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Prying Open the Japanese Market: Tender Offers and the Legal System in Japan

I. INTRODUCTION

The Japanese have been actively investing in the United States for the last several years. The United States' huge trade deficit with Japan has created an atmosphere of tension between the two countries causing Japanese businesses to fear that the United States government will impose quotas or embargoes against Japanese products. To preempt such retaliatory measures by the United States government, Japan has changed its method of investment in the United States. In the past, Japanese manufacturers typically built their businesses from the ground up by purchasing real estate, building factories, and hiring employees.¹ However, as the fear of embargoes and other retaliatory measures against Japanese products becomes more imminent, Japanese businesses have turned to mergers and acquisitions as ways to invest in the United States.² The soaring value of the yen against the United States' dollar³ is another factor that has fueled this trend.⁴

While Japanese investment in the United States has been extremely profitable, United States investment in Japan is not as viable for economic, legal and cultural reasons. Why is foreign acquisition of Japanese companies so rare, so difficult and so unthinkable? The assessment of the current feasibility of United States investment in Japan is almost uniformly negative among various commentators. Indeed, one commentator stated recently that an acquisition of a Japanese company was "undoubtedly the most difficult form of entry into

1. Misawa, *Merger and Acquisition Activities in Japan: The Present and the Future*, 19 VAND. J. TRANSNAT'L L. 785, 795 (1986).

2. Japanese corporations seek to acquire United States corporations as if they were hunting for a "bargain sale." Y. TAKENAKA, *MERGER & ACQUISITION KIGYŌ BAISHŪ SENRYAKU: M&A NI YORU ATARASHII KIGYŌ SEICHŌ (MERGER AND ACQUISITION STRATEGY: NEW CORPORATE GROWTH BY MERGERS AND ACQUISITIONS)* 4 (1987).

3. Recent reports indicate that the depreciating dollar has an effect on Americans. One newspaper comments that the dollar buys about half the Japanese yen as it did in 1985. L.A. Times, Nov. 14, 1987, § 1, at 1, col. 1. On November, 13, 1987, foreign exchange listed 135.85 yen to a United States dollar. *Id.*, § 4 (Business), at 10, col. 2.

4. NIHON MEDIA PURAN, *KIGYŌ M&A NO TETTEI KENKYŪ (CORPORATE MERGERS AND ACQUISITIONS COMPLETE RESEARCH)* 387 (1987) [hereinafter *CORPORATE MERGERS AND ACQUISITIONS*].

the Japanese market."⁵ Another commentator observed that "acquisitions and takeovers are simply not an effective device for Americans to enter the Japanese market."⁶ Yet another commentator has lamented that acquiring a Japanese company is impossible.⁷ Are these views justified?

This Comment explores the legal and non-legal barriers to acquisitions in Japan with an emphasis on tender offers by foreign investors. What price must the Japanese pay in order to keep up these barriers? Are such barriers an intentional strategy devised by Japanese bureaucrats or the natural consequence of cultural differences?

This Comment is comprised of four major parts. First, it sets forth the legal obstacles to the acquisition of Japanese companies as foreign investments. Second, this Comment examines the Japanese Foreign Exchange and Foreign Trade Control Law,⁸ the Japanese Securities and Exchange Law,⁹ and the Japanese Commercial Code¹⁰ to determine the potential disadvantages suffered by foreign investors who seek to purchase Japanese businesses. Third, social and cultural barriers including the Japanese corporate practices relating to tender offers are explored. Finally, this Comment answers the question of whether the Japanese have deliberately erected legal barriers, or have simply maintained them to augment existing cultural barriers. The effect of these barriers appears to be that the Japanese domestic businesses are protected from being taken over by foreign investors.

II. ACQUISITIONS VERSUS NEW BUSINESSES

Most companies, regardless of where they do business, choose acquisitions as a growth mechanism because acquisitions offer a ready-made package of distribution networks, management teams and employees. The conventional method of establishing a business, however, requires investors to purchase real estate, build a factory and an

5. E. ASIAN EXECUTIVE REPS., Feb. 15, 1985, at 9, col. 1.

6. Henderson, *Access to the Japanese Market: Some Aspects of Foreign Exchange Controls and Banking Law*, in LAW AND TRADE ISSUES OF THE JAPANESE ECONOMY: AMERICAN AND JAPANESE PERSPECTIVES 131, 143 (G. Saxonhouse & K. Yamamura ed. 1985).

7. Crabb, *The Reality of Extralegal Barriers to Mergers and Acquisitions in Japan*, 21 INT'L LAW. 97 (1987).

8. *Gaikoku Kawase Oyobi Gaikoku Bōeki Kanri-hō* (*Foreign Exchange and Foreign Trade Control Law*), Law No. 228 of 1949, as amended in Law No. 70 of 1986 [hereinafter FECL].

9. SHŌKEN TORIHIKI HŌ (Securities and Exchange Law), Law No. 25 of 1948 [hereinafter Japanese SEL].

10. SHŌHŌ (Commercial Code), Law No. 48 of 1899.

office, and hire workers. In essence, this is starting from the ground up.¹¹ In addition, the traditional way of establishing a business or a market is time consuming. In manufacturing sectors, the result may be that by the time a product is developed and a distribution system is set up, consumers are ready for a new generation of products.¹² Establishing a new business also requires energy, resources, and significant capital. Thus, one advantage of corporate acquisitions is that they save a considerable amount of time, energy, and resources which are normally required in establishing a new business.

Strategically, acquiring an existing business in Japan may be more sound than building one from the ground up since the latter form of investment imposes difficulties not normally encountered in the United States. First, distribution systems are quite complicated in Japan.¹³ Large manufacturers dominate both wholesale and retail dealers to comprise closed and anti-competitive distribution systems.¹⁴ Like any other network, a distribution system may be difficult for a foreigner to build in a short time.¹⁵ Second, recruiting and hiring experienced workers may be difficult since major corporations, in most instances, have life time employment systems.¹⁶ Most workers expect to stay in one company for their entire lives and mobility in the workplace is generally not a familiar concept in Japan. Third, real estate prices in recent years have skyrocketed in Japan,¹⁷ making prime office space literally unavailable.¹⁸ Lastly, since articles 56¹⁹

11. Starting from scratch by purchasing land for office or factory building is called "green field up." Misawa, *supra* note 1, at 795; ABEGGLEN, *THE STRATEGY OF JAPANESE BUSINESS* 127 (1984).

12. KOKUSAI KIGYŌ BAISHŪ HANDBOOK (INTERNATIONAL MERGERS & ACQUISITIONS HANDBOOK) 387 (K. Ishizumi ed. 1987) [hereinafter *INTERNATIONAL MERGERS & ACQUISITIONS*] (an interview with Mr. K. Ishizumi, an attorney licensed in New York and Japan and senior attorney in Chiyoda International Management Legal Office, Tokyo, Japan).

13. "[T]he Japanese distribution system is so complex and exclusive that it has been a trade barrier for marketing in Japan." Matsushita, *The Legal Framework of Trade and Investment in Japan*, 27 HARV. INT'L L.J. 361, 372 (1986).

14. Iyori, *Antitrust and Industrial Policy in Japan: Competition and Cooperation*, in *LAW AND TRADE ISSUES OF THE JAPANESE ECONOMY* 64 (G. Saxonhouse & K. Yamamura ed. 1985).

15. NIHON BŌEKI SHINKŌKAI, *OPERATING A BUSINESS IN JAPAN* 11 (1974). This difficulty has an historical root. The tripartite system of distribution between wholesaler and retailer makes foreign products prohibitively expensive for the general consumers, thereby comprising another obstacle for the foreign investor. See also, Henderson, *supra* note 6, at 145.

16. See ABEGGLEN, *supra* note 11; Henderson, *supra* note 6, at 145.

17. Schoenberger, *For Japan, Gilded Age of Riches*, L.A. Times, Jan. 30, 1989, § 1, at 1, col. 1; Hiltzik, *Japanese Feel the Squeeze as Land Prices Skyrocket*, L.A. Times, Feb. 7, 1988, § 1, at 1, col. 5.

18. *1988 Tokyo Office Space Conditions*, 15 FOCUS JAPAN 2-3 (July, 1988). Even before

and 57²⁰ of the Japanese Commercial Code prohibit foreign corporations from merging with Japanese corporations, a foreign investor may be required to acquire an entire company as an alternate form of corporate consolidation. The remaining option for the United States investors is to set up a Japanese subsidiary. Hence, if investors successfully acquire an existing business in Japan, they will be able to bypass many of the initial hurdles involved in establishing a business.

Further, acquiring an existing Japanese business is attractive because Japanese corporate stock is generally undervalued with respect to the true worth of the corporate assets.²¹ A substantial portion of many Japanese companies' assets are invested in real estate. When the value of a corporation's shares is undervalued, that corporation makes an attractive acquisition target because investors can acquire more shares for their money. While this undervaluation has been rectified to some extent in recent years, stocks still do not reflect their fair market value.

III. LEGAL ASPECTS OF TENDER OFFERS IN JAPAN

When foreign investors seek to execute a tender offer in Japan, they must first overcome legal obstacles established by the Foreign Exchange and Foreign Trade Control Law ("FECL") and the Japanese Securities and Exchange Law ("Japanese SEL"). The Japanese SEL applies equally to Japanese investors and foreign investors. But a potential foreign tender offeror must also satisfy the requirements of the FECL. As will be seen, the FECL imposes the most significant barrier to potential foreign investors in Japan.

A. *The Foreign Exchange and Foreign Trade Control Law*

1. Direct Domestic Investments²²

The FECL governs acquisitions and takeovers by foreign interests in Japan. In 1979, the FECL was substantially amended²³ such

the current surge in land prices, prime office locations were expensive and scarce. NIHON BŌEKI SHINKŌKAI, OPERATING A BUSINESS IN JAPAN 20 (1974).

19. SHŌHŌ, § 56.

20. SHŌHŌ, § 57.

21. CORPORATE MERGERS AND ACQUISITIONS, *supra* note 4, at 27.

22. GAIKOKU KAWASE OYOBI GAIKOKU BŌEKI KANRI-HŌ (Foreign Exchange and Foreign Trade Control Law), Law No. 228 of 1949 [hereinafter Old FECL], ch. 5.

