SHAREHOLDERS AS STAKEHOLDERS: A FUTURE PARADIGM FOR INSTITUTIONAL ACTIVISM IN JAPAN

GARRETT L. BRODEUR*

ABSTRACT

Over the last quarter century, the landscape of Japanese corporate governance has been overhauled by a combination of domestic reform, financial collapse, and foreign influence. Amidst these changes, institutional investors have claimed a growing role within Japanese listed companies, not only as monitors of management but as crucial agents for corporate governance reform. In this new role, institutional investors have adopted a diverse array of strategies and tactics for their dealings with management. This paper explores the future contours of Japanese shareholder activism against the backdrop of Japan's twenty-first century corporate evolution. In particular, it analyzes how Japan's modern corporate governance regime alters the behavior of institutional investors, and in turn the nature of their engagements with management of Japanese companies. Due to recent changes in Japanese law, Japan's current governance standards limit the effectiveness of "aggressive" institutional activists. Rather than encourage contentious, highly public battles between adversarial activists and target companies, Japan's current regime limits the opportunities for investment available to aggressive institutional investors by encouraging constructive engagement between investors and management. Although the quest for profits will continue to influence the behavior of investors and managers, Japan's current regime invites institutions to act not only as profit-seeking shareholders, but also as stakeholders invested in the long-term financial stability of listed companies.

* Duke University School of Law, J.D. expected 2017; The University of Houston, B.A. 2013. My sincerest thanks in completing this Note are due to Professor James Cox for providing valuable guidance and sparking my interest in corporate law; to Professor Robert Carp for inspiring me to pursue a legal career; to the faculty of the Moores School of Music for instilling in me the discipline of a dedicated musician; and finally, to my family for their constant love and support.

TABLE OF CONTENTS

INTRODUCTION

Change is afoot in the Land of the Rising Sun. Over the last quarter century, Japanese corporate governance has been transformed by domestic reform, financial collapse and foreign influence. In addition to government efforts to enhance corporate accountability, financial collapse during the 1990s exposed Japan's equity market to foreign investment and the importation of Western governance mechanisms. Against this backdrop, the role of institutional investors in Japanese society has drawn public interest for a variety of reasons. Scandals and managerial misconduct have plagued several of Japan's most influential corporations[1] and have underscored the necessity of effective managerial oversight. These developments highlight the importance of investors as independent, external monitors of management. Additionally, Japanese governance has long been criticized for

---

1. *See, e.g.*, Bruce Aronson, *The Olympus Scandal and Corporate Governance Reform: Can Japan Find a Middle Ground Between the Board Monitoring Model and Management Model?*, 30 PAC. BASIN L.J. 93, 106–14 (2012) (describing a financial reporting scandal and ensuing investigation at Olympus Corporation in 2011); Yuki Hagiwara & Matthew Campbell, *Mitsubishi Motors' Scandal Was an Accident Waiting to Happen*, BLOOMBERG NEWS (May 18, 2016), http://www.bloomberg.com/news/articles/2016-05-18/mitsubishi-motors-scandal-was-an-accident-waiting-to-happen [https://perma.cc/V7XG-Q72J] (documenting misstatements of fuel economy and testing standards by Mitsubishi Motors Corporation in 2016).

"lagging behind" the Western world,[2] and the country has historically lacked institutions capable of monitoring and exerting meaningful pressure on corporate insiders.

In response to these concerns, institutional investors have emerged as agents of reform. Domestic institutions including Japan's Pension Fund Association and Strategic Capital, Inc., as well as foreign institutions such as Steel Partners Holdings L.P., The Children's Investment Fund, Effissimo Capital and Third Point, LLC, have played a pivotal role in Japan's corporate transformation by pressing for reform within target companies. Each institution has adopted unique strategies, a "model" of activism, for its engagement with Japanese companies.

This paper explores the future contours of Japanese shareholder activism in light of the country's twenty-first century corporate evolution. Part I frames our discussion with a brief explanation of Japan's corporate governance transformation—from a traditional firm-centric culture of "internalism," to a modern regime trending toward shareholder primacy. Part II introduces several of Japan's prominent foreign and domestic institutional investors and analyzes their specific engagements with Japanese listed companies. These institutions and their strategies illustrate several "models" of activism implemented in Japan—adversarial or "public" activism, constructive or "quiet" activism and collaborative activism. Part II serves as a useful backdrop to discuss and critique two of Japan's twenty-first century corporate developments introduced in Part III, namely (a) the publication of guidelines in 2005 by Japan's Ministry of Economy, Trade and Industry and Ministry of Justice for legitimate defensive maneuvers by management within Japanese companies, and (b) legislative reform in 2015 encouraging independent board membership, heightened accountability and greater dialogue with shareholders among Japanese firms. These byproducts of Japan's corporate evolution are likely to influence the future of institutional activism. In conclusion, Part IV draws an inference as to the future contours of Japanese institutional activism based on connections between Japan's corporate reform and the likely future interactions between activist investors and management.

This paper sets out to analyze how Japan's modern corporate governance regime will alter engagements between activist institutional investors and management. Scholars of Japanese law have recognized that the future of the country's corporate governance regime depends on the

2. Takako Taniguchi, *Japan '30 Years Behind' in Corporate Governance*, THE JAPAN TIMES (May 31, 2015), http://www.japantimes.co.jp/news/2015/05/31/national/japan-30-years-behind-corporate-governance-top-u-s-money-manager-says/#.V9U0lGVlmu7 [https://perma.cc/BZ3U-VRZM].

evolution of shareholder-management relations.[3] I adopt the *inverse* perspective: namely, that Japan's modern corporate governance regime is primed to influence interactions between institutional investors and management of Japanese target companies. This new regime could well impact the future balance of power between "models" of institutional activism. In sharp contrast to Western regimes, Japan's current governance standards mitigate the effectiveness of aggressive activism. Rather than encourage contentious, highly public battles between adversarial activists and target boards, Japan's current regime limits the effectiveness of aggressive institutional activism by encouraging *constructive* engagements between investors and management. Although the quest for profits will continue to influence the behavior of investors and managers, Japan's current regime invites institutions to act not only as profit-seeking shareholders, but also as *stakeholders* invested in the long-term financial stability of listed companies.

I. A BRIEF HISTORY OF JAPANESE CORPORATE GOVERNANCE

While foreign institutional investors have assumed a substantial role in shaping contemporary Japanese corporate governance, the country today is vastly different in several important respects from Japan in the mid-twentieth century. The following section documents the evolution of Japan's corporate sphere in response to several sources of change. Beyond the direct influence of government reform over the last fifteen years, corporate evolution has been driven by financial collapse during the 1990s and an increase in foreign investment since the turn of the twenty-first century.[4]

A. Japan's Traditional Conception of the Corporation—A "Community Firm"

Since the 1950s, Japanese corporate governance has revolved around a unique conception of the corporation as a "community firm."[5] At its core, the "community firm" ideal rested on the assumption that companies were "comprised of a community of stakeholders rather than being the shareholders' property."[6] As such, corporations were historically conceived

3. *See* Takaya Seki & Thomas Clarke, *The Evolution of Corporate Governance in Japan: The Continuing Relevance of Berle and Means*, 37 SEATTLE U. L. REV. 717, 719 (2014).

4. Sanford M. Jacoby, *Foreign Investors and Corporate Governance in Japan*, *in* CORPORATE GOVERNANCE AND MANAGERIAL REFORM IN JAPAN 93, 94 (D. Hugh Whittaker & Simon Deakin eds., 2009).

5. *See generally* JOHN BUCHANAN ET AL., HEDGE FUND ACTIVISM IN JAPAN: THE LIMITS OF SHAREHOLDER PRIMACY 107–13 (2013) (describing the "community firm" idea which "became the principal distinguishing feature of Japan's post-1945 corporate governance" regime).

6. Jacoby, *supra* note 4, at 93.

as "stable social system[s] not run primarily for the benefit of shareholders," but rather run to promote internal goals and embody the values of employees, managers and creditors.[7] Japanese companies "[were] regarded not as money-making machines but as self-perpetuating institutions . . . expected to pursue 'service to society' first and profits second."[8] Scholars have described traditional corporate Japan as a realm "of stable, friendly shareholders, expansive views of corporate purpose . . . beyond shareholder wealth maximization, and abiding social concern for the preservation of harmonious relationships."[9]

With shareholder wealth assuming only marginal importance, Japanese governance promoted "internalism" and emphasized duties to the company rather than stakeholders.[10] Most traditional firms were controlled "at all levels by long-serving, internally promoted managers who identif[ied] with the company's interests because they belong[ed] to a cohesive and rewarding 'community firm.'"[11] These managers were similar to "winners of a fierce competition for internal promotion"[12] and relied on internal company knowledge to guide their business decisions in lieu of external pressure or guidance.[13] Traditional Japanese companies therefore differed from their American counterparts: whereas American firms relied on directors as monitors of management, the directors of Japanese firms *were* the management and consequently had free reign over business decisions.[14]

In addition to a lack of internal monitoring, traditional Japanese firms also resisted outside influence. The historical role of *kansayaku* (internal "corporate" or "statutory auditors") illustrates the reluctance of Japanese firms to expose internal "community" cultures to external influence. Although *kansayaku* have long served as the primary monitors of management and accounting decisions within Japanese listed companies,[15]

7. BUCHANAN ET AL., *supra* note 5, at 108–09.

8. *Takeovers in Japan: Hostility, of Sorts*, THE ECONOMIST (Dec. 19, 2007), http://www.economist.com/node/10331522 [https://perma.cc/8J8U-LC7N].

9. Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171, 2172 (2005).

10. BUCHANAN ET AL., *supra* note 5, at 109.

11. TAKESHI INAGAMI & D. HUGH WHITTAKER, THE NEW COMMUNITY FIRM: EMPLOYMENT, GOVERNANCE AND MANAGEMENT REFORM IN JAPAN 3–5 (2005).

