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NOTES AND COMMENTS

INSIDE THE JAPANESE STOCK MARKET: AN ASSESSMENT

Mark J. Happe*

INTRODUCTION

The globalization of the world's equity markets is creating difficult enforcement issues for international securities regulators. Although internationalization facilitates the free flow of capital, it also increases the opportunity for fraudulent trading practices. Because the actions of stock market participants in one country's market affect the participants in another country, economic policies of isolationism are not the correct course of action. Conversely, a country's unilateral attempts to correct perceived regulatory deficiencies are likely to create more problems than they solve. The only realistic solution to improving international securities regulation involves a mutual consensus of market regulators who are committed to solving securities trading abuses.

To achieve a consensus, however, each participant must have an understanding of the unique cultural and historical background of the country in which the regulated activity occurs. Each country's development of securities regulations has a unique economic, political, and cultural background; thus, it is nearly impossible for market regulators to correctly apply regulatory standards derived solely domestically. Before a common standard of market evaluation may be derived, it is essential for all countries to recognize the need for parity in capital trading practices to accommodate the growing interlinking of the international economic markets.

Part I of this Comment discusses Japan's emerging position as the world's financial leader. Part II notes the response of the United States to the difficulty of enforcing securities regulations in the international

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market, focusing specifically on actions taken in Japan. Part III examines the historical, political, and legal contexts in the development of Japan's securities regulation. Part IV compares the development of stock-trading regulations of the Japanese equity markets to that of the United States. Part V examines the specific Japanese legal provisions pertaining to unfair stock transactions on the Japanese stock market. Part VI discusses the Japanese market regulators and their effectiveness in policing the securities market. Finally, Part VII suggests the reintroduction of an autonomous securities regulatory government agency, using the Japanese Fair Trade Commission as a model similar to that of the United States Securities and Exchange Commission.

I. GLOBALIZATION—JAPAN AS THE WORLD'S FINANCIAL LEADER

Until recently, most commentators considered the Japanese equity trading practices unimportant because they believed that the Japanese stock markets were "isolated."¹ Beginning in 1978, however, the Japanese stock markets grew at an annual compound rate of twenty-three percent and began to assume global importance.² In the spring of 1987, the Tokyo Stock Exchange (TSE) surpassed the New York Stock Exchange (NYSE) in market value of shares and became the largest exchange in the world.³

The growth of the Japanese stock markets reflects the trend of globalization of the world's equity markets and dispels prior misconceptions that the TSE does not affect other countries.⁴ The development of

1. See, e.g., Fingleton & Jackson, *So a Gamble Came Unstuck Get an Ambulance*, EUROMONEY, Mar. 1987, at 155, 156 (noting the earlier belief that the Japanese stock markets were too small with which to be concerned).

2. See Perlmutter, *Developments in Japanese Securities Markets*, in INTERNATIONAL SECURITIES MARKETS (Sept. 17, 1987) (WESTLAW, Law Rev. library, PLI file) (describing the growth of the Tokyo and Osaka Stock Exchanges).

3. *Id.* Concurrently, the Osaka Stock Exchange, Japan's second largest, surpassed the London Stock Exchange to become the third largest exchange in the world. *Id.*; see also NIKKO RESEARCH CENTER, LTD., THE NEW TIDE OF THE JAPANESE SECURITIES MARKET 16 (1988) [hereinafter NIKKO] (listing the 1987 total market value and volume of turnover of securities (in United States dollars) for Tokyo as \$2.98 trillion and \$1.71 trillion, for New York as \$2.21 trillion and \$1.87 trillion, and for London as \$660 billion and \$270 billion).

4. See Bornstein & Dugger, *International Regulation of Insider Trading*, 2 COLUM. BUS. L. REV. 375, 376 (1987) (discussing that the growth in transnational trading widens the scope of securities violations and creates problems in securities enforcement); *Japan's Effort to Fight Insider Trading Must Overcome the Acceptance of the Practice*, Wall St. J., Feb. 24, 1988, at 12 [hereinafter *Acceptance*] (noting that the October 1987 stock market break demonstrated the close relationship between the world's equity markets).

a global market with nearly twenty-four hour trading⁵ has blurred national boundaries so that prices are now established by international supply and demand.⁶ The significance of players' identities continues to diminish as foreign investors increasingly participate in Japan's previously domestically homogenous markets.⁷

The participation of foreigners on the TSE has grown significantly.⁸ In 1986, for the first time, the TSE granted six foreign corporations memberships on the Exchange.⁹ Market analysts expect the number of foreign corporations listed on the TSE to increase from fifty-eight to several hundred by 1991.¹⁰

The world's equity forums are linked not only through foreign participants, but also through electronic telecommunication devices and computers.¹¹ Electronically-linked brokers on each trading floor further facilitate global trading.¹² The TSE linkage,¹³ one of a number of inter-

5. *Acceptance, supra* note 4, at 12. The developing global market is described as a market without boundaries and where transactions "can be affected on a twenty-four hour basis or close to it." *Id.*; *Melting Clocks*, *ECONOMIST*, Oct. 5, 1985, at 82 (describing that international securities trading occurs all but 3.5 hours of the day).

6. See Gruson, *The Global Securities Market: Introducing Remarks*, 2 COLUM. BUS. L. REV. 303, 303-05 (1987) (discussing the driving forces of globalization, including the increased availability and demand for capital, investor's abundance of disposable liquidity, the changing political and economic policies favoring economic deregulation, the abandonment of fixed exchange rates, the trend towards the institutionalization of investments, and the increasing levels of technology); Note, *Barriers to International Flow of Capital: The Facilitation of Multinational Securities Offerings*, 20 VAND. J. TRANSNAT'L L. 81, 82 (1987) (noting that the reasons for the internationalization of securities includes computer advances, the international diversification of funds, capital accumulation in large funds, and changes in tax laws).

7. See Cox, *Internationalization of the Capital Markets: The Experience of the Securities and Exchange Commission*, 11 MD. J. INT'L L. & TRADE 201, 208 (1987) (noting that the stock of 410 companies are traded in the issuer's domestic market and at least one foreign market).

8. See Perlmutter, *supra* note 2 (discussing the TSE's 1986 opening of membership to foreign brokerage companies). As of the middle of 1987, the Ministry of Finance (MOF) had licensed thirty-six foreign financial institutions to conduct securities business through Japanese branch offices, compared to ten institutions in 1985. *Id.*

9. *Id.*

10. See *The Nikko Perspective on International Equities (Sponsored Supplement)*, *EUROMONEY*, Nov. 1986, at SS3 (noting that the securities markets of the United States are no longer domestically confined because the securities issued by American-based corporations are traded on foreign exchanges, and foreign securities are purchased and sold on domestic exchanges).

11. See Grass, *Internationalization of the Securities Trading Markets*, 9 HOUS. J. INT'L L. 17, 37 (1986) (noting the development of the American and Toronto stock exchange linkages); see also Bernard, *International Linkages Between Securities Markets: "A Ring of Dinosaurs Joining Hands and Dancing Together?"*, 2 COLUM. BUS. L. REV. 321, 328 (1987) (stating that the first stock market link, although not international, was the Intermarket Trading System, established in 1978).

12. See Grass, *supra* note 11, at 37-38 (discussing that the purpose of electronic linkages is to provide for the direct flow of orders between the two trading floors and to

national market linkages,¹⁴ allows computer assisted orders and stock trading through computer terminals.¹⁵

In addition, one of the few Japanese attorneys specializing in securities notes that lax securities regulations in Japan allow the Japanese securities houses to amass large amounts of capital.¹⁶ Consequently, the Japanese securities companies can then enter foreign markets with a substantial edge and, thereby, erode the leveled playing field that the United States seeks to maintain.¹⁷ Currently, Japan's main exports are the commodities of money and financial services which are as readily available for export as manufactured goods have been in the past.¹⁸

The Japanese government's securities regulator, the Ministry of Finance (MOF), does not admit to planning to turn Japanese financial services into an export product.¹⁹ Whether due to Japanese planning or the macro-economic policies of the United States,²⁰ however, the Japanese financial houses are gaining an unprecedented influence over the allocation of global resources.²¹ Therefore, Japan's market practices can no longer be thought of as restricted only to Japan.

facilitate transactions on each exchange).

13. *Id.* at 38. The Tokyo Stock Exchange Linkage Computer-assisted Order Routing and Executive Systems (CORES) permits computer trading of over two thousand stocks. *Id.*

14. See Bernard, *supra* note 11, at 333-36 (describing the United States OTC's National Association of Securities Dealers Automated Quotation system and the London Stock Exchange's Automated Quotation market data link, the Philadelphia Stock Exchange and the London Stock Exchange mutual offset linkage, and the American and Toronto trading linkage).

15. See Grass, *supra* note 11, at 38 (discussing CORES).

16. Jameson & Schoenberger, *Tokyo Exchange Now Charting a Global Course*, L.A. Times, Aug. 15, 1988, part IV, at 2 (quoting Seijiro Wantanabe as stating that Japanese financial investment allows for amassing capital).

17. *Id.*

18. See Cottrell, *Plenty of Room at the Top for the Big Four*, FAR E. ECON. REV., Sept. 11, 1986, at 87 (comparing Japan's present exportation of currency with the previous exportation of manufactured goods).

19. *Id.*

20. See JAPAN ECONOMIC ALMANAC: 1987 18-20 (1988) (discussing the yen appreciation through United States policy manipulation and market pressure). The Japanese refer to the "strong-yen-induced crunch" as *endaka*. *Id.* at 5.

21. See J. BURNSTEIN, YEN—JAPAN'S NEW FINANCIAL EMPIRE AND ITS THREAT TO AMERICA 126 (1988) (noting that in 1987 the Japanese financial services company, Nomura, had the highest market capitalization and corporate net income in the world). Nomura's global equity trading volume is twenty times greater than the largest United States firm. *Id.*; see also Bernard, *Internationalization: Recent Developments in Japan's Securities Markets*, in BROKER-DEALER INSTITUTE 1986: NEW PRODUCTS, 24-HOUR TRADING, FINANCIAL STRUCTURES, MARKET INFORMATION (Sept. 29, 1986) (WESTLAW, Law Rev. library, PLI file) (noting that Nomura has forecasted that the companies revenues will be balanced at a fifty-fifty level split between domestic and foreign transactions within the next five years).

II. THE RESPONSE OF THE UNITED STATES TO PERCEIVED SECURITIES TRADING ABUSES IN JAPAN

The growth in the international stock markets facilitates the free flow of capital and the efficient allocation of resources.²² Internationalization, however, also increases the potential for securities fraud.²³ Without international cooperation among regulators, investors in foreign markets will face increased exposure to fraudulent stock trading practices.²⁴

As the interaction between the Japanese stock exchanges and other securities markets continues to grow, market regulators are beginning to recognize the need to coordinate surveillance and enforcement policies among the major markets.²⁵ In the United States, the Securities and Exchange Commission (SEC) has recognized that the difficulty of collecting foreign evidence may limit the international enforcement of securities laws.²⁶ Moreover, a foreign country's bank secrecy laws and blocking statutes prevent the production of evidence and, thus, may im-

22. See Gruson, *supra* note 6, at 306 (stating that the free flow of capital across national boundaries enables the most efficient distribution of investment resources); Cox, *supra* note 7, at 202 (stating that corporations benefit from internationalization because of increased stability and liquidity, a potential increase in interest in the companies products, and the facilitation of foreign acquisitions). Investors benefit because they are able to diversify their investments and seek out higher returns; whereas, securities companies benefit by being able to broaden product lines. *Id.*

23. See Bornstein & Dugger, *supra* note 4, at 376 (describing that the increase in international trading augments the potential of securities fraud and complicates the policing of the markets). The numerous regulatory problems are due to the limited ability of a country's enforcement system and self-regulatory organizations to investigate and adjudicate. *Id.*

24. *As Global 24-Hour Trading Nears, Regulators Warn of Market Abuses*, Wall St. J., Feb. 11, 1985, at 25.

25. See SEC Staff Report, *The October 1987 Market Break*, MUTUAL FUNDS GUIDE, No. 498, Feb. 9, 1988, at 11-21 (discussing the need for global securities regulators to cooperate in order to ensure the integrity of the securities markets); *Report of the Securities and Exchange Commission to the House Committee on Energy and Commerce on the Internationalization of the Securities Market (Interim Report)*, Fed. Sec. L. Rep. (CCH) at ¶ 88, 299 (Oct. 9, 1986) [hereinafter *Interim Report*] (recognizing the growing need for cooperation in international securities enforcement).

26. See Note, *Transactional Securities Fraud: Are the United States Courts Closing Their Doors to Foreign Plaintiffs?*, 22 INT'L LAW. 1171, 1173 (1988) (stating that under traditional principles of international law, the United States can assert jurisdiction over extrajurisdictional conduct that has domestic repercussions). *But see* Begin, *A Proposed Blueprint for Achieving Cooperation in Policing Transborder Securities Fraud*, 27 VA. J. INT'L L. 65, 66 (1986) (discussing that competing national traditions hinder discovery of information located abroad, often complicating international securities enforcement); Grass, *supra* note 11, at 54 (stating that although the extraterritorial reach of a nation's securities laws may be recognized and asserted, other countries may impose obstacles to enforcement).

pede the surveillance of a domestic market.²⁷ For example, the United States was frustrated in its attempts to compel the Toyota Corporation to produce documents²⁸ located in Japan,²⁹ despite a tax treaty to the

27. See Bornstein & Dugger, *supra* note 4, at 410 (explaining that the two most serious obstacles to international enforcement of securities laws, other than the difficulty of reaching a common consensus on terms, are blocking statutes (nonwaivable general prohibition of disclosure covering the inspection or removal of documents) and bank secrecy laws (a prohibition on a bank from disclosing information)); Ferrara & Mackintosh, *Legal Representation in the International Securities Market: Representing a Party or Witness in a SEC or SRO Proceeding*, in INTERNATIONAL FINANCIAL MARKETS 141 (1988) (noting that blocking statutes vary and depend on a foreign country's concern for safeguarding the information); Mann & Mari, *Current Issues in International Securities Laws Enforcement*, in INTERNATIONAL FINANCIAL MARKETS 68 (1988) (stating that the blocking laws represent governmental control on the distribution of certain information outside its territory; whereas, secrecy laws give individuals the right to require others to keep specific information secret); see also INTERNATIONAL CHAMBER OF COMMERCE, THE EXTRATERRITORIAL APPLICATION OF NATIONAL LAWS 8-9 (1988) [hereinafter ICC] (stating that nearly twenty countries have blocking statutes, including Australia, Canada, France, the Netherlands, and the United Kingdom); see, e.g., Foreign Extraterritorial Measures Act, 1984-85, ch. 49, § 5(1) (authorizing the Canadian Attorney General to prohibit the disclosure of information and comply with a foreign court order if the disclosure would adversely affect Canadian interests); The Protection of Trading Interests Act of 1980, ch. 11 (prohibiting domestic courts from complying with foreign court orders if the orders infringe on the United Kingdom's jurisdiction or are "otherwise prejudicial" to the United Kingdom's sovereignty); Journal Officiel de la Republique Francaise (July 16, 1980) (forbidding French nationals from communicating economic, commercial, industrial, financial, or technical matters to foreign authorities).

Secrecy laws can take a variety of forms. See Mann & Mari, *supra*, at 71 (stating that secrecy laws can range from a fiduciary relationship, waivable only by the principal, to a statute incurring a state interested confidentiality); see also Brister, *Regulation of International Markets—Solutions*, in INTERNATIONAL FINANCIAL MARKETS INSTITUTE 231, 233 (1987) (describing a foreign bank's "devil's alternative" of either complying with a United States court order to disclose the name of a customer or abide by its duty of confidentiality to the customer). The number of countries with blocking statutes differs with the source consulted. Compare Note, *The Future of Global Securities Transactions: Blocking the Success of Market Links*, 11 MD. J. INT'L L. & TRADE 283, 293 n.48 (1987) (stating that approximately 20 countries have bank secrecy statutes including Austria, the Bahamas, the Cayman Islands, Costa Rica, El Salvador, Germany, Greece, Panama, and Switzerland, and that Anguilla, Antigua, Barbados, Bermuda, Caicos, Israel, Monsterrat, the Netherlands, St. Vincent, and Turkey have customs similar to secrecy laws) with Brister, *supra*, at 233 (approximating the number of countries that have bank secrecy laws to fifteen).

