matured, Japan has begun to face serious problems both internally and externally. In the international arena, Japanese economic growth has generated serious trade friction with its trading partners, and in particular with the U.S.A. Nationally, Japan's rapid economic growth is also believed to have caused the collapse of the bubble economy.\textsuperscript{81} Corporate managers themselves are now aware of the necessity of changing the so-called "Japanese style" management, and have


\textsuperscript{81} Apart from the argument of whether Japan has gone into an era of recession, or simply started restructuring its economy, one fact remains: the Japanese economy has ceased to sky-rocket. Several indicators evidencing this fact are clearly apparent. The Nikkei Stock Average, the index of 225 key issues on the first section of the Tokyo Stock Exchange was once fluctuating below the 15,000 yen level (The Nikkei Stock Average on August 17, 1992 was 14309.41 Yen), down more than 8,000 points (a 35 per cent decrease) from the 1991 close (The 1991 close was 22983.77 Yen (December 30, 1991): Japan Economic Almanac: The Nikkei Weekly, 1992 (Tokyo Nihon Keizai Shimbun, Inc.), at 15-16); This was one of the highest closing figures recorded ever. The Real Domestic Demand of Japan has been declining since 1990 (Country Report: Japan, No.2, 1992 (London, The Economic Intelligence Unit), at 15-16), and the number of bankruptcies of corporations in Japan have continued to increase (Ibid, at 17; According to a survey by Tokyo Shôkô Research, the number of bankruptcy in the first six months of 1992 was 6,570. This accounted for a 39.3 per cent increase from the same period of 1991; Nihon Keizai Shimbun [The Japan Economic News Paper], August 10, 1992).
been predicting forthcoming changes. Furthermore, Japanese individuals, who have been suppressed by a company oriented society which has recklessly pursued economic growth at their expense, are now becoming aware of the necessity of introspection. Now everyone is asking the question: "Has the time come to turn round? What went wrong?"

In the midst of the dark clouds of the recent Japanese economic slowdown, the Economic Planning Agency of Japan released the Keizai Hakusho or the White Paper on the Economy in August, 1992. In its general remarks, the White Paper identified five characteristics of the Japanese corporate management system: 1) stable shareholders of corporations; 2) the existence of "main banks"; 3) a specific labour management system, including lifetime employment; 4) the existence of production and distribution keiretsu; and 5) process innovations.

The rest of this chapter will briefly explain and examine corporate management practices in contemporary Japan by focusing on some of the above characteristics of the Japanese corporate management system. We will also examine how recent views regarding Japanese style management have diverged from the traditional views held by scholars, business people, and politicians.

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82 According to a survey by the Keidanren or the Federation of Economic Organization during 1990 to 1991 cited in Keidanren Geppō [The Federation of Economic Organization Monthly Report] (Tokyo, Keizai Dantai Rengō-kai, February 1991 at 29), 84.8% of the corporate managers surveyed responded to a question, "Do you think the Japanese style management will change?" by saying that "it will in the future."


84 "Process innovations" refers to technological innovations which improve quality and efficiency of products or reduce production costs by inventing a new production process or reforming a pre-existing production process or technology. This term is used in comparison to "product innovations" which invent or develop new products.
2. Corporations v. Corporations

One of the most unique characteristics of the Japanese corporate management system is the "keiretsu" system which is defined as "a group of companies federated around a major bank, trading company, or large industrial firm."  

Keiretsu may be divided into three types depending upon the origin and nature of business. The first type of keiretsu is a group which is a descendant of the pre-W.W.II Zaibatsu such as Mitsui, Mitsubishi, and Sumitomo. The second type is a group centred around a bank such as Dai-Ichi Kangin, Fuyo, and Sanwa. The last type is a group formed around a large manufacturing company, such as Toyota, Nissan, and Hitachi.

Among the keiretsu, six major keiretsu have extremely strong economic powers in Japan. The total assets of these six keiretsu occupy about thirteen per cent of the gross assets of all listed Japanese corporations. Three of these six keiretsu (Mitsubishi, Mitsui, and Sumitomo) are modern descendants of the pre-W.W.II Zaibatsu; the other three (Fuyo, Sanwa, and Dai-Ichi Kangin) are those established by major banks.

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87 "Zaibatsu" is a big economic combine which existed and dominated Japanese economy until W.W.II; Infra, note 175 and accompanying text.


89 In 1991, the total assets of 6 keiretsu was 12.98% of the total gross assets of all listed corporations; Tōyō Keizai, Kigō Keiretsu Sōran, '93 [Eastern Economy, Corporate Groups: General remarks, '93] (Tokyo, Tōyōkeizai Shimpō-sha), at 29; Nihon Keizai Shinbun, August 25, 1992.

90 Ibid.

91 Ibid.
In addition to these six major *keiretsu*, there are more than 2,000 company groups,\(^92\) as of September, 1992 these groups contain more than 25,000 corporations.\(^93\) It would not be an exaggeration to say that these *keiretsu* have controlled the Japanese economy.

What is significant is that corporations in the *keiretsu* reciprocally hold each other’s shares among themselves as stable and friendly shareholders. This so-called cross-shareholding has been suggested as being the key factor of Japanese companies’ strength by both Japanese and non-Japanese. The merits of cross-shareholding are said to include:

1. It eliminates the threat of takeover and releases the management from excessive pressure from the capital market. Accordingly, it stabilizes the long-term management of a corporation.\(^94\)

2. It enhances the long-term and continuous trade relationship between corporations which hold shares reciprocally. These cross shareholdings produce a characteristic hostage-like situation; as such securing the position of the corporation who holds the shares against the corporation whose shares are held.\(^95\)

3. An exchange of equity between trading parties connects their economic fortunes, which helps to mitigate incentives to act opportunistically.\(^96\)

4. It creates mutual trust and shared expectations. Accordingly

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\(^{92}\) Parent companies of these groups include all listed, Over-The-Counter, large non-listed, and life assurance companies; *Tōyō Keizai, Kōgyō Keiretsu, supra* note 89, at 27.

\(^{93}\) For instance, Hitachi has 799 subsidiaries and affiliate corporations. Sony has 695; *Tōyō Keizai, Kōgyō Keiretsu, supra* note 89, at 61.


\(^{95}\) *Ibid.*

\(^{96}\) Kester, *supra* note 85, at 67.
this enables companies in a group to pursue unwritten contracts.97

5. "Implicit contracting among individual managers better enables companies to make rapid, informal, and highly refined adjustments in the terms of trade to preserve the spirit and substance of a business covenant rather than the letter of a written agreement."98

Strong ties between corporations in keiretsu are further enhanced by information sharing within a group. Keiretsu centred on the main banks, major industrial companies, and large trading companies form the hub of a vast information sharing network.99 Various business interest associations and councils which consist of presidents of companies within a group are said to promote friendship and understanding among the presidents of the group.100 Almost all the major keiretsu groups have their own group councils which meet monthly or at least on some regular basis.101 Hence, corporations within keiretsu may not only stimulate each other’s business performance, but may take necessary measures as quickly as possible against new or ongoing problems.

Although the keiretsu system has been the key factor which has made Japan’s modern economic success possible, many people who used to sing the praises of the keiretsu have started to question the system and focus on its demerits, which have fostered a negative fair trade image and practice both inside and outside of Japan.

For instance, an American economist argues that Japanese consumer prices are very high because the distribution keiretsu "attempt to control the flow of

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97 Ibid, at 62.
98 Ibid, at 63.
99 Ibid, at 68.
100 Ibid, at 69.
101 These councils include Kinyō-kai of Mitsubishi, Hakusui-kai of Sumitomo, and Nimoku-kai of Mitsui; Tōyōkeizai, Kigyō Keiretsu, supra note 89, at 46; Kester, supra note 85, at 69.
products, accessories, services, and their prices from the factory to the consumer." This distribution *keiretsu* also excludes the participation of outsiders from the group to the distribution line. Meanwhile, the manufacturers' *keiretsu*, a group of "suppliers and component manufacturers, sometimes with hundreds of companies in a single structure" virtually shuts out foreign suppliers. This kind of practice is especially intolerable for American business people, since it has long been prohibited in the U.S.A. under anti-trust laws.

Another detrimental effect of the *keiretsu* and cross-shareholding is that it has impeded normal securities transactions. In other words, because the free-float of tradable shares is much smaller on the Tokyo Stock Exchange, compared to other stock markets of the world, it has been very "easy for Japanese brokerages or buying syndicates to manipulate stocks."

Recognizing these criticisms, the Japanese Fair Trade Commission (JFTA) has recently changed its position toward the *keiretsu* system from complete praise to a somewhat critical assessment. The JFTA's criticisms primarily focus on

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103 Ibid.

104 Cutts, *supra* note 78, at 49.

105 Cutts points out that "the U.S. auto parts makers, for example, accounted for just 1% of Japan's $120 billion parts market in 1990 - this after years of negotiation *keiretsu* import barriers."; Ibid., at 50.


detrimental effects of the *keiretsu* system on fair trade and quality of people’s life.\(^{109}\) This year’s White Paper suggests that: 1) due to the long-term, continuous trade within *keiretsu*, communication costs raise.\(^{110}\) Accordingly employees are compelled to work long hours; 2) the relationship between a parent company which sits on the top of the pyramid and contractors who occupy the bottom of the pyramid is a vertical one, therefore producing an inequality of bargaining powers between them; and 3) the system eliminates any new participation from outside of the group.\(^{111}\)

Along with these criticisms, the recent sluggish economy has in fact caused some alterations to the long time practices of the *keiretsu*. For instance, an average of reciprocal trading within a group of the six major *keiretsu* in 1989 declined to 7.2%\(^{112}\) in terms of their sales, and 8.1%\(^{113}\) in terms of their purchases. Cross-shareholding has also been declining recently. The average cross-shareholdings within a group was 25.47% in 1981, but it decreased to 23.40 per cent in 1985, to 22.65 per cent in 1987, and to 21.64 per cent in 1989.\(^{114}\)

Some brave undaunted outsiders have also started a challenge with the intent to break this unfavourable practice. The American corporate raider, T. Boon Pickens, was one of these challengers who tried to smash Japan’s *keiretsu* system by acquiring some 26% of the shares of a parts-supplier company controlled by Toyota,
Koito.\textsuperscript{115} However, this attempt ultimately failed largely due to a strong support given to Koito from Koito’s keiretsu member, Toyota, to defeat Picken’s proposal for board representation.\textsuperscript{116} This demonstrates that although the keiretsu has been criticized and is gradually changing, it is still a strong fortress which at present appears impregnable to outsiders.

It is beyond the scope of this thesis to delve any further into the analysis of the changing practices of the keiretsu. However, one thing is certain, despite the criticisms and challenges to the keiretsu, it will take a long time to change this long-standing Japanese trade practice since the system has contributed so much to Japan’s modern economic success. Moreover, since Japanese corporations belonging to some keiretsu have never experienced any detrimental effects, what is the impetus for them to give up such a wonderful practice? It is simply too good a thing for them to give it up.

3. Corporations v. Financial Institutions

Another major factor peculiar to Japanese corporate management is the intimate relationship between financial institutions and other corporations. The outstanding feature of banks in Japan is that they have controlled corporations to the utmost extent, not only financially, but also managerially.

Banks have been the main source of corporate financing in Japan. As a survey has shown, in 1975 (the end of the high-growth period which had started in the mid-1950s), among sources of external funds, loans had exceeded 80 per cent of


\textsuperscript{116} \textit{Ibid}, at 354 to 355
However, this heavy debt financing had ceased to function in the period of slow growth of the Japanese economy and during the oil crisis. In the 1980s, the liberalization and internationalization of financial markets and the increase of share prices accelerated the diversion of the financing system of Japan. In 1989, the debt financing ratio to the total external funds decreased to 52 per cent. This ratio was even smaller when only large corporations were counted. This decrease in debt financing undoubtedly indicates the expansion of equity financing in recent years. However, the debt financing ratio of Japanese corporations is still relatively large when compared to that of their American counterparts.

Banks, along with other financial institutions in Japan have also played an important role as stable shareholders. About one-third of Japanese corporations' shares are in the hands of banks and other financial institutions.

Among financial institutions, "main banks" have the influence to build a specific relationship with corporations in Japan. Most corporations have their own "main bank" which is defined as "the bank from which a corporation obtains a major loan continuously for a long term." A typical function of the "main bank" in relation to the corporate management is summarized as follows:

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117 These external funds included loans, bonds and shares. *The White Paper on Economy*, table 3-2-3; *supra* note 83.

118 35.3%; Large corporations with the capital of 100 million yen; *The White Paper on Economy*, Table 3-2-3; *supra* note 83.

119 In the 1980s, issuance of shares and convertible debentures had increased rapidly. After the 1990 stock collapse of the Japanese share market, the common debenture has become a popular funding of corporations in Japan; *The White Paper on Economy*, Figure 1-6-8, *supra* note 83.

120 The average ratio of loans from outside of a corporation during 1985-1989 was 32.1% of total financing of corporations in Japan; whereas the ratio was 14.0% in the U.S.A.; *The White Paper on Economy*, *supra* note 83, at 284.

121 Kester, *supra* note 85, at 57 to 59.

1. It stabilizes the external finance;\textsuperscript{123}

2. In the case where a corporation encounters financial difficulties, the main bank will become the Saviour for the corporation;\textsuperscript{124}

3. In most cases, the main bank holds a large portion of the shares of a given corporation and sits on its Board. Thus, the main bank plays an important role in the management of the corporation as a shareholder and/or an executive;\textsuperscript{125}

4. As a stable shareholder, the main bank releases or reduces the risk of the corporation from a threat of takeover.\textsuperscript{126}

In short, the main bank protects its corporation both as a creditor and as a shareholder.

The main bank appears to have greatly contributed to the efficiency of the Japanese corporate management system.\textsuperscript{127} However, other effects of the main bank have been noticed in recent years. Banks have given continuous support to managers of Japanese corporations freeing them from pressures of the capital market. As such, managers have been able to expand their corporations' market shares without worrying about profitability. It is accepted that small profits may and most likely will accompany this expansion of the market shares of the corporation, along with shareholders receiving a smaller return and employees receiving lesser

\textsuperscript{123} Horiuchi, Akiyoshi, "Tenkan Semarareru Nihongata Shihon-shugi [Japanese-style Capital Market Being Urged To Be Changed]" in \textit{Ekonomisuto [Economist]} (Tokyo, Mainichi Shinbun-sha), at 92.

\textsuperscript{124} \textit{Ibid.}

\textsuperscript{125} \textit{Ibid}; More than 50\% of corporations which are within "keiretsu" have executives who are sent by the main bank; \textit{The White Paper on Economy, supra} note 83, at 288 to 289).

\textsuperscript{126} Horiuchi, \textit{supra} note 123, at 92.

\textsuperscript{127} It is stated by an author that "in terms of modern organizational economics, the banking industrial complex is a governance system shaping the actions of companies and banks."; Okimoto, \textit{supra} note 86, at 54.
payment. The sacrifices of the above mentioned persons have encouraged this type of corporate management. However, in a democratic society, a corporation may not unreasonably suppress or exploit persons for ever who have some legal rights to the corporation. Shareholders and employees in Japan are no longer as silent and patient as they were in the past.\textsuperscript{128}

The role of the main bank is still an important one and most corporations do not agree with the idea that the role of the main bank will diminish to a great extent. However, the fact remains that as the debt financing decreases, the role of the main bank as a creditor is on a decrease. In addition, as share value remains low and holding shares become more speculative\textsuperscript{129} the role of the main bank as a stable shareholder is also expected to decrease.\textsuperscript{130}

Japanese life insurance companies have also acted as stable shareholders. As such, they have played a similar role to the main banks in Japanese corporations. Such companies hold some 13 per cent of shares of the Tokyo Stock Exchange by volume or 12 per cent by value.\textsuperscript{131} However, as the Japanese economy continues to be sluggish and the Japanese share market hangs low, these life insurance companies are also changing their attitude. They are becoming more income or return oriented. In 1990, they "began threatening to start dumping part of their long-

\textsuperscript{128} Changing attitude of shareholders and employees in Japan will be explained in the following two sections in this chapter: 4. Corporations v. Individual shareholders and 5. Corporations v. Employees.


\textsuperscript{130} The Dai-Ichi Insurance company's Report on Cross-shareholding dated August 16, 1992 states "Due to the developments of the liberalization of interest rate and the increase of bad credits, banks are compelled to regard the profitability of share investment as important." thus, it is expected that banks will not be willing to hold shares of any corporations which are not profitable, even if the banks have a specific relationship with the corporations.

\textsuperscript{131} Rowley, Anthony, "Stock Questions", supra note 107, at 54.
term holdings if the companies concerned did not raise their dividend-payout ratios."\textsuperscript{132} In fact, these life insurance companies have started to dump their holdings even though the volume of their disposed shares is presently very minuscule.

In summary, it appears that corporations may not be able to rely on financial institutions as stable shareholders any longer. However, it may be too early to conclude that this is so. Even if it were true, at this point it will be fair to say that the role of financial institutions is still of too great in importance to ignore. The only foreseeable change in the role of financial institutions in Japanese corporate society is a decrease in the extent of the role of these institutions, not a disappearance of their role, yet to what extent this shall be is unknown.

4. Corporations v. Shareholders

Considering the known success of Japanese corporations, one may think that shareholders of these corporations have been enjoying a great deal of profits as investors in these corporations. This thought is a myth; the following facts evidence that it was never and still is not the case. A survey undertaken in 1988\textsuperscript{133} revealed a very interesting contrast in the corporate objectives of Japanese and U.S. corporations. Around 80 per cent of corporations in the U.S.A. surveyed responded that "return of investment" is important as a corporate objective, compared to only 30 per cent of corporations in Japan. More than 60 per cent of corporations surveyed in the U.S.A. responded that "capital gain for the shareholders of the corporation" is important as a corporate objective, while less than 5 per cent of corporations in Japan responded in this way. More than 50 per cent of U.S. corporations responded that "maintenance and expansion of market share" is important, whereas more than 60 per cent of Japanese corporations responded affirmatively here. Lastly, only around 10 per cent of corporations in the U.S.A.

\textsuperscript{132} Ibid.

placed great importance on "the expansion of new products, new business", while a wopping 60 per cent of Japanese corporations had this as a primary goal.\textsuperscript{134}

This comparison indicates that the principal objective of corporations in Japan is to promulgate their corporate growth through new products and expansions of their market share, even at the expense of investors of the corporations (in a broad sense) including shareholders and employees. The return of profits to their investors is almost ignored by corporations in Japan (only 5 per cent of corporations in Japan consider this of importance!). On the other hand, the principal objective for American corporations is the return of investment followed by share price increase. Judging from this survey, it would be fair to say that Japanese corporations place their highest interest in the growth of their corporations based on a long range planning strategy, while American corporations value profit maximization over the short term. This difference of corporate objectives in the two countries is reflected by difference in the average dividends paid out by the corporations of these countries. The average dividends paid by major Japanese corporations each year during the period of 1985 to 1992 was consistently below a return of 1.0 per cent\textsuperscript{135}; comparatively, in the U.S.A., during the same time period corporations paid out between 3 to 4 per cent in returns.\textsuperscript{136}

Abegglen states that, "Aggressive pricing, high profit retention in the firm, low dividends, and aggressive use of debt [to pursue the expansion of the corporation's market share] are mechanisms that enable a growing company to grow faster. The welfare of the employees, of the management, and of the shareholders is improved

\textsuperscript{134} Ibid.

\textsuperscript{135} A return of an average dividend is calculated as: the average dividends/the average share price x 100; \textit{The White Paper on Economy}, supra note 83, at 282.

\textsuperscript{136} Ibid.
with continued strong growth - therefore, growth is the principle goal of all parties.\footnote{Abegglen, James C. and Stalk, George, Jr. \textit{Kaisha, The Japanese Corporation} (New York, Basic Books, Inc., 1985), at 176.} It is true that as a company grows its share price increases, and shareholders ought to obtain a great deal of capital gain. However, if a corporation pursues its growth only focusing on capital gain, in the process of its growth the corporation is most likely to ignore one of the fundamental corporate principles: The maximization of corporate profits ought to be returned to investors by way of distribution of dividends. This normative economic theory that investors are entitled to receive a proper share of the corporate profits in dividend or other distribution is presently recognized by statutes either directly or indirectly in most jurisdictions.\footnote{The Commercial Code explicitly recognize the shareholders’ right to demand distribution of profits (art.293-2, para.1); Kitazawa, \textit{supra} note 75, at 142; Contrarily, in Canada, although most statutes do not explicitly state so, it appears to be the general rule that “dividend rights (the right to determine whether or not dividend should be distributed) rests with the board of directors.” (Welling, Bruce, \textit{Corporate Law in Canada} (Toronto, Butterworth, 1991), at 640 to 645). However, in theory, since shareholders may always replace directors, the ultimate power to demand distribution of profits in way of dividend is vested in shareholders.} In short, the growth of Japanese corporations was made possible at the expense of profits to which shareholders had a right to share in more adequately.\footnote{Abegglen, \textit{supra} note 137, at 148.}

Japanese corporations’ lack of regard for individual investors and their rights may undoubtedly be ascribed to the unique role played by corporate groups and main banks in the corporate arena, and especially the cross-shareholding practice which they partake in. Although today’s Japanese corporate strength has no doubt been made possible by a reckless pursuit of the economic growth, nothing may justify their ignoring of their shareholders’ interest, for it is a right of shareholders to obtain an appropriate portion of the profits of their corporation. No company ought to be allowed to demand that its shareholders wait for ten or more years until the corporation grows and its share price rises before giving them appropriate return. Furthermore, if too much emphasis is put on the capital gain among shareholders,
it tends to cause a fluctuation of share prices.\footnote{White Paper on Economy, supra note 83, at 282 to 283.} In other words, if shareholders only expect to gain profits through capital gain not through dividends, the shareholders would become extremely sensitive about fluctuation of share prices. The consequence would be, as Japan is now experiencing, when the share market declines, investors would lose their interest in investing in the share market since they can expect neither capital gain nor the distribution of fair amount of dividends. Hence corporations would face difficulties in raising their capital in the share market, and this, along with the decreasing role of financial institutions as external fund suppliers, would cause another economic slowdown in Japan.

The Tokyo Stock Exchange has proposed several measures to increase the number of individual shareholders per corporation in an attempt to deal with the declining value of stocks.\footnote{Tokyo Stock Exchange Report titled "Kabushiki Tōshisha no Kakudai ni Tsuite - Shōhō Kaisei tō eno Taiō" [Report concerning the expansion of the class of share investors - Report corresponding to the Amendments of the Japanese Commercial Code etc.], Shōji Hōmu [Commercial Law Review], (Tokyo, Tokyo Shōji Hōmu Kenkyūkai) No.1249, April 5, 1991, at 2.} The \textit{Keizai Dantai Rengōkai (Keidanren)} or the Federation of Economic Organization has also proposed several measures to improve the Japanese management system including reviewing the system of dividend distributing of corporations.\footnote{Endo, Hiroshi, "Kaisha Hōsei No Arikata Ni Tsuiten Keidanren Kenkai Ni Tsuite" [Concerning the view of the Federation of Economic Organization regarding how the legal system governing corporations ought to be", in Shōji Hōmu, No.1281, April 1992, at 2.} The changing economic situation in Japan is now forging changes to the Japanese corporate management system.

As the ties among corporations, and between corporations and financial institutions have weakened, it was inevitable that the role of individual shareholders would increase. As individual shareholders have gained more powers, they have become more aggressive and demanding. Today, corporations in Japan ought not and dare not ignore individual shareholders any longer. The sleeping shareholders
have awakened and are now also ready to enjoy more of the benefits of Japan's economic growth and strength.

5. Corporations v. Employees

The last element which greatly differentiates the management system in Japan from that of most western countries is the unique labour management system in Japan. Two typical practices uniquely representative of the Japanese labour management system are life-time employment and seniority-based wage determination system.

(1) Lifetime Employment

The key elements of lifetime employment may be summarized as follows:

1. A corporation hires its employees from a pool of fresh graduates from universities, colleges, high schools, or other schools upon graduation.
2. A company hires employees not for their specific abilities or skills which they have already cultivated, but for their general ability to adapt to any environment or any job situation which they will be assigned to.
3. At the initiation of the employment, there is a tacit agreement, not an explicit employment contract, between the corporations and their employees that they will remain with the company until their retirement, and that the corporation will not lay them off in the interim.
4. Once the employees are hired, they are transferred from one section to another to develop their understanding of the corporation's philosophy and to acquire necessary technical skills.

5. The employees climbs up the ladder to higher positions by competing among themselves until their retirement.

This practice has given corporations the incentive to invest corporate assets into human resources; at the same time, this has inspirdied employees to commit themselves to their corporations. Nonetheless, there is always an accompanying great risk for both employees and employers. For employers, "a recruiting error is not easily corrected and has long and expensive consequences." For employees, "his commitment is not for a single, particular job, but for a career."

Nonetheless, it is true that this system has greatly contributed to the efficiency of the Japanese labour market. However, this stereotype of lifetime employment which has long been attributed to having contributed to the efficiency of Japanese labour management appears to be changing.

It ought to be noted that although lifetime employment has long existed in Japan, it has not generally been the practice as to workers of small or medium size corporations, or applicable to female workers, part-time workers, and seasonal workers. Furthermore, it should be remembered that lifetime employment is not peculiar to Japanese corporations. This system has also been practised, to some extent, by a few American corporations.

144 The White Paper on Economy, supra note 83, at 294 to 295.
145 Abegglen, supra note 137, at 199.
146 Ibid.
147 In 1991, an unemployment rate of Japan was relatively low compared to that of other countries. Japan-2.1%; the U.S.A.-6.6%; England-8.9%; Germany-4.3%; and France-9.4%; The White Paper on Economy, supra note 83, at 351.
148 Abegglen suggests that "some 30 percent of the Japanese labour force is covered by the system of permanent employment."; Abegglen, supra note 137, at 201.
As the Japanese economic situation changes, so also have the recruiting practices. As businesses have become more diversified and complex, more skilled workers have been sought after.\textsuperscript{150} Companies are becoming aware of the logical necessities when recruiting of not limiting themselves primarily to fresh graduates whose abilities are unknown and untested, but now gladly seek to hire skilled workers from a broad labour market. Another factor which appears to be responsible for the transition in the practice is the fact that the work ethic of Japanese people has been changing recently. Japanese people have become more leisure-oriented rather than income-oriented.\textsuperscript{151} For instance, the proportion of employees who are changing their jobs more than once has been on the increase, especially among young people\textsuperscript{152}; the proportion of corporations which are hiring mid-career workers has been increasing\textsuperscript{153}; the willingness to change jobs has been increasing, particularly among the young generation.\textsuperscript{154}

(2) Seniority Based Wage Determination System

A seniority based wage determination system is another characteristic of Japanese style labour management. In Japan, wage determination is primarily based on length of service with the corporation. As Abegglen points out, "Most societies have some degree of age-grading, and most personnel systems pay some respect to

\textsuperscript{150} Keidanren Geppō, supra note 82, at 29.

\textsuperscript{151} The White Paper on Economy, supra note 83, at 299; Summary of Professor Ronald Dore's lecture "When will the Japanese slow down?" at Pacific Region Forum on Business and Management Communication by Simon Fraser University at Harbour Centre on November 22, 1991, at 2.

\textsuperscript{152} In 1990, the proportion of employees who had changed their jobs more than once was more than 70%. It was 55 to 65% (depending upon the generation) in 1980; see Rōdō Jihō [Labour Report], August, 1992 (Tokyo The Ministry of Labour), at 28; Nakatani, Iwao, The Japanese Firm in Transition (Tokyo, Asian Productivity Organization, 1988), at 55 to 56.

\textsuperscript{153} A proportion of companies which hired mid-career workers increased from 25% to 45% (depending on a type of industry) in 1986 to 60 to 75% in 1991; Rōdō Jihō [Labour Report] (Tokyo, The Ministry of Labour), May, 1992, at 53.

\textsuperscript{154} A proportion of employees who desire to remain with the corporation until their retirement sharply decreased since 1982. In 1991, it was less than 25% compare to some 35% in 1982; ibid, at 30.
length of service in their reward system. It is the degree of weighting, the systematization of the seniority factor ..." which makes the Japanese system peculiar.  

The Japanese seniority based wage determination system is closely related to the lifetime employment system. The wage increase generally continues until the employee's retirement age. The system may be rationalized in the following manner: The harder an employee works and the better his productivity during his young age, the faster he goes up the corporate promotion ladder. The higher he ascends, the more he earns. And in the latter years of his career, the higher the base salary and the higher his wage increases. Hence, the seniority wage system would enhance the incentives of young workers who are generally more productive compared to older workers. In other words, even though young workers are in most cases not fairly compensated compared to their productivity, there is incentive for them to work hard. The dream of advancing in position and future rewards is an effective motivating stimulus.

The seniority system has not received so much praise compared to the lifetime employment system. Its disadvantages have become more conspicuous in recent years to the extent that the system appears to be no longer viable. Japan's aging population is directly reflected in the number of older workers of the corporations; their high wages due to the seniority wage system are threatening the finance of corporations. Corporations are now paying more money than ever to a large number of older workers who are not as productive as their young workers. From the workers' point of view, a large number of middle aged or senior aged workers are now competing for a smaller number of higher positions, than ever before. Workers who have failed in their bid to advance due to the high degree

155 Abegglen, supra note 137, at 205.
156 The White Paper on Economy, supra note 83, at 295; Nakatani, supra note 152, at 58.
157 See Nakatani, supra note 152, at 60 to 61.
158 Nakatani, supra note 152, at 59.
of competitiveness are now overly frustrated and dissatisfied with their positions and salaries. Young workers, as their work ethic has changed, also feel that they are being treated unfairly or even cheated because they are paid less than the older workers who are less productive than they are.\footnote{Abegglen, supra note 137, at 204.}

Changes in the system have already been undertaken. A survey shows a clear shift of Japanese corporations’ wage determination system "from seniority system to ability oriented system."\footnote{Hanaoka, supra note 149, at 174 to 176; Rōdō Jihō, August, 1992, supra note 152, at 35.} However, this does not necessarily mean that Japanese corporations intend to abolish the seniority system entirely. Japanese corporations are now searching for a balanced wage determination system which is fair to their workers and still efficient for the corporations. They are now adopting many methods to evaluate workers’ ability in addition to the seniority system.

(3) Changing Labour Management System in Japan

The Japanese style labour management system and other Japanese style management systems are now changing. Changes in economic situation, work ethic, and the aging population are some of the factors which have been primarily responsible for these changes. Japanese corporations have been highly adaptable; they have been taking these changes seriously and adjusting appropriately to deal with the growth of the aging population. Japanese corporations have been initiating pertinent measures for some time such as early retirement plans, and promotions to overseas’ subsidiaries, and related corporations.\footnote{Dore, supra note 151, at 2.} To hire more mid-career skilled workers, corporations have started to reduce the differences in wages between lifetime employees and mid-career employees in the same age group.\footnote{Rōdō Jihō, August, 1992, supra note 152, at 39.} To adjust
to the changing work ethic, many corporations are now cutting work hours, and adopting a so-called "flex time." Finally many corporations are now adopting an ability based wage determination system.

Although it is difficult to predict at present how far these changes to the labour management system will proceed, it is certain that in Japan there will be the development of another unique form of labour management system which will most likely be a hybrid between the conventional and contemporary.

In any events, one should bear in mind that any particular practice or working system in a society affects the laws of the society of the time in various ways. Although most fundamental principles of corporate laws in most advanced nations are presently similar, yet different sociological, philosophical and economic histories and present situations which evolved from these histories have led to conceptual differences of principles of law in these jurisdictions.

Now this thesis moves into the legal analysis of statutory corporate organs which play a critical role in managing a corporation. It is hoped that the preceding two chapters, historical background of corporations and corporate laws, and present practice of corporations, will furnish some light to enable an understanding of the legislative purposes of relevant provisions of the statutes and the legal reasonings of the judiciary regarding presented issues.

164 "Flex time" is a flexible working time system. Under the system, employees are allowed to start or finish their work at any time within certain time span. For example, if an employee is required to work eight hours a day, he may start at any time, say, between 9:00 to 11:00 a.m., and he may finish his work once eight hours has elapsed; Ibid.
165 Supra, note 160 and accompanying text.
Corporate management systems differ greatly from one jurisdiction to another. As explained in the preceding chapter, Japanese corporations have developed unique and particular ways of conducting the various aspects of their business. However, the basic legal principles underlying modern corporations are by and large the same in most jurisdictions.

A corporation generally functions with two primary organs, namely "The Shareholders' General Meeting (hereinafter the SGM)" and "The Board of Directors (hereinafter the BOD)." This chapter will examine: 1) how these two principal corporate organs have functioned in the Japanese jurisdiction by focusing on the separation of ownership and control; and 2) the present concept of corporate organs under the Japanese Commercial Code.

1. Separation of Ownership and Control

The present basic concept of the SGM and the BOD in Japan is similar to that of most western countries, particularly the United States.\textsuperscript{166}

Though these organs are an integral part of a corporation, it is important to note, their delineation is of great importance and is best explained by an examination of the concept of separation of ownership and control within a corporation.

In theory, a corporation consists of a large number of investors who control it. These investors have rights which include not only the right to receive a

\textsuperscript{166} This similarity is largely due to the American influence after World War II on the Japanese Commercial Code; \textit{supra} note 51 and accompanying text.
distribution of profits from the corporation, but also the right to participate in the management and control of the corporation as joint owners. Although this is considered a fundamental concept and an inevitable characteristic of the corporation by most, in fact, it is rarely actualized. This is due to the fact that the average investors are neither sufficiently knowledgable of corporate management and control, nor do they have any inclination or intention to take an active role in the management and control of the corporation. Moreover, the realization of this ideal situation is virtually impossible. Thus, it is recognized that the separation of ownership and control within a corporation is an inevitable phenomenon.

The publication by Berle and Means, "The Modern Corporation and Private Property" has been available in Japan since it was first published. The principles within it have been analyzed and supported by a multitude of Japanese legal scholars. Japanese scholars examined the principles stated in the book and adapted them to the Japanese environment. Kitazawa explains the principles of the theory in the following manner:

"... the enormous centralization of capital and business enterprises is characteristic of the growth of the capital economy which had started in late 19th century. Due to this centralization of capital, corporations grew giganticly, share ownership among the large industrial corporations was dispersed into the public at large, and corporate management became more

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171 Ibid.
complex. Shareholders of the large industrial corporations were differentiated into two types: 1) a small number of shareholders who had the managerial ability and owned shares for the purpose of control of the corporation; and 2) a large number of shareholders who owned shares for investment or speculative purposes, and were indifferent and ignorant about corporate management. Consequently, among these gigantic corporations, separation of ownership and management became more distinct, and separation of ownership and control occurred.\footnote{172}

In "The Modern Corporation and Private Property", the authors postulated five types of corporate control: "1) control through almost complete ownership, 2) majority control, 3) control through a legal device without majority ownership, 4) minority control, and 5) management control. Of these, the first three are forms of control resting on a legal base and revolve about the right to vote a majority of the voting stock. The last two, minority and management control are extra-legal, resting on a factual rather than a legal base."\footnote{173} Berle and Means through their analysis revealed the fact that "management control"\footnote{174} had become dominant in the U.S.A. at the time of their publication.\footnote{175}

Similarly, in Japan, separation of ownership and control has become more and more conspicuous after the postwar period and management control has shown its dominance.\footnote{176} After World War II, the Zaibatsu (big economic combine)\footnote{177},

\footnote{172} Kitazawa, Kabushiki KaishaKENKYÅ, supra note 168, at 206 (My translation).


\footnote{174} In The Modern Corporation and Private Property, 1967, Berle and Means defines "management control as: "control in which ownership is so widely distributed that no individual or small group has even a minority interest large enough to dominate the affairs of the company", ibid, at 78.

\footnote{175} Ibid, at 84 to 111.

\footnote{176} Infra, note 185 and accompanying text.
which had controlled the Japanese economy up to that time, was forced into dissolution; and the immoderate centralization of economic power which was associated with the Zaibatsu was eliminated.  

The resulting dispersion of shares to the open market was followed by the great growth of the Japanese economy. This high growth of the economy fostered capital centralization, which in turn led to "management control" in Japanese corporations.

Zaibatsu control was dominant in the Japanese economy prior to World War II. Between 1945 to 1951, The Holding Company Liquidation Commission (HCLC), which was established by the Japanese Government, with the approval of the Supreme Commander for the Allied Powers (SCAP), and other Japanese Governmental agencies had disposed of an extremely large number of the shares which had mainly belonged to the Zaibatsu. In 1947, The Law relating to Prohibition of Private Monopoly and Methods of Preserving Fair Trade modeled after the Clayton Anti-Trust Act of the U.S.A., was enacted. What followed was an increase in the number of individual shareholders in the 677 publicly traded companies to 4,190,000; a 94.6 per cent increase of shareholders, with the new shareholders holding 70 per cent of the outstanding shares.

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177 Ando, Nisuke, Surrender, Occupation, and Private Property in International Law (New York, Oxford University Press, 1991), at 18, "Zaibatsu" literally means 'financial clique' in Japanese. The word has been used to designate a small number of gigantic economic combines controlled by a few families, which throughout the modern history of Japan, have nearly monopolized the finance, industry, and commerce of the country and, with their economic power, have affected its national policies."

178 Ando, supra note 177, at 18 to 20.

179 Infra, note 185 and accompanying text.

180 Salwin, supra note 51 at 490: In 1946, 164 million shares from ten Zaibatsu families, 158 million shares from several thousand overseas companies, control associations, banks and other closed institution etc., and 36 million shares by 'restricted concerns' comprising the first line subsidiaries of eighty-three designated holding companies, total of 358 million shares, were taken over by HCLC and the other Japanese Governmental agencies.; See also Ando, supra note 177, at 19 to 20.

181 Law No.54, April 24, 1947.

182 Kawamoto, supra note 76, at 12.
Comparatively, in 1980, the number of individual shareholders grew to 19,270,515. This number represents 97.4 per cent of the total number of shareholders. However, these shareholders only owned 29.3 per cent of the outstanding shares. Seventy and one half per cent of the total shares were owned by financial institutions, such as banks and other corporate entities. This control by financial institutions and other corporate entities is considered as one form of minority control or management control.

It is clear that in Japanese contemporary society, while more shares are dispersed amongst individual shareholders, substantial ownership by corporate bodies has been increasing; companies are being controlled by companies. This is one of the major characteristics of the Japanese economic system.

