ISSN 1936-5349 (print)
ISSN 1936-5357 (online)

HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS

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Discussion Paper No. 935

09/2017

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Cambridge, MA 02138

Prepared for the OXFORD HANDBOOK OF FIDUCIARY LAW, *and the Harvard Conference on Fiduciary Duties, November 2017*

JEL: K15, K22, L22
Key words: Fiduciary duty, duty of loyalty, duty of care, business judgment rule

Draft of September 29, 2017

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Fiduciary Principles in Japanese Law

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Solicited for the *Oxford Handbook of Fiduciary Law*, this essay offers a general introduction to Japanese fiduciary principles. Using corporate law as an example, it outlines the scope of the duties of loyalty and care, and of the business judgment rule. It compares the application of these principles in Japan to their application in the United States. It briefly examines their use beyond the corporate context, and outlines several recent extensions.

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Japanese courts place an agent's obligation to work industriously and honestly at the core of the law of agency. With these twin legal obligations -- analogous to the American duties of care and loyalty -- they structure all transactions in which two parties contract for one to act on behalf of the other and in the interests of the other.[1] They apply the principles to relations between directors and corporations. They apply them as well to the wide range of agency relationships in the law: to relationships between trustees and beneficiaries, financial advisers and clients, guardians and children, and many others.

To facilitate the cross-national comparisons of fiduciary law envisioned by the organizers of this Handbook project, we offer this introduction to Japanese fiduciary principles. To motivate the discussion, we start with a simple illustration from the banking world (Section I). We then use corporate law as an example and explore the ramifications of the fiduciary principles in more detail (Section II). As in the U.S., the core of this body of law lies with the duty of loyalty, the duty of care, and their converse -- the business judgment rule. We accordingly focus on these three principles. They govern a broad range of other agency relationships as well, of course, and we note their application to several additional fields (Section III).

I. <u>An Illustration</u>

A. <u>The Dispute</u>:[2]

It was 7:50 in the morning on August 5, 1993. Hanwa Bank vice president Tomosaburo Koyama stepped into the limousine waiting outside his home in Wakayama City. A man with sunglasses walked by, reached into the car, and shot him dead.

Back in 1991, the monthly tabloid <u>Seikai</u> had published a series of articles attacking Hanwa managers. Board member Bunshichiro Fukuda (son of bank president

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[1] Not all observers agree that the duty of care should be considered a fiduciary obligation. See generally Res. (Third) Agency, Sec. 8.02 (2006); comments to Subsec. (3) of Uniform Partnership Act, Sec. 409 (2013); Julian Velasco, <u>A Defense of the Corporate Law Duty of Care</u>, 40 J. Corp. L. 647 (2015).

[2] [No names given], 2003 WLJPCA 09099002 (Wakayama D. Ct. Sept. 9, 2003); background to the case is taken from ALSOK Aoyama shinshachoto, aru kaishi jiken wo tsunagumono [The Connection Between the New ALSOK President Aoyama and a Certain Mysterious Death], Business Journal, May 3, 2012, available at: http://biz-journal.jp/2012/05/post_83.html; Wakayama Shinmei jinja satsujin jiken ... [The Wakayama Shinmei Shrine Murder ...], May 3, 2009, available at: http://blogs.yahoo.co.jp/asayama55/57696770.html; Kinyu biggu ban no hate ni [After the Financial Big Bang], May 5, 2012; available at: http://wing-of-icarus.blogspot.com/2013/10/blog-post_9254.html; Andrew Pollack, Where Meetings Are Truly Feared, New York Times, June 28, 1994.

Hideo Fukuda) had taken particular offense. The younger Fukuda sued the Seikai publisher for libel. The publisher retaliated by accusing bank officers of insider trading.

In the ensuing chaos, senior officers jockeyed for control of the bank. At the next shareholder meeting, the two Fukudas resigned. Koyama became bank vice president, and Takeji Hashimoto replaced the senior Fukuda as president.

Meanwhile, Koyama asked one Takashi Maeda to intervene in the bank's conflict with Seikai. Maeda knew the Seikai publisher, and convinced him to stop his stream of articles. In return, Maeda asked the bank to lend 3 billion yen ($1 was about 135 yen in mid-1991) to his son's Sankyo Real Estate firm. Koyama negotiated his demand down to 500 million, and asked the bank to lend the money. The bank complied.