The antisuit injunction, a third type of "anti-litigation device," is a judicial action aimed at restricting litigation. See Mann & Mari, *supra*, at 67 (describing the antisuit injunction as a court order aimed at preventing a party from seeking relief in another court or complying with another court's order). The antisuit injunction is in "considerable disfavor" and is less of an impediment to litigation than blocking statutes and secrecy laws. *Id.* at 67-68.

28. See Note, *Enforcing Securities Regulations Through Bilateral Agreements With the United Kingdom and Japan: An Interim Measure or a Solution?*, 23 TEX. INT'L L.J. 251, 257 (1988) [hereinafter Note, *Enforcing Securities Regulation*] (stating that although no specific blocking statute exists in Japan, the government effectively blocked discovery through its conduct).

contrary.³⁰

The United States efforts to address international securities enforcement obstacles focus primarily on three methods: unilateral enforcement of United States securities laws abroad, multinational mutual-assistance treaties, and bilateral agreements.³¹

A. UNILATERAL ENFORCEMENT EFFORTS

1. The "Waiver-By-Conduct" Approach

In the mid-1980s, the SEC introduced for comment the "waiver-by-conduct" approach.³² This proposal provided that those trading in United States securities waive the protection of "otherwise applicable foreign secrecy laws" and that the purchasing or selling of securities "constitutes an irrevocable consent to disclose."³³ The response to the SEC proposal was extremely unfavorable.³⁴

Commentators warned that the adoption of the waiver-by-conduct approach would have an adverse impact on the United States as a par-

29. See *United States v. Toyota Motor Corp.*, 569 F. Supp. 1158, 1162-64 (C.D. Cal. 1983) (holding that Toyota was required to produce documents pertaining to an alleged shift in corporate income from Toyota USA to Toyota Japan); see also Ohara, *Judicial Assistance to be Afforded by Japan for Proceedings in the United States*, 23 INT'L LAW. 10, 27-28 (1989) (noting the Japanese case of *Mitsui Steamship Co. v. FMC* in which the court instructed the company not to comply with an order from the United States to provide documents).

30. Convention Between the United States of America and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, July 9, 1972, United States-Japan, art. 26, 23 U.S.T. 967, T.I.A.S. No. 7365.

31. See Exchange Release No. 21,186, Fed. Sec. L. Rep. (CCH) at ¶ 86,983 (July 30, 1984) [hereinafter Exchange Release] (noting the three approaches that the Securities and Exchange Commission considered as a response to the globalization of the securities markets).

32. *Id.* at ¶ 86,977.

33. *Id.* at ¶ 86,985; Brister, *supra* note 27, at 243 (explaining that the principle behind waiver-by-conduct is that a participant in the United States securities markets must play by the rules of the United States securities market).

34. See Begin, *supra* note 26, at 87-90 (describing the adverse public response); Mann & Mari, *supra* note 27, at 111 (noting that the proposal received a negative and adverse reaction). The authors discussed three general objections: first, waiver-by-conduct represented an extraterritorial extension of American law; second, under most foreign laws it would be unenforceable; and third, the adoption of waiver-by-conduct would reduce the number of investors because of the desire to participate in a less regulated market. *Id.*; Brister, *supra* note 27, at 246-52 (describing criticisms of waiver-by-conduct, including the fact that waiver-by-conduct avoids normal judicial assistance channels, and, therefore, would be ineffective against "sophisticated fraudsters"); ICC, *supra* note 27, at 16 n.60 (noting that European and Canadian governments are opposed to waiver-by-conduct, based on the assertion that private foreign organizations may not waive the mandatory laws of their home jurisdiction).

ticipant in the international market.³⁵ Additionally, critics contended that the adoption of the waiver-by-conduct approach would have no effect on foreign blocking laws and could provoke the passage of more blocking laws.³⁶ Currently, although there are suggestions of an attempted revival,³⁷ most commentators feel that the waiver-by-conduct approach is a dead proposal³⁸ with the SEC even disparaging unilateral attempts at international securities regulation.³⁹

2. Court Order to Compel Information

A United States court may request through diplomatic channels that Japanese courts provide assistance in the production of evidence.⁴⁰ In 1905, Japan enacted the Reciprocal Judicial Assistance to Be Given at the Request of Foreign Courts Act (Reciprocal Act).⁴¹ The Reciprocal Act requires specificity in document requests; general requests for information will be denied.⁴² The Reciprocal Act, however, does not afford assistance to the SEC.⁴³ Moreover, the request by the court may take up to one year to complete.⁴⁴ In an alternative to using the Reciprocal Act, a United States court may issue an order to compel the pro-

35. See, e.g., Brister, *supra* note 27, at 252 (explaining that many commentators believe that the adoption of waiver-by-conduct would reduce domestic investment).

36. See Exchange Release, *supra* note 31, at ¶ 83,648 (stating that the waiver-by-conduct approach would fail because it does not address blocking laws, thereby, limiting its effectiveness); Note, *Enforcing Securities Regulation*, *supra* note 28, at 263 (noting that a private party may not waive because they are designed to protect a state's interest in nondisclosure). *Contra* Nelson, *Insider Trading Originating Abroad and "Waiver by Conduct,"* 19 INT'L LAW. 817, 820-21 (1985) (commenting that blocking statutes are generally enacted for different reasons than securities regulation).

37. See SEC, *House Clash Over Handling of Suspicious Trades by Foreigners*, 20 Sec. Reg. & L. Rep. (BNA) 872 (June 10, 1988) [hereinafter *SEC and House Clash*] (quoting Syracuse University Law Professor Sandra Hurd testifying before Congress, that waiver-by-conduct would be "direct, clear, and easy to implement"). The professor stated that only waiver-by-conduct would be effective to enforce international securities regulation. *Id.*

38. See Begin, *supra* note 26, at 92 (describing the waiver-by-conduct proposal as dead).

39. *SEC and House Clash*, *supra* note 37, at 873. The United States Securities and Exchange Commissioner testified that unilateral attempts are "time consuming, expensive and a strain on international relations." *Id.*

40. Ohara, *supra* note 29, at 19.

41. *Id.* at 28. The requests must come through diplomatic channels and contain a translation in Japanese with the requesting state guaranteeing payment for the expenses incurred in the execution of the request. *Id.* In addition, reciprocal judicial assistance must be afforded to the Japanese courts. *Id.*

42. *Id.* at 25.

43. *Id.* at 22.

44. Goldstein, Goodwin & Popofsky, *Conducting Discovery Abroad in Federal Court Litigation*, in CURRENT PROBLEMS IN FEDERAL CIVIL PRACTICE 1988 (Dec. 1, 1988) (WESTLAW, Law Rev. library, PLI file).

duction of information and may institute a contempt proceeding for noncompliance with the court order.⁴⁵

B. MULTILATERAL APPROACHES

Multilateral negotiations pertaining to securities are infrequent.⁴⁶ Although multinational conferences may reduce tensions between nations and provide a forum for dispute resolution,⁴⁷ the diversity of national interests greatly reduces the chance for success of a multilateral accord.⁴⁸ Although the United States is a signatory to several multilateral securities agreements,⁴⁹ the United States and Japan are not yet bound by any multilateral conventions for evidentiary cooperation.

The Hague Convention on the Taking of Evidence Abroad (Evidence Convention),⁵⁰ to which the United States and Japan are both signatories, applies to every "civil or commercial case" in which a party transmits a document abroad.⁵¹ The Evidence Convention provides for methods of discovery in foreign countries,⁵² but Japan has not yet ratified it.⁵³ Even if Japan were to ratify the Evidence Convention it would be of limited use to the SEC because the treaty is usually implemented only in connection with litigation, not pretrial discovery.⁵⁴ Additionally,

45. See Comment, *Comparative Analysis of Recent Accords Which Facilitate Transnational SEC Investigations of Insider Trading*, 11 MD. J. INT'L L. & TRADE 243, 245 (1987) [hereinafter Comment, *Comparative Analysis*] (noting instances where a court can compel information through a court order and contempt proceedings).

46. See Note, *Enforcing Securities Regulation*, *supra* note 28, at 264 (stating that multinational securities regulatory accords are rare, probably because of dissimilar laws).

47. Exchange Release, *supra* note 31, at ¶ 86,982.

48. *Id.*

49. See CURRENT INTERNATIONAL TREATIES 541 (1984) [hereinafter CURRENT TREATIES] (presenting the major multinational treaties to which the United States is a signatory).

50. The Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters (Evidence Convention), *opened for signature* Mar. 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444.

51. See Ferrara & Mackintosh, *supra* note 27, at 146-47 (noting the application of the Evidence Convention). The signatories attach different meanings to the terms civil and commercial. *Id.* Japan's interpretation excludes administrative matters. *Id.*

52. See Mann & Mari, *supra* note 27, at 93 (describing the three devices a treaty encompasses for foreign discovery: letters rogatory, evidence-taking by a consular official, and private commissioners).

53. See Ohara, *supra* note 29, at 10, 18 (stating that the United States and Japan have not established multinational evidentiary cooperation).

54. Mann & Mari, *supra* note 27, at 93-94; see Ferrara & Mackintosh, *supra* note 27, at 147 (noting that the Evidence Convention is available for pretrial discovery if it is relevant to the trial). This standard is a difficult standard to meet because the evidence sought is often not dispositive proof of violative conduct, but a conduit to discovery of such proof. *Id.*

utilization of the Evidence Convention has proven costly and time consuming.⁵⁵

Effective multilateral accords can eliminate conflicting regulations between nations and conserve finite financial resources because each regulatory agency does not have to negotiate separately with each country.⁵⁶ Nevertheless, to date, multinational efforts at resolving securities regulatory conflicts have not been successful.⁵⁷ The major reason for this failure appears to be the inability of the countries to reach a consensus on binding terms.⁵⁸

C. BILATERAL ACCORDS

1. *The Consular Convention*

Japan and the United States entered into the Consular Convention in 1964.⁵⁹ Under the Consular Convention, a United States consular officer may take depositions on behalf of the courts of the United States.⁶⁰ The deposed must voluntarily give the deposition and the consular officer must depose the witness in accordance with Japanese law.⁶¹ Because pretrial discovery is sharply limited in Japan, the Convention's effectiveness as an enforcement tool has been slight.⁶²

2. *Memoranda of Understanding*

A memorandum of understanding (MOU) between the parties gives assurances of mutual cooperation and allows the two nations' regulatory agencies to share information.⁶³ Unlike some bilateral trea-

55. See *Interim Report*, *supra* note 25, at ¶ 88,301 (stating that discovery under the Evidence Convention is expensive and slow).

56. See *Begin*, *supra* note 26, at 96 (noting that multilateral approaches are superior to bilateral approaches because the bilateral approaches result in an expensive patchwork of regulations).

57. See 10 INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATIONS § 2.20[3] (H. Bloomenthal ed. 1988) (denoting the failure of multilateral accords).

58. See Note, *Enforcing Securities Regulation*, *supra* note 28, at 267 (stating that multilateral enforcement agreements are unlikely to succeed because of different international attitudes and laws).

59. Consular Convention, Mar. 22, 1963, United States-Japan, 15 U.S.T. 768, T.I.A.S. No. 5602, 518 U.N.T.S. 179.

60. See *Ohara*, *supra* note 29, at 18 (describing the bilateral convention).

61. *Id.* at 18-19 (noting that the United States consular officer may take depositions on behalf of authorities in the United States in a manner consistent with the law of Japan).

62. See *Mori*, *The Difference Between U.S. Discovery and Japanese Taking of Evidence*, 23 INT'L LAW. 3, 3 (1989) (pointing out that little pretrial discovery is allowed in Japan).

63. See *Mann & Mari*, *supra* note 27, at 85 (stating that MOU provides for the

ties,⁶⁴ the SEC's MOU do not contain a dual criminality requirement.⁶⁵ The SEC has entered into MOU with Switzerland,⁶⁶ the United Kingdom,⁶⁷ Canada,⁶⁸ Brazil,⁶⁹ and Japan.

In May 1986, the MOF and the SEC signed a MOU.⁷⁰ The accord contained three objectives: to improve the protection of investors, to assure adequate supervision of securities companies, and to prevent deceptive securities transactions.⁷¹ The United States-Japan MOU was designed to facilitate each agency's respective request for supervisory and investigatory information on a case-by-case basis.⁷² No public enforcement actions to utilize the agreement have been reported.⁷³

exchange of information and assurances of cooperation between the SEC and foreign agency inquiries).

64. See Treaty on Mutual Assistance in Criminal Matters with the Republic of the Netherlands and the United States, June 12, 1981, United States-Netherlands, T.I.A.S. No. 10734 (entered into force Sept. 15, 1983) (reading that in executing the request, compliance is required if compulsory measures are mandated in the requested states' jurisdiction).

65. See Mann & Mari, *supra* note 27, at 86 (stating that the SEC's MOU do not require that the act complained of is a violation of law in both countries). In the past, conduct that was proscribed in one country that was not against the law in the other hampered enforcement efforts where a dual criminality requirement existed. *Id.*

66. Memorandum of Understanding to Establish Mutually Acceptable Means for Improving International Law Enforcement Cooperation in the Field of Insider Trading, Aug. 31, 1982, *reprinted in* 22 I.L.M. 1 (1983).

67. Memorandum of Understanding on Exchange of Information Between the SEC, CFTC, and the United Kingdom Department of Trade and Industry in Matters Relating to Securities and Futures, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) at ¶ 88,244 (Sept. 23, 1986), *reprinted in* 25 I.L.M. 1431 (1986).

68. See Begin, *supra* note 26, at 73-74 (describing the exchange of correspondence between the Ontario Securities Commission and the United States SEC which culminated in a letter of confirmation pledging information assistance).

69. See Mann & Mari, *supra* note 27, at 92 (noting the MOU between the SEC and Brazil's Comissão de Valores Mobiliários).

70. Memorandum of the United States SEC and the Securities Bureau of the Japanese Ministry of Finance on the Sharing of Information, Securities and Exchange Commission, News Release No. 86-34 (May 23, 1986), *reprinted in* 25 I.L.M. 1429 (1986); Begin, *supra* note 26, at 74-75; Note, *Enforcing Securities Regulation*, *supra* note 28, at 262-63.

71. See Note, *Enforcing Securities Regulation*, *supra* note 28, at 263 (stating the objectives of the MOU). The MOU generally makes its effectiveness dependent on the good will of the agencies and contemplates negotiations when necessary. *Id.*

72. See Begin, *supra* note 26, at 74 (stating that to facilitate the timely processing of requests, each agency agrees to appoint specific contact personnel).

73. See Perlmutter, *supra* note 2 (noting that the MOU has not been utilized). On January 11, and 12, 1989, members of the Japanese Securities Bureau met with members of the SEC and jointly reiterated their "cooperative intention." SEC, *Japanese Officials Meet, Reaffirm "Cooperative Relationship,"* Sec. L. Daily (BNA) (Jan. 17, 1989) (WESTLAW, Securities library, BNA file). The representatives agreed to strengthen their cooperative relationship and to organize a "working group," providing an assembly for regular discussions. *Id.* Former United States SEC Chairman Ruder stated in March 1989 that the cooperation received from the United States-Japanese MOU "has been first rate." *Tightening of Insider Trading Memo Denied*, Jiji Press

3. Analysis of Bilateral Accords

In addition to the MOU, the United States has entered into several bilateral agreements that may be utilized for securities regulation.⁷⁴ The SEC Chairman, David Ruder, has commented that bilateral agreements are the most effective means of obtaining information located in foreign countries.⁷⁵ Bilateral agreements may be the most effective method of addressing the problem of international securities fraud.⁷⁶ Not all individuals involved in the securities market, however, are in favor of the bilateral agreement structure.

The SEC has called the bilateral agreements time consuming and has stated that their adoption would lead to an uneven "patchwork" of differing provisions.⁷⁷ Furthermore, Gary Mountjoy of the United States General Accounting Office (GAO) raised allegations before a congressional subcommittee that the SEC failed to investigate suspicious trades even when a bilateral agreement existed.⁷⁸ Mr. Mountjoy

Ticker Serv. (Mar. 22, 1989) (LEXIS, Nexis library, Omni file).