23. The bill for the "Law concerning partial amendment of the Foreign Exchange and Foreign Trade Control Law" was presented to the Diet and passed on December 11, 1979. LEGAL DIVISION, INTERNATIONAL FINANCE BUREAU, MINISTRY OF FINANCE, COMMEN-

that the Law Concerning Foreign Investment²⁴ was abrogated and absorbed into the FECL.²⁵ The original principle behind the FECL had been to prohibit all external transactions and to relax earlier prohibitions emanating from cabinet orders and ministerial ordinances.²⁶ Although there had been a substantial liberalization through the amendment of cabinet orders and ministerial ordinances for the FECL, it was not until the amendment of the FECL that the approval system was transformed into one based on the principle of freedom of external transactions.²⁷ Under this principle, all external transactions are permitted unless there is a specific obligation to obtain a license or secure approval.²⁸

The current chapter 5²⁹ governs the area of direct domestic investments which includes acquisitions by foreign interests. The FECL charges that when a "foreign investor" engages in a direct domestic investment, a notice of direct domestic investment³⁰ must be filed with the Minister of Finance, the Minister of International Trade and Industry,³¹ and the minister(s) in charge of the business con-

TARY ON THE AMENDMENT OF THE FOREIGN EXCHANGE AND FOREIGN TRADE CONTROL LAW, 1 (1980) [hereinafter COMMENTARY] It is the broadest amendment in the FECL's thirty year history. *Id.*, at 2.

24. Law No. 163 of 1950.

25. COMMENTARY, *supra* note 23, at 1.

26. Hasegawa, *Shōken Shijō Kokusaika eno Taiō: Tokuni Hakkōshijō no Seidoteki Kōchokuka Dakaiwo (Facing the Internationalization of the Security Market: Especially the Relaxation in Systematic Rigidity of Over-the-Counter Sales)*, 894 COM. L. REV. 41 (1981); Crampe & Benes, *Majority Ownership Strategies For Japan*, 1 UCLA PAC. BASIN L.J. 41, 43 (1982); Smith, *The Japanese Foreign Exchange and Foreign Trade Control Law and Administrative Guidance: The Labyrinth and the Castle*, 16 LAW & POL'Y INT'L BUS. 417, 421 (1984). However, the exceptions are forestry, fishery, mining, oil, and leather industries (wholesale and retailing). *Katakura Kōgyō no Shin-gaitame Hō ni Yoru Kokuji Shobun Torikeshi Seikyū Jiken no Sojō*, 899 COM. L. REV. 30, 32 (1981).

27. Hasegawa, *supra* note 26, at 41; Crampe & Benes, *supra* note 26, at 43; Reynolds, *Foreign Investment in Japan: The Legal and Social Climate*, 18 TEXAS INT'L L.J. 175, 195 (1983). "This contrasts sharply with previous statutory schemes that forbade all capital transactions unless permitted by administrative validation after a case-by-case [*kobetsu shinsa*] review." *Id.*; Old FECL, *supra* note 22, arts. 1, 2 (stipulating that when the competent ministry, upon case-by-case evaluation, believed the transaction would positively contribute to the Japanese economy, it granted validation), *cited in* Smith, *supra* note 26, at 423; Reynolds, *supra* at 421 & n.11.

28. *See infra*. text accompanying notes 65-67.

29. FECL, ch. 5. "Direct Domestic Investments, etc" chapter replaced former corresponding provisions in the Foreign Investment Law. GAISHINI KANSURU HÖRITSU (Foreign Investment Law) Law No. 163 of 1950; COMMENTARY, *supra* note 23, at 9.

30. FECL, ch. 5, art. 26.

31. COMMENTARY, *supra* note 23, at 29.

cerned.³² The notice must disclose the purpose of the business, the amount involved, and the time of execution.³³ A foreign investor as defined in chapter 5 is:

- (1) a non-resident natural person;³⁴
- (2) a juridical³⁵ person or other organization established under foreign law³⁶ or one that has its principal office of business in a foreign country;³⁷
- (3) a company in which a foreign investor defined in (1) or (2) above directly or indirectly possesses a number of shares equal to or greater than 50% of that company's total issued shares;³⁸
- (4) a company in which a foreign investor defined in (1) or (2) above directly or indirectly possesses a number of shares equal to or greater than 50% of the total capital contribution made to that company;³⁹
- (5) a juridical⁴⁰ person or another organization in which a majority of directors or officers having the power of representation are non-resident natural persons;⁴¹ or
- (6) any person, not mentioned in (1)-(5) above, who transacts a direct domestic investment on behalf of a foreign investor, but does not do so in the latter's name.⁴²

As defined in chapter 5, the relevant form of direct domestic investments are:

32. FECL, ch. 5, art. 26, para. 3 (translated in *DOING BUSINESS IN JAPAN*, 19 (Z. Kitagawa ed. 1986)); Crampe & Benes, *supra* note 26, at 43.

33. FECL, ch. 5, art. 26, para. 3 (translated in *DOING BUSINESS IN JAPAN*, app. 3C-19 (Z. Kitagawa ed. 1987)).

34. FECL, ch. 5, art. 26, para. 1 (translated in *DOING BUSINESS IN JAPAN*, app. 3C-17 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 43.

35. Juridical means "relating to admission of justice, or office of a judge." *BLACK'S LAW DICTIONARY* 765 (5th ed. 1979).

36. Branches of foreign juridical persons located in Japan are construed to be foreign investors within the meaning of this subsection. *COMMENTARY*, *supra* note 23, at 30.

37. FECL, ch. 5, art. 26, para. 1(2) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-17 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 43-44.

38. FECL, ch. 5, art. 26, para. 1(3) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-17 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 44 & n.8.

39. FECL, ch. 5, art. 26, para. 1(3) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-17 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 44 & n.8.

40. *See supra* note 35.

41. FECL, ch. 5, art. 26, para. 1(4) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-17 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 44.

42. FECL, ch. 5, art. 26, para. 5 (translated in *DOING BUSINESS IN JAPAN*, app. 3C-19 (Z. Kitagawa ed. 1987)). But the provision specifically exempts from the category of direct domestic investments, securities house stock transactions for portfolio purposes. *See supra* text accompanying note 33.

- (1) with respect to the shares of an unlisted company,⁴³ acquisition⁴⁴ or transfer⁴⁵ of shares or contribution shares, and
- (2) with respect to listed corporations, acquisition of aggregate total shares equal to or greater than 10% of total outstanding shares when counted together with shares already held by a juridical person.⁴⁶

When a resident buys shares, subsequently becomes a non-resident and then transfers his/her shares to a foreign investor, the chapter does not apply.⁴⁷ Further, there is no requirement of filing a notice with the ministries where routine share purchases through designated securities firms are involved,⁴⁸ or when the acquisition of a listed company's shares amounts to less than 10% of the outstanding shares.⁴⁹

2. The Waiting Period and Ministerial Inquiries

A foreign investor who has given notice of a pending acquisition is not permitted to proceed with the transaction until thirty days after the ministers receive the notice.⁵⁰ This period may be shortened, and most transactions are generally carried out before the thirty day period has elapsed.⁵¹ Hence, it is theoretically possible for foreign purchasers to initiate tender offers as quickly as their domestic counterparts. Domestic counterparts in Japan are required to file a notice only ten days prior to the intended starting date for tender offers.⁵² In fact, during the first tender offer in Japan in 1972, a United States investor, Bendix Corporation, was allowed to initiate the tender offer on the tenth working day from the date it gave notice to the

43. Listed companies are defined in Japanese SEL, art. 2, para. 11.

44. FECL, ch. 5, art. 26, para. 2(1) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-17 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 44.

45. FECL, ch. 5, art. 26, para. 2(2) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-17-18 (Z. Kitagawa ed. 1987)).

46. FECL, ch. 5, art. 26, para. 2(3) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-17 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 44 & n.10.

47. FECL, ch. 5, art. 26, para. 2(2) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-17-18 (Z. Kitagawa ed. 1987)).

48. Henderson, *supra* note 6, at 140. Japanese SEL, No. 25, 1948 art. 2, 9 and Foreign Securities Firm Act, art. 2, item 2, Law No. 5, 1971. But this is not really an exemption, because the designated securities firms are required to report their transactions through the Bank of Japan. K. TSUNEMATSU, S. YANESE, M. YASUDA & T. TAKUOKA, *INTERNATIONAL SECURITIES REGULATION*, Booklet 1, (1986) [hereinafter *TSUNEMATSU & YANESE*].

49. *Id.* at 18; Crampe & Benes, *supra* note 26, at 44 & n.10.

50. *COMMENTARY*, *supra* note 23, at 34.

51. *Id.*

52. Japanese SEL, art. 2.

ministries of the intent to make a tender offer.⁵³

Additionally, according to article 27, chapter 5 of the FECL, if the ministers "deem it necessary to make an inquiry," the execution of the direct domestic investment will be suspended for up to four months from the receipt of the report.⁵⁴ Further, this suspension may be extended an additional month, to a total of five months from the receipt of the report, in order to allow the Committee on Foreign Exchange and other Transactions⁵⁵ to express an opinion.⁵⁶

Such extensions may lead to a recommendation by the ministers to "alter the particulars" of the direct domestic investment.⁵⁷ Further, a directive to suspend the execution of the direct domestic investment may be given in certain circumstances as explained below.⁵⁸ Where the ministers recommend to "alter the particulars," the investors must decide whether or not to consent to the recommendation.⁵⁹ However, what constitutes an alteration of particulars is unclear. Moreover, while this quasi-regulatory guidance by the ministries is called "administrative guidance,"⁶⁰ it is an unfortunate label because the plain meaning of "guidance" implies an option to reject a recommendation. Investors, however, have no choice but to accept administrative guidance.

According to article 27, once parties are notified of the recommendation and they fail to give notice of their consent or lack of con-

53. Matsuzawa, *Kabushiki no Kōkai Kaitsuke Daiichigō wo oete (Having Completed the First Public Tender Offer)*, 595 COM. L. REV. 17 (1971).

54. FECL, ch. 5, art. 27, para. 1, (translated in *DOING BUSINESS IN JAPAN*, app. 3C-20 (Z. Kitagawa ed. 1987)).

55. The Committee on Foreign Exchange and other Transactions was established in place of Foreign Investment Council which was set up under the now-abrogated Foreign Investment Law. COMMENTARY, *supra* note 23, at 51. The Committee was established for the purpose of "investigating and studying important matters concerning direct domestic investments, etc. . . ." *Id.* What "important matters" are to be studied is not entirely clear. Lack of case law aggravates the difficulty of construing the extent of the Committee's authority or power. However, the fact that the Committee is an auxiliary organ of the Ministry of Finance may signify that it is not entirely independent of the Ministry. Hence, the Committee is subject to the Ministry's opinion. Further, the Committee members are scholars appointed by the Minister of Finance. FECL, ch. 6-2, art. 55-3, para. 2.