Koyama had also promised Maeda that the younger Fukuda would drop his suit. The Seikai publisher had agreed to stop his critical articles if he did, and Koyama promised to convince him to do so. Fukuda refused, however, and petitioned the government to bring criminal charges against the publisher. Seikai had kept its part of the bargain; Koyama had failed to deliver.

Koyama reneged on a promise to the wrong people. Maeda's own firm was one from which 30 billion yen would eventually disappear. His son's Sankyo initially included on its board the head of a fringe-right political group and the don of the local branch of Yamaguchi-gumi organized crime syndicate.

The police never arrested anyone for Koyama's 1993 murder. They did arrest Hashimoto for his part in the Sanko Development loans. On March 30, 1999, the district court sentenced him to two years in prison (suspended).

B. The Law:

In 1996, the Hanwa Bank failed. As part of the government's deposit guarantee program, a newly formed Kii yokin kanri Bank succeeded to its assets and sued several directors for their part in the Sankyo loans. In 2003, the district court held three of the directors liable.

The court declared that the bank directors could not have expected the mob-connected Sankyo to repay the "loans." In truth, they were not loans at all, wrote the court. They were extortion fees. They were payments to the mob in response to threats both express (libelous articles) and implied (brutal violence). "The defendants claimed they needed to pay this money in order to forestall the chaos that would have ensued if they had not made the loans," wrote the court. It promptly rejected the claim. The directors "did not provide sufficient evidence," it reasoned (implausibly in the extreme), "that they had considered these matters."

The payoff to the mob was illegal. Illegal payments violate an agent's fiduciary duty in the U.S., and they violate it in Japan.[3] Given that the court separately sentenced Hashimoto to a prison term for his part in the payment, the point was over-determined. But by the 1990s, the organized crime syndicates had begun to extort massive amounts from the corporate sector. In so doing, they dwarfed the traditional corporate

[3] E.g., [No names given], 2006 WLJPCA 02039003 (Kyoto D. Ct. Feb. 3, 2006) (business judgment rule does not apply to illegal conduct). On the illegality of payments to shareholders relating to their votes, see Kaisha ho [Corporate Code], Law No 86 of 2005, Sec. 970.

blackmailers -- they had focused on the annual shareholders' meeting and generally collected only modest amounts.[4] The mainline syndicates dramatically raised the stakes.

The mainline mob employed far more ruthless and effective tactics. In order to stop their advance, the government pushed firms hard to refuse to pay -- and sentenced payers like Hashimoto to prison. The mob retaliated by punishing those who failed to pay -- and shot men like Koyama who reneged. The Hanwa directors found themselves caught in the middle.

The payoff may have violated the directors' duty of loyalty. Corporate directors owe their firm a duty of loyalty in the U.S., and they owe it in Japan. The directors paid the mob with corporate funds. They knew what the mob could do to them, and Koyama confirmed their worst fears. Arguably, they gave the mob the corporate money in order, literally, to save their own lives.

Consistent with the general judicial approach in Japan, the court did not distinguish clearly between the duties of care and loyalty. Directors owe their firm a duty of care in the U.S., and they owe it in Japan. Rather than address any conflict of interest between the directors and the firm, the court focused on their making a loan with no realistic chance of repayment. The mob was not likely to return the money, it reasoned. The security interests were problematic on several counts. And if the bank tried to sell Sanko's assets, the mob would stop the auction cold. The fourth director avoided liability by opposing the loans. The other three violated their duty of care in approving them.

II. Fiduciary Duties in Corporate Law

A. Introduction:

It was not always thus. For reasons beyond the corporate sector, organized crime syndicates expanded the level of extortion during the 1980s and 90s. The Diet liberalized the rules for derivative suits in 1993. And as the economy collapsed in 1990, investors (whether honest or opportunistic) found more to complain about in court about.

In the resulting maelstrom, investors and managers litigated fiduciary duties. As in the U.S., the core to this body of law in Japan lies in the duty of loyalty, the duty of care, and their converse -- the business judgment rule. We first outline the Japanese statutory structure (Section II.B.). We then turn to the case law on these three core fiduciary principles: the business judgment rule (Section II.C.), the duty of care (Section II.D.) and the duty of loyalty (Section II.E.). Throughout, we use corporate law as an example by which to explore the scope of fiduciary duties. We discuss several other applications in Sections III.