74. See, e.g., Treaty on Extradition and Mutual Assistance in Criminal Matters Between the United States of America and the Republic of Turkey, June 7, 1979, United States-Turkey, 32 U.S.T. 3111, T.I.A.S. No. 9891 (entered into force Jan. 1, 1981) (providing for mutual assistance with the production of evidence); The Treaty Between the United States and the Swiss Confederation on Mutual Assistance in Criminal Matters, May 25, 1983, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302 (entered into force Jan. 23, 1977) [hereinafter Swiss MAC] (providing for assistance in locating and obtaining testimony of witnesses and service of judicial documents, but providing for a dual criminality requirement); see also Ferrara & Mackintosh, *supra* note 27, at 138 (noting that the United States has proceeded with mutual assistance negotiations with Colombia, Italy, Morocco, Canada, and the Cayman Islands).

The SEC may institute only civil or administrative proceedings. Mann & Mari, *supra* note 27, at 72. The SEC may utilize bilateral criminal treaties for the production of evidence, however, because United States securities laws provide criminal sanctions. *Id.*; see United States Securities Act of 1933, 15 U.S.C. § 77e, 77q (1982) (specifying that violations of the specific provisions are *unlawful*) (emphasis added); 15 U.S.C. § 77x (1982) (proscribing penalties for willful violators of the Securities Act of a fine up to \$10,000, and/or five years *imprisonment*) (emphasis added).

75. SEC and House Clash, *supra* note 37, at 872.

76. See Note, *Enforcing Securities Regulation*, *supra* note 28, at 268 (stating that the bilateral approach is preferable because it encourages cooperation and fosters a mutual recognition of conflicting national resources). The author views multilateral treaties as "cumbersome." *Id.*; see also Begin, *supra* note 26, at 69 (declaring that bilateral accords have been the most effective device to address international securities fraud).

77. Exchange Release, *supra* note 31, at ¶ 88,4011; see also Note, *Enforcing Securities Regulation*, *supra* note 28, at 268 (stating that bilateral agreements are time consuming and expensive); Comment, *Comparative Analysis*, *supra* note 45, at 224 (calling bilateral accords piecemeal resolutions that cause the problems to shift to other forums, rather than offering other resolutions).

78. See SEC and House Clash, *supra* note 37, at 872 (noting the testimony of a member of the GAO).

gave testimony alleging that because of the SEC's concern that a foreign government will no longer welcome its presence, vigorous utilization of bilateral treaties has yet to occur.⁷⁹ Moreover, in cases where the SEC does get involved, the results may be highly protracted because the foreign government may take up to three years to provide the requested information.⁸⁰

In actuality, bilateral agreements may be the best solution to the difficult situation of enforcing securities regulations involving foreign nations. The MOU, with adequate enforcement, is a pragmatic approach to obtaining information expeditiously.⁸¹ Because bilateral negotiations force the United States to acknowledge and respect a foreign nation's right to create and enforce its own legal system, bilateral agreements appear to be the best option.⁸²

III. THE DEVELOPMENT OF THE JAPANESE SECURITIES MARKET

The modern Japanese commercial legal system is a unique hybrid of European civil law and United States common and statutory law superimposed onto a distinctly far eastern legal, social, and cultural system.⁸³ Japanese trading methods first developed in the mid-seventeenth century on the Osaka rice market.⁸⁴ As the markets further developed,

79. *Id.*

80. *Id.*

81. Mann & Mari, *supra* note 27, at 86.

82. See Note, *Enforcing Securities Regulation*, *supra* note 28, at 268 (stating a preference for MOU); see also Gardner, Pitt, Hardison & Salzer, *SEC Enforcement Actions*, in SECURITIES ENFORCEMENT INSTITUTE 1988 (June 2, 1988) (WESTLAW, Law Rev. library, PLI file) (noting that MOU offer three major benefits: they may establish detailed procedural guidelines, they may establish a timetable for response to United States SEC requests, and they do not require formal ratification by the United States Congress, allowing the SEC to utilize the agreement earlier than other accords).

83. See Hahn, *An Overview of the Japanese Legal System*, 5 NW. J. INT'L L. & BUS. 517, 522 (1983) (discussing the development of the Japanese commercial legal system); *Introduction to Japanese Law*, 1 Jap. Bus. L. Guide (CCH) ¶ 8-870 (1988) (describing the Japanese Civil Code as primarily of Germanic origin with approximately twenty to thirty percent of its text based on French and Swiss precedents).

84. See JAPANESE SECURITIES REGULATION 106 (L. Loss, M. Yazawa & B. Bunoff eds. 1983) [hereinafter JAPANESE SECURITIES] (describing the development of the Osaka rice market); see also T. ADAMS, JAPANESE SECURITIES MARKETS: A HISTORICAL SURVEY 11 (1953) (noting that the Dojima rice market in Osaka was first officially recognized in 1730). A rice ledger system developed on Osaka facilitating the hedging and trading of fictitious transactions. *Id.* at 10. The Meiji government actively stabilized the price of rice by directly influencing the market. *Id.*

arbitrage⁸⁵ became the major method of conducting business,⁸⁶ injecting a speculative atmosphere into the markets which still exist today.⁸⁷

The Meiji government, in power from 1868 to 1912,⁸⁸ enacted the earliest Japanese securities legislation, the Stock Transfer Ordinance of 1874⁸⁹ (STO of 1874). The STO of 1874, a translation of the London Stock Exchange Rules,⁹⁰ was the Japanese government's attempt to facilitate Japanese integration into world trade.⁹¹ Although the London Stock Exchange based rules were designed for stock transactions, few securities were actually traded in Japan during this period.⁹² Ultimately, the STO of 1874 failed because it did not address the Japanese arbitrage transactions.⁹³

85. See R. MILLER & R. PULSINELLI, *MODERN MONEY AND BANKING* 113 n.8 (1985) (defining arbitrage as the simultaneous purchase and sale of an item to exploit an artificial price difference).

The trading of rice resulted in a mix of commodity trading and equity trading techniques and significantly influenced modern trading methods on the exchanges. T. ADAMS, *supra* note 84, at 8-12. On the Osaka Exchange, commodities were exchanged with contracts for reimbursement by a certain date. *JAPANESE SECURITIES*, *supra* note 84, at 106. Clearing agents acting as arbitrageurs received the contracts for payment. *Id.*

86. See *JAPANESE SECURITIES*, *supra* note 84, at 106 (elaborating that while the spot and arbitrage transactions existed at the beginning of the Osaka Exchange, spot transactions were subsequently dropped).

87. See *JAPANESE SECURITIES RESEARCH INSTITUTE, SECURITIES MARKETS IN JAPAN* 18 (1988) [hereinafter JSRI 1988] (noting that the origins of Japanese securities markets with the speculation against customer orders and fictitious trading created practices that currently exist); see also 5 *DOING BUSINESS IN JAPAN* § 1.02[3] (Z. Kitagawa ed. 1988) [hereinafter *DOING BUSINESS IN JAPAN*] (explaining that the Japanese securities market has played a limited role in government and corporate financing). One of the many distinctions between the Japanese and the United States stock markets is that Japan's equity markets have not been viewed as performing a primary capital formation function. *Id.*

88. See Y. NODA, *INTRODUCTION TO JAPANESE LAW* 41-62 (A. Angelo trans. 1976) (explaining the Meiji regime and the Western influence on the Japanese culture).

89. See M. TATSUTA, *SECURITIES REGULATION IN JAPAN* 8 (1971) (tracing Japan's early development of securities laws).

90. See T. ADAMS, *supra* note 84, at 16 (noting that the securities regulations of 1874 were based on the rules of the London Stock Exchange); *JAPANESE SECURITIES*, *supra* note 84, at 106 (discussing the adoption of the London Stock Exchange's constitution and its rules); see also Fingleton & Jackson, *supra* note 1, at 157 (describing the Meiji government's adoption of an Anglo-American modeled stock market system in an attempt to reduce speculation).

91. See Y. NODA, *supra* note 88, at 42-43 (discussing the pressure on Japan to follow the Western countries' legal systems in order for Japan to remain autonomous).

92. *Id.* at 26. The main transactions in Japan were based on speculative rice and grain transactions. *Id.* at 27.

93. See *JAPANESE SECURITIES*, *supra* note 84, at 106 (emphasizing that the failure of the STO of 1874 was a result of the small number of securities exchanged and the nonexistence of permanent stock exchanges).

The Stock Exchange Ordinance of 1878⁹⁴ (SEO of 1878) superseded the STO of 1874.⁹⁵ The SEO of 1878 established the Tokyo and Osaka stock exchanges.⁹⁶ Similar to the old rice exchange markets, the stock exchanges under the SEO of 1878 continued to use an arbitrage settlement method.⁹⁷

After several unsuccessful attempts to further reform the securities regulations,⁹⁸ the Japanese government enacted the Exchange Law of 1893 (Exchange Law),⁹⁹ incorporating key provisions of the SEO of 1878. The Exchange Law provided for the organization of stock exchanges as stock corporations whose shares could be traded on the exchanges.¹⁰⁰

The Japanese government, hoping to continue Japan's industrialization, anticipated that the Exchange Law would facilitate long term capital formation.¹⁰¹ Prior to World War II, a limited group of companies called *zaibatsu* controlled the majority of stock holdings in large corporations.¹⁰² Thus, instead of the equity market providing long-term

94. *Id.*

95. *Id.* at 26.

96. See 3 INTERNATIONAL SECURITIES REGULATION: JAPAN, 13 (K. Tsunematsu, S. Yanese, M. Yasuda, & T. Takuoka trans., R. Rosen ed. 1986) [hereinafter Rosen] (discussing the establishment of the Tokyo and Osaka stock exchanges). Government bonds, including those issued to feudal lords, were traded on these exchanges. *Id.* The STO of 1874 called for the establishment of the Osaka and Tokyo exchanges, although they were not immediately established. T. ADAMS, *supra* note 84, at 16. Significant transactions in corporate shares did not occur until 1894. *Id.* at 12.

97. See T. ADAMS, *supra* note 84, at 12 (stating that the trading in corporate shares occurred using the trading methods of the old rice exchange).

98. JAPANESE SECURITIES, *supra* note 84, at 107. In 1887, the Bourse Regulations were enacted and designated to reform the exchanges under the Anglo-Saxon model. *Id.* The attempted reforms failed. *Id.*

99. See Rosen, *supra* note 96, at 3 (describing the Exchange Law of 1893 as the main regulation of the stock exchanges until World War II). The Exchange Law of 1893 revised existing securities regulations, but continued to follow the trading methods of the old rice exchanges. JSRI 1988, *supra* note 87, at 20 (noting that the transactions were for gambling purposes rather than for changes of ownership).

100. See JAPANESE SECURITIES, *supra* note 84, at 27 (discussing the incorporation of the stock exchanges and the ability to trade the shares of stock on the exchanges). The exchanges, functioning as profit making entities, derived revenue from commissions on the sale of their own stock. A. VINER, *INSIDE JAPANESE FINANCIAL MARKETS* 54 (1988).

101. See Rosen, *supra* note 96, at 4 (discussing the Japanese government's hope that the stock exchanges would facilitate long-term capital formation).

102. Prewar *zaibatsu* existed in Japan for centuries, and the first of the four major *zaibatsu* date to the sixteenth century. See H. IYORI, *ANTIMONOPOLY LEGISLATION IN JAPAN* 2 (1969) (describing the emergence of the *zaibatsu* families); see also H. IYORI & A. UESUGI, *THE ANTIMONOPOLY LAWS OF JAPAN* 4 (1984) (noting that during the Meiji period the *zaibatsu* established holding companies that generally controlled its subsidiaries through equity ownership, the license to appoint subsidiary directors, and the use of interlocking directorates); Miaswa, *Securities Regulation in Japan*, 6 VAND.

capital, the *zaibatsu* facilitated capital formation.¹⁰³ Because the *zaibatsu* held a concentration of the corporate shares, individual investors played an insignificant role in the securities markets. The Exchange Law lasted until World War II, when the government subsequently incorporated key provisions of it into the Securities Exchange Act of 1943.¹⁰⁴

The Supreme Commander for the Allied Powers (SCAP) promulgated the Securities and Exchange Law of 1948¹⁰⁵ (SEL) as a replacement of the Securities Exchange Act of 1943 to dissolve the *zaibatsu* and form a democratic capital market in Japan.¹⁰⁶ Under pressure

J. TRANSNAT'L L. 447, 448 n.4 (1973) (defining *zaibatsu* as a "money-clique," "plutocracy," and large industrial banking combinations); THE HOLDING COMPANY LIQUIDATION COMMISSION, LAWS, RULES, AND REGULATIONS CONCERNING THE RECONSTRUCTION AND DEMOCRATIZATION OF THE JAPANESE ECONOMY 9 (1949) [hereinafter HOLDING COMPANY] (describing *zaibatsu* as unique to Japan, extending over many areas of business and exercising large amounts of control over Japan's trade and industry); Comment, *Corporate Governance in Japan: The Position of Shareholders in Publicly Held Corporations*, 5 U. HAW. L. REV. 135, 141 n.12 (1983) [hereinafter Comment, *Shareholders*] (describing *zaibatsu* as "large holding companies" and "financial oligarchies" closely tied with the government).

103. See Miaswa, *supra* note 102, at 448 (discussing that until the dissolution of the *zaibatsu*, capital requirements were met either through *zaibatsu* banks or *zaibatsu* holding companies); Rosen, *supra* note 14, at 4 (stating that the *zaibatsu* and the government provided long-term capital).

The dissolution of the *zaibatsu* required a large scale redistribution of previously concentrated stock holdings. T. ADAMS & I. HOSHII, A FINANCIAL HISTORY OF THE NEW JAPAN 43 (1972). The Allies instructed the shares to first be distributed to employees and residents of where the factory was located and then to the general public. *Id.* One commentator has suggested that the dissolution of the *zaibatsu* after World War II, which allowed more extensive public involvement in stock transactions, facilitated the acceptance of the Anglo-Saxon securities regulatory structure. JAPANESE SECURITIES, *supra* note 84, at 107-08.

104. See DOING BUSINESS IN JAPAN, *supra* note 87, at § 1.02[2] (describing the Exchange Law of 1893 and its subsequent replacement in 1943 by the Securities Exchange Act); JSRI 1988, *supra* note 87, at 33 (noting that the existing stock exchanges were consolidated into one joint stock company in 1943). The exchange's primary objective was to fix and stabilize the prices of the securities traded. *Id.*

105. See DOING BUSINESS IN JAPAN, *supra* note 87, at § 1.02[3] (discussing the adoption of the Securities Exchange Law (SEL)); Rosen, *supra* note 96, at 4-5 (noting the adoption of the SEL and stating that it remains the main source of present securities regulation).

106. See DOING BUSINESS IN JAPAN, *supra* note 87, at § 1.02[3] (stating that the Allied forces wanted to end the *zaibatsu* and advance the securities laws ideals of the United States to form a democratic capital market); HOLDING COMPANY, *supra* note 102, at 8, 10 (describing the Potsdam Declaration of 1945 as requiring the construction of a democratic Japanese economy that would be achieved through the destruction of the *zaibatsu*); Comment, *Shareholders*, *supra* note 102, at 141 (discussing that the SCAP reforms were aimed at reducing economic concentration to increase shareholder freedom).

Although the allies wanted to reconstruct Japanese corporate ownership into democratic control, this structure was foreign to the Japanese. See Note, *Trustbusting in Japan: Cartels and Government-Business Cooperation*, 94 HARV. L. REV. 1064, 1065-

from SCAP¹⁰⁷ to incorporate principal provisions borrowed from the United States Securities Act of 1933¹⁰⁸ and the Securities Exchange Act of 1934,¹⁰⁹ the Japanese Diet (Diet)¹¹⁰ enacted the legislation with little debate.¹¹¹ Although the Japanese traded securities for nearly two centuries, for the first time, Japan's securities laws had regulations against market manipulation and insider trading.¹¹² The SEL also established the Japanese Securities Exchange Commission (JSEC), a counterpart of the SEC, to enforce the SEL's provisions.¹¹³

66 (1981) [hereinafter Note, *Trustbusting*] (stating that democratic ideals contradicted the cooperative business environment within Japan).

SCAP's failure to dismantle the *zaibatsu* banking infrastructure and its failure to realize the importance of the *zaibatsu* significantly contributed to a subsequent re-grouping of prewar components into groups called *keiretsu*. A. VINER, *supra* note 100, at 55-56. *Keiretsu* exist through mutual agreement using interlocking and mutual shareholding; it created precedent for postwar *neo-zaibatsu* organizations. *Id.* at 56; see also *infra* notes 132-36 and accompanying text (discussing Japan's current stable share-holding corporate practices).