56. FECL, ch. 5, art. 27, para. 2-3 (translated in *DOING BUSINESS IN JAPAN*, app. 3C-21 (Z. Kitagawa ed. 1987)).

57. FECL, ch. 5, art. 27, para. 2 (translated in *DOING BUSINESS IN JAPAN*, app. 3C-21 (Z. Kitagawa ed. 1987)).

58. COMMENTARY, *supra* note 23, at 34.

59. FECL, ch. 5, art. 27, para. 4 (translated in *DOING BUSINESS IN JAPAN*, app. 3C-21 (Z. Kitagawa ed. 1987)).

60. For an inside account of administrative guidance, see generally Smith, *supra* note 26.

sent to alterations, the ministers may order an alteration of the particulars of the investment or a suspension of the execution.⁶¹ Due to the lack of case law, it is unknown exactly how broad the ministers are willing to interpret the meaning of "alter the particulars." However, if the ministers have the power to order a suspension of the execution of tender offers, their power to vary the terms of the offers is inclusive. Also, the repercussions of rejecting the recommendation may be serious because the ministries may not take kindly to such a defiant stance from the foreign sector.

Two circumstances warranting ministerial inquiries are of interest here.⁶² The relevant provisions to which the ministerial inquiries apply are as follows:

- (1) When [the acquisition] might imperil the *national security*, hinder the maintenance of *public order*, or hinder the protection of *the safety of the general public*;⁶³
- (2) [the acquisition] might have a serious bad effect on the activities of business enterprises in Japan engaging in a line of business similar (including business related) to the one in which the direct domestic investment, etc., is to be made or the *smooth operation of Japan's economy*;⁶⁴

61. FECL, ch. 5, art. 27, para. 7 (translated in *DOING BUSINESS IN JAPAN*, app. 3C-22 (Z. Kitagawa ed. 1987)). Cf. Matsushita, *supra* note 13, at 376, which gives an official definition of administrative guidance. See generally, Smith, *supra* note 26.

62. Other instances requiring notice to the ministries, but not relevant for discussion here are: where the ministers deem the use of the fund to require alteration of the particulars, such as requiring investors to obtain a permit or cessation of execution all together. The ministers may find that the necessity arose where the transaction (a) might make the maintenance of the equilibrium of Japan's balance of international payments difficult; (b) might result in a sudden and severe fluctuation in [the value of the Japanese yen]; or (c) might result in transfers of large amounts of funds between Japan and foreign countries and thereby have a bad effect on [Japanese yen] or capital market. FECL, ch. 4, art. 21, para. 2 (translated in *DOING BUSINESS IN JAPAN*, app. 3C-10 (Z. Kitagawa ed. 1987)).

63. FECL, ch. 5, art. 27, para. 1(1), (translated in *DOING BUSINESS IN JAPAN*, app. 3C-20 (Z. Kitagawa ed. 1987)) (emphasis added); see also Crampe & Benes, *supra* note 26, at 46.

64. FECL, ch. 5, art. 27, para. 1(2) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-20 (Z. Kitagawa ed. 1987)) (emphasis added); Crampe & Benes, *supra* note 25, at 46. Additional prerequisites to the recommendation or directive are:

- 3) Where, because it is made by a foreign investor with whose country no treaties or other international agreements have been concluded by Japan with regard to the direct domestic investments, etc., its particulars must be altered, or its execution must be stopped, in order to make conditions substantially equal to those allowed to Japanese nationals' direct investment activities (which mean those equivalent to direct domestic investment, etc., mentioned in any item of paragraph 2 of the proceeding article) in that country; or
- 4) When, in light of its purpose regarding the use of funds, etc., it falls under, in whole or in part, capital transactions upon which an obligation to obtain a permit

For reference purposes, the first clause above will be called the *national security clause*, while the second will be called the *economic protection clause*.

The *national security clause* presupposes protection for industries in which liberalization is not required by the Organization for Economic Cooperation and Development's ("OECD")⁶⁵ Code of liberalization of capital movements such as "weapon, explosives, nuclear power, and special vaccine" industries.⁶⁶ The *economic protection clause* was designed to protect industries such as "agriculture and fishery, mining, oil, leather and leather products manufacturing"⁶⁷ as they were still not liberalized at the time of 1979 amendment of the FECL. The second provision is especially important because a Cabinet Order referring to this clause allows the government to designate industries which the government deems should be free of takeover threats.⁶⁸ The case of *Newpis v. Katakura*⁶⁹ illustrates an instance in which the government exercised the power of designation.

B. Analysis of the Foreign Exchange and Foreign Trade Control Law

The FECL sets forth its statutory purpose as follows:

The purpose of this Act shall be, on the basis of freedom of . . . foreign transactions, and by exercising necessary but *minimum controls or adjustments*, to enable proper expansion of our foreign transactions, and thereby to facilitate the equilibrium of our balance of international payments and the stability of our currency, as well as to contribute towards the sound development of our national economy.⁷⁰

Despite this preamble, evidence of protectionism is rampant in the

is imposed pursuant to the provisions of Article 21, paragraph 2, and therefore its particulars must be altered, or its execution must be stopped.

FECL, ch. 5, art. 27, para. 1(2)-(4) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-20.

65. Organization for Economic Cooperation and Development).

66. COMMENTARY, *supra* note 23, at 36; Direct Investment Ordinance Article 5, para. 2(1)-(2), and Notification (kokuji) No. 1 of June 20, 1985, *cited in* International Securities Regulation, *supra* note 48, at 102-103.

67. COMMENTARY, *supra* note 23, at 36.

68. FECL, ch. 5, art. 27, para. 2, (translated in *DOING BUSINESS IN JAPAN*, app. 3C-20 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 46.

69. For a discussion of *Newpis v. Katakura*, Case No. 20 of 1981, Tokyo District Court, 2nd Civil Affair Division, see *infra* text accompanying notes 87-102.

70. GAIKOKU KAWASE OYOBI GAIKOKU BŌEKI KANRI-HŌ (Foreign Exchange and Foreign Trade Control Law), Law No. 65, 1979, ch. 1, art. 1 (translated in *DOING BUSINESS IN JAPAN*, app. 3c-16 (Z. Kitagawa ed. 1987)) (emphasis added).

FECL. First, in the direct domestic investment provisions of the FECL, there is evidence of an intent to discourage foreign takeovers in Japan.⁷¹ Second, the vague language of the provision facilitates and promotes a manipulative application. For example, the Ministry of Finance conceded that certain regulatory measures are to be imposed under the provisions of the FECL where any external transaction "causes a friction at home or abroad."⁷² The probable nature of friction that is likely to arise in Japan and outside of Japan are different from each other. However, what kind of situations warrant the regulatory measures to be triggered? Likewise, what constitutes "causing friction?" It seems that the Japanese government has discretion when determining what situations are deemed to be causing friction. The restriction under the article that such measures should be limited to "necessary but minimum control or adjustment" is an illusory restriction when the Japanese government has so much discretion.

The new FECL has not changed the substantive restriction which pervaded the original FECL. The recommendation issued by the advisory Committee on Legal System of Foreign Exchange and Foreign Trade⁷³ sheds some light on the process by which the new FECL retained the old restrictive nature. The Advisory Committee report was adopted as the basis of the amendment and reads as follows:

- (1) External transactions should be liberalized as far as possible, and the restrictions imposed thereupon should be limited to those of absolute necessity.
- (2) Nonetheless, under the current international economic situation of rapid changes, in order to allow our national economy to cope with such changes timely and properly, a mechanism should be retained which can exert a quick and effective control in such events as turbulent foreign exchange rate fluctuations and other anomalies.
- (3) Current transactions are to be liberalized almost fully, except in such sensitive areas as resources, energy, etc. Administrative formalities concerning foreign trade, such as export certification, etc., should be extensively simplified, and at the same time the current control over the methods of payments should also be rearranged towards liberalization.
- (4) The basic system of freedom in principle with restriction only

71. COMMENTARY, *supra* note 23, at 38.

72. COMMENTARY, *supra* note 23, at 9.

73. COMMENTARY, *supra* note 23, at 6.

in cases of emergency should also be applied to capital transactions. The impossible restrictions might include not only quantitative ones to cope with the speculative movement of funds in large sum[s] and for the maintenance of equilibrium of the balance of international payments, but also qualitative ones to cope with the extraordinary and abnormal dealings which adversely affect domestic and foreign money markets.

- (5) With a view to ensuring effective activation of emergency regulations as given in (2) above, as well as gathering constant information of external transactions, the current system of authorized foreign exchange banks should be retained.
- (6) Intake of foreign capital and foreign technology should also be liberalized in principal, but a mechanism should be retained in order to cope with exceptional cases which might adversely affect our national economy.⁷⁴

Despite the claim that "external transactions should be liberalized as far as possible," each recommendation of liberalization is always coupled with some exceptional cases warranting a restriction. According to the recommendation to the Advisory Committee, the principle of freedom should be conditioned upon a restriction. The ambivalence toward a total liberalization conveyed in the Advisory Committee report was transferred straight into the amendment. The report, as well as the amendment, takes away with its left hand what it gives with its right. The direct domestic investment provisions warranting ministerial inquiries are illustrative.

At the time of the 1979 amendment to the FECL, the ministries clearly contemplated that the regulation would serve as a preventive measure against foreign takeovers. This position was explicated in an official commentary published by the legal division of the Ministry of Finance.⁷⁵ By a cabinet order,⁷⁶ the Japanese government retained the power to regulate stockholding of 25% or more held by "non-resident natural persons"⁷⁷ in certain designated companies. When such an acquisition is intended, the potential purchaser must give prior notice and may not acquire the stock for thirty days.