B. The Statutory Structure:

Two statutes organize the fiduciary duties of corporate directors: the Civil Code and the Corporate Code (prior to 2005, the corporate section of the Commercial Code). Section 644 of the Civil Code provides:[5]

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[4] Called "sokaiya." Police estimated that 1160 men worked as sokaiya in 2015. https://www.npa.go.jp/sosikihanzai/bouryokudan/boutai18/h27_jousei.pdf

[5] Minpo [Civil Code], Law No. 89 of 1896, Sec. 644. The Civil Code uses two terms to describe different aspects of agency. It uses "dairi" in discussing the relation between the principal and the third party (e.g., Civil Code, Sec. 99), and "i'nin" in discussing the relation between the principal and the agent (Sec. 44); see generally Uchida treatise. English translations sometimes distinguish the two by translating

Civil Code Sec. 644: An agent has a duty to carry out the work of the agency following the aim of the agency and with the care of a faithful manager.

The provision is not specific to a corporate director. Rather, it inheres in the basic concept of agency. The duties of Sec. 644 apply to any agent -- in the corporate context both to directors and to officers not on the board, and outside the corporate world whenever two parties agree that one will undertake to work on behalf of another:

Civil Code, Sec. 643: An agency takes effect when one party entrusts actions with legal consequences to another, and the second party consents.

The corporate law elaborates on these principles. First, general agency principles apply to corporate relations:

Corporate Code, Sec. 330:[6] The relations between a corporation and its directors ... shall be governed by the provisions regarding agency.

Second, directors owe a duty of loyalty:

Corporate Code, Sec. 355:[7] Directors have a duty to obey the provisions of the laws, the articles of incorporation, and the decisions of the general meeting of shareholders, and a duty to carry out their work loyally in the interests of the corporation.

Third, two intertwined sections govern the most common conflicts of interest. The combination of Section 355 (Section 254-3 of the earlier Commercial Code) with these two more detailed provisions reprises the obvious North American rules-versus-standards debates of recent decades. More specifically, the Corporate Code provides:

Corporate Code, Sec. 356:[8] (a) In any of the following situations, a director must disclose the major facts of the transaction to the general meeting of shareholders [or, where the firm has a board, the board -- Corporate Code, Sec. 365], and obtain its consent:

(i) Whenever the director intends to conduct a transaction in the line of business of the corporation on his own behalf or that of a third party.

(ii) Whenever the director intends to transact with the corporation on his own behalf or that of a third party. ...

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the former as "agency" and the latter as "mandate." Following standard English usage, we use "agency" in both contexts

[6] Kaisha ho [Corporate Code], Law No 86 of 2005, Sec. 330. Prior to 2005, Section 254(c) of the Commercial Code, Sho ho [Commericial Code], Law No. 48 of 1899.

[7] Initially Section 254-2 of the Commercial Code, and then renumbered as Section 254-3 until the enactment of the Corporate Code in 2005.

[8] Prior to 2005, Section 265(a) of the Commercial Code.

Corporate Code, Sec. 423:[9]

(a) Where a director ... fails to perform his duties, he must compensate the corporation for all resulting damages.

(b) Where a director ... has violated the provisions of section 356(a) ... and engaged in a transaction specified in section 356(a)(i), the amount of profit realized by the director ... shall be presumed to be the damages specified in the previous subsection.

(c) Where a corporation has sustained damages through transactions specified in Sections 356(a)(i), (ii), or (iii) ..., the following directors shall be presumed to have neglected their duties:

(i) The directors ... specified in section 356(a) ....

(iii) The directors who voted in favor of the transaction at the board meeting ...

C. The Business Judgment Rule:

Absent fraud, illegality, conflict of interest, negligence, or waste, U.S. courts defer to the business judgment of the directors. Japanese courts did not traditionally use the term "business-judgment-rule," and did not necessarily defer. Although lower courts had begun to refer to the rule explicitly by the close of the 20th century, most judges still seemed less willing to defer to managers than in the U.S. The judge did not defer to them in the Hanwa Bank case, and neither did judges necessarily defer to them in the cases in Subsection D below.