107. See Miaswa, *supra* note 102, at 448 (describing the enactment of the SEL as a condition precedent for reopening the stock exchange). The allied forces stopped trading on the Japanese Stock Exchange on August 9, 1945, and the Japanese Securities Exchange closed in 1947 permanently. *Id.*; JAPANESE SECURITIES, *supra* note 84, at 28 (discussing the suspension of trading in 1945 and the subsequent dissolution of the Japanese Securities Exchange in 1947). But see T. ADAMS & I. HOSHII, *supra* note 103, at 38 (noting that although the allies closed the stock exchanges, trading resumed on the over-the-counter market immediately after the war); see also *infra* note 230 and accompanying text (comparing the over-the-counter markets of Japan and the United States).

108. United States Securities Act of 1933, 15 U.S.C. § 77a-77ll (1934), amended by 15 U.S.C. § 77a-77ll (Supp. V 1987).

109. United States Securities Exchange Act of 1934, 15 U.S.C. § 78a-78kk (1934), amended by § 78a-78jj (Supp. V 1987).

110. The Japanese Diet is the "[h]ighest organ of state power and the sole legislative organ of the state." 2 MODERN LEGAL SYSTEMS CYCLOPEDIA, PACIFIC BASIN § 2.3(B) (1984) [hereinafter PACIFIC BASIN] (quoting article 41 of the Japanese Constitution).

111. See JAPANESE SECURITIES, *supra* note 84, at 29 (describing that prior to the passage of the law, the Diet debated the merits with "cursory deliberation"); M. TATSUTA, *supra* note 88, at 10 (noting that the SEL was enacted without debate due to urgent demand to reopen the stock exchange and the unlikelihood of obtaining SCAP's approval of any changes).

SCAP simultaneously revised the Japanese Commercial Code utilizing the United States Uniform Stock Transfer Act of 1909 (USTA) and the Illinois Business Corporation Act of 1917 (IBCA). See Comment, *Shareholders*, *supra* note 102, at 143 n.26 (describing the use of the USTA and the IBCA). The Illinois statute was most likely used because a SCAP official assisting with the drafting had lived in Chicago rather than the statute's excellence. *Id.*

112. See DOING BUSINESS IN JAPAN, *supra* note 87, at § 1.02[2] (analyzing the introduction of the proscription against insider trading and market manipulation). The Act also introduced the requirements for the registration of securities and the separation of the securities business from commercial banking. *Id.*

113. See JAPANESE SECURITIES, *supra* note 84, at 29-30 (discussing the establishment of the JSEC in 1948 and its subsequent abolishment in 1952); DOING BUSINESS

Commencing with the departure of the SCAP in 1952, the Diet has frequently amended the SEL,¹¹⁴ resulting in a substantial reduction of securities trading restrictions and a general trend toward the former system of *zaibatsu* trading activities. In 1953, the Diet abolished the JSEC and its responsibilities were absorbed by the MOF.¹¹⁵ The Diet also allegedly abolished a key SEL provision that required insiders to report stock transactions because it was "ineffective."¹¹⁶ Commentators contend that the abolition of the reporting requirement essentially nullified the prohibition against insider trading.¹¹⁷

As amended, the SEL currently provides for the prohibition against market manipulation¹¹⁸ and insider trading.¹¹⁹ In addition, it contains general antifraud provisions.¹²⁰ These provisions, however, have not stopped the prohibited activities because of subsequent amendments to the SEL and an apparent government public policy of nonenforcement.¹²¹ Furthermore, unlike the United States, a plaintiff's securities bar¹²² has not developed in Japan.¹²³ Consequently, no significant com-

IN JAPAN, *supra* note 87, at § 1.02(4) (explaining the establishment of the JSEC in 1948 and the abolishment of the JSEC four years later); Miaswa, *supra* note 102, at 479 (analyzing the abolition of the JSEC and its subsequent absorption into MOF); *see also infra* note 190 and accompanying text (commenting on the JSEC and purported justifications for its abolition).

114. *See* JAPANESE SECURITIES, *supra* note 84, at 28-34 (noting the twenty amendments to the SEL since its adoption in 1948).

115. *See infra* notes 198-204 and accompanying text (describing the statutory powers of the MOF).

116. *See* Ishizumi, *Insider Trading Regulation: An Examination of Section 16(b) and a Proposal for Japan*, 47 FORDHAM L. REV. 449, 488 (1979) (discussing the abolishment of article 188, which was comparable to section 16(a) of the United States Securities Exchange Act of 1934). Article 188 required that directors and officers report the amount and the type of security ownership. *Id.* Scholars have speculated that rather than being ineffective, the requirement was perceived as excessive. *Id.* at 488-89.

117. *See infra* notes 158-62 and accompanying text (pointing out the difficulty for potential plaintiffs to discover a securities law violation).

118. *See infra* note 143 and accompanying text (providing article 125 of the Securities Exchange Law which prohibits market manipulation).

119. *See infra* notes 153-60 and accompanying text (explaining the prohibition of insider trading in article 189 of the SEL).

120. *See infra* notes 175-88 and accompanying text (analyzing articles 50 and 58 of the SEL antifraud provisions).

121. *See* Miaswa, *supra* note 102, at 507 (stating that because no reported cases of insider trading exist in Japan, there are obvious enforcement problems); Chira, *Japan's Different Stock Market*, N.Y. Times, Dec. 7, 1987, at D6 (quoting a MOF official stating that no insider trading exists in Japan).

122. *See* Pitt & Shapiro, *Insider Trading Proscriptions Act of 1987: A Legislative Initiative for a Sorely Needed Clarification of the Law Against Insider Trading*, 39 ALA. L. REV. 415, 416 (1988) (noting that plaintiffs in the United States have shaped the definition of securities laws).

123. *See* M. TATSUTA, *supra* note 89, at 5 (comparing the large amount of judicial precedent in the United States with the scarcity of case law in Japan); Miaswa, *supra*

mon law precedents have evolved to proscribe insider trading activities.

IV. COMPARISON OF THE EQUITY MARKETS IN THE UNITED STATES AND JAPAN

Scholars have long believed that market manipulation and insider trading are endemic in Japanese stock exchanges.¹²⁴ Until very recently, however, scholars have been more concerned with market manipulation of stock prices than insider trading.¹²⁵ As this Comment discusses earlier, general concern over insider trading has greatly increased because of the growing interlinking of securities markets.¹²⁶

The inconsistent application of securities trading regulations between Japan and the United States may be traced to the different historical and political origins of the Japanese securities market and its structural donor, the United States. In response to the Depression, Congress enacted the United States Securities Act of 1933 and the Securities Exchange Act of 1934 as part of Roosevelt's New Deal¹²⁷ to stabilize the securities markets and protect individual investors.¹²⁸

Japan, however, did not enact its securities laws in response to an economic crisis; instead, Japan enacted the laws to promote the nation's economic development and participation in the international marketplace. In Japan, an elite group of business and government officials for-

note 102, at 494 (hypothesizing that the lack of securities litigation is a result of cultural and structural barriers); *infra* notes 260-71 and accompanying text (discussing the various systemic barriers to litigation that potential plaintiffs must face, including the low number of litigators, the high cost of filing claims, and Japanese attorneys' unfamiliarity with securities law).

124. See Fingleton & Jackson, *supra* note 1, at 156 (describing stock price manipulation and securities "broker churning"—excessive nonspeculative trading by brokers for commission—as frequently occurring on the Japanese stock exchanges).

125. See *id.* (noting one researcher calling insider trading, as compared with market manipulation, "small potato[es]"); Zoglin, *Insider Trading in Japan: A Challenge to the Integration of the Japanese Equity Market Into the Global Securities Market*, 2 COLUM. BUS. L. REV. 419, 421-22 (1987) (describing market manipulation on the Japanese exchanges as a much larger problem than insider trading).

126. See Fingleton & Jackson, *supra* note 1, at 156 (discussing the increased attention on market regulation because of the growth of the global market and the participation of foreign firms); Zoglin, *supra* note 125, at 419 (maintaining that the growth and internationalization of Japan's equity market has added pressure on Japan to more actively prohibit insider trading); see also Peters, *Overview of International Securities Regulation*, 6 INT'L TAX & BUS. L. 229, 230 (1988) (noting that market internationalization leads to market interdependence).

127. L. SODERQUIST, UNDERSTANDING THE SECURITIES LAWS 1 (1987) (describing the securities laws of the United States as a "quintessentially New Deal").

128. See L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 7 (1983) (describing securities regulations as a safeguard for the United States economy and protection for the individual investor through disclosure).

mulates domestic economic policy.¹²⁹ The group shares a common understanding of the importance of economic planning for the future of Japan, and unlike the United States,¹³⁰ the mutual sharing of information between Japanese businesses has traditionally been encouraged.¹³¹

Motivation for stock ownership in Japan is also different from that in the United States. In the United States, stocks are widely held and are expected to deliver a return on investment in the form of dividends and capital gains. In Japan, however, a widespread system of interlocking directorships exists with extensive cross-holdings of shares.¹³² Stockholders cross-hold stocks to perpetuate business relationships and to reduce the possibility of takeovers,¹³³ which have been historically and culturally disfavored in Japan.¹³⁴ As a result, over sixty-five percent of corporate equity is kept out of the market, creating a "thin float" because of the few stocks that are publicly traded.¹³⁵ The low number of

129. Note, *Trustbusting*, *supra* note 106, at 1064.

130. See, e.g., Sherman Antitrust Act, 15 U.S.C. § 1 (1988) (holding that every combination in restraint of trade is illegal).

131. Note, *Trustbusting*, *supra* note 106, at 1064. Collusion is thought of as cooperative effort, and cooperation is believed to be the superior way to implement national economic policies in Japan. *Id.*

132. See Note, *Enforcing Securities Regulations*, *supra* note 28, at 255 n.26 (discussing that a comprehensive system of interlocking directorships exists). These directorships facilitate insider trading. *Id.*; see also JSRI 1988, *supra* note 87, at 58-59 (noting that individual shareholding, as a percentage of total outstanding shares, dropped from sixty-one percent in 1950 to twenty-four percent in 1986).

133. See Lehner, *Japan's Bias Against Domestic Mergers May Become Trade Issue*, *Tokyo Fears*, Wall St. J., Dec. 1, 1988, at A18 (explaining that most big Japanese companies put large blocks of their stock in the hands of their customers, suppliers, and banks, thus, protecting themselves from takeovers); Perlmutter, *supra* note 2 (stating that corporations hold each other's shares for reasons other than the realization of capital gains or receipt of dividends); Ramseyer, *Takeovers in Japan: Opportunism, Ideology and Corporate Control*, 35 UCLA L. REV. 1, 21-22 (1987) (asserting that Japanese firms operate with either an explicit or implicit agreement that neither firm will trade the other's stock in a hostile takeover bid); A. VINER, *supra* note 100, at 129 (noting that corporations frequently borrow from *keiretsu* institutions minimizing the risk of early cancellation of loans); Comment, *Shareholders*, *supra* note 102, at 147-48 (describing the concentration of stock in "safe hands" and the high incidence of corporate cross share-holdings).

134. See *supra* notes 132-33 and accompanying text (elaborating on the practice of cross-holding of shares to repel takeovers); Nishimara, *Corporate Acquisitions in Japan: Evolving Business and Legal Environment*, in LEGAL ASPECTS OF DOING BUSINESS WITH JAPAN: 1985 181 (1985) (discussing that acquisitions have traditionally been referred to as *nottori* ("hijacking")). The Japanese have viewed takeovers as hijacking because, in the past, most attempted takeovers were not really takeovers at all, rather the acquiring corporation purchased the target's stock hoping to induce the target management to repurchase the shares at a premium. *Id.*; A. VINER, *supra* note 100, at 94 (describing *kaishime* as where groups purchase large blocks of stock and corporations directly buy back the stock at a premium).

135. See Fingleton & Jackson, *supra* note 1, at 156 (stating that under the Japanese system of stable shareholding, approximately sixty-five percent of the shares are

public transactions facilitates price manipulation because major shareholders and brokerage firms that control a large percentage of available stocks may unilaterally influence share prices.¹³⁶

Although no laws expressly prohibit takeovers,¹³⁷ labor¹³⁸ and business¹³⁹ do not welcome the practice. Unlike corporations in the United States, Japanese companies are not regarded as the disposable property of the shareholders, but as the property of the management, the workers, and the shareholders.¹⁴⁰ There are indications, however, that Japanese corporations are becoming more receptive to takeovers.¹⁴¹ For example, *Nihon Keiza Shimbun*, Japan's leading business newspaper, forecasted in the early 1980s that a significant growth in acquisitions was likely to occur.¹⁴² If the Japanese anxiety about takeovers declines,

excluded from the market); Zoglin, *supra* note 125, at 421-22 (describing that a stable shareholding practice exists among institutions to promote business relationships and that it removes sixty to seventy percent of outstanding shares from active trading).

136. See Perlmutter, *supra* note 2 (stating that the large investors and brokerage firms control a large percentage of the limited floating shares available and are therefore able to unilaterally influence share price); see also JSRI 1988, *supra* note 87, at 59-60 (noting that the practice of interlocking shareholding undermines the function of the securities exchanges, alienates the investing public from issuers, and negatively affects the efficiency of trading and the equitable price determinations of stocks).

137. See JSRI 1988, *supra* note 87, at 188 (noting that although Japan does not have a law against takeovers per se, takeovers must meet increasingly stringent antimonopoly statutes). Foreign investors may acquire up to ten percent of a Japanese corporation without contacting the Japanese government if they purchase through designated securities companies. *Id.* If a foreign investor acquires over ten percent of a corporation, the government may disapprove the sale. *Id.*

In addition, businesses are sold less frequently in Japan than in the United States for tax reasons. See Brockman, *Alternatives for Entering the Japanese Market*, in LEGAL ASPECTS OF DOING BUSINESS WITH JAPAN: 1985 59-60 (1985) (describing how the Japanese tax structure exempts individual sellers from the capital gains tax unless the sale is of a "controlling interest" of a corporation).

138. See Fingleton, *Tokyo Takeovers Are for Japanese Only*, EUROMONEY, Feb. 1986, at 114 (discussing that the traditional lifetime employment system has been an obstacle to takeover attempts). Japanese workers view the corporation as a family and the company president in a patriarchal role. *Id.*; see also Yoshino, *Japanese Trade and Investment Strategies, Including Current Policies and Restrictions Affecting Trade and Investment in Japan*, in CURRENT LEGAL ASPECTS OF DOING BUSINESS IN THE PACIFIC BASIN 13, 16 (1987) (describing that Japanese companies are viewed as common properties). If a company is taken over, the workers may respond with a labor disturbance. *Id.*

139. See *supra* notes 132-36 and accompanying text (explaining the Japanese system of interlocking directorships and cross-holding of shares).

140. See Yoshino, *supra* note 138, at 16 (describing that Japanese companies are viewed as common properties).

141. See Ames, *Entering the Japanese Market Via Acquisitions*, in LEGAL ASPECTS OF DOING BUSINESS WITH JAPAN: 1985 93, 105 (noting that although the Japanese dislike acquisitions for cultural and sociological reasons, the number of acquisitions will most likely continue to rise).

142. *Id.* (referring to an article in *Nihon Keizai Shimbun* stating that foreign acquisitions in Japan are likely to increase); Freadhoff, *Picken's Battle to Control Koito*

then shareholder diversification may increase, and the opportunity to manipulate stock prices will diminish due to the dilution of concentrated stock holdings. Of course, the shareholder base may not increase percentage-wise if the new companies also participate in the close-holding practices.

V. MARKET MANIPULATION, INSIDER TRADING, AND ANTIFRAUD PROVISIONS

A. MARKET MANIPULATION

Article 125 of the SEL¹⁴³ contains provisions similar to section 9(a) of the United States Securities Exchange Act of 1934.¹⁴⁴ Article 125 prohibits any sale or purchase of securities not involving any change in the ownership for the purpose of defrauding others or conducting any manipulative transaction in any security listed on a securities exchange.¹⁴⁵ Although the government may invoke criminal sanctions¹⁴⁶

May Mark End of Era for Japan, Investor's Daily, Oct. 30, 1989, at 7 (noting that there are signs of increasing takeovers in Japan); see also A. VINER, *supra* note 100, at 89 (stating that as deregulation continues in the Japanese capital markets, warrants—debt securities that allow the holder to buy the issuer's common stock at a future date at a specified price—and convertible bonds will facilitate hostile takeovers).