The subsequent procedures after the thirty day period are similar to those of direct domestic investments. For example, the ministries

74. COMMENTARY, *supra* note 23, at 5-6.

75. *Id.*

76. FECL, Cabinet Order of 1980; COMMENTARY, *supra* note 23, at 39.

77. "Non-resident natural person" includes non-resident natural persons, juridical persons or organizations established under foreign legislation, and/or juridical persons or organizations having main offices in a foreign country. COMMENTARY, *supra* note 23, at 39.

may extend the waiting period to a maximum of four months if the Ministries perceive a potential threat to national security, economy, or to any industry.⁷⁸

The direct domestic investment provisions governing investments which involve complex shareholding patterns appear to indicate that the Japanese government intends to exert a maximum control over foreign investments. Before certain types of transactions are carried out, the Japanese government must be notified of the investor's intentions and allowed to investigate the impact of the proposed investment. For example, in a transaction between two juridical persons who occupy a "special relationship"⁷⁹ results in a holding of 10% or more of the total outstanding stock of the listed corporation, the transaction must be reported to the Japanese government. As an illustration, let us designate the purchaser as *A*, the juridical person or organization holding shares or interest in the listed company in question as *B*, the second juridical person or organization as *C*, and the third juridical person or organization as *D*. For a special relationship to exist, the relationship between the purchaser, *A*, and the target, *B*, must be such that:

- (a) the purchaser, *A*, owns 50% or more stock or interest in the juridical person, *B*;
- (b) *B* owns 50% or more stock or interest in *A*;
- (c) *A* owns 50% or more interest in *C* which, in turn, owns 50% or more interest in *B*;
- (d) reciprocally, *B* owns 50% or more interest in *C* which, in turn owns 50% or more interest in *A*;
- (e) *C* owns 50% or more interest in *A* and *B*;
- (f) *C* wholly owns *B*, and 50% or more of *D* which owns 50% or more of *A*;
- (g) *D* owns 50% or more interest in *A* and *C*, and *C* wholly owns *B*; or
- (h) *A* and *B* are foreign government agencies.⁸⁰

The foreign investment regulation according to shareholding pattern is quite extensive and thorough. The scheme of the regulation shows that the Japanese government has a deep-rooted desire to keep a close

78. COMMENTARY, *supra* note 23, at 40.

79. The "special relationship" is defined extensively in a Direct Investment Cabinet Order. *Tainai Chokusetsu Tōshinado ni Kansuru Seirei* (Cabinet Order Concerning Direct Domestic Investment) (translation by Crampe & Benes) art. 2(4)-(5), *cited in* Crampe & Benes, *supra* note 26, at 44 nn.8 & 10.

80. *Id.*

check on foreign holding of interests in existing Japanese corporations.⁸¹

1. Ministerial Inquiries

An example of a ministerial inquiry can be seen in a recent case involving a United States-United Kingdom joint venture, Trafalger-Glen Investment Inc., and a Japanese precision ball bearing manufacturer, Minebea.⁸² The joint venture attempted a hostile takeover of Minebea after acquiring a considerable quantity of convertible bonds overseas. Trafalger-Glen was uncertain if Minebea and the Ministries would block the tender offer on the ground that Minebea's articles of incorporation contain a clause enumerating the capacity to engage in "manufacturing and sales of aircraft or flying objects." The *national security clause*⁸³ allows a ministerial inquiry to interrupt the tender offer when the Ministries deem the transaction poses a danger to national security.⁸⁴ This was a major concern for the purchaser who later initiated a rescission suit against Minebea who started negotiating an acquisition of Sankyō Corporation, a Japanese music box manufacturer.⁸⁵

Due to the absence of case law defining the scope of the *national*

81. For example, outside the direct domestic investment area, the FECL exempts routine share purchases through designated securities firms from notification requirements but actual notice is done by the securities firms. TSUNEMATSU & YANESE, *supra* note 48, at 12. See generally, Henderson, *supra* note 6.

82. Ames, *Buying a piece of Japan, Inc.: Foreign Acquisitions in Japan*, 27 HARV. INT'L L.J. 541, 553-54 (1986); Crabb, *supra* note 7, at 106.

83. See *supra* text accompanying note 63.

84. FECL, ch. 5.

85. Ames, *supra* note 79, at 553-54. Minebea had been acquiring Sankyō shares but had not disclosed its intention to acquire to the Sankyō management.

In February, 1986, upon learning of Minebea's plan to takeover Sankyō, Trafalger-Glen brought a suit in *Ueda Shibu, Nagano Chihō Saibansho* (district court) seeking to block the merger of Minebea and Sankyō and the issuance of new stocks. M. MIYAZAKI, M&A NO KENKYŪ (MERGERS AND ACQUISITIONS RESEARCH), 82 (1986). *Chihō Saibansho* is a court of first instance for civil and criminal cases and hears appeals from Summary Court (*Kōtō Saibansho*, or *Kōsai*). Trafalger-Glen claimed that Minebea's intention to acquire Sankyō was not in the best interest of the shareholders such as Trafalger-Glen, and therefore the merger between Minebea and Sankyō should be annulled. *Id.*

However, it is doubtful that the annulment of the merger between the two Japanese corporations was Trafalger-Glen's true motive in bringing the suit. First, Trafalger-Glen brought the suit knowing that their chances of winning were slim. *Id.* at 86. The *Saikō Saibansho* (Supreme Court) had previously held that invidious intentions or motives have no effect on the validity of decisions in a shareholder meeting. *Nagano Chihōsai Ueda Shibu Minebea gawa no Tanpo Teikyō Seikyū Mitomeru Kettei gaku wa Gōkei ¥15 million (Ueda Shibu, Nayano District Court Endorses Minebea's demand for Bond; The Amount is ¥15 Million)*, 1075 COM. L.

security clause in the FECL, Trafalger-Glen had no recourse but to proceed blindly with the acquisition while fearing that the ministries might invoke the clause against them. In the worst case, Trafalger-Glen would have had to wait for five months before it could proceed with the tender offer. This is an extremely long waiting period because five months allow ample time for the target company to prepare its defense to the unwanted acquisition attempt.

The FECL clauses which allow ministerial inquiries permit the ministries to tailor the direct domestic investment pattern as desired. The articles of the FECL are worded in vague terms so that potential investors, as well as legal scholars,⁸⁶ have trouble finding meaningful guidelines as to when a provision of the FECL is triggered. Two key factors keep the whims of the ministers in check: international criticism of Japanese "protectionism" and the mounting pressure caused

REV. 733, 734 (1986) (*Saikō Saibansho* is a regional court of appeal for appeals from District, Family and Summary Courts.)

Trafalger-Glen also waited for four months before they decided to bring suit. *Id.* In October, 1985, Minebea announced the plan to acquire Sankyō and their acquisition was to take place in April, 1986. *Id.* Trafalger-Glen claimed that they owned Minebea shares at the time of announcement, and was qualified to bring the suit. *Id.* The court held that because of the unexplained delay in filing the suit and the fact that their claim was legally unfounded, the plaintiffs had other motives in mind: namely, the suit was to serve as a threat to the defendant, Minebea. *Id.* Further, the court found that Trafalger-Glen was hoping for the shares to go up in value so that they could sell them at a higher price. *Id.* Trafalger-Glen filed the suit knowing that the suit would cause various damages to Minebea. The court ordered them to pay the bond required of foreign plaintiffs in the amount of fifteen million yen to be paid in ten days. *Id.* at 735.

The press also reported that the takeover was an attempt at "crass greenmail," and Trafalger-Glen was just testing the waters in the Japanese market. M. MIYAZAKI, *supra*, at 65. The speculation has been that Trafalger-Glen was feeling out the possibility of tender offers in Japan. *Id.* One of the notable characteristics of this takeover attempt was that Minebea is the merger and acquisition growth firm of Japan. Minebea grew ten times in ten years at the annual growth rate of 25% by merging and acquiring related and unrelated companies. T. ABE, JISSEN KIGYŌ BAISHŪ (CORPORATE ACQUISITION PRACTICE), 39. By 1971, Minebea already had a marketing base in the United States. Muramatsu, *Beikoku ni Okeru Wagakuni Kigyō no Gappai, Baishu Kōdō no Shintenkai (New Development in Merger/Acquisition activities of Japanese corporations in the United States)*, KINYU J. 14 (Oct. 1985). But in September of 1971, Minebea bought a ball bearing manufacturing factory owned by a Swedish corporation that has the biggest ball bearing market share in the world. *Id.* Minebea paid cash for the factory. *Id.* Trafalger-Glen was in fact sparring with a corporation quite experienced in mergers and acquisitions both in Japan and in the United States. Starting in 1971, when it bought an United States ball bearing manufacturer, SKF Reed Factory, Minebea has taken over twenty-two companies. T. ABE, *supra*, at 41, table 4.

86. For example, see Crampe & Benes, *supra* note 26, at 50. Misawa, *supra* note 1, at 793 (expressed fear that "all foreign investments which would be construed as being unfavorable to the Japanese side would be eliminated in the screening process.")

by the huge trade surpluses Japan has against the United States and other nations.

2. The *Newpis* case: abuse of government power

In *Newpis v. Katakura*,⁸⁷ the controversy arose between Katakura Industries, Ltd., and a group of Hong Kong investors who were heavily involved in real estate and leasing operations.⁸⁸ Katakura was one of the firms to be designated by the government as requiring an inquiry before the enforcement of the FECL.⁸⁹ At that time, the Hong Kong group in Katakura held about 23.5% of issued stock.⁹⁰ The government had prescribed 25% as the level of foreign holdings that would trigger an inquiry. The 25% designation was criticized not only by Wang and his associates—the Hong Kong investors involved in the case—but also by the Japanese public.⁹¹ While all the other designated companies are involved in industries that arguably should or can be protected—oil, nuclear power, aircraft instruments, narcotics and vaccines, and agriculture-fisheries—Katakura is a textiles company.⁹²

After the designation, the government attempted to legitimize the action by arguing that Katakura's business activities fell into the protected category of "agriculture" because it held a 10% share of the raw silk processing market and a 13% share in the "traditional" silk-worm market.⁹³ This argument, unfortunately, was undermined by the fact that only about 2% of Katakura's sales were comprised of the traditional silkworm business and 46% of the raw silk process market.⁹⁴

In 1981, *Newpis* announced that they were filing with the Minister of Finance a plan to purchase nearly 10% of Katakura's shares on the open market.⁹⁵ Fearing the takeover by the Hong Kong group, Katakura's top management pressured the government.⁹⁶ Katakura's

87. Case No. 20 of 1981, Tokyo District Court, 2nd Civil Affair Division.

88. Crampe & Benes, *supra* note 25, at 54.

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. Nikkei Shinbun, Feb. 24, 1981, at 3, *cited in* Crampe & Benes, *supra* note 26, at 54, n.66.

94. Crampe & Benes, *supra* note 26, at 54-55.

95. *Id.* at 56.

96. *Id.* at 55.

designation was a product of considerable lobbying.⁹⁷ And, the government refused to accept Newpis' notification on a technical ground.