Another example which shows the phenomenon of separation of ownership and control is best illustrated in a book written by Mr. Masaki in 1965. Mr. Masaki looked at the top 200 of 558,016 Japanese companies. Though these 200 companies represented only 0.03 per cent of the total companies, they controlled 34 per cent of the aggregate capital. Of the 200 companies, 120 companies or 60 per

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183 Shōji Hōmu Kenkyū, No.1249, at 7: In 1990 this proportion further decreased to 23.1 per cent. In the U.S.A., individual shareholders owned 56.0% of all the outstanding shares in the U.S.A. in 1990; The White Paper on Economy, supra note 83, at 274 to 275.


185 Kawamoto, supra note 76, at 13.

186 Ibid, at 12 to 15.

187 H. Masaki, Sengo ni okeru kabushiki gaisha no shōryō to shihai waga kuni soidai shisangaku 200 sha(hi-kin'yū gaisha) no jittai bunseki [Ownership and Control of Limited Companies in Post War Period: An Analysis of the Actual Circumstance of the Japan's Biggest 200 Companies (excluded financial institutions)] (Tokyo, Dōshisha Shogaku No.21-1,1965), at 80, as quoted in Kawamoto, supra note 76, at 12 to 13.
cent of them were management controlled,\textsuperscript{188} while the remaining 40 per cent were owner controlled.\textsuperscript{189}

A quick look at the corresponding Canadian situation reveals a startling and interesting contrast to the Japanese case.

In Canada, ownership and control seems to be more concentrated in large Canadian corporations.\textsuperscript{190} This is largely due to the large number of foreign ownership among the largest Canadian corporations.\textsuperscript{191} According to a 1981 Canadian Government publication,\textsuperscript{192} among the fifty largest Canadian corporations, twenty were foreign controlled (in other words twenty per cent or more of their shares were owned by non-Canadians), while thirty corporations were controlled by Canadians. Among these thirty corporations, only nine corporations were owned by large number of individual shareholders who held less than twenty per cent of shares of each corporation. In other words, more than 80 per cent (41 out of 50) of large Canadian corporations were owner controlled.

Unless shareholders see themselves as owners who ought to pursue their own best interests and therefore keep a watchful eye on the management of their corporations, management may pursue their own best interest and neglect the interests of the rightful owners of the corporations. This aspect of separation of ownership and control may inevitably lead to an undesirable influence on the

\textsuperscript{188} Mr. Masaki defined "management control" as "a situation where no shareholders own more than 10 per cent of outstanding shares and no group controlling the company can be identified."(my translation), as quoted in Kawamoto, \textit{supra} note 76, at 13.

\textsuperscript{189} Kawamoto, \textit{supra} note 76, at 13.

\textsuperscript{190} Hadden, \textit{supra} note 67, at 77 to 82.

\textsuperscript{191} Ibid.

corporation in various ways by corporate management. If corporate management pursues their own interest, they may, jeopardize their corporations' financial bases, harm the corporations' name, or cause other detriment to their corporations.

2. The Present Concept of Corporate Organs under the Japanese Commercial Code

Reflecting the separation of ownership and control, corporate laws of most jurisdictions recognize two separate corporate organs: "The Shareholders General Meeting" and "The Board of Directors." In addition, as long as the management and control of the corporation is separated from the ownership, it is necessary to have a watchdog to monitor the corporate management; under the Japanese Commercial Code, this watchdog is the auditor(s).

The Japanese Commercial Code, under the section of "The Organs of Company," has three sub-sections: 1) "General Meeting of Shareholders"; 2) "Directors and Board of Directors"; 3) and "Auditors." These three corporate organs are fundamental statutorily required organs within every corporation.

This concept of three corporate organs is largely the result of the influence of the German Commercial Code on the Japanese Commercial Code in its early stage of development. It was considered to be a reflection of the modern democratic political theory in Europe, namely "the separation of the three powers of state into the administration, the legislature, and the judicature." In Japan the function of

193 The Japanese Commercial Code, Book II KAISHA [Companies], Chapter IV Kabushiki-Kaisha [Limited Companies], Section 3.
194 Ibid, Sub-section 1.
195 Ibid, Sub-section 2.
196 Ibid, Sub-section 3.
197 See, supra note 43 and accompanying text.
198 Ueyanagi, supra note 167, at 3.
these organs has been changed because of the amendments to the Japanese Commercial Code. The present form and function of the corporate organs are as follows: The shareholders' general meeting, constituted of shareholders who are joint owners of the corporation, determines fundamental matters including the selection and appointment of directors and auditors of the corporation; The Board of Directors composed of directors who are appointed or selected by shareholders at the shareholders general meeting, determines managerial matters and appoints representative directors; Representative directors are appointed from among the directors of the corporation by its Board of Directors, to manage the day-to-day business of the corporation and represent the corporation; Auditors, who are appointed by the shareholders general meeting, inspect the financial statements of the corporation and monitor the management of the directors of the corporation.

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201 The Commercial Code, art.230-10 to art.252.
202 The Commercial Code, art.254 to art.272.
203 "Representative directors" are statutorily recognized and are considered by some as a sub-corporate organ along with the BOD, the SGM, and the auditors under the Japanese Commercial Code. The BOD is made up of representative directors and ordinary directors. All members of the BOD are elected by the shareholders. Ordinary directors are not representative directors. Though they are members of the BOD, they do not have the power, unless so recognized by the articles of the corporation, to execute decisions of the BOD and the SGM or to represent the corporation. On the other hand, the representative directors are statutorily recognized and required to: 1) represent the corporation and execute external affairs of the corporation on behalf of the corporation; 2) execute decisions resolved by the SGM and/or the BOD; and 3) decide and execute the decisions made by themselves relating to the day-to-day business of the corporation; The Commercial Code, art.261; Ueyanagi, supra note 163, at 132; A significant difference of the representative directors under the Japanese Commercial Code and the Anglo-American or Canadian counterparts who are generally, but not necessarily, referred to as officers of their corporations, is that the former are statutorily required to perform certain duties, while the latter is composed of a group of persons whose powers are conferred upon or delegated to them by their articles or bylaws of the corporation.
204 The Commercial Code, arts.261 and 262.
205 The Commercial Code, art.273 to 280.
This Japanese statutory requirements of corporations are similar to those in the U.S.A. or Canada, but differs largely in respect to the function of auditors. This difference is, again due to the fact that the Japanese Commercial Code was greatly influenced by European law, in its early stages of development. Unlike the corresponding Canadian law, the Japanese Commercial Code requires that every company have an auditor, regardless of, whether it is a publicly-held company or not, and the auditor has the power to monitor the directors' activities in the corporation in addition to inspecting books of the corporation.

Another significant difference pertinent to corporate organs between the law of Japan and that of some common law jurisdictions is that under the Japanese Commercial Code, officers, such as presidents or secretaries, are not statutorily required executives of the corporation. Executives with such titles exist in Japan as a matter of practice, but these executives have no statutory powers to represent the corporation or manage the corporation. Only the representative directors have any statutory powers to represent their corporation, execute decisions resolved by the SGM or the BOD or manage the day-to-day business of the corporation. In practice, most Japanese corporations have only one representative director who generally carries the title "president".

On the registration of a corporation, the name(s) of the representative

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206 Takeuchi, supra note 170, at 144.
208 Under the Canadian laws, companies, other than reporting companies may waive the appointment of an auditor. The CBCA, s.163, The BCCA, s.203.
209 Under the Canadian law, auditors' duties are only concerning financial statements of a corporation. The CBCA, s.169(1), The BCCA, s.212; Under the Japanese Commercial Code, auditors of companies with capital more than 100 million yen are authorized to investigate the management of directors of the corporation. The Commercial Code, art.273 to 280.
210 Under some Canadian laws, such as the BCCA, every company is required to have a president and a secretary.(The BCCA, s.157).
director(s) and the other directors of the BOD (ordinary directors or non-representative directors), together with the auditors, must be registered as statutorily required officers.

Apart from the statutorily recognized group of directors and auditors, in practice, within corporations, there are also several customary recognized groups. According to custom, ordinary directors are referred to by different titles depending upon the level of their positions. The lowest level of directors are simply called torishimariyaku or directors; they "might be a department head or the second in command of a division." The next higher level of directors are called jyōmu torishimariyaku or managing directors; these directors are "usually responsible for two or three departments or a small division." The next level of directors is called senmu torishimariyaku or senior managing directors; they "are in charge of larger units of the company." Superior to these directorial groups is the fuku shachō or the vice president and finally above the vice president and all others is the shachō or the president. From among these different levels of directors, a corporation generally delegates its powers to manage the affairs of the corporation by its articles or resolutions of the BOD, to the managing directors and the senior managing directors.

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211 Clark Rodney, supra note 14, at 100.
212 Ibid.
213 Ibid.
214 Most corporations in Japan form executive committees or management committees which meet more frequently than the BOD. "According to a survey, 87 per cent or 86 per cent of the large corporations have management committees"; Kono, Toyohiro, Strategy and Structure of Japanese Enterprises (London, The MacMillan Press Ltd., 1984), at 24; Though these committees are not statutory recognized, in fact, they play a similar role as to the BOD, and determine affairs of day-to-day business of the corporation. These committees are composed of high ranking directors, such as the president, the vice-president, senior managing directors, and managing directors; Heftel, Christopher Lee, "Corporate Governance in Japan: The Position of Shareholders in Publicly Held Corporations" in University of Hawaii Law Review, Vol.5, No.1, Spring 1983, at 154-155; Tanaka, supra note 21, at 478; Ueyanagi, supra note 167, at 21; Kitazawa, Kaishahō, supra note 75, at 350.
The distinction between the statutory and customary categories of directors should be clearly kept in mind when considering or dealing with Japanese corporate directors.

The SGM and the BOD are the primary statutory corporate organs, and thus their legal positions and powers should be closely examined in the course of any legal analysis of corporate management. This thesis will therefore head in this direction. However, at the same time, it is also important to recognize that, as demonstrated above, there exist other legal and extra-legal organs or groups who have been deeply involved in corporate management.
CHAPTER FOUR
THE HISTORICAL TRANSITION OF SGM AND BOD
UNDER THE COMMERCIAL CODE

As the Japanese social, economic and political situation underwent tremendous change, so the legal positions of the primary corporate organs, in particularly two of them (namely the Shareholders' General Meeting (SGM) and the Board of Directors (BOD)) also experienced change to a great extent. In this chapter, these changes will be briefly examined by looking at the New Japanese Commercial Code in 1899 and its amendments to date, as well as the social, economic, and political background behind these amendments. The amendments looked at are: 1) 1911 amendment; 2) 1938 amendment; 3) 1950 amendment; 4) 1955, 1966, 1974 amendments; and 5) 1981 amendment.

1. The 1899 Japanese Commercial Code\(^{215}\)

This first Commercial Code, as described in Chapter I as "the New Commercial Code," was modeled after the German Commercial Code of the day. The Code "inherited the concept of the corporate law of Europe in the late 19th century; though the concept was based on the separation of ownership and management, yet the shareholders general meeting had the ultimate and omnipotent power over the corporation."\(^{216}\)

According to this Commercial Code, the SGM could decide all corporate matters, even those which were not specifically laid down under the provisions of the charter of the corporation or granted to it by statute. Moreover, the SGM, by

\(^{215}\) Supra note 43.

\(^{216}\) Kitazawa, Kabushiki Kaisha\(h\)\(o\) Kenky\(u\), supra note 168, at 212 (My translation).
resolution, could restrict any activities of the directors of the corporation.217

2. The 1911 Amendment218

The main purpose of this amendment was to deal with the flood of bubble corporations after the Russo-Japanese War.219 The main point of the amendment was to clarify and reinforce directors' liabilities.220 The relationship between the corporation and the directors was not clearly stated in the Commercial Code prior to this amendment. At this time the first definition concerning this relationship was written into the statute and has been an inherent part of the Code ever since. It provides as follows: "The relations between the company and the directors shall be governed by the provisions relating to mandates."221 Accordingly, "directors have a duty to conduct the business of the company with the standard of care of a good manager."222

3. The 1938 Amendment223

After the amendment in 1911, the Japanese economy underwent radical change which was attributed to World War I. Post World War I Japan experienced remarkable economic growth. As companies grew bigger, the separation between ownership and control also increased.224 Against this background, the 1938

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217 *Ibid*, See also Ueyanagi, *supra* note 167, at 5; 1899 Commercial Code arts.164, 167, 175, 179, 189, 199, 208, 213, 221, 222; This issue will be discussed in Chapter V; see *infra*, note 286 to 293 and accompanying text.

218 *Supra* note 47.

219 1904-1905.


222 *The Civil Code of Japan* (Law No.101, September 26, 1987), art.644; This duty will be explained in Chapter VI. 2. Duty of Care and Skill.

223 *Supra* note 48.

amendment was introduced.225

The main discussion leading up to the amendment centred around whether or not the powers of the SGM ought to be reduced. The resulting amendment followed the principle of the supremacy of the SGM. Moreover, it expanded the power of the SGM, adding to the matters which should be resolved by the SGM.226 It was no longer mandatory that directors and auditors of a corporation be shareholders, as was the case prior to the amendment. This allowed the corporation to recruit managers from outside the corporation more easily. It shall be realized that outside directors might not desire to be shareholders of the corporation, or the corporation may not wish to have the outside directors as shareholders.

In addition, non-voting shares were first introduced by this amendment. The introduction of non-voting shares was in part an outright statutory recognition of the concept of separation of ownership and control. In other words, it recognized "shareholders who, had no interest in the management of the corporation, and retained their shares exclusively for investment purposes in the corporation. To these shareholders the existence of the voting rights did not matter. Their main concern was the quantity of the dividends which they would receive; the non-voting shares, which were required by statute to be preferred shares, were the most suitable to appease these shareholders’ concern."227

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225 This amendment was made based on the draft amendment of Commercial Code in 1931. See The Code Translation Committee, The Commercial Code of Japan Vol I, supra note 221, at xxxix to xliii.


227 Tanaka, supra note 21, at 442 (My translation).
4. The 1950 Amendment\textsuperscript{228}

This amendment was the most significant in the history of the Japanese Commercial Code. Through this amendment, the Japanese Commercial Code, which up to this point had been based on an European continental model, largely adopted American corporate laws.\textsuperscript{229}

Professor Tanaka points out three reasons for this amendment.\textsuperscript{230} The first was to facilitate the financing of corporations, through the introduction of non-par value shares\textsuperscript{231} and authorized but unissued capital.\textsuperscript{232}

The second, was the seeking of American funds for the Japanese market. It was thought that the harmonization of the Japanese Commercial Code and its American statutory counterparts would produce a feeling of security that would entice American investors to invest their capital in the Japanese market. "Registration requirements applicable to foreign companies and a clear guarantee of their equal and nondiscriminatory standing as compared with domestic concerns"\textsuperscript{233} were also added.

The third reason, usually stated as having the greatest significance and relevance, was the democratization of the shareholders' position within the

\textsuperscript{228} Supra note 50.

\textsuperscript{229} Supra, see Chapter I.4, Amendments to the New Commercial Code; Kitazawa, Kabushiki Kaishahō Kenkyū*, supra note 168, at 221 to 222; Kitazawa, Kaishahō, supra note 75, at 230; Tokyo Hōgaku Kenkyūkai and Inoue Hōritsu Sōgō Kenkyūkai, supra note 184, at 43; Ueyanagi, supra note 167, at 7 to 8; Tanaka, supra note 21, at 99 to 106; Salwin, supra note 51, at 484 to 488.

\textsuperscript{230} Tanaka, supra note 21, at 99 to 101.

\textsuperscript{231} Salwin, supra note 51, at 500; art.199.

\textsuperscript{232} Ibid, at 500; art.166, para.1.

\textsuperscript{233} Ibid, at 487; art.485-2.
corporation, corresponding to the democratization of the Japanese society in general. This phenomenon of the shareholders' democracy movement is seen as being responsible for the recognition of new rights of shareholders. These rights included: rights of access to corporate books and records; preemptive rights; cumulative voting rights; the rights to bring derivative actions; the right to demand stoppage of parallel directors' actions; and the right to outright stop a director from doing something which shareholders consider not in the best interest of the corporation.

Along with the democratization of the shareholders' position, another significant change to the Commercial Code was also made. This reduced the power of the SGM and expanded the power of directors. Because the dissolution of the Zaibatsu led to the further separation of ownership and control, it was considered important to reform the corporate management system. For this reason, the power of the SGM, which to this point had been omnipotent in a corporation, was extensively curtailed, while the powers of directors were expanded. It is important to note that prior to this amendment, the statutory recognized organ for managing

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234 A contrary view is held by Professor Kojima. He argues that this amendment was intended not to democratize shareholders' position, but to reorganize monopolistic Japanese capitalism by uniting American monopolistic capitalism under the American occupation. He mentions facts which support his view: 1) The Anti-Monopoly Law was amended in 1949. This amendment mitigated the restriction of share ownership, while mergers and acquisitions of corporations became possible by notifying instead of getting approval of Minister of Finance. The restriction on concurrent position as directors was relieved. Moreover the laws which were designed to dissolve Zaibatsu was actually broken down by the announcement by SCAP to remove most of the companies from the list of companies which were to be dissolved. 2) By this amendment the power of shareholders general meeting was reduced. See Kojima, Yasuhiro, *Daikigyo Shakai no Hochitsujo* [Legal Order in the large corporations' society] (Tokyo, Keisô Shobô, 1981), at 166 to 171.

235 Art.293-6.

236 Arts.245-2, 408-3.

237 Art.256-3.

238 Art.267.

239 Art.272 reads "In case a director performs an act which is not within the scope of the objects of the company, or an act against any law or ordinance or the articles of incorporation, and thereby gives rise to fear of irreparable damage done to the company, any shareholder who has held a share continuously at least for the last six months may demand of the director for the stoppage of such act on behalf of the company."
a corporation was individual directors and directors acting as a group. The concept of the BOD, as a policy-making organ, did not exist.\textsuperscript{240} The introduction of the notion of the BOD and provisions regulating the BOD into the Code is one of the greatest influences of American corporate laws on Japanese corporate law. Further, the adoption of this concept has been one of the major fundamental changes in Japanese corporate law.

The SGM no longer had the power to decide all corporate matters, but could only decide matters which were explicitly stated in the corporate statute or the charter of the corporation as being within its jurisdiction.\textsuperscript{241} Further, the matters which were provided by the statute as being within the jurisdiction of the SGM to resolve were also decreased by this amendment.\textsuperscript{242}

5. The 1955, 1966, 1974 Amendments\textsuperscript{243}

Through these amendments, the power of the SGM was further reduced, while the powers of the BOD were increased.\textsuperscript{244} At the same time, the auditors' powers to monitor the activities of directors were expanded.\textsuperscript{245} For instance, prior to the 1955 amendment, any restriction of the preemptive rights of shareholders had to be explicitly stated in the charter of the corporation. By the 1955 amendment, shareholders, in principle, had no preemptive rights, unless they were granted to them

\begin{itemize}
\item[\textsuperscript{240}] Tanaka, \textit{supra} note 21, at 377 to 378.
\item[\textsuperscript{241}] \textit{Infra}, see Chapter V. 1. The Power of Shareholders General Meeting.
\item[\textsuperscript{242}] \textit{Ibid}; Kitazawa, \textit{Kai\-sha-\-hô}, \textit{supra} note 75, at 230.
\item[\textsuperscript{243}] Law No.28 June 30, 1955; Law No.83 June 14, 1966; Law No.21 Apr 2, 1974; Kitazawa, \textit{Kabushiki Kai\-sha-\-hô Kenkyû}, \textit{supra} note 168, at 229 to 232; Tokyo Hôgaku Kenkyûkai, \textit{supra} note 184, at 45; Ueyanagi, \textit{supra} note 167, at 8 to 9.
\item[\textsuperscript{244}] Kitazawa, \textit{Kai\-sha-\-hô}, \textit{supra} note 75, at 232.
\item[\textsuperscript{245}] \textit{Ibid}.
\end{itemize}
by the BOD or the charter of the corporation provided otherwise.\textsuperscript{246}

Some changes were introduced for the purpose of protecting individual shareholders. In case of the issuance of new shares to persons other than shareholders of the corporation, the provision which had formerly required an ordinary resolution of shareholders by way of authorization was amended to require a special resolution.\textsuperscript{247} But this provision was further amended in 1966. The Code now provides that the issuance of new shares with a special favourable issue price to persons other than shareholders must be authorized by a special resolution of the SGM.\textsuperscript{248}

The 1974 amendment gave additional power to the BOD and improved the monitoring role of the auditors. The BOD was allowed to issue convertible bonds. Prior to these amendments, a special resolution of the SGM would have been required to issue these bonds. Also pursuant to this amendment, auditors of large corporations, whose capital exceeded 100 million yen, were authorized to inspect, not only the financial statements of the corporation, but also the management of the corporation.\textsuperscript{249}

6. The 1981 Amendment\textsuperscript{250}

In 1973, the Judicial Affairs Committee of the House of Representatives and

\textsuperscript{246} Art.280-2, para.1: Kitazawa, \textit{Kaishahō, supra} note 75, at 232: Prior to the amendment, the company had to provide in its charter the existence, non-existence, or restriction of pre-emptive rights of its shareholders. Pre-1955 Code art.166, para.1(5), art.374, para.2.

\textsuperscript{247} Pre-1966 Commercial Code, art.280-2, para.2.

\textsuperscript{248} Art.280-2, para.2.

\textsuperscript{249} For instance, art.274 of the Code prescribes "An auditor shall audit the execution by the directors of their functions." Art.275 and 275-2 provide for respectively; the auditor's duty to examine the proposal prepared by directors which are to be submitted to the SGM, and the auditor's right to request directors that they stop actions which are not within the scope of the corporation's objective or in violation of laws; Prior to the amendment, auditors had power to monitor only the financial statements of the corporation.

\textsuperscript{250} Law No.74, June 9, 1981; Ueyanagi, \textit{supra} note 167, at 9 to 13; Takeuchi, \textit{supra} note 170, at 1 to 16; Tokyo Hōgaku Kenkyūkai, \textit{supra} note 184, at 46 to 51.
the House of Councillors requested that the Japanese Government immediately amend the article of the Commercial Code concerning the social responsibility of corporations, the active role of the SGM and the system of the BOD. These requests arose out of specific social circumstances in Japan at the time.

First, "anti-social activities, such as buying up of land, by large corporations, had been criticized since around 1972." Second, it was pointed out that the SGM had become ineffective. While preparation of the amendment had been in progress, the Lockheed Scandal involving the Japanese Prime Minister, took place. The Japanese Government requested its Committee on the Commercial Code to formulate an amendment for immediate implementation to prevent the occurrence of any such further scandals.

Three major headings were established under the tentative plan for amending the Commercial Code. These were: 1) shares; 2) corporate organs; and 3) accounts. Here, only the second will be explained. The basis of the amendment dealing with corporate organs was a plan to revitalize the SGM through allowing shareholders' proposals to be considered at the SGM. At the same time, a new

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252 Ibid, at 3.

253 Ibid; Tokyo Hōgaku Kenkyūkai, supra note 184, at 46 to 48.


255 Ibid, at 3 to 7.


257 Art.232-2; Takeuchi, supra note 251, at 96 to 103.
provision stating that the directors and auditors should explain matters when requested by a shareholder at the shareholders' general meeting to do so was inserted. To improve the functioning of the SGM, it was also important that the so-called "sökai-ya" (professional shareholders) be eliminated. For the purpose of eliminating the Soki-ya, the provision prohibiting a company from offering any of its property or assets to shareholders as remuneration for the exercise of their rights as shareholders was introduced.

Finally, came the last amendment in 1990 which was mainly concerned with the procedures of incorporation, shares and accounting standards for corporations. No significant changes were made concerning the SGM or the BOD.

Through, over a century of historical transition in positions and powers of the SGM and the BOD, demonstrated above, these two organs are now exercising their present powers subject to the relevant provisions of the present Code. Among these two organs, the SGM sits on the top of corporate structure as the ultimate decision maker. The SGM is empowered to steer the corporation in its future direction. The next chapter examines the legal powers of the SGM under the present Code, and its present problems.

258 Art.237-3; Takeuchi, supra note 251, at 103 to 108.

259 "The 'sökai-ya' have been described as professional stockholders in Japan's larger corporations who either extort funds from management under threat of revealing company errors and misdeeds, or work for the companies by providing information, stifling criticism and intimidating opposition shareholders.... One who earns his living from general stockholders meetings"; Rostrom, Dean L., "Corporate Extortion in Japan: Sökai-ya Endure Commercial Code Amendment" in Brigham Young University Law Review, Vol.1987, No.2, at 699; Kawamoto, Ichiro and Monma, Ittoku, "Japan's Breed of Fixers" in Far Eastern Economic Review, June 25, 1976; For a detail, see infra, Chapter V.3. Present Problems Surrounding Shareholders General Meeting in Japan.

260 Art.294-2; a detailed discussion regarding the sokai-ya will be made in the next chapter; infra, Chapter V. 3. Present Problems Surrounding Shareholders' General Meetings in Japan.

CHAPTER FIVE
SHAREHOLDERS' GENERAL MEETING

The Shareholders' General Meeting is the key corporate organ composed of the shareholders of the corporation. Its main function is to determine the management of the corporation.\(^{262}\)

The powers of the SGM, as granted by the Commercial Code, have undergone tremendous change. Though the SGM remains the supreme corporate organ, it is no longer the omnipotent body that it was prior to the 1950 amendment.\(^{263}\) In this chapter, the present powers of the SGM, the conduct of the SGM under the Commercial Code and the present problems concerning the SGM in Japan are examined. Comparison will also be made to the relevant provisions of Canadian corporate statutes (primarily the *British Columbia Company Act* (the BCCA)\(^{264}\) and the *Canada Business Corporations Act* (the CBCA)\(^{265}\)).

1. The Power of Shareholders' General Meeting

Article 230-10 of the Commercial Code\(^{266}\) provides that resolutions shall be adopted by the general meeting *only regarding matters specifically provided for in the Code or in the articles of incorporation.*\(^{267}\) What is the meaning of this article? Does it limit the resolutions which may be adopted by the SGM? Does it exclusively allow only certain matters to be resolved by the SGM? What happens if the statute


\(^{263}\) *Supra,* Chapter IV. 4. The 1950 amendment.


\(^{266}\) Law No.64, June 29, 1990; *supra*, note 53.

\(^{267}\) Art.230-10.
grants certain powers elsewhere and if those same powers are granted by the articles
of the corporation to the SGM? In other words, may the SGM by the articles of the
corporation contract out of statute and decide matters which are to be resolved by
someone else?

(a) "The matters provided for in this Code" to be resolved by the SGM include:
1) fundamental changes to the corporation; 2) election and removal of the
directors and auditors of the corporation; 3) approval of the financial statements
of the corporation; 4) the declaration of share dividends; 5) the issuance of
new shares, to those other than shareholders, at an especially favourable issuing
price; and 6) the remuneration of the directors and auditors. These
matters are to be resolved exclusively by the SGM, and the SGM may not delegate
any of these powers to any other person(s) or organ(s), even through the articles of
the corporation or a resolution of the SGM. For example, a contract concluded
between a representative director and a director of the corporation, providing that
the latter director shall not be removed within a certain period of time is null and
void. The SGM may always remove any directors at any time, by a special resolution
(two-third or more of the quorum).

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268 Art.342, para.1 (Alteration of the article of the corporation); art.245, para.1 (The transfer of
the whole or of an important part of the business of the corporation; art.408, para.1 (Amalgamation);
art.404(2) (Dissolution); art.406 (The continuation of the dissolved corporation;
Art.375,para.1 (Deduction of stated capital).
269 Art.254,para.1; art.257, para.1; art.280, para.1; art.254, para.1; art.375, para.1.
270 Art.283, para.1; art.419, para.1; art.427, para.1.
271 Art.293-2.
272 Art.280-3, para.2.
273 Art.269; art.279.
274 Ueyanagi, supra note 167, at 21 to 23.
275 Ueyanagi, supra note 167, at 23; Tanaka, supra note 21, at 378: This view is ostensibly accepted.
276 Tokyo District Court, February 13, 1952, Kōminshū 5-9-360; Quorum for a SGM is one-half
of the total number of the issued shares (art.343).
Comparing the statutes of Japan and Canada, there are several interesting differences concerning matters which are required to be resolved by the SGM under the statute.

Firstly, although it is presumed that directors are to be elected by shareholders of their corporation at a general meeting and, in fact, most statutes in Canada including the CBCA\(^{277}\) so provide,\(^{278}\) the BCCA is silent on this point. The BCCA only provides that the power to elect the directors is a matter for the articles of the corporation.\(^{279}\) Therefore, it is possible, under the BCCA, for directors to be elected by specific persons or groups, if the articles of the corporation so stipulate.\(^{280}\)

Secondly, with regard to the power to remove directors, the provision in the BCCA appears to be an exceptional one in comparison to those in other Canadian jurisdictions.\(^{281}\) The provision of the BCCA confers the power to remove directors, at any time, on the SGM regardless of any contracts or provisions in the corporation’s articles to the contrary.\(^{282}\) In most other jurisdictions (since their statutes do not contain such a provision and the issue appears not to have been a bone of contention),\(^{283}\) it is not clear whether or not the power to remove directors by the SGM overrides any contracts or the articles of the corporation.

\(^{277}\) The CBCA, sec.106(3).

\(^{278}\) Hadden, \textit{supra} note 67, at 198.

\(^{279}\) BCCA, sec.134(2).

\(^{280}\) Hadden, \textit{supra} note 67, at 199.

\(^{281}\) This probably reflects the greater influence of the English Company Act on BCCA. (comment by Professor Robert K. Paterson of the University of British Columbia, Faculty of Law on August 9, 1993).

\(^{282}\) The BCCA, sec.154(3).

\(^{283}\) A 1960 English case (Shindler \textit{v.} Northern Raincoat Co. Ltd. [1960] 2 All E.R.239,[1960] 1 W.L.R. 1038) stated "no contract between the director and the corporation could circumvent the statutory power of the shareholders to change the corporate constitution."
Thirdly, it has generally been assumed that under Canadian law the power to declare dividends is a matter entirely within the discretion of the BOD, whereas in Japan "the shareholders general meeting has the power to approve or negate a decision of the board of directors declaring a dividend." The notion behind this distinction appears to be that in Japan the right to receive a distribution of profits from the corporation is considered to be one of the most fundamental right of shareholders, hence the power to make the final decision to declare a dividend is vested in the SGM. On the other hand, in the U.S.A. or Canada, the power to decide whether profits should be distributed to the shareholders of the corporation is vested in the BOD, because it is deemed to be within the discretion conferred upon the directors.

(b) "The matters provided for in the articles of the corporation" are also to be exclusively resolved by the SGM. It is generally accepted by the majority of scholars and jurists that this provision allows the SGM to resolve matters which are placed under its jurisdiction by the articles of the corporation, even though they ought to be resolved by the BOD according to the statute. Under these conditions, the shareholders are not considered directors, and are not held responsible as directors for their actions.

Some scholars object strongly to this point. They present arguments which can be illustrated by the following example:

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284 Although, statutes in Canada do not provide for directors' dividends power, the power to dividends is "assumed to emanate from the directors' statutory power to manage corporate affairs"; Welling, supra note 138, at 644; Hadden, supra note 67, at 321.

285 Kitagawa, supra note 55, at sec.7.06[23].

286 Supra, note 262.

287 Tokyo Hōgaku Kenkyūkai, supra note 184, at 199; Ueyanagi, supra note 167, at 25.

288 Ueyanagi, supra note 167, at 25.
In the case of the appointment of a representative director, the resolution should not be made by the SGM, even though the articles of the corporation provides so. This is because, if the SGM has the power to appoint a representative director, the power to remove him would no longer vest in the BOD. Therefore, the BOD would lose an important element of its monitoring power over representative directors.\(^{289}\)

It is my opinion, in looking at any conflict between the statute and the articles of the corporation, the interest of the shareholders should be paramount in making a decision.

Comparing the principle supported by the majority of scholars in Japan with the laws of Canadian jurisdictions, I will examine the relevant sections of the BCCA. According to the BCCA,\(^{290}\) any articles which are inconsistent with a mandatory provision of the Act are null and void as a matter of ordinary interpretation. Thus, it would not be possible for the SGM to resolve matters which ought to be resolved by the BOD under the statute. The BCCA also clearly states that the managerial powers of the BOD are subject to the articles of the corporation.\(^{291}\) In other words, the articles of the corporation may reserve a variety of powers of the BOD, unless it is clearly contrary to the statute. It is clear, according to the statute and also the common law,\(^{292}\) that if matters are to be resolved by the BOD according to the

\(^{289}\) Even if the shareholders do not have the power granted to them by the articles of the corporation to elect a representative director, they still hold the power of determining who the representative directors will ultimately be. If the directors should chose a representative director whom the shareholders do not desire, then the shareholders may request that he step down; if the director should fail to step down, the shareholders may call an appropriate meeting and remove him as directors.

\(^{290}\) Sec.13.

\(^{291}\) The BCCA, sec.141.

\(^{292}\) Automatic Self-Cleansing Filter Syndicate Co.Ltd. v. Cuninghame [1906] 2 Ch.34, 75 L.J.Ch.437 (C.A).
articles of the corporation, the SGM may not resolve the matter without first altering the articles of the corporation. Does this mean that the SGM may resolve any matters provided that such matters are within its jurisdiction under the articles of the corporation? Does it mean that the articles of the corporation might reserve a variety of powers for the SGM, and thereby be able to reduce the powers of the BOD of the corporation?

It seems to me that the answer to both of these questions is "yes." Further, it would appear that shareholders through the SGM may contract out of statute or common law unless the statute explicitly prohibits such contracting out. Though, if they should choose to do this, in respect of the duties of directors, they will be considered as directors for their actions.293

2. The Conduct of The Shareholders' General Meeting

This section mainly deals with procedural issues of the SGM under the Code. Although these issues are not directly related to the primary purpose of this thesis, they will shed some light on the basic viewpoint of the Code regarding the SGM.

2.1 Convening a Shareholders' General Meeting

Articles 231 to 237 of the Japanese Commercial Code deal with matters concerning the convening of the SGM. The shareholders annual general meeting is required to be held at least once in every corporate year.294 The BOD may call a SGM at any time by the passing of a resolution of the BOD.

The shareholders by written petition to the BOD may request a SGM. Only

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293 The BCCA, sec.1 defines "director" as "every person, by whatever name he is designated, who performs functions of a director".

294 Kitagawa, supra note 55, at sec.7, 06[19]; Kitazawa, Kaishahō, supra note 75, at 258 to 261; Kawamoto, supra note 76, at 278 to 279; Ueyanagi, supra note 167, at 92 to 101; Tanaka, supra note 21, at 397 to 403.
shareholders who hold shares representing not less than three-hundredths of the total number of the issued shares, continuously at least for the last six months prior to the petition, may be involved in this petition. In the absence of co-operation by the BOD with their petition, the shareholders may convene the SGM with the permission of the court.

Under the Canadian law (for instance the BCCA), the same requisitioned meetings are recognised, but the limitations placed on the shareholders who may call these meetings are not as stringent. The BCCA only requires that the requesting shareholder hold a minimum of five percent of the total issued shares at the date of the deposit of the requisition, and no court approval is needed for the convening of a SGM by the shareholder in the absence of cooperation from the BOD with the shareholder's original request.

The requirement that one must hold shares for at least the last six months prior to the request for the SGM was inserted in the 1950 amendment to eliminate "Kaisha Arashi", individuals who, by threatening to convene a SGM for their own purposes, would temporarily acquire shares of a corporation for the purpose of extorting the corporation.

The other procedural requisitions provided for in the Commercial Code are relatively simple and are omitted here. Two issues related to the procedure of the SGM which have been controversial are discussed below: 1) The Validity of

\[\text{Art.237, para.1.}\]
\[\text{Art.237, paras.1,2.}\]
\[\text{The BCCA, sec. 171.}\]
\[\text{"Kaisha Arashi" literally means corporate robbers, or corporate damagers.}\]
\[\text{Tanaka, supra note 21, at 400; Ueyanagi, supra note 167, at 110.}\]
\[\text{Kitagawa, supra note 55, at sec.7.06[19].}\]
unanimous shareholders’ resolutions; and 2) Resolutions of one-person corporations.

2.2 Unanimous Shareholders’ Resolutions

The SGM, in principle, should be convened by a resolution of the BOD. Unlike Canadian law, there is no provision in the Commercial Code which clearly provides for the validity of resolutions signed by all the shareholders of a corporation, but not actually held or held through defective procedures. Formerly, the validity of unanimous shareholders resolutions was denied by the court, but in 1956 the Tokyo District Court, together with the majority of legal scholars, decided otherwise and recognised the validity of unanimous shareholders resolutions.

In a decision rendered in 1956, the Tokyo District Court held "... it has to be recognized that there was a defect on the procedure to convene the meeting, but it is appropriate to understand that this kind of defect does not affect the validity of the resolution. This is because the rationale of the requirement of sending the notification for convening a SGM to each shareholder by the Commercial Code is, presumably, to protect the shareholders’ interest; therefore, in the case where all the shareholders waive their statutory rights and resolve the matter without any objection, there is no reason to render it null and void."

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301 Art.231.
302 The CBCA, sec.142 provides that a resolution by all the shareholders is as valid as if it had been passed at a SGM; See Zeigal, supra note 66, at 904 to 908.
303 The Daishinin Hanketsu, February 12, 1932, Minshu, 11-207; See Tanaka, supra note 21, at 458; The court held that a meeting, which is not convened by the required procedure, even though all the shareholders attended to the meeting, is a mere meeting of shareholders; therefore the resolutions which were made by the meeting are null as a resolution of the SGM.
304 Ueyanagi, supra note 167, at 33 to 35; Kitazawa, Kaishahô, supra note 75, at 264 to 265; Tanaka, supra note 21, at 458.
305 The Tokyo District Court, December 22, 1956, Jurisuto No.128, at 77.
306 Ibid (My translation).
2.3 One-person Corporations and the Shareholders’ General Meeting

It is also considered to be valid for one-person corporations, which are corporations constituted of only one person each, to resolve matters without the statutorily required procedures of convening a SGM. The reasons are the same as those referred to in the above section on the unanimous shareholders resolutions.\(^{307}\)

It should be noted that while one-person corporations are not statutorily recognized corporations in Japan, majority academic opinion\(^{308}\) and case law\(^{309}\) recognize their existence. The rationale for this recognition is two-fold. Firstly, by the 1938 amendment of the Commercial Code, the provision which provided that a corporation shall be dissolved by the reduction of its shareholders to fewer than seven persons,\(^{310}\) was deleted. The purpose of this amendment was seen as condoning one-person corporations.\(^{311}\) Furthermore, it is now possible to incorporate a corporation with only one subscriber, though this was not the case prior to the 1990 amendment.\(^{312}\) This amendment substantiated the legal existence of one person corporations. Secondly, even if all the shares are presently owned by a sole shareholder, due to their transferability, it is potentially possible for the shares to be transferred to several other persons in the future.