12. TOSHIAKI TACHIBANAKI, WHO RUNS JAPANESE BUSINESS? MANAGEMENT AND MOTIVATION IN THE FIRM 249 (1998).

13. SIMON LEARMOUNT, CORPORATE GOVERNANCE: WHAT CAN BE LEARNED FROM JAPAN? 136 (2002).

14. Aronson, *supra* note 1, at 95.

15. *See* BUCHANAN ET AL., s*upra* note 5, at 111. *Kansayaku* remain employed in most modern Japanese firms, albeit not in firms that have established "audit committees" under the optional "committee" system of governance introduced by amendments to Japan's Commercial Code in 2003.

they were historically marginalized and limited in their capacity to challenge upper management.[16] Rather than holding independent positions as disinterested external monitors, *kansayaku* were often drawn from the ranks of former employees or directors of the firm or its subsidiaries.[17] Instead of demanding accountability of directors and upper management, *kansayaku* merely emphasized legal compliance by employees.[18] *Kansayaku* have achieved greater independence in recent years,[19] but their past subordination illustrates the tradition of "internalism" that has rendered corporate Japan reluctant to entertain external perspectives or influence to this day.

With little in the way of foreign influence, Japanese governance was shaped by domestic financial activity and the dynamics of the *keiretsu*—"groups of allied firms organized around a main bank" typically "own[ing] substantial quantities of each other's shares."[20] Cross-ownership arrangements such as *keiretsu* insulated management from outside shareholders, provided boards of directors an early defense mechanism against takeovers, and facilitated information sharing among "business groups" of firms.[21] Perhaps most importantly, *keiretsu* mitigated the influence of market discipline in traditional Japanese firms. Management was relieved of the need to obsess over stock prices, market confidence, or short-term profitability, since firms relied primarily on loans from a main bank rather than equity from investors.[22] With practical immunity from external influence, Japanese corporate governance developed throughout the twentieth century with a clear emphasis on the interests of management, employees, and creditors, rather than shareholders.

---

16. *Id.* ("[*Kansayaku*] . . . [became] co-opted into the corporate structure. A senior director at a very large company . . . interviewed in 2004 admitted they were not an effective check on management: 'Our corporate auditors are legally obliged to supervise the directors but in practice they are tied up with lower level stuff, what you might call operational matters, and they are busy checking fine details of daily business.'").

17. *Id.*

18. Aronson, *supra* note 1, at 99 n.57.

19. An amendment in 2002 to the Japanese Commercial Code has empowered *kansayaku* by requiring Japanese listed companies to have "at least three corporate auditors, of whom at least half [must] be persons who [have] not been either directors or employees of the company or its subsidiaries." BUCHANAN ET AL., *supra* note 5, at 112.

20. PAUL KRUGMAN, THE RETURN OF DEPRESSION ECONOMICS AND THE CRISIS OF 2008, at 59 (2009).

21. Yaron Nili, *Missing the Forest for the Trees: A New Approach to Shareholder Activism*, 4 HARV. BUS. L. REV. 157, 188–89 (2014).

22. *See* KRUGMAN, *supra* note 20, at 59.

B. The "Lost Decade" & the Financial Sector's Waning Influence Over Corporate Governance

Japan's financial sector traditionally enjoyed considerable influence over corporate governance. As the financial centerpiece of the *keiretsu* framework, the financial sector maintained dominant ownership in domestic listed companies and exercised considerable influence over corporate governance; often at the expense of other investors.[23] As recently as 1990, financial institutions owned forty-three percent of the overall value in Japan's equity market.[24] In the same year, business corporations (likely as part of *keiretsu* or cross-shareholding) held the next highest percentage ownership of Japan's equity market, at thirty percent of overall market value.[25]

Despite its longstanding impact on corporate governance, Japan's *keiretsu* framework unraveled during the 1990s and 2000s with the onset of the "lost decade"—a period of systemic, nationwide financial collapse.[26] Japan had experienced decades of rapid growth following World War II, but asset prices skyrocketed in the late 1980s, due primarily to excessive loan growth quotas, or lending targets, imposed by the Bank of Japan.[27] To satisfy the central bank's lending quotas, Japanese banks "lent more, with less regard for quality of the borrower" than banks in any other country.[28] Excessive lending fueled severe inflation. When the Bank of Japan raised interbank lending rates in 1989 to restrict market liquidity and curb inflation,[29] asset prices plummeted, Japan's stock market crashed and widespread financial collapse ensued. Scholars and economists have credited a variety of contributing factors for the collapse, but one factor, in particular, relates directly to the internal "community firm" ideology that was pervasive among traditional Japanese firms: a "cozy relationship" had developed among government, banks and Japanese firms, and an expectation of bailouts from government-backed banks to financially-distressed companies created significant moral hazard problems.[30] Banks therefore had little incentive to

23. *See* Nili, *supra* note 21, at 188.

24. TOKYO STOCK EXCHANGE, INC., TSE-LISTED COMPANIES SHAREOWNERSHIP SURVEY 2015 tbl.3 [hereinafter TSE 2015 SHAREOWNERSHIP SURVEY], http://www.jpx.co.jp/english/markets/statistics-equities/examination/b5b4pj00000154dp-att/e-bunpu2015.pdf [https://perma.cc/PL87-F7T3].

25. *Id.*

26. Nili, *supra* note 21, at 189.

27. W.R. GARSIDE, JAPAN'S STAGNATION: FORGING AHEAD, FALLING BEHIND 77 (2012) (documenting the reaction of Japanese commercial banks to Bank of Japan lending quotas).

28. KRUGMAN, *supra* note 20, at 66.

29. *Japan Raises Interest Rates*, N.Y. TIMES (Dec. 25, 1989), http://www.nytimes.com/1989/12/25/business/japan-raises-interest-rates.html [https://perma.cc/VJ2H-PHMB].

30. KRUGMAN, *supra* note 20, at 60.

mitigate credit risk and widespread reductions in lending standards propelled the financial collapse. In a sense, the protections of the *keiretsu* framework contributed to its own demise.

The "lost decade" left Japan's financial sector in shambles; many banks were bailed out with government capital infusions or cheap credit from the Bank of Japan. The resulting economic fragility severed ties between banks and corporate borrowers, and the financial sector ceded its long held influence over Japanese corporate governance. The sector's waning influence is highlighted by share ownership data collected by the Tokyo Stock Exchange ("TSE"). The TSE's data indicate that financial institutions' percentage share of Japan's equity market has decreased from a high of 43% in 1990 to 27.9% in 2015.[31] On a unit-of-share basis, the percentage of shares owned by financial institutions decreased from 45.2% to 24.8% during the same period.[32] Among financial institutions, city and regional banks experienced the greatest decline in percentage market share—from 15.7% in 1990 to 3.7% in 2015.[33] As discussed below, the financial sector's declining market share can be explained primarily by a substantial increase in the percentage of foreign shareholdings.[34]

C. The Emergence of Activist Investment & the Murakami Fund

At the onset of the twenty-first century, foreign investment emerged to fill the void left by Japan's weakened financial sector. Japan has been considered an unlikely playing field for activist institutional investors.[35] In the majority of countries, foreign activism is impractical because few, if any, domestic institutions are available and willing to cooperate with investors from abroad. Foreign activists are often portrayed as overly aggressive and threatening toward domestic companies.[36] Additionally, there is typically a lack of historical guidance or a model approach for institutional activism in foreign countries. Despite Japan's efforts to jumpstart economic growth and

31. TSE 2015 SHAREOWNERSHIP SURVEY, *supra* note 24, at tbl.3.

32. *Id.* at Ref. tbl.2.

33. *Id.* at tbl.3.

34. *See id.* (illustrating an increase in the percentage market share held by "Foreigners" from 4.7% in 1990 to 29.8% in 2015).

35. Bruce E. Aronson, *A Japanese CalPERS or a New Model for Institutional Investor Activism? Japan's Pension Fund Association and The Emergence of Shareholder Activism in Japan*, 7 N.Y.U. J. L. & BUS. 571, 577–78 (2011).

36. *Samurai v. Shareholders: Japan's Establishment Continues to Rebuff Foreign Activist Investors*, THE ECONOMIST (Feb. 14, 2008), http://www.economist.com/node/10698467 [https://perma.cc/D6P6-43XE] ("Japanese businessmen and politicians fear that the activists are short-term investors keen to strip firms of their cash. The conflict highlights a fundamental divide: companies in Japan are social institutions with a duty to provide stable employment and consider the needs of employees and the community at large, not just shareholders.").

invite foreign investment,[37] the country's corporate milieu poses unique obstacles to activism by foreign shareholders.

Beyond the reluctance of domestic firms' to expose their internal affairs to outside investors,[38] Japan's foreign exchange and trade laws have limited foreign investment in key industries.[39] Under the Foreign Exchange and Foreign Trade Act,[40] any foreign investor intending to make an "inward direct investment"[41] in a Japanese corporation must notify in advance and receive permission for the transaction from the Minister of Finance and any other ministry with jurisdiction over the target corporation.[42] The Act has had a broad impact on foreign investment in Japanese companies. For example, in 2008, the Japanese Ministry of Economy, Trade and Industry ("METI") issued a recommendation effectively preventing a British hedge fund from doubling its ownership from 9.9% to 20% in Electric Power Development Co. ("J-Power"), an electricity wholesaler and formerly government-owned public utility.[43] The METI opposed the fund's increased ownership out of concern that it could disrupt J-Power's capital investment in nuclear power plants and threaten national security.[44] In addition to

37. Japanese Prime Minister Shinzo Abe has adopted a "three-pronged approach"—Abenomics—to stimulate economic growth. The third prong emphasizes structural corporate governance reform to attract foreign investment in Japanese companies. *See Japan's Economy is Back to Where it Started*, STRATFOR (Jul. 12, 2016), https://www.stratfor.com/analysis/japans-economy-back-where-it-started [https://perma.cc/578E-V7GV].