Nonetheless, the Tokyo District Court at least nominally invoked the business judgment rule in 1993:[10]

[9] The combination of the two sections is less straightforward than one might think. Prior to 2005, Section 266 of the Commercial Code contained roughly similar provisions:

> Commercial Code, Sec. 266(a):[9] Directors who commit any of the following actions shall be jointly and severally liable to the corporation: ... in the case of actions given in subsections (iv) or (v), for damages suffered by the corporation. ...
>
> (iv) Actions specified in subsection (a) of the preceding Section.
>
> (v) Actions that violate the law or the corporation's articles of incorporation.

If a director engaged in a conflicted transaction without board approval, he was strictly liable under Sec. 266(a)(v). Suppose he did obtain board approval, but the conflicted transaction caused corporate harm nonetheless. In Kameda v. Tabuchi, 1729 Hanrei jiho 28 (Sup. Ct. July 7, 2000), the Supreme Court held that the "law" in Sec. 266(a)(v) included fiduciary duty rules (and the violation of then thus potentially gave rise to liability). In Hoshino v. Kajima kosan, K.K., 1731 Hanrei jiho 125 (Sup. Ct. Oct. 20, 2000), it further explained that a conflicted transaction that had been approved by the board could therefore fall under Sec. 266(a)(iv). Liability under this subsection arose, the Supreme Court then explained only if the director had acted either intentionally or negligently.

[10] Ikenaka v. Tabuchi, 1469 Hanrei jiho 25 (Tokyo D. Ct. Sept. 16, 1993), aff'd 1549 Hanrei jiho 11 (Tokyo High Ct. Sept. 26, 1995), aff'd 1729 Hanrei jiho 28 (Sup. Ct. July 7, 2000). To same effect, see Imamura v. Muraki, 1996 WLJPCA 02080003 (Tokyo D. Ct. Feb. 8, 1996); K.K. Namihaya ginko v. Fujinaga, 1119 Hanrei taimuzu 194 (Osaka D. Ct. Mar. 27 2002).

> In deciding whether a board made the right business decision, a court should not compare the board's actual business decision against the court's own determination of the business decision the board should have made. ... Instead, the court should ask whether the board was negligent in determining the facts that served as the predicate for the decision, and whether its decision-making process based on those facts was extremely careless by the standards of an ordinary businessman ....

The Supreme Court recited the business judgment rule in 2010.[11] Through the Apamanshop Network, Koji Omura had run a chain of real-estate rental brokerage firms, and by 2001 had attracted over 400 franchisees.[12] Network also ran several businesses through subsidiaries. Through Apamanshop Monthly, it competed in the market for furnished month-to-month rental apartments. It held 66.7 percent of Monthly's stock, and key franchisees held the rest.

In the 1990s, Omura had worked the Fukuoka real estate market with one Keiji Kaida. As one of their business entities, the two men had run a firm called Marui kenso. By the close of the decade, Omura decided to expand the business as a national franchise. Toward that end, he created Network in 1999 and became its president. In turn, Kaida became president of Marui. Kaida personally held stock in Network, however, and ran Marui as a Fukuoka-area Network franchisee.

Around the middle of 2005, Omura and Kaida turned bitter enemies. Quite what caused the rift is not clear, but by 2006 they found themselves locked in angry litigation. Early that year, Omura decided to reorganize his firms. He would transform affiliated corporations like Monthly into wholly owned subsidiaries, and rename Network as Apamanshop Holdings. Kaida's Marui owned 4.5 percent of the Monthly stock.

On the one hand, Omura worried that some Monthly shareholders might resent his forcing them to transfer their shares. Given that these shareholders were key franchisees, he preferred to buy their shares through consensual trades. Omura and two of the other directors decided to offer to buy their shares at 50,000 yen each ($1 was about 105 yen in early 2006). As the shares were not listed on an exchange, they had no market price. But given that the investors had paid 50,000 yen when they bought the shares in 2001, Omura and his colleagues decided to stay with 50,000.

On the other hand, Omura reasoned that Kaida would refuse to sell. Accordingly, he and his colleagues decided to freeze him out through a forced "share exchange."[13] They consulted two appraising firms about the price to pay. One suggested an exchange ratio of 9,709 yen per share. The other suggested a range between 6,561 yen and 19,090 yen. Omura and his colleagues decided to buy Marui's stock at 8,448 yen per share.