143. Securities and Exchange Law, Law No. 25 of 1948, art. 125 (amended 1981) (Jap.) (elaborating on the prohibition on washed sales, manipulation of stocks, and restriction on stabilizing activities). Article 125 of the SEL states in pertinent part:

No person shall engage in following [sic] acts for the purpose of creating false or misleading appearance with respect to the status of transactions in any security, including for instance a false or misleading appearance of active transaction of certain securities listed on a securities exchange . . . [and] no person shall engage in following [sic] acts for the purpose of inducing the purchase or sale of any security on the securities market . . . to effect or to entrust or to be entrusted, by himself or with other persons, a series of transactions in the security concerned creating a false active trading in such security or making the price of such security fluctuate

Id.

144. Securities Exchange Act of 1934 § 9(a), 15 U.S.C. § 78i(a) (1982). Section 9(a) states in pertinent part:

It shall be unlawful . . . [f]or the purpose of creating a false or misleading appearance of active trading . . . to effect alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

Id. The fact that no Japanese equivalent to section 10(b) of the United States Securities Exchange Act exists is particularly noteworthy. Miaswa, *supra* note 102, at 504.

145. Securities and Exchange Law, art. 125 (Jap.).

146. See *id.* art. 197 (elaborating on the penal provisions for violations of article 125). Sanctions for violations include three-year imprisonment with hard labor or a fine up to three million yen. *Id.* SEL article 197 provides in pertinent part:

Any person who falls under any of the following Items shall be confined to imprisonment with hard labor for not more than three years or be fined not more

and hold a violator liable for damages,¹⁴⁷ the government rarely applies article 125 because of the difficulty in proving the intention of the violator.¹⁴⁸

A shareholder of a Japanese corporation may sue for damages resulting from the illegal acts under the Commercial Code.¹⁴⁹ The shareholder may also sue in tort under the Civil Code.¹⁵⁰ Without a criminal or administrative proceeding to reveal the level of manipulation, however, a shareholder may have great difficulty in proving that any damages occurred through the illegal conduct.¹⁵¹ Not surprisingly, stockholder suits for price manipulation have yet to be reported.¹⁵²

than three million yen Any person who, for the purpose of public offering of new or outstanding security, buying or selling or other transactions of any security or of attempting to fluctuate quotations of any security, has circulated false rumours, used deceptive schemes . . . (or) who violated the provisions of Article 58 and Article 125

Id.; see also *id.* art. 207 (applying SEL article 197 to an organization's representatives or managers).

147. *Id.* art. 126 (requiring damages from violators of article 125 for qualified persons who sustained the damage). Article 126 states in pertinent part:

Any member who acted in contravention of the provision of the preceding Article shall [sic] liable to compensate the damage sustained by any person who made or entrusted transaction of the security concerned at a price which was affected by such act

Id.

148. See M. TATSUTA, *supra* note 89, at 87 (discussing the difficulty of establishing the "purpose" of the parties). The United States SEC proves the intent of the parties through circumstantial evidence that may be collected through stock watch systems, but the MOF has no comparable system. *Id.*; see also Miaswa, *supra* note 102, at 506 (elaborating on the fact that the MOF has not regulated stock price manipulation because of the difficulty in proving intention and the MOF's finite resources).

149. See INTERNATIONAL SECURITIES REGULATION: JAPAN § 11.12 (M. Tatsuta ed. 1986) [hereinafter INTERNATIONAL SECURITIES] (noting that a shareholder who has held shares for at least six months can bring a derivative suit on behalf of the shareholder's corporation against the company's directors and supervisors for damage sustained by the corporation); see also SHOHO (COMMERCIAL CODE), Law No. 48 of 1899, arts. 267-268-3 (Jap.) (allowing for derivative suits).

150. See INTERNATIONAL SECURITIES, *supra* note 149, at § 11.12 (stating that for the tort provision to apply, the plaintiff must establish the defendant's illegal conduct as well as causation and damages).

151. See *id.* at § 11.11[5] (indicating that the plaintiff must prove that the damages occurred as a result of the defendant's illegal conduct); see also *infra* notes 162-63 and accompanying text (describing the difficulty of discovery without a reporting provision).

152. See Miaswa, *supra* note 102, at 505 (stating that no stockholder suits have occurred for violations of article 125). In 1984, the first conviction for price manipulation of stock prices in a primary offering occurred. A. VINER, *supra* note 100, at 98 n.18. In 1988, the Tokyo Supreme Court upheld a fine equivalent to \$2300 and a suspended sentence arising from the 1972 market manipulation case. Sanger, *Insider Trading, The Japanese Way*, N.Y. Times, Aug. 10, 1988, at D1, D5.

B. INSIDER TRADING

1. Articles 188 and 189 of the SEL

Article 189 of the Japanese Security Exchange Law¹⁵³ is the functional equivalent of the short-swing prohibition incorporated in the United States Securities Exchange Act of 1934 section 16(b).¹⁵⁴ Article 189 requires management and/or ten-percent shareholders¹⁵⁵ to dis-

153. Securities and Exchange Law art. 189 (Jap.) (elaborating on Japan's insider trading provision). Article 189 states in full:

1. For the purpose of preventing the unfair use of secret information of a corporation which may have been obtained by any officer or major shareholder (the term refers to the shareholder or the contributor who holds or owns more than ten percent of the corporation's total number of issued shares or the total amount of contributions in his own name or in the name of other persons including fictitious person; the same shall apply hereinafter) of the corporation by reason of his office or position in the corporation, if such person realizes any profit by doing purchase within six months after sale, or sale within six months after purchase, of shares of the corporation, the corporation may claim him to tender such profit to the corporation.

2. If the corporation fails to claim, in accordance with the provisions of the preceding Paragraph, within sixty days after any shareholder of the corporation made a request that the corporation shall claim in accordance with the provisions of the preceding Paragraph, such shareholder may claim in the name of and on behalf of the corporation.

3. The right to claim to the officer or major shareholder under the provisions of the preceding two Paragraphs shall be cancelled unless the claimant exercises it within two years from the date on which such profit was realized.

4. The provisions of the preceding three Paragraphs shall not be applied to the case where such major shareholder was not such either at the time of purchase or sale.

Id. Unlike the equivalent American provision, article 189 of the SEL does not provide for the recovery of attorney's fees. Smith, *Commercial Law*, Jap. Bus. L. Guide (CCH) ¶ 14-390 (1988).

154. See Ishizumi, *supra* note 116, at 489 (describing Japan's SEL article 189 as analogous to the United States Securities Exchange Act of 1934, section 16(b)); *cf.* Securities Exchange Act of 1934, § 16(b), 15 U.S.C. § 78p(b) (1982). Section 16(b) provides in pertinent part:

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase . . . within any period of less than six months . . . [shall] be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted . . . by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized

Id.

155. See Securities and Exchange Law art. 189 (Jap.) (defining major shareholders as those who hold or own more than ten percent of the issued shares). Article 189 is weakened, however, because the provision is inapplicable if the acquisition of stock

gorge any profits obtained through the use of confidential information gained from any purchase and sale within six months.¹⁵⁶ A stockholder may bring a derivative suit if the corporation does not receive the ill-gotten profits after a shareholder has provided sixty days notice.¹⁵⁷

A 1953 amendment to the SEL deprived article 189 of its enforceability¹⁵⁸ because the amendment eliminated the requirement that corporate insiders and/or ten-percent shareholders report their respective holdings and changes therein to the government.¹⁵⁹ The Japanese gov-

brings the purchaser's holding above ten percent. Smith, *supra* note 153, at ¶ 14-390.

The MOF announced in May 1989 its plans to amend the regulation to require stockholders who acquire more than five percent of a corporation's outstanding stocks. *Japan to Require More Disclosure on Major Acquisitions*, Asahi News Serv. (May 25, 1989) (LEXIS, Nexis library, Omni file).

156. Securities and Exchange Law art. 189 (Jap.); see also Yanase, *Disclosure System*, in LECTURES ON JAPANESE SECURITIES REGULATION 78 (1980) (noting that article one of the MOF's Ministerial Ordinance Concerning the Fair Practice of Securities Companies prohibits directors and employees from purchasing or selling securities based on the use of nonpublic information obtained through the course of their business). The MOF proposed to expand the provision in order to apply it to anyone with confidential information gained from a listed company, a related financial institution, or government official. See Sneider, *Developments in the Japanese Securities Markets*, INTERNATIONAL SECURITIES MARKETS 255, 291 (1988) (noting the proscription of criminal sanctions for those who purchase or sell stock based on the communication of material nonpublic information related to a corporation's business from a "company-related person"). The new amendment does not proscribe insider trading by tippees of tippees. *Id.* at 263. See Schoenberger, *Japan Will Beef Up Insider Trading Laws*, L.A. Times, Feb. 24, 1988, sec. IV, at 10 (discussing the proposed expansion of article 189 to include "tippees"). In May 1988, article 189 was expanded to include "information recipients." *Id.*

157. Securities and Exchange Law art. 189, para. 2 (Jap.) (allowing shareholders, after sixty days notice and subsequent failure of the corporation to pursue a claim, to sue on behalf of the corporation).

158. See INTERNATIONAL SECURITIES, *supra* note 149, at § 11.13 (stating that the 1953 amendment effectively eliminated the insider duty to report changes to the MOF); Ishizumi, *supra* note 116, at 488 (finding that the main reason for the inactivity of article 189 was the deletion of the reporting requirement of article 188).

159. See INTERNATIONAL SECURITIES, *supra* note 149, at § 11.13 (discussing the elimination of the insiders' duty to notify the MOF of any changes in stockholding); Ishizumi, *supra* note 116, at 488 (stating that under article 188, principal stockholders, corporate directors, and officers had to report any changes in the amount of securities owned within ten days after the end of the month); JAPANESE SECURITIES, *supra* note 84, at 194 (addressing the elimination of the duty of insiders to notify the MOF of changes in stockholding). Article 188 was modeled after section 16(a) of the Securities Exchange Act of 1934. *Id.* Cf. Securities Exchange Act of 1934, § 16(a), 15 U.S.C. § 78p(a) (1982). Section 16(a) states in pertinent part:

Every person . . . [owning] more than 10 per centum of any class of any equity security . . . or who is a director or an officer of the issuer of such security, shall file . . . a statement with the Commission . . . indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

Id. Commentators have generally acknowledged that the reporting requirement of section 16(a) places outside investors on equal footing with insiders because it allows the

ernment repealed the provision on the grounds that it was inoperative.¹⁶⁰ Prior to the amendment, insiders could easily evade the provision because the government did not publicize the filed reports, thereby, denying notice to potential plaintiff-shareholders.¹⁶¹ Rather than repealing article 188, the Japanese government could have strengthened the law by strictly enforcing the reporting provision and making stock transaction reports public.

The repeal of article 188 left the market regulators unable to monitor those corporate directors, officers, and ten-percent shareholders involved in insider trading.¹⁶² Without the mandatory reporting requirement, it was nearly impossible for regulators to discover trading violations.¹⁶³ Private suits without article 188 were therefore less likely because potential plaintiffs were unable to discover the violation.

In an attempt to redress these difficulties and in response to public outcry over perceived trading abuses,¹⁶⁴ 1988 Diet members introduced new legislation designed to strengthen the insider trading laws in the spring of 1988.¹⁶⁵ Two months later, the Diet amended SEL article 189

monitoring of reports, thereby, alerting the plaintiff's bar, which has primarily been responsible for enforcement of section 16(b) in the United States. Samuels, *Liability for Short-Swing Profits and Reporting Obligations Under Section 16 of the Securities Exchange Act of 1934*, in INTRODUCTION TO SECURITIES FILINGS 1988: A SATELLITE PROGRAM (Feb. 23, 1988) (WESTLAW, Law Rev. library, PLI file).

160. See JAPANESE SECURITIES, *supra* note 84, at 194 (stating that the repeal of article 188 was justified because it was "ineffective"); Ishizumi, *supra* note 116, at 488 (discussing the SEL's official comment to the repeal of article 188). The official comment was that the provision was "inefficient." *Id.* at n.209. Some scholars believe, however, that rather than being inefficient, the provision was perceived as excessive, and the resultant opposition in the business community was responsible for its abolishment. *Id.* at 488-89.

161. See Tatsuta, *Ininjo Kisei Kabushiki Kokai Kaitsuke: Naibusha Torihiki*, in 2 AMERICA TO NIPPON NO SHOKENTORIHICI HO 564 (L. Loss & M. Yazawa eds. 1975) (discussing the ease of evading the provision of article 188 because of the failure of the MOF to publicize the report).

162. Zoglin, *supra* note 125, at 420.

163. See *supra* notes 158-59 and accompanying text (describing the difficulty of discovering insider trading violations without article 188).

164. See *Insider Trading in Japan—So Many Misunderstandings*, ECONOMIST, Oct. 10, 1987, at 78 [hereinafter *So Many Misunderstandings*] (discussing the infamous 1987 Tateho Chemical Company scandal). One day prior to Tateho's public announcement of large losses in government bonds and futures investments, several large shareholders, including one of Tateho's banks, sold their holdings. *Id.*; see also *Insider Trading Rules to Take Effect in April*, Jiji Press Ticker Serv. (Mar. 13, 1989) (LEXIS, Nexis library, Omni file) (noting an investigation by the Osaka Stock Exchange which found the Tateho sales "infinitely close to unlawful conduct," but determined that the laws were too vague to use for the prosecution of the violations); Graven, *Tokyo Moves Timidly on Insider Trading*, Wall St. J., Aug. 19, 1988, at 8 (stating that the Tateho scandal prompted the Diet to revise the SEL and give the MOF more investigatory power).

165. See Sneider, *supra* note 156, at 261 (discussing the introduction of new legis-

and reintroduced article 188 into law, thereby, strengthening the restrictions on short-swing insider trading.¹⁶⁶ Significantly, major shareholders¹⁶⁷ and corporate officers of a listed corporation must now submit to the MOF a report detailing all applicable stock transactions.¹⁶⁸ Upon the discovery of a violation, the MOF publishes the stock transaction report submitted by shareholders and officers.¹⁶⁹ The report serves as notice of trading violations to potential plaintiffs. In addition, the laws also establish new criminal penalties for violators.¹⁷⁰

Because it is unlikely that the Japanese government will enforce the new sanctions or that shareholder suits will ensue, the effects of the changes in the law remain largely unknown.¹⁷¹ The MOF's traditional preference for informal administrative guidance,¹⁷² as opposed to a formal enforcement policy, coupled with the various systemic barriers shareholders face within the Japanese litigation system¹⁷³ and the business community,¹⁷⁴ retard the regulation of fraudulent stock transactions.

lation to curb insider trading because of internal public pressure and United States pressure resulting from the Tateho and the Recruit Cosmos stock scandal); *supra* notes 164, 180 and accompanying text (describing the Tateho Chemical Company and Recruit Comos stock scandals).

166. See Securities and Exchange Law art. 190 (Jap.) (prohibiting the short sales of stock).

167. *Id.* at 188. Major shareholders are defined as beneficial owners of ten percent or more of stock. *Id.* But see Smith, *supra* note 153, at ¶ 14,390 (excluding the provision for ten percent shareholders unless the shareholder owned ten percent prior to the acquisition).

168. Smith, *supra* note 153, at ¶ 14,310; Sneider, *supra* note 156, at 291 (discussing tippee liability for stock transaction violations).

169. See Sneider, *supra* note 156, at 288-89 (noting that upon receipt of the report, the MOF will determine whether the party in question received a short swing trading profit, and unless the profit was tendered to the company within three days, the MOF will subsequently publish the report).

170. *Id.* at 289-91 (explaining that executive officers, employees, or other agents who obtain knowledge of material information related to the business, in connection with the performance of their duties, who use such knowledge for the purchase and sale of securities, are subject to up to six months imprisonment and a fine of five hundred thousand yen).

171. In May 1989, however, a Japanese corporation disgorged short swing profits made from the purchase and sale of shares between November 1988 and February 1989 of the equivalent of nearly \$9 million to the Japanese government. *Japanese Firm Gives Up Trading Profits*, L.A. Times, May 17, 1989, at 6.

172. See *infra* note 198 and accompanying text (discussing administrative guidance as a very persuasive extralegal source of government power).

173. See *infra* notes 252-71 (specifying the low number of Japanese litigators, their unfamiliarity with securities law, and the lack of class actions and contingency fees, which serve as impediments to potential litigation).