For these reasons, although the Commercial Code does not explicitly recognize the legitimacy of one-person corporations, it is generally recognized that one-person corporations exist, and that resolving matters without following statutorily required

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\(^{307}\) Ueyanagi, \textit{supra} note 167, at 34; Tokyo Hôgaku Kenkyûkai, \textit{supra} note 184, at 7 to 8.

\(^{308}\) \textit{Ibid}.

\(^{309}\) \textit{Ibid}; \textit{The Supreme Court, June 24, 1971}, Minshû, 25-4, at 596.

\(^{310}\) Prior-1938 Commercial Code, Art.221, para.3; For the English translation, see \textit{The Commercial Code of Japan} by the Code Translation Committee.

\(^{311}\) Tokyo Hôgaku Kenkyûkai, \textit{supra} note 184, at 8.

\(^{312}\) Prior to 1990 amendment, at least seven subscribers were required (art.165).
procedures constitutes a valid SGM.\textsuperscript{313} In 1971, the Supreme Court held\textsuperscript{314}:

"as for one-person corporations, the sole shareholder constitutes the shareholders general meeting, and it is not necessary to follow the required procedure under the law".\textsuperscript{315}

Similarly, it has been controversial in Canadian jurisdictions as to whether or not one-man meetings are legitimate. Although the common law position seems negative on this point,\textsuperscript{316} recent statutes in some jurisdictions recognize the legitimacy of one-man meetings.\textsuperscript{317}

3. Present Problems Surrounding Shareholders' General Meetings in Japan

Although the Commercial Code recognizes that the SGM is vested with considerable powers as the supreme corporate organ, it is the accepted fact that the SGM has been reduced to nominal importance and that, adding insult to injury, it does not function as it ought to.

The SGM in Japan was traditionally not the place for the exchange of information or holding debates among shareholders or between shareholders and management.\textsuperscript{318} "The 1990 White Paper on The Shareholders' General Meeting"\textsuperscript{319} reported on a survey of 2,089 corporations. Some startling facts emerged from the report. In 78.9 per cent of the corporations, the SGMs were

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\textsuperscript{313} In Canada, one-person corporations are recognized by the statutes; The CBCA, sec.139(4), sec.114(8), The BCCA, sec.165.
\textsuperscript{314} Supra, note 309.
\textsuperscript{315} Kitazawa, Kaishahō, supra note 74, at 265.
\textsuperscript{316} Welling, supra note 138, at 491 to 492.
\textsuperscript{317} The CBCA, s.139 (4); The BCCA, s.165.
\textsuperscript{318} Foster, supra note 256, at 592.
\end{flushright}
conducted in thirty minutes or less. Only 3.8 per cent of surveyed corporations had SGMs longer than 60 minutes. At 3.4 per cent of the meetings, motions were laid on the table, while at only 12.3 per cent of the meetings at least one shareholder other than a director or executive of the corporation spoke. Obviously, most SGMs in Japan are expedited one-sidedly by corporate management, without any objections by the shareholders of the corporation.

The expeditiously concluded SGMs in Japan can be attributed not only to indifferent shareholders but also the existence of the "Sôkai-ya" or professional shareholders who "either extort funds from management under threat of revealing company errors and misdeeds, or work for the companies by providing information, stifling criticism and intimidating opposition shareholders." Before the 1981 amendment to the Commercial Code, the Sôkai-ya had a large number of persons associated with it, and they generally controlled the SGM.

Prior to the 1981 amendment, there existed a provision, which still exists in the present Commercial Code, concerning "the crime of bribery in connection with voting or bringing action". The provision states: "Persons who have, in response to unlawful solicitations, received, demanded or entered into an agreement to receive or to give any benefit of a proprietary nature ... shall be liable to imprisonment with hard labour ... or to a fine ..." But due to the difficulty in proving, the "unlawful solicitation", it was and continues to be an extremely up-hill battle to obtain a conviction under this section. In fact, only a few cases have been reported in

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320 Ibid, at 78 to 79.
321 Ibid.
322 Rostrom, supra, note 259.
323 Art.494.
connection with this provision. In one 1969 case, the directors of a corporation who had failed in their attempt to invent a new type of colour television after investing a huge amount of corporate funds in the venture, requested of some Sōkai-ya that they take the initiative at the SGM to control those shareholders who were predicted to pursue the liabilities of the directors for their misdeeds, and rewarded them with remuneration for their cooperation. In this case, the Supreme Court held that the activity of the directors was "unlawful solicitation" under Article 494 of the Commercial Code. Except for a few cases, a Sōkai-ya or officers of corporations who made use of the Sōkai-ya, have rarely been convicted under Article 494.

It had been suggested by many scholars that Article 494 was not effective in eliminating the Sōkai-ya. These scholars suggested the introduction of a more effective provision into the Commercial Code. Consequently, a new provision prohibiting a corporation from offering any of its property or assets to shareholders as remuneration for the exercise of their rights as shareholders was inserted into the Commercial Code in 1981. Since the insertion of this provision, the activities and the number of the Sōkai-ya have diminished. The number of Sōkai-ya is now estimated at one thousand, having decreased from an estimated ten thousand just prior to 1981. The amount of money that corporations were offering to these Sōkai-ya prior to 1981 was calculated at 100 billion yen per year or roughly 1 billion Canadian dollars per year. This amount is also presumed to have been reduced

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325 Ibid.

326 Art.294-2.


328 Calculated by exchange rate of 1 Can$ = 100 Japanese Yen.
by a large margin.\textsuperscript{329} \textit{S\=okai-ya} still exist and like most parasites have built up an immunity to the methods developed to extinguish them. The members of this group have been altering their methods, mode and manner and making use of new technology and in most of the known cases they have done so to their advantage. For instance, in the past, the \textit{S\=okai-ya} would extort money from corporations of which they were shareholders by simply visiting the offices of these corporations and implicitly stating their business. Here there would be no direct threats or demands made during their visit, but the purpose and the motive of such visits would be clearly understood by the officials of the corporation, who were expected to pay off these culprits to prevent any unfavourable disruptions of the SGM. This activity was not considered illegal since the shareholders had a right to visit the office of their corporations and the corporations would voluntarily offer them money or some other consideration in return for their silence of lack of it.

Since the 1981 amendment, offering the \textit{S\=okai-ya} money or other consideration in return for some specific exercise of their rights as shareholders has been prohibited by law; but these \textit{S\=okai-ya} have resorted to other ways and means which technically fall within the law, such as use of publications. For example, they would publish a so-called "magazine" containing information which would not necessarily relate to the corporation. This magazine would be presented to the corporation which would be requested to purchase it for an exorbitant amount of money. Again there would be no direct threats on which to base criminal action.

It should be noted that in a few cases there would be direct extortion. Here the \textit{S\=okai-ya} might threaten to expose some illicit corporate activity at the SGM. In a few cases, management of the corporation would hire the \textit{S\=okai-ya} to perform some coercive function at the meeting which would be to management’s benefits. These

\textsuperscript{329} \textit{Supra}, note 327; no information was obtained for the actual amount.
kinds of activities would be considered illegal under both Article 294-2 introduced by the 1981 amendment and Article 494.

It is also significant that many gangsters are now playing an active part as Sōkai-ya though this was formerly not the case. The old Sōkai-ya were rarely members of gangster organizations, even though they would sometimes utilize gangsters as body guards.330

Although the Sōkai-ya still exist and have become more adroit in extorting pecuniary benefits from corporations, the 1981 amendments have undoubtedly contributed to the reduction of the Sōkai-ya and hopefully their activities to some extent. However, the same amendment ironically contributed to legitimize the power of the Sōkai-ya. The amendment was undertaken with the aim of promoting the concept of "shareholder democracy", which was thought could be realized not only by eliminating the Sōkai-ya, but also encouraging shareholders to enthusiastically participate in the SGM and thus activate the SGM.331 Thus, the amendment inserted provisions which gave shareholders the right to request in writing of the director six weeks before the meeting to make a certain matter the object of discussion at the general meeting.332 In other words, shareholders were given the statutory right to place certain matters on the agenda of a general meeting, providing a request is made from the shareholders to the BOD at least six weeks before the day of the general meeting. The amendments also mandated corporations to explain the matters requested by the shareholder in the general meeting.333

330 Ibid, at 82.
331 Rostrom, supra note 259, at 706 to 707.
332 Art.232-2; The provision continues as "Provided that, this shall not apply if the matter is not the one to be resolved in the general meeting.
333 Art.237-3; The provision continues as "Provided that, this shall not apply if there are reasonable cause, such as if the matter has no relation with the object of meeting, if the explanation injures the common interests of the shareholders, or if the explanation needs investigation. 2. The director and auditor cannot refuse explanation by reason that investigation is needed if the shareholder had before
Hence, the more power shareholders obtained, the more power the Sokai-ya also obtained. The Sokai-ya started to utilize these newly recognized rights of shareholders as a weapon to harass corporate management. The problem here is that it is almost impossible to distinguish the Sokai-ya's harassment from the legitimate exercise of shareholders rights. If a corporation refuses to fulfil the Sokai-ya's request to explain matters it may end up facing the wrath of the law in more ways than one which may end up being vary costly to it. The Sokai-ya is sometimes not only a blackmailer but also a legal expert. Miyata Kogyo and Matsumura-Gumi were actual cases which the Sokai-ya sued the corporations alleging that, at the meetings, the corporation ignored their questions which had been legally submitted prior to the meetings. Regrettably these cases were withdrawn by the plaintiffs before the courts would express their views towards the Sokai-ya and protecting shareholders rights. It is interesting, but probably impossible to find out what deals were made between the corporations and the Sokai-ya pertaining to this matter. One thing appears to be clear, and that is that the corporations learned a lesson from these cases: mistreating the Sokai-ya may cause them an expensive law suit. The only way for a corporation to avoid this would be either to pay them off or be prepared to answer any legitimate questions without regard to cost.

So far, however, it is apparent that Japanese corporations have not developed the mind-set which would allow them to engage and remove the Sokai-ya. This is evidenced from the fact that in the ten years since the passing of the amendment,

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334 Rostrom, supra note 259, at 707.
335 The law suit was brought to the Yokohama District Court on February 21, 1985. But the case was withdrawn on February 5, 1986; Kawamoto, Ichiro et.al. "Saikin no Kabunushi Sokai kankei Soshô o Megute [Regarding the recent cases involving the shareholders general meeting]" in Shôji Hômu, No.1078, June 5, 1986, at 865.
336 The law suit was brought to the Osaka District Court on March 12, 1985. But the case was withdrawn on February 17, 1986; Shôji Hômu, No.1078, June 5, 1986, at 865.
337 Shôji Hômu, No.1078, supra note 327, at 865.
only fourteen cases relating to the amended provisions have been reported. I postulate these cases represent not the tip of the iceberg but an area occupied by a fly on the tip of the iceberg. It is extremely difficult to obtain figures concerning actual activities in this area, yet surveys of shareholders support my postulation. According to "the 1990 White Paper on Shareholders General Meetings", 52.7 per cent of the persons questioned, who were in charge of the SGM, answered affirmatively to the question, "Do you think there exist corporations which latently offer proprietary profit to the Sôkai-ya?" In short, corporate management itself is in part responsible for the failure to eliminate the Sôkai-ya.

Japanese corporate management has also induced and enforced the lackadaisical attitude of shareholders. The following facts evidence this view;

According to the "the 1990 White Paper on Shareholders General Meeting", seventy per cent of the SGM of some 2,089 reporting companies were held on one specific date within one year, which was June 28, 1989. Further within every month there existed a specific date on which most SGMs were held. These arrangements were deliberately made by the corporations. The main reasons for these arrangements were: 1) the avoidance of Sôkai-ya (45.1 per cent); and 2) the avoidance of a prolonged SGM (26.4 per cent). Among the surveyed corporations only 0.6 per cent of them selected a date for their SGM to avoid conflicting with SGMs of other corporations.

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338 Shôji Hômu, No.1249, at 85.
340 Ibid, at 106.
341 Supra, note 319.
343 Ibid, at 106.
344 Ibid, at 29.
The only concern of the corporate management is to breeze over the SGM without any arguments or objections from the shareholders. It appears to be an arduous task to eliminate the Sōkai-ya completely from Japanese society. Nor does it seem probable that in the near future the SGM will be energized with legitimate shareholder concerns. This is probably due to the attitude of the Japanese corporations which is extremely resistant to change in this area. Another possibility is that Japanese corporations may have some skeletons in their closets. Shareholders' democracy appears quite a distance away for the shareholders of Japanese corporations.

In conclusion, in Japan although the SGM is conferred great powers by the statute as the ultimate corporate organ, in practice, individuals who engage in secret maneuvers behind the SGM and those who have no interest in exercising their rights at the SGM are hindering the proper functioning of the SGM. This practice undoubtedly hampers the normal corporate management which the law aims at pursuing.
The preceding chapter dealt with the Shareholders' General Meeting (SGM). Although the SGM ought to steer the corporation in its general direction, as seen earlier, the power to manage the corporation is in fact vested in the Board of Directors (BOD or the board). Directors, as board members, exercise their powers at board meetings by determining and initiating the path their corporation shall follow. In some instances, some of these powers are delegated to individual directors or groups of directors to enable them to make decisions to facilitate the day-to-day operation of the corporation. Because such great powers are conferred on these directors, it is reasonable to expect that these directors will discharge their duties faithfully and in the utmost interest of their corporations.

The legal duties of directors under the Japanese Commercial Code are, in great part, similar to those under the common law and statutes applicable in the common law jurisdictions, in particular those of the U.S.A. This is largely due to the influx of concepts and influence of the American corporate laws during the American occupation of Japan after World War II. However, there exist enormous conceptual differences regarding directors' duties under the Commercial Code when contrasted with American corporate laws, despite the appearance of similarity on the surface between the Code and its American counterparts.

The resulting conceptual differences in the legal duties of directors under the Japanese Commercial Code and its American counterparts appear to be derived from at least four factors, some of which overlap. These factors are as follows: 1) the differences in historical background to the respective legislation; 2) the different of

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345 Supra note 51.
the social situations; 3) the practice of different management systems; and 4) the
different philosophies of the peoples, in general in these two jurisdictions.

In this chapter, some aspects of directors' duties in Japan will be examined by
analyzing statutory provisions pertinent to these duties, the actual functioning of the
relevant Japanese statutes, and some relevant court cases. In addition, any historical
background to the legislation and any factors which appear to be responsible for the
legislation will be looked at. Comparison will be made between the common law
jurisdictions as a whole and the various statutory reforms within the common law
jurisdictions, especially those of Canada\textsuperscript{346} and the U.S.A.\textsuperscript{347} and Japan to try to
elucidate the character of the Japanese provisions.

The duties which will be examined in this chapter are: 1) \textit{Chüi-Gimu} or the
duty of care and skill; and 2) \textit{Chūjitsu-Gimu} or the fiduciary duty. These two duties
have been generally considered to be the two primary duties directors owe to their
corporations. These two duties have been discussed in the common law jurisdictions
since corporate statutes were first enacted. Contrastingly, in Japan, up until the 1950
amendments of the Japanese Commercial Code when the concept of fiduciary duty
was first introduced, the duty of care and skill had been the only general legal duty
which directors owed to their corporations, rather than the specific duties provided
for individually in the Commercial Code.

Because of this background, the duty of care and skill has a relatively lengthy
history and has been frequently considered by Japanese courts and legal scholars. It
is also because of this historical background that the concept of fiduciary duty has not
been fully comprehended by the Japanese legislature or the judiciary. The duty of

\textsuperscript{346} Canadian statutes examined in this chapter are mainly the \textit{Canadian Business Corporation Act},
R.S.C.1985 (The CBCA) and the \textit{British Columbia Company Act}, R.S.B.C.1979 (The BCCA).
\textsuperscript{347} American statutes referred to include the \textit{Model Business Corporations Act} in 1989.
care and skill and the fiduciary duty are still, for some scholars and judges, difficult concepts to distinguish. Hence, the concept of the duty of care and skill and that of the fiduciary duty under the Japanese Commercial Code are different from that of the common law and statutes of the common law jurisdictions, though not to a large extent.

It is hoped that this chapter will serve to illuminate the present concepts of the duty of care and skill and the fiduciary duty, the historical, social, and philosophical background behind these concepts, the practical ways of discharging the duty of care and skill and the fiduciary duty by directors, and the prospects for legal and practical changes concerning these duties.

Before delving into a detailed discussion of these duties, the status of directors shall be analyzed, since it is one of the major factors which determines what duties directors owe to their corporations.

1. The Status of Corporate Directors

The status of corporate directors (and officers348) has been analyzed and modified in the common law jurisdictions for, not merely decades, but centuries.349 Some courts have held, that directors are analogous to trustees of a corporation.350

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348 Officers of a corporation are not discussed in this thesis.
349 "For more than two hundred years courts have attempted to define the status and character of corporate directors and officers in an effort to establish and delineate their responsibilities and liabilities"; McMurray, Marcia M., "An Historical Perspective on the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule" in Vanderbilt Law Review, Vol.40, No.3, April 1987 at 605.
350 Charitable Corp. v. Sutton, 2 Atk. 400, 26 Eng. Rep. 642 (1742). The analogy of directors to trustees was originally established by the Courts of Equity in England. The trustee analogy used by the Courts of Equity appears to have stemmed from the fact that "[in] eighteenth and nineteenth century England the constitution of an unincorporated partnership often consisted of a deed of settlement which named trustees of the funds and other property of the undertaking. Management was delegated to a committee of directors but some of the trustee were often directors as well" (Paterson, R.K. "Reformulating the Standard of Care of Company Directors" in Victoria University of Wellington Law Review, Vol.8, No.1, August, 1975, at 2). This view was adopted later in the American
However, this analogy of directors to trustees has been criticized by other courts and by scholars. The courts have expressed their reservations to this and similar analogies on several occasions. In one of many instances, the courts in *Re: City Equitable* articulated its view as follows:

"It has sometimes been said that directors are trustees. If this means no more than that directors in the performance of their duties stand in a fiduciary relationship to the company, the statement is true enough. But if the statement is meant to be an indication by way of analogy of what those duties are, it appears to me to be wholly misleading."

Gower further augmented this criticism with the following elucidation:

"In truth, directors are agents of the company rather than trustees of it or its property. But as agents they stand in a fiduciary relationship to their principal, the company. The duties of good faith which this fiduciary relationship imposes are virtually identical with those imposed on trustees, and to this extent the description "trustee" still has validity. It is when we turn to the duties of care and skill that the trustee

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351 Contrary to the view of the Courts of Equity and some subsequent American courts (* supra* note 350), "by the end of the nineteenth century ... courts of law treated directors as agents of the corporation" (McMurray, * supra* note 349, at 605, n.3), and since then the common law courts have adopted either view, the trustee or agent analogy, or both. See *Sequoia Vacuum Sys.* v. *Stransky*, 229 Cal. App. 2d 281, 40 Cal. Rptr. 203 (1964); *Dixmoor Golf Club* v. *Evans*, 325 Ill. 612, 156 N.E.785 (1927); *Kavanaugh* v. *Kavanaugh Knitting Co.*, 226 N.Y. 185, 123 N.E.148 (1919) (cited in McMurray, * supra* note 349, at 606). However, some courts have explicitly stated that directors were not identical to trustees or agents in a strict sense. See *Spering's Appeal*, 71 Pa. 11,20 (1872); accord *Sequoia Vacuum Sys.*, 229 Cal. App. 2d at 287, 40 Cal Rptr. at 206; and *Re: City Equitable Fire Insurance Co. Ltd.*, [1925] 1 Ch. 407.


analogy breaks down."\textsuperscript{354}

These statements would seem to strongly suggest that the characteristics of corporate directors (and officers) is to be determined according to the duties which they, the directors, owe to their corporations. Thus, distinction between the duty of care and skill of directors and the fiduciary duty of directors\textsuperscript{355} has been clearly established in common law jurisdictions.

The common law principle advocating two supposedly distinct sets of duties of directors is now set forth in the corporate statutes of numerous common law jurisdictions including the Canadian jurisdictions\textsuperscript{356}. In the Canadian jurisdictions, these duties may be summarized as follows:

"Every director and officer of a corporation in exercising his powers and discharging his duties shall

(a) act honestly and in good faith with a view to the best interests of the corporation, and

(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."\textsuperscript{357}

The duty stated in paragraph (a) is the fiduciary duty, while that of (b) is "the

\textsuperscript{354} Gower, \textit{supra} note 52, at 550.

\textsuperscript{355} The fiduciary duty would be regarded as a duty which is derived from a fiduciary position directors occupy, and this concept of fiduciary relationship was originally established by the Courts of Equity. See \textit{Re Lands Allotment Co} [1894] 1Ch.616,631. The fiduciary duty was understood to be a duty of directors to "exercise their powers in good faith and for the benefit of the company as a whole" by the Courts of Equity,\textit{ibid}, at 3; while, the duty of care and skill was recognized by the common law courts "with an appreciation of commercial reality .. to wear down the higher standards imposed by the equity courts." (\textit{Paterson, ibid}, at 3).

\textsuperscript{356} The CBCA, s.122; The OBCA, s.142; The BCCA, s.142; Hadden, \textit{supra} note 67, at 214.

\textsuperscript{357} Hadden, \textit{supra} note 67, at 214.
duty of care and skill." How the concept of duty of care and skill, which appears to have been originally established in the common law jurisdictions, has been interpreted and developed in Japan shall be examined below in detail in the next section followed by the detailed examination of fiduciary duty.

2. Duty of Care and Skill

2.1 Relationship between Directors and their Corporation

The concept of duty of care and skill was statutorily recognized, though not directly, by the 1911 amendments of the Japanese Commercial Code (the Code). The amendment ensued after a long and arduous debate on the pertinent issues pertaining to the relationship between directors and their corporation.\(^{358}\)

Prior to these amendments, the Japanese courts had been divided into two distinct pertinacious camps. One camp was of the view that directors were the legal representatives\(^{359}\) of their corporation (i.e. they were shareholders, whose directorial powers were conferred on them, not by any mutual contract, but by appropriate laws or some other authority) and therefore the relationship between these directors and their corporations was not a contractual one.\(^{360}\)

According to this view, a director obtains his status as a director by a unilateral act of the Shareholders' General Meetings (SGM). By resolution, the SGM

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\(^{358}\) Ueyanagi, \textit{supra} note 162, at 17-20.

\(^{359}\) A legal representative under the Japanese law is defined as "a representative to whom the representative right is conferred, by laws and regulations, the appointment by courts or other authorities other than the principal; Kawashima, Takenori, \textit{Minpō Sōoku [The General Introduction of the Civil Code]} (Tokyo, Yūhikaku, 1980), at 315; The Civil Code, art.99; Legal representatives under the Civil Code include: 1) a person in parental authority (arts.818, 819, 824); 2) a guardian (arts.839 to 841, 859); and 3) a custodian of property (arts.25,26,28).

\(^{360}\) Ueyanagi, \textit{supra} note 167, at 18; \textit{The Supreme Court, March 14, 1903 (Minroku 9-307)}; At the time of these arguments, a director was required to be a shareholder of his/her corporation. This qualification of being a shareholder in order to be a director was deleted by the 1938 amendments.
would elect a director, and from the time of this election, this director would be locked into all the responsibilities and/or liabilities of a director of the corporation.

This view was further sub-divided. This sub-division arose in regard to a director's right to resign from his directorship. Again, two primary opposing views surfaced. Of those cases which managed to make it to court, some courts held that directors ought to have the freedom to resign from their office regardless of whether their resignation was accepted by their corporations or not, since, in the first place, corporations were given the freedom to elect directors regardless of these directors' intentions to accept their election or not.

Conversely, some courts held that the resignations by directors ought not to be automatically recognized at all, since the relationship between directors and their corporations was not contractual, and hence, only the SGM had the power to dismiss directors whom they had elected; thus directors who wished to resign from their office needed to seek their own dismissal from their SGM. In other words, it was advocated by these courts that to begin with, directors must request their dismissal from the SGM, but even after this request is made, the SGM had the authority to refuse to comply with the request.

The prevailing view of the other major pertinacious camp, concerning the relationship between directors and their corporations, was that it was contractual. However, among scholars, there was no consensus concerning the nature of this

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361 Ibid.
362 Nagoya High court, December 4, 1902 (Hōritsu Shinbun 121-8), cited in Ueyanagi, supra note 167, at 18.
363 Tokyo High Court, Date unknown, 1904 (Hōritsu Shinbun 257-20), cited in Ueyanagi, supra note 167, at 18.
364 Osaka High Court, November 20, 1907 (Hōritsu Shinbun 465-21), cited in Ueyanagi, supra note 167, at 18.
contractual relationship. Several arguments were advanced in an attempt to cast some light on the nature of this contractual relationship. The arguments included:

1) the nature of the contract between directors and their corporations is that of a mandate or quasi-mandate\textsuperscript{365};
2) the nature of the contract between directors and their corporations is of a mixed nature of mandate and employment contract\textsuperscript{366}, and
3) the nature of the contract between directors and their corporations is a "nontype contract\textsuperscript{367}, not a "type contract\textsuperscript{368}, such as a mandate or an employment contract, set forth in the Civil Code\textsuperscript{369}.

This third argument is upheld by those courts who are of the opinion that a contract between directors and their corporations is of a nontype contract. In other words, the contract between directors and their corporations is a particular type of contract which is not provided for in the Civil Code. If a contract is of the type which is specifically set forth in the Civil Code the provisions in accordance with the

\textsuperscript{365} The Civil Code of Japan (The Civil Code, Law No.89, April 27, 1896, amended as Law No.101, Sep 26, 1987) provides for mandate and quasi-mandate respectively: "A mandate becomes effective when one of the parties has commissioned the other party to do a juristic act, and the latter has consented thereto"(art.643); "The provisions of this section shall apply mutatis mutandis to commissions of affairs other than juristic acts"(art.656); For English translation of the Civil Code of Japan, see \textit{EHS Law Bulletin Series} (Tokyo, Eibun-Horei-Sha).

\textsuperscript{366} \textit{Ibid}, art.623: "A contract of service becomes effective when one of the parties agrees to render services to the other party and the latter agrees to pay the former remuneration therefore."

\textsuperscript{367} \textit{Mumei Keiyaku} [nontype contract]; "... under the Civil code, the contract parties are allowed to create other types of contracts differing from those already recognized (under the Civil Code or the Commercial Code)" This type of contract is called a "nontype contract"; Kitagawa, \textit{supra} note 55, at II 1-82.

\textsuperscript{368} \textit{Tenkei Keiyaku} [type contract]; "The Civil Code recognizes thirteen "type contracts" (\textit{tenkei keiyaku}, Typenvertrag), stating with respect to each, several special provisions which supplement the General Provisions applicable to all contracts"; Kitagawa, \textit{supra} note 55, at II 1-65.

\textsuperscript{369} See, \textit{supra} note 367 and 368.
Civil Code, pertaining to this specific type of contract would apply to it. On the other hand, if a contract is of a particular type which does not fall into any of the categories of contracts which are set forth in the Civil Code, it is treated as a nontype contract. And if a contract is a nontype contract, the general principles of Japanese contract law apply to it, since there does not exist any specific provisions in accordance with the Civil Code pertinent to such a contract.

According to the first two arguments under the contractual nature view, due to the mandatory nature\(^{370}\) of the contract, directors were said to be free to resign from their office without the consent of their corporation. On the other hand, under the last argument the approval of the corporation was required in this regard\(^{371}\) due to the general principles of contract.\(^{372}\)

At present, it may appear that these arguments are vacuous and serve only to augment the chaos among the Japanese legal scholars in this and related areas. However, at the time these arguments were being postulated, these arguments were critical to the parties involved since the relationship between directors and their corporation, it would appear, was not thoroughly thought out before, or if it was, then the changing times caused a shift of the equilibrium of thoughts and ideas pertinent to this relationship and the situations governing it. A firm grasp of this relationship was needed since this would be the major factor in determining, among other things, the time of commencement and undertaking of duties of directors and the time of

\(^{370}\) The Civil Code, art.651 provides: "A mandate may be rescinded by either party at any time."

\(^{371}\) Ueyanagi, supra note 167, at 19-20.

\(^{372}\) According to this view, since the contract between directors and their corporations is a nontype contract, the general principles of contract applies unless otherwise provided. Though there is a provision concerning dismissal of directors in the Commercial Code, there is no provision concerning resignation of directors. Therefore the general principles of contract apply to the resignations of directors; accordingly, directors' resignations due to their sole intentions and decisions alone, without the consent of the other party, i.e. the corporation, are not permitted; The Civil Code, Section 5, Sub-section 3. Rescission of Contract, art.540 to art.547; Ueyanagi, supra note 167, at 19.
cessation of these duties.

Now, it would seem today to be out of the question to argue, as some of the camps of courts and scholars mentioned above did, that the relationship between directors and their corporation is not contractual and/or directors are not allowed to resign from their office without their company’s consent. However, it must be remembered that these arguments occurred as a natural consequence in understanding the general principles of the corporate law in Japan at the time.\footnote{The 1899 Commercial Code, \textit{supra} note 43.}

At that time, the SGM had the ultimate and omnipotent power in the corporation, and could make the final decisions concerning all the affairs of its corporation\footnote{Kitazawa, Masayoshi, \textit{Kabushiki Kaisha-ho Kenkyu}, \textit{supra} note 168, at 212.}; therefore it would not have been problematic at all to say that the SGM, and only the SGM should select and dismiss its directors regardless of their will. In addition, at the time, directors of a corporation were required to be shareholders of the corporation\footnote{The 1899 Commercial Code, art.164, para.1; This provision was amended in 1938 and 1950. Presently directors of a corporation do not need to be shareholders of the corporation. Moreover, it is even prohibited for the charter of the corporation to provide that directors shall be shareholders of the corporation; The present Commercial Code, art.254, para.2.}; therefore a shareholder who was selected as a director, or dismissed or refused to resign from his/her directorship ought to have obeyed the resolution of the SGM as a shareholder.

However, it is only fair to point out that at the time there were those legal scholars who held a contrary view which saw the relationship between directors and their corporation as contractual.\footnote{Ueyanagi, \textit{supra} note 167, at 17.} These were the scholars with vision, who had the best interest of corporations as a whole in mind. They wanted to develop corporations in a way which would be beneficial to all involved in and with the
As stated earlier, if the relationship between directors and their corporations are not contractual, as soon as persons are elected as directors at the SGM regardless of whether they are ready, willing and able to do the job, the elected individuals would be locked into all responsibilities and liabilities as directors. At the same time, freedom of resignation of directors from their office may not be fully guaranteed. In short, if the relationship between directors and their corporations is not contractual, directors’ freedom would be limited. Thus, if the relationship between directors and their corporations is not contractual, there would be few competent and knowledgeable people who would be willing to be directors of corporations. Without a competent and knowledgeable director, the concept of using corporations as a responsible vehicle for investment and/or running a business would be constrained.

These various arguments spawned statutory clarification. The Code was amended in 1911, introducing the following provisions: "The relationship between the company and the directors shall be governed by the provisions relating to mandates." The insertion of this article terminated many of the above arguments; accordingly it became recognized that the legal relationship between directors and their corporation is based on contract, and the nature of this contract is that of a mandate or quasi-mandate. In the meantime, it had also become clear that directors owe a duty to their corporation based on this mandate. This duty was recognized to be, "the

377 Supra note 361 and accompanying text.
378 Supra note 363 and accompanying text.
379 The Civil Code of Japan, art.644 provides: "A mandatary is bound to manage the affairs entrusted to him with the care of a good manager in accordance with the tenor of the mandate."
380 Tanaka, supra note 21, at 478; Ueyanagi, supra note 167, at 21; Kitazawa, Kaishahô, supra note 75, at 350.
381 See, supra note 379.
duty of care and skill.” It is a duty which has a specific and unique Japanese flavour, to be examined below.

It is noteworthy that the above statutorily defined relationship between directors and their corporations would not apply when a fiduciary duty is concerned.\(^{382}\) As has been advocated by scholars and courts in the common law jurisdictions, it has been recognized by many of Japanese scholars and courts that a fiduciary duty is not derived from the directors’ position as mandatories as set forth in the Commercial Code and the Civil Code.\(^{383}\) Therefore the principles pertaining to the fiduciary duty concept should be discussed on completely different grounds from those of the duty of care and skill.

Also worthy of note is that the concept of fiduciary duty, as expressed in the common law jurisdictions, did not exist in Japan until the 1950 amendments to the Code. These amendments, as with many other amendments to the laws of Japan after World War II, were primarily conceived and delivered into existence due to a process of forced imposition by the SCAP\(^{384}\) while Japan was under occupation.\(^{385}\)

The above amendments have been unlike the earlier development of the

\(^{382}\) Kawamoto, supra note 76, at 334.

\(^{383}\) The issue regarding the realtionship between the duty of care and the fiduciary duty will be discussed later in the section of fiduciary duty; see infra note 514 to 528 and accopanying text; In short, there has been a long debate among scholars and members of judiciary in Japan as to whether the fiduciary duty is a different duty from the duty of care and skill. However, the present majority view is that the fiduciary duty is a different duty from the duty of care and skill. According to this majority view, a fiduciary duty is not derived from an ordinary relationship of mandate as set forth in the Civil code of Japan; Ueyanagi, supra note 167, at 29; Tanaka, supra note 21, at 540; Namiki, Toshimori, Torishimalyaku no gimu to sekinin [Directors’ Duties and Liabilities], (Tokyo, Chuó Keizai-sha), at 46.

\(^{384}\) The Supreme Commander for the Allied Powers; “SCAP directives were ordinarily formulated on the basis of instructions received from the US Government”; Ando, supra note 177, at 29.

\(^{385}\) Salwin, supra note 51, at 484-488.
concept of a duty of care and skill in the laws of Japan, which had existed in Japan prior to the post-war amendments incorporating American law. This historical background is greatly responsible for the different notion in the concept of duty of care and skill in Japan compared to that of the common law jurisdictions.

When one, especially a non Japanese person, looks at the laws of Japan, in particular those laws which are due to these amendments implemented as a result of the occupation after World War II, one may be quick to say, that Japan only pays lip service to the principles of these laws. But a better understanding may be obtained by looking at the psyche of children born out of a similar relationship or process as these laws were.

2.2 Duty of Care and Skill

As stated above, it was codified that, "the relationship between the company and the directors shall be governed by the provisions relating to mandates." Directors, therefore, owe a duty to their corporations as mandataries. It should be kept in mind at this point that the duty of mandataries set forth in the Civil Code of Japan is different from those generally understood in the common law jurisdictions. However, since directors of corporations appear to have never

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386 The Commercial Code, art.254, para.3.; "mandates" is provided for in the Civil Code, art.643, supra note 365 and art.644, supra note 379.

387 Under the Japanese Civil Code, "mandate" and "quasi-mandate" is comprehended as a contract of which one party (a mandator) commissions or mandates the other party (a mandatary) to do a juristic act or any other affairs with or without payment. (The Civil Code, art.643 and 656, supra note 365). Though the Civil Code of Japan was mainly influenced by both the German Civil Code and the French Civil Code at the time of the enactment in 1898 (Wagatsuma, Sakae, Shintei Minpō Sōsoku (Minpō Kōgi 1) [General Provisions of the Civil code (Lecture on the Civil Code, 1)], (Tokyo, Iwanami Shinsho, 1980), at 9-10), the concept of mandate under the Civil Code of Japan is similar to but not the same as either the German Law or the French Law. (Kurusu, Saburo, Kōyakuhō: Hōritsugaku Zenshū 21 [Contracts: Series of Jurisprudence Vol.21] (Tokyo, Yūhikaku, 1977). Furthermore, the Common Law concept of mandate is also different from the above Japanese concept; "mandate" under the Common Law is defined as "A contract by which a lawful business is committed to the management of another, and by him undertaken to be performed gratuitously. The mandatary is bound to the exercise of slight diligence, and is responsible for gross neglect", or "a bailment of
been thought of as mandataries in the common law jurisdictions, it would be of little
use to discuss the different notions of mandataries between Japan and the common
law jurisdictions. Directors' duties, as far as the duty of care and skill is concerned,
under the Japanese law should be discussed as the duties of mandataries, whereas
directors' duties in the common law jurisdictions should be discussed as a matter of
duties specific to directors, not as mandataries.

Due to the principle which mandates that directors owe a duty to their
corporation due to their position as mandataries, under the Japanese law, "directors
have a duty to conduct the business of the company with the standard of care of a
good manager." The standard of care of a good manager in this context would
appear to be similar to the standard of care of a director under the common law
or the statutory provisions such as those in Canada. If this were the case,
directors would be expected to exercise a duty of "care, diligence and skill of a
reasonably prudent person." However, the wording "care of a good manager"

property in regard to which the bailee engages to do some act without payment. Agreement to
perform services for another without pay."(Black's Law dictionary) In short, mandate, including quasi-
mandate, under the Japanese Law is a contract in respect to the commission of affairs regardless of
whether it is gratuitous or with consideration, while under the Common Law, mandate is a contract
which generally involves a bailment of property, and one party does some act for the other party
gratuitously. Stated from the different point of view, the concept of mandate under the Japanese law
(The Civil Code) appears to be similar to the concept of trust or agency under the Common Law.
Trust and agency laws are generally categorized as several types depending upon their nature, such
as express trust, constructive trust, resulting trust, implied trust, simple trust, special trust for the
former (Smith, Beverly G., Introduction to the Canadian Trusts, (Toronto, Butterworths, 1979, at 1 to
14), and contractual agency and agency resulting from ratification for the latter (Fridman, G.H.L., The
to be similar to the Common Law "express trust" or contractual agency relationship as far as creation
of the relationship between mandator and mandatary is concerned, - beneficiary and trustee, and
principal and agent - . However, where their duties are of concern, no equivalent category of trusts
or agency could be found in the Common Law with respect to mandate.

388 Kitagawa, supra note 55, at 7-47; The duty of mandatary is provided for in art.644 of the Civil
Code of Japan, supra note 379.
389 Re: City Equitable, supra note 353; This case clarifies the Common Law position on the
subject.
390 The BCCA, sec.142(1)(b); The CBCA, sec.122(1)(b).
391 The BCCA, sec.142(1)(b).
under the Civil Code of Japan, reflects a somewhat different sense from the expression as used in the Canadian statutes or in other common law jurisdictions. Further analysis of this wording shall be made by contrasting this principle of the common law and the statutory reforms in Canada with those which are analogous in Japan.

An examination of the different degree of care and skill which is expected to be discharged by directors under the Japanese statute, the common law and the Canadian statutes will be looked at below; followed by a treatment of more specific instances in this regard.