38. Kana Inagaki, *Japan is Hostile to Activist Investors*, WALL ST. J. (May 14, 2013), http://www.wsj.com/articles/SB10001424127887324216004578482943175923954 [https://perma.cc/5474-NQTT] ("Big Japanese investors have generally circled the wagons to protect companies—with which they often had deep shareholding and business ties—from intervention by outsiders. Historically, those networks of big investors held large enough stakes that they could prevent hostile campaigns from succeeding.").

39. In 2008, Japanese foreign exchange law required foreign investors to seek government approval before seeking a stake of ten percent or more in electric utilities or other companies related to "national security" and "public order." The law authorized government regulators to issue orders or recommendations requiring foreign investors to drop or alter their acquisition plans. *British Fund Faces Limit on its Stake in J-Power*, THE JAPAN TIMES (Apr. 6, 2008), http://www.japantimes.co.jp/news/2008/04/06/business/british-fund-faces-limit-on-its-stake-in-j-power/#.V-EeVWVlmu4 [https://perma.cc/GGV8-QY68].

40. 外国為替及び外国貿易法 [Foreign Exchange and Foreign Trade Act], Act No. 228 of Dec. 1, 1949 [hereinafter Japanese Foreign Exchange and Trade Act].

41. The Act's definition of "inward direct investment" includes any acquisition of shares in a Japanese listed corporation in which at least ten percent of the corporation's shares will be held by a non-resident individual after completion of the acquisition. *See id.* at art. 26(2)(iii).

42. *Id.* at art. 27(1).

43. *Funds Lose Against J-Power and NipponKoa*, N. Y. TIMES (June 26, 2008), http://www.nytimes.com/2008/06/26/business/worldbusiness/26iht-activist.1.14007959.html [https://perma.cc/93XK-2A5R].

44. *British Fund Faces Limit on its Stake in J-Power*, *supra* note 39. Japan's Foreign Exchange and Foreign Trade Act specifically authorizes the Japanese government to "take countermeasures . . .

regulatory protection, foreign investors have encountered formidable cultural friction during aggressive engagements with Japanese firms. In 2010, Steel Partners Holdings L.P., a U.S.-based hedge fund well-known for its aggressive strategies, sold its shares in Sapporo Holdings Ltd. after "battling for corporate reform and management overhaul"[45] for nearly five years.[46] The fund has since exited the Japanese market after fully divesting its ownership in Aderans Holdings Co. Ltd. in 2015.[47]

Despite these political and cultural obstacles, foreign institutional investors have nonetheless assumed a growing role within Japanese listed corporations. The percentage market value of Japanese equity held by foreigners has increased from a mere 4.7% in 1990 to 29.8% in 2015.[48] This shift is due in large part to the emergence of domestic Japanese funds in the 1980s who first employed activist tactics by purchasing shares "in underperforming or undervalued companies with a view to profiting from subsequent improvements in their performance."[49] Most of these funds, including Sparx Asset Management and Tower Investment Management, have maintained their stakes in listed Japanese firms without resorting to Western-style confrontation or intervention.[50] In contrast, M&A Consulting, one of several investment vehicles originated by Yoshiaki Murakami (known collectively as the "Murakami Fund"), employed a highly-public, confrontational style of engagement.[51]

The Murakami Fund made a splash in January of 2000 when it initiated a hostile tender offer valued at roughly ¥1.41 billion for Shoei Corporation, a Japanese industrial and real estate company with an electronic parts manufacturing wing.[52] Mr. Murakami criticized the company's "inefficient management," and justified his intervention as a means to address Shoei's unnecessary real estate operations, crippling debt and "unusually large

---

when it is particularly necessary in order to maintain peace and security in Japan." *See* Japanese Foreign Exchange and Trade Act, art. 10(1).

45. Inagaki, *supra* note 38.

46. Letter from Warren G. Lichtenstein, Chairman and Chief Exec. Officer, Steel Partners Holdings L.P., to Shareholders, Steel Partners Holdings L.P. 9 (Mar. 12, 2010) [hereinafter 2010 Letter to Shareholders of Steel Partners].

47. Letter from Warren G. Lichtenstein, Chairman and Chief Exec. Officer, Steel Partners Holdings L.P., to Shareholders, Steel Partners Holdings L.P. 14 (app. A) (May 18, 2015) [hereinafter 2015 Letter to Shareholders of Steel Partners].

48. *See* TSE 2015 SHAREOWNERSHIP SURVEY, *supra* note 24, at tbl.3. The 2015 Survey defines "Foreigners" as "non-Japanese corporations and individuals." *Id.* at tbl.1.

49. BUCHANAN ET AL., *supra* note 5, at 154.

50. *Id.*

51. *Id.*

52. *Id.*

board."[53] Shoei's domestic shareholders ultimately rebuffed Murakami's tender offer and the bid failed, but it was "one of the first postwar hostile bids *for* a Japanese corporation *by* a Japanese corporation."[54] Most importantly, Murakami demonstrated the feasibility of aggressive activism in Japan by using Shoei's annual general meeting to advocate aggressively for greater shareholder returns and heightened managerial accountability.[55] Studies by the Japan Center for Economic Research estimate that Murakami's collection of funds maintained shareholdings in as many as fifty-two Japanese firms by late 2005.[56] Additional studies published in NLI Research in 2007 predict that Murakami intervened in at least 135 listed companies; likely a conservative estimate given the likelihood of additional interventions in companies where Murakami avoided disclosure obligations by holding less than five percent ownership.[57]

The Murakami Fund ultimately blazed a trail for subsequent waves of activist shareholders. Although the Fund's takeover bid failed, its intervention signaled the dawning of a new era in Japanese corporate governance. Management could no longer promote narrow internal interests and feel secure from unwelcome shareholder engagement. In Murakami's wake, Japanese companies were targeted by domestic and foreign hedge funds which used small shareholdings to engage with management on matters of corporate governance and financial strategies.[58] These funds' tactics exhibited unique characteristics capable of classification into three general "models" of activism, discussed below. After decades of market-driven transformation, the stage was set for a heterogeneous, multi-faceted assault by activist investors on Japan's traditional corporate landscape.

II. MODELS OF INSTITUTIONAL SHAREHOLDER ACTIVISM

Corporate law scholarship offers numerous criteria for assessing the strategies of institutional activists.[59] This paper characterizes Japan's most prominent institutional investors based simply on the nature of their

---

53. *Id.* at 154–55.

54. Curtis J. Milhaupt, *A Lost Decade for Japanese Corporate Governance Reform? What's Changed, What Hasn't, and Why* 13–14 (Columbia Law & Econ. Working Paper No. 234, 2003).

55. *See* BUCHANAN ET AL., *supra* note 5, at 155.

56. *See id.* at 156.

57. *See id.*

58. *See id.* at 153.

59. *See, e.g.*, Aronson, *supra* note 35, at 586–92 (discussing resource and expertise constraints, and constituency constraints as applied to public pension funds to compare Japan's Pension Fund Association with the California Public Employees Retirement System, or "CalPERS"); K.A.D. Camara, *Classifying Institutional Investors*, 30 J. CORP. LAW 219, 229–42 (2005) (classifying institutional investors as either "market-driven," "politically-driven," "socially-driven," or "multilateral" investors).

engagements with Japanese listed companies and their particular investment goals. Institutional activism in Japan can be classified into three broad categories: adversarial or "public" activism, constructive or "quiet" activism, and collaborative activism. Using these classifications, this paper forecasts the future contours of engagements between investors and management given the likely influence of Japan's recent corporate governance reform.

A. Adversarial or "Public" Activism

Since the turn of the twenty-first century, institutional activists have often assumed a highly-public, adversarial approach in their engagements with management. The adversarial model has been employed recently by institutions such as Steel Partners Holdings L.P., The Children's Investment Fund, Strategic Capital, Inc. and Effissimo Capital—hedge funds based in the United States, the United Kingdom, Japan and Singapore, respectively. Adversarial activism can be described in myriad ways, but the approach generally involves heightened media attention, aggressive proxy voting in direct opposition to management, publicized communications intended to invite public scrutiny over disagreements between shareholders and management and short-term shareholding in expectation of a financial payout. Among institutional investors, hedge funds have most frequently employed the adversarial approach; primarily due to their profit-driven investment goals.[60] Most importantly, activist funds generally invest only in companies with untapped profit potential and they acquire shareholdings with the narrow goal of exerting pressure on management to enhance profitability.[61]

Rather than investing dispersedly across several listed companies, hedge funds strategically concentrate their investments[62] in capital-intensive companies capable of producing shareholder value. For most funds—and adversarial activists, generally—activism is profit-driven and shareholding is simply the vehicle for promoting a pre-meditated agenda to alter the governance of a company.[63] Unlike traditional institutional investors such as

60. *See* BUCHANAN ET AL., *supra* note 5, at 67 ("Activist hedge funds share the same client base as other hedge funds, namely wealthy individuals or institutions willing to accept high risk in exchange for the possibility of high return . . . but in many ways they operate differently from 'macro funds' or 'relative value funds.' They do not use automated [investment strategies] . . . Instead, they research individual companies carefully to locate targets that appear to have the characteristics of latent value they seek and then undertake controlled investments.").

61. *See id.*

62. *See id.* at 169 (discussing the difficulty of conducting activist campaigns with investments spread across a variety of listed companies).

63. *See* Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1091 (2007).

pension or private equity funds, hedge funds have little interest in promoting long-term or systemic change. Instead, they rely on "firm-specific agitation" to improve corporate performance and extract short-term value for shareholders.[64] Many scholars of Japanese corporate law consider adversarial activism to have peaked in Japan shortly before the 2008 financial crisis,[65] but aggressive engagements have remained common, particularly in the context of hostile takeover bids. As discussed in Part IV below, the threat of aggressive takeover bids has led many Japanese firms to adopt Western-style defensive mechanisms consistent with government guidelines.