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[11] [Apamanshop Derivative Litigation], 2091 Hanrei jiho 90 (Sup. Ct. July 15, 2010); this discussion is taken from J. Mark Ramseyer, et al., Soto kara mita Nihon ho [Japanese Law from the Outside] (Tokyo: Yuhikaku, expected 2017).

[12] Apamanshop Network, 2001 securities law filing, available at http://www.apamanshop-hd.co.jp/ir/portfolio_pdf/011218.pdf

[13] Kaisha ho [Corporate Code], Law No. 86 of 2005, Secs. 767-768.

Several Network shareholders[14] then sued derivatively to challenge the 50,000 yen price. In buying the stock at so high a price, they claimed, Network directors violated their duties of loyalty and care. They could have bought the stock for 8,448 yen, but paid 50,000 instead. In fact, the transaction raised no duty of loyalty problem: Omura had no incentive to overpay. With 19.6 percent, he held the largest block of Network stock.[15] If the firm paid more for Monthly shares than it needed to pay, he paid a fifth of that excess himself. The notion that he might either selfishly or carelessly overpay was implausible on its face.

The Supreme Court decided for Omura and the board. Network might have acquired the stock for less than 50,000 yen per share, but its directors could reasonably worry about the goodwill of their key franchisees. Given those concerns, they could reasonably decide to pay 50,000 per share, and it would defer to their "business judgment":[16]

> This is the kind of issue that should be left to the professional judgment of managers. They can evaluate its impact on future prospects of the firm .... When structuring and pricing the transaction, directors consider a wide range of factors -- the assessed value of the shares, the need for the acquisition, any financial burden on [Network], the need to carry out the transaction smoothly, and so forth. Unless the process or content of the decision-making is extremely unreasonable, a director who does this does not breach his duty of care as a prudent manager.

D. <u>The Duty of Care:</u>

1. <u>Process or outcome</u>? -- In duty of care cases, Japanese judges show an unwillingness to defer to board decisions as automatically as American courts do. Take a simple case from 1938. After the secretary of a trade association swindled the group's funds, the association sued its directors for failing to monitor him carefully enough. The Supreme Court held them liable. They had owed the association a duty of care, it explained; they had failed to meet that duty; the secretary had stolen from the association -- and they were liable for its loss.[17] Quite what they had failed to do, the Court never said.

Faced with the same dispute, a U.S. court would have looked to process. It would have asked whether the directors had gathered the information they needed, focused on the problem at hand, debated options. Generally, it would not have decided whether they had exercised their care by looking at outcome. Rather, it would have looked to outcome

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[14] Note that the suit was filed by lawyers representing Marui in other claims against Network. http://www.google.co.jp/url?sa=t&rct=j&q=&esrc=s&source=web&cd=10&ved=0CFAQFjAJ&url=http%3A%2F%2Fwww.wipo.int%2Famc%2Fen%2Fdomains%2Fdecisions%2Fword%2F2006%2Fd2006-0288.doc&ei=XaHTVK6WBoemNrCVgeAI&usg=AFQjCNGNHj49oGR5ZoWO8Gfqaa7SuAnPZA&bvm=bv.85464276,d.eXY

[15] Toyo keizai, ed., Kaisha shikiho [Corporate News] 1674 (Tokyo: Toyokeizai, 2006 I).

[16] [No names given], 2091 Hanrei jiho 90 (Sup. Ct. July 15, 2010). I take the translation from Masakazu Iwakura & J. Mark Ramseyer, M&A Keesu & Materiazu [M&A Cases & Materials] (Tokyo: Shoji homu, 2015).

[17] Kawamukai v. Hosho sekinin Tairamura ... kumiai, 17 Daishin'in minji hanrei shu 100 (Feb. 8, 1938).

only when it seemed so wildly unjustifiable as to constitute "waste." Absent waste, it would have invoked the business judgment rule and deferred.

In the 2010 Apamanshop opinion, the Japanese Supreme Court articulated a practice that tracks this deferential U.S. approach rather than that of its 1938 predecessor. The stock redemption in Apamanshop involved no conflict of interest, so the court asked whether the board had considered the relevant "wide range of factors." The board had. The "process or content of the decision-making" was not "extremely unreasonable." Hence, the court reasoned, the directors had met their duty of care, and the business judgment rule applied.