1) Degree of Care and Skill

The basic position of the common law on the degree of care which directors are expected to discharge is well illustrated in case Re. City Equitable:

"The care that he is bound to take has been described by Neville J. in the case referred to above as "reasonable care" to be measured by the care an ordinary man might be expected to take in the circumstances on his own behalf....A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience."³⁹²

The above common law position was codified in most Canadian jurisdictions. For instance, the CBCA provides³⁹³:

"Every director and officer of a corporation in exercising his powers and

³⁹² Supra note 353, at 428.
³⁹³ The CBCA, sec.122(1)(b); The BCCA equivalent is sec.142(1)(b).
discharging his duties shall ... (b) exercise the care, diligence and skill that 
a reasonably prudent person would exercise in comparable 
circumstance.\textsuperscript{394}

The Japanese law, however, defines the degree of directors' duty of care and 
skill in a slightly different manner. As was explained earlier, directors are 
mandataries\textsuperscript{395} of their corporations and as such owe to them a duty of care. They 
are obliged to discharge this duty with "the standard of care of a good manager" as 
provided for in the Civil Code of Japan\textsuperscript{396}. "The standard of care of a good 
manager", in a general sense under the Civil Code of Japan, is to be determined 
"depending upon the degree of education and expertise expected for the management 
position, and the abilities and characters of the mandatary in the management 
position, which is known or ought to be known by the mandator."\textsuperscript{397} By applying 
this interpretation, directors are said to owe a duty of care and skill to their 
corporations as would be generally expected of persons who are in a similar position. 
However, in questionable circumstances, the abilities or character of the directors 
ought always to be taken into account.\textsuperscript{398} Stated another way, there is an objective 
standard which is to be applied to all directors. However, in addition to this objective 
standard, a subjective standard is also of importance which takes into account the 
individual abilities and characters of the directors. Moreover, "the care required is 
of a higher degree than that which an individual director is expected to execute in 
his own business"\textsuperscript{399} under the civil law principles of Japan.

\textsuperscript{394} In the U.S.A. the expression "ordinarily prudent person(director) in a like position under 
similar circumstances" is commonly used in the statutes; McMurray, supra note 349, at 608.
\textsuperscript{395} See, supra note 379 and accompanying text.
\textsuperscript{396} The Civil Code, art.644, supra note 379.
\textsuperscript{397} Hironaka, Toshio, Saiken Kakuron Rongi (Dai 5 Hen) [Discussion of Particulars of Right in 
Personam (5th ed.)] (Tokyo, Yūhikaku, 1980), at 251 (my translation).
\textsuperscript{398} Kitazawa, Kaishahō, supra note 75, at 350.
\textsuperscript{399} This Kitagawa's interpretation appears to be based on the majority view of interpreting art.644 
of the Civil code: Kitagawa, supra note 55, at 7-47.
In summary, a director is required to exercise the care of a higher degree than that which he is expected to execute in his own business. The standard of care of a director is that degree of care that a reasonably competent manager in his position or occupation would exercise in the particular circumstances.

As far as the actual wording is concerned, it would appear that the degree of care under the Japanese law is more stringent than under the Canadian law. In other words, the Japanese Code has adopted an objective standard which requires the degree of care expected of a competent manager, as opposed to the standard of a reasonably prudent person, under similar circumstances, which is the case under the Canadian law. However, it would be, in my opinion, inappropriate to conclude so, since there appear to have been no reported cases in Japan so far, which clearly stated whether a higher degree of care, i.e. the professional standard, was expected to be discharged by directors in fulfilling their duty of care. In fact, at least one Japanese scholar expresses the opinion that the degree of care "should be interpreted in the same manner as the Model Business Corporations Act ss.8.30 of the U.S.A." The relevant wording is that "[a] director shall discharge his duties as a director ... with the care an ordinary prudent person in a like position would exercise under similar circumstances ..."

Moreover, how the above differences in standards would effect any actual results appears to be unknown. It is questionable, if in practice, the results due to the above differences in standards are of any real importance. In reference to this point, it should be noted that arguments regarding this principle of standard of care have been taking place in common law jurisdictions for many years, and at least one commentator has suggested that the differing standards of an "ordinarily prudent man in his own affairs" and an "ordinarily prudent director" have not resulted in any

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400 Namiki, supra note 383, at 45.
"significant differences in [the] outcome" of cases.\textsuperscript{401}

Apart from any differences in outcome due to the above different standards of the Japanese and the common law jurisdictions, there also exists a conceptual difference between the two standards of these jurisdictions. There may be two reasons why the Japanese statute has adopted a more stringent standard ("the standard of care of a good manager" as opposed to the lesser standard, "the degree of care that an ordinarily prudent person in a like position under similar circumstances would exercise"\textsuperscript{402}).

One reason has to do with the purpose for the codification and the dominant law which had any effect on the Japanese laws at the time of the codification. The duty of care was first codified to eliminate the various arguments regarding the relationship between directors and their corporations.

At this time the Code was still under the influence of the German law and not the laws of the U.S.A. Not much study, if any, had been undertaken on the concept of Duty of Care as practised and philosophized in the common law jurisdictions. No specific consideration regarding the fiduciary relationship between directors and their corporations, which had been on the table of discussion in the common law jurisdictions for numerous years, had been taken into account. The Japanese legislature simply adopted the concept of mandate under the Civil Code of Japan in characterizing the position of directors. By doing thus, they failed to take a close look at the degree of care to be discharged specifically by directors.

It may be argued that the legislature exhibited a lack of prudence or was even

\textsuperscript{401} McMurray, \textit{supra} note 349, at 607, footnote 13.

\textsuperscript{402} \textit{The Model Business Corporations Act} (1989), ss.8.30.
negligent in their duty in dealing with this important matter. After all, the legislature had at their disposal a battery of advisors both legal and non-legal, to whom they may have turned for advice. A much closer look at this and other concepts pertinent to this discussion, especially those on which they ruled, should have been undertaken. But maybe one should not be too hard on these legislators. They seem to have been afflicted with the same conditions which many of our past and present-day legislators, the world over, have been suffering from. Though it is debatable whether or not this condition is deleterious, symptoms of the affliction include the making of legislation which is questionable with respect to their respective electorates. It appears that legislators some more than others, in every part of the world, have been making decisions, which are not necessarily supported by, or in the best interest of the majority of their electorates.

However, regarding this specific issue, the imposition of higher standard on directors, the Japanese legislature would have acted in the best interest of the majority of the electorates, if the electorates are to be shareholders. Because the higher the standard of care of directors, the securer the shareholders' interest. On the other hand, this legislative position would be detrimental to corporations where the necessity of recruiting outside directors is concerned.

In the U.S.A., one commentator in an attempt to shed some illumination in this area has stated, "... if a higher standard were adopted, qualified persons might not accept positions as corporate directors. This argument directly addresses the possibility of qualified individuals declining to serve as outside directors because of potential liability." To the contrary, in Japan the above consideration on outside directors appears to have never been taken into account by the Japanese legislature. Presumably this is largely due to the significance of the corporate management system

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403 McMurray, supra note 349, at 610.
of Japan.

In Japan, most directors are inside directors who are also senior employees of the corporation.\textsuperscript{404} This fact is clearly evidenced from several surveys. One survey\textsuperscript{405} indisputably shows, "that out of 1522 promotions [to directorship] 80 per cent are from within the company, 13 per cent are from the parent company or from a subsidiary, and only 7 per cent from complete outsiders."\textsuperscript{406} Another survey shows that 34 per cent of large corporations, such as Toyota and Canon, do not have outside directors at all.\textsuperscript{407} Contrary to this Japanese pattern, for example, in the U.S.A., approximately 40 per cent of the Boards of Directors of similar companies are occupied by outside directors.\textsuperscript{408} This is a significant point pertaining to Japanese directors and should be kept in mind when looking at other aspects of directors under the Japanese law.

This significant difference in corporate management structure, between Japan, and the U.S.A. and other common law jurisdictions including Canada, appears to arise out of a difference in the systems of corporate monitoring.

The following discussion concerning differences in the corporate monitoring systems of Japan, the United State and Canada is worthy to note here.

In Japan, every stock corporation is required to have a monitoring organ, "the

\textsuperscript{404} "Now the directors of most Japanese companies come from the ranks of the employees, after having worked their way up through management over twenty or thirty years": Clark, Rodney, \textit{supra} note 14, at 100.

\textsuperscript{405} Kono, \textit{supra} note 214, at 31.

\textsuperscript{406} \textit{Ibid}.

\textsuperscript{407} \textit{Ibid}, at 23.

\textsuperscript{408} \textit{Ibid}. 
auditors", separate and independent from the BOD. On the other hand, in the common law jurisdictions, such as the U.S.A. or Canada, though several proposals or arguments have been addressed by many writers of these jurisdictions to restructure the corporate laws regarding the supervisory organs, at present there appears to be no mandatory requirement for an independent supervisory organ which is equivalent to "the auditors" in Japan.

In Canada, for example, there are statutory requirements, subject to exceptions, for appointing auditors who must be independent of the corporation. In addition, the majority of members of an audit committee is required to be independent of the corporation. At first glance, one may be quick to think that these two bodies have a similar function to the Japanese corporate organ "the auditors", but this is not the case; there are fundamental differences between the Japanese corporate organ "the auditors" and, "the audit committee" and "auditors" of a Canadian corporation. First, the auditors and an audit committee, under the Canadian laws, are not considered to be a corporate

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409 The Commercial Code, art.276.


411 In Canada, the appointment of an auditor is mandatory only for reporting companies. (The CBCA, s.162 and 163; The BCCA, s.202 and 203). In addition to the appointment of auditor, in Canada, every reporting company is required to appoint the audit committee which is composed of directors, "of whom a majority shall not be officers or employees of the company or an affiliate of the company." (The BCCA, s.211; The CBCA, equivalent is s.171) However, duties of both auditor and the audit committee is to inspect financial statements of the corporation, and not to supervise activities of directors of the corporation.

412 Ibid.

413 Both the CBCA and the BCCA exempt certain corporations, basically closely held corporations, from the requirement of appointing auditors and audit committee.; The CBCA, s.163, s.171(2); The BCCA, s.203, s.211(1).

414 The CBCA, s.161; The BCCA, s.207.

415 The CBCA, s.171; The BCCA, s.211.
organ along with the SGM and the BOD. Second, the range of duties, responsibilities and powers of the auditors under the Japanese Commercial Code is broader than those of the auditors and/or audit committee under the Canadian laws. In Japan, several statutory amendments pertaining to the auditors\textsuperscript{416} have left this corporate organ with the power not only to inspect and assess the financial statements of their corporation, but also to monitor and supervise the activities of directors of its corporation.

On the other hand, the function of auditors and an audit committee of a corporation under the Canadian laws\textsuperscript{417}, are strictly limited to the assessment of the financial statements of the corporation.

In common law jurisdictions, there appears to be the belief that this supervisory function of the management of a corporation may be realized by having outside directors who are disinterested members\textsuperscript{418} of the BOD. This belief appears to be the major reason for the trend in favour of appointing outside directors in these jurisdictions. In truth, it has been recently elucidated by many commentators in the common law jurisdictions that the appointment of outside directors is a healthy practice for corporations since the outside directors are believed to be "unaffiliated

\textsuperscript{416} The auditors' power has been a controversial issue in Japan, and has been modified by several amendments of the Commercial Code. Originally the auditors had the power not only to inspect the financial statements of the corporation but also to supervise activities of directors of the corporation. However, this power was reduced by the 1950 amendments which only allowed the inspection of the financial statements of the corporation due to: 1) the assumption that it is impossible to supervise directors' activities outside the board; and 2) the supervisory power of the auditors had not been functioning in practice as had been expected. Then, in 1974, the auditors regained the power to supervise directors' activities again. This was largely due to the frequent occurrence of bankruptcy of big corporations at the time due to the mismanagement of directors of these corporations. It was thought to be urgent at the time to confer the wider power, more specifically the power to supervise directors' activities, to auditors to prevent such disasters; Ueyanagi, \textit{supra} note 167, at 431 to 434.

\textsuperscript{417} The CBCA, s.170, 171(3); The BCCA, s.212, s.211.

\textsuperscript{418} Bradley, \textit{supra} note 410, at 21.
with and independent of the corporation,"\textsuperscript{419} and would be able to play the role of watch dog within and for the corporation.\textsuperscript{420}

Despite the difference between Japan and Canada concerning who is conferred with the statutory power of corporate monitoring or who is expected to play the monitoring role, both jurisdictions appear to have similar problems concerning corporate monitoring. As Professor Eisenberg suggests, in the United States, although outside directors, in theory, play the role of watch dog in their corporations (assuming that they are independent from inside directors) most of these outside directors are, in reality, under the great influence of executives of their corporations.\textsuperscript{421} Thus, it appears that their monitoring role is dysfunctional. Even the policy-making role of these outside directors and other non-executives have been questioned due to their dependence on the executives.\textsuperscript{422} Several factors are suggested as being responsible for this dependence of outside directors and other non-executives on executives. Some of these factors include: a non-executive is selected by executives "in part because he can be counted on to go along"\textsuperscript{423} with the wishes and policies of the executives and "not to rock the boat"\textsuperscript{424}; non-executives have limited time to actively participate in corporate management\textsuperscript{425}; and non-executives have limited access to information regarding corporate affairs.\textsuperscript{426} The dysfunction of non-executives, including outside directors, has been

\textsuperscript{419} Ibid.
\textsuperscript{420} Ibid.
\textsuperscript{421} Eisenberg, Melvin Aron, The Structure of the Corporation (Boston, Little, Brown and Company, 1976), at 139 to 148.
\textsuperscript{422} Ibid.
\textsuperscript{423} Ibid, at 147.
\textsuperscript{424} Ibid, at 146.
\textsuperscript{425} Eisenberg suggests that about half of surveyed corporations' boards spent only 18 hours a year or less for their meetings. Thus, directors' participation in the corporate management through board meeting are constrained; Ibid, at 141 to 142.
\textsuperscript{426} Ibid, at 143 to 144.
a great concern in the American corporate sphere. It is assumed that in Canada, a similar problem has existed as well. To resolve such disfunction of the board, particularly its monitoring role, several suggestions including the following have been made. The introduction of a two-tier system which distributes powers (management and supervisory powers) onto two separate organs, the board of directors and a board of auditors (a supervisory board)\textsuperscript{427}, while recruiting a majority of independent directors with a strict definition of "independence."\textsuperscript{428}

Similarly, in Japan it has been suggested that the auditors ought to be more active and their powers strengthened.\textsuperscript{429} Unlike the United States, and presumably Canada, executive control within the board appears not to have been of great concern in the area of corporate monitoring in Japan. But there exist different ranks of directors within the board, and thus it appears that the influential powers of higher ranking directors on their subordinate directors has sometimes caused a disfunction of the BOD in Japan as well.\textsuperscript{430} However, the main issue in Japan has been how to realize the proper functioning of the auditors, rather than the outside directors. One major reason for this may be the fact that most Japanese corporations have only a few, if any, outside directors, and the auditor who is independent of the board is the only statutory recognized monitoring organ.

In theory, the auditor under the Code is independent from the board. Unlike outside directors in Canada and the United States, auditors are elected by the SGM, separately from board members. Auditors are prohibited from being employees of their corporation or any entity affiliated with their corporation.\textsuperscript{431} In addition, the

\textsuperscript{427} Ibid, at 177 to 185.
\textsuperscript{428} Ibid, at 175.
\textsuperscript{429} Kurasawa, Koichiro, "Kansa-yaku Seido Kaisei no Hitsuō [Necessity of improving the auditor's system]" in Shōji Hōmu, No.1311, February 5, 1993, at 5.
\textsuperscript{430} Ibid.
\textsuperscript{431} The Commercial Code, art.276.
auditors are given statutory rights, including the right to demand that directors report their corporate affairs, the right to participate in board meetings, the right to convene a board meeting, and the right to demand that a director stop engaging in wrong-doing.

Despite these statutory powers and the statutory requirements of the independence of the auditors, it is quite apparent that the auditors do not function as they are expected to. In one survey, more than 50 per cent of the surveyed corporations responded that the present legal system regulating the auditors should be improved. Problems similar to those regarding non-executives in the United States have arisen in Japan in recent years with regard to the auditors. Even though auditors are elected at a SGM, the initial selection of candidates is generally within the hands of executives; many auditors are former employees or directors of the corporation, and as such they hold a close relationship to incumbent directors; and the auditors' access to the information regarding corporate business is limited.

Considering these problems, some reforms of the Code governing auditors have been strongly suggested by both business people and legal scholars. This has prompted the Hōsei Shingi-kai or the Legal Council of Ministry of Justice to commence reviewing the present regulation regarding auditors. One of the main issues of reform in this area has been how to enhance the independence of auditors.

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432 The Commercial Code, art.274.
436 A survey by Kobe University, cited in Yanaga, Masao, "Kansa-yaku no Genjyō to Kadai [Present situation and Problems of Auditors]" in Hōritsu Jihō, Vol.64, No.7, at 32.
437 Ibid.
438 Kurasawa, supra note 429, at 2.
439 Ibid.
It is my opinion, that so far as a monitoring role is concerned, auditors under the Code could play a more independent role compared to outside directors. This is simply because auditors are selected by the SGM and act completely independently of the BOD or individual shareholders. It appears questionable how much if any a monitoring role outside directors, who generally occupy subordinate positions to inside directors, may play within the board. Although it is assumed that directors in Canada and the United States are becoming more aware of the possibilities of being sued for their mismanagement, and hence tend to be somewhat more particular about their responsibilities, their independence still remains questionable. Despite the issue of independence, the role of outside directors can not be ignored. However, it appears to be preferable to have a monitoring organ completely independent from the board, such as auditors under the Code, in addition to the outside directors. Dual monitoring bodies (outside directors and auditors) would greatly enhance the overall efficiency of corporate monitoring.

The problems of auditors, in particular the question of their independence under the present Code, may be resolved by introducing stricter regulation. Some possible changes are: altering the appointment system for auditors (e.g. auditors should not be selected by directors, they should be nominated and appointed either by a auditors' resolution or by the SGM); imposing more stringent requirements on the eligibility of auditors (e.g. prohibiting not only present but former employees or directors from becoming auditors); and increasing the number of auditors (present number required by statute for large corporations to be expanded from two to at least three).

The realization of a perfect corporate monitoring system is still far out of reach not only in Japan, but in Canada and the United States as well. However,

\footnote{Similar suggestions are addressed by some scholars; Kurasawa, supra note 429, at 5 to 6.}
although some changes should be made to the relevant provisions of the Code, the legal position of auditors under the Code is worth considering for possible adoption in Canada and the United States.

In conclusion, directors of Japanese corporations appear to be expected to discharge a higher degree of care compared to those of Canadian and American corporations. However, it appears that the Japanese courts⁴⁴¹ have recently become reluctant to impose liability on directors for their breach of the duty of care and skill, as has been the case in the common law jurisdictions.⁴⁴² This is largely due to the recognition of the so-called Business Judgment Rule, which was introduced from the U.S.A.⁴⁴³ But, some Japanese scholars have strongly opposed the adoption of the principles of the Business Judgment Rule into Japanese corporate law. This will be explained in detail later. What is noteworthy here, is that these arguments relating to the Business Judgment Rule, evidence the fact that Japan is still struggling to fuse common law concepts introduced to Japan with the conventional and traditional Japanese legal concepts derived from civil law concepts, including those concepts pertinent to directors’ duties.

Next, I will examine how this high degree of care is to be discharged in practice, by directors in Japan, as compared to similar situations in the common law jurisdictions, particularly in the U.S.A. and Canada by focusing on: 1) attendance at the board meetings; and 2) the duty of observation.

2) Attendance at the Board Meetings

Since the Board of Directors (hereinafter the BOD) is the major corporate

⁴⁴¹ In Tokyo District Court, March 1, 1978 (Kinyōshōji Hanrei, vol.562, p.40), the Court adopted the Business Judgment Rule and rejected the director’s liability; see infra, 2.3 Business Judgment Rule.
⁴⁴² Infra, see 2.3 Business Judgment Rule.
⁴⁴³ Ibid.
organ which primarily determines or charts the course of affairs of the
corporation, if the BOD functions properly, directors' breach of duty would be
less likely to occur. The ideal situation of managing a corporation would be: the
SGM decides the fundamental matters or affairs of the corporation and elects
competent directors, to whom it delegates its powers to manage the day to day
business of the corporation. This ideal situation may only be actualized if the
following two premises are realized. First, the SGM selects directors who would
discharge their duty faithfully and in the best interest of the corporation. Secondly,
the directors who are selected by the shareholders do discharge their duty faithfully
and in the best interest of the corporation as is expected by the shareholders.

The shareholders at the SGM, may elect the directors who will form the BOD
for the upcoming term of the BOD and, may vote on policy which will steer the
corporation in a general direction. But this steering policy on which they vote
and the directors whom they elect are usually first selected by the present BOD, and
then presented to them to be voted on at the SGM. Hopefully the BOD think
of the best interest of the corporation and the shareholders when they are making
their selections. Of course there is the assumption here that these directors can and
do exercise the process of thought involving those interests. The crux of the matter
is, that the shareholders merely rubber stamp the decisions of the BOD at these

444 The Commercial Code, art.260 provides: "The board of directors shall decide the administration of affairs of the company, and supervise execution of duties of directors"; Similarly, the BCCA, s.141(1) provides "The directors shall, subject to this Act and the articles of the company, manage or supervise the management of the affairs and business of the company"; The CBCA equivalent is s.102(1).

445 In short, it is clear under the Canadian or American laws that "Shareholders are statutorily empowered to vote for directors and also in respect to an enumerated set of transactions that are often referred to as corporate "fundamental changes", Ziegel, supra note 66, at 844 at 843 to 844; It is the same under the Japanese Commercial Code.

446 The Commercial Code, art.254, para.1; The BCCA, s.134; The CBCA, s.106(3).

447 The Commercial Code, art.230-10; The BCCA, s.141(1); The CBCA, s.102.

448 Ueyanagi, supra note 162, at 11; Ziegel, supra note 66, at 844.
shareholders' meeting. Here we have the typical chicken and egg phenomenon; a proverbial catch 22. To sum up, for the proper functioning of the SGM, the proper functioning of the BOD has to be realized in the first place. Of course some may say the reverse, namely that, for the proper functioning of the BOD, the proper functioning of the SGM has to be realized first.

For the proper functioning of board meetings, directors are expected to attend these board meetings and discharge their duty. This is the major way of preventing any wrongful acts by their fellow directors. But, does this mean that directors' absence from board meetings may constitute a breach of their duty? And, should directors attend all the board meetings to carry out their duty?

Unlike the principles spelt out in the common law jurisdictions, both via its common law and statutes, such as the BCCA, s.151, the Commercial Code

449 Welling, supra note 138, at 43; Tokyo Hōgaku Kenkyūkai, supra note 184, at 206.
450 Directors’ duties here include "directors duty of care and skills" and other duties.
451 Re: City Equitable, supra note 353.
452 The CBCA has provisions which set forth the treatment of directors who were absent from specific board meetings. The provisions read: "a director who was not present at a meeting at which a resolution was passed or action taken is deemed to have consented thereto unless within seven days after he becomes aware of the resolution he (a) causes his dissent to be placed with the minutes of the meeting; or (b) sends his dissent by registered mail or delivers it to the registered office of the corporation." (s.123(3)) However, these provisions do not explicitly provide for the liability of these absent directors. In addition, though provisions which set forth the liability of absent directors are found in both the CBCA(s.118) and the BCCA(s.151), these provisions are only concerning directors who are absent from the meeting at which only specific resolutions are passed. For instance, the BCCA, sec.151(1) and (6) provides respectively:“(1) Directors of a company who vote for, or consent to, a resolution authorizing (a) the purchase, redemption or other acquisition of shares contrary to section 260; (b) a commission or discount contrary to section 47; (c) a payment of a dividend if (i) the company is insolvent; or (ii) the payment renders the company insolvent; (d) a loan, guarantee or financial assistance contravening section 126 or 127; (e) a payment of an indemnity referred to in section 152 to a director or former director without the approval of the court required by section 152; or (f) an act contravening section 22 in respect of which the company has paid compensation to any person, are jointly and severally liable to the company to make good any loss or damage suffered by the company as a result; and (6) A director who is not present at a meeting of directors, or of a committee of directors, at which a resolution referred to in subsection (1) is passed shall be deemed to have consented to it, unless within 7 days after he becomes aware of the resolution he mails his written dissent by registered mail or delivers it to the registered office of the company." Therefore,
does not explicitly provide for the liability of directors who are not present at the board meeting at which a resolution is passed which turns out to be detrimental to their corporation. The Code only provides that in the case where directors attended a meeting but did not express their dissent at the meeting where a resolution was passed leading to directors' liability, the directors are jointly liable. As a guide to providing the proper answers to the questions raised above and since no explicit provision exists in the Code, some court cases and scholarly opinions shall be looked at next.

Since the fundamental duty of directors is to make decisions at the board meetings on matters related to the management of their corporation, there ought to be no objections to saying that directors are expected to attend these board meetings unless a sufficient reason exists for their absence. Professor Namiki, one of Japan's leading scholars in the area of corporate law, states that "... directors shall attend the board meetings ... failure to attend the board meetings establishes a breach of the duty of care .... if the directors work concurrently as employees of their corporations, their duty as directors shall be preferred (paramount) to their duty as an employee." Liabilities of directors who are absent from a meeting other than the above specific meetings are not clearly set forth in the statute.

453 The Commercial Code, art.266, para.3 provides: "The directors who have participated in the resolution mentioned in the preceding paragraph and who have not expressed their dissent in the minutes shall be presumed to have assented to such resolution."

454 The Canadian statutes have similar provisions. For instance, the BCCA, sec.151(4) provides: "For the purposes of this section, a director of a company who is present at a meeting of directors, or of a committee of directors, shall be deemed to have consented to a resolution referred to in subsection (1) passed at the meeting unless (a) his dissent is entered in the minutes of the meeting; (b) his written dissent is delivered to the secretary of the meeting before its adjournment; or (c) his written dissent is delivered or sent by registered mail to the registered office of the company immediately after the adjournment of the meeting.

455 Namiki, supra note 383, at 63.

456 Namiki, supra note 383, at 63-64.
The first court case to be looked at in this regard is *K.K Kōjin v. Unknown*. In this case the majority of legal scholars concurred with the decision of the Tokyo District court, which held that the directors who were absent at the board meeting at which a questionable resolution was passed, were also liable for the damages the company sustained due to that resolution:

**Summary of the facts of K.K Kōjin v. Unknown**

This case involved the bankruptcy of one of the largest multiple management corporations in Japan in 1970.

An application for an assessment of a claim for damages arising out of the possible liability of the directors of the corporation was submitted to the court by the trustee of the corporation. Seventeen former directors were alleged to be liable for the damages of some 35 billion yen, which was distributed to the shareholders of the corporation by way of dividends, to the directors as remuneration, and also as a resulting overpayment of tax, due to a window-dressing settlement of accounts.

**Decision**

The Tokyo District Court in its decision held: that the directors who were absent from the meeting where the said window-dressing settlement was approved were also liable for the wrongful distribution of the assets of the corporation by way of dividends and in any other ways which stem from the said approval. Notwithstanding that, the

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457 *Tokyo District Court, July 1, 1977 (Hanrei Jihō, No.854, p.43-51).*

458 The directors and auditors of the corporation drew up an untrue balance sheet by diluting the assets and profits of the corporation for three years.
motion for the distribution of the corporate profits was approved by the SGM, the motion presented to the SGM was based on the resolution by the BOD. Directors of the board had a duty to prevent the resolution from being presented to the SGM.

The court decision clearly shows that directors who are absent from a board meeting at which a resolution is passed which triggers the wrongdoing of directors are likely to be deemed to have consented to the resolution. As such, the directors are liable for not preventing the wrongdoing along with the other directors who attended the meeting and consented to the resolution. In other words, directors who actually committed the wrongdoing are, of course, liable in the first place. Directors who, at the board meeting, assent to a resolution which leads to a wrongdoing are also liable since they are deemed to have done the wrongdoing. Moreover, directors who were absent from the meeting at which a resolution is passed are also liable since they are deemed to have consented to the resolution, and accordingly they are deemed to have done the wrong deed also.

Under what circumstances, if any, directors who fail to attend a board meeting at which a detrimental resolution is passed, would be excused from being liable has not clearly been established by the Japanese courts. However, by extrapolating from the above court decision and scholarly opinions, it appears to be the case that directors should show very sufficient reasons for their absence from a given meeting at which a resolution of concern is passed to convince a court that they did not

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459 Ueyanagi, supra note 167, at 285.

460 The Commercial Code, art.266, para.1 states: "In the following cases, directors who have done any one of the acts mentioned there shall be jointly and severally liable in effecting performance or in damages to the company, in the case of item ... (5) for the amount of any damages caused to the company: ... (5) Where they have done any act which violates any law or ordinance or the articles of incorporation."

461 The Commercial Code, art.266, para.3, supra note 453.

462 Supra note 456.
breach their duty as a director.\textsuperscript{463}

The position of the common law in this regard appears to be less strict than the Japanese courts. The court, in Re: City Equitable Fire Insurance Co. Ltd.\textsuperscript{464}, stated that "A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so." It was also stated in Francis v. United Jersey Bank\textsuperscript{465} that, "Regular attendance does not mean that directors must attend every meeting, but that directors should attend meetings as a matter of practice. A director of a publicly held corporation might be expected to attend regular monthly meetings, but a director of a small, family corporation might be asked to attend only an annual meeting. The point is that one of the responsibilities of a director is to attend meetings of the board of which he or she is a member."

The strict position of the Japanese courts compared to those of the common law with regard to the attendance of board meetings appears to be due to the

\textsuperscript{463} Here it might be said that, in theory there is no duty to attend meetings and therefore no liability for the breach of duty to attend meetings per se. The real issue here has to do with directors who do not dissent to a resolution which turns out to be detrimental to the corporation. These directors are liable for not dissenting to this resolution being passed. In other words, in narrow sense, liability does not stem from the mere absence from the meeting at which the questionable resolution is passed. But it might be argued that there is, in fact, a duty to attend meetings, since directors' fundamental duties are to decide the affairs of their corporations at meetings. To discharge this duty, it would appear that attendance at meetings is of utmost importance, regardless of whether a questionable resolution is passed or not at a concerned meeting. However, as far as liability is concerned, unless some detrimental result is sustained by either the corporation or their parties, liability of directors would never become the issue. And once liability becomes an issue, the liability does not stem from the failure to attend the meeting, but rather from the failure to dissent to the questionable resolution.

\textsuperscript{464} Supra note 353.

characteristic of the Japanese BOD. The BOD in Japan consists mostly of full-time inside directors, most of whom are senior employees of the corporation. Since most of these directors are employees of the corporation and work within the corporation, they ought to be able to give continuous attention to the affairs of their corporation, compared to outside directors; also inside directors are in a more convenient position to attend their board meeting than outside directors: inside directors usually work full-time within their corporation, and only for their corporation. Thus scheduling meeting to ensure their attendance and informing them of these meetings, even emergency meetings, should be quite easy and they ought to be able to attend their BOD meetings.

3) Duty of Observation

Non attendance of board meetings which was explained above is only one of many instances where directors are likely to be held liable even when they have not directly committed a wrongful act. There are many other instances in which directors may be held liable for the wrongful actions of their fellow directors in the Japanese corporate world. This issue is generally known as the duty of observation over other directors of the corporation.

The principle that directors have a duty to supervise the activities of other directors has been long recognized in Japan. Furthermore, it had been codified through amendments to the Commercial Code in 1981. The Commercial Code presently provides that "The board of directors shall decide the administration of affairs of the corporation, and supervise execution of duties of directors."

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466 Kono, supra note 214, at 29; Clark, Rodney, supra note 14, at 100.
467 Kitazawa, Kaishahō, supra note 75, at 350-351.
468 Ueyanagi, supra note 167, at 279.
469 Art.260, para.1.
As to the extent of the supervisory duty, the Japanese Supreme Courts' position, since a 1973 Supreme Court decision,\(^{470}\) has been that directors have a duty of observation not only as to matters brought up at any BOD meetings, but also concerning matters which are not discussed at a BOD meeting. A 1973 Supreme Court decision reads in part as follows:

"Directors shall supervise whether the resolution of the board meeting has been properly executed by representative directors or managing directors\(^{471}\). Matters which should be supervised by directors are not limited only to the matters which were brought up for discussion at the board meeting."\(^{472}\)

However, the position of the Supreme Court does not necessarily suggest that directors owe an unlimited duty to supervise all of the activities performed by other directors. In fact it has left the matter dangling in the air. Thus far, the Supreme Court has not elaborated on where, if any, the limits ought to be in this area. But, it has been recognized by some lower courts, that there should be a certain limitation on the extent to which directors must discharge their duty of observation, otherwise the burden on directors would be far too heavy to bear. In one instance,\(^ {473}\) a lower court ruled as follows:

\(^{470}\) The Supreme Court, May 22, 1973 (Minshū 27-5-655); Prior to this decision, the Japanese courts had been taking a position that directors owe a duty of observation only to matters which are brought up at the board meetings. (Tokyo District Court, May 13, 1957 (Kaminshū 8-5-923), etc.).

\(^{471}\) Here, the court referred to a directors' duty to supervise only representative directors and managing directors, probably because these directors generally manage the affairs of the corporation in practice; see, supra Chapter V.3. The present concept of corporate organs under the Japanese Commercial Code.

\(^{472}\) Supra note 470.

\(^{473}\) Sapporo District Court, July 30, 1976 (Hanrei Jihō, No.840, p.111).
"To pursue the liability of a director for matters which were not brought up at a BOD meeting, special circumstances are required, such as the director having known or ought to have known of the wrongful doing [of the representative director] and yet overlooking it." ⁴⁷⁴

An interesting contrast is seen from the above two decisions. As the 1973 Supreme Court decision shows, the Japanese Supreme Court generally takes a stringent and conservative position in its ruling. On the contrary, lower courts are more flexible and they sometimes take a more liberal approach in their ruling even if the ruling is in principle, opposed to the Supreme Court's decision.

It could be concluded that, if the matter is brought up to the Supreme Court of Japan, directors are likely to be held liable even for matters which were not discussed at a board meeting, since the above 1973 Supreme Court decision has not been overruled by any other Supreme Court decisions. However, if it could be proven that specific circumstances existed which prevented a director from knowing of the wrong doing of another director, the director may be able to convince the court, at least a lower court, that he did not breach his duty, and therefore ought to be excused from liability. ⁴⁷⁵

There appears to be another obvious difference between the decisions of the 1973 Supreme Court and the lower courts. The Supreme Court does not distinguish duties of directors depending upon their position, whereas lower courts tend to impose a heavier responsibility on representative directors ⁴⁷⁶ compared to non-

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⁴⁷⁴ Ibid.
⁴⁷⁵ Ueyanagi, supra note 167, at 281.
⁴⁷⁶ For differences between representative directors and non-representative directors, see, supra I. The basic concept of corporation.
representative directors.\footnote{Dziubla, Robert W., "Enforcing Corporate Responsibility: Japanese Corporate Directors' Liability to Third Parties for Failure to Supervise", in \textit{Law in Japan}, Vol.18, 1985, at 55.}

A Japanese high court, in a 1978 case\footnote{\textit{Tokyo High Court, Aug. 4, 1978} (\textit{Hanrei Times}, 371-153; \textit{Hanrei Jihō}, 900-103).}, held that "Even if the area of activity under the defendant representative director's charge was "management", he owed a duty of observation over the business activities of the other representative director who was in charge of accounting... in this case, the representative director did not breach his duty with gross negligence\footnote{In this case, the defendant director was pursued as to liability for the breach of his duty, by third parties, not by his corporation. Directors of a corporation are personally liable to third parties under the Commercial Code if they have breached their duties regarding corporate affairs with wrongful intent or with gross negligence; In Japan, if a director damages a third party with intention or negligence, he would be liable to the third party under art.709 of the Civil Code. This is a general tort liability which applies not only to directors but any individuals. In addition to this civil liability, the Commercial Code imposes specific liability on directors due to their specific position; The Commercial Code, art.266-3 provides: "If directors have been guilty of wrongful intent or of gross negligence in respect of the assumption of their duties, they shall be jointly and severally liable in damages to third persons also"; For further information regarding directors' liability to third parties under the Civil Code and the Commercial Code, see Namiki, supra note 383, at 209 to 211.} because he did not know of the illegal business activities of the other representative director who was in charge of accounting, and he had examined the accounting document which did not reveal the unlawful appropriation."\footnote{\textit{Supra} note 478.} The defendant representative director in this case was held not liable since he exercised the appropriate degree of care, i.e. he had examined the accounting documents and it was not possible for him to uncover the unlawful appropriation by the director who was in charge of accounting of the corporation. However, the importance of this case is that the court explicitly stated that representative directors owe a duty of observation over the business activities of other (representative) directors, and could not rely on other (representative) directors even if these other (representative) directors' responsibilities are different from those of the representative directors.\footnote{\textit{Ibid.}}
The rationale behind the recognition of a heavier duty on representative directors is due to the fact that representative directors, as opposed to ordinary directors, are generally more intimately involved in the affairs of their corporation; they are more likely to be in a position to find out any inappropriate business activities of other directors, and therefore these representative directors are required to discharge a higher degree of duty of observation than non representative directors.\footnote{\textit{Ueyanagi, supra} note 167, at 283.}

It appears to be doubtful, however, whether representative directors of corporations with a large number of shareholders, i.e. widely held corporations, are actually in a position to monitor the misconduct of other directors. It would be fair to so hold, since the boards of large corporations in Japan are generally comprised of a large number of directors from different departments of the corporations.\footnote{\textit{Kono, supra} note 214, at 23.} A survey shows that the average number of directors of large corporations is sixteen.\footnote{\textit{ibid.}} They are composed of not only "the president and the chief executive officer (who are usually representative directors), the senior executive directors and executive directors in charge of several departments,"\footnote{\textit{Ibid.}} but also of "ordinary directors who are usually the heads of important departments"\footnote{\textit{Ibid.}} of the corporation. It would be almost impossible for the representative directors of such large corporations to control the activities of all these directors. It would be even more unreasonable not to expect these representative directors to rely on, or trust their fellow directors who ought to be experts in their own specific areas.

Switching to the common law, it appears that no clear distinction has been
established between the duty of observation of representative directors and that of non-representative directors. Courts of common law jurisdictions have generally recognized that directors may rely on or trust other officials of their corporation if it is reasonable or justifiable to do so; though depending on the circumstances, they may still be held liable. In the City Equitable case, the court expressly stated that, "In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly."

This principle is also statutorily recognized in Canada. The BCCA provides that a director will not be held liable for consenting to a resolution ... if (1) he proves that he did not know and could not reasonably have known that the act authorized by the resolution was contrary to the governing statute or, (2) he relies and acts in good faith upon statements of fact represented to him by an officer of the company to be correct, or upon statements contained in a written report of the company's auditor.