Although it fully divested its Japanese holdings in 2015,[66] the aggressive approach of Steel Partners Holdings L.P. ("Steel Partners") offers an iconic example of the adversarial model. In its latest annual letter to shareholders,[67] Steel Partners explained the necessity of an "activist" approach[68] and proclaimed its mission "to work with . . . management teams to effect catalytic events or, if required, *pursue an active strategy and encourage such catalytic events*."[69] Steel Partners' mission to alter corporate governance unilaterally has undoubtedly influenced its aggressive engagements with two Japanese listed companies—Aderans Holdings Co. Ltd. ("Aderans"), Japan's largest wig manufacturer, and Sapporo Holdings Ltd. ("Sapporo"), a Japanese listed global food and beverage manufacturer.[70]

As a 27.74% owner in Aderans—and the company's largest shareholder—Steel Partners leveraged its dominant position in 2009 to stage a successful proxy campaign and block a tender offer by an outside acquirer who sought a 35.2% ownership position in Aderans.[71] The acquirer's proposed offer was for ¥1,000 per share of Aderans stock—a 5.6% discount to market; Steel Partners opposed the offer as "significantly underpriced."[72] At Aderans' annual shareholder meeting, the Fund proposed six nominees to

---

64. *See id.* at 1091–92.

65. BUCHANAN ET AL., *supra* note 5, at 166 ("December 2007 represents the high point of hedge fund activism in Japan. Interventions . . . that had developed into public confrontations were being widely reported and the full impact of the global financial crisis had not yet affected the funds' investors.").

66. *See* 2015 Letter to Shareholders of Steel Partners, *supra* note 47, at 14 (app. A).

67. Letter from Warren G. Lichtenstein, Chairman and Chief Exec. Officer of Steel Partners Holdings, L.P. to Shareholders of Steel Partners Holdings, L.P. (Apr. 13, 2016) [hereinafter 2016 Letter to Shareholders of Steel Partners].

68. *See id.* at 14.

69. *See id.* (emphasis added).

70. Steel Partners first acquired ownership in Aderans and Sapporo through its investment vehicle, Steel Partners Japan Strategic Fund L.P. ("Steel Partners Japan") in 2004 and 2005, respectively. *See* 2010 Letter to Shareholders of Steel Partners, *supra* note 46, at 8–9.

71. *Id.* at 8–9.

72. *Id.* at 8.

the company's board of directors and Aderans' shareholders elected each of the nominees in a subsequent vote, giving Steel Partners eight directors and majority board membership.[73] With majority board control, Steel Partners defeated the tender offer and successfully defended its financial stake in Aderans. The Fund proudly announced that its engagement represented "the first time in history that a [U.S.] based or foreign investor [had] taken control of a Japanese company in a contested election and against the wishes of a management team."[74]

Other contentious engagements between Steel Partners and management have proven less successful. In February of 2007, the Fund entered into a prolonged struggle with the management of Sapporo Holdings, Ltd. after initiating a takeover of the company and exercising its 18% ownership to launch a tender offer for ¥825 per share; a price merely ¥3 below the then-current market value of Sapporo's stock.[75] The offer would have boosted Steel Partners' ownership in Sapporo to 66.6%.[76] Sapporo's board reacted by adopting an "advance warning system" requiring Steel Partners to respond to questions about its motives for the tender offer and to solicit management's approval of the sale.[77] The advance warning measure also included a "dilution clause" allowing the board to issue new shares to existing shareholders and prevent Steel Partners from acquiring a large stake in the company.[78] The struggle between Steel Partners and Sapporo's management continued after Sapporo fell short of sales targets and lost its position among Japan's top three domestic brewers in 2008.[79] In March of 2010, Steel Partners initiated a proposal to oust Sapporo's management by placing six of its own nominees on the ten-person board.[80] The proposal was driven by a "deterioration of [Sapporo's] corporate and shareholder value,"[81] which Steel Partners attributed to "poor management and poor oversight by

73. *Id.* at 9.

74. *Id.*

75. Shu-Ching Jean Chen, *Sapporo Adopts Defense Against Steel Partners*, FORBES (Mar. 29, 2007), http://www.forbes.com/2007/03/29/sapporo-steel-vote-markets-equity-cx_jc_0330markets19.html [https://perma.cc/K4R9-DYHS].

76. *Id.*

77. *Id.*

78. *See id.*

79. *See Steel Partners Seeks Support for Its Highly Qualified Director Nominees from Sapporo Shareholders*, BUSINESS WIRE (Feb. 23, 2010), http://www.businesswire.com/news/home/20100222007174/en/Steel-Partners-Seeks-Support-Highly-Qualified-Director [https://perma.cc/5MVZ-NLB9].

80. *Id.*

81. 2010 Letter to Shareholders of Steel Partners, *supra* note 46, at 9. Sapporo had fallen short of sales and profit budgets on several occasions since 2002, and in 2008 Sapporo ceded its position among Japan's top three domestic brewers. *See id.*

the management-controlled Board."[82] The Fund's proposal ultimately failed so that after years of public battles with management, Steel Partners sold its Sapporo holdings in December of 2010.[83]

Engagements by The Children's Investment Fund ("TCI"), a British hedge fund, offer additional examples of adversarial activism. TCI made extensive use of the Japanese press to highlight its agenda and invite public pressure on management. This strategy was particularly evident in the Fund's attempted tender offer for greater ownership in J-Power.[84] In its dealings with J-Power, TCI's principal Japanese spokesperson used the Fund's regional website and the Japanese press to highlight its agenda for reform.[85] The spokesperson "was interviewed extensively [by] the Japanese press" and at times "received favorable comment from . . . mainstream newspapers" with regards to his financial justifications for reorganizing J-Power.[86] Beyond the adversarial strategies of Steel Partners and TCI, Strategic Capital, Inc. ("Strategic Capital") and Effissimo Capital—funds based in Tokyo and Singapore, respectively—illustrate that adversarial activism has gained acceptance among non-Western institutions.[87]

B. Constructive or "Quiet" Activism

Constructive, or "quiet,"[88] activism offers a less adversarial brand of institutional engagement. Constructive activism generally involves informal, non-public communications with management, decision making based on objective or criteria-based evaluations of firm performance and an emphasis on highlighting "good governance" rather than attacking inefficient

82. *Id.*

83. Naoko Fujimara, *Steel Partners Sells Entire Stake in Sapporo Holdings*, BLOOMBERG (Dec. 16, 2010), http://www.bloomberg.com/news/articles/2010-12-16/lichtenstein-s-steel-partners-sells-its-entire-stake-in-sapporo-holdings [https://perma.cc/3242-28PA]. The Fund's exit was widely construed as a retreat from Sapporo's hostility toward aggressive, foreign influence. *See id.*

84. *See supra* Part I.C.

85. *See* BUCHANAN ET AL., *supra* note 5, at 183.

86. *Id.*

87. In April of 2016, Strategic Capital introduced aggressive proposals with a handful of Japanese companies to lobby for increased dividend payments and the Fund has filed lawsuits against individual directors for duty violations. *See* Kathleen Chu & Tom Redmond, *This Activist Investor Doesn't Have Time for Japan's Nice Meetings*, BLOOMBERG (May 10, 2016), http://www.bloomberg.com/news/articles/2016-05-09/this-japanese-activist-investor-doesn-t-have-time-for-your-nice-meetings [https://perma.cc/E7V6-Y76C]. Effissimo Capital has also adopted adversarial tactics by focusing narrowly on portfolio companies' financial returns in deciding whether to oppose proposals by management. *See* Kana Inagaki, *Activist Investors' Focus on Returns Unsettles Japan CEOs*, AUSTRALIAN FIN. REVIEW (Aug. 3, 2016), http://www.afr.com/business/activist-investors-focus-on-returns-unsettles-japan-ceos-20160803-gqjuug [https://perma.cc/JNU6-JRN5].

88. *See* BUCHANAN ET AL., *supra* note 5, at 282 (introducing a contrast between confrontational activism and an alternative form of "quiet" activism).

management.[89] At its core, the constructive approach rests on a fundamental belief in the power of market influence. Rather than using aggressive proxy campaigns or hostile takeover bids to advocate for governance reform, constructive activists promote industry-wide knowledge of effective governance, presumably in hopes that firms will alleviate the need for costly battles between shareholders and management by tailoring their internal governance to market preferences.

The constructive approach is typified by the Pension Fund Association ("PFA"), one of Japan's primary pension funds established in 2004.[90] The PFA manages pension assets for Japanese citizens who have withdrawn from corporate pension plans and it provides benefit payments by reinvesting these assets in bonds and portfolio companies.[91] At the end of fiscal year 2014, the majority of the PFA's "basic pension" assets were invested domestically—41.6% in domestic bonds and 17.2% as equity in domestic firms compared to 12.8% in foreign bonds and 28.5% in foreign equities.[92] The PFA relies on independent asset managers to ensure returns on its portfolio of investments for its pension holders.[93] In evaluating the governance of portfolio companies, the PFA has provided financially-oriented and performance based proxy voting standards[94] to guide its managers when exercising the Pension's shareholder voting rights. For instance, the PFA opposes the reappointment of directors in companies where shareholder value has been "impaired" either by business losses or a failure to pay dividends.[95]

The PFA's guidelines are modest by Western standards, but they "created a stir in Japan," where pension funds have traditionally avoided focusing narrowly on shareholder returns.[96] The PFA's proxy voting patterns

89. *See* Aronson, *supra* note 35, at 574n.1 (contrasting "activist" hedge funds with the "limited" activism of pension funds); Nili, *supra* note 21, at 190 ("[The] constructive activism model is based on cherry picking examples of good governance to educate the public, investors, and firms as to how governance should be.").

90. *What is the Pension Fund Association?*, PENSION FUND ASSOCIATION, https://www.pfa.or.jp/english/about/ [https://perma.cc/5QSY-FU5Z].

91. *Overview and Approaches of Investments*, PENSION FUND ASSOCIATION, https://www.pfa.or.jp/english/about/investments/overview.html [https://perma.cc/N35F-7ELP].