Nor was this Apamanshop approach entirely unprecedented. Take a Tokyo High Court opinion from 1972. Kikei Mizutani was a lawyer.[18] The Izu Development firm had appointed him president, but before he could take the position he needed his bar association's permission. He asked Tadao Kobayashi to stand in for him during the interim. It would only be about two months, Mizutani assured him. Kobayashi agreed, and periodically came to the office. Mizutani had promised him that the position would not entail any responsibilities, and Kobayashi did not undertake any. Instead, he entrusted the work to a subordinate.

When that subordinate mismanaged Izu Development, the court held Kobayashi liable for the resulting losses. As president, it reasoned, he had become an executive director. Necessarily, he undertook the responsibility to oversee firm management. He could not avoid that duty by agreeing to serve only as figurehead:

> As agent for a firm, a director bears a good faith manager's duties of care and loyalty. He incurs a social responsibility to ensure that the firm conducts its business in a healthy manner. ... He may not entrust the firm's work to another director or to a third party, and ignore unethical conduct or the dereliction of duty. Should he do so, he himself breaches his duties ....

At least apparently, the court had looked only at process. It did not hold Kobayashi liable because bad things happened. It held him liable because he did nothing to stop them.

Even after Apamanshop, however, Japanese courts often take the 1938 approach and decide duty-of-care questions by outcome. In the process, they largely leave the business judgment rule by the wayside. Duped by an out-of-town lawyer, the directors of the small-town Takanabe Credit Union made a series of loans that went bad.[19] In doing so, said the Miyazaki District Court, they violated their "duty of faithful care and loyalty":

> We take as our premise the fact that decisions about loans involve an exercise of discretion. Sometimes, however, given the circumstances a decision by a credit union trustee can be extremely irrational. In such a case, the executive trustee who makes the decision violates his duty of faithful care and loyalty. Accordingly, he is liable for the damage suffered by the credit union.

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[18] Nihon gakki seizo, K.K. v. Kobayashi, 286 Hanrei taimuzu 360 (Tokyo High Ct. July 28, 1972).

[19] Kobayashi v. Takanabe shin'yo kinko, 2115 Hanrei jiho (Miyazaki D. Ct. Mar. 4, 2011), appellate disposition not published.

Given that the transaction involved no conflict of interest, the trustee could only have violated a duty of care. Yet the court did not look at the information he gathered. Neither did it look at the time he spent weighing it. Instead, it looked only at outcome: he made the wrong decision. Necessarily, he must have failed to take care. Although the court called his decision "extremely irrational," the decision did not involve the level of folly a U.S. court would call "waste." The Miyazaki District Court simply evaluated the decision, found it a mistake, declared the trustee careless, and held him liable for the loss.

A year before Apamanshop, even the Supreme Court had decided a duty-of-care case by looking only to outcome.[20] Residents of provincial Kochi had long hosted brutal dogfights. To compete, breeders had created the Japanese mastiff called "Tosa" (after the historical name of the area). So violent and powerful is the dog that several countries ban it outright.

Even rural prefectures like Kochi, however, are not immune from changing attitudes toward blood sports. For many years, the local dog-fighting park had attracted tourists. More recently, it fell on hard times. Given the economic importance of tourism, the Kochi government asked the local Shikoku Bank to lend the park money. Although the prefecture then lent it additional sums besides, the park remained broke. Hoping that still more money might help it recover and repay its earlier loans, the bank advanced yet more funds. The park defaulted, and shareholders sued.

The Supreme Court held the directors liable for breaching their duty of care. The court did not look at the information they collected, or the process by which they decided to lend. Instead, it simply declared that they could not rationally have thought that the extra money would let the park recover. Their loans were "extremely irrational," and in making them they breached their duty of care.

2. Caremark. -- Through the duty of care, Japanese directors also owe what American lawyers call a "Caremark duty"[21] to install and run a monitoring system. Under Section 362(d)(vi) of the Corporate Code, the board must maintain a risk management system that "ensures the implementation of board responsibilities consistent with the law and the corporate charter."[22]

Japanese corporate law did not always include this section. Delaware courts first introduced the requirement in 1996, and Japanese courts did so in 2000. The pivotal case -- and one that attracted massive media attention in both the U.S. and Japan -- involved one Toshihide Iguchi.[23] After failing the admissions exams to Japanese colleges, Iguchi

[20] [No names given], 2063 Hanrei jiho 138 (Sup. Ct. Nov. 27, 2009). The Supreme Court similarly used an ex post analysis of the outcome to declare loans by the Hokkaido Development Bank to a troubled real estate firm to constitute a duty of care violation in [No names given], 1997 Hanrei jiho 143 (Sup. Ct. Jan. 28, 2008).