In conclusion, the Japanese Code, unlike the Canadian laws, does not explicitly recognize the possibility of a director escaping from liability even if certain

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487 In Francis v. United Jersey Bank (supra note 445), the defendant director was held to be liable for the losses sustained by the clients of the company. In this case, the company of which the defendant was a director went bankrupt due to the mismanagement of the company by her sons who were officers of the company. Although the defendant director was not active in business, the defendant was alleged to be liable for failing to detect and constrain the wrongful act of her sons. The Court held that "she had a duty to deter the depredation of the other insiders, her sons." and "breached that duty and caused plaintiffs to sustain damages."; Revelstoke Credit Union v. Miller, [1984] 2 W.W.R. 297 (B.C.S.C.).

488 Supra note 353.

489 The CBCA, sec.150(1); The BCCA, sec.151(9).

490 Iacobucci, Frank et. al., Canadian Business Corporations (Ontario, Canada Law Book Limited, 1977), at 330.
requirements are met, such as relying on other directors or officials. It is explicitly stated in the Code\textsuperscript{491} that directors are required to positively and continuously supervise or observe other directors' business activities. Because of this codification, the Japanese Courts have been hesitant to relax the supervisory duty of directors toward their fellow directors; and courts tend to recognize that directors have a duty of observation. In principle, only when a court recognizes that special circumstances exist which may preclude or excuse the performance of this duty, may directors be exempted from liability for the actions or inactions of their fellow directors.\textsuperscript{492}

The above examination shows that being a director of a Japanese corporation appears to be a much more riskier business than being a director of a corporation in the common law jurisdictions such as Canada. Compared to directors of corporations in the common law jurisdictions, directors of Japanese corporations appear to have a higher possibility of being liable for the breach of the duty of observation. Directors of Japanese corporations have a duty to discharge a comparably higher degree of care. But this is not the only factor which imperils the directorship of Japanese corporations. Directors under the Japanese Commercial Code may be personally liable not only to their corporations, but, if specific requirements are met,\textsuperscript{493} they may also be liable to third parties for any breach of their duties. They should be aware that they are expected to discharge their duty of observation continuously, and they should also keep in mind that they could be sued by third parties who suffered from losses or damages due to other directors' illegal or wrongful activities related to the affairs of the corporation.

\textsuperscript{491} The Commercial Code, art.260, para.1, supra note 469.
\textsuperscript{492} Ueyanagi, supra note 167, at 283.
\textsuperscript{493} The Commercial Code, art.266-3, supra note 479; The Supreme Court, Nov.26, 1969 (Minshû 23-11-2150) clarifies two requirements for a director to be liable to third parties: 1) the existence of wrongful intent or gross negligence; and 2) the existence of a proximate causal relationship between the third parties' damages and the director's wrongful act; For the detail of directors' liability to third parties, see Dziubla, supra note 477.
However, one commentator\footnote{Kanzaki, Katsuro, Torishimariyaku Seidoron \textit{[Discussion of the Board of Directors' System]}, cited in Ueyanagi, \textit{supra} note 167, at 283.} suggests that recent court cases show that though Japanese Courts have, in theory, long recognized the positive supervisory duty of directors, the courts have, in practice, tended to reject holding directors liable for the breach of this supervisory duty, by taking into account the specific circumstances\footnote{Such as: the defendant directors physical inability to supervise other directors' activities due to the distance of his residence (Ueyanagi, supra note 167, at 283, case unknown); the director had not obtained remuneration from the corporation (Osaka District Court, March 28, 1980, Hanrei Jihō, No.963, at 96); or the director was very old (Ueyanagi, supra note 167, at 283, case unknown).} of each case. It is fair to say that the Japanese courts are in theory very strict by not relaxing directors' duties on the one hand, yet on the other hand they are quite concerned about being too heavy handed or ruthless toward the directors. To resolve this dilemma, some Japanese courts have recently tended to focus on very practical elements of each case; this course of reasoning has been successfully used to reject claims of directors' liability, without bending the established theory or principles of the law.

This attitude of Japanese Courts would appear to be philosophically consistent with the general attitude of the Japanese people. The Japanese people are generally thought to be very conservative and persistent and very hard to deal with, but in fact, they are quite flexible and progressive. Another way of simply explaining the above idea in a manner which is easily understood by non-Japanese would be to use one of the Western stereotypes of the Japanese that "the Japanese are typically two-faced."\footnote{The Japanese behaviour patterns are typically described in terms of the "Honne" an "Tatemae" dichotomy. "Honne means one's natural, real, or inner and proclivities, whereas tatemae refers to the standard, principle, or social rule by which one is bound at least outwardly. This cultural pressure for situational discrimination may also underlie the Japanese recognition of what Ben Dasan (1970) calls "law behind law," "reason behind reason," and "word behind word."; Lebra, Takie Sugiyama, \textit{Japanese patterns of behaviour} (Honolulu, University Press of Hawaii, 1976).}
2.3 Business Judgment Rule

In connection with the directors' duty of care and skill, the so-called "Business Judgment Rule" has been used in the American and Canadian jurisdictions as a device for insulating corporate decision-makers from personal liabilities for the breach of such duty. The essential principle of this Rule has been stated by the U.S. courts as:

"directors are to be insulated from liability for business judgments that were made without any presence of fraud, illegality or conflict of interest."

The U.S. courts gave further enlightenment on this interpretation:

"the mere absence of colourable motive will not insulate directorial decision-making from review for breach of duty unless there is also evidence that the director has been reasonably diligent in arriving at the decision."

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497 "The business judgment rule is a specific application of the directors' duty of care to the situation where, after reasonable investigation, the directors adopt a course of action which they honestly and reasonably believe will benefit the corporation, but which turns out to have been in error. Should the directors be sued because of their decision, the court -- at least in theory -- will not second-guess the merits of the decision but will examine only the directors' good faith and due care."

498 The following cases are some of the American cases which adopted the business judgment rule: Kamin v. American Express Co. 383 N.Y.S. 2D 807 (N.Y.S.C. 1976); Smith v. Van Gorkom 488 A. 2d 858 (Del. S.C. 1985).


500 Ziegel, supra note 66, at 461-463.


502 Ziegel, supra note 66, at 461; Smith v. Van Gorkom 488 A.2d 858 (Del.S.C.1985); One commentator advocates that five elements must be present for a court to adopt the business judgment rule. The elements are: 1) a business decision; 2) disinterestedness; 3) due care; 4) no abuse of discretion; 5) good faith. Where all of these are present, corporate actions will not be enjoined and directors will be held liable; Arsht, 8 Hofstra Law Review, at 108, 114-30, cited in Goldwasser, supra note 497, at 19.
The principles of the Business Judgment Rule have been introduced to Japan over a period of time through academic exchanges and studies with the jurisdictions which embraced this and similar principles. It has been greeted with favourable approval by many Japanese legal scholars. Since the late 1970's some Japanese courts have recognized this principle in the course of their decisions regarding directors' duty of care and skill.

In a 1978 judgment, a Japanese court found a director to be not liable by adopting the Business Judgment Rule. The court held that when a company faced a financial difficulty and a director of the corporation borrowed money for the corporation, if the action was done in the best interest of the corporation and also if it is recognized that the director acted reasonably as a director, and furthermore, if the action was not done in an illegal way, it may not be said that the director breached his duty of care as a director. The court clearly espoused the Business Judgment Rule concept in its rationale of the judgment by stating:

"Adventures and risks are, to some extent, inseparable from managing a business. When a director entered into a risky deal to the extent expected for carrying on the business of his corporation, based on his reasonable judgment as an experienced and knowledgeable business person, and unfortunately its results are unsuccessful, the director may not be said to have breached his duty to the company and be liable merely because of the unfortunate result. Such conclusion imposing

\[503\] Namiki, supra note 383, at 227-228; Ueyanagi, supra note 167, at 276.

\[504\] Osaka District Court, April 20, 1967 (Hanrei Jihō, 488-64); Fukuoka High Court, October 8, 1980 (Kaminshū 33-4-341), cited in Ueyanagi, supra note 15, at 276-277; Tokyo District Court, March 1, 1978 (Kinya Shōji, 562-36), Tokyo District Court, September 30, 1982 (Hanrei Times, 486-169), cited in Namiki, supra note 383, at 228.

\[505\] Ibid.

\[506\] Tokyo District Court, March 1, 1978 (Kinya Shōji, 562-36).
liability on the director is to be improper in practical business management.\textsuperscript{507}

It should be carefully noted that basically, though the Business Judgement Rule has taken root in Japan, there exists vehement opposition by some to this principle.\textsuperscript{508} In short, a group seems obstinately persistent in opposing this principle. Their opposition appears to be based on several fears, the chief of which seems to be that directors of corporations may be able to escape from judicial supervision too easily. The flames of their fears are further fuelled by the thought that the courts, if the adoption of the Business Judgement Rule is fostered, may hold in extremely high esteem the business decision-making abilities of directors and also possibly accept that directors of corporations may make business decisions more effectively than they, the judiciary may. Two conceivable rationales which flow from these views are:

1) the judiciary must maintain their dignity. In other words, although the judiciary routinely defers to the higher judicial authorities, bureaucrats' expertise, or established scholars in making their judgment, business people appear not to be considered the authority they may yield to; and

2) it is against the general principles of tort laws\textsuperscript{509} to give only to the directors of corporations, an opportunity to escape from liabilities resulting from the breach of their duty, by considering the importance of the pursuit of smooth business activities or economic efficiency on behalf of corporations by directors. In other words, as far as tort

\textsuperscript{507} The Judgment cited in Namiki, supra note 383, at 99-100.

\textsuperscript{508} Ueyanagi, supra note 167, at 276-279.

\textsuperscript{509} It is stated in the Civil Code of Japan that "A person who violates intentionally or negligently the right of another is bound to make compensation for damage arising therefrom."(art.709).
liability is concerned, if someone causes damages to someone by breaching their duty, they generally ought to be bound in making compensation for the damages. Therefore, if a director has breached his duty and has caused damage to their corporation or to any other parties, they ought to be liable for the tort due to this general principle of tort liability.

Although there exists no concrete evidence for the first rationale, it is most likely the result of the heightened consciousness of the Japanese people toward their judiciary. The Japanese people as a rule, appear to hold their judges in extremely high esteem; the majority of the people believe, "every judge is just and impartial," and the legal professionals including judges and scholars for the most part maintain and uphold this dignity attributed to the judiciary. It may also be the thought of those who oppose the acceptance of the Business Judgment Rule that it would be harmful to this dignity of the judiciary to recognize that directors, as business experts, may make better business decisions than the judiciary; or, it may be thought that, even if it is recognized to be true that directors may make better business decisions than the judiciary, the omnipotent power to determine whether these decisions are made properly or appropriately should be entrusted only to the judiciary.

The second rationale also indicates another interesting contrast in the philosophy of Japanese and people in the West, and the differences in historical background of the development of the concept of a duty of care and skill in Japan and the common law jurisdictions. First of all, it is frequently said that Japanese people consider any obligations in their life, including liabilities, to be of paramount

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importance, even to the extent of placing them ahead of their own rights and freedoms. This is certainly true compared to North American people. This tendency of Japanese people to stress obligations appears to be responsible for their hesitance in relaxing the liabilities of not only directors, but also anyone else who has any duty to discharge due to their position.

Secondly, the concept of the duty of care and skill in Japan is based on the relationship between a corporation and its directors. As was stated earlier, directors are considered to be mandataries. Their duties, as far as the duty of care and skill is concerned, are derived from their position as mandataries; these duties are set forth in the Civil Code of Japan as duties pertaining to all mandataries. Therefore, to get the full support of Japanese scholars and the judiciary to recognize an exemption in the application of the relevant provisions of the Code, so as to relax these duties when dealing with only directors of corporations would necessitate some sort of amendment to the relevant provisions of the Code, since for some conservative scholars and members of the judiciary, special considerations pertinent to the economic efficiency or smooth business activities of a corporation would not be a sufficient enough reason to make a different interpretation, of the pertinent statutory provisions, which is contrary to the generally accepted statutory interpretation.

It should, however, be noted here, that this view of opposing the adoption of the Business Judgment Rule, is a strong one, but is not necessarily the prevailing one. Many leading Japanese scholars, especially those who have studied the laws of the common law jurisdictions\textsuperscript{511}, in particular the American laws, have been supporting the adoption of the Business Judgment Rule. In addition, though no clear position

\textsuperscript{511} Namiki, supra note 383, at 60-61; Kanzaki, Osakadani, etc., cited in Ueyanagi, supra note 167, at 276.
toward the adoption of the Business Judgment Rule appears to have been firmly
taken by the Supreme Court of Japan, since at least some of the lower courts have
already recognized and adopted the principles of the Business Judgment Rule, there
is no doubt in my mind that these principles are spreading their roots successfully
along the ground and penetrating the rocky terrain deeply. The principles of the
Business Judgment Rule will continue to be discussed in the Japanese Courts; and
who knows, in time, they may be improved upon and sold back to the common law
jurisdictions for a profit!! It is clear in my opinion that the Japanese upper courts
may rationalize and implement a change of approach in this area. They need only
realize that they would not be impinging upon their judicial expertise by merely
deferring to business people’s expertise, since these business people may be placed
in the category of "professionals," the same as doctors are. It has been the accepted
practice of the courts to defer to experts such as doctors and other professionals.

To conclude regarding the Business Judgment Rule, if a director has made a
business decision on behalf of the corporation without any personal interest, with due
care and diligence, and acted in good faith, it would not be reasonable for such a
director to be liable for this business decision. Since, the corporation itself, i.e.
shareholders, has, in the first place, elected and conferred the powers to manage the
corporation upon this director\textsuperscript{512}, it would be ludicrous for the corporation to hold
this director liable for mismanagement if he has discharged his duty faithfully and in
the best interest of the corporation. Of course, a court, when it adopts the Business
Judgment Rule and rejects directors’ liability, should be very prudent to judge
whether the director has discharged his duties with sufficient due care, whether the
director was diligent enough, and whether the director acted faithfully toward their
corporation and in its best interest.

\textsuperscript{512} The Commercial Code, art.254, para.1; art.260.
3. Fiduciary Duties

One of two primary duties corporate directors owe to their corporations (some may extend these duties to others associated with the corporations), the duty of care and skill, has been examined and discussed in the preceding part of this chapter. Hopefully the preceding examination and discussion has shed some light on some of the principles governing directors' duties under the Commercial Code. The rest of the chapter will examine the other primary duty of directors, namely the fiduciary duty.

3.1 Concept of Fiduciary Duty

The basic equitable principles, regarding corporate directors and their duties, in respect to their corporations are generally regarded as the same as those of other fiduciaries. One of the primary duties corporate directors owe to their corporations, as fiduciaries, is the so-called "fiduciary duty of loyalty (and good faith)."

The concept of fiduciary duty of loyalty was originally developed by the Courts

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513 Gower, supra note 52, at 551.
514 The status of corporate directors has been a controversial issue, and the discussion of this issue is beyond the scope of this thesis. In sum, corporate directors have been viewed as either trustees or agents, or mixture of both of their corporation. For a detailed discussion, see: Gower, supra note 52, at 550-551; Welling, supra note 138, at 378-380; Paterson, supra note 350, at 2; McMurray, supra note 349, at 605-606.
In the U.S.A., it has been recommended by the American Bar Association Committee on Corporate Laws (1984 Revision of the Model Business Corporation Act, sec.8.30 (a), at 222, 1984) that the term "fiduciary" should not be used.
515 Gower, supra note 52, at 551; Ziegel, supra note 66, at 491; however, some authors are of the opinion not to use the term "fiduciary duty of loyalty." For instance, The American Law Institute uses the term "Duty of Fair Dealings" instead of the term "duty of loyalty" in its Principles of Corporate Governance: Analysis and Recommendations -Proposed Final Draft-, March 31, 1991. In the book, it is stated that "Courts have traditionally analyzed the obligation of a director or officer who acts with a pecuniary interest in a matter in terms of a "duty of loyalty" to the corporation. However, courts have also used the term "duty of loyalty" in other contexts where a director or officer may be viewed as having conflicting interests. For clarity of analysis, Part V avoids the use of the term "duty of loyalty," when dealing with the obligations of a person who acts with a pecuniary interest in a matter, and instead uses the term "duty of fair dealing." (at 264).
of Equity over two centuries ago, and subsequently courts in numerous common law jurisdictions have since adopted this principle. In the course of its adoption, judges in the common law jurisdictions have attempted to unmuddy the waters in this area. Several have elucidated on the concept of fiduciary duty. Since no two cases have ever been identical and each case had specific circumstances to be taken into consideration, this area has been a fertile plain of issues for elucidation. The present statutory provisions with regard to fiduciary duty in common law jurisdictions are abundantly articulate, at least compared to its Japanese counterpart. These provisions undoubtedly owe their derivation to the historical developments of the concept by the common law courts. Notwithstanding, the common law still remains a primary source of law for the treatment of the majority of cases involving directors' fiduciary duty. The following is a brief look at the common law cases which have established some rules in regard to the directors' fiduciary duty.

A classic, and probably the most important case pertinent to the area of fiduciary duty is the 1854 English case, *Aberdeen Railway Co. v. Blaikie Bros.* In this case, Lord Cranworth L.C. illustrated the principle of the fiduciary duty as follows:

"... it is a rule of universal application that no one having such duties to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possible may conflict with the interests of those whom he is bound to protect ..."

Sixty years later a Canadian court also found directors who deliberately

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518 For example, the CBCA, s.122; the OBCA, s. 142; the BCCA, s.142.
519 (1854), 2 Eq. Rep. 1281.
520 *Cook v. Decks* [1916] 1 A.C.554, 85 L.J.P.C. 161 (P.C.)
took over a contract which rightfully belonged to their corporation, accountable to their corporation for the benefit they obtained through the contract.

Another English decision, Regal Hastings, took the elucidation one step further. Here, although the corporation did not have enough financial resources to take advantage of an opportunity, and thus did not incur any actual harm by the directors taking advantage of the opportunity, the court found the director liable to the company. The primary fact the court emphasized was that the directors' profit accrued "by reason and only by reason of the fact that they were directors of Regal...", and thus whether or not the corporation actually sustained harm, or whether the corporation could not take the opportunity itself was irrelevant.

The leading Canadian case in this sphere, Canaero, has followed Regal Hastings, and further augmented another dimension to this area of law. In short, the case expanded or redefined the scope of directors who ought to owe a fiduciary duty to the corporation. The court ruled that (senior) officers and former directors (and officers) also owe a fiduciary duty to their corporation, and if they breached this duty they are accountable for any profits which they derive from such a breach.

Although these cases are only some of the landmark cases in this area, and other cases relevant to the area of fiduciary duty should be carefully noted, they illustrate the underlying principles relevant to fiduciary duty in the common law jurisdictions.

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522 Ibid.
524 Liability of former directors will be discussed later; see infra not 693 to 714 and accompanying text.
Contrary to this long history of the judicial scrutiny and scholarship on the concept of fiduciary duty in the common law jurisdictions, the concept of fiduciary duty (of loyalty) has a relatively short history in Japan. The concept of fiduciary duty was first introduced by the 1950 amendments to the Commercial Code.\footnote{Art.254-3.} However, despite the non-existence of this concept in the Code prior to the amendment, several duties of corporate directors, which are now considered to be specific types of fiduciary duty of loyalty, had been regulated by the Code, since its original enactment in 1899.\footnote{Art.254-3.} Although these old provisions were based on the provisions of the German Commercial Code of that time through several amendments to the relevant provisions of the Code, these provisions have been changed largely due to the influence of the laws of common law jurisdictions, in particular the laws of the U.S.A. after World War II. Hence now, these provisions closely resemble those of the U.S. company laws, but are not identical to them.

Prior to the 1950 amendments, by which the term "fiduciary duty" and the provision regulating this duty was introduced to the Code,\footnote{Art.254-3.} the duty of care and skill was viewed as an umbrella duty which may regulate any directors' conduct.\footnote{Ueyanagi, supra note 167, at 28-34.} Other specific duties of directors, such as the duty to avoid competition\footnote{Art.264; a detailed discussion on this duty will be made later in this chapter; infra see 3.3 Competition.} and the duty to avoid self-dealing transactions,\footnote{Art.265; a detailed discussion on this duty will be made later in this chapter; infra see 3.2 Self-Dealing Transactions.} were viewed either as specific civil duties which only apply to directors or a specific type of the duty of care and skill.\footnote{Ueyanagi, supra note 167, at 205 to 205 and 225 to 227.}
When the concept of fiduciary duty was introduced to the Code, it appears to have been very difficult for the Japanese legislature, judiciary and other legal experts to comprehend the concept and accept that there exists another fundamental duty of directors.

In addition, according to the concept of fiduciary duty in common law jurisdictions, the duty to avoid competition and the duty to avoid self-dealing transactions are considered to be within the scope of the fiduciary duty, not the duty of care and skill. This principle also appears to have been met with difficulties pertaining to its acceptance to the Japanese legal arena. It is evident from the fact that even at present there still exist arguments as to whether or not the fiduciary duty including the duty to avoid competition and the duty to avoid self-dealing transactions is a different duty from the duty of care and skill. This confusion and hardship in understanding the concept of fiduciary duty by Japanese legal experts has led to a somewhat different concept of fiduciary duty in Japan as compared to the concept in common law jurisdictions.

Despite, the difference in the concept of fiduciary duty in Japan and common law jurisdiction, the Code prescribe for the fiduciary in a manner similar to its common law counterpart. The following provisions of the Code and the BCCA regulating the fiduciary duty illustrate the similarity of the fiduciary duty regulations in both jurisdictions.

The Commercial Code, Article 254-3

"The directors shall be obliged to obey any law or ordinance and the articles of incorporation as well as resolutions adopted at a general meeting and to

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532 Gower, supra note 52, at 559 to 572.
533 This issue will be discussed shortly.
perform their duties faithfully on behalf of the company."

The BCCA, Section 142(1)(a)
"Every director of a company, in exercising his powers and performing his function shall act honestly and in good faith and in the best interest of the company."

One example which demonstrates the confusion and complexity of understanding the concept of fiduciary duty among Japanese legal scholars and the judiciary is seen in the argument regarding the interpretation of Article 254-3 of the Code. The majority opinion was and probably still is that the duty provided for in Article 254-3 is, in principle, the same duty as the duty of care, and the provision merely clarifies the duty of care. Thus the fiduciary duty is not a duty which requires a different degree from that of the duty of care. The Japanese Supreme Court also supported this view in a 1970 decision. The Court stated that "The provision of Article 254-3 [fiduciary duty] of the Commercial Code is confined to amplify and clarify the duty of care set forth in Article 254, paragraph 3 of the Code and Article 644 of the Civil Code. The provision [the fiduciary duty] does not prescribe a duty which is separate from or higher than the duty of care which is derived from an ordinary relationship of mandate." However, an alternate view has emerged in recent years.

The new view appears to be derived from a gradual understanding of the original concept of the fiduciary duty in common law jurisdictions. According to this

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534 Suzuki, Osumi, Ishii, Kawamoto, cited in Namiki, supra note 383, at 46.
535 Ueyanagi, supra note 167, at 28-29; Kitazawa, Kaishahô, supra note 75, at 351.
536 Supra note 369.
537 The Supreme Court, June 24, 1970 (Minshu 24-625).
538 Ueyanagi, supra note 167, at 29; Tanaka, supra note 21, at 540; Namiki, supra note 383, at 46.
view, the fiduciary duty, in contrast to the duty of care which requires the standard of care of a good manager, is one which requires a higher standard than the standard of duty of care. Scholars in this camp advocate that fiduciary duty is a duty which requires directors to act honestly, faithfully and in the best interest of their corporations; if a conflict arises between the director's interest and the corporation's interest, the director shall act in the best interest of the corporation. And it is not sufficient for a director to merely discharge his duties by satisfying the requirement of acting with a good care as a good manager. This interpretation is, to a large extent, similar to that generally observed in common law jurisdictions.

Although it appears that in common law jurisdictions these two duties have been recognized to be two distinct duties, in the Japanese legal regime, rationalizing this view requires that more regard be given to observations of the Code and other relevant laws and their historical developments. In conclusion, it is my opinion that in Japan the fiduciary duty should be treated as a different and distinct duty from the duty of care and skill for the following reasons:

(a) As mentioned earlier, the provision which sets forth the fiduciary duty was inserted to the Commercial Code due to the expansion of directors' powers by the 1950 amendments. The insertion of the provision was originally purported to impose a heavier duty on directors and to prevent possible abuses of the directors' expanded power. Therefore, it should be recognized that the fiduciary duty is a duty which is imposed on directors for their activities which may not be controlled by the duty of care which had existed before the amendments.

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539 Ueyanagi, supra note 167, at 29; Namiki, supra note 383, at 47-48; Tanaka, supra note 21, at 540-541.

540 The Commercial Code, art.254-3; see previous page.

541 Tanaka, supra note 21, at 543; Ueyanagi, supra note 167, at 28.
(b) As the business judgment rule\textsuperscript{542} has become an accepted rule by some Japanese courts,\textsuperscript{543} imposing the duty of care on directors has become less efficient in preventing directors from abusing their powers. Thus, it has been the predominant view among scholars who recognize the business judgment rule in Japan\textsuperscript{544} that the business judgment rule should not be applied in the case where directors have breached their fiduciary duty. On the other hand, if the fiduciary duty is recognized to be the same duty as the duty of care, the business judgment rule may be applied to the fiduciary duty as well. Hence, if Japanese courts recognize the business judgment rule and reject directors' liability, they should also recognize the concept of fiduciary duty as being different from that of the duty of care and not being sheltered by the business judgment rule.

(c) If the fiduciary duty is recognized as the same duty as the duty of care, for a director to be liable, the corporation should bear the onus of proof that the wrong doing was done by intention or with negligence\textsuperscript{545}. On the other hand, if the fiduciary duty is recognized as a duty of a different or higher degree than the duty of care, the mere fact that a director puts himself in a situation where his interest conflicts with the interest of the corporation would constitute a breach

\textsuperscript{542} Supra 2.3 Business Judgment Rule.

\textsuperscript{543} Ibid.

\textsuperscript{544} It is also said by an American commentator: "The business judgment rule provides no shelter for directors and officers who breach the duty of loyalty."; McMurray, supra note 349, at 628.

\textsuperscript{545} Ueyanagi, supra note 167, at 30; It is an established view of the Japanese courts that for directors to be liable for a breach of duty of care, the action should have been done with intention or by negligence.
of this fiduciary duty; intention or negligence would be irrelevant.\footnote{This view has been supported by some scholars (Kitazawa, Kanzaki, cited in Ueyanagi, \textit{supra} not 167, at 30); Some scholars disagree, stating that intention or negligence is not necessary for a breach of fiduciary duty. These scholars argue that the existence of negligence should be determined based on whether the director knew the fact that his/her action conflicted with the interest of his corporation. Therefore this school of scholars, as far as the requirement of negligence is concerned, deals with the fiduciary duty more strictly than the duty of care. (See Ueyanagi, \textit{supra} note 167, at 30).}

In other words, if a director’s activity causes or may cause any conflict of interest between the director and his corporation, he would be liable to the corporation for damages regardless of whether or not the activity was done by intention or with negligence. To pursue the liability of the director, the corporation merely has to prove that his activity conflicts with the interest of the corporation.\footnote{Namiki, \textit{supra} note 383, at 50 to 51; \textit{Jurisuto}, No.920, at 34-40.}

In light of the fundamental principles of fiduciary duty, it appears obvious that if a conflict of interests between a corporation and its director is evident, the director ought to be liable for his actions if they were undertaken and were not in the best interest of his corporation, irrelevant of his intention or negligence.

Although the view which recognizes that the fiduciary duty is different from the duty of care is a quite strong one, at present it appears that the Japanese courts are still reluctant to distinguish these two duties.\footnote{Most cases which should be dealt with as breach of fiduciary duty cases have been dealt with as breach of duty of care cases or both breach of duty of care and fiduciary duty cases by the Japanese courts; \textit{Re: Nihon Setsubi}, Tokyo District Court, March 30, 1988, \textit{Hanrei Jiho}, No.1272, p.23; \textit{Nitho co}, Ltd. v. \textit{Asakura}, Tokyo district Court, July 23, 1970, \textit{Hanrei Jiho}, No.607, at 81 to 84.}

The argument concerning whether or not fiduciary duty should be distinguished from the duty of care is one example which illustrates a somewhat different notion of the concept of fiduciary duty in Japan as compared to common law jurisdictions.
The concept of fiduciary duty under the Japanese Commercial Code will be further illustrated by a detailed analysis of several different situations which might give rise to a conflict between directors and their corporations. The rest of the chapter will examine three typical conflict of interest situations. The situations are: 1) self-dealing transaction; 2) competing with the corporation; and 3) taking a corporate opportunity.

3.2. Self-dealing Transactions

1) Statutory Provisions

When directors contract with their corporations, such transactions are generally referred to as "self-dealing transactions." During these transactions, a conflict of interest situation is highly likely to occur. When directors enter into a contract with their corporations, either directly or indirectly, in many cases they may have a pecuniary self interest in this contract. Consequently they may favour their self interest and forsake the interest of their corporation which they ought to be protecting.

Since corporate directors occupy positions which give them numerous opportunities to enrich themselves, justly or unjustly, by utilizing valuable information which only few individuals including themselves are privy to and at the same time allows them to conceal secret profits they may obtain by use of this information, it would appear that it may be quite a laborious task for them to resist temptations in this area.

Though this may be a general tendency for corporate directors anywhere in

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549 There are several types of transactions which are usually called "self-dealing transactions." They include four types of transactions: 1) a transaction between a corporation and its directors; 2) a transaction between a corporation and a third party in which a director of the corporation has a significant interest; 3) a transaction between two corporations which have interlocking directors; and 4) a transaction between a corporation and its subsidiaries. Due to the limited scope of this thesis, the first two types of transactions will be focused on here.
the world, in Japan, corporate directors appear to utilize their positions more frequently for their own self interest. For instance, they frequently borrow money from financial institutions or issue bills with their corporation’s endorsement.\textsuperscript{550} As a result of this practice, numerous cases regarding self-dealing transactions have been reported.\textsuperscript{551}

No reliable evidence could be obtained pertaining to whether in fact, more cases have been reported or, more such transactions have been undertaken without being reported, in Japan, as compared to other jurisdictions such as the U.S.A. or Canada. However, the assumption that corporate directors in Japan have been less aware of or ignorant of their duties regarding self-dealing transactions would not be missing the mark. It is a well known fact, to the Japanese any way, that Japanese directors have for the longest time rested on their laurels ignoring their shareholders who are usually quiet and patient, despite the attempts of the law to restrain this and other unbecoming types of directors’ behaviour.\textsuperscript{552} Most corporate directors appear not to be conscious of or simply do not care about the fact that they are fiduciaries of their corporations. With this attitude of corporate directors (in Japan), it is most likely that self-dealing transactions have been undertaken more frequently by directors of Japanese corporations compared to directors of other jurisdictions such as those of the U.S.A. or Canada.

\textsuperscript{550} Tanaka, \textit{supra} note 21, at 556.
\textsuperscript{551} \textit{Ibid}.
\textsuperscript{552} As seen in Chapter V (supra Chapter V. 3. Present Problems Surrounding Shareholders’ General Meeting in Japan), in Japan the SGM has been nominal and not functioning in a way as it ought to be. It has been said this is largely because corporate management have tended to ignore shareholders, while shareholders themselves have tended to be disinterested in corporate management. (Sueyoshi, Toshikazu, "Kabunushi Sōkai no Genjyō to Kadai [Present Situation and Problems of Shareholders’ General Meetings]" in \textit{Hōritsu Jihō}, Vol.64, No.7, at 24 to 30.) In addition, a small number of law suits against directors including cases involving directors' self-dealing transactions in Japan also evidences Japanese shareholders' unawareness of their own rights and directors' unwanted behaviours. The issue regarding law suits against directors will be addressed in conclusion (\textit{Infra} note 785 to 787 and accompanying text).
Despite the differences of behaviour of corporate directors in Japan compared to their American and Canadian counterparts, in all jurisdictions directors are not legally free to enter into transactions with their corporations. To restrict self-dealing transactions primarily for the purpose of protecting the interest of a corporation, such self-dealing transactions are, in principle, prohibited without the approval of the corporation under both the Japanese Commercial Code and the statutes of common law jurisdictions including those of Canada and the U.S.A.

In Japan, as stated earlier, self-dealing transactions had been under regulation since the inception of the original Commercial Code along with some other directors activities with regard to fiduciary duty of loyalty. Though the provision pertaining to self-dealing transactions was originally based on provisions of the German Commercial Code of the time, through several amendments of the Code the present fundamental principles of restricting self-dealing transactions are analogous to those of the common law and the statutory provisions of common law jurisdictions with some exceptions.

To commence the rest of this discussion, the relevant provisions of the Commercial Code of Japan (the Code) and those of common law jurisdictions shall be observed. For simplicity, here the British Columbia Company Act (the BCCA) of Canada will be dealt with as a representative statute of common law jurisdictions.

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553 Article 265 of the Commercial Code.
554 The CBCA, s.120; The BCCA, s.144; The OBCA, s.132.
555 The Revised Business Model Corporations Act in 1989 (RMBCA), s.8.31.
556 The original Commercial Code (1899 Commercial Code) provided: "A director can do business with the company either on his own account or on that of a third person only when he has obtained the consent of the inspectors." (art.176); Loenholm, supra note 43, at 49.
557 Other directors' activities regulated under the original Commercial Code included competing with the corporation. (1899 Code, art.175).
558 The provision was amended in 1911, 1938, 1950, and 1981. For the detail of the amendments, see Ueyanagi, supra note 167, at 228-229.
Both statutes - the Code and the BCCA - explicitly and minutely regulate self-dealing transactions. The following provisions constitute the major thrust of the statutes in this area:

**The Commercial Code of Japan, Article 265, paragraph 1**

"When a director intends to acquire the company's products or other properties by transfer or to transfer his own products or other properties to the company or to receive loans from the company or to effect any transaction with the company on his own behalf or on behalf of a third person, he shall obtain the approval of the board of directors. The same shall apply in the case where the company guarantees liability of the director or otherwise effects with a person other than the director in a transaction in their interests are contrary between the company and the director."  

**The British Columbia Company Act, Section 144, sub-section 1**

"Every director of a company who is, in any way, directly or indirectly, interested in a proposed contract or transaction with the company shall disclose the nature and extent of his interest at a meeting of the directors."

The underlying principles of both provisions may be summarized as follows: When directors contract with their corporations, a conflict of interest situation between the directors and their corporations is likely to occur. To protect the interest of the corporations in such circumstances, the statutes require that interested directors disclose their interest in these transactions to their corporations and/or acquire approval for executing any such transactions from their corporations.

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559 Note that unsound translation of this section is due to the direct quote from the *EHS Law Bulletin Series*.

560 The CBCA equivalent is s.120, ss.(1).

To shed light on the regulatory schemes of self-dealing transactions under the Commercial Code, further examinations will be made with regard to: 1) direct and indirect transactions; 2) the scope of self-dealing transactions; 3) effect of self-dealing transactions; 4) disclosure, approval and fairness relevant to self-dealing transactions; and 5) accountability of directors involved in self-dealing transactions.

2. Direct and Indirect Transactions

Self-dealing transactions which are required to be disclosed under the Commercial Code may be divided into two types: 1) a direct transaction, a transaction between a director and his corporation; and 2) an indirect transaction, a transaction between a corporation and a third party, which causes or might cause a conflict of interest between the corporation and its directors.

A direct transaction has been prohibited if disclosure is not made by the director and if the board's approval is not granted, under the Commercial Code. On the contrary, due to no explicit reference to indirect transactions in any provisions of the Code prior to the 1981 amendments, it had been long debated whether indirect transactions ought to be regarded as being statutorily prohibited self-dealing transactions if the board's approval was not obtained before their undertaking. Examples of situations which added fuel to this debate included: a transaction made between a corporation and a third party, which in reality was made on behalf of a director of the corporation, such as a guarantee contract between a corporation and a bank when a director of the corporation borrows money from the bank; and a transaction made between a corporation and another corporation with interlocking directors.

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562 Ueyanagi, supra note 167, at 244.
563 Ibid.
564 Namiki, supra note 383, at 161.
565 Ueyanagi, supra note 167, at 244.
The original position of the Japanese courts was to exclude this kind of indirect transactions from self-dealing transactions which required the board's approval. In a 1964 case, the Supreme Court of Japan stated that, "a transaction under the provision referred to is a direct transaction between a corporation and its director(s) which caused a conflict of interest between them." It was based on the presumption that any transaction which violates Article 265 was null and void. In other words, if indirect transactions were regarded as self-dealing transactions, they would be null and void. If it were the case, the safety of bona fide third parties would be imperiled. Thus, it was considered necessary to exclude indirect transactions from statutorily restricted self-dealing transactions. Although this interpretation would protect the interest of third parties, it would endanger the interest of the corporation. Corporate directors may easily make a deal with their corporation to obtain secret profits by simply using a third party's name.

Thus, this rigid interpretation of the provision as defined by the above court decision was reversed by subsequent courts. In a 1968 decision, the Supreme Court of Japan held that transactions under Article 265 should be interpreted to include not only a direct transaction between a corporation and its director(s) but also a transaction made between a corporation and a third party on a director's behalf, if the transaction constitutes a conflict of interest situation between the director and the corporation. With this background, the provision of the Commercial Code was amended in 1981 in an attempt to make this point as clear as day. Due to this amendment, presently the Code explicitly includes indirect transactions as part of statutorily restricted self-dealing transactions.

566 In the Supreme Court Judgment, March 24, 1964 (Saihanshu 72, p.619); see Kitazawa, Kaishahô, supra note 75, at 368-369.
567 The Supreme Court, December 25, 1968 (Minsha 22-13, p.3511).
568 Ibid.
569 The 1981 amendments.
570 The Commercial Code, art.265, para.1; supra, note 559 and accompanying text.
Regarding the point explained above, the position of the common law as well as the Canadian statutes appears to be similar to the present provisions of the Japanese Commercial Code. In Transvaal Lands Co. v. New Belgium Land and Develop Co., the court held that "...Where a director of a company has an interest as a shareholder in another company or is in a fiduciary position towards and owes a duty to another company which is proposing to enter into engagements with the company of which he is a director, he is in our opinion within this rule. .... It is immaterial whether this conflicting interest belongs to him beneficially or as trustee for others." (emphasis added). This common law position has been codified into most Canadian statutes.

Now it appears that both in Japan and in Canada, directors who have a self-interest in a contract with their corporations may not escape from liability by concealing themselves with any exquisitely carved masks. The only way for interested directors to avoid liability would be, as will be seen later, to follow the statutorily required procedures, and not to resort to petty trickery or deceptive cloaking techniques.