Newpis subsequently instigated the suit against the Ministers of Finance, International Trade and Industry, Welfare, and Agriculture, attacking the government's designation of Katakura and seeking its annulment.⁹⁸ The government was reported to be more cautious after the *Newpis* case. However, the FECL's susceptibility to government manipulation was apparent.⁹⁹

Prior amendments and changes in the FECL have indeed liberalized the market in a gradual manner. The most recent amendment in the five stage liberalization program, the 1979 amendment to the FECL, changed the general statutory philosophy: foreign investments are "permitted unless specifically prohibited."¹⁰⁰ Formally, foreign investments were "prohibited unless allowed specifically."¹⁰¹ And, there is no doubt that the Japanese government would rather keep the market closed as much as possible. Although the Japanese government has always publicized that extensive liberalization is being undertaken and has exhibited sensitivity to external criticism, it has managed to keep the extent of liberalization to a minimum.¹⁰²

3. The Future Direction of the FECL

What are some of the possible solutions to limit arbitrary government actions? One possible way to restrict expansive reading of the statute by the government is to repeal all the provisions warranting ministerial inquiries. However, a complete repeal of the restriction may be too drastic and dangerous to national security and economic stability of Japan. For example, if the *national security clause*¹⁰³ is

97. *Id.*

98. Case No. 20 of 1981, Tokyo District Court, 2nd Civil Affairs Division.

99. Crampe & Benes, *supra* note 26, at 58.

100. COMMENTARY, *supra* note 23, at 2-3.

101. *Id.*

102. Henderson, *supra* note 6, at 136.

The 1980 Amendment to the FECL was the first major statutory revision since its enactment in 1949. Through the years, administrative practices under the statute changed gradually to approve routine transactions. These administrative changes are what has been called liberalization in the press during the past twenty years. Basically, the restrictive statutory framework remained: all transactions with foreign investors and nonresidents are prohibited, until approved by the government.

Henderson also notes that the gap between these announcements and the actual official practices has damaged the credibility of the Japanese bureaucrats. *Id.*

103. When the acquisition might "imperil the national security, hinder the maintenance of public order, or hinder the protection or the safety of the general public." FECL, ch. 5, art.

repealed, a serious repercussion is clearly foreseen. One example of the type of incident that might occur happened to Toshiba. In the Toshiba incident, the sale of the military sensitive products was consummated in the United States and the final destination was the Soviet Union. The fact that the United States is Japan's ally does not prevent the risk of repeating a Toshiba incident since an incident similar to Toshiba selling military sensitive products to the Soviets may result from abolishing the *national security clause*.

Further, a blanket repeal of the *national security clause* does not preclude manipulation by lobbyists. The following United States example demonstrates how easily national security can be manipulated to block potential foreign takeovers. In 1971, Minebea acquired a New Hampshire ball bearing company.¹⁰⁴ Having decided to make an inroad into the United States market, Minebea set out to establish a United States subsidiary.¹⁰⁵ However, the Pentagon shut out foreign competitors in ball bearing manufacturing on the pretext that the national defense would be adversely affected.¹⁰⁶ As did the Japanese company in the *Newpis* case, United States ball bearing companies, under fierce competition from Japanese ball bearing manufacturers, lobbied the Pentagon to keep the Japanese out of the domestic market.¹⁰⁷ Their rationale was that foreign-made ball bearings would imperil the United States national security.¹⁰⁸

This provides insight into two propositions. First, lobbying is an extremely effective way to manipulate the government. Both the Jap-

27, para. 1(1) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-20 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 46.

104. The target was SKF Reed Factory. Since then, Minebea has taken over twenty-two companies. T. ABE, *supra* note 83, at 41, Table 4.

105. T. ABE, *supra* note 83, at 40.

106. Another instance of the United States government invoking the national defense argument to prevent a foreign acquisition is Fujitsu's attempt to acquire Fairchild. M. Gitin & R. Barker, *Structuring Transactional Acquisitions*, NAT'L L.J., May 18, 1987, at 21, col. 4 and at 27, col. 1, n.4. In that case, Fujitsu, Ltd., a Japanese conglomerate involved in manufacturing computer chips, attempted to acquire 80% interest in Fairchild Corporation, a United States computer chip maker. *Id.* at 21, col. 3-4. The Pentagon vigorously opposed the Fujitsu plan, and Fujitsu abandoned the idea of pursuing negotiations. *Id.* However, when the hoopla died down, Fujitsu negotiated a technology tie-up with Fairchild. *Id.* at 27, n.4. This time, Congress and the Pentagon did very little in the way of opposing the technological exchange. *Id.* The United States government, by failing to follow up on the case, undermined their initial position in opposing the acquisition. In that sense, the United States government is as guilty of manipulating its antimonopoly law as the Japanese government of protecting certain industries. *Id.*

107. T. ABE, *supra* note 85, at 40.

108. T. ABE, *supra* note 85, at 41 (1986).

anese government and the United States government owe a duty to construe their respective national safety provisions objectively so as not to abuse their respective powers. More importantly, however, in the United States example the Pentagon expended considerable energy looking into the matter. Yet, in the end, they declined to promulgate a blanket prohibition over foreign takeovers in ball bearing manufacturing. In contrast, the Japanese government, in the context of the *economic protection clause*, designated Katakura off-limits. While the Pentagon had a plausible argument that the Minebea's takeover posed a threat to national security, it declined to prohibit the takeover. The Japanese government exhibited its willingness to stretch the letter of the law to protect its national industries.

It is unwise to abrogate the entire provision in an extremely sensitive area such as national security. On the other hand, repealing a provision restricting a competitive foreign investment in a purely economic sense is less problematic. The *economic protection clause* provides that when an acquisition may "detrimentally affect the activities of business enterprises in a line of business similar or related to the one in which the direct domestic investment is to be made, or when the acquisition may adversely affect on the smooth operation of Japan's economy."¹⁰⁹

The *economic protection clause* bars from Japan foreign investments which adversely affect the Japanese economy. The clause designates "petroleum, agriculture and fishery, mining, leather and leather product manufacturing"¹¹⁰ as areas requiring ministerial inquiry. However, clean-slate liberalization of these industries is probably not forthcoming. Petroleum is an important resource to Japan, a country of scarce resources. The control over resources such as petroleum is in effect political control. Such a sensitive area is not likely to be liberalized unless substantial pressure is applied from outside.

The agriculture, fishery, mining and leather industries are also unlikely to be liberalized in the near future. The Japanese government considers these as declining industries.¹¹¹ Rather than revitalizing the industries with an infusion of foreign capital, the government has chosen to keep them closed to foreign investment. Furthermore, these protected industries are a major part of the con-

109. FECL, ch. 5, art. 27, para. 1(2) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-20 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 46.

110. COMMENTARY, *supra* note 23, at 36.

111. Smith, *supra* note 26, at 467.

stituency base of leading politicians in the ruling Liberal Democratic Party.¹¹² There is no reason why politicians should jeopardize their political base by subjecting their constituents to competition from abroad. Hence, these industries will remain closed to foreign investment.

An alternative to a total repeal of the *national security clause* and the *economic protection clause* is to redraft them narrowly. In their present state, the clauses are vague and overbroad. For instance, the *national security clause* grants protection if the acquisition might imperil the national security, hinder the maintenance of public order, or hinder the protection of the general public's safety.¹¹³ It is conceivable that these three matters are one and the same and in the tradition of legal draftsmanship are simply reiterated. However, what constitutes endangering the national security or hindering maintainance of public order and safety remains largely undefined.

In the *economic protection clause*,¹¹⁴ protection is granted where the acquisition might have a "serious bad effect" on the activities of business enterprises; but what is a "serious bad effect?" It is unknown how serious a "bad effect" has to be. What constitutes an interference with the "smooth operation of Japan's economy"¹¹⁵ is also ambiguous. There is very little guidance in applying the *national security clause* and *economic protection clause*, and a lack of judicial precedent interpreting the clauses aggravates the situation. However, the outrageous application of the *economic protection clause* in the *Newpis* case forces one to apply the clause conservatively.

The drafters may be better able to guide potential investors if the legislative purpose is made clear by listing the typical situations in which the ministry will apply the *economic protection clause* and the *national security clause*. Yet, Advisory report does not provide a typical situation which triggers protection of the FECL.¹¹⁶

C. The Japanese Securities and Exchange Law

It was not until 1971 that the Japanese Securities and Exchange Law ("Japanese SEL") was amended to provide a mechanism for a

112. *Id.*

113. FECL, ch. 5, art. 27, para. 1(1) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-20 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 46.

114. FECL, ch. 5, art. 27, para. 1(2) (translated in *DOING BUSINESS IN JAPAN*, app. 3C-20 (Z. Kitagawa ed. 1987)); Crampe & Benes, *supra* note 26, at 46.

115. *Id.*

116. See, COMMENTARY, *supra* note 23, at 6-7.

tender offer called an "open stock acquisition system."¹¹⁷ A concern which triggered the amendment was that foreign enterprises would take over businesses in Japan in the wake of capital liberation.¹¹⁸ This section discusses the background and the law of the Japanese SEL followed by the comparative study of the *Bendix* case which involves a foreign purchaser and the *Okinawa Power* case which involves a Japanese purchaser.

It must be conceded, that the current Japanese SEL does not treat foreign interests and Japanese investors differently. The language of the Japanese SEL does not differentiate between a foreign investor and a Japanese investor, nor does it have a facially neutral requirement which discriminates against a foreign investor. The case law below demonstrates that application of the Japanese SEL was uniform in a case involving a takeover by a foreign investor, *Bendix*,¹¹⁹ and another involving a takeover by a Japanese company, *Okinawa Electric Power Co.*¹²⁰

Before 1971, the Japanese Commercial Code categorized corporate consolidations into three classes:¹²¹ (1) mergers,¹²² (2) consolidations,¹²³ and (3) transfers of business or business assets.¹²⁴ As no tender offers were made before 1971, the Japanese Commercial Code did not specifically deal with tender offers.¹²⁵ Instead, the Japanese were heavily engaged in mergers¹²⁶ most of which took place among affiliated companies.¹²⁷

117. *Kōkai Kaitsuke* in Japanese. See Misawa, *supra* note 1, at 790.

118. LOSS, YAZAWA & BANOFF, JAPANESE SECURITIES REGULATION, 174 (1983); see also, Misawa, *supra* note 1, at 790.

119. See *infra* text accompanying notes 151-60.

120. See *infra* text accompanying notes 161-65.

121. TSUNEMATSU & YANESE, *supra* note 48, at 69.

122. A merger takes place when the surviving corporation takes over all of the assets and liabilities of the dissolving corporations. *Id.* Shareholders of the dissolved corporation become shareholders of the surviving corporation. *Id.*

123. Where a new corporation emerges as a result of the dissolution of two or more corporations, a consolidation occurs. *Id.* The liabilities and assets of the dissolved corporations become the responsibilities of the newly-emerged corporation. *Id.*

124. All of the business and business assets of a corporation may be transferred to another corporation irrespective of status of the first transferring corporation after the transfer. *Id.*

125. LOSS, *supra* note 118, at 172 & n.55.

126. S. Muramatsu, *The Effect of Corporate Mergers* 1 (1986) (unpublished manuscript).

127. Approximately 70% of the post-war period mergers were of this type. *Id.* But, note that this type of merger is not considered a merger as in the United States, and hence is excluded from statistics. *Id.* To illustrate the magnitude of this type of merger in Japan, dissolved corporations' assets were valued at ¥9.3 billion per merger in the period from 1980 to 1983. *Id.* See also, Misawa, *supra* note 1, at 791, 804, table 3 (pointing out that mergers often take place among "firms belonging to the same group," called *keiretsu* companies).