[21] In re Caremark Int'l Inc. Deriv. Litig., 698 A. 959 (Del. Ch. 1996); see generally the careful analysis in Stephen M. Bainbridge, Caremark and Enterprise Risk Management, 34 J. Corp. L. 967 (2009).

[22] That is, the board may not delegate the job to individual directors.

[23] Nishimura v. Abe, 1721 Hanrei jiho 3 (Osaka D. Ct. Sept. 20, 2000). See generally Katie Holliday, I'm Not a Criminal, CNBC Finance, Apr. 29, 2014. Available at http://www.cnbc.com/2014/04/29/im-not-a-criminal-daiwa-rogue-trader-who-lost-1-billion.html; An

moved to the United States. He made his way through Southwest Missouri State College, and landed a job at the New York office of the Daiwa Bank. By 1983, he was trading bonds in the bank's New York office. That year, while trading Federal Reserve Notes, he lost $70,000. When he tried to hide the loss, he lost even more. Increasingly desperate, he made one unauthorized trade after another until by 1995 he had lost $1.1 billion. News of the losses became public, and a federal court sentenced him to four years in prison.

Litigation also proceeded in Japan. In 2000, the Osaka District Court held the Daiwa directors liable for failing to spot Iguchi's growing losses. It reasoned:

> In order to maintain healthy corporate management, the board must be able accurately to understand the many types of risks the firm faces. These risks depend ... on the type and nature of the firm. The board must control these risks properly. It must, in other words, maintain a risk management system -- a system of internal control. That risk management system must be one that is appropriate to the scale and nature of the firm's business. ... As a member of that board, each director ... has a duty to create a risk management system .... It is part of his duties of faithful care and loyalty.

The Supreme Court confirmed the duty to maintain a risk management system in 2009,[24] and by 2015, the Diet had added the requirement to the Corporate Code (Sec. 362).

3. Duty-of-Care Waivers. -- After the Delaware Supreme Court imposed massive liability on directors in 1985 for violating their duty of care,[25] Delaware firms claimed to find it hard to convince distinguished executives to serve on their boards. In response, the state legislature declared the duty of care waivable.[26]

In 2015, the Japanese Diet enacted a parallel waiver in Section 427(a) of the Corporate Code:

> ... A corporation may provide, in its charter, that it may enter into contracts with its outside directors ... limiting their liability ... for actions undertaken in good faith and without gross negligence. It may limit liability to the greater of (x) an amount specified in the charter, or (y) [double the director's pay from the firm -- Sec. 425].

By Section 428, firms may not opt out of the liability for conflict of interest transactions.

E. The Duty of Loyalty:

Unusual Path to Big-Time Tradng, N.Y. Times, Sept. 27, 1995; Sheryl Wudunn, Daiwa Bond Trader Puts His Spin on Scandal, N.Y. Times, Jan. 13, 1997.

[24] [No names given], 2055 Hanrei jiho 147 (Sup. Ct. July 9, 2009).

[25] Smith v. Van Gorkom, 488 A.2d 858 (Del. Sup. Ct. 1985). Apparently, however, the directors actually paid very little (if any) of this amount. See Stephen M. Bainbridge, The Story of Smith v. Van Gorkom, in J. Mark Ramseyer, ed., Corporate Law Stories, 197, 225 (Foundation Press, New York: 2009).

[26] Del. Gen. Corp. L. Sec. 102(b)(7).

1. The duty. -- When corporate officers or directors engage in undisclosed transactions with their firms, Japanese courts routinely hold them liable. They may not call it a "duty of loyalty" breach. Sometimes they call it a tort. Sometimes they call it an abuse of agency rights.[27] Other times, they use "duties of loyalty and faithful care" as an all-purpose appellation -- violate the duty of either loyalty or care, and they invoke the combined phrase.[28] The appellation may vary, but (for the most part) no matter: jeopardize corporate welfare for private gain, and the courts usually find the conduct illegal.