174. See *infra* notes 272-76 (discussing that some shareholders are viewed as outside of the corporation).

2. Security Exchange Law Article 50

Article 50 of the SEL allows the MOF to prohibit conduct that is detrimental to the objectivity of securities transactions or undermines the integrity of the industry.¹⁷⁵ Article 50 also explicitly prohibits employees and officers of a securities corporation from engaging in insider trading.¹⁷⁶ In addition, the MOF may prohibit securities companies from engaging in any acts where "[a]n officer or employee[] tak[es] advantage of special information obtained through his position for selling or purchasing securities or act[s] solely for the purpose of lucrative speculation."¹⁷⁷ The MOF may also apply administrative sanctions such as the suspension of trading to violators of article 50.¹⁷⁸ Furthermore, MOF may also hold directors and officers liable if their conduct reflects bad faith or a grossly negligent breach of their duties under the Japanese Commercial Code article 266-3.¹⁷⁹ Despite the enactment of these enforcement provisions, article 50 provisions against insider trading have been invoked only once.¹⁸⁰

175. See Securities and Exchange Law art. 50 (Jap.) (stating that it is unlawful for a securities corporation to commit acts prejudicial to the fairness or credibility of the securities industry). Article 50 states in pertinent part:

It shall be unlawful for any securities corporation, its officers or employees to commit . . . (s)uch acts relating to buying, selling or other transactions of securities, . . . as may be prescribed by Ministerial Ordinance as prejudicial to the fairness of transactions or undermining the credibility of the securities industry.

Id.

176. See H. FFRENCH, INTERNATIONAL LAW OF TAKEOVERS AND MERGERS 3, 22 (1986) (discussing that the MOF may utilize article 50 to prohibit parties from trading when information is obtained by virtue of their position).

177. DOING BUSINESS IN JAPAN, *supra* note 87, at § 2.02[4].

178. See Securities and Exchange Law art. 35 (Jap.) (elaborating on the application of administrative sanctions that the MOF may apply to violators of article 35). Article 35 provides in pertinent part:

In case that any securities corporation comes under any one of the cases set forth in the following items, the [MOF] may cancel the license of such corporation or order to suspend its business in whole or in part for a period which he designates within six months . . . when it violated statutes or disposals taken by an administrative authorities

Id.; see also *id.* art. 64-3 (describing the administrative sanctions available to the MOF including the cancellation of registration or suspension from trading securities); INTERNATIONAL SECURITIES, *supra* note 149, at § 11.20[2] (outlining the administrative sanctions available to the MOF).

179. INTERNATIONAL SECURITIES, *supra* note 149, at § 11.12 (citing SHOHO (COMMERCIAL CODE) (as amended by Law No. 74 of 1981), art. 266-3, para. 1 (Jap.)).

180. See Ishizumi, *supra* note 116, at 487 (discussing the use of article 189 once in 1963 to recover the short-swing profits of the former chief executive officer of the Shokusanutakusogo Kabushikikaisha Corporation).

Neither article 189 nor 50 cover the recent Recruit Cosmos insider trading stock scandal because it involves the private placement of unlisted shares. See *All 76 Recruit Cosmos Shareholders Identified*, Daily Yomiuri, Oct. 27, 1988, at 2 [hereinafter *Recruit*] (detailing the distribution of 1.25 million unlisted Recruit shares to 76 persons in

C. ANTIFRAUD

Article 58¹⁸¹ of the SEL is a general antifraud provision. The provision is modeled after section 10(b) and rule 10(b)(5) of the United States Exchange Act of 1934.¹⁸² Violations of article 58 may result in the imposition of criminal and administrative penalties.¹⁸³

Although article 58 is not regarded as a source of private remedy,¹⁸⁴ a violation may give rise to general tort liability under Mimpo Civil Code article 709.¹⁸⁵ As with article 50 violations, company directors may be held liable for conduct that constitutes bad faith or that is a

December 1984, and the subsequent sale of the shares of stock). The Japanese Securities and Exchange Law has a private offering exemption limited to fifty persons. JAPANESE SECURITIES, *supra* note 84, at 63. Miaswa, *supra* note 102, at 483 (discussing the fifty-person limit of the private offering exception to registration).

181. See Securities and Exchange Law art. 58 (Jap.) (prohibiting unfair transactions). Article 58 provides:

No person shall . . . employ any fraudulent device, scheme or artifice with respect to buying, selling or other transactions of securities, . . . obtain money or other property by using documents or by any representation which contain an untrue statement of a material fact or any omission to state a material fact necessary to make the statements therein not misleading, or . . . make use of false quotation for the purpose to solicit buying, selling or other transactions of securities.

Id.

182. See Note, *Enforcing Securities Regulation*, *supra* note 28, at 255 (describing article 58 as parallel to section 10(b) of the United States Securities Exchange Act). Section 240.10b-5 of the Securities Exchange Act provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Securities Exchange Act, 17 C.F.R. § 240.10b-5 (1988).

One Japanese scholar has postulated that article 58 has not been utilized as often as its American model because of the abstract wording of the former. JAPANESE SECURITIES, *supra* note 84, at 76 n.37.

183. See *Ishizumi*, *supra* note 116, at 486 (discussing the criminal and administrative sanctions applicable to violators of article 58). For criminal sanctions to apply, the violation must have been intentional. *Id.* The administrative penalties applied are the same as those applied against violation of SEL article 50. *Id.* at 487.

184. See Note, *Enforcing Securities Regulation*, *supra* note 28, at 255 (stating that article 58 does not provide civil remedies).

185. See JAPANESE SECURITIES, *supra* note 84, at 192 n.142 (discussing that a violation under article 58 may give rise to damages under the Civil Code). Under article 709 of the Civil Code "a person who violates intentionally or negligently the right of another is bound to make compensation for damage arising therefrom." MIMPO (CIVIL CODE) art. 709 (Jap.).

grossly negligent breach of their duties.¹⁸⁶ Because article 58 does not expressly prohibit insider trading, commentators generally believe that the provision is too vague to be applied to insider trading infractions.¹⁸⁷ In fact, article 58 has not yet been applied to any civil, criminal, or administrative proceedings.¹⁸⁸

VI. THE MARKET REGULATORS

A. THE MINISTRY OF FINANCE

1. *Regulatory Procedure—Administrative Guidance*

Between 1948 and 1952, the Japanese Securities Exchange Commission (JSEC), modeled after its counterpart in the United States, administered the SEL.¹⁸⁹ In 1952, the JSEC was abolished,¹⁹⁰ and the MOF assumed its responsibilities.¹⁹¹ In 1964, the Securities Bureau,

186. See Note, *Enforcing Securities Regulation*, *supra* note 28, at 255 (holding directors liable for breach of duties); see also SHOHO (COMMERCIAL CODE) art. 266-3 (Jap.) (stating that where the supervisors and directors are liable for damages sustained by the corporation or third parties, the liability is joint and several).

187. See Kanzaki, *Developments in Insider Trading in Japan*, 4 J. COMP. CORP. L. & SEC. REG. 391 (1982) (noting that the provision is too general to apply to potential insider trading violations).

188. See JAPANESE SECURITIES, *supra* note 84, at 192 (stating that article 58 has never been applied to insider trading); Sato, *Securities Administration*, in LECTURES ON JAPANESE SECURITIES REGULATION 97, 101 (1980) (discussing that although the United States equivalent statutory provision has produced volumes of cases, no reported cases exist under article 58).

189. See DOING BUSINESS IN JAPAN, *supra* note 87, at § 1.02[4][a] (describing the creation of the Japanese Securities Exchange Commission). The Allies introduced the concept of independent administrative agencies after World War II, a concept that the Japanese did not view favorably. *Id.* The Japanese Fair Trade Commission, the counterpart to the United States Federal Trade Commission, was also created during this period. *Id.*

190. See Miaswa, *supra* note 20, at 479 (explaining the elimination of the JSEC because of staff problems); M. TATSUTA, *supra* note 7, at 4-5 (discussing that the JSEC was eliminated to simplify the administrative structure); JSRI 1988, *supra* note 5, at 101 (stating that the JSEC was abolished for economic reasons and noting that the Chairman of the JSEC had just died prior to its abolition). Although commentators have forwarded various explanations for the elimination of the JSEC, in actuality, the JSEC was probably eliminated because of the Japanese dislike for autonomous administrative agencies. See H. IYORI & A. UESUGI, *supra* note 102, at 15 (explaining that no independent regulatory commission existed in Japan before World War II); Sato, *supra* note 188, at 99 (noting that Japan, unlike the United States, has historically had an integrated financial administration system); see also *infra* note 282 and accompanying text (describing government and business leaders criticism and ostracism of the Japanese Fair Trade Commission, an autonomous administrative agency created during the same period as the JSEC).

191. See JSRI 1988, *supra* note 87, at 21 (describing the absorption of the JSEC into the MOF).

part of the MOF, was established.¹⁹² The Securities Bureau is similar to the SEC; it too has extensive influence over securities transactions through its rule-making and administrative powers.¹⁹³ Unlike the SEC, however, the Japanese Securities Bureau has the ability to offer "administrative guidance."¹⁹⁴

Japanese government agencies implement administrative guidance, an extra-legal source of government power, for the supervision and oversight of individuals and public bodies.¹⁹⁵ The power derived from traditional concepts of government administration is largely carried over from Japanese imperial theories.¹⁹⁶ Administrative guidance is more a mode of expressing power than a source of power.¹⁹⁷ The authority for administrative guidance exists in the broad mandates of the legislation that establishes the government agency. The Securities Bureau of the MOF, like most other Japanese government agencies, may issue administrative guidance to provide business persons with statements of government policy upon which they may rely in making business decisions.¹⁹⁸ The process of administrative guidance involves the

192. *Id.*

193. See Rosen, *supra* note 96, at 15 (describing the creation and the powers of the JSEC).

194. See Luney, Book Review, 10 N.C.J. INT'L L. & COM. REG. 297, 298 (1983) (reviewing JAPANESE SECURITIES REGULATION (1983) (classifying administrative guidance as unique to Japan)).

195. *Id.* at 298-99; Yamanouchi, *Administrative Guidance and the Rule of Law*, 7 LAW JAP.: ANN. 22, 22-23 (1974) (defining administrative guidance as advisory and regulatory guidance).

196. See Lansing & Wechselblatt, *Doing Business in Japan: The Importance of the Unwritten Law*, 17 INT'L LAW. 647, 657 (1983) (describing administrative guidance as a natural outgrowth of the feudal tradition). Government officials, the modern descendants of feudal lords, are respected authorities. *Id.*

197. See Luney, *supra* note 194, at 298-99 (quoting D. HENDERSON, FOREIGN ENTERPRISE IN JAPAN 200-01 (1973)) (discussing administrative guidance as an extra-legal source of government power).

198. *Id.* at 299 (presenting the view that administrative guidance, rather than requiring a statutory basis, exists in broad mandates in establishing the government agency). Little judicial precedent exists relating to securities law, thus, the MOF's administrative guidance exerts great influence over the operation of the securities market and, surprisingly, foreign companies. See DOING BUSINESS IN JAPAN, *supra* note 87, at § 1.02[4][a] (discussing the importance that the MOF's guidance assumes due to the lack of judicial precedent). The reliance of administrative guidance is probably reflective of the Japanese cultural preference for consensus rather than reliance on the written word. *Id.* at § 1.02[4][b]. For example, in a contractual dispute, rather than looking at the specific provisions to define the rights and duties of the parties, many Japanese believe that the contract language to be secondary. See Hahn, *supra* note 83, at 520 (commenting on traditional Japanese contracts which are usually a short, one page document and "strange animals" to American lawyers); Schrager & Gresser, *Going Public, Japanese Style*, Wall St. J., May 2, 1988, at A19 (discussing that foreign issuers find the Japanese securities markets risky and uncertain because the "rules of the game" change rapidly, and that "the written rules are the ones that are subject to

voluntary, consensual performance¹⁹⁹ by an organization or a person in order to realize the administrative agency's intent.²⁰⁰ The agency's acts may include: instructions, warnings, cautions, guidance, recommendations, requests, or advice.²⁰¹

The MOF may request, through administrative guidance, that companies investigate insiders' securities transactions.²⁰² Although compliance with the request is "purely voluntary" and the failure to comply with the request will not result in an official punishment or a judicial order to perform, the MOF would suffer an embarrassment if its request remained unanswered.²⁰³ Subsequently, the MOF may become extremely uncooperative in providing future licenses and regulatory exceptions to the refusing party.²⁰⁴

2. Regulatory Policy

The MOF has publicly denounced insider trading as a serious violation of business ethics.²⁰⁵ Conversely, administrative guidance has been traditionally informal and has remained unannounced to the public. Indicative of the agency's enforcement attitude, MOF officials have adamantly insisted, as late as 1987, that no insider trading exists in Japan.²⁰⁶ One Japanese commentator has concluded that the MOF does not want to eliminate securities fraud because, although the agency has the capability to prosecute securities fraud, it has failed to exercise it.²⁰⁷ The MOF appears to be pursuing a policy of vigorous nonpublic

change, while the unwritten rules appear to be more inflexibly construed").

199. See Yeomans, *Administrative Guidance: A Peregrine View*, 19 LAW JAP. ANN. 125, 158 (1986) (noting that the imposition of formal sanctions would remove the act from being categorized as administrative guidance).

200. Luney, *supra* note 194, at 299 (stating that administrative guidance results in voluntary compliance with government policies).

201. See *id.* (describing administrative guidance as government agency acts that may take the form of instructions, requests, warnings, suggestions, and encouragements).

202. See Note, *Enforcing Securities Regulation*, *supra* note 28, at 255 (discussing the MOF's request that securities companies investigate the insider purchase or sale orders before processing these orders).

203. See Luney, *supra* note 194, at 299 (explaining that failure to comply with administrative guidance may result in a government agency "losing face" and becoming uncooperative in providing future services, licenses, and permits to noncomplying parties).

204. *Id.* Conversely, compliance with administrative guidance may be rewarded through government subsidies. *Id.*

205. See Note, *Enforcing Securities Regulation*, *supra* note 28, at 256 (describing the MOF publicly denouncing insider trading as against the "business ethic").

206. See Chira, *supra* note 121, at D6 (quoting an unnamed MOF official who denied that insider trading exists in Japan).

207. See Schoenberger, *supra* note 156, at 1 (quoting Seijiro Wantanabe's descrip-

enforcement through administrative guidance while denying that it is doing so. The denial of the existence of the need for enforcement means that the MOF has failed to exploit the full potential of deterrence from the public prosecution of insider trading.²⁰⁸

B. THE STOCK EXCHANGES

The MOF licenses the securities exchanges.²⁰⁹ To receive a license the securities exchanges must have three basic authoritative guidelines which regulate the conduct of members of the exchanges: a constitution, business regulations, and entrustment contract regulations.²¹⁰ The constitution of the TSE, the largest exchange in Japan,²¹¹ is based on the constitutions of the New York (NYSE) and San Francisco stock

tion of the MOF as lacking the desire to police against securities fraud). *But see* Yanase, *supra* note 156, at 76-78 (discussing the MOF's use of administrative guidance in an attempt to curb insider trading).

208. *See* Lansing & Wechselblatt, *supra* note 196, at 659 (describing administrative guidance as undemocratic and dangerous because of the lack of accountability). In addition, as in other applications of administrative guidance, basic structural problems exist. *Id.* No legal checks on the power of an agency's use of administrative guidance and no formal legal recourse for its abuse exist. *Id.*

Just as no legal checks for overzealous or selective enforcement exist, neither do checks for underenforcement. Perhaps most damaging is the appearance of an incestuous relationship between the regulating body and the regulated industry, with little chance of the public discovering the extralegal activity because of the shroud of informality. *See* Tanaka & Takeuchi, *The Role of Private Persons in the Enforcement of the Law: A Comparative Study of Japanese & American Law*, 7 LAW JAP.: ANN. 34, 44 (1974) (noting that the resolution of disputes through administrative guidance is unnoticeable to outsiders). Administrative agencies are then able to monopolize enforcement and preclude private litigants from enforcing the law and from knowing whether the administrative agency is properly performing its responsibilities. *Id.* at 46. Moreover, individuals are denied the opportunity to avoid future dealings and subsequent harm because of the lack of notice. A. VINER, *supra* note 100, at 78.

209. *See* Securities and Exchange Law art. 81 (Jap.) (stating that only a securities corporation may establish a securities exchange). The securities exchange must procure a licence from the MOF prior to operation. *Id.* As of 1988, there were eight stock exchanges in Japan: Tokyo, Osaka, Nagoya, Kyoto, Hiroshima, Fukuoka, Niigata, and Sapporo. JSRI 1988, *supra* note 87, at 55. The MOF has not permitted any new exchanges since the registration of the original group in 1948. Smith, *supra* note 153, at ¶ 14-210.