92. *Id.*

93. *Id.*

94. GUIDELINES FOR THE EXERCISE OF SHAREHOLDER VOTING RIGHTS, PENSION FUND ASSOCIATION [hereinafter PFA PROXY VOTING GUIDELINES], https://www.pfa.or.jp/english/about/investments/files/gov_e20101228.pdf [https://perma.cc/J8PC-6YZJ]. The PFA's proxy voting guidelines, first published in 2003, were influenced by "ideas from Anglo-American pension funds such as CalPERS, TIAA-CREF, and Hermes (CalPERS' partner in the United Kingdom.)." Jacoby, *supra* note 4, at 110–11.

95. *See* PFA PROXY VOTING GUIDELINES, *supra* note 94, at 1.

96. Martin Fackler, *An Investor Activism Uncommon in Japan*, N. Y. TIMES (Aug. 30, 2007),

in Japan have been much less anti-management than pension funds based in the United States, such as the California Public Employees Retirement System ("CalPERS"). Whereas the PFA voted in opposition to roughly forty-nine percent of director appointments in Japan in 2004, United States pensions opposed ninety-three percent of such proposals.[97] Several phenomena may explain the PFA's tempered approach in its engagements with management. Perhaps most significantly, as a domestic institution, the PFA has been constrained by Japanese social, cultural and behavioral norms. According to its former managing director, Tomomi Yano, the PFA could not openly propose dismissals of directors or CEOs in the same manner as Western pensions have. He further explained that such actions would draw criticism from Japanese society;[98] the PFA "[could not] be such an activist as CalPERS"[99] or other Western pension funds. These constraints tempered the PFA's proxy voting patterns and likely explain its preference for private discussions with under-performing and under-paying firms, rather than public battles or communication with management.[100] Beyond establishing objective standards for evaluating corporate governance, the PFA has also highlighted models of effective management by establishing a "corporate governance fund" in March of 2003.[101] The fund was intended to create an investment portfolio of the 50 listed companies with the best governance practices among approximately 1,500 companies listed on the Tokyo Stock Exchange.[102] The PFA selected its portfolio companies after developing its own evaluation standards, distributing governance questionnaires,[103] and undertaking onsite visits to interview listed companies.[104] Although the corporate governance fund was closed in February of 2009, it "'[sent] a message' to corporate managers concerning the PFA's expectation as to

http://www.nytimes.com/2007/08/30/business/worldbusiness/30investor.html?_r=1 [https://perma.cc/X89H-DLH5].

97. Jacoby, *supra* note 4, at 111.

98. Interview with Kuny Kobayaschi, Director of Asian Development, Investor Responsibility Research Center, in Tokyo, Japan (Mar. 17, 2005), *cited in* Jacoby, *supra* note 4, at 113 ("Noting that CalPERS has on numerous occasions proposed a CEO dismissal, Yano said, 'PFA cannot do such a thing yet, though we want to. If we do, we will be criticized in the Japanese society.'").

99. *Id.*

100. Jacoby, *supra* note 4, at 111.

101. Tomomi Yano, Exec. Managing Dir., Pension Fund Ass'n, Closing Keynote Speech, Asian Business Dialogue on Corporate Governance 2007: Strengthening Companies and Capital Markets through Corporate Governance: The Critical Role of Investors in Strengthening Corporate Governance in Japan 3 (Nov. 8, 2007) [hereinafter Yano Keynote Speech].

102. Aronson, *supra* note 35, at 621.

103. Yano Keynote Speech, *supra* note 101.

104. Aronson, *supra* note 35, at 621.

what constituted 'good governance.'"[105]

C. Collaborative Activism

Collaborative activism incorporates a more intermediate style of engagement than the adversarial or constructive approaches. Collaborative activists generally apply a lighter touch in their engagements with firms by lodging private arguments or disagreements with management,[106] by cooperating with other shareholders and by emphasizing a long-term interest in target firms' stability, rather than pursuing short-term payouts for clientele. In essence, the engagements of collaborative activists are focused less on shareholding for the sake of financial returns and more on shareholding as a means of *stakeholding*, or undertaking a long-term commitment to a target firm's financial and social stability.

In sharp contrast to its strategies with United States-based target firms,[107] recent engagements in Japan by Third Point, LLC ("Third Point") are indicative of the collaborative approach. The hedge fund's manager, Daniel Loeb, has tactfully engaged Japanese firms over the last decade and implemented a style of activism reliant on trust and long-term investor-management relations, rather than firm-specific agitation and financial payout. In May of 2013, Loeb hand-delivered to the board of Sony Corporation a letter announcing Third Point's majority ownership in the company[108] and proposing the company sell fifteen to twenty percent of its ownership in Sony Entertainment, a separate division of the firm focusing on television, motion picture production and music publishing.[109] Rather than a typical public offering, Loeb suggested that Sony undertake a subscription rights offering to allow current shareholders to acquire direct

105. *Id.*

106. *See* BUCHANAN ET AL., *supra* note 5, at 172 (contrasting the "aggressive and publicly confrontational" approach of Steel Partners with firms such as Perry Corporation and Ichigo Asset Management Ltd. that generally avoided public confrontation with target boards).

107. Third Point's manager, Daniel Loeb, is well-known for his aggressive engagements with management of Western target firms. In 2005, Loeb pointedly accused a CEO of a portfolio firm of managerial ineptitude: "Sadly, your ineptitude is not limited to your failure to communicate with bond and unit holders . . . your record reveals years of value destruction and strategic blunders which have led us to dub you one of the most dangerous and incompetent executives in America." Letter from Daniel S. Loeb, Chief Exec. Officer of Third Point, LLC, to Irik P. Sevin, Chairman, President and Chief Exec. Officer of Star Gas Partners L.P. (Feb. 14, 2005), *reprinted in* JEFF GRAMM, DEAR CHARIMAN: BOARDROOM BATTLES AND THE RISE OF SHAREHOLDER ACTIVISM 230 (2016).

108. Letter from Daniel Loeb, Chief Exec. Officer of Third Point, LLC, to Kazuo Hirai, President and Chief Exec. Officer of Sony Corp. 1 (May 14, 2013) [hereinafter Letter from Daniel Loeb to Sony Corp.]. As Sony's largest shareholder at the time of Loeb's letter, Third Point held approximately 64 million shares in the company valued at over ¥115 billion ($1.1 billion); ¥71 billion ($700 million) was held through direct ownership. *Id.*

109. *Id.* at 2.

ownership in the entertainment subsidiary.[110] Loeb anticipated that such a sale would "reward" the management of Sony Entertainment by offering them shares "specifically tied to a company [under their] control" and would therefore encourage them to improve the subsidiary's financial performance.[111] Perhaps more significant than the practical and economic justifications underlying Loeb's proposal, the letter was framed in terms of a *partnership* between shareholders and management to advance interests *beyond shareholder value*. For example, Loeb argues in the letter's closing paragraphs that his approach to strengthen Sony "serves all of [the company's] stakeholders—employees, management, and fellow owners" by "reduc[ing] debt, increase[ing] profitability, and creat[ing] significant shareholder value."[112] The letter also concludes by stating "[Third Point] is confident that by acting as partners, Sony will grow stronger."[113] While some may discount Loeb's statements as mere window dressing, Third Point's actions supported its manager's collaborative tone—the Fund stood ready to "ensure the success of [Loeb's proposed] subscription rights offering" by committing itself to a significant financial guarantee of Sony's sale "up to ¥150–200 billion" ($1.5–2 billion).[114] Third Point's financial pledge amounted to nearly fifteen percent of its assets under management and underscored its commitment to supporting Sony's long-term financial stability.[115]

Although Loeb's proposal was rejected by Sony's board in August of 2013,[116] the company nonetheless decided in November to cut costs and prioritize its television operations.[117] Similar engagements by Third Point with other Japanese firms have facilitated successful governance reform. In February of 2015, the Fund announced a dominant stake in Fanuc Corporation ("Fanuc")—an industrial Japanese robot manufacturer—and requested that the company dispense greater cash dividends to shareholders.[118] Fanuc responded favorably by announcing two months later

110. *Id.*

111. *Id.*

112. *Id.* at 3.

113. *Id.* at 4.

114. *Id.* at 2.

115. Inagaki, *supra* note 38.

116. Daniel Miller, *Activist Investor Dan Loeb Sells Stake in Sony Corp.*, L.A. TIMES (Oct. 21, 2014), http://www.latimes.com/entertainment/envelope/cotown/la-et-ct-activist-investor-dan-loeb-sells-stake-in-sony-corp-20141021-story.html [https://perma.cc/6Q8E-6ZEV].

117. *Id.*

118. Eric Pfanner, *Japanese Robot Maker Fanuc to Double Dividend*, WALL ST. J. (Apr. 27, 2015), http://www.wsj.com/articles/fanuc-to-increase-dividends-after-push-by-activist-investor-daniel-loeb-1430121007 [https://perma.cc/FHF8-VYBR].

its plans to double cash dividends by distributing sixty percent of net profits to investors; up from thirty percent previously.[119]

III. KEY BYPRODUCTS OF MODERN LEGISLATIVE REFORM & FOREIGN INFLUENCE

Since the turn of the twenty-first century, Japan has experienced significant reform to its corporate law. This paper does not undertake to explain Japan's evolving standards of governance or to summarize the legal developments underlying its current corporate governance regime. However, this section focuses on two 'byproducts' of Japan's recent corporate evolution that will interact with its current array of activist strategies and influence the future behavior of institutional investors.

Two byproducts of Japan's reformation have the potential to influence the future behavior of institutional investors. First, the Japanese Ministry of Economy, Trade and Industry and Ministry of Justice published a set of Guidelines in May of 2005 to clarify standards for reasonable defensive maneuvers by management in Japanese companies. The Guidelines include a list of specific scenarios in which defensive maneuvers are appropriate in response to aggressive acquirers. Although the Guidelines were intended to relax the defensive postures of management and establish a framework enabling target firms to interact with outside investors, the inclusion of these specific scenarios has ultimately invited stronger resistance by management toward acquirers. As such, the Guidelines have created a significant obstacle for aggressive activism in twenty-first century Japan; adversarial activists must now contend with defensive measures sanctioned by the Japanese government in addition to longstanding cultural friction and social hostility.