However, even though a transaction may appear to be a self-dealing transaction (regardless of whether it is a direct or indirect transaction) not all transactions which involve a corporation and its directors will be within the scope of

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571 [1914] 2 Ch. 488, 84 L. J. Ch 94 (C.A).
572 See also Fern Brand Waxes Ltd. v. Pearl (1972), 29 D.L.R. (3d) 662 (Ont.C.A.). Here the court clearly stated that separate identities are not to be used as an instrument of fraud.
573 The BCCA, sec.144, para.1 provides: "Every director of a company who is, in any way, directly or indirectly, interested in a proposed contract or transaction with the company shall disclose the nature and extent of his interest at a meeting of the directors." Sec.120, para.1 of the CBCA is analogous; The Model Business Corporation Act, sec.8.31 also applies "if a director has an 'indirect interest' in a transaction"; see D'Ambrosio, Thomas A., "The Duty of Care and the Duty of Loyalty in the Revised Model Business Corporations Act" in Vanderbilt Law Review, Vol.40, No.3, April, 1987, at 688.
574 Infra, see 5. Disclosure, Approval, and Fairness.
the statutorily restricted transactions. The next section will examine the scope of self-dealing transactions which are subject to the corporate laws of Japan and Canada.

3) Scope of Self-dealing Transactions

Transactions which would fall into the scope of statutory restricted self-dealing transactions were originally interpreted by the Japanese courts to include any transactions between a corporation and its director(s), including those transactions which did not induce any conflict of interest. However, this view was criticized as being too stringent and impractical, and eventually overturned by the Supreme Court of Japan in 1963. Since then courts have followed this reversed decision. The basic purpose of the legislation was to prevent the conflict of interest between corporations and their directors; therefore transactions which would not cause adverse results to the corporations need not to be treated as self-dealing transactions which require board's approval.

This notion, however, appears to have misled the Japanese courts when dealing with one-man corporations. The Japanese courts have generally been reluctant to impose liability on the director who is a sole shareholder of the corporation even if he enters into a contract or transaction with his corporation,

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575 The Supreme Court, October 21, 1915 (Minroku, 21, 1670).
576 The Supreme Court, December 6, 1963 (Minshū 17-12, p.1664); The Supreme Court, August 20, 1970 (Minshū 24-9, p.1305); Tokyo High Court, Sep 25, 1979 (Hanrei Times, 401-152).
577 Transactions which were excluded from the self-dealing transaction under art.265 by the Japanese courts include:
   1) performance of obligation: Daishinin Judgment, February 20, 1920 (Minroku 26, p.188);
   2) offset between the corporation and the director: Daishinin Judgment February 22, 1930 (Shohan, p.353);
   3) donation by the director to the corporation: Daishinin Judgment September 28, 1938 (Minshū 17-20), p.1912;
   4) underwriting of shares, investment in kind: Fukuoka Kōhan, October 12, 1955 (Kōminshū, 8-7, p.535);
   5) acquisition of a corporate asset by the director by auction: Tokyo District Court, August 6, 1927 (Kōminshū, 9-2, p.76).
under any circumstance. This appears to be based on the presumption that if the
director is a sole shareholder of the corporation, the interests of the director, the sole
shareholder, and the corporation are one and equal.\footnote{578} The Supreme Court in a
1970 decision\footnote{579} explicitly stated that at the time of the deal, the director was a sole
shareholder, and the corporation had been managed in a similar manner to a private
business, therefore no conflict of interest between the corporation and the director
existed. The court, then, stated, "no board's approval was required" in this instance.

It is quite apparent that in the 1970 decision the Supreme Court \textbf{pierced the
corporate veil}\footnote{580} for purposes completely opposite to those for which this principle
was generally adopted and used in common law jurisdictions.\footnote{581} Courts in common
law jurisdictions have generally adopted this doctrine, piercing the corporate veil, to
disregard the usual immunity of shareholders from liability to third parties despite the
fundamental principle of corporate law, that "[a] corporation is a separate legal entity
from its shareholders."\footnote{582} However, in this 1970 case, the Japanese Supreme Court
pierced the corporate veil to release the director from liabilities instead of imposing
liabilities on him. This court decision is, in my opinion regrettable. The reasons for
this assessment are as follows.\footnote{583}

Since a corporation is a separate legal entity from its individual shareholders,

\footnote{578} The Supreme Court, August 20, 1970 \textit{(Minshū 24-9, p.1305)}; The Tokyo High Court, September
25, 1979 \textit{(Hanrei-Times, 401-152)}.

\footnote{579} The Supreme Court, August 20, 1970 \textit{(Minshū 24-9, p.1305)}.

\footnote{580} "Piercing (lifting) the corporate veil" is a metaphor frequently used in common law jurisdictions
when a court considers necessary to impose shareholder personal liability and disregards the principle
that a corporation is a separate legal entity and the shareholder owes only limited liability; Gower, \textit{supra}
note 52, at 108 to 138; Ziegel, \textit{supra} note 66, at 120; Hamilton, Robert W., \textit{The Law of
Corporation} (MN, West Publishing Company, 1990), at 81 to 102.

\footnote{581} \textit{Ibid}, The veil is lifted more readily by courts in the U.S.A. than any other jurisdictions; Gower, \textit{supra}
ote 52, at 108.

\footnote{582} Gower, \textit{supra} note 52, at 85.

\footnote{583} Hattori, \textit{Hihan Minshō hō Zashi}, 64.6, p.769. cited in Ueyanagi, \textit{supra} note 162, at 231-232.
even in the case where a corporation is owned by a sole shareholder who is also a
director of the corporation, the interest of the corporation and the sole shareholder
are not necessarily identical.\textsuperscript{584} The assumption that the interest between a
corporation and its director who is a sole shareholder of the corporation does not
conflict, ignores the interest of other stakeholders including creditors of the
corporation to which the corporation owes certain rights and obligations.\textsuperscript{585}
Furthermore, there may exist a situation where a corporation is owned by a sole
shareholder, but the board of the corporation contains directors in addition to the
sole shareholder.\textsuperscript{586} In such a situation, the board's decision may differ from the
decision of the sole shareholder in a given instance. It appears to be an erroneous
conclusion that there exists no conflict of interest between a corporation and its
director(s) in the case of any one man corporations. Whether or not a transaction
is within the scope of a self-dealing transaction should be determined by looking at
all the factors surrounding the transaction, and not merely by the fact that the
corporation is a one-man corporation.

Though the Japanese courts have recently tended to judge cases in this area
of law by looking closely at the particulars of each individual case instead of simply
adopting a general standard (which used to be the case), as far as one man
corporations are concerned, the 1970 Supreme Court decision remains as the
authority in opposition to the recent trend. It is my opinion that only if the interests
of all possibly affected parties to a transaction are examined, and it is then confirmed
that there is no adverse affect, due to the transaction, on any of the concerned

\textsuperscript{584} Ueyanagi, supra note 167, at 232.
\textsuperscript{585} Ibid.
\textsuperscript{586} The Commercial Code of Japan originally (1899 Commercial Code, art.164, para.1) required
that a director be a shareholder of the corporation. This provision was amended in 1938 and 1950.
Presently directors of a corporation do not need to be shareholders of the corporation. Moreover,
the Code even prohibits in the charter of the corporation from providing that directors shall be
shareholders of the corporation. (The present Commercial Code, art.254, para.2).
parties, then and only then it would be fair to exclude the transaction from statutory restricted self-dealing transactions.

Interestingly, the position of the common law in its early stages of development dealing with the scope of self-dealing transactions was similar to the above very strict original Japanese courts' position which restricted all self-dealing transactions even if a transaction did not cause any conflict between a corporation and its directors. The original position of the common law courts was that "contracts of a corporation in which one of its directors had a personal interest, whether pecuniary or non-pecuniary, were voidable at the option of the corporation." Apt criticism of this rule was best cited by a one author as follows: "its application could be inequitable since contracts which were fair, reasonable and even advantageous to the company were not protected from the vitiating effect of the strict common law rules." This criticism led to statutory reforms in most of common law jurisdictions including the Canadian jurisdictions. For example, the Canadian statutes explicitly exclude from the imposition of the disclosure requirement some transactions which are not considered to conflict with the interest of the corporation.

Instances enumerated as being excluded from disclosure obligation in the

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587 Iacobucci, supra note 490, at 301; North-west Transportation Co. v. Beatty, (1887), 12 App. Cas. 589 (P.C.); Aberdeen railway Co. v. Blaikie Bros. (supra, note 488).
588 Iacobucci, supra note 490, at 302.
589 Welling, supra note 138, at 426-432.
590 The BCCA, sec.144(4) reads as follows: A director of a company shall be deemed not to be interested or not to have been interested at any time in a proposed contract or transaction by reason only, (a) where the proposed contract or transaction relates to a loan to the company, that he or a specified corporation or specified firm in which he has an interest has guaranteed or joined in guaranteeing the repayment of the loan or any part of the loan; (b) where the proposed contract or transaction has been or will be made with or for the benefit of an affiliated corporation, that he is a director or officer of that corporation; (c) that the proposed contract or transaction relates to an indemnity under section 152 or to insurance under section 152; or (d) that the proposed contract or transaction relates to the remuneration of a director in his capacity as a director."
Canadian statutes[^591] are also likely to be excluded from the disclosure obligation in Japan as well, since the underlying principle for the exclusion is same in both countries. The principle is, *where no conflict exists, no restrictions on such transactions are needed.*

### 4. Effect of self-dealing transactions

Now it would appear to be clear that any transactions which cause or might cause a conflict of interest between a corporation and its directors are subject to the statutory disclosure obligation both in Japan and in Canada. Then when a self-dealing transaction has been executed in violation of the relevant provisions of the laws of either jurisdiction, i.e. without statutorily required disclosure[^592], how have such transactions been treated?

Due to the lack of explicit provisions in the Code, the views of the Japanese courts along with the Japanese scholars regarding the validity of self-dealing transactions have been evidenced by a division into several camps since the first enactment of the Japanese Commercial Code[^593]. The historical transition of the interpretation of the effect of self-dealing transactions however is beyond the scope of this paper; this thesis will only focus on the present dominant interpretation of this issue.

The interpretation which is presently accepted by the courts is that such transactions are, in principle, null and void regardless of whether they are direct or indirect transactions, however a corporation may not claim the nullity of such transactions to the detriment of third parties unless the corporation can prove some


[^592]: The statutory disclosure requirement will be discussed in the next section of this chapter; *infra* see 5. Disclosure, approval and fairness.

[^593]: The 1899 Japanese Commercial Code; *supra* note 43.
bad faith on the part of the third parties.\(^{594}\) This decision is in my opinion somewhat questionable.\(^{595}\)

Three points shall be considered when evaluating this view: 1) if a transaction involves third parties, the interest of the third parties should be protected at least in the case where the third party acted in good faith; 2) the interest of a corporation should be protected, unless doing so is oppressive to \textit{bona fide} third parties; and 3) if a corporation is compelled to sacrifice its interest to protect third party's interest, then damages the corporation has sustained by the transaction should be compensated by the director who is responsible.

In light of the above points, it would be fair to say that: 1) a transaction between a corporation and a third party, an indirect transaction, entered into without the board approval, should be valid unless the third party acted in bad faith, for the purpose of the protection of the interest of the third party; 2) a remedy for the corporation in such a case would be to pursue the liability of the director on whose behalf the transaction was made; and 3) where a transaction is made between a corporation and its director(s), a direct transaction, such a transaction should be invalidated at the option of the corporation for the purpose of the protecting the interest of the corporation.

To say that all self-dealing transactions are, in principle, invalid, which has

\(^{594}\) The courts which adopted this view include: The Supreme Court, December 25, 1968 (\textit{Minshû}, 22-13-3511); The Supreme Court, March 12, 1980 (\textit{Hanrei Jihô}, 591-88); The Supreme Court, April 23, 1990 (\textit{Minshû}, 24-4-364).

\(^{595}\) In fact, the present views of Japanese scholars are mainly divided into three. The dominant view ("Sôtaiteki Mukô Setsu or relative nullity theory") is advocated by supporters of the 1968 Supreme Court decision (\textit{ibid}). Another view ("Yukô Setsu or valid theory") is that such transactions are valid, however a corporation may claim damages from the director who has executed a transaction in violation of article 265 of the Commercial Code. The third view ("Mukô Setsu or Nullity theory") is that such transactions are null and void even with respect to third parties.
been the view of the Japanese courts, would be too stringent or might be deleterious to corporations. If a direct transaction is recognized to be automatically null and void in any event, by no means would the interest of the corporation be best protected. In the case where a corporation wishes to maintain the validity of a transaction, and doing so is in its best interest, it would be more appropriate, as far as direct transactions are concerned, to give a corporation an option to determine whether any such transactions should be invalidated. If a transaction involves bona fide third parties, it is my opinion that if either party, a corporation or the third party involved, seeks to set aside the transaction, the seeking party should have an option to invalidate the transaction. Finally, in the event of any damages sustained by a corporation due to a self-dealing transaction, the interested director should be liable for these damages.

As opposed to the rigid position of the Japanese courts which denies the validity of self-dealing transactions, at least direct transactions, if the transaction does not meet the statutory disclosure requirements, the Canadian and American statutes have adopted a more lenient stance.

Historically, up to the early twentieth century, the common law courts had taken a very rigid position that a transaction between a company and its director(s) was "automatically voidable at the insistence of the corporation or its shareholders."
However, the common law courts have radically changed their standpoint on the issue; now most courts and corporate statutes in most common law jurisdictions including Canadian and the American jurisdictions take the position that "no transaction is voidable solely because it is a self-dealing transaction if certain requirements are met." One of the rationales for the adoption of this flexible rule appears to be the practical need of allowing corporations, particularly small corporations, to engage in transactions with their directors. Such a transaction might be advantageous to the corporations.

In sum, though provisions of the statutes in Canada and the U.S.A. differ slightly depending on the jurisdiction, the common underlying principles with regard to self-dealing transactions are: 1) interested director(s) should disclose their interest to the board; 2) self-dealing transactions should not be automatically invalidated even where interested directors fail to meet the required disclosure obligation; toward the common law position is erroneous. He claims that "Interested director contracts were not always voidable."

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600 Eisenberg, supra note 599 at 997; Clark, Robert, supra note 598, at 160.


602 The BCCA, sec.146.

603 RMBCA, s.8.31 (a) reads: " ... A conflict of interest transaction is not voidable by the corporation solely because of the director's interest in the transaction if any one of the following is true: (1) the material facts of the transaction and the director's interests were disclosed or known to the board of directors or a committee of the board of directors and the board of directors or committee authorized, approved, or ratified the transaction; or (2) the material facts of the transaction and the director's interest were disclosed or known to the shareholders entitled to vote and they authorized, approved, or ratified the transaction; or (3) the transaction was fair to the corporation."; Clark, Robert, supra note 598, at 160 to 166.

604 Infra, see 5. Disclosure, Approval, and Fairness.

605 Eisenberg, supra note 599, at 997.

606 The BCCA, s.144(1); The CBCA, s.120(1).

607 The BCCA, s.146 provides that "The circumstance that a director is, in any way, directly or indirectly, interested in a proposed contract or transaction, or a contract or transaction, with the company shall not make the contract or transaction invalid, but, if the matters referred to in section
3) interested director(s) are not accountable if they disclose their interest to and obtain approval from the board, or the contract was fair to the corporation and the contract is approved by shareholders of the corporation after full disclosure; and 4) if statutory requirements were not fulfilled, the contract may be set aside by a court by the application of the company or any interested person.

With regard to the validity of self-dealing transactions, the principles are summarized as follows: The Canadian and American statutes, in principle, recognize the validity of self-dealing transactions regardless of whether the transaction is a direct or indirect transaction. The statutes then provide a remedy for the corporation or any other persons who has been affected by such transactions. The BCCA, s.145(1)(a) to (c) or section 145 (1)(d) and (e) have not occurred, the court may, on the application of the company or any interested person, enjoin the company from entering into the proposed contract or transaction, or set aside the contract or transaction, or make any other order that it considers appropriate; The CBCA, sec.120. para.7 provides; "A material contract between a corporation and one or more of its directors or officers, or between a corporation and another person of which a director or officer of the corporation is a director or officer of in which he has a material interest, is neither void nor voidable by reason only of that relationship or by reason only that a director with an interest in the contract is present at or is counted to determine the presence of a quorum at a meeting of directors or committee of directors that authorized the contract, if the director or office disclosed his interest in accordance with subsection (2),(3),(4) or (6), as the case may be, and the contract was approved by the directors or the shareholders and it was reasonable and fair to the corporation at the time it was approved"; In the U.S.A., the Revised Model Business Corporations Act, sec.8.31 is generally interpreted by the courts to be consistent with the common law. In other words, before conflict of interest transactions to be validated, it is required that the transaction be fair to the corporation; Rivercity v. American Can Co., 600 F. Supp. 908, 919-22 (E.D.La.,1984), Aff's, 753 F. 2d 1300 (5th Cir.1985); D'Ambrosio, supra note 573, at 663.

145(1)(a) to (c) or section 145 (1)(d) and (e) have not occurred, the court may, on the application of the company or any interested person, enjoin the company from entering into the proposed contract or transaction, or set aside the contract or transaction, or make any other order that it considers appropriate; The CBCA, sec.120. para.7 provides; "A material contract between a corporation and one or more of its directors or officers, or between a corporation and another person of which a director or officer of the corporation is a director or officer of in which he has a material interest, is neither void nor voidable by reason only of that relationship or by reason only that a director with an interest in the contract is present at or is counted to determine the presence of a quorum at a meeting of directors or committee of directors that authorized the contract, if the director or office disclosed his interest in accordance with subsection (2),(3),(4) or (6), as the case may be, and the contract was approved by the directors or the shareholders and it was reasonable and fair to the corporation at the time it was approved"; In the U.S.A., the Revised Model Business Corporations Act, sec.8.31 is generally interpreted by the courts to be consistent with the common law. In other words, before conflict of interest transactions to be validated, it is required that the transaction be fair to the corporation; Rivercity v. American Can Co., 600 F. Supp. 908, 919-22 (E.D.La.,1984), Aff's, 753 F. 2d 1300 (5th Cir.1985); D'Ambrosio, supra note 573, at 663.

608 The BCCA, s.145(1); The CBCA, s.120(7); The CBCA does not refer to the accountability.

609 The BCCA, s.146; The CBCA, s.120(8); This statutory reform has been confirmed by the Canadian court (Ronbar Hldg. Inc. v. Realecash Services Inc., [1991]B.C.W.L.D. 1875 (S.C.)). A court may set aside the contract where a director fails to meet the disclosure obligation and if a court considers it is equitable to do so.; see Hadden, supra note 67, at 221-224.

610 The B.C. Supreme Court affirmed that the noncompliance with the statutory disclosure obligation does not render the agreement invalid. Until such time as a court orders otherwise, an agreement remains valid; Botty v. Siscoe Callahan Mining Group., [1990]B.C.W.L.D. 526 (S.C.); As opposed to this principle under the BCCA and OBCA, under the CBCA, it appears to be the general understanding that only where disclosure is made, approval is obtained and the contract is reasonable and fair to the corporation at the time of approval, the transaction can be made non-voidable. In other words, self-dealing transactions are voidable; See Welling, supra note 138, at 448.
remedy is to allow the party involved to recourse to a court for setting aside the transaction. In contrast, as stated earlier it is an established principle of the Japanese courts that a self-dealing transaction is in principle null and void if interested directors fail to disclose their interest and obtain board approval; the Japanese Courts recognize the validity of such transactions only if it is made between a corporation and *bona fide* third parties.

It would appear that the Japanese courts have been more attentive to the protection of the interest of third parties on the one hand, while they have been less diligent about observing the possibilities of a self-dealing transaction being advantageous to a corporation on the other. It would appear that the Japanese courts are still, standing on, or should one say, asleep maintaining, the same position as the common law courts of nineteenth century. This is also evidenced by the fact that the so-called "fairness test" which is even more lenient than any other tests and has been adopted in many major jurisdictions of the U.S.A. has never been considered at all in Japan.

5) Disclosure, Approval and Fairness

By the above examination, the consequences stemming from the violation of the statutory requirements pertinent to the execution of a self-dealing transaction under the statutes of Japan and Canada appear to be clear. Then what constitutes a violation of the statutes? When a director intends to enter into a contract with his corporation either directly or indirectly, what, if any, are the alternatives for such a director who does not wish to violate the relevant statutes? How can the director avoid liabilities, and thereby legitimate the transaction? The case law and the corporate statutes of the U.S.A. have taken a novel and unique evolution in this area.

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611 See infra, 5.(3) Fairness.
612 Ibid.
of the law establishing three alternative ways to make a self-dealing transaction legitimate and effective. Whether these alternatives are available in Japan or in Canadian jurisdictions will be looked at below. Through this examination, the following shall be looked at: how easy or difficult it is for Japanese directors to enter into such a transaction; how the Japanese statute attempts to control undesirable activities of corporate management; and the differences in the Japanese statute's approach toward regulation of corporate management compared to its Anglo-Canadian counterpart.

(1) Disclosure to and Approval by the Board

The first alternative to make a self-dealing transaction legitimate is to disclose the material fact of the transaction to the board and obtain its approval before the interested director executes the transaction. In this instance, the interested director is required to refrain from participating in the associated decision making of the board. This alternative is available under both the Canadian and the Japanese statues, though some procedural requirements differ slightly. At least, the substantial requirement that interested directors disclose their interest in a transaction appears to be relatively similar. The rationale of regulating self-dealing transactions in both jurisdictions appears to have been same, that is to give a corporation a fair chance to assess the transaction: whether such a contract will cause a conflict of interests situation between the corporation and its directors to the

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613 This rule (disclosure to the board) was established by the Court in Pervival v. Wright, [1902] Ch.421, at p.426 The rule is based on the view that "directors owe duties to their company, no to their shareholders." Therefore, if directors are required to disclose their interest, as in the case of corporate opportunities and self-interested contracts, disclosure should be made to those who control the business of the company, that is to other directors; Hadden, supra note 67, at 224.

614 The BCCA, s.144(1), s.145(1), (2); The CBCA, s.120(1), (5).

615 The Code, art.265(1), 260-2; The Japanese Commercial Code does not explicitly require that an interested director "disclose the material fact" of the transaction. The provision simply requires that a self-dealing transaction be approved by the board. However, it appears that "to obtain the approval, the material fact must be disclosed" has been a recognized interpretation in Japan; Namiki, supra note 383, at 452.
detriment of the corporation, or whether it will be inevitable or advantageous to the corporation.

In light of the policy behind the legislation in the different jurisdictions, it is perceived that it is not sufficient for an interested director to disclose his interest in a transaction by simply stating "I am interested in the transaction." Although, the extent of the material facts has not obtained a definite judicial determination in either jurisdictions, Japan or Canada, the director must disclose all the material facts that might affect the decision of the corporation on the issue.

As to the appropriate time when the disclosure to and the approval by the board should be made, the Canadian statutes explicitly provides that it should be made in advance. On the contrary, no statutory provision is found in the Code regarding this point. However most Japanese courts have affirmed ex post facto

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616 In Japan, it has been argued by the courts whether the approval of an inclusive, not an individual, transaction is admissive (An inclusive approval is the one which gives a director a blanket permission to enter into any transactions). The courts' view are diverse. Among decisions which held the inclusive approval was sufficient are: The Supreme Court, December 23, 1971, Hanrei Jihô 656-85; The Tokyo District Court, April 3, 1967, Kinyû Hômu, 478-36. The courts which held that the approval must be obtained to every specific transaction individually include: The Tokyo Hight Court, March 22, 1934, Hôritsu Shinbun, 3697-12.

617 The Liquidators of the Imperial Mercantile Credit Association v. Edward John Coleman and John Watson Knight [1873] L.R.7E&I.App.189 (H.L.). In the case, Load Chelmsford stated that a mere disclosure of a conflict was not sufficient, but the nature of that interest must have been disclosed. Also in Gray v. New Augarita Porcupine Mines Ltd, [1952] 3 D.L.R.1(P.C.), the court held that "The amount of detail required must depend in each case upon the nature of the contract or arrangement proposed and the context in which it arises. It can rarely enough for a director to say "I must remind you that I am interested" and to leave it at that, unless there is some special provision in a company's articles that makes such a general warning sufficient"; more recently, Morton v. Asper (1988), 55 Man.R.(2d)61 (Q.B.) at 72; see Eisenberg, supra note 599, at 1000; Welling, supra note 138, at 452; Presently, the BCCA, s.144(1), the CBCA, s.120(1) explicitly requires that an interested director disclose the nature and extent of his interest by contract.

618 The BCCA, s.144(2); The CBCA, s.12(2).

619 The first decision which affirmed the ratification of the board was made in 1931 (The Supreme Court, November 21, 1931 (Hôritsu Shinbun, 3344-11), and has been followed the other Japanese Courts with a few exceptions. The contrary decisions include Tokyo High Court, March 30, 1959 (Tôkômin Jihô 10-3-68).
(after the fact) approval by the board, and it also has been the prevailing view of Japanese scholars.\textsuperscript{620}

Supporters of this view advocate that even though such a self-dealing transaction is approved \textit{ex post facto} by the board, the director is still liable for damages, if any, to the corporation.\textsuperscript{621} Thus regarding the liability of a director, \textit{ex post facto} approval does not reduce the director's liability and no actual harm to the corporation results from the approval.\textsuperscript{622} However, this argument overlooks several points. Firstly, recognizing \textit{ex post facto} approval as proper board approval does not reduce the director's liability but gives the director a broader chance to escape from liability; as will be seen later,\textsuperscript{623} the proper board approval reduces the statutory requirements, which allow for relief of an interested director from liability from unanimous consent of all the shareholders of the corporation to two-thirds of issued shares of the corporation. What does this really mean? If \textit{ex post facto} approval is not recognized as proper board approval, the interested director needs to obtain the unanimous consent of all the shareholders of the corporation to avoid liability for damages incurred from his action; on the other hand, if it is recognized that \textit{ex post facto} approval is proper board approval, if the corporation has sustained damages as a result of the director's action despite the board approval the interested director may be able to escape from liability by obtaining the consent of merely two-thirds of the issued shareholders voting.

Secondly, in light of the fundamental principles pertaining to restricting self-dealing transaction, that is "the best interests of the corporation", such ratification by

\textsuperscript{620} Ueyanagi, \textit{supra} note 167, at 248-249.

\textsuperscript{621} Art.266, para.6 provides that only the special resolution of shareholders can release a director from liability; For detail, see \textit{infra}, 6. Accountability.

\textsuperscript{622} Ueyanagi, \textit{supra} note 167, at 248.

\textsuperscript{623} \textit{Infra}, see 6. Accountability.
the board should not be recognized. One reason is, that it would be quite possible
that such ratification would be made by members of the board, who possibly though
not necessarily were not the members of the board at the time of the transaction.
Such board's members may support the concerned director due to the influence of
the concerned director over them at the time of ratification. In other words, the
concerned director may manoeuvre so as to get his puppets on the board and have
them to ratify the transaction.

The first alternative to make a self-dealing transaction legitimate (obtaining
a board approval) is available both in Japan and Canada. However, in Japan, since
ex post facto approval by the board appears to be effective, it is fair to say that
directors have an additional alternative within this first alternative.

(2) Disclosure to and approval by shareholders

In the case where the first alternative (approval by the board) is not available,
such as the case where there is no disinterested director and/or no legitimate
approval may be obtained by the board, the second alternative for a director to
legitimately enter into a self-dealing transaction is to disclose the material facts about
the conflicting transaction to shareholders of the corporation and obtain their
approval.

Basically, the Canadian statutes recognize the validity of a self-dealing
transaction if a majority of the shareholders\footnote{624} approve or ratify the transaction
after a full disclosure, provided that the transaction was fair and reasonable to the
corporation\footnote{625} at the time it was entered into.\footnote{626} As for the voting, unlike the

\footnote{624} The CBCA (s.120(7)) requires only a simple majority for the approval, whereas the BCCA
(s.145(1)(e)) requires a special resolution.

\footnote{625} The CBCA, s.120(7); The BCCA, s.145(1)(d)(e), s.146.
board approval, there is no statutory requirement for an interested director to abstain from voting in the case of shareholders' approval.\textsuperscript{627} Allowing an interested director to participate in the voting as a shareholder is consistent with the established common law rule in \textit{North West Transportation Co. Ltd. v. Beatty}.\textsuperscript{628} In this case, the court explicitly recognized the right of an interested director as a shareholder to vote. The rationale of allowing interested directors as shareholders to vote in this instance was based on one of the fundamental principles of corporate democracy, that is "the vote of the majority must prevail, unless the adoption (of the contract) was brought about by unfair or improper means."\textsuperscript{629} This rule created by the court appears to be responsible for the adoption of this second alternative into the Canadian statutes. The core of this alternative, based on the \textit{Beatty} decision, is that shareholders' approval will be able to validate the contract only if the contract was fair and reasonable to the corporation in the first place, regardless of who voted for the approval.

On the contrary, in Japan it appears that the Code requires\textsuperscript{630} that the approval be made exclusively by the BOD. However, the Japanese Supreme Court has ruled to the contrary. In a 1974 decision,\textsuperscript{631} the Supreme Court of Japan held that since the purpose of the legislation was to protect the interests of a corporation, if the consent of all the shareholders of the corporation was acquired, it could

\begin{footnotes}
\footnote{626} The BCCA, s.145(1)(d); However, under the CBCA, the transaction must have been fair and reasonable at the time it was approved. How this difference of the time actually affects the outcome is not clear at this point.

\footnote{627} Welling, supra note 138, at 446.

\footnote{628} (1887), 12 App. Cas. 589 (ont., J.C.P.C.).

\footnote{629} Ibid.

\footnote{630} The Code, art.265; Ueyanagin, supra note 167, at 248.

\footnote{631} The Supreme Court, September 26, 1974 (Minshû 28-6, 306).
\end{footnotes}
substitute for the board approval. Here again, there lies an erroneous premise: "a corporation = its shareholders," and "the interest of a corporation = the interest of its shareholders." If so recognized, the interests of other stakeholders of the corporation other than shareholders are at stake. Grave dangers are latent if shareholders ratification is simply admitted without requiring the transaction to be fair and reasonable to the corporation as a whole.

Another dubious point of the 1974 Supreme Court's decision is that if the unanimity is required for the shareholders' approval or ratification, the shareholders' approval would almost be unobtainable for a widely-held corporation. This means that in Japan, an interested director of a widely-held corporation might have no way of legitimately entering into a self-dealing transaction if the first alternative (approval by the board by disinterested directors) is not available; this second alternative (approval by shareholders) would be available, though not definitely, only to small corporations in which unanimous consent of shareholders can be obtained.

In sum, this second alternative for a director to legitimately enter into a self-dealing transaction is definitely available in Canada, but it is questionable if it is available in Japan. Even if it were available in Japan because of 1974 Supreme Court's decision, in practice it would only be available to small corporations.

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632 The unanimity requirement of the decision would appear to be very stringent compared to the Canadian statutes which require a simple or special resolution of the shareholders. However, surprisingly the decision has been even criticised to be inappropriate by some scholars. This school of scholars argue that the approval should be made exclusively by the board. Primary concerns of those appear to be that if the shareholders approval is recognized to be sufficient, the interest of other stakeholders, such as creditors would be neglected. This argument is as follows. The Japanese Commercial Code (art.266-3), unlike the Canadian statutes, expands the liability of directors in respect of the breach of fiduciary duty to third parties where a director acts in bad faith or with gross negligence. Therefore, if the approval is made by shareholders, such shareholders are deemed to be directors and be liable to the third parties if the approved transaction has caused damages to the third parties. If it is so recognized, it would be completely contrary to the fundamental corporate principle, that is shareholders limited liability.
It is my opinion that: first, the Japanese statute should explicitly recognize that shareholders should be able to play a role in ratification, thus recognize this second alternative, approval by shareholders, as a valid approval; second, requiring unanimity for such shareholders' approval, as the Japanese courts have done, appears to be too stringent and impractical. As far as a threshold, if a transaction is fair to the corporation, the requirement for the shareholders approval ought to be at least a special majority.

(3) Fairness Test

The last alternative to make a self-dealing transaction legitimate is the so-called "fairness test" in the U.S.A. which was originally adopted by the California Corporation Code, Section 820, in 1931. The Revised Model Business Corporations Act and some other corporate statutes in the U.S.A. now incorporate this test.

Under this alternative, even if a transaction has been executed without proper disclosure and approval, if the transaction was fair to the corporation at the time it was authorized or approved, then the transaction is neither void nor voidable. Here, the term "fair" is said to mean "full adequacy of consideration." It appears to be clear that under this test even though some form of approval of the transaction is required (note the word "proper"), the approval could be made in any manner: either by the board or shareholders; either in advance or after the fact; or either by disinterested directors or interested directors.

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633 Ziegel, supra note 66, at 502.
634 States which adopted this test include California, Delaware, New Jersey, and New York.
635 Cal. Stat. 2322-2323, 1038, s.820.
636 Geddess v. Anaconda Copper Mining Co., 254 U.S.590, 599 (1921).
637 Clark, Robert, supra note 598, at 168.
638 Ibid.
In short, if a transaction is fair to the corporation, it does not really matter how the transaction was approved. The interested director may control the decision by participating in the meeting to obtain approval.

Nevertheless, there arises a question of burden of proof. Generally, if the transaction was approved by disinterested directors, the burden of proof that the transaction is not fair is said to be on the plaintiff who claims that the transaction ought to be set aside. However, the burden of proving the fairness of the transaction will be shifted to the interested director(s) if the transaction was not approved by disinterested directors.

If the converse is also true, it could be said that even if statutorily required disclosure and approval were obtained, and if the transaction were not fair to the corporation, then the transaction would be void. If this were the case, the first two alternatives would not be available unless the transaction is fair to the corporation in the first place. This, indeed, appears to be the case at least in the U.S.A. and Canada. Even in Japan, it would seem unlikely that the courts would completely disregard the fairness of a transaction even in the case where the approval was legitimately obtained. It would be fair to say that the underlying principle which has always been considered by courts in dealing with a self-dealing transaction in any jurisdictions has been fairness: and therefore, this more lenient "fairness test" which only regards fairness of the transaction appears to have been evolved.

639 Remillard Brick Co. v. Remillard Dandini Co., 241 P.2d 66 (Cal. Ct. App. 1952). In this case, the defendant corporation was owned by the plaintiff corporation's directors who were the majority shareholders of the plaintiff corporation. The contract entered into by the plaintiff corporation and the defendant corporation was set aside by the court even though the contract had been approved by the majority shareholders of the plaintiff corporation. The court emphasized that "directors and officers shall exercise their power in good faith, and with the view to the interest of the corporation." The court took the position that fairness should not be disregarded even if statutory disclosure requirements were met. (Beveridge, supra note 59, at 666); As for similar cases, see Fliegler v. Lawrence, 361 A.2d 218 (Del. 1976); Scott v. Multi-Amp Corp., 386 F. Supp. 44 (D.N.J. 1974).

640 Welling, supra note 138, at 444.
This fairness test appears not to have been completely adopted in Canada. Though the Canadian statutes require fairness in addition to the disclosure requirements, mere fairness does not immunize a transaction from attack, at least under the statute. No case recognizing the fairness test (mere fairness being enough to validate the contract regardless of whether the statutory required procedure was followed) appears to have been reported so far in Canada. It is not clear at this point if the Canadian legislature would go that far in near future.

Japanese courts and legislature appear to be even further from adopting the fairness test. No reference to the test can be found in the Code, or in any of the cases. Furthermore, unlike the Canadian statutes which require fairness in addition to the disclosure and approval, fairness has been completely absent from the Code. As stated earlier, though it is hard to believe that the Japanese courts would completely disregard fairness of a transaction, it would be possible that a court would overlook fairness by focusing on the mere compliance with the disclosure obligation under the Code. Contrary to the recent tendency of the U.S.A., the Japanese judiciary and legislators appear to have no interest in relaxing the rigid statutory requirements in this area.

In conclusion, the third alternative (fairness test) appears not to be available both in Canada and Japan at this point. However, Canada might be one step closer than Japan to adopting the test.

6) Accountability

The final point to be looked at relates to the consequences directors may face for entering into a self-dealing transaction. In what case are directors accountable? Accountability shall be examined separately relating to two types of situations: 1)

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641 The BCCA, s.145(1)(d); the CBCA, s.120(7)
where directors enter into self-dealing transactions in violation of the provisions of the relevant governing statutes; and 2) where directors enter into self-dealing transactions in compliance with the provisions of the relevant governing statutes.

As stated in the proceeding section, in Japan the Code explicitly recognizes the board approval as the only legitimate condition for allowing directors to enter into self-dealing transactions; therefore any transactions without the appropriate board approval are considered to be in violation of the Code.

In the first of the above situations, if a director executes a transaction with his corporation without the board approval, the action is unquestionably in violation of the Code. The consequences are simple. In this case, the director is accountable to his corporation. The only relief from accountability under the Code is to acquire the unanimous consent of all the shareholders of the corporation as is the case for other breaches of duty.

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642 The Board's approval might be substituted for by the unanimous consent of shareholders; see (2) Disclosure to and approval by shareholders.

643 Art.266, para.1, (5) provides: "In the following cases, directors who have done any one of the acts mentioned there shall be jointly and severally liable in effecting performance or in damages to the company, ... or in the case of ... item (5) for the amount of any damage caused to the company: ... (5)Where they have done any act which violates any law or ordinance or the articles of incorporation.

644 Art.266, para.5 states "The liability of directors mentioned in paragraph 1 cannot be released except by the unanimous consent of all the shareholders"; Prior to the 1950 amendments of the Code, the relief was made possible by the special resolution of the Shareholders General Meeting. (Pre-1950 amendments, art.245, para.1(4); The Commercial Code of Japan (Law No.72, Apr.5, 1938) as amended by Law No.148, July 12, 1948) in Law, Rules and Regulations concerning the Reconstruction and Democratization of Japanese Economy, edited by The Holding Company Liquidation Commission(Tokyo, Kaiguchi Publishing Company, 1949), at 363) However, owing the expansion of the power of directors by the 1950 amendments, the provision was amended to impose heavier responsibility on to directors for the protection of shareholders's interest. Another reason for the amendment of the provision was that, because the derivative action was introduced to the Code by the amendments, the consent to relieve directors from liability should be made by all the shareholders who have the right of derivative action. Because, consenting to relieve directors from liability was considered to mean the waiver of the right of derivative action; Ueyanagi, supra note 167, at 291-292.
However, it is, in practice, almost impossible for directors of a corporation with a large number of shareholders to obtain this unanimous consent of the shareholders. In other words, under the Code, directors of a corporation with a large number of shareholders who for some reason failed to fulfil the necessary statutory requirements and violated the Code, can rarely be relieved from liability by obtaining the necessary unanimous consent of the shareholders.