210. *See* JAPANESE SECURITIES, *supra* note 84, at 276-77 (stating that article 82 mandates that an application for a license must be accompanied with a constitution, business regulations, brokerage agreement standards, and other documents as the MOF may require).

211. JSRI 1988, *supra* note 87, at 54 (noting that the volume of transactions between 1976 and 1986 on all the exchanges may be broken down as follows: TSE 83%, Osaka Exchange 12%, Nagoya Exchange 4.5%, and the other five exchanges 0.5%). The TSE is also the largest stock exchange in the world. *See* NIKKO, *supra* note 3 (listing total market value and volume of turnover of securities for the Tokyo, New York, and London stock exchanges).

exchanges (SFSE).²¹² The aims of the TSE constitution are to develop equitable principles, to promote securities transactions, and to protect investors.²¹³

The TSE is a self-regulating organization possessing the sole power to take action against an exchange member.²¹⁴ Rather than actively enforcing the regulations, however, the TSE has merely issued a series of passive letters to exchange members, lecturing against participation in fraudulent trading practices. In 1971, the TSE issued a letter discouraging members from engaging in short-swing trading profits²¹⁵ through insider trading.²¹⁶ The letter stated that if the TSE found a securities firm intentionally participating in such trading practices, it would impose a fine or suspend the corporation's trading activities.²¹⁷ A 1972 letter requested that stock exchange members scrutinize orders from corporate insiders.²¹⁸ In 1973, the TSE sent another letter emphasizing the importance of avoiding participation in insider trading.²¹⁹

The TSE has stated that if it finds that a director, officer, or corporation is involved in insider trading, it will issue a warning.²²⁰ Although public disclosure would shame the violators,²²¹ the TSE usually does not publicly disclose the specific findings of any trading investiga-

212. See JAPANESE SECURITIES, *supra* note 84, at 132 (discussing that the TSE's constitution is derived from the constitutions of the NYSE and the SFSE).

213. CONSTITUTION OF THE TOKYO STOCK EXCHANGE art. 2 (1961).

214. See Sato, *supra* note 188, at 106-07 (noting that the power to take disciplinary action is left to the exchanges).

215. See Securities and Exchange Law art. 189 (Jap.) (defining short-swing trading as the purchase and sale, or sale and purchase, of shares within six months).

216. See Ishizumi, *supra* note 116, at 491 (describing the MOF's letter which stated that upon accepting stock orders from directors, officers, or principal shareholders, a securities corporation must perform background checks and ascertain the reasons for the stock orders). If the securities company determines that the transaction violates a law or regulation, the company "shall warn, and refuse such orders" and report the refused order to the stock exchange. *Id.*

217. *Id.* In 1975, a stock exchange ordered an individual to disgorge short-swing profits. *Id.*

218. Kanzaki, *supra* note 187, at 392.

219. Ishizumi, *supra* note 116, at 491 n.232.

220. See Jackson & Fingleton, *supra* note 1, at 158 (quoting Kenjro Egashira, professor at the University of Tokyo, as stating that upon a finding of insider trading, the TSE has only issued informal warnings). Between 1978 and 1981, the TSE conducted sixty-seven insider trading investigations. Kanzaki, *supra* note 187, at 392. Between 1973 and 1983, the TSE gave twenty-six insider trading warnings. *Id.* Alternatively, the exchanges could restrict a member's right to trade. Jackson & Fingleton, *supra* note 1, at 158.

221. See Fingleton & Jackson, *supra* note 1, at 157 (discussing the power of negative deterrence in corporate Japan). An alternative interpretation is that because the disclosure of an impropriety is shameful for the exchange itself, investigations are not reported. *Id.*

tions.²²² As a result, the investigations do not serve as an effective deterrent. Additionally, the exchanges may only impose private sanctions on members who violate the exchanges' rules.²²³ The TSE may also be reluctant to impose sanctions, because the decision-makers may fear that a rigorous rule may be applied to their own future transactions.²²⁴ Moreover, unlike the NYSE,²²⁵ the TSE did not have a formal computerized market surveillance program until 1987, making it difficult to monitor and track any trading violations.²²⁶

C. THE JAPANESE SECURITIES DEALERS ASSOCIATION

The SEL created the Japanese Securities Dealers Association (JSDA or Association)²²⁷ and patterned it after the United States National Association of Securities Dealers (NASD).²²⁸ The JSDA is organized to assure fair trading and protection of investors²²⁹ in the over-the-

222. See *id.* (stating that the industry only publishes an investigation as a last resort).

223. See JAPANESE SECURITIES, *supra* note 84, at 118 (discussing that the available sanctions that may be levied against exchange members include: a fine, the suspension or restriction of the right to trade on the floor of the exchange, or expulsion). Some commentators argue that because no express provision for suspension of membership exists, the exchange cannot impose this penalty. *Id.* Because an exchange may expel a member, however, it should be able to impose the lesser penalty of suspension of trading. *Id.*; see also Sato, *supra* note 188, at 107 (noting that the MOF may revoke the exchange's license for failure to "take necessary action" against improper traders).

224. See JAPANESE SECURITIES, *supra* note 84, at 118 (discussing the reluctance of the exchanges to impose sanctions because of the fear of creating binding precedent).

225. See Hawes, *Insider Trading Law Developments: An International Analysis*, 14 LAW & POL'Y INT'L BUS. 335, 382-83 (1982) (emphasizing the importance of the NYSE's computerized market surveillance program called the Stock Watch Group (Group)). The Group watches for unusual fluctuations in corporate stock percentages. *Id.* If a corporate development follows the fluctuations, the Group investigates and may report its findings to the SEC. *Id.*

226. See *So Many Misunderstandings*, *supra* note 164, at 78 (noting that the TSE first started using a stock transactional monitoring computer system in June 1987); Sato, *supra* note 188, at 111 (describing the monitoring of transaction trends in an attempt to identify manipulation). If "substantial irregularities" are found, the case is reported to the TSE's Board of Governors. *Id.*

227. See Securities and Exchange Law art. 67 (Jap.) (listing the requirements for registration in JSDA).

228. See JAPANESE SECURITIES, *supra* note 84, at 99-100 (stating the fact that the JSDA is patterned after the NASD); JSRI 1988, *supra* note 87, at 147 (noting that prior to 1968, the Japanese Federation of Securities Dealers was comprised of one association in each of the thirty-three districts). In 1968, the districts were consolidated into ten regional blocks. *Id.* The ten blocks were abolished in 1973 and a single national organization was established. *Id.*

229. See JSRI 1988, *supra* note 87, at 176 (noting that the purpose of the JSDA is to protect the public and enforce fair business practices).

counter (OTC) market²³⁰ and is registered with the MOF.²³¹ The JSDA's constitution,²³² Rules of Fair Practice,²³³ and Uniform Practice Rules²³⁴ are important supplements to the SEL.²³⁵

The JSDA must provide in its constitution that it will attempt to prevent fraudulent or manipulative acts and it will promote equitable principles of trade.²³⁶ The JSDA has incorporated into its constitution an objective to "promote fair practices by member firms in securities transactions and to maintain the integrity and credibility of members."²³⁷ For example, a securities company's employee who violates the rules of the JSDA is subject to an employer's disciplinary procedures.²³⁸ If the employee's acts would be damaging to the securities

230. Compare L. Loss, *supra* note 128, at 674-76 (describing the American OTC market as a residual, decentralized securities market where broker-dealers and customers negotiate transactions) with JAPANESE SECURITIES, *supra* note 84, at 82 (describing the Japanese OTC market as a wide variety of securities transactions occurring in the offices of the securities corporations) and Kanzaki, *Over-the-Counter Markets*, in LECTURES ON JAPANESE SECURITIES REGULATION 117 (1980) [hereinafter *OTC Markets*] (defining the Japanese OTC as loosely organized with private trading conducted between customers and securities companies). The OTC accounts for approximately six percent of the volume of all stock exchange transactions. Smith, *supra* note 153, at ¶ 14-840.

231. See Rosen, *supra* note 96, at 29 (stating that the registration of a security dealer's association is mandatory; membership is optional). But see JAPANESE SECURITIES, *supra* note 84, at 100 (noting that all Japanese securities companies belong to the JSDA because commission rate structures make membership pragmatically necessary).

232. See H. FRENCH, *supra* note 176, at 23-24 n.7 (describing the JSDA's constitutional aims which are to ensure that members' securities transactions are fair, to protect investors, and to promote the development of the securities industry). Compare DOING BUSINESS IN JAPAN, *supra* note 87, at § 2.02[7][b] (stating that the articles of incorporation prescribe fundamental matters of the business administration of the securities association as contained in article 71 of the SEL) with Certificate of Incorporation, Nat'l A. Sec. Dealers, Inc. M. (CCH) ¶ 1003 (May 1988) (providing that NASD's purpose is to promote "high standards of commercial honor" and to "promote just and equitable principles of trade for the protection of investors").

233. DOING BUSINESS IN JAPAN, *supra* note 87, at § 2.02[7][b] (citing Articles of Incorporation, article 5, para. 1, item 2). Compare *id.* (noting that the Fair Trade Practice Rules were established to maintain fairness in securities transactions and to protect investors interests) with Rules of Fair Play, Nat'l A. Sec. Dealers, Inc. M. (CCH) ¶ 2151 (Oct. 1987) (noting that a United States NASD member shall observe high standards of commercial honor and equitable principles).

234. DOING BUSINESS IN JAPAN, *supra* note 5, at § 2.02[7][b]. Compare *id.* (stating that the Uniform Practice Rules are designed to standardize securities transactions to achieve efficiency and eliminate disputes) with Uniform Practice Code, Nat'l A. Sec. Dealers, Inc. M. (CCH) ¶ 3501-68 (Oct. 1988) (elaborating the NASD's Uniform Practice Code).

235. DOING BUSINESS IN JAPAN, *supra* note 87, at § 2.02[7].

236. See Securities and Exchange Law art. 71 (Jap.) (stipulating the requirements for the content of securities dealers' constitutions).

237. See JAPANESE SECURITIES, *supra* note 84, at 148 n.35 (quoting articles 9.3 and 10 of the Japanese Securities Dealers Association Constitution).

238. *Id.* at 148 (quoting articles 9.3 and 10 of the Japanese Securities Dealer Asso-

industry's public image,²³⁹ the corporation must also submit an Unethical Conduct Report.²⁴⁰

In addition, the JSDA may discipline a member firm by censure, fine, or suspension of trading activities.²⁴¹ Grounds for disciplinary action include violation by a member firm of any law, regulation, regulatory guideline, resolution, the JSDA constitution, or the commission of any act that undermines the integrity and credibility of transactions.²⁴² Although modeled after the United States NASD,²⁴³ and despite the recent development of a market surveillance program,²⁴⁴ the JSDA's regulatory activity is less vigorous than the NASD.²⁴⁵ Like the Tokyo Stock Exchange, the JSDA has also sent cautionary letters warning of insider trading to all Japanese companies listed on the Japanese stock exchanges.²⁴⁶ The letter urged participants to adhere to the legal guidelines, but it did not directly condemn insider trading.²⁴⁷ One Japanese scholar has suggested that rather than functioning as a self-regulating body, the Association promotes the interests of the securities companies.²⁴⁸

The MOF polices the JSDA with its own disciplinary powers. The MOF may instruct the JSDA to discharge any officer who has failed to enforce the constitution or other regulation of the Association and may cancel the registration of the JSDA or suspend its business when it determines that it is necessary for the public interest or for the protection of investors.²⁴⁹ Despite these powers, however, the MOF has not

ciation Rules on the Employers of Securities Corporations).

239. *Id.*

240. *Id.*

241. *Id.* at 102.

242. *Id.*

243. See *supra* note 226 and accompanying text (discussing the computerized market surveillance program).

244. See *OTC Markets*, *supra* note 230, at 120 (noting the existence of the Japanese OTC market surveillance committee). The staff watches for unusual activity and if activity merits investigation, the staff will conduct a market study. *Id.* If the JSDA finds an unusual price variation, the JSDA may suspend either the trading in the particular stock or the trading by the member company involved. *Id.*

245. See M. TATSUTA, *supra* note 89, at 80 (discussing that the JSDA has never taken the initiative to expel members and has only expelled members who other regulatory bodies previously sanctioned).

246. See *Tokyo Exchange Puts Out Insider Trading Warning*, Wall St. J., June 18, 1987, at 27 (describing the 1987 cautionary letter sent to Japan's listed corporations and domestic and foreign securities companies). The MOF stated that the letters were part of a cooperative effort between Japan and the United States. *Id.*

247. *Id.*

248. See M. TATSUTA, *supra* note 89, at 80 (viewing the associations as primarily concerned with the promotion of public relations of the securities industry).

249. See Securities and Exchange Law art. 75 (Jap.) (stating that the MOF may cancel, suspend the registration of a securities dealer association, order the association

invoked any sanctions against the JSDA for failing to enforce insider trading regulations.

D. PRIVATE LITIGANTS

1. *Lack of Securities Litigation*

In the United States, federal securities laws do not explicitly prohibit insider trading.²⁵⁰ The SEC and judicial decisions have progressively defined the offense.²⁵¹ In the United States, the SEC and private parties have brought many actions²⁵² which sharply contrasts with the lack of litigation in Japan.²⁵³ Rather than litigating, the MOF has "enforced" the SEL provisions through the use of extra-legal administrative guidance.²⁵⁴ Additionally, the Japanese culture stresses *wa*, which may be roughly characterized as a common understanding or consensus.²⁵⁵ The result is an emphasis on parties arriving at a self-negotiated resolution²⁵⁶ because of their aversion to litigation.²⁵⁷

to expel any member who violated the statutes, or order the association to dismiss any officer who has abused his authority or failed to enforce the constitution).

250. See Pitt & Shapiro, *supra* note 122, at 417 (describing the fact that federal securities law does not define or clearly forbid insider trading).

251. *Id.*; see also *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 911-12 (1961) (holding that a corporate insider who possesses material inside information must disclose the information or must abstain from trading in the security).

252. See M. TATSUTA, *supra* note 89, at 5 (comparing the large amount of judicial precedent in the United States with the scarcity of case law in Japan). But see PACIFIC BASIN, *supra* note 110, at § 2.4(c) (stating that *stare decisis* does not exist in Japan).

253. See Miaswa, *supra* note 102, at 494 (describing the lack of litigation in securities and hypothesizing that it is a result of cultural and structural bias); DOING BUSINESS IN JAPAN, *supra* note 87, at § 1.02[4] (noting that Japanese securities regulation has been given infrequent judicial review); Schoenberger, *supra* note 156, at 10 (discussing that no criminal insider trading cases have been tried in the Japanese courts).

254. See *supra* notes 194-204 and accompanying text (defining and describing administrative guidance).

255. See Hahn, *supra* note 83, at 518-19 (discussing the importance of the Confucian ideal of social harmony); Kim, *The Law of the Subtle Mind: The Traditional Japanese Conception of Law*, in SELECTED WRITINGS ON ASIAN LAW 52 (1982) (defining *wa* as a Confucian ideal of harmony or concord). If a dispute arises, disharmony results and a lawsuit further strains the relationship. *Id.* The "fight to the finish" in a courtroom is seen as shameful. *Id.*; see also *Introduction to Japanese Law*, *supra* note 83, at ¶¶ 8-770 (explaining that *wa* diverts discord into informal dispute resolution channels).

The Japanese concept of group harmony may be based on more than Confucian idealism. See Lansing & Wechselblatt, *supra* note 196, at 648 (noting that Japan's agrarian history may explain the adoption of the group-consensus mode of behavior); *Introduction to Japanese Law*, *supra* note 83, at ¶¶ 8-670, 8-730 (describing that the historical functional interdependency of rice farming contributed to the Japanese aversion to litigation).

256. See Hahn, *supra* note 83, at 518 (stating the Japanese preference for conciliatory self-resolution between the parties).