Second, a 2015 amendment to the Japanese Companies Act and the passage in 2015 of a new Japanese Corporate Governance Code have encouraged companies to increase independent board membership and ensure that directors are subject to heightened accountability. These governmental initiatives—greater board independence and heightened accountability—have distanced Japanese companies from their "internalist" roots, and have fundamentally altered the nature of Japanese corporate governance. Interestingly, the government's quest for greater board independence may serve as a moderating influence on the defensive postures supported by the aforementioned Guidelines of 2005. With greater board independence and accountability, shareholders now have a meaningful role in managerial decision-making and opportunities have emerged for constructive engagement.

119. *Id.*

As these byproducts demonstrate, "significant norm shifts are under way in Japan,"[120] including greater emphasis on managerial oversight, "a heightened awareness of shareholders' economic expectations" and a fundamental shift in perspectives on management's "proper role in running the firm."[121] These dynamics will play a crucial role in shaping the future contours of engagements between shareholders and management.

A. Guidelines on Defensive Maneuvers to Counter Aggressive Acquirers

In September of 2004, Japan's Ministry of Economy, Trade and Industry ("METI") and the Ministry of Justice ("MOJ") convened a Corporate Value Study Group of experts and business representatives[122] to analyze Japan's market for corporate control in response to an "increasing threat of hostile takeovers."[123] The Study Group ultimately published a Report in March of 2005 to develop a "framework for fair and reasonable hostile takeover defensive measures that would enhance corporate and shareholder value" based on globally-accepted Western standards.[124] Most significantly, the Report concluded that key principles of Delaware takeover jurisprudence[125] could be incorporated into existing Japanese law and it expressly endorsed the "poison pill" shareholder rights plan as a legitimate defensive mechanism available to management in Japanese firms.[126] Prior to the Report, Japanese firms rarely adopted defensive measures for fear that share prices would react negatively or that the measures would be impermissible under Japanese law.[127] However, the Study Group's report provided government support for defensive maneuvers and encouraged Japanese firms to adopt Western defense measures to replace traditional

120. *See* Milhaupt, *supra* note 54, at 18.

121. *Id.*

122. MINISTRY OF ECON., TRADE AND INDUS. (METI): CORP. VALUE STUDY GRP., SUMMARY OUTLINE OF DISCUSSION POINTS 1 (Mar. 2005) [hereinafter CORPORATE VALUE STUDY GROUP DISCUSSION POINTS], http://www.meti.go.jp/english/information/downloadfiles/Corporate%20Value.pdf [https://perma.cc/M9BN-PR8N].

123. *See* Milhaupt, *supra* note 9, at 2172–73.

124. CORPORATE VALUE STUDY GROUP DISCUSSION POINTS, *supra* note 122, at 1.

125. For example, the Report includes a two-pronged analysis to assess the reasonableness of defensive measures. The Study Group's test closely resembles Delaware's *Unocal* Doctrine and asks (1) whether a threat exists that may impair corporate value, and (2) whether the defensive measure adopted is proportional to the threat posed. *Id.* at 8.

126. *See id.* at 15 (concluding that "[m]ost Western-style defense measures . . . are permissible in Japan" and "[r]ights plans are possible through the [issuance] of Shinkabu Yoyakuken (warrant[s] to subscribe for new shares)" following a board decision).

127. *See id.* at 5. According to an METI survey in September of 2004, the Report states that thirty-three percent of non-adopting Japanese firms were concerned over market reactions and thirty-one percent were unsure of the legality of defensive measures under Japanese law. *Id.*

cross-shareholding alignments.[128] To aid Japanese firms in their defensive maneuvers, the Report called upon the METI and MOJ to establish guidelines for the reasonable implementation of defensive mechanisms.[129]

The METI and MOJ responded immediately and published a set of Guidelines (the "METI-MOJ Guidelines," or the "Guidelines") for defensive maneuvers in May of 2005.[130] The Guidelines supplement existing regulations in the Japanese Commercial Code[131] and apply specifically to defensive measures adopted in anticipation of "unsolicited takeover proposal[s]"[132] by outside investors. While not legally binding, the METI-MOJ Guidelines have achieved wide acceptance among Japanese listed companies[133] and have affected a subtle shift in the focus of Japanese corporate governance toward shareholder primacy.

The Guidelines rest on three basic principles: (1) the protection and enhancement of corporate value and shareholder interests; (2) prior and full disclosure out of respect for shareholders; and (3) a requirement that defensive measures be necessary and reasonable in relation to threats posed by outside investment.[134] The principles have empowered shareholders and fundamentally altered the nature of engagements between investors and management. As the METI and MOJ note:

> [I]f the Guidelines are shared and respected by . . . corporate managers, shareholders, investors, stock exchanges, lawyers, financial advisors, etc., they will facilitate a major change in the Japanese business community and lead to the enhancement of corporate value. More specifically, they will lead to the establishment of corporate management focused on the interests of shareholders, active use and independence of external board members, establishment of procedures to reasonably investigate takeover proposals, improved procedures governing shareholders meetings, *exercise of responsibility by institutional investors, and consensus-*

128. *See id.* at 3 (recognizing a "dissolution" of traditional cross-shareholding alignments and a subsequent "desire of Japanese corporations" to seek replacement defense mechanisms).

129. *See id.* at 16.

130. MINISTRY OF ECON., TRADE AND INDUS. & MINISTRY OF JUSTICE, GUIDELINES REGARDING TAKEOVER DEFENSE FOR THE PURPOSE OF PROTECTION AND ENHANCEMENT OF CORPORATE VALUE AND SHAREHOLDERS' COMMON INTERESTS [hereinafter METI-MOJ TAKEOVER DEFENSE GUIDELINES] (May 27, 2005), http://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/shishin_hontai.pdf [https://perma.cc/J2BL-QLPH].

131. ENRICO COLCERA, THE MARKET FOR CORPORATE CONTROL IN JAPAN: M&AS, HOSTILE TAKEOVERS AND REGULATORY FRAMEWORK 193 (2007).

132. METI-MOJ TAKEOVER DEFENSE GUIDELINES, *supra* note 130, at 1.

133. Nels Hansen, *Japan's First Poison Pill Case*, Bulldog Sauce v. Steel Partners*: A Comparative and Institutional Analysis*, 26 J. JAPAN L. 139, 144 (2008).

134. *See* METI-MOJ TAKEOVER DEFENSE GUIDELINES, *supra* note 130, at 3.

> *building between corporate managers and investors about the long-term enhancement of corporate values*.[135]

The Guidelines were promulgated in hopes that they would offer a "code of conduct"[136] for the Japanese business community in response to engagements by outside investors. The first principle above (i.e. the protection of corporate value and shareholder interests) is particularly significant given its effect on engagements between outside investors and management. In explaining the first principle, the Guidelines recognize as "legitimate and reasonable" any defensive measures designed to "protect . . . shareholder interests by preventing certain shareholders from acquiring a controlling stake" in a Japanese listed company.[137] In a supplemental note, the METI and MOJ offer specific examples of reasonable defensive measures, including measures to prevent takeovers by acquirers (a) seeking to accumulate shares with the intention of requiring a "buy back" at a higher price by the target firm, (b) pursuing temporary control of a target firm for their own financial benefit and to the firm's detriment, (c) seeking to pledge the target firm's assets as collateral for the debts of the acquirer, or (d) pursuing temporary control of management in a target firm so as to sell assets and dispense dividends to the acquirer's shareholders.[138] By listing these examples and "blessing" managerial hostility to aggressive acquirers, the Guidelines—although designed to facilitate cooperative engagement, or "consensus-building,"[139] between management and outside investors—have arguably hardened the defensive posture of management toward aggressive acquirers seeking short-term extraction of financial gain. The Japanese government's acquiescence in this regard, as discussed in Part IV below, likely imposes significant obstacles for adversarial activists seeking to acquire shares in Japanese listed companies.

B. Greater Emphasis on Independent Board Membership & Accountability

Along with the METI-MOJ Guidelines, significant changes to Japan's standards of corporate governance will also influence future engagements between shareholders and management. Two developments in particular are significant in this regard: an amendment to the Japanese Companies Act offering firms an alternative governance model, and the adoption in 2015 of a new Corporate Governance Code.

135. *Id.* at 3 (emphasis added).

136. *Id.*

137. *Id.* at 4.

138. *Id.* at 4, Note 1(i)(a)–(d). Note 1 also recognizes as legitimate any defensive measures designed to prevent "coercive, two-tiered takeovers," or to ensure time and negotiating power for target firms. *Id.* at Note 1(ii), (iii).

139. *Id.* at 3.

Over the last two decades, amendments to Japanese corporate law have focused on specific topics such as merger procedures, managerial liability, share repurchase rights, and shareholder derivative suits.[140] However, in June of 2014, the Japanese Diet published an amendment to the Japanese Companies Act[141] intended to overhaul the country's corporate governance regime. The Amendment (hereinafter, the "Reform Act") took effect in May of 2015 and aimed to improve accountability among management in listed companies.[142] Most importantly, the Reform Act appears primed to facilitate open communication between shareholders and management, and to position investors to agitate for governance reform.

Prior to the Reform Act, Japanese law prescribed two traditional governance regimes for listed companies: (1) the "Company with Board of Company Auditors" regime composed of a board of at least three statutory auditors,[143] a majority of whom were required to be "outside company auditors;"[144] and (2) the "Company with Committees" regime composed of nominating, compensation, and audit committees,[145] each with a majority of "outside directors."[146] Japanese firms were authorized to adopt either regime, but most preferred the "Board of Company Auditors" approach; firms were hesitant to entrust outside directors under the "Committee" regime with authority to nominate and determine the compensation of management.[147] This preference for outside company auditors and the "Board of Company Auditors" approach, rather than outside directors under the "Company with Committees" approach, may also be explained by the limited supervisory

140. *See* Milhaupt, *supra* note 54, at 4–11 (documenting various amendments to the Japanese Commercial Code from 1993 to 2002).