In the second situation, if a director executes a transaction with his corporation in compliance with the Code, i.e. with the board approval, the issue is somewhat more complex than in the case where a director enters into a self-dealing transaction without the board approval. In summary, the general interpretation of the relevant provision of the Code is that even though a director may have obtained the appropriate board approval as is required by the Code to execute a transaction, if the corporation sustained damages as a result of the transaction, the director is still liable for the damages sustained by the corporation. For instance, where a director had sold his property to a corporation of which he is a director, with the approval of the board, and it was found afterwards that the price he obtained was above the fair market value, the director is accountable to the corporation for the profit, i.e. the difference between the sale price and the fair market value.

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645 Professor Kondo states that this unanimity requirement by some Japanese courts for shareholders consent in fact denies the shareholders' approval for directors of widely-held corporations, since its impossible to obtain (Ueyanagi, supra note 167, at 292); There appears to be no reported cases in which the unanimity requirement for shareholders' approval for the relief of directors' liability were disputed. (The Supreme Court, September 26, 1974 (supra note 631) is a case which the validity of shareholders' approval itself was argued.)

646 Art.266, para.1, (4) states "In the following cases, directors who have done any one of the acts mentioned there shall be jointly and severally liable in effecting performance or in damages to the company, ... or in the case of item (4) for the amount of any damage caused to the company: (4) Where they have effected any transaction mentioned in paragraph 1 of the preceding article [provision concerning self-dealing transaction]."

647 Ueyanagi, supra note 167, at 292 to 293.

648 Namiki, supra note 383, at 292.
In Japan, it is a general understanding that the board approval does not relieve directors from any liabilities arising from violation of the Code. In other words, even though directors follow the statutory required procedure and obtain the board approval for their action, if the directors cause damages to their corporations they remain liable. Relief from liability in this type of case may be obtained, as is the case in other violations of the Code, via the unanimous consent of all the shareholders of the corporation.\(^{649}\)

However, in the case of self-dealing transactions, where a transaction which was executed \textit{with the board approval} has nevertheless caused damages to the corporation, then the liabilities of interested directors may be relieved by disclosing the material facts at a Shareholders' Meeting and obtaining an appropriate resolution of \textit{two-thirds of issued shares of the corporation}.\(^{650}\) The reasons that the requirement for the relief from liability is relaxed only in the case of self-dealing transactions with the board approval appear to include the following: 1) such self-dealing transactions frequently occur regardless of the size or type of corporations in contemporary Japanese society, especially within corporate groups, and in addition, such actions are sometimes done for the interest of the corporate group as a whole; and 2) it is sometime difficult for directors of the board to determine whether the transaction should be approved.\(^{651}\)

The first reason (frequent occurrence of self-dealing transactions within corporate groups and merits of such transaction for the group) is an interesting one. It is a reflection of the very specific Japanese management structure. As stated in Chapter II, it is well-known that many Japanese corporations are very closely related

\(^{649}\) See the 1974 Supreme Court case (supra note 611); Ueyanagi, \textit{supra} note 167, at 293.

\(^{650}\) The Commercial Code, art.166, para.6.

\(^{651}\) Ueyanagi, \textit{supra} note 167, at 293.
to each other within *keiretsu* or corporate groups,652 and cross-shareholdings653 is a common phenomenon among these corporations. As one survey shows654, "on average, about one-third of the Japanese corporations stock is owned by financial institutions, primarily banks. ... Another third is generally in the hands of other corporations."655 According to the picture vividly painted by this survey, directors of these financial institutions, or other corporations within the group occupy the seats of the board of other fellow corporations; thus the number of interlocking directors would appear to be significant and the phenomenon of self-dealing transaction could not help but occur very frequently.

The Japanese Code appears to be relatively stringent in this area supposedly because in theory self-dealing transactions are in the first place not welcome. On the other hand, the Japanese legislators have been aware that in actuality the law may not prohibit this kind of transaction. This appears to have been the main dilemma in regulating self-dealing transactions in Japan. Consequently, the Code, in the first place, imposes strict requirements on directors who intend to execute self-dealing transactions, but thereafter gives them leeway by relaxing the requirements necessary for relief from liability.

A question remains: what is the rationale of depriving the rights of shareholders who objected to a resolution which obtained a two-thirds assent? If consenting to relieve directors from liability means the waiver of the right to sue directors, then two-thirds of issued shareholders may deprive from the minority of shareholders a statutory right to sue directors on behalf of the corporation. Directors owe their fiduciary duties to their corporation as a whole, not to the majority or two-

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652 *Supra*, note 85 and accompanying text.
653 *Supra*, note 95 and accompanying text.
655 Kester, *Supra* note 85, at 57-59.
thirds of the shareholders; only the corporation ought to be able to forgive directors’ breach of duty.

However, as stated, requiring unanimity for shareholders’ approval on the issue appears not to be practical. As far as the majority of shareholders of the corporation agree to relieve the involved director from liability based on the fact that the transaction is fair to the corporation, such approval ought to be recognized.

Despite the argument addressed above, it appears that directors have rarely resort shareholders’ approval for the relief of their liability accrued from self-dealing transactions. No reliable evidence which supports this view appears to exist. However, since no case appears to have been reported so far regarding shareholders’ approval pertinent to self-dealing transactions, and moreover, since such approval is in practice difficult to obtain for directors of widely-held corporations, this assumption would not be missing a mark.

In Canada, only the BCCA and statutes of a few other jurisdictions mention accountability in connection with self-dealing transactions. The BCCA now clearly replace the common law formula regarding accountability. The BCCA imposes accountability on a director who engages in a self-dealing transaction except in the following instances:

1. where a director: 1) discloses his interest to the board; 2) gets approval from the board; and 3) abstains from voting, or

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656 Supra note 632 and accompanying text.
657 The BCCA, s.145.
658 The OBCA, s.132(7)(8)(9); NBBCA, s.77.
659 Welling, supra note 138, at 453.
660 The BCCA, s.145(1)(a).
661 The BCCA, s.145(1)(b).
662 The BCCA, s.145(1)(c).
2. where: 1) the contract is reasonable and fair to the corporation at the time it is entered into; and 2) it is approved by special resolution after full disclosure about the contract.

Under the BCCA, if a transaction is executed with the proper board approval (the above paragraph 1), it appears that the interested director is no longer accountable. On the other hand, under the Code, as stated earlier, even in the case where the board approval is properly obtained, the interested director is still liable for any damages which his corporation suffered as a result of his transaction. For a director to be relieved from this liability, the consent of a two-thirds of the issued shares is required. Under the BCCA, if a director does not fulfil the first requirements, the director would not be accountable if and only if in the first place the transaction was fair and reasonable to the corporation and a special resolution is obtained after the full disclosure of the material facts of the transaction (the above paragraph 2). The Code, on the other hand, requires unanimous consent of shareholders after the full disclosure of the material facts for the relief from accountability, if the board approval is not obtained.

In summary, the Japanese Code appears to be more strict in regards to accountability. The BCCA removes directors liability to account by fulfilling either of the above two criteria: 1) disclosure to and approval from the board; or 2) disclosure to and approval from the shareholders and fairness of the transaction. The

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663 The BCCA, s.145(1)(d).
664 The BCCA, s.145(1)(e).
665 Hadden supra note 67, at 223; Phyolite Resources Inc. v. CanQuest Resource Corp., [1990] B.C.W.L.D. 2004 (S.C.), The court states "in the case of a proposed contract or transaction, an interested director is absolved from liability, if he or she complies with s.144 ... the clear intention of the legislature was to replace the common law."; In other words, noncompliance with the section is sufficient to hold a director liable. A company need not prove that the director in fact obtained a profit.
666 Supra, note 649 and accompanying text.
Code, on the other hand, removes directors from liability to account under two circumstances: 1) proper disclosure to and approval from the board and the consent of two-thirds of the issued shares; or 2) disclosure to and approval from all the shareholders. Again, under the Code, it would be almost impossible for directors of a widely-held corporation to escape from liability if these interested directors do not obtain the appropriate board approval, because of the unanimity requirement for the relief from accountability. Under the BCCA, it would be much more easier for a director who failed to obtain the appropriate board approval to successfully waltz around the situation by fulfilling the above second condition of the provision of the BCCA.

In conclusion, the Canadian (and American) statutes are more practically designed, probably because they have evolved from a common law which has reflected the voice of the business society. On the contrary, the Japanese statute is overly rigid and unpractical. It seems to ignore the Zen proverb of "Bend like the willow or snap." This is probably because the Japanese statute was primarily based on the notion that self-dealing transactions should be prohibited in the first place; the law should be strict enough to control deviant individuals.
3.3. Competition

Another typical example where a conflict of interest situation may occur is in the situation where a director competes in business with his corporation directly or indirectly. Some of the various scenarios which fall within this area include: where a director of a corporation, himself carries on the same line of business as his corporation does; where a director associates with another corporation which is engaged in the same line of business as his corporation; or where, after a director resigns from his corporation he starts his own corporation which carries on the same line of business as his former employer does. In any of these cases, a conflict of interest situation between the director and his corporation, or the former director and his previous corporation is likely to occur. In this section, how the Japanese courts and the common law courts, in particular the Canadian courts have looked at an adjudicated such situations and the accompanying conduct shall be looked at. Also, the statutory requirements for prohibiting or allowing such directors' conduct in both jurisdictions will be briefly examined.

1) Statutory Provisions

The Commercial Code, in a manner similar to that by which it regulates self-dealing transactions, in principle, prohibits directors from competing with their corporations, unless they disclose the material facts about the transaction to be entered into and obtain approval to do so from their corporation.\(^{667}\)

The general principles of the so-called "duty to avoid competition" under the

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\(^{667}\) The Commercial Code, art.264: "A director who intends to effect such a transaction that comes under the class of business carried on by the company on his own behalf or on behalf of a third person shall show all the material fact in connection with the said transaction at a board of directors and obtain its approval; 2. The director having effected the transaction in the preceding paragraph shall report the important matters as to the transaction to the board of directors without delay; 3. If a director has, in contravention of the provisions of paragraph 1, effected a transaction on his own behalf, a board of directors may treat such transaction as effected on behalf of the company."
Commercial code are similar to the principles established by the common law courts and the subsequent codification of these principles into the statutes of common law jurisdictions including those of Canada. However, on a closer perusal of these statutes, it would be noted that the provisions of the Code and statutes of the common law jurisdictions differ technically. The Code directly prescribes for this duty as a distinct and a specific duty (to avoid competition). The Canadian statutes, on the other hand, regulate a duty to avoid conflict of interest including, a duty to avoid competition and a duty not to appropriate opportunities which rightfully belong to the corporation (corporate opportunity). This statutory difference in these jurisdictions are primarily derived from the different historical developments of the principles relating to this duty in these jurisdictions.

In Japan, a provision providing for the duty to avoid competition existed in the original Code, although it was not identical to the corresponding provision of the present Code. Up until the 1950 amendments of the Code by which the common law concept of fiduciary duty was first introduced, the duty to avoid competition was comprehended, not as a specific duty derived from directors' position as fiduciaries, but simply as a civil duty of forbearance. Here again, due to the importation of the principles and concept of fiduciary duty from the U.S.A. to the Japanese Commercial Code, arguments were raised on how the duty to avoid competition

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668 This duty to avoid competition has not been defined as such in the common law, rather it has been treated as one type of fiduciary duty.

669 The BCCA, s.147 provides: "(1) Every director of a company who holds any office, or possesses any property, whereby, whether directly or indirectly, a duty or interest might be created in conflict with his duty or interest as a director of the company, shall declare at a meeting of the directors of the company the fact, and the nature and extent of the conflict; (2) The declaration shall be made by a director referred to in subsection (1) at the first meeting of the directors held (a) after he becomes a director; or (b) if he is already a director, after he commenced to hold the office or possess the property;" The CBCA equivalent is sec.120.

670 The Commercial Code of Japan in 1899, art.175 provided: "Without the consent of a general meeting of shareholders no director can undertake commercial transactions in the same kind of business as that of the company, either on his own account or that of a third person, or become a partner with unlimited liability in another company whose object is the same kind of business. ..."; Loenholf, supra note 43.

671 Ueyanagi, supra note 167, at 205; "forbearance" in this context means "refraining from action."
should be understood.

The same arguments as to whether or not the fiduciary duty is different from the duty of care raised their head again.\textsuperscript{672} The arguments here dealt with whether the duty to avoid competition is a specific type of duty of care, or whether it is a duty derived from directors' position as fiduciaries, namely the fiduciary duty. As was the case relating to the argument presented before regarding the nature of the fiduciary duty,\textsuperscript{673} the dominant view has been that the duty to avoid competition is within the scope of the duty of care.\textsuperscript{674} However, it is my opinion that the duty to avoid competition should be recognized as one of the fiduciary duties, and not merely as one of or part of the duty of care. My reasoning on this point has been stated earlier, namely fiduciary duty should be recognized as a different duty from the duty of care. You may wish to briefly recall this reasoning.\textsuperscript{675} This view has started to gain some approval by some scholars who supposedly do not adhere to the traditional civil law concepts.\textsuperscript{676}

Another significant statutory change which further elucidated the concept of the duty to avoid competition was made by the 1981 amendments of the Code.\textsuperscript{677}

By this amendment, the requirements for granting the approval to a director who wishes to execute a competing transaction was relaxed. This relaxation was achieved by giving jurisdiction to the BOD to grant the necessary approval.\textsuperscript{678} Prior to this amendment, the granting of this approval was exclusively within the

\textsuperscript{672} Supra note 534 to 548 and accompanying text.
\textsuperscript{673} Supra note 534 and accompanying text.
\textsuperscript{674} Ueyanagi, supra note 167, at 206.
\textsuperscript{675} Supra note 540 to 547 and accompanying text in 3.1 Concept of fiduciary duty.
\textsuperscript{676} Ueyanagi, supra note 167, at 206.
\textsuperscript{677} Kanzaki, supra note 256, at 251.
\textsuperscript{678} Infra, note 737 to 738 and accompanying text.
domain of the SGM. This amendment was made for the purpose of meeting a practical necessity. Up until this amendment, it had been too cumbersome and even almost impossible for a director of a corporation with a large number of shareholders to obtain such approval (the SGM's approval).\textsuperscript{679} Yet, since it was a common practice for directors to compete with their corporations in various ways in Japan, more lenient and practical requirements enabling directors to legally enter into such transactions were strongly suggested. Against this background the amendment was made.

The present Commercial Code, through the above amendments, now minutely and practically provides for the directors' duty to avoid competition, but in a slightly different manner from the regulation in common law jurisdictions. In addition, Japanese courts have also shown a different approach toward this duty compared to courts in common law jurisdictions. The upcoming section will expose the more pragmatic functioning of the Code in this area and the Japanese courts' position toward the duty to avoid competition. The following five aspects of the duty to avoid competition will be examined: 1) Being a director of more than one corporation; 2) the scope of competition; 3) disclosure and approval; 4) effect of the transaction by a breach of the duty to avoid competition; and 5) right of intervention.

2) Being a Director of More Than One Corporation

An issue which arises frequently in practice in relation to the duty to avoid competition concerns a director who is concurrently a director of another corporation which carries on a line of business similar to his first corporation's business. Whether a transaction made by this director for one corporation is within the scope of competition, or more precisely whether it is allowable to be a director of more than one corporation carrying on the same line of business is the question to be resolved.

\textsuperscript{679} Takeuchi, \textit{supra} note 251, at 134 to 135.
The Commercial Code is silent on this point. However, it appears to be clearly implied from the fact, that a provision which had once provided that, "a director shall not ... become a member with unlimited liability or a director of any other company having for its object the same kind of business," was deleted by the 1950 Amendments, that a director, subsequent to this deletion, is now allowed to be a director of more than one corporation even if some of these corporations carry on business of the same kind. The Japanese courts have supported this view, as in the following case.

Nitho Co. Ltd. v. Asakura

Summary of the facts:

The defendant was a representative director of the plaintiff corporation. When the plaintiff corporation’s business went into difficulties, a creditor (not the concerned party) became a director of the plaintiff corporation. After some time, the creditor took real power over the plaintiff corporation and the defendant’s position as a representative director became nominal. With the fear of being compelled to be a mere employee of the plaintiff corporation, the defendant proposed to the plaintiff corporation that he, the defendant, be allowed to resign from the plaintiff corporation and establish a new corporation. He clearly in his request sought not only to establish his own corporation but to obtain one of the main clients of the plaintiff corporation with which he, as a representative director of the plaintiff corporation, had been dealing for a long time. However, the plaintiff corporation refused to accept his resignation. Thus, the defendant resigned from the plaintiff corporation without the plaintiff

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680 Pre-1950 Amendments, art.175, cited in Ueyanagi, supra note 167, at 211 to 212.
681 Tanaka, supra note 21, at 551.
682 Tokyo District Court, July 23, 1970 (Hanrei Jihô, No.607, at 81-84).
corporation's consent. After the defendant director's resignation, the creditor became a representative director of the plaintiff corporation. Shortly before his resignation, the defendant had established a new corporation, and after his resignation the defendant on behalf of his new corporation commenced dealing with the plaintiff corporation's client which he had formerly sought in his resignation.

The plaintiff corporation alleged that the defendant deprived them of one of their most important clients by utilizing his former position as a director of the plaintiff corporation; accordingly such an activity is a breach of the duty of care and fiduciary duty (duty to avoid competition) which he owed to his former corporation; and therefore the defendant is liable for damages which the plaintiff corporation suffered.

The Court held:

1) The Commercial Code does not prohibit a director from being a director of another corporation which carries on the same line of business. Therefore, as to the defendant having become a director of the new corporation, there is no breach of the duty of care or the fiduciary duty.

2) Although the defendant entered into a transaction which came under the same class of business as that which is carried on by the plaintiff corporation, at the time the defendant actually commenced operating his own business, he was no longer a director of the plaintiff corporation and did not owe any duties as a director to the plaintiff corporation.

3) It is true that the business which was established by the
defendant was the same line of business as that which is carried on by
the plaintiff corporation, and the dealings between the plaintiff
corporation and its client were terminated because of the new
relationship established between the defendant and his corporation,
and the client. However, concerning the circumstances under which
the defendant resigned from the plaintiff corporation, it could be said
that it is a common practice for the defendant to choose the way to
make his livelihood by utilizing his past experience. It would be too
harsh to blame the defendant for the fact that he competed with the
plaintiff corporation as a result of having chosen to utilize his past
experience, as a way of making his living.

Unless there existed a violation of laws, or fair and equitable
principles, in managing the business of the new corporation, (though,
it could be argued that the fact the defendant was a representative
director of the plaintiff corporation should be taken into consideration
when determining the existence of violation of fair and equitable
principles), the defendant is not liable for causing a conflict of interests
between the defendant and the plaintiff corporation, which occurred as
a result of free competition, and after the resignation of the defendant
from the plaintiff corporation.

This case demonstrates that a director may join a rival concern and be a
director of the rival corporation, and being a director of a rival concern itself does
not constitute a breach of fiduciary duty. However, it should be noted here, that if
being a director of a rival concern falls into the scope of "the event that the effect of
such interlocking directorate may be substantial to restraining competition in any
particular field of trade" under the laws of Japan concerning anti-monopoly, the director may not be a concurrent director of a rival corporation.

This principle of allowing a director to become a concurrent director of a rival concern, has also been a judicial principle of the common law. Load Blanesburgh L. C., in Bell v. Lever Bros. Ltd. cited Mr. Justice Chitty's judgment in London and Mashonaland, and stated that "a director may engage in a competing business ... it not appearing from the regulations of the company that a director's services must be rendered to that company and to no other company, he was at liberty to become a director even of a rival company,..." This principle has also been recognized by Canadian courts.

However, this principle is only recognized on the premise that the director acts in the best interest of both corporations. As Professor Gower suggests that, "one who is a director of two rival concerns is walking a tight-robe and at risk if he fails to deal fairly with both." It is very likely that the director will fail to act in total fairness to both corporations. In other words, although it is not prohibited for a director to join a rival concern, a director would most likely be liable "if he subordinates the interest

684 Ibid.
685 Art.13, para.1 of the law (note 631) provides: "No officer or employee (referring to a person continuously engaging in the business of a company but being other than an officer; henceforth the same in this article.) of a company shall hold at the same time a position as an officer in another company or companies in Japan in the event that the effect of such interlocking directorate may be substantially to restrain competition in any particular field of trade."
686 Science Accessories Corp. v. Summagraphics Corp. 425 A. 2d 957 (Del. 1980); The Court held that "they were free to make reasonable preparations to compete while still employed by SAC and after quitting SAC's employ, to compete with SAC."
of the one company to those of the other\textsuperscript{690} under the common law including Anglo-Canadian laws.\textsuperscript{691} It is also doubtful, whether it is possible in practice, for a director to act with complete fairness to both corporations. This is paramount to serving two masters. You most likely end up loving one and despising the other and thus only acting in the best interest of one of them. In conclusion, it would be a very risky business for a director to put himself into such a situation except for a few cases where the likelihood for a conflict to occur is highly unlikely.\textsuperscript{692}

This is also the position under the Commercial Code. Although the above Japanese court held that a director is not prohibited from being a director of rival concerns, it does not necessarily suggest that a concurrent director is free to subordinate the interest of one corporation to those of the other. The director of the above discussed case was held not liable, because he was not a director of the plaintiff corporation at the time he and his new company started to compete with the plaintiff corporation.

Here other questions arise. Do former directors have no fiduciary relationship with their former employees? Are former directors free to compete with their former employees at will?


\textsuperscript{691} It is said under the Canadian Law that "a director who joins a rival concern and prefers its interests to those of the first company would likely face an application under s.241 of the CBCA, ... or s.224 of the BCCA (oppression remedy), with respect to the conduct of the first company" (Ziegel, supra note 66, at 567); In the American case, Foly v. D'Agostino (21 A.D. 2d 60, 248 N.Y.S 2d 121), the court also held that "Where employees, during the period of their employment, and a corporation formed by them, engage in and carry out a conspiracy to compete with the employer in violation of the duties of loyalty owing by the employees, said conduct constitutes actionable unfair competition."

\textsuperscript{692} For instance, a director is unlikely to be liable if he is a director of a parent company and its 100\% owned subsidiary, and he acts in the best interest of the subsidiary; Ueyanagi, supra note 167, at 213; infra, note 729 and accompanying text.
As was clearly stated by the Japanese court in Nitho, former directors are most likely excluded from the group of directors who are restricted from competing with their corporations in Japan. However, although the court explicitly rejected in the said case the former director's liability for a breach of fiduciary duty, and also recognized that a director should be allowed to enter freely into competition with his past business after his resignation from it, it would be misleading to say that Japanese courts will never hold a former director liable for competing with his former employer. It should be remembered that: firstly, in the said case, there existed specific circumstances which the Court had to take into consideration and the court was sympathetic to the defendant director. Secondly, as the court holding indicates, if a violation of laws or unfair or unequitable conducts by the former director is proven, it would be possible for the former director to be held liable.

Contrary to the above Japanese court's position, the common law courts appear to have been generally more stringent toward the conduct of former directors. In Industrial Development Consultants Ltd. v. Cooley (I.D.C.), a former director was held liable for a breach of fiduciary duty by having contracted with a corporation with which he had been negotiating a contract with in his personal capacity as an architect (and not as a director of the plaintiff corporation), when he was still a managing director of the plaintiff corporation. In the I.D.C., the English court held

693 Supra, note 682.

694 The court took into account the circumstances under which the defendant director had been compelled to resign from the corporation, and also the relationship between the defendant director and the said client.

695 In a 1988 case (Re: Nihon Setsubi, Tokyo District Court, March 30, 1988, Hanrei Ji10, No.1272, p.23), the Court held that the director who resigned from his corporation and started his own business and induced his former colleagues of his former corporation to resign from the corporation and work for him (in fact, they quit the corporations and joined the defendant director's corporation) was held liable for a breach of fiduciary duty. However, in this case, the director's own resignation and his starting the same line of business was not disputed as a breach of duty to avoid competition or fiduciary duty. Only his conduct of inducing employees of his former employer was recognized to be a breach of fiduciary duty.

the former director liable for a breach of duty. The court stated that the liability arose primarily because at the time he obtained the information he was under an obligation to pass on the information to the corporation of which he was a director at the time, since the information "was of concern to the plaintiffs and was relevant for the plaintiffs to know." The court completely disregarded, whether or not the said contract was signed after the director left the service of the plaintiff corporation, how the information was obtained (the director obtained the information in his personal capacity) or whether or not the corporation could have obtained profits if the director did not take the opportunity (the plaintiff corporation had failed to obtain the contract, and the corporation with which the director himself successfully contracted did not want to deal with the plaintiff corporation at all).

Canadian courts have also followed the above English decision. In Canadian Aero Services, a former director was held liable for a breach of fiduciary duty. Here, the former senior officers were held liable for appropriating a corporate opportunity. Here the court "recognized that accountability could extend beyond the termination of the employment relationship." In this case, "The issue was how they (the defendant former senior officers) obtained the opportunity to profit, not whether they were occupying fiduciary positions when they began exploiting the opportunity." However, the Canadian court appears to have attempted to show its flexibility against the rigid corporate opportunity doctrine as enunciated by some prior common law courts. The court stated:

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697 Ibid.
698 Prior to this case, the Canadian court (Peso Silver Mines Ltd. v. Cropper, [1966] S.C.R.673, 56 W.W.R. 641, 58 D.R.(2d) 1 (B.C.S.C.C.) ruled to the contrary. In this case, the defendant director was held not accountable since he took the opportunity in his personal capacity, not in a capacity as a director of his corporation. The decision was criticized to be against the fundamental principle regarding the fiduciary duty.
699 Supra note 523.
700 Welling, supra note 138, at 390.
701 Ibid, at 393.
The general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or senior officer must conform, must be tested in each case by many factors which it would be reckless to attempt to enumerate exhaustively. Among them are the factor of position or office held, the nature of the corporate opportunity, its ripeness, its specificness and the director’s or managerial officer’s relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special or, indeed, even private, the factor of time in the continuation of fiduciary duty where the alleged breach occurs after termination of the relationship with the company, and the circumstances under which the relationship was terminated, that is whether by retirement or resignation or discharge...

This statement, however, does not necessarily suggest that Canadian courts would consider specific circumstances and the director would possibly escape from liability, even where there exists an actual conflict of interest between a former director and his former corporation such as in the Nitho case. The fundamental principle is, in any case, that a director who occupies a fiduciary position is not entitled to take any opportunities derived from his position regardless of whether or not he utilize the opportunity and gains profits after his resignation.

American courts, as compared to their Canadian counterparts, have not

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703 Supra note 682.
followed the above English decision. American courts have been divided into two camps. The main views of these camps are: 1) the fiduciary duty terminates upon the director’s resignation from his office\(^705\); and 2) a director’s "resignation does not terminate the duty because the seed of the opportunity was planted prior to the resignation."\(^706\) However, the former view appears to be predominant.\(^707\)

It can be concluded that the Japanese courts and the common law courts (including Canadian courts) have taken completely opposite approaches regarding the liability of former directors. Japanese courts stand on the proposition that former directors are, in principle, released from their fiduciary duty to the corporation upon their resignation from their office. Contrastingly, the common law courts generally recognize that the termination of the employment does not terminate any director’s liability to his corporation.

It would be interesting to scrutinize the roots of these two distinct notions. From the findings of the Nitho case\(^708\) it might be said that Japanese judges favour economic freedom, namely freedom of competition, over restraint of trade based on directors’ fiduciary duty. But this hypothesis is not necessarily plausible. For although Japanese business people are known to have a highly competitive spirit,\(^709\) the Japanese judiciary appears to be reluctant to take into consideration business or


\(^708\) Supra note 682.

\(^709\) A term, "Economic animal" is sometimes used to refer to the Japanese people who recklessly pursue their economic growth by fair means or foul.
economic aspects in making their decisions.\textsuperscript{710} Rather, particulars of the Japanese corporate management system and Japanese philosophy, namely the emphasis on humanity or sympathy (\textit{ninjy6}) seem responsible for the general attitude of the Japanese judiciary. As explained earlier, most Japanese directors are senior employees and generally spend many long hard years with their company before becoming directors. During these long years they almost entirely devote themselves to only their work and even after they become directors they tend to continue to work hard for their corporations until their retirement. Hence, if a director resigns from his office before his retirement there generally exists some unavoidable reason for doing so. Thus in a dispute of the kind being discussed, fuelled by this type of situation, the director would probably obtain the sympathy of the courts and others (not the disputing company of course), and it would be thought fair that he deserves to leave his corporation with some of the fruits which he himself had cultivated and nurtured over his years of work.

In comparison, in western common law jurisdictions directors, as well as ordinary employees, tend to be more free spirited and move with little qualm from one company to another. Thus more emphasis would be expected to be placed on the protection of the corporation's interest in such instances. This might, however, be a misconception. One author argues that "... the common law system encourages competition in business matters..."\textsuperscript{711} and "... we have the public policy in favour of competition to limit the extent to which an interpersonal relationship between two people can subsequently impede one of them from making his knowledge and skills available to other employers and customers."\textsuperscript{712} In fact, some courts have taken a different stance from Canaero, and limited (but not denied) the scope of the

\textsuperscript{710} For instance, recall the objection to the adoption of the Business Judgment Rule, \textit{supra} note 488 and accompanying text.

\textsuperscript{711} Welling, \textit{supra} note 138, at 417.

\textsuperscript{712} \textit{Ibid.}
fiduciary relationship between former directors and their corporations.\textsuperscript{713} However, as far as the I.D.C. case and Canaero continue to remain as authorities, a clear definition of the scope of "former director" remains ambiguous, and the common law courts will most likely uphold the position that does not allow former directors to compete with their former corporations. In fact, it appears that the conceptualization of the fiduciary duty obligation is primarily concerned with warning anyone who occupies a fiduciary position rather than being a remedy in itself for a corporation; thus in this area stricter regulations are preferable. Another way of saying this is that fiduciary duty regulation in common law jurisdictions is primarily preventative in nature rather than remedial.

At any rate, both the views of the Japanese courts and the common law courts (except for some courts which have attempted to limit the scope of fiduciary relationship between former directors and their corporations) appear to be extreme. If, as the Japanese court stated, former directors are no longer liable to their former employers upon their resignation, directors may very easily utilize their position for future appropriation at will. Although the court stated that a director's conduct should not violate equitable principles, it would be difficult to determine what constitutes the violation of equitable principles in the Japanese legal arena. Considering the fact that the Japanese court denied that the former director's solicitations of his former employee's clients is a violation of equitable principles, which in the common law jurisdictions has been recognized to be the violation of equitable principles,\textsuperscript{714} what would constitute the violation of the equitable principles appears to be questionable.

\textsuperscript{713} Dialadex Communications Inc. v. Crammond (1987), 77 O.R.(2d) 746 (Ont. H.C.); \textsuperscript{714} W.J.Christie & Co. v. Greer (supra note 657) The court held that "Upon his resignation and departure, G(defendant director) was entitled to accept business from clients of his former employer, but direct solicitation of that business was not permissible."
On the other hand, as the English court in the I.D.C. states, if a former director is recognized to be liable solely because he obtained the information when he occupied a seat in his former corporation’s board, regardless of whether or not the director obtained the information in his personal capacity, or the corporation could have utilized the opportunity, no director would be allowed to start his own business unless he abandons any information which he had obtained or any personal relationship which he had built up when he was a director of his former employer. It may be argued that a director may still have a chance to utilize the information by informing his former corporation of the intended transaction and getting their approval. But, another question arises: how long does the fiduciary relationship between a director and his former employer continue to exist? Does a former director have a life-long obligation to his former employer? It would appear in the vast majority of cases that to answer affirmatively to this latter question would be quite unreasonable. There ought to be some boundaries which a former director may pass to get into the unfettered free competition zone after leaving this corporation.

At this point, it appears that the only solution to the problem would be, as some recent common law courts suggest to limit the scope of fiduciary relationship between former directors and their past corporations by scrutinizing each case and determining whether or not the directors should be liable based on what is fair, not only to the corporation, but also to the (former) directors.

3) Scope of Competition

Whether or not a transaction falls within the scope of transactions which requires appropriate corporate approval due to the concept of competition is dependent upon several factors. The chief of which include: 1) the nature of the business; and 2) for whom the transaction is made.
(i) Nature of business which falls within the scope of competition

The Japanese Commercial Code states that a director who intends to effect a transaction, "that comes under the class of business carried on by the company" should disclose all material facts relevant to the transaction to his corporation. Then, what is the scope of a transaction that comes under the class of business carried on by the company?

Firstly, a competing transaction is generally recognized as a transaction which conflicts with the business presently carried on in the market place by the corporation, or which might cause a conflict between the corporation and the director. In other words, it does not include a business, which is stipulated in the articles of the corporation but is neither actually carried on presently, nor is intended to be carried on in the future. However, it does include a business which is reasonably expected to be carried on in the future even if the corporation is not presently carrying on such business.

Secondly, if a transaction is executed by a director for purely private purposes, but not for any business purposes, should this type of transaction be included under the umbrella of competitive transactions under Article 264 of the Commercial Code? For instance, take the case of a director of a real estate company who obtains information that a house is on sale at an absurdly inexpensive price and then purchases the house for himself? Is this to be considered a competing transaction?

This sort of situation has been discussed in common law jurisdictions as one

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715 The Commercial Code, art.264, para.1.
716 Ueyanagi, supra note 167, at 207; Tanaka, supra note 21, at 552.
717 Ueyanagi, supra note 167, at 210.
718 Art.264.
of many instances of appropriating a "corporate opportunity." Accordingly, in the common law jurisdictions, "corporate directors may not take opportunities belonging to the corporation." However, in Japan, as will be discussed later, such a "corporate opportunity doctrine" did not exist until recently and no statutory provisions regulating the phenomenon exists. It is therefore not surprising that not much discussion or study has been conducted in this area of law. The doctrine was and still remains a completely alien one to Japanese law. As a result, cases such as the above, which are not quite within the scope of competition, appear not to require disclosure to and approval from the board, under the Commercial Code. Moreover, in general, up until recently it appears that no attempts have been made to treat such cases as falling within the ambit of breach of fiduciary duty. The traditional view, and probably the prevailing view toward the case scenario presented above, has been that a transaction such as described, not being commercial but purely private in nature, is not to be considered as a competing transaction. Consequently these transactions are not subject to the disclosure obligation under the Commercial Code. The rationale for this view appears to stem from the reasoning that the provisions which prescribe the duty to avoid competition aim at restraining directors from entering into business transactions, not private transactions, which conflicts with the business of the corporations of which they are directors. In my opinion, this view is myopic in nature. It overlooks the fundamental principle of the concept of fiduciary duty, that is that directors must act in the best interest of their corporations and the nature or the purpose of their actions are irrelevant.

However, recently some Japanese scholars have attempted to review this

719 Infra, see 4. Corporate opportunities.
720 Ziegel, supra note 66, at 518.
721 Infra, see 4. Corporate opportunities.
723 Ibid.
concept of duty to avoid competition. The views advocated by them have attracted attention and revitalized interest in this area. These views are basically that transactions which are purely private in nature ought also to be treated under the umbrella of "competition," thus are subject to the area of the Code which makes provisions prescribing the duty to avoid competition. Hence, directors who intend to enter into such transactions ought to disclose the material facts of their transactions to their boards. It should be noted here, however, this is still merely an non-mainstream academic view at this point, and no cases supporting this view appears to have been reported so far. It, therefore, seems probable that private transactions shall continue to remain excluded from the scope of competing transactions, and thus not subject to the disclosure obligations.

Recently there have been other academic attempts to obtain a firm grip on transactions which are not purely within the scope of the presently accepted concept of competition, but which clearly fall within the scope of transactions giving rise to a conflict of interest. Flowing from these attempts is the view that if a transaction is not within the scope of competition, but rather within the scope of corporate opportunity (in the common law sense), such a transaction ought to be subject to the general provisions on fiduciary duty. A detailed discussion on this issue will be made later in the section on "corporate opportunity." But, briefly, the problem is that since the provision which sets forth the law dealing with fiduciary duty does not prescribe any disclosure obligations, disclosure may not be demanded as a condition to be fulfilled to allow a director to enter into the transaction of the type under consideration, nor may disclosure be a defence for a director wishing to be excused

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724 Ueyanagi, Katsuro, et al., "Torishimariyaku no Kyogyo ni Kansuru Jirei Kenkyu [8]: Eigyo no Burui ni Zokusuru Torihiki no Igi [Case study regarding the directors' duty to avoid competition Vol.8: The meaning of "a transaction that comes under the class of business"]", in Shōji Hōmu No.1064, Jan 5, 1986, at 74-76.

725 Ibid.

726 Namiki, supra note 383, at 115.
from liability.

In conclusion, the provisions of the Code regulating general fiduciary duty may not appropriately deal with a transaction which is outside the scope of competition.

(ii) For whom the transaction is made.

Another case scenario concerns a transaction which may fall into the scope of competition but which is executed not for the benefit of a director himself, but for someone else. Is such a transaction subject to the disclosure obligation? The Commercial Code explicitly provides: "A director should disclose all material facts, if such transaction is done on his own behalf or on behalf of a third person." \(^{727}\)

As is the case with self-dealing transactions, it is clear that, since the purpose in avoiding such transaction is to protect the interest of the corporation, then to realize this purpose directors should act in the best interest of corporation regardless of whose name they use or to whom they benefit of a transaction shall pass. Any direct or indirect transaction which might conflict with the interest of the corporation should be considered as within the scope of "competition."

It ought also to be clear, as described in the section on self-dealing transaction, that even if a transaction was undertaken "on his own behalf or on behalf of a third party", a director may not be liable, if such a transaction did not conflict with the interests of the corporation.\(^{728}\)

 Probably the most frequently asked question in relation to the scope of conflict of interest is whether or not a conflict of interest exists between a parent corporation

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\(^{727}\) The Commercial Code, art.264, para.1; supra note 667.

\(^{728}\) Namiki, supra note 383, at 131.
and its subsidiary. Consider the case of a director who is a concurrently a director of a parent corporation and its wholly owned subsidiary, and both of these corporations happen to be carrying on the same line of business. Should the director disclose the material fact concerning the transaction to the other corporation every time he enters into a transaction on behalf of one of them? The answer at present seems to be as follows. If a transaction is made on behalf of the subsidiary, the director is not under any obligation to disclose material facts about the transaction to the parent corporation. This is simply because the interest of the subsidiary corporation generally ought to be identical to the interests of the parent corporation, and therefore no conflict arises.

On the other hand, if things are reversed, a director is and ought to be under disclosure obligations to the subsidiary. The rational for disclosure in this instance flows from the fact that if he enters into a transaction on behalf of the parent corporation, the best interest of the subsidiary is not necessarily served. This is because what is in the best interest of the parent corporation is not always in the best interest of the subsidiary.