The current Japanese SEL defines a tender offer as an exchange or sale of share certificates (or other securities) either by a public offer to buy or a public solicitation to sell.¹²⁸ Tender offers may be classified as friendly,¹²⁹ hostile,¹³⁰ or neutral.¹³¹ A friendly tender offer occurs when the target corporation agrees to the acquisition plan and is cooperative toward the plan.¹³² For example, the 1972 case of Bendix acquiring a Japanese corporation, Jidosha Kiki, Co. (Jidosha Kiki), where the two corporations agreed to the tender offer of Jidosha Kiki's shares is a typical friendly tender offer.¹³³

If, on the other hand, the target corporation either rejects the purchaser's proposal of acquisition or is not informed about the plan at all, the tender offer is hostile.¹³⁴ An example of a hostile takeover is the attempt by Minebea, a Japanese ball bearing manufacturer, to acquire Sankyō Co., a Japanese music box manufacturer.¹³⁵ Before Sankyō had notice of the acquisition attempt, Minebea had acquired approximately three million shares of Sankyō stocks and about six million Sankyō convertible bonds¹³⁶ issued overseas. The third type of tender offer is a neutral tender offer and the target company is neither cooperative nor hostile toward the acquisition attempt.¹³⁷

The Japanese SEL requires the filing of a tender offer registration statement with the Minister of Finance before every tender offer.¹³⁸ The Japanese SEL includes an advance notice system which requires that the statement be filed ten days before the tender offer can be made.¹³⁹ Before the tender offer takes effect, ten days from the filing, the offeror must deliver a copy of the tender offer registration state-

128. Japanese SEL, art. 27-2, para. 1. Cf. LOSS, *supra* note 118 at 175. Tender offers include cash tender offers, exchange tender offers, and cash tender offer and convertible preferred stock mergers depending on the form of payments. CORPORATE MERGERS AND ACQUISITIONS, *supra* note 4, at 56. The Japanese SEL treats cash and exchange offers for outstanding securities in the same way. LOSS, *supra* note 118, at 175.

129. INTERNATIONAL MERGERS & ACQUISITIONS, *supra* note 12, at 175.

130. *Id.*

131. *Id.*

132. *Id.* For definition of friendly tender offers, see also Misawa, *supra* note 1, at 790.

133. See *infra* text accompanying notes 151-60.

134. INTERNATIONAL MERGERS & ACQUISITIONS, *supra* note 12, at 175. For definition of hostile tender offers, see Misawa, *supra* note 1, at 790.

135. M. MIYAZAKI, *supra* note 85, at 71-72.

136. M. MIYAZAKI, *supra* note 85, at 72. Convertible bonds may be converted to shares upon satisfaction of certain conditions. *Id.*

137. INTERNATIONAL MERGERS & ACQUISITIONS, *supra* note 12, at 175.

138. Japanese SEL, art. 27, § 2.

139. The advance notice system makes controlling the flow of information difficult. But, see LOSS, *supra* note 118, which opines that the effect of the advance notice system is pro-

ment (and the amendments, if any) to the issuer of the securities.¹⁴⁰ When the ten-day period is over, the offeror must give public notice of the tender offer in two daily newspapers of general circulation reporting general affairs.¹⁴¹ The content of this report must include the following matters:

- (1) period of purchase;
- (2) purchase price;
- (3) cancellation of contract;
- (4) delivery of share certificates, etc. and other settlements relating to the purchase;
- (5) necessary matters relating to the purchase other than those mentioned in the preceding items.¹⁴²

The minister may order the filing of an amendment if, after a hearing, he/she finds that the form of the registration statement is defective or that material items have not been sufficiently disclosed.¹⁴³ The minister may also issue a stop order if he/she finds that the registration statement violates the law or is materially misleading.¹⁴⁴ In addition, the minister has the power to inspect the files and documents of the tender offeror or its affiliates and to order the tender offeror to make reports or submit materials.¹⁴⁵ Finally, the minister may order the target company to submit a report or additional materials.¹⁴⁶

Only in recent years have the Japanese started to recognize mergers and acquisitions as viable business tactics in Japan.¹⁴⁷ This fact stands in sharp contrast to the United States' business community

incumbent management. (In the United States, the notice to the Securities Exchange Commission within ten days after the 10% acquisition of shares). M. MIYAZAKI, *supra* note 85, at 77.

140. Japanese SEL, art. 27-3, para. 1.

141. Japanese SEL, art. 27-3, para. 2; Tender Offer Ordinance, arts. 6, 7.

142. Japanese SEL, art. 27-4, para. 3.

143. *Id.* art. 27-2, para. 2; art. 9. The registration statement will then become effective ten days after compliance with the Minister's order. *Id.* art. 27-2, para. 2; art. 8, para. 1

144. *Id.* art. 27-2, para. 2; art. 10. The Minister may also issue a stop order if the registration statement is filed by a person who was subjected to an amendment order or stop order under article 10 for any registration statement filed within the preceeding year. *Id.* art. 27-2, para. 2; art. 11.

145. *Id.* art. 26, para. 1; art. 27-8, para. 1.

146. *Id.* art. 27-8, para. 2.

147. This is despite a large Japanese investment in the United States which is often done through acquisitions. "Japanese firms last year announced 94 United States acquisitions worth a total of \$5.9 billion, up from \$2.7 billion in 1986." Peterson, *Weak Dollar, Deficits Put U.S. on Sale*, L.A. Times, Feb. 24, 1988, § 3, at 1, col. 3. The article noted that the figures are conservative ones due to the fact that many deals are consummated unannounced.

which is currently experiencing a surge in merger activities¹⁴⁸ after the three major merger and acquisition eras¹⁴⁹ between World War II and the present. In Japan, a traditional corporate consolidation takes place when one company acquires another in order to rescue the weakened company from financial collapse, or merges with a sister or subsidiary company. Hence, tender offers are rare in Japan—only three cases have been reported.¹⁵⁰

Bendix, a United States corporation, was the first to complete a takeover in the Japanese market. Bendix is a United States automobile parts manufacturer with a Japanese subsidiary, Bendix International Finance Corporation.¹⁵¹ Bendix owned 13% of Jidosha Kiki Co., an automobile parts manufacturer located in Japan with whom Bendix does business.¹⁵² In 1971, Bendix sought to increase the equity share ratio to 20%.¹⁵³

Bendix initially attempted to acquire floating shares from the market.¹⁵⁴ However, the attempt netted Bendix a modest 2.1% increase to 15.1%. Hence, in 1972, Bendix managed to obtain Jidosha Kiki's agreement to cooperate in Bendix's takeover so that Bendix could achieve a 20% equity share in Jidosha Kiki.

First, the Ministry of Finance gave their approval of the takeover because the sole purpose of the tender offer was to acquire an ownership interest of 20% as opposed to total control.¹⁵⁵ Since the object was not to "takeover" in the sense that Jidosha Kiki's management

148. The deregulation policy of the Reagan Administration triggered a merger mania starting in 1981. CORPORATE MERGERS AND ACQUISITIONS, *supra* note 4, at 27-41.

149. The first merger and acquisition era was between 1893 and 1904. *Id.* at 14-17. The second one was between 1925 and 1930, and the last merger and acquisition which produced numerous conglomerates in the United States took place between late 1960's and the early 1970's. *Id.* at 17-21.

150. ONOZAKI, KIGYŌ BAISHŪ BAIKYAKU SENRYAKU (CORPORATE PURCHASE AND SALE STRATEGY), 168-72 (1987).

151. *Kigyō Baishū Q & A (Merger & Acquisition Questions and Answers)*, (1987) [hereinafter *Mergers & Acquisitions Questions and Answers*]; Onozaki, *Introduction of M&A Activities in Japan*, OBIRIN ECON., 125, 135 (July 1987); Matsuzawa, "TOB Daiichigō" no Tanjō no Haikei to Igi (*The Meaning and the Background of the Birth of the First TOB*), 590 COM. L. REV. 336; Matsuzawa, *Kabushiki no Kōkai Kaitsuke Daiichigō wo Oete (Having Completed the First Public Tender Offer)*, 595 COM. L. REV. 551; Crampes and Benes, *supra* note 26, at 77, n.176 (1982).

152. ONOZAKI, *supra* note 150, at 170.

153. *Id.*

154. Bendix obtained permission to do so by filing with the Ministry of Finance pursuant to the FECL.

155. ONOZAKI, *supra* note 150, at 136.

would have to compromise its control of the company,¹⁵⁶ the Ministry of Finance saw no threat in approving the takeover.

Second, without the cooperation of the target Jidosha Kiki, Bendix would not have had access to Jidosha Kiki shareholder list.¹⁵⁷ The shareholder list enabled the tender offer representative, Yamaichi Securities Co., Ltd.,¹⁵⁸ to solicit responses from 392 shareholders by extending offers to 1889 shareholders on the list.¹⁵⁹ If the takeover had been hostile, Bendix would not have been able to gain access to the shareholder list. In the end result, Bendix acquired 97,300 shares in one month, whereas previously Bendix had spent one year acquiring only a small number of floating shares.¹⁶⁰

In contrast, in 1972, Okinawa Electric Power, Co. carried out the first takeover by a Japanese corporation and the second takeover ever in Japan.¹⁶¹ At that time, various public utility companies were operating in the Okinawa area with different utility rates and duplicated utility facilities.¹⁶² The Japanese government noticed the low efficiency in the area and led the effort to rectify the situation.¹⁶³ Okinawa Electric Power purchased five other electric companies. All six companies were receptive to the Japanese government's objective, and the target companies, along side Okinawa Electric Power, took an active part in the tender offer effort. The management of the five target corporations helped to persuade the potential sellers of the shares of the takeover's purpose and benefit.¹⁶⁴ The result of the takeover was the astonishing acquisition of 72.6% of Matsuoka Haiden and 100% of the remaining four companies.¹⁶⁵

In comparing the *Bendix* case and the *Okinawa* case, it becomes

156. *Id.*

157. Matsuzawa, *Kabushiki no Kōkai Kaitsuke Daiichigō wo Oete (Having Completed the First Public Tender Offer)*, 595 COM. L. REV. 15, 19.