141. 会社法[Companies Act of Japan], Act No. 86 of 2005 [hereinafter Japanese Companies Act].

142. *See* Masamichi Sakamoto & Yohei Harima, *Companies Act Reform 2014: Can the New Amendment to the Companies Act of Japan Strengthen the Corporate Governance Systems of Japanese Listed Companies?*, CITY-YUWA PARTNERS 56 (June 2014), http://www.city-yuwa.com/english/publication/shared/PDF/JLG201415_cy_56-59.pdf [https://perma.cc/Z4ZU-HBBT].

143. Japanese Companies Act, *supra* note 141, at art. 2(x).

144. *Id.* at art. 2(xvi) (defining "outside company auditor"); *see also id.* at art. 335(3) ("A Company with Board of Company Auditors shall have three or more company auditors, and . . . half or more of them shall be Outside Company Auditors.").

145. *Id.* at art. 2(xii).

146. *Id.* at art. 400(3). The Japanese Companies Act generally defines an "outside director" as a director of a listed company who is not an Executive Director, Executive Officer, manager, or other employee of the company or of a subsidiary, and who has not been an Executive Director of the company or of a subsidiary for ten years prior to assuming office. *See id.* at art. 2(xv).

147. Sakamoto & Harima, *supra* note 142, at 58.

function of auditors[148] and the *de facto* subordination of auditors under Japanese law.[149]

The Reform Act offered a third alternative arrangement: the "Company with Audit and Supervisory Committee" regime.[150] Under this regime, companies must establish an "audit and supervisory committee"[151] of at least three directors, the majority of which are outside directors. The committee is authorized to monitor and prepare reports on the performance of directors,[152] and to develop a committee opinion to be expressed at shareholders' meetings with regards to the appointment, removal and remuneration of non-committee member directors.[153] Members of the committee are further authorized to request that directors report on matters related to the execution of their duties and to investigate the status of their company's business or assets.[154] On a fundamental level, the audit and supervisory committee provides firms a mechanism to improve managerial oversight and facilitate shareholder accountability.

In conjunction with the Reform Act's audit and supervisory committee regime, Japan's recently enacted Corporate Governance Code[155] imposes an obligation on all companies operating under a traditional "Company with Board of Company Auditors" regime to appoint at least one independent director, or else explain to shareholders in an annual corporate governance report why such an appointment is inappropriate.[156] While the effect of a single independent director may prove minimal, since the "Company with Board of Company Auditors" regime is ubiquitous among Japanese listed firms,[157] the comply-or-explain approach pressures the majority of firms to embrace director oversight, or else answer to shareholders.[158] Thus, although

148. *See* Japanese Companies Act, *supra* note 141, at art. 381 (explaining auditors' authority to audit directors' performance and prepare "audit reports").

149. *See also id.* at art. 382 (requiring auditors to report to directors if they uncover misconduct or legal violations by directors).

150. Japanese Companies Act, *supra* note 141, at art. 2(xi)-2; *see also id.* at arts. 399-2 to 399-12.

151. Japanese Companies Act, *supra* note 141, at art. 399-2.

152. *Id.* at art. 399-2(3)(i).

153. *Id.* at art. 399-2(3)(iii).

154. *Id.* at art. 399-3(1).

155. TOKYO STOCK EXCHANGE, INC., JAPAN'S CORPORATE GOVERNANCE CODE: SEEKING SUSTAINABLE CORPORATE GROWTH AND INCREASED CORPORATE VALUE OVER THE MID- TO LONG-TERM (2015) [hereinafter JAPANESE CORPORATE GOVERNANCE CODE], http://www.jpx.co.jp/english/equities/listing/cg/tvdivq0000008jdy-att/20150513.pdf [https://perma.cc/XH5Q-AC6Y].

156. *See id.* at 34–35 (explaining the "Comply-or-Explain" approach).

157. Sakamoto & Harima, *supra* note 142, at 58.

158. *Id.* at 57 ("A company may find it very difficult to explain the reason why it believes that the appointment of an outside director is not appropriate. The absence of an appropriate person to serve as an outside director, for example, would not be a valid reason under the Reform Act. According to an officer of the Ministry of Justice . . . a company will be required to show that the appointment of an outside

the Reform Act stopped short of *requiring* firms to adopt the new "supervisory committee" system, Japanese law has *indirectly* promoted a degree of board independence and accountability among firms with traditional governance regimes.

While the Reform Act is a recent development and its effects have yet to be measured, data on listed companies gathered by the Tokyo Stock Exchange ("TSE") illustrate a steady trend toward independent board membership since 2008. Among listed firms organized under the "Company with Board of Auditors" regime (also known as companies with *kansayaku*, or statutory auditors), 63.8% had appointed at least one outside director in 2014, up from 44.1% in 2008.[159] Among firms organized under the "Company with Committees" regime—and thus required to appoint a majority of outside directors to each committee[160]—the total number of outside directors appointed has gradually increased; 80.8% had appointed more than four outside directors in 2014, compared with only 58.3% in 2008.[161] These trends are particularly pronounced among firms with the largest foreign shareholding ratios, suggesting that foreign investors have imported Western preferences for board independence and accountability. Among firms with the highest percentage of foreign shareholding (30% or greater), 26% appointed at least one-third of their directors as outside directors in 2014, up from 23.7% in 2012.[162] The Reform Act and its supervisory committee regime is likely to bolster Japan's current progression toward greater board independence and accountability among listed companies.

In a more recent development, a new Corporate Governance Code[163] (the "Code") took effect on June 1, 2015 as part of the Japanese government's Revitalization Strategy to enhance corporate governance and promote economic growth.[164] Preliminary discussions of the draft Code were

---

director will have a negative impact on the company. As this is a high hurdle to leap, the 'comply or explain' rule set to be implemented under the Reform Act . . . will oblige listed companies to appoint outsider directors as a matter of practice.").

159. TOKYO STOCK EXCHANGE, INC., TSE-LISTED COMPANIES WHITE PAPER ON CORPORATE GOVERNANCE 2015, at Chart 25 [hereinafter 2015 WHITE PAPER ON CORPORATE GOVERNANCE], http://www.jpx.co.jp/equities/listing/cg/tvdivq0000008jb0-att/2015.pdf [https://perma.cc/L4ML-VWJH].

160. Japanese Companies Act, *supra* note 141, at art. 400(3).

161. 2015 WHITE PAPER ON CORPORATE GOVERNANCE, *supra* note 159, at Chart 27.

162. *Id.* at Chart 31.

163. JAPANESE CORPORATE GOVERNANCE CODE, *supra* note 155.

164. Ken Kiyohara et al., *Japanese Corporate Governance is Changing with the Adoption of a New Code in 2015: Commentary*, JONES DAY (Feb. 2015), http://www.jonesday.com/Japanese-Corporate-Governance-Is-Changing-with-the-Adoption-of-a-New-Code-in-2015-02-03-2015/?RSS=true [https://perma.cc/M2Y4-45XJ].

led by a Council of Experts, established by the TSE and Japan's Financial Services Agency ("FSA") to consult with the private sector.[165] The final version of the Code sets forth seventy-three principles of effective corporate governance[166] and listed firms are expected (after conducting an independent governance examination and submitting an annual "corporate governance report" to the TSE) either to comply with each principle, or else submit a "non-compliance explanation."[167]

A substantial portion of the Code encourages constructive dialogue between shareholders and management in pursuit of long-term corporate growth.[168] In particular, Section Five of the Code ("Dialogue with Shareholders") encourages collaboration and essentially warns against a return to the culture of internalism that dominated Japanese firms in the past. To this point, the Code recognizes that management and directors "have opportunities to interact . . . with employees, business partners and financial institutions on a daily basis," but typically remain insulated from shareholders.[169] Rather than resist interactions with shareholders, the Code encourages management to respond reasonably to shareholders' requests and interests.[170]

While the Code's long term influence remains undetermined, data gathered by the TSE suggest that its governance principles have already gained acceptance among a majority of Japanese firms. As of July 14, 2016, 3,164 Japanese listed companies have submitted corporate governance reports detailing the extent of their compliance with the Corporate Governance Code.[171]

Among the Code's seventy-three principles, only twelve had compliance rates of less than ninety percent among the 2,262 companies

---

165. *See* Stephen Mulrenan, *Japanese Corporate Governance: A Matter of Principle*,, INTERNATIONAL BAR ASS'N (Apr. 7, 2015), http://www.ibanet.org/Article/Detail.aspx?ArticleUid=39c1745e-cbaf-45f1-a67a-b03c9753e829 [https://perma.cc/52K9-84NX] ("A draft of the new code was finalized on 5 March, following consultation overseen by Japan's Council of Experts Concerning the Corporate Governance Code, headed by the country's Financial Services Agency (FSA) and the TSE.").

166. These Principles are subdivided into five "General Principles," each accompanied by a set of "Principles" and "Supplementary Principles." *See* TOKYO STOCK EXCHANGE, INC., HOW LISTED COMPANIES HAVE ADDRESSED JAPAN'S CORPORATE GOVERNANCE CODE 4 (Sept. 13, 2016) [hereinafter HOW LISTED COMPANIES HAVE ADDRESSED JAPAN'S CORPORATE GOVERNANCE CODE], http://www.jpx.co.jp/english/equities/listing/cg/tvdivq0000008jdy-att/b5b4pj000001akx0.pdf [https://perma.cc/D7VL-YAE3].

167. *See id.* at 2.

168. JAPANESE CORPORATE GOVERNANCE CODE, *supra* note 155, at 26.

169. *Id.*

170. *See id.* at 27.