A similar parent-subsidiary situation was found in *Scottish Co-operative Wholesale Society Ltd. v. Meyer.* In this case, the directors were held liable since they put the parent company's interests ahead of the subsidiary company, and they did nothing to defend the interests of the subsidiary company. They were therefore found to have "conducted the affairs of the subsidiary in a manner...

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730 *Osaka District Court,* May 11, 1983, *Kinyû Shôji Hanrei,* No.678, at 39, cited in Ueyanagi, Katsuro, et al., "Torishimariyaku no kyogyo ni kansuru jirei kenkyu [6]: Dai Sansha, Eigyô no burui ni zokusuru torihiki no igi [Case study regarding the directors' duty to avoid competition Vol.6: The meaning of "a third party and a transaction that comes under the class of business"], Shôji Hômu No.1061, December 5, 1985, at 14.

oppressive to the other shareholders."

On the contrary, in the Science Accessories Corp. case, though not a parent-subsidiary case, the court declined to impose liability on a director on the basis that the action done by this director did not cause any actual damage to the corporation.

In any event, in all jurisdictions, the underlying principle is that where no conflict exists, no disclosure is required because no breach of duty occurs.

4) Disclosure and Approval

As explained briefly, the Code restricts directors from entering into competition by imposing obligations on them to disclose the material facts to their boards when they intend to enter into a transaction which competes with the business of their corporation. The only remedy for a director who has entered into such a transaction without the statutory required approval of the BOD is to obtain the unanimous consent of all the shareholders of the corporation.

In addition, as in the case of self-dealing transactions, even when such approval by the board is obtained, if the corporation sustains damages arising out of such a transaction, the director may still be liable for the damages.

Prior to the 1981 amendments, the necessary approval mandated by statute was the consent of two-thirds of the issued shares present and voting at a SGM. A

732 Supra note 686.
733 Ibid.
734 The Commercial Code, art.264, para.1; supra note 667.
735 The Commercial Code, art.266, para.5 provides: "The liability of directors mentioned in paragraph 1 cannot be released except by the unanimous consent of all the shareholders."
736 Ueyanagi, supra note 167, at 214; Takeuchi, supra note 251, at 135.
director who entered into a transaction after obtaining this approval was no longer liable for any damages which the corporation sustained, since majority of shareholders of the corporation had approved the transaction.\(^{737}\) By the 1981 amendments, this approval requirement was relaxed. It became possible to obtain the required approval from the board. As a consequence of this change, it is now considered to be the case that even if a director obtains the statutory required board approval, he remains liable to the corporation if the corporation sustains any damages due to his actions.\(^{738}\) Furthermore, other directors who consented to the transaction at the board meeting are also jointly and severely liable for any damages sustained by the corporation.\(^{739}\) However, where the board has approved the transaction, the onus is on the corporation to prove that the corporation actually did suffered damages resulting from the transaction,\(^{740}\) if director's liability is pursued.

Additionally, the Commercial Code further requires that the director having carried out the transaction report all the material details of the transaction to the BOD without delay.\(^{741}\)

As is the case with self-dealing transactions, "all material facts" to be disclosed are the facts which give the board members enough information to determine whether or not the corporation should approve the transaction.\(^{742}\)

\(^{737}\) Pre-1981 Code, art.264, para.1,2; Takeuchi, \textit{supra} note 251, at 369.

\(^{738}\) See the argument addresses in self-dealing transactions; \textit{supra} 3.2. 6. Accountability.

\(^{739}\) The Commercial Code, art.266, para.2 and para.3 provide respectively:"In cases where any act mentioned in the preceding paragraph has been done in accordance with the resolution of the board of directors, the directors who have assented to such resolution shall be deemed to have done such act"; and "The directors who have participated in the resolution mentioned in the preceding paragraph and who have not expressed their dissent in the minutes shall be presumed to have assented to such resolution."

\(^{740}\) Ueyanagi, \textit{supra} note 167, at 295.

\(^{741}\) The Commercial Code, art.264, para.2; \textit{supra} note 667.

\(^{742}\) Kitazawa, \textit{Kaishaho, supra} note 75, at 355; Namiki, \textit{supra} note 383, at 135.
Most statutes of Canadian jurisdictions now impose disclosure obligations on directors where a conflict of interest situation between a director and his corporation may arise. However, unlike the explicit provisions pertaining to self-dealing transaction, no reference is made to the board's approval or director's accountability with regard to conflict of interest situations which may be outside the scope of self-dealing transactions. Thus, various common law cases including cases mentioned in this section must be carefully observed when determining whether or not, or from whom approval is required to be obtained, and in what instances directors are to be accountable.

Further, it appears that the underlying principle of the common law with regard to accountability is that unless an interested director discloses his interest in a transaction to his corporation, and his corporation approves this transaction, the director is accountable. Mere compliance with the statutory disclosure obligation to the board appears not to immunize a director from liability. In other words, it appears that for a director to be held unaccountable, he must disclose his interest in the transaction not only to the board, but also to shareholders of his corporation, and obtain their consent to take an opportunity which rightfully belongs to his corporation. However, there are many questions to be answered here. What constitutes consent? Is a simple majority sufficient, or is a special resolution required? Should the concerned director abstain from voting? All these questions are left to judicial scrutiny in the common law jurisdictions.

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743 The BCCA, sec.147; The CBCA, sec.120; supra note 669.
744 The BCCA, s.144, 145, 146; The CBCA, s.120; see supra 3.2 Self-dealing transactions, 5. Disclosure, approval, and fairness.
5) **Effect of Competing Transactions**

When a transaction has been executed in violation of the duty to avoid competition under the Commercial Code,\(^746\) the transaction is deemed to be valid even when the other party acted in bad faith, i.e. knew the fact that the transaction was in violation of the article of the Code.\(^747\) The same applies to the common law\(^748\) and Canadian statutory provisions.\(^749\) Then how would a corporation seek a remedy in such instances? This will be looked at next.

6) **Right of Intervention**

A statutory remedy for a corporation in the case where its director has violated the Commercial Code and entered into a competing transaction is the "right of intervention." This right is defined as follows:

> "If a director has, in contravention of the provisions of paragraph 1 [Article 264], effected a transaction on his own behalf, a board of directors may treat such transaction as effected on behalf of the company." (emphasis added)\(^750\)

Under what circumstances this right of intervention may be exercised by the corporation, and the effects of the right of intervention will now be examined.

(i) **Circumstances under which the right of intervention may be exercised by the corporation**

As far as the provision\(^751\) which provides for the right of intervention reads, the right of intervention appears to be exercisable when such a transaction has been

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\(^746\) The Commercial Code, art. 264; *supra* note 667.


\(^748\) See cases, *supra* note 581.

\(^749\) The BCCA, sec.146; The CBCA, sec.120(7).

\(^750\) The Commercial Code, art.264, para.3.

\(^751\) *Ibid.*
made by a director on his own behalf regardless of in whose name the transaction was made. Here, at least two questions are raised. Firstly, if a transaction (a competing transaction) is executed on a director’s own behalf, but in a third party’s name, can his corporation exercise the right of intervention, and order the director to transfer the misappropriated rights or goods or any profits which he may have derived to the corporation? Secondly, if such transaction is made in a director’s name, but on a third party’s behalf, can a corporation order the director to transfer the misappropriated rights or goods or profits derived therefrom which are actually possessed by the third party?

The answers to both questions ought to be answered, in my opinion, affirmatively. As for the first question, there would be no reasonable objections, since the name in which the transaction was carried out is irrelevant to the issue of the directors’ accountability, when he actually misappropriated the rights or goods rightly belonging to the corporation. With regard to the second question, in light of the fundamental principle of allowing a corporation to exercise the right of intervention, even if a director is not a beneficiary, the director ought to be liable for simply utilizing his position by using his name. However, a majority of scholars presently disagree with this view. They argue that since the provision explicitly states, "on his own behalf", and fails to state "on a third party’s behalf", that no accountability arises as a matter of strict interpretation of the provision. It appears that the legislature wilfully omitted the phrase "on a third party’s behalf" for the purpose of protecting the interest of third parties. If this is the correct interpretation of the intent of the legislation, interpreting the provision to include "on a third parties

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752 For this point, a strong opposing view has been advocated by some Japanese scholars. The opposing view is that if a transaction is made in a third party’s name, the corporation may not exercise the right of intervention to the director. Because, even if the director is the actual beneficiary, the third party might possess legal rights or ownership, and there would be no way for the corporation to demand the third party to transfer such rights or ownership to the corporation. Therefore, exercising the right of intervention to the director in such case is, in fact, useless; Kitazawa, Kaishahō, supra note 75, at 357-358.
behalf" would be against the clear purpose of legislature. This is exactly the argument of scholars who oppose the inclusion of "on a third parties behalf." Here lies the general and typical attitude of the Japanese legislature and legal scholars, as well as that of civilians in general that "written statutes are to be rigidly and faithfully observed."

What is the rationale of protecting the interests of third parties who knowingly utilize a director’s name to gain personal profits? What is the rationale of excusing a director who used his name to benefit someone other than his corporation? It does not make any sense to allow a director to escape from liability if he claims "I did it. But I did it for my son or someone else." This view is also supported by some Japanese courts,\textsuperscript{753} and some Japanese scholars.\textsuperscript{754}

As regards the nature of the right of intervention, it is one which can be exercised by a corporation unilaterally by a resolution of the BOD of the corporation. In other words, when a corporation finds that a director breached his duty to avoid competition, and if the board decides to exercise the right of intervention, the corporation has a legal right to order the director to transfer the wrongfully appropriated rights, goods or benefit derived therefrom, to the corporation without needing to bring suit.

\textsuperscript{753} Tokyo District Court, march 26, 1981 (Hanrei-Jiho, Vol.1015, p.27) In the case, the court held the director liable in violation of the duty to avoid competition, even though the transaction was not made on his own behalf, but on a third party’s behalf (the corporation he was in control); The facts of the case were: the defendant who was a representative director of the plaintiff corporation purchased shares of a corporation which was in the same business as that of the plaintiff corporation. The purchase of the shares was made by borrowing money from the plaintiff corporation. Though the defendant was neither a representative director nor a managing director of the corporation of which he has purchased shares, by having acquiring majority shares of the corporation, the defendant controlled the corporation. The defendant, on behalf of the corporation of which he was in control, without disclosing the fact to the plaintiff corporation, started to deal with distributors which used to be the plaintiff company's distributors. The other representative director of the plaintiff corporation brought a suit against the defendant alleging that the defendant if liable to the plaintiff corporation for a breach of the duty to avoid competition.

\textsuperscript{754} Kitazawa, Kaishaho, supra note 75, at 357-358.
It would appear that the principle of the right of intervention is similar to that of the constructive trust, which has been the most commonly used remedy under similar circumstances in the common law jurisdictions.

Further examination will be undertaken to assess to what extent the right of intervention under the Japanese Commercial Code may be imposed. This issue will be discussed below by contrasting the right of intervention to the constructive trust.

(ii) Effect of the right of intervention

The fundamental principle of the right of intervention is that once one or more of a company's directors is involved in a competing transaction, it (by a BOD resolution) may order the director(s) involved in the transaction to transfer to the corporation any goods, services, effects and benefits derived therefrom. The nature of the right of intervention is clearly illustrated by the following court case:

Tokai Mokuzai Kogyo K.K. v. Yamazaki

Summary of the facts:

The articles of the plaintiff corporation specified that one of the business activities of the corporation included, "woodwork and supplementary business." The defendant was a representative director

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755 In Japan, generally, properties wrongfully appropriated are not regarded as those which are merely possessed by the director for the corporation based on his position as a fiduciary. Though the result of the exercising of the right of intervention and imposition of constructive trust seems similar, the fundamental concept is somewhat different. (Ueyanagi, supra note 167, at 223).

756 "Constructive trust" is a creature of equity that operates to prevent unjust enrichment; such trust will be imposed when property interest has either been acquired by fraud or where, in the absence of fraud, it would be inequitable to allow property interest to be retained by person who holds it. (George D. Coupounas v. Joseph F. Morad et al., Ala., 380 So.2d 800).


758 Ueyanagi, supra note 167, at 222.

759 The Supreme Court, June 4, 1949 (Minshû Vol.3, No.7, p.235).
of the plaintiff corporation. He had been purchasing wood and lumber for his son without disclosing this fact to the plaintiff corporation. After the plaintiff corporation became aware of his activity, the plaintiff corporation exercised its right of intervention under Article 264 of the Commercial Code. The plaintiff corporation brought an action for the recognition of ownership of the wood and lumber which the defendant had purchased for his son and for the enforcement of delivery of the wood and lumber to the plaintiff corporation.

The court held:

1) Regarding the actions of the defendant:
   It is a violation of the duty to avoid competition.

2) Regarding the effect of the right of intervention:
   It should be proper to interpret the right of intervention as being that "a director is required to transfer any goods, rights or benefits obtained by the transaction to the corporation. However, that which was obtained by the transaction, the ownership or other legal rights obtained by the transaction are not automatically transferred to the corporation by its exercise of the right of intervention.

What is demonstrated in the above ruling is that exercising the right of intervention confers on a corporation the right to order the director to transfer any goods or rights or benefits acquired by the director. The effect of exercising the right
of intervention is, to create *jus in personam* to the corporation against the
director, and not to create *jus in rem* against the other party of the
transaction. In other words, even after a corporation exercises its right of
intervention, the director still continues to be the party of the transaction. The
director has a duty to his corporation to transfer any goods, benefits or rights which
he obtained by the transaction to the corporation. More precisely, unless the
director transfers the ownership or rights or goods to the corporation, the corporation
does not have any enforceable power, as a party to the transaction with the other
party. Needless to say, the corporation may seek the court’s assistance to order the
director to make the necessary transfer, if he refuses to do so.

In addition, it is generally understood that if a corporation exercises the right of
intervention and the director complies, at the same time the corporation owes a
duty to the director to discharge him of any obligation which he owed to the other
party, and also must compensate the director for expenses which the director incurred
as part of the transaction.

It is important to note that even if a corporation exercises its right of
intervention, and the director complies fully by making all necessary transfers, the
corporation may still claim damages against him (if any were sustained by the
corporation).

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760 A right against a person; a right which gives its possessor a power to oblige another person to
give or procure, to do or not to do something (Black's Law Dictionary, 6th ed., St.Paul, Minn, West

761 "A right in a thing: a right existing in a person with respect to an article or subject of property,
inherent in his relation to it, implying complete ownership with possession, and available against all
the world." (*Ibid*, at 860).

762 *Ibid*.

763 *Ibid*.


765 Ueyanagi, *supra* note 167, at 221; The Commercial Code, art.266, para.1(5); *supra* note 643.
As stated briefly, when a director takes an opportunity of his corporation (and here many events in this area overlap into the area of wrongful competition), a remedy for the corporation in the common law jurisdictions has been traditionally to impose "a constructive trust upon the wrongfully appropriated properties." The underlying principle of this "constructive trust" is that "a fiduciary who breaches his duty and makes a profit must account for the profit ... to the person to whom the duty is owed." The accountability in this context is said to mean putting the profiteering fiduciary and the corporation in a "debtor-creditor relationship." It would appear that the principle of accountability laid down by the constructive trust under the common law is similar to that of the right of intervention under the Japanese Commercial Code. Moreover, though not so definite as the Japanese Commercial Code, the common law courts, for the purpose of redressing competitive harms, may also impose monetary damages in addition to the constructive trust.

It may be concluded that the remedies for breach of a director's duty to avoid competition in Japan and in the common law jurisdictions are not significantly

766 Popofsky, supra note 757, at 1214; Couponas v. Morad; supra note 756.
767 Welling, supra note 138, at 380.
768 Ibid at 387; Welling clarifies this point as "There has been a great deal of sloppy analysis, both judicial and academic, on this point and the fiduciary is often mistakenly said to hold the profit in trust for the corporation because he has made it in breach of his duty. This is clearly not correct. There is not a cause and effect relationship between breach of fiduciary duty and trust. Trust is a proprietary relationship whereas a debt relationship is inter-personal."; It appears that corporate directors are not, in a strict sense, trustees. Therefore the corporation does not have power to force a third party to return the profit if the profit the director obtained is transferred to a third party. Nor does the corporation have the automatic right to take over the director's rights or goods which ought to belong to the corporation.
769 This is generally only so in the case where a corporation has sustained harms by competition. This monetary remedy does not generally apply to the usurpation of a corporate opportunity. This is because "the corporate opportunity analysis focuses on the acquisition and not the competition, the measure of damages also is addressed solely to the wrongful acquisition and the harm it caused."; Popofsky, supra note 757, at 1215; In Red Top Cab Co. v. Hanchett et.al, 48 F.2d 236 and Lincoln Stores, Inc. v. Grant 309 Mass. 417, 34 N.E.2d 704 (1941), which involved competition, the courts affirmed that the defendants pay damages sustained by the plaintiff corporations in addition to the wrongfully acquired profits.
different. The only difference is that in Japan the right of intervention may be exercised by the corporation, without seeking court assistance (unless the director refuses to comply and make the requested transfers to the corporation), whereas in common law jurisdictions a corporation must seek court assistance to obtain a remedy. Again, this difference appears to be a natural consequence of the different historical background of these two remedies. The right of intervention under the Code is a right conferred on a corporation by the statute, whereas the constructive trust is a creature of equity and, as such, only the courts have a power to grant the remedy.\(^{770}\)

### 3.4 Corporate Opportunities

The "corporate opportunity doctrine" in common law jurisdictions is based on a fundamental rule of equity, which may be stated as being that, "a corporate fiduciary may not appropriate to himself an opportunity that rightfully belongs to his corporation."\(^{771}\) This principle has been codified into most Canadian statutes\(^{772}\) by imposing disclosure obligations on corporate directors who intend to enter into transactions which conflict or may conflict with the interest of their corporations. Based on this principle, corporate opportunity situations sometimes overlap with competition situations, but may also include situations which are outside the scope of the competition principle.

As briefly mentioned in the preceding section of this chapter, the corporate opportunity doctrine has not been clearly established in Japanese law. There is no explicit provision dealing with a director’s duty in connection with corporate opportunities or conflicts of interest as a whole. Thus any conflict of interests arising out of director’s conduct, other than by competition, has rarely been questioned in

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\(^{770}\) *Supra* note 766.


\(^{772}\) The BCCA, sec.147; *supra* note 669.
Japanese courts. Also, even if some relevant case law exists, since Japan is a civil law jurisdiction, such case law will not be necessarily recognized as a valid source of law. Furthermore, owing to the fact that the concept of corporate opportunity is one of the more recently introduced foreign concepts in this area of law, Japanese academic discussion about it is still questionable. Hence, only hypothetical questions may be asked at present. For example, if a case occurs which falls within the scope of the corporate opportunity concept, and not within the scope of competition, it is not clear how it will be decided. The method most likely to be adopted by Japanese courts could be to find some preexisting legislation to apply which they consider relevant.

The only relevant provisions in connection with conflict of interest under the Japanese Commercial code are provisions pertaining to: 1) fiduciary duty; 2) duty to avoid competition; and 3) self-dealing transaction. If a case does not fall into the scope of the last two categories, it will be dealt with under the first provision (fiduciary duty). A problem of dealing with a corporate opportunity case as a matter of a breach of fiduciary duty is, as mentioned above, the problem with the disclosure requirement or lack thereof. A concerned director would be unable to use his compliance with the disclosure obligation as a defence, even if he had

773 "Legislation in Japan, as in Roman-Germanic systems, is the most important of the formal source of law, and a judge is required to apply it to the cases that come before him in preference to all other sources of law. Legislation is not, of course, as the school of exegesis would have it, the sole source of law, and a judge can refer to other source of law in the case of the absence, obscurity, or inadequacy of the legislation, for his function is not so much to apply the preexisting law faithfully as to give a reasonable solution to the social conflicts that arise, without the parties having to ask whether laws exist to regulate their dispute or not. In the usual run of cases the judge finds legislation to apply, since all the important matters likely to cause legal disputes are now regulated by legislation. In this sense, and in this sense only, legislation is the primary source of law"; Noda, supra note 10, at 188; Though court decisions, especially the interpretation of a law made by courts, are likely to be followed by other courts in deciding similar cases, "in strict theory no judge is bound by any judicial precedent", Noda, supra note 10, at 226.

774 Art.264-3; supra note 534 and accompanying text.
775 Art.264, Supra note 667.
776 Art.265; supra note 559.
made disclosure, since no disclosure obligation is set forth in the provision.

From the corporation's point of view, if such cases are dealt with as breaches of fiduciary duty, the corporation may not be appropriately compensated. The right of intervention, which is a similar remedy to the constructive trust under the common law, is only statutorily recognized in the case of competition. The only remedy for a corporation in other cases is to seek damages to compensate for the loss it has sustained. Therefore, if a corporation finds that a director has misappropriated an opportunity which rightfully belonged to the corporation, the corporation really has no way to get the opportunity back, or to order the transfer of the misappropriated benefits which the director obtained by the transaction. Basically, the only remedy for the corporation in such a case would be to seek damages from the director by proving that it actually sustained damages.

In conclusion, unless the facts are undoubtedly within the scope of the competition principle, a director has no way to ensure that he is legitimately entering into a transaction and a corporation has no way to recover any benefits the director obtained which may rightfully belong to it.

The real problem is, since no explicit provision exists and no clear concept of the corporate opportunity doctrine has yet been established in Japan, that directors in Japanese corporations are more likely to utilize their positions to partake in opportunities which rightly belong to their corporations without being held liable. The only way to prevent or deal with such undesirable conduct is to introduce appropriate amendments to the present Code.

777 Ibid.
778 Art.264; supra note 647.
779 Art.266; supra note 623.
A simple amendment to the Code might read as follows:

"a person employed by a corporation may not take, for his benefit, or for the benefit of anyone else, any opportunity which rightfully belongs to the corporation."

Here, I wilfully use the word "person" which may be defined appropriately to include not only directors but senior officers and other customary executive groups of people within the corporation who are in positions of importance. The use of this word and others such as "rightfully" gives quite a bit of leeway to a court to look at the relevant circumstances in each case.

4. Conclusion

Through the examination of various duties of directors under the Japanese Commercial Code and laws of Canadian jurisdictions, it would appear that the Code regulates director's duties in a different manner from laws in the common law jurisdictions. In short, Japanese corporate law tends to regulate directors' duties in a stricter manner. This rigidness is well depicted in the attitude of Japanese courts. Japanese courts, when interpreting relevant provisions, tend to adhere to their strict interpretation. This behaviour of the courts appears to be encouraged by the supportive attitude of Japanese legal experts who generally foster this type of policy. This has ignored considerations of practical fairness and created disparity between what the law is and what the law ought to be.

However, this strictness and rigidness spoken of above appears to be only true with regard to legal principles which were derived from civil law concepts. A typical example is the regulation of the directors' duty of care and skill. Directors are expected to discharge higher degree of care compared to their counterparts in the West, and they are expected to supervise other directors' conducts positively and continuously. Principles which have been introduced from common law jurisdictions, primarily the United States, such as the fiduciary duty concept, are not necessarily
regulated in the same way as concepts which have been derived from civil law concepts. Such legal principles are not regulated in a coherent manner under the Code. Some provisions regarding some aspects of the fiduciary duty (such as requirements for approval for entering into a self-dealing transaction and validity of self-dealing transactions), regulate matters in a relatively strict manner, while other provisions do not explicitly regulate other principles of the same duty (such as liability of former directors and the scope of competing transactions, whether or not private transactions are included). If principles are not explicitly regulated in the Code or other relevant laws, Japanese courts have tended to reject the acceptance of such principles. As a consequence, Japanese directors are sometimes very strictly controlled by statute, and other times they are quite free from statutory controls. It appears that this incoherence and inconsistency in the attitudes of Japanese legislature and courts are derived from conflicts arising between pre-existing civil law concepts and newly imported common law concepts. If a principle hails from the common law and is completely alien to the Code, such a principle tends to be ignored by both the legislature and judiciary of Japan. Contrarily, if the newly adopted common law principle overlaps with some pre-existing civil law concepts, they tended to be codified in a very strict manner.

It can be concluded that this area of Japanese law is for the most part very rigid and stringent. It has not been changed from its original spirit even after the adoption of foreign concepts. In other words, Japanese law have never substantially altered its original principles. Or view another way, Japan has always altered foreign principles into a form which is acceptable to the Japanese legal arena.

In any event, the law should not be merely concern with legal principles regardless of whether they are civil law concepts or common law concepts. Regulation which are either too rigid or too lax generally would not meet the real needs and expectation of society.
CHAPTER SEVEN
CONCLUSION

This thesis has, one hopes, shed some light on the peculiarities of Japanese corporate law, regarding corporate management, judicial responses to the legal principles questioned, and actual practices by various actors inside and outside of the corporation in Japan.

As far as written laws are concerned, Japanese corporate law, at first glance, regulates matters pertinent to corporate management (including the SGM, the BOD and individual directors) in a manner similar to that of the corporate laws in the Canadian and American jurisdictions.

Although corporate laws in Japan and Canada originated from different sources, the American influence over the corporate laws of both of these jurisdictions has guided these different streams of laws into the same estuary. For instance, the two corporate organs (the SGM and the BOD) and the duties of directors are presently regulated in a similar manner in both jurisdictions. Even some concepts which formerly had not existed within Japanese law (concepts which included fiduciary duty of directors, the business judgment rule, and the corporate opportunity doctrine) were all imported from the U.S.A. and have been discussed amongst Japanese scholars and in judicial decisions in Japan. It may therefore be said that most concepts under the Canadian and the U.S. corporate laws are now also familiar within Japanese corporate law.

Moreover, as stated several times in this thesis, as the Japanese economic and political ties with the U.S.A. have become stronger, Japanese corporate laws have come to resemble their American counterparts. This general statement is true for
Canadian corporate law as well.

However, since the Commercial Code of Japan has its origin in German corporate law, it continues to contain some non-North American concepts, one may call them "civil law concepts", compared to American and Canadian corporate laws which have mainly been derived from English common law origins.

This is a unique characteristic of the Japanese Commercial Code, along with other laws of Japan. Due to this uniqueness, the Japanese legislature and the judiciary have faced difficulties in balancing the pre-existing civil law concepts alongside newly imported concepts, especially those from the common law jurisdictions. This is typically evident from some arguments mentioned in this thesis, such as those concerning the concept of fiduciary duty.

The conflicts between pre-existing legal concepts and new foreign concepts appear to be a natural consequence. The recent adoption of most foreign concepts by Japan have been undertaken due to the great political and economic influence and power of the United States over Japan. Hence, most amendments of the law have been technical rather than substantive. More importantly, the importation of foreign legal concepts has not entirely altered the social norms of the Japanese people. Thus, even after these amendments to corporate statutes, Japanese, society as a whole, individuals' attitude, and corporate culture has, in great part, remained unchanged. For instance, the 1950 amendments were undertaken under the instruction of the United States for the purpose of pursuing shareholders' democracy. Since then, the law explicitly stipulates various rights for shareholders, including rights to bring derivative actions, cumulative voting rights, the right to access to the corporate documents, and so on. Some forty years after, since legislating these ideas, shareholders' democracy appears still quite a long way off for shareholders of Japanese corporations. Shareholders rarely attend their SGM, and corporate
directors are still attempting to breeze over their SGMs without any meaningful input from their shareholders.

Recklessly adopting a foreign concept into the Japanese legal sphere is, of course, just as dangerous a practice as blindly objecting to its introduction. However, adopting a foreign concept which has been well established through careful examination and lengthy consideration by a foreign legislature or judiciary would be advantageous for Japan. This is providing sufficient studies of the concept are undertaken before its adoption by appropriate Japanese groups and the adaptability of the concept to Japanese society is carefully scrutinized. Since the Japanese are known for their ability at adapting to and adopting what is advantageous to them, they ought to be able to adopt foreign legal concepts in pursuit of an advanced legal system. However, one thing that the Japanese legislature should remember when choosing to adopt foreign legal concepts is that they should continue to keep a close eye on whether the adopted principles are actually taking root in their society as they were intended to. If they are not, they should implement some measures to achieve necessary structural changes in the society, or alter the adopted principles to function harmoniously in Japanese society. This has been a major problem with the introduction of legal principles from the United States. The principles as written have met with great opposition due to opposing cultural underpinnings.

In addition to the influx of foreign legal principles into Japanese corporate law, changing situations and problems in Japanese society at the time have altered the corporate law. A typical example is the amendment of the corporate law for the purpose of prohibiting the illegal activities of Sokai-ya. However, here again, the law has failed to control such individuals. The Sokai-ya still exist and function. As the law has become more stringent, the Sokai-ya have become more technical and skilful in their adaption to it.
In any society, although law is a guiding principle for individuals' behaviour, law by itself may not be the sole or ultimate factor in the control of or success of individuals and corporations. It may be that the role of law in Japanese corporate society is less important for its success than in the West. This is because despite such failures of Japanese corporate law to control certain undesirable behaviours, Japanese corporations have flourished, achieving great economic success. There would seem, therefore, to be some other factors which led to this success besides law. The cultural, sociological and philosophical peculiarities of Japanese people and their society have played a very important role in this success story. This is evidenced from several examples mentioned in this thesis.

One of these examples is the Japanese structure of the BOD of corporations. The real relationship between directors and their corporations in Japan appears to be more than contractual. The view in the West is that this relationship is strictly contractual. In Japan most directors are senior employees who have for the most part almost entirely devoted their lives to their corporations. As such, they tend to act in the best interest of their corporations. The problem here is that their actions, which may be in the best interest of their corporation, may sometimes be realized at the expense of individual shareholders. Such directors' activities may also be derived from a philosophical attitude peculiar to the Japanese people in general. It is generally said that the Japanese are a group-oriented people, and "what are important (for them) are duty, devotion, and responsibility toward the particular closed group." This phenomenon can be readily observed, especially in the smallest groups of the Japanese business society, corporations; directors, as well as other employees of these corporations, have been expected to show and give their

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781 Ibid, at 46.
total commitment to their individual corporations.\textsuperscript{782} It has been demanded of directors that they keep a diligent eye on all events or affairs of their corporations, "to balance the interests of all involved"\textsuperscript{783} and to prevent any events which might destroy so-called "groupism."\textsuperscript{784}

Because of such devotion and commitment of directors to their corporations, directors appear to adopt understanding that their corporations are in fact "theirs." As a result, some undesirable phenomena contrary to the spirit of law have inevitably occurred; The frequent occurrence of self-dealing transactions is a typical example.

The following fact also typifies the distance between the spirit of the law and factual scenarios in practice typical of Japan. Directors subject to Japanese law are generally expected to discharge their duties in a very positive manner to manage their corporations. One may think that if such a heavy duty is imposed on directors of corporations in Japan, that there must have been numerous cases brought against directors for breaches of duty. However, in reality, this is not the case. In fact, cases in which directors' liability was at issue and pursued by their corporations or by shareholders of their corporations have been very few and far between.\textsuperscript{785} But cases in which directors' liability was pursued by third parties, such as creditors, have

\textsuperscript{782} Nakatani, \textit{supra} note 152, at 18; However, recently, this peculiarity of business-oriented attitude of Japanese people, especially men, has been changing toward a family-oriented attitude, along with many other changes of the traditional Japanese characteristics, Nakatani, \textit{supra} note 152, at 18 to 19.

\textsuperscript{783} \textit{Ibid}, at 17.

\textsuperscript{784} The "groupism" is defined by Odaka (\textit{supra} note 780) as "a "value orientation" in which a group or organization, in this case usually a corporation, "perceives itself as a close-knit community with a shared destiny" and therefore "place less emphasis on realizing its members' potential and satisfying their individual aspirations than on ensuring continued well-being of the whole and the overall peace and happiness of the group ...", Nakatani, \textit{supra} note 152, at 29.

\textsuperscript{785} The exact number of cases brought against directors pertinent to the breach of duty of care could not be ascertained. However, according to \textit{Hō bun Hōrisu Zashi Kijō Sakūn [Index to articles of Japanese law journals]} by the Supreme Court Library, between 1980 to 1989, cases which were commented upon in the major law journals in Japan (such as Hanrei-Jihō and Shōji-Hōmu) has been just one or none every year.
been much more numerous. The number of these cases appears to be still relatively small at least compared to that of the U.S.A. In other words, in Japan, though directors' statutory duties are relatively stringent, in practice there appears to be less possibility that directors will be sued for the breach of their duties compared to in the U.S.A.

This may be based on the oft-repeated belief (in the West) that the Japanese are non-litigious people. However, I rather postulate, it is more the result of shareholders' lack of awareness of their rights and unrealistic trust of directors. This unrealistic trust exhibited by shareholders appears to be based on the notion that directors ought to act in the best interest of their corporation as senior employees, and what is in the corporation's best interest is in their best interest. If Japanese shareholders ever become aware that directors have been wasting or utilizing corporate assets for their own purposes, they would not be so quiet. I believe that if the issue involves purely economic matters, the Japanese people are not so hesitant to seek court assistance as they are believed to be.

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786 According to the same source in the same term, Hō bun Hōritsu Zashi, ibid note 737, the average number of cases commented in law journals pertinent to directors' liability brought by third parties were five to six.

787 According to the Wyatt Survey of the U.S.A. in 1989, 625 cases has been reported among the surveyed 1537 corporations between 1980 to 1988; Shō jī Hōmu, No.1244, March 15, 1991, at 2; However, in Canada, the number of law suits brought against directors and officers of corporations are quite small. It is stated that "the majority of claims initiated against directors are settled out of courts for relatively insignificant sums." (Ziegel, supra note 66, at 486).

788 Some of the books which have penetrated this idea to the world are: Kawashima, Takeyoshi, Nihonjin no Hō Ishiki [Japanese Legal Consciousness] (Tokyo, Iwanami, 1967) at 125 to 203; Henderson, Dan F., Conciliation and Japanese Law: Tokugawa and Modern, Vol.2 (University of Washington Press, 1965), at 191 to 200.

789 One commentator suggests that mutual dependence of senior and junior employees exists in Japanese companies. It is said in his book, that senior employees take responsibilities for their junior employees. Thus senior employees generally depended and trusted by their junior employees; Clark, Rodney, supra note 14, at 126.

790 Haley objects to Kawashima's argument (supra note 788) that "Japanese people are non-litigious people." He points out structural barriers which have hindered Japanese people from litigating; Haley, John Owen, "The Myth of the Reluctant Litigant" in Journal of Japanese Studies, vol.4, No.2, 1978 (University of Washington), at 359 to 390; Oghigian, Haig(ed.), The Law of
It should be pointed out here that the social and philosophical peculiarities of Japanese society and its people would seem to have been responsible for possibly misleading the Japanese legislature and judiciary in some events. For instance, it is considered that representative directors are expected to discharge their duty to supervise other directors’ activities continuously and positively since they ought to know everything concerning the affairs of their corporations and all the activities of all the directors of the corporation. This however, would seem to be more wishful thinking than reality. The assumption that representative directors are in a position of being able to control or grasp all the corporate affairs of their corporation is no more than a myth in this contemporary business society. The strict accountability imposed on directors in the case of conflict of interest likewise shows a somewhat unrealistic expectations of the law toward directors. Rather than placing the unrealistic expectations on directors, the law should adopt some other measures to monitor directors’ activities, including the introduction of mandatory outside directors who are completely independent from any of the board members and the enhancement of the auditor’s powers.

Lastly, peculiarities of the Japanese judiciary are noteworthy. Once legal principles are introduced which are postulated as a reflection of the voice of their society or sometimes as the dominant views of legal scholars of the time, regardless of whether or not these adoption are a real reflection of the society or based on fair or equitable principles, the Japanese judiciary tends to adhere to a strict interpretation of the relevant provisions. The consequences of this could sometimes be a real detriment to the people or the society which they ought to be taking into consideration the most. As demonstrated in the section of self-dealing transactions, Japanese courts tend to look at the board’s approval stipulated in the law as the only legitimate procedure for directors to enter into such transactions, without regard to

the fairness of such transactions. I strongly believe that the role of the courts should not be to adhere to strict interpretation of relevant provisions of the law, but to look more closely at the spirit of the law and to adjudicate according to what is in the best interest of corporation as a whole.

On the other hand, if matters are not explicitly prescribed by legislation, the Japanese judiciary has tended to be reluctant to partake in judicial legislation or to adopt or establish new rules in their courts, even if this would be in the best interest of society. This is evident from facts mentioned in this thesis: the strong opposition to the Business Judgment Rule, no liability having been imposed on directors in the case of corporate opportunity, and so on. This judicial attitude is disadvantageous to the Japanese people and to their society. It is suggested that insofar as the written statute has a great influence on the judiciary in Japan, these proposed principles should be codified into Japanese corporate law.

Although it may be the case that written law may not have the greatest power to influence in Japan, at least in the area of corporate law, law remains a necessary tool to guide people in the appropriate direction that society ought to pursue. In the corporate society, since there exist several groups of people whose interests may conflict but who must co-exist, clear guidance from the law for these groups is needed.

However, some of the above conclusions may be viewed as outdated in the near future. Things are rapidly changing in Japan largely due to the present sluggish economy and difficulties of managing corporations. Japanese shareholders and other parties associated with corporations have started to gain some realization about how to protect their interests; it is a "Directors Beware" situation at present. As a consequence, the number of law suits against directors has been on the increase, and it appears that this trend will continue. It is also noteworthy that the first insurance
policy for directors' liability\textsuperscript{791} was approved to be sold and appeared in the marketplace in 1990.\textsuperscript{792} These facts alone should trigger a change in the attitude of corporate actors and might produce changes, yet unknown, to the laws of Japan.

Hopefully, these changes will be in the best interests of the corporation as a whole. Shareholders, third parties and the societies in which corporations operate and effect should all benefit positively from these changes.

As mentioned before, the obvious similarity between the commercial laws of Japan and those of the West should be viewed with great caution. The commercial laws of Japan or the way of doing business in Japan, like many other areas of Japanese life, which has experienced foreign influence has proven quite resistant to it. On the surface there is a system which includes written statutes which greatly resembles corresponding systems found in the West. This, however, is as far as the similarity goes, for in the implementation of new ideas, traditional Japanese values and customs take over. This phenomenon is resistant to the total implementation of new and foreign systems into Japan.

The imported written codes were and are meant to deal with and regulate particular aspects of life in Japan; But these particular aspects of life has been and remain more closely influenced by historical and traditional values of various types, which were present before the newly introduced systems and codes. This is one of the reasons that many Westerners find it hard to comprehend (business or commercial) practices in Japan.

\textsuperscript{791} The insurance is called "Directors and Officers Liability and Company Reimbursement Policy" (by Taisho Kaijyo Kasai Insurance Co. Ltd.).

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