158. The tender offer representative is required by Japanese SEL § 10. *Mergers and Acquisitions Questions & Answers*, *supra* note 151, at 80. Yamaichi Securities is one of the designated securities firms officially licensed to be a tender offer agent. Japanese SEL, § 10, Law regarding Securities Firms.

159. See Matsuzawa, *supra* note 157, at 18.

160. Undoubtedly also contributing to the success of the takeover was Bendix's offer to purchase all the shares tendered regardless of satisfaction of the quota. Matsuzawa, *supra* note 157, at 19.

161. The *Bendix* case was the first takeover in Japan.

162. Yao, *Okinawa Denryoku no Kabushiki Kōkai Kaitsuke no Gaiyō (Summary of Okinawa Electric TOB)*, 724 COM. L. REV. 18 (1976).

163. Matsuzawa, *supra* note 157, at 136.

164. Yao, *supra* note 162, at 20.

165. Additional reasons contributed to the successful takeover: 1) a limited number of investors had accumulated the shares of the involved companies, obviating the need to con-

clear that the fact that Bendix was a foreign investor did not affect any aspect of the tender offer. The Japanese SEL applies equally to foreign investors and domestic investors including the advance notice requirement. A minor exception was noted by a securities dealer who was involved in the Bendix tender offer. The Japanese SEL requires advance notice of tender offers which means that the involved parties must keep the acquisition plan confidential before the notice requirement is fulfilled.¹⁶⁶ The fact that Bendix was a foreign corporation with headquarters overseas, and the transaction involved dealings in two languages, resulted in an increase in the number of people involved.¹⁶⁷ However, this only goes to the degree of effort necessary to keep the tender offer confidential.

IV. NON-LEGAL BARRIERS IN JAPAN: THE CORPORATE STRUCTURE

Numerous commentators have accurately identified that despite the so-called "liberalization" of laws regulating foreign investments, non-legal cultural barriers still remain. One commentator noted that "there are already so many natural barriers to takeovers that legal restrictions are hardly needed."¹⁶⁸

The main non-legal barrier to acquisitions is the shareholding pattern in Japan's corporate world which is relevant in two respects. First, shares held in stable shareholders' hands are unavailable to the public. A large number of shares resting in the hands of these stable shareholders leave fewer shares floating, making it difficult for outside investors to purchase enough shares to carry out a tender offer. Second, corporate shares in Japan are often crossheld. Cross-shareholding occurs when two companies which do business together hold each other's shares. Cross-shareholding is used to strengthen the relationship between the two companies as well as to discourage any takeover attempts. Such shareholding patterns also leaves less floating shares available for the potential investors.

vince a large number of shareholders; 2) the offered purchase price was 2.3 to 2.8 times the face value which made it very attractive for the shareholders to sell. Yao, *supra* note 162, at 18.

166. See, Matsuzawa, "TOB Daiichigō" no Tanjō no Haikai to Igi (*The Meaning and the Background of the Birth of the First TOB*), 590 COM. L. REV. 336; see also, Matsuzawa, *supra* note 157, at 1.

167. *Id.*

168. Crampe & Benes, *supra* note 26, at 71; Comment, *Adequate Remedies for Tender Offer Abuse*, 9 U. HAW. L. REV. 209 (1987); CORPORATE MERGERS AND ACQUISITIONS, *supra* note 4, at 56.

A few legal restrictions are imposed against the shareholding practices which keep the shares away from outside investors. The effect, however, is minimal because of the restrictions' limited scope. One restriction imposed by the Japanese Commercial Code section 210¹⁶⁹ prohibits corporations from holding their own shares except temporarily upon merging.¹⁷⁰ In the United States, stock buyback is an effective way to defend against takeover bids¹⁷¹ because a corporation may demand a higher price on shares or restrict the number of available shares. Further, the Japanese Commercial Code section 210, subsection 2 prohibits subsidiaries from holding the parent corporation's shares.¹⁷² The legislators sought to prevent corporations from manipulating the prices of their own shares by using inside information to gain advantage over other shareholders.¹⁷³

Recently some Japanese corporations in order to protect themselves against possible takeovers have developed strategies which deliberately leave fewer shares available.¹⁷⁴ For example, Jidosha Kiki had only a small number of floating shares available for outside investors. This was precisely why it was extremely difficult for Bendix to acquire shares in the Japanese open market.

Major stable shareholders are financial institutions¹⁷⁵ which own

169. SHŌHŌ (Commercial Code) § 210 Law No. 48, March 9, 1899 as amended in Commercial Code Amendment Law No. 74, 1981. The Commercial Code section 211 allows for an "appropriate period of time" to dispose the shares. Most of the companies dispose of the shares by cancelling them. Kawamura, *Kigyō Baishū Teikei no Kenshū to Bunseki Kigyō Teikei to ni Kansuru Ankēto Chō sa wo Mite (Analysis and Testing of Corporate Merger and Acquisition, Joint Venture: Analysis on Questionnaire regarding Corporate Joint Venture and Others)*, 1069 COM. L. REV. 19, 23 (1986).

170. The Japanese Commercial Code section 210 is interpreted to mean that it applies with equal force where a wholly owned subsidiary bought the shares of the parent corporation. For a case reinforcing this view, see, *Mizuno v. Mitsui Kōzan News*, 1078 COM. L. REV. 920 (1986) (reporting a shareholder recovered damages caused by the subsidiary corporation buying back its parent corporation's shares at a higher price). See also, Okumiya, *Kabukaishime to Mitsui Kozan Jiken Hanketsu no Hamon (Share Acquisition and the Extent of Mitsui Kozan Case)*, 1079 COM. L. REV. 972 (1986). The Japanese Commercial Code allows a corporation to take up to 20% of all its issued stock in pledge. SHŌHŌ art. 211-12, para. 1; Kanzaki & Tatsuta, *Major Statutory Amendments in Japan in 1981*, 5 J. COMP. BUS. & CAP. MARKET L. 259 (1983).

171. *Amerika ni Okeru Jisha-kabu Kaimodoshi no Ugoki (Stock Buyback in the United States)*, 1079 COM. L. REV. 1079 (1986).

172. SHŌHŌ § 210, para. 2. This prohibition applies when the parent holds more than 50% of the stock of the subsidiary. Kanzaki & Tatsuta, *supra* note 170.

173. SHŌHŌ § 210.

174. *Round Table Discussion*, 894 COM. L. REV. 6 (1981). Cross shareholding by companies is a powerful defense to takeovers. *Id.*

175. E. ASIAN EXECUTIVE REP., Feb. 15, 1985, at 9, 14.

39% of the shares of Japanese companies. Financial institutions in Japan yield considerable power over the corporations in which they hold shares because they play a major role in the financing of those corporations. Japanese financial institutions are responsible for financing nearly all Japanese corporations.¹⁷⁶ In fact, only 12% of the financing is done through bond issue and stock increase.¹⁷⁷

Recent developments in Japanese law may change the power structure in Japanese corporate governance. The extent of the change, however, is unknown at this point. For instance, section 11 of the Japanese Antimonopoly Law requires banks and insurance companies to reduce holdings of shares in any corporation to 5% and 10% respectively.¹⁷⁸ The grace period for compliance with the section expired in December, 1987. As a result, significant amount of stocks previously held by banks and insurance companies may have

176. Major financial institutions provide more than 80% of the capital for Japanese corporations. 22 MERGERS & ACQUISITIONS, 81, 85 (1987).

177. *Id.*

178. Antimonopoly Act, § 11; *See*, Watanabe, *Gaikoku Gaisha ni yoru nihon Kigyō no Kabushiki Shoyū to Dokusen Kinshi-Hō* (Shareholding of Japanese Corporate Shares by Foreign Corporations and Antitrust Act), 719 COM. L. REV. 22-26 (1975). Other anti-monopoly issues are outside the scope of this Comment, and will not be discussed. Where a foreign corporation acquires shares in an existing Japanese corporation, the Prohibition of Private Monopoly and Maintenance of Fair Trade Act (the "Act") governs anti-monopoly concerns. SHITEKI DOKUSEN NO KINSHI OYOBI KŌSEI TORIHIKI NO KAKUHO NI KANSURU HŌRITSU (Prohibition of Private Monopoly and Maintenance of Fair Trade Act), Law No. 54 of 1947 (translated in Matsuo, *Mergers and Acquisitions under Japanese Law*, in 52 ANTITRUST L.J. 92, 1011 (1983)) [hereinafter Antimonopoly Act]. Generally, a market share of 25% or above steps into the range governed by the Antimonopoly Act. *Kaisha no Gappei tonō Shinsa ni Kansuru Jimu Shori Kijun* (Standards for Review of Corporate Mergers), Japan Fair Trade Commission [guidelines] No. 3, July 15, 1980, *cited in* Iyori, *supra* note 14, at 56, 77 & n.45. Under section 10 of the Act, acquisition of shares by a foreign corporation may not unreasonably restrain trade in any particular field. Antimonopoly Act, § 10. A corporation may not engage in unfair business practices in acquiring shares. *Id.* Further, section 9 of the Act prohibits the establishment and operation of a holding company, Japanese or foreign. *Id.* § 9. The Act defines holding company as a company whose principal business is to control another corporation or corporations through stockholding. *Id.*; Matsuo, *supra*, at 1014. However, where the holding company is foreign, enforcing the regulation may involve jurisdictional problems. Matsushita, *supra* note 13, at 375. The Japan Fair Trade Commission ("JFTC") is the organizational body charged with investigating and setting guidelines for mergers and acquisitions with possible antimonopoly problems. *See*, Matsuo *supra*; *see also*, Iyori, *supra* note 14, at 56, 77 & n.45. The JFTC requires filing of agreement or contract within thirty days. The JFTC reporting requirements include: (1) international agreement or contract involving more than a single transaction by filing a copy of the agreement or a contract (even though this requirement does not apply where the foreign corporation is in a financial business). Antimonopoly Act, § 6; (2) a foreign company intending to acquire control of a Japanese company. *Id.*; and (3) annual reports on holding of the Japanese corporation's shares. *Id.* § 10(2). The Antimonopoly Act section 11 grace period ended December 1, 1987.

become available to the general investment community. However, one commentator speculated that banks will simply transfer the shares held over the statutory limit to affiliate companies.¹⁷⁹ Although it is too early to accurately assess the movement of the shares, those shares will remain unavailable for outside investors to purchase.

The power in Japanese companies resides with a president, a director or directors of the corporation because of their positions as family members of the founder or the previous leader of the Japanese corporation.¹⁸⁰ From a capitalistic point of view, it is hard to comprehend such allocation of power when the officers and directors do not necessarily own shares in the company. In Japan, however, loyalty, knowledge of the company and the trust earned over the years all count heavily and translate into power. Such a concept of corporate control differs greatly from that found in the United States where the number of shares equals the amount of power one has in a corporation. The clash between the non-capitalistic philosophy and the capitalist mentality of the tender-offeror and the offeree creates an effective non-legal barrier.