2. Japanese Judges, Attorneys, and Procedural Barriers

Unlike judges in the United States, judges in Japan believe they are more closely restrained by statutory provisions, and, therefore, less likely to create law.²⁵⁸ Moreover, while the United States has over 400,000 lawyers, Japan has only 11,000.²⁵⁹ The low number of attorneys and the high costs involved in litigation prevent most persons from using an attorney if a dispute arises.²⁶⁰ Additionally, most Japanese lawyers are not familiar with Japanese securities laws.²⁶¹ Their lack of knowledge of securities laws, their limited numbers, and the lack of incentive to develop a securities practice,²⁶² renders them ineffective in policing the stock markets.²⁶³

257. *Id.* at 519-20 (explaining that many Japanese continue to follow the model of the traditional precepts of conciliatory dispute resolution). *But see* Ramseyer, *The Costs of the Consensual Myth: Antitrust Enforcement and Institutional Barriers to Litigation in Japan*, 94 YALE L.J. 604, 608-09 (1985) (stating that the Japanese reluctance to litigate is primarily based on specific legal procedural barriers rather than a cultural aversion). Litigation would ensue if the financial disincentives were removed. *Id.*

258. *See* Introduction to Japanese Law, *supra* note 83, at ¶ 8-370 (noting that Japanese judges see their role as interpreting legislative acts rather than creating law). The judges believe that their exclusive function is to resolve disputes, not to create or make law. *Id.*; *see also* Comment, *Shareholders*, *supra* note 102, at 189 (describing the judiciary's reluctance to consider novel policy arguments). This role of the judges has led to a reluctance on the part of attorneys to bring suit on matters where no express precedent exists. *Id.*; *see also* Dziubla, *The Impotent Sword of Japanese Justice: The Doctrine of Shobunsei As a Barrier to Administrative Litigation*, 18 CORNELL INT'L L. REV. 37, 62 (1985) (noting that few statutory provisions in this area exist).

259. *See* Michand, *Correcting a Popular Misconception About the Legal Profession in Japan*, N.Y. ST. B.J., Apr. 1986, at 26-27 (noting that the highly restrictive admission policy at Japan's sole law school, keeps the number of attorneys at an artificially low quantity); *see also* E. HAHN, JAPANESE BUSINESS LAW AND THE LEGAL SYSTEM 12 (1984) (noting that the main reason for the lack of lawyers in Japan is that the one law school in the country only admits about 500 of nearly 30,000 applicants each year). *But see* Hahn, *supra* note 83, at 530 (stating that Japan allows a much larger number of "quasi-lawyers" to work in areas that are normally the domain of attorneys in the United States).

260. E. HAHN, *supra* note 259, at 14; *see also* Ramseyer, *supra* note 257, at 604 (explaining that the lack of lawyers has led to a scarcity of litigation and a minimal enforcement of statutes).

261. *See* Graven, *Tokyo Moves Timidly on Insider Trading*, WALL ST. J., Aug. 19, 1988, at 8 (quoting Professor Marda of Hosei University as stating that securities law classes are not taught separately in Japan).

262. *See* Ishizumi, *supra* note 116, at 490 (noting that because few attorneys and ample work exist in Japan, there is no desire to increase business). Put in economics terms, demand far exceeds supply, facilitating the existence of a "seller's market" where the attorneys can pick and choose their potential clients, selecting only those that are most likely to succeed.

263. *Id.* As a further disincentive to lawyers, the Japanese courts generally allow low fees to successful attorneys. *See* Comment, *Shareholders*, *supra* note 102, at 183-

In addition to the attitudes of the Japanese judiciary and bar, potential litigants face other significant procedural barriers. Upon the initiation of a lawsuit, lawyers typically require a down payment prior to filing the suit.²⁶⁴ The litigant must also pay a tax to the court in which the action is filed.²⁶⁵ Furthermore, if the respondent is a corporation, it may ask for the litigant to post a security for litigation expenses.²⁶⁶ This security deposit represents a potentially large exposure especially because of the lack of the availability of class action suits that could mitigate the costs.²⁶⁷ In addition, the Japanese legal system generally does not allow for pretrial discovery;²⁶⁸ thus, Japanese courts are solely vested with the authority to gather evidence.²⁶⁹ The reluctance of the judiciary to create law²⁷⁰ and the existent procedural barriers²⁷¹ create

84 (describing that the Japanese courts have awarded attorney's contingency fees under the Commercial Code at a rate less than that paid for other causes of action).

264. See *Introduction to Japanese Law*, *supra* note 83, at ¶ 8-550 (describing how Japanese attorneys typically charge "commencement fees").

265. See *id.* (stating that a stamp tax of one and one half to two percent of the amount in controversy must be paid upon filing the court documents); Comment, *Shareholders*, *supra* note 102, at 183 (describing the revenue stamps that must be purchased and affixed to court documents). Although the percentage is low, if the amount in controversy is substantial, the expense may be large. *Id.* at 165. But see Mayer, *Japan: Behind the Myth of Japanese Justice*, AM. LAW., July-Aug. 1984, at 117 (stating that plaintiffs can avoid a large initial payment by understating their damage claims and later amending their claim if the case is proceeding favorably).

266. See Smith, *supra* note 153, at ¶ 15-420 (noting that although the Commercial Code allows for derivative actions, because of the potential for requiring a posting of a security, fewer derivative actions have occurred in Japan than in the United States).

267. See Tanaka & Takeuchi, *supra* note 208, at 43 (discussing the lack of availability of class action suits in Japan).

268. See Mori, *supra* note 62, at 3 (noting that an attorney cannot gather facts outside of court and is required to ask for the cooperation of the opposing and third parties). The only method of pretrial discovery allowed is to use *Shoko-Hozen*, which may be used to preserve evidence that might otherwise be lost. *Id.* Japan's limited pretrial discovery may be due to structural factors of the legal system rather than societal factors; Seidel, *Introduction and Overview*, in EXTRATERRITORIAL DISCOVERY IN INTERNATIONAL LITIGATION 23 (1984) (explaining that pretrial disclosure in civil countries is nearly nonexistent).

269. *Id.* But see PACIFIC BASIN, *supra* note 110, at § 2.5(D)(1) (noting that ex officio evidence is not allowed in the Japanese judicial system).

270. See *supra* note 256 and accompanying text (discussing the preference for self-resolution between parties).

271. See Mayer, *supra* note 183, at 114 (describing the "incredible delays" in the Japanese judicial system as compared with the United States and noting that a contested case can take ten years for final settlement). The Japanese legal system generally operates at a slower pace than the United States. *Id.* The extended litigation process may, however, reflect Japan's preference for informal dispute resolution. See, *The Judiciary and Dispute Resolution in Japan: A Survey*, 10 FLA. ST. U.L. REV. 339, 361 (1982) (noting that the drawn out litigation process allows parties' emotions to cool, thus, facilitating private settlement of disputes). Arguably, rather than facilitating voluntary settlement, the drawn out process extorts compromise with the threat of an expensive, protracted litigation.

a chilling effect on potential litigation.

3. "Inside" and "Outside" Shareholders

Shareholders, who were the impetus for the growth of the United States private securities bar, are viewed much differently in Japan than in the United States.²⁷² As discussed earlier, a large number of the shares are cross-held among corporations, particularly to facilitate business relationships and deter hostile takeovers. As a result, corporate shareholders are viewed as either "inside" or "outside" shareholders. Japanese corporate directors, referred to as insiders, generally come from within the company and are committed to the organization rather than to the shareholders.²⁷³ Japanese management is primarily interested in the preservation of corporate autonomy and resists shareholder attempts to encroach in this area.²⁷⁴ As a result, although Japanese shareholders may bring derivative suits,²⁷⁵ many shareholders perceive themselves as outsiders and are thus less likely to bring suit.²⁷⁶ Inside

272. See H. FRENCH, *supra* note 176, at 26 n.63 (describing the Japanese view that shareholders are only the providers of capital). In the United States, shareholders are viewed as the owners of the corporation.

273. See Comment, *Corporate Extortion in Japan: Sokaiya Endure Commercial Code Amendment*, 1987 B.Y.U. L. REV. 699, 700 (1987) [hereinafter Comment, *Corporate Extortion*] (discussing the fact that management views the company as primary). Profits are sought to expand market share rather than to be distributed to shareholders. *Id.*; Yamaguchi & Tozuka, *The Situation of Corporate Management in Japanese Corporate System*, 18 OSAKA U.L. REV. 1, 5 (1971) (noting that Japanese corporate management considers the organization's assets private property).

274. See Comment, *Corporate Extortion*, *supra* note 273, at 700 (explaining how the management's desire to stifle shareholder dissent led to corporate payoffs being made to the *sokaiya* ("thugs")). This situation allowed the *sokaiya* to gain access to the higher echelons of these organizations. *Id.* Management hired *sokaiya* to attend shareholder meetings to guarantee minimal discussion of substantive issues and to ensure that the meetings end quickly. Motoki, *Revision of Corporation Law*, in LECTURES ON JAPANESE SECURITIES REGULATION 29 (1980) (dividing *sokaiya* into two groups: those aiding management; and those opposing management, who receive compensation for not making trouble at shareholders meetings); Comment, *Shareholders*, *supra* note 102, at 170 (describing *sokaiya* as "gangsters" who maintain order at shareholder meetings); see also A. VINER, *supra* note 100, at 92-93 (stating that a 1982 law made payments to *sokaiya* illegal and proscribed prison sentences for guilty *sokaiya* and participating corporate officials). In response to the new law, cash payments were partially replaced with payments of inside stock information. *Id.*

275. See Comment, *Shareholders*, *supra* note 102, at 182 (describing the right of Japanese shareholders to bring a derivative suit against corporate directors for failure to meet their obligations under the Commercial Code); see also SHOHO (COMMERCIAL CODE), arts. 254-3, 264 to 268, 280 (Jap.) (discussing statutory restrictions on directors and shareholders).

276. See Comment, *Shareholders*, *supra* note 102, at 165 (describing the classifications of shareholders as those inside the corporation who retain large percentages of holdings for control and safety, and those outside the corporation). Outside shareholders are analogous to "second class creditors" in the United States; although they may

shareholders whose major motivation for ownership is to facilitate relationships are also unlikely to bring a suit against the corporation.

VII. PROPOSALS

Although the Japanese reliance on informal social enforcement and social restraint may have been an acceptable substitute for a formal system of legal requirements in its relatively closed forum with few participants, the effectiveness of such enforcement is likely to decline as the number of market participants increases.²⁷⁷ Given the trend toward the integration of global equity markets, Japan probably will find itself under increasing pressure to correct perceived deficiencies in the system.²⁷⁸ Japan should effectively respond to these pressures to guard against erosion of the global investor's confidence in the integrity of the Japanese stock markets.

A. REESTABLISHING THE JAPANESE SEC

Japan should reestablish an autonomous securities regulatory agency. A regulator distanced from the regulated entity can more objectively enforce the laws and regulations. Although the introduction of autonomous administrative agencies in Japan after World War II was without precedent,²⁷⁹ the past four decades have demonstrated that such agencies can successfully function in the Japanese system. For example, the Japanese Fair Trade Commission (JFTC), an independent regulatory agency, is responsible for the administration and enforcement of the Antimonopoly Act (Act).²⁸⁰

The Diet implemented the Act to foster a free and equitable competitive environment.²⁸¹ Business leaders and government officials criticized the Act from its inception and excluded JFTC officials from their

receive small and consistent dividends, they have no control over the management. *Id.*; see also Tatsuta, *Governance & Shareholders Rights Under the Corporation Law*, in LECTURES ON JAPANESE SECURITIES REGULATION 25 (1980) (stating that shareholders have no leverage over corporations). Essentially, the corporation's management and banks exercise control over the corporation. *Id.*

277. See Bornstein & Dugger, *supra* note 4, at 378 (stating that although informal market regulations may have been sufficient for a closed system, the increase in market participants reduces the informalities effectiveness).

278. See *Recruit*, *supra* note 180, at 2 (addressing the existence of a current, infamous stock scandal which is likely to result in internal pressure for increased securities regulations).

279. See H. IYORI & A. UESUGI, *supra* note 102, at 12 (noting that no independent regulatory commissions existed before World War II).

280. See Brockman, *supra* note 137, at § 10.02[2] (discussing the establishment of the JFTC in 1947).

281. *Id.*

economic planning groups.²⁸² In 1953, the same year of the SEL revision, the Act underwent major revisions.²⁸³ Unlike the Japanese Securities Exchange Commission, however, the JFTC survived, although its enforcement capabilities were substantially curtailed.²⁸⁴ The JFTC's anti-monopoly enforcement policies were further complicated because large corporations formed cartels with the encouragement of the Ministry of International Trade and Industry's (MITI) administrative guidance.²⁸⁵

Because of the changing political and economic climate, the JFTC gradually began to pursue a more aggressive approach to antitrust enforcement.²⁸⁶ In the late 1970s, the Act provisions were substantially fortified.²⁸⁷ The JFTC, partially in response to an increase in the public's interest in anti-cartel enforcement, began to criticize MITI's administrative guidance and successfully prosecuted a MITI sanctioned oil cartel.²⁸⁸

The JFTC has illustrated its willingness to enforce the Act despite intense political and industry pressure. Like the Japanese experience with antitrust enforcement in the 1960s, the current Japanese political climate appears to be growing hostile toward stock trading abuses; demands for regulatory reform and an effective enforcement policy are increasing. A reestablished, autonomous Japanese SEC could effectively enforce a newly fortified SEL.²⁸⁹

282. See Note, *Trustbusting*, *supra* note 106, at 1067 (discussing the criticism prominent Japanese business leaders levied at the Act). The Ministry of International Trade and Industry (MITI) was especially critical. *Id.*

283. *Id.* at 1068.

284. *Id.* at 1068-69. The repeated intervention of the MITI and the newly introduced high standards of proof required to prove monopolies, however, complicated the FTC's enforcement policies. *Id.* at 1069-72.

285. *Id.* at 1070-72.

286. *Id.* at 1073-74. The major impetus was the oil shocks of the 1970s and the public's outrage at the oil cartels. *Id.* at 1074.

287. *Id.* at 1081-83. One commentator has described the late 1970s as a period when the JFTC "finally reached maturity." IYORI & UESUGI, *supra* note 102, at vii.

288. See Note, *Trustbusting*, *supra* note 106, at 1076-78 (stating that public pressure led to the JFTC's decision to prosecute a cartel for limiting production and fixing prices).

289. In the alternative, the JFTC could absorb the responsibilities for securities enforcement. Prior to the formation of the SEC, the United States Federal Trade Commission regulated securities transactions. See M. PARRISH, *SECURITIES REGULATION AND THE NEW DEAL* 43-44 (1970) (tracing the development of securities regulation in the United States).

B. REVISE THE SEL

1. *Expand Article 188*

Japan's recent revision of article 188 may serve to allow potential plaintiff-shareholders notice of insider violations involving the purchase and sale of securities.²⁹⁰ The Japanese Diet enlarged the scope of article 188 beyond officers, directors, and ten percent shareholders to include "tippees."²⁹¹ The amendment, however, remains silent regarding the liability of remote tippees.²⁹² The SEL should be revised to include punishment of those individuals who receive material nonpublic information by virtue of their position and then effectuate a trade based on that knowledge.

2. *Clarify Article 58 to Explicitly Prohibit Insider Trading*

The Japanese government should clarify and refine article 58 to make it clear that insider trading is prohibited. In the United States, judicial precedent significantly contributes to the shaping of broadly stated statutes. As previously discussed, because of the Japanese preference for nonlitigious dispute resolution and the presence of various systemic barriers, a parallel judicial development has not occurred. Therefore, the Diet should more precisely define the provision and clearly state that article 58 applies to insider trading and that liability will attach to violators.²⁹³

CONCLUSION

The regulation of the global securities market requires an awareness to the unique features of each country. The Japanese experience in securities regulations can not be separated from the distinct realities of the Japanese cultural environment.²⁹⁴ As Japan's postwar adoption of the securities laws of the United States illustrates, unilateral attempts at forcing change upon an unwilling country is not enough to alter culturally specific behavior. An increase in the number of players on the

290. See *supra* note 169 and accompanying text (discussing that the MOF will publish exports of short-swing transactions).

291. *Id.*

292. *Id.*; see *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 190 (1976) (holding that a remote tippee is one who receives material nonpublic information secondhand).

293. See Ishizumi, *supra* note 116, at 493 (proposing that article 58 should be amended to make it clear that it applies to insider trading and that wrongdoers will be subject to civil penalties).

294. See Luney, *supra* note 194, at 301 (noting that political and administrative processes play an integral role in Japanese securities regulation).

world market and a smaller global playing field, as a result of internationalization, however, require a change in Japanese laws and mandate a continued response from the Japanese government insuring global parity in securities trading practices.