171. *See* HOW LISTED COMPANIES HAVE ADDRESSED JAPAN'S CORPORATE GOVERNANCE CODE *supra* note 166, at 2. The number of reporting companies increased by 21.5% (an additional 679 companies) from December of 2015. *Id.*

listed on the first and second sections of the TSE.[172] According to TSE data,[173] the principles with the lowest compliance rates involve requirements for full disclosure of company objectives, governance views, and board nomination policies,[174] the implementation of a "mid-term business plan,"[175] appropriate oversight of succession planning for executives,[176] and the inclusion of compensation incentives for management reflecting mid- to long-term business results.[177] The most controversial principles (those with exceedingly low compliance rates) were the obligation to provide shareholders an "electronic voting platform" (44.25% compliance)[178] and annual evaluations of directors (55.04% compliance).[179] Most significantly, *none* of the principles or supplementary principles relating to engagements with shareholders exhibited compliance rates below ninety percent.[180] In fact, only one of the six principles relating to shareholder engagement exhibited a compliance rate of less than ninety-eight percent.[181] These data suggest that the vast majority of Japanese listed firms intend to comply with the Corporate Governance Code's preference for collaborative engagement between shareholders and management. While the actual practices of Japanese firms and the effect of the Code remain undetermined, these data highlight a baseline of cooperation that has emerged to guide future shareholder-management relations.

---

172. *See id.* at 4.

173. *See id.*

174. *See id.* (referencing "P3-1," or Principle 3.1 of Japan's Corporate Governance Code, *supra* note 155, at 14).

175. *See* HOW LISTED COMPANIES HAVE ADDRESSED JAPAN'S CORPORATE GOVERNANCE CODE, *supra* note 166, at 4 (referencing "SP4-1-2," or Supplementary Principle 4.1.2 of Japan's Corporate Governance Code, *supra* note 155, at 18).

176. *See* HOW LISTED COMPANIES HAVE ADDRESSED JAPAN'S CORPORATE GOVERNANCE CODE *supra* note 166, at 4 (referencing "SP4-1-3," or Supplementary Principle 4.1.3 of Japan's Corporate Governance Code, *supra* note 155, at 18).

177. *See* HOW LISTED COMPANIES HAVE ADDRESSED JAPAN'S CORPORATE GOVERNANCE CODE, *supra* note 166, at 4 (referencing "P4-2," or Principle 4.2 of Japan's Corporate Governance Code, *supra* note 155, at 18).

178. *See* HOW LISTED COMPANIES HAVE ADDRESSED JAPAN'S CORPORATE GOVERNANCE CODE, *supra* note 166, at 4 (referencing "SP1-2-4," or Supplementary Principle 1.2.4 of Japan's Corporate Governance Code, *supra* note 155, at 7).

179. *See* HOW LISTED COMPANIES HAVE ADDRESSED JAPAN'S CORPORATE GOVERNANCE CODE, *supra* note 166, at 4 (referencing "SP4-11-3," or Supplementary Principle 4.11.3 of Japan's Corporate Governance Code, *supra* note 155, at 23).

180. *See* HOW LISTED COMPANIES HAVE ADDRESSED JAPAN'S CORPORATE GOVERNANCE CODE, *supra* note 166, at 4.

181. *See id.* All principles relating to shareholder engagement exhibited a compliance rate of greater than 98%, except for Principle 5.2, requiring the disclosure of earnings plans and capital policies (90.14% compliance). *Id.*

IV. A SHIFTING BALANCE OF POWER & IMPLICATIONS FOR THE FUTURE

Taken together, these byproducts of Japan's twenty-first century transformation appear likely to *mitigate* the influence of adversarial activism while *empowering* constructive and collaborative activists in their engagements with Japanese firms. As scholars have recognized, Japan's market for aggressive activism and hostile takeovers has proven "enigmatic."[182] Despite increasing volumes of takeover activity in Western jurisdictions,[183] Japan's market for hostile takeovers has remained lukewarm.[184] Although Japan exhibits many characteristics of an attractive takeover market (e.g., a variety of independent public companies with dispersed share ownership), it has become the antithesis of Western, takeover-centric regimes.[185] In proportion to Japan's gross domestic product, foreign direct investment in Japanese companies stood at 3.4% as of 2012, compared with an average of 30.6% for all other member states of the Organization for Economic Cooperation and Development ("OECD").[186] While this data is not *directly* indicative of a slow market for hostile takeovers by foreign institutional investors, the fact that foreign investment remains well below OECD standards lends credence to the viewpoint that Japan has diverged from Western takeover-centrism.

In Japan's current investment climate, the aggressive approach of adversarial activists faces significant obstacles. Directors of Japanese companies are authorized by the METI and MOJ to bolster their defenses against aggressive acquirers. Further, the "code of conduct" envisioned by the METI-MOJ Guidelines and Japan's new Corporate Governance Code essentially predisposes management of target companies against adversarial

---

182. *See generally* Dan W. Puchniak & Masafumi Nakahigashi, *The Enigma of Hostile Takeovers in Japan: Bidder Beware* (National Univ. of Singapore, Centre for Asian Studies Working Paper No. 16/03, 2016).

183. *See generally* DANIELLE CARBONE, DAVID CONNOLLY, STEPHEN GLOVE, DOREEN LILIENFELD, & RORY O'HALLORAN, SHEARMAN & STERLING LLP, CORPORATE GOVERNANCE & EXECUTIVE COMPENSATION SURVEY 2 (2015), http://shearman.uberflip.com/i/581575-2015-corporate-governance-executive-compensation-survey/0 [https://perma.cc/VM83-FHFE] (recognizing "a substantial increase in publicly disclosed shareholder activist activity at the Top 100 [U.S.] Companies, with activist campaigns increasing 33%—from six companies in 2014 to eight companies in 2015" and predicting that "activists will continue to look toward larger targets" as capital flows are allocated to the "activist fund asset class").

184. *See generally* Puchniak & Nakahigashi, *supra* note 182 (documenting the underlying reasons for the "enigma" of Japan's subdued market for hostile takeovers).

185. *See* Dan W. Puchniak, *The Efficiency of Friendliness: Japanese Corporate Governance Succeeds Again Without Hostile Takeovers*, 5 BERKELEY BUS. L.J. 195, 201 (2008) (characterizing Japan's early twenty-first century transformation and resulting governance regime as "the antithesis" of the American takeover-centric governance model).

186. *See* U.S. DEPT. OF STATE, INVESTMENT CLIMATE STATEMENT 2 (June 2014).

activists by encouraging a focus on long-term corporate value[187] rather than the short-term profits typically sought by aggressive investors. In light of increasing costs and greater resistance from management, adversarial institutions have begun to exit the Japanese market altogether.[188] Under Japan's modern standards of corporate governance, aggressive forms of engagement are quickly becoming a 'lost art.' By contrast, activists seeking less-hostile, cooperative means of influence face far fewer obstacles than their adversarial counterparts. Recently, the collaborative strategies of Third Point, LLC, Taiyo Pacific Partners (another United States-based firm) and numerous other institutions have demonstrated significant progress in promoting governance reform within Japanese target companies.[189] Recent interactions between institutional investors and management have focused on long-term investment goals, and the Japanese public has taken notice.[190]

Despite the likelihood of coordination between cooperative investors and target firms, it remains to be seen whether stakeholder and cultural constraints on managers under the remnants of Japan's former *keiretsu* system may ultimately prove stronger than the system of collaboration and engagement introduced by the regulatory changes discussed above. This question will turn primarily on the evolving role of outside directors in Japan's culture of conformity. Will outside directors be empowered to operate independently of the "community firm" and traditional norms of firm-centrism? Or, will the independent oversight of outside directors be

187. *See* METI-MOJ TAKEOVER DEFENSE GUIDELINES, *supra* note 130, at 3 (recognizing the importance of "consensus-building" between managers and investors on enhancing long-term corporate values).

188. *See, e.g.*, 2015 Letter to Shareholders of Steel Partners, *supra* note 47, at 14 (app. A) (notifying shareholders of full divestment of holdings in Aderans Holdings Co. Ltd.—the Fund's last remaining investment in Japan); Atsuko Fukase, *Cerberus Sells Big Chunk of Seibu Stake: Unloading of Stake Worth More than $800 Million is U.S. Firm's Latest Japan Asset Sale*, WALL ST. J. (May 22, 2015), http://www.wsj.com/articles/cerberus-sells-830-million-chunk-of-seibu-stake-1432279872 [https://perma.cc/6QRC-HG6R] (documenting the sale of Japanese assets by Cerberus Capital Management LP, a U.S. private equity fund, including the sale of its entire stake in Aozora Bank Ltd., the sale of its fifty-five percent ownership in Kokusai Kogyo Co., and the sale a large portion of its stake in Seibu Holdings Inc. The article credits "a clash of Japanese and Western corporate cultures" as a contributing factor to Cerberus' disputes with Japanese management and subsequent market exit.).

189. Ritsuko Ando, *'Friendly' Activist Wins Japan's Trust as Hostile Funds Struggle*, REUTERS (May 16, 2014), http://www.reuters.com/article/japan-investment-idUSL3N0O116T20140516 [https://perma.cc/RQ2F-QA7L] (describing the approach of Taiyo's manager, Brian Haywood, in engaging with Roland Corporation, a Japanese musical instrument manufacturer. Haywood's cooperative approach led to a management buyout in order to privatize Roland and guide it successfully through restructuring).

190. *See id.* (acknowledging "the rise of a new and friendly style of shareholder activism in Japan, where funds such as Steel Partners have grappled with a conservative corporate culture criticised for prioritising long-standing business ties over shareholder returns."); Inagaki, *supra* note 38 ("The key to success, in a country where domestic shareholders still tend to rally around management to repel outsiders, is a soft touch and shrewd tactics, say corporate-governance experts.").

limited by traditional Japanese internalism, perpetuating the insular nature of the historical Japanese firm? This question remains unresolved and will likely attract greater attention as Japanese corporate governance evolves. Nonetheless, given the changes ushered in by the Japanese government's recent initiatives, investors no longer appear best served by agitating for pre-meditated, narrow-purpose governance reform in order to secure short-term profitability and extract financial returns for shareholders. Rather, institutional investors navigating Japan's current governance framework are strongly encouraged to assume a broader stake in the long-term financial stability of domestic Japanese firms, and to act as *stakeholders* rather than *shareholders*.