Another restriction limiting the power of shareholders is the Japanese Commercial Code section 241, paragraph 3. This law requires that a corporation holding more than 25% of the stocks in another corporation be restricted in its voting rights.¹⁸¹

Another unique aspect of Japanese corporations is their high debt ratio, which is higher than ones seen in United States corporations. This makes Japanese corporations attractive targets.¹⁸² Two factors enhance this attractiveness. The first factor is the skyrocketing prices of real estate in the Tokyo business district. In the last couple of years, soaring property values have tripled and quadrupled the assets of Japanese companies.¹⁸³ In general, Japanese corporate shares are undervalued in relation to the real estate holdings.¹⁸⁴ Thus, the increase in the value of real estate has adjusted the prices of shares. Notwithstanding these trends, shares in such corporations may still be a good investment. The second factor is that financial

179. *Chūmoku Sareru Kinyūkikan no Kabushiki Shobun (Destination of Financial Institution-held Shares)*, 1080 COM. L. REV. 1039 (1986).

180. E. ASIAN EXECUTIVE REP., Feb. 1985, at 14.

181. SHŌHŌ, § 241, para. 3; Kanzaki & Tatsuta, *supra* note 170, at 260.

182. See, Nakamura, *Kinyū-Kikan no Kabushiki-Hoyū Kisei ni Tsuite (On Financial Institution Shareholding)*, 1083 COM. L. REV. 43 (1986).

183. See Hiltzik, *supra* note 17.

184. *Id.*

institutions in Japan are stepping up their effort to improve their debt ratio.¹⁸⁵ One example of this is that banks are offering shares to increase capital. While some business people voice concern about the effectiveness of equity increasing mechanisms, the Japanese corporations are apparently ready to deal in a more liquid market.¹⁸⁶ As a consequence, if banks successfully carry out a tender offer, the reward may indeed be high.¹⁸⁷

Are the Japanese ready to defend takeovers if foreign investors decide to realize their takeover plans? At a glance, corporate Japan seems well prepared to defend against unsolicited tender offers. Questionnaires, directed to both listed and unlisted corporations and distributed by a securities house in Japan, indicated that almost 70% of the companies are, in some way, prepared for takeovers.¹⁸⁸ According to this questionnaire, the two most popular defenses against takeovers are securing stable shareholders and monitoring the stock market for fluctuations indicating takeover possibilities. Among unlisted corporations surveyed, the most popular defense was the restriction of sale or transfer of shares.¹⁸⁹ However, this will not protect them if closed corporations later choose to do public offerings because listed corporations are not allowed to restrict sale of shares.¹⁹⁰

Despite the result of the above survey, many corporations in Japan are not in fact adequately prepared. Japanese corporations for the most part are vulnerable to takeovers. However, it is important to be aware of the peculiar realities of Japanese businesses such as: a) vertical and horizontal business relationships among employees in a company and among corporations; b) years of interaction among business acquaintances fostered by the life long employment structure; and c) the Japanese government's procurement policies. Also, as seen

185. Interview with Kenji Uchida, General Manager, Mergers & Acquisitions, Cosmo Securities Co., Ltd. and Yoshihisa Miyanaga, Managing Director, Est Co., Ltd., in Los Angeles, California (Sept. 2, 1987).

186. *Id.*

187. However, what is commonly known as "Tateho shock" may be a good example of a liquid market trend going awry. Tateho Chemical Corporation ("Tateho") was a ceramics manufacturer in which the operation had not been very profitable. *Asahi Shinbun*, Oct. 8, 1987, at 14. The managers started dealing in stocks to make a quick profit and the scheme was unsuccessful. Tateho nearly went bankrupt. "Tateho shock" became a deterrent to Japanese business' preoccupation with the "zai tech (finance technology)." *Id.*; see also, *Tateho Kagaku Kōgyō no Zai-tekū Shippai (Failure of Tateho Chemical Industries' Finance Technology)*, 1122 *COM. L. REV.* 51 (1987).

188. Kawamura, *supra* note 169, at 19-23.

189. *Id.*

190. *Id.*

in the *Newpis* case, Japanese corporations can easily solicit allies among government branches and business partners¹⁹¹ to ward off unsolicited tender offers. These factors carry considerable weight when contemplating tender offers in Japan. For instance, in the *Minebea* case, Trafalger-Glen, the offeror, was unable to obtain a statutory-required tender offer representative; this detrimentally affected the deal.¹⁹² This was caused by Trafalger-Glen proceeding with the takeover as if they were unaware of the importance of having allies in Japanese business circles. Not only did they fail to solicit a Japanese security house in advance, but later Daiwa Securities refused to be their takeover representative.¹⁹³

The above illustrates that when doing business in Japan, it is vital to create a good relationship with the government.¹⁹⁴ It is well known that ministries (such as the Ministry of International Trade and Industry) and industries often act in concert in shaping policy goals. In certain instances, the government even gets production quotas.¹⁹⁵ Thus, it is possible to set policies which are favorable to particular parties.

Similarly, the presence of various government branches in particular transactions may also influence the way the transactions turn out. For instance, in both the *Bendix*¹⁹⁶ and *Okinawa*¹⁹⁷ cases, the appropriate government branches closely watched the process. In *Okinawa*, the government even formed Okinawa Electric Committee to monitor the acquisition.¹⁹⁸ There is no doubt that the government interest in the project lent a certain amount of legitimacy in the transaction, thereby facilitating the solicitation process for the purchaser. Lobbying and past relationships have also been known to influence the government's position under certain circumstances.¹⁹⁹ Conse-

191. The Japanese business community is a tight network of *keiretsu* companies and further tied in contractor-subcontractor relationships. Hoshino, *The Performance of Corporate Mergers in Japan*, J. BUS. FIN. ACCT. 153 (1982). *Keiretsu* companies are a family of companies. Henderson, *supra* note 6, at 144.

192. M. MIYAZAKI, *supra* note 85, at 75.

193. *Id.*

194. See Smith, *supra* note 26, at 417.

195. This elicits criticism from the public called *yuchaku*, where officials and businesses develop a "you scratch my back, I scratch your back relationship."

196. See *supra* text accompanying notes 151-60.

197. See *supra* text accompanying notes 161-65.

198. Yao, *supra* note 162.

199. *Katakura Kōgyō no Shin Gaitame Hō ni yoru Kokuji Shobun Torikeshi Seikyū Jiken no Sojō* (Demand to Withdraw the FECL Listing of Katakura Kōgyō), 899 COM. L. REV. 30 (1981).

quently, taking a position against government policy or guidance is strongly discouraged. In other words, in Japan's homogeneous society, taking an adversarial stance may not serve one well.²⁰⁰

Culturally, it cannot be ignored that the idea of taking over another corporation is inherently an uncomfortable proposition to the Japanese.²⁰¹ Most sectors of the Japanese market remain *de facto* off limits to foreign investors. This has been the case through five stages of the "so-called" liberalization process in the area of foreign trade and investments in Japan. The attitude of the Japanese people plays a part in the perpetuation of these barriers.²⁰² However, to explain the resistance solely on the basis of cultural differences is to ignore the reality of the *Newpis* case. If the government faithfully followed the letter of the law, Katakura Industries would not have been designated as off-limits by the government. Hence, it is not entirely cultural barriers which keep the potential investors away, but also the law and its applications discourage investors.

V. CONCLUSION

Japanese business people are rapidly educating themselves in mergers and acquisitions.²⁰³ In 1986 alone, Japanese corporations accounted for twenty-seven acquisitions worth almost two billion dol-

200. Even behavior that attracts attention may be undesirable. A Japanese psychologist comments that in a Japanese company, employees who seem shy and do not speak out do better than an aggressive and outspoken manager. Address by Professor Robert Ballon, JETRO Business Round Table Meeting (Jun. 18, 1981), *reprinted in* Decision-Making in Japan: The Real vs. the Conceptual Process, Speaking of Japan, Sept. 1981, at 22.

201. A question posed directly to the point, why are there so few takeovers in Japan, elicited the following answer: "because it is rude." (Conversation with Professor S. Muramatsu, a professor of business at Seikei University, Tokyo, Japan. (1987))

202. If there is anything advantageous which comes out of the Japanese culture, it's the lack of litigiousness. Since the Japanese prefer to resort to arbitration and other alternate methods of dispute resolution, shareholder suits are not commonly brought in Japan. Consequently, in Japan, a potential purchaser is relatively free from the risk of shareholder suits. However, some commentators note that commercial litigation in Japan is on the decrease due to "distrust of decisions based on legal principles." Shapiro, *Can the Japanese Lack of Litigiousness Continue*, in LEGAL ASPECTS OF DOING BUSINESS IN JAPAN, 25, 30 (1983).

203. "M & A" has become a Japanese term and is used interchangeably with "*kigyō kyūshu gapperi*" (corporate mergers and acquisitions). Feverish M & A education takes on a form of lectures and speeches as well as trips. For example, Technology Tour, Inc. recently organized a trip to the United States for a group of businessmen to study mergers and acquisitions by visiting lawyers, financial institutions, and businesses that were involved in recent mergers and/or acquisitions. See, *Tekunologī Toransufū Kenkyūjo, M & A Tekunologī Hōbē Chōsadan (M & A Technology Research Group)* (1987).

lars in the United States.²⁰⁴ The stigma that accompanied mergers and acquisitions in Japan has decreased. The image of *nottoriya*,²⁰⁵ once attached to mergers and acquisitions, is disappearing.²⁰⁶ Japanese securities houses have been setting up merger and acquisition teams, and major United States law firms have been rushing to open Tokyo offices or establish working relationships with existing Japanese law firms. Various United States investment banks and accounting firms are also trying to establish a market for Japanese businesses. Hence, potential foreign investors seem to have all the tools required to initiate a takeover bid.

Unfortunately, not only legal barriers remain in the way of interested foreign investors, but also the nature and philosophy of Japanese corporations. While a great deal of discrimination against foreign interests comes from non-legal forces inside and outside of the Japanese government, until the Japanese law is amended to preclude the chance of bureaucratic manipulation, foreign interests will have to pay a prohibitive price to begin investing in Japan.

Hisako Muramatsu

204. *M & A in Japan: Halting Steps Toward a New Era*, MERGERS & ACQUISITIONS 85 (1987).

205. *Nottoriya* is someone who forcibly takes over a business.

206. Kawamura, *supra* note 169, at 23.