2. Theft. -- Take a straightforward example of theft. Nihon Journal published a popular men's scandal magazine.[29] In 2003, the firm's auditor discovered that the president had diverted large amounts to his family. The firm paid rent on his daughter's apartment, his wife's office, and an apartment for himself. In the resulting civil suit, the court had a choice between a rule and a standard. It might have invoked the Section 356(a)(ii) rule. Instead, it turned to the Section 355 (and Civil Code Section 644) standard:

> As a director of the defendant firm, the [president] had a duty to the firm to perform his work loyally and with the care of a faithful manager. He violated that duty, and enriched his family and third parties at the expense of the defendant. Through this conduct, he violated his duties of loyalty and faithful care.

The violation was straightforward. For the company's loss, the court held the president liable.

3. Corporate opportunities. -- The Section 355 standard and 356 rule cover corporate opportunities as well. Yamazaki is the largest bread company in Japan, and possibly in the world.[30] Founded in 1948, by 2016 it boasted sales of 1.04 trillion yen. It grew by selling a basic Wonder-Bread-equivalent (the firm called it "America Bread"), but by 2016 included within its portfolio such brands as the upscale Vie de France breads.

During the 1960s and 1970s, founder Tojuro Iijima still owned a controlling stake in the public company and ran it. Cantankerous and autocratic, he ran it however he liked. During the 1960s, he ran it by placing bakeries and retail outlets in private firms he controlled on the side.

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[27] If the agent causes the principal to transact with a third party for his own welfare, the transaction may be an "abuse of right." If so, the principal is not bound to a third party who knew or should have known that the transaction was abusive. See Tokyo bussan, K.K. v. K.K. Takahashi sohon ten, 484 Hanrei jiho 48 (S. Ct. Apr. 20, 1967).

[28] See, e.g., Sakai, supra note, at 120.

[29] [No name given] v. K.K. Nihon Jaaneru shuppan, 2005 WLJPCA 09260005 (Tokyo D. Ct. Sept. 26, 2005).

[30] Yamazaki seipan, K.K. v. Iijima, 1015 Hanrei jiho 27 (Tokyo D. Ct. Mar. 26, 1981).

In litigation, the court declared that he had violated his duties on a variety of counts, and included within them the taking of corporate opportunities. Again, it might have invoked the formalistic Section 356(a)(i), but did not bother. Iijima, it simply declared, had "appropriated the opportunity for [Yamazaki bakery] to enter the Kansai [market] directly or through a subsidiary." In doing this, he "violated his duty of loyalty, and therefore his duty of faithful care."

4. Conflicted transactions. -- Undisclosed conflicts of interest also violate Sections 355 and 356. Take credit extensions. Toshihiro Matsumoto served on the board and worked as the chief operating officer of the Nara Forestry Development timber yard.[31] In the mid-1960s, he began to participate in firms that supplied the yard. In due course, Nara Forestry extended these suppliers trade credit.

When the suppliers defaulted on the debt, Nara Forestry sued Matsumoto for its losses. The Nara District Court declared the transactions a "violation of the duty of loyalty" by Matsumoto, and held him liable. Unlike the Yamazaki court, however, it also invoked the formal rules of Section 356:

> Section [356(a) of the Corporate Code] requires a director to obtain the consent of the board whenever he, in a capacity other than director, transacts with the firm, or causes a third party to transact with the firm. Should he violate that requirement and damage the firm, he must (by Section [423]) compensate it for the total amount of its damages.

5. Wooing employees and customers. -- Directors who leave their firm and take with them favored employees and customers raise similar issues.[32] In doing so, they can violate both the formal rules of Section 356(a) and the more general duty of Section 355. Probably, which the courts cite often turns on the plaintiff's litigation strategy. Whatever the reason, courts decide these disputes by citing either the formal rules or the general duty, neither, or both.

In 1983, the Osaka High Court cited both the standard and the rule (and unfair trade practices and negligence law to boot) when a director of a mail order business resigned to start a competing firm.[33] In the process, he had taken with him an employee and much of the firm's customer base. The court held him liable to the firm for its losses.

A few years later, the Tokyo High Court invoked only the general standard.[34] Kunihiro Fukui owned and operated Japan Equipment. After trying manufacturing, he decided to move the firm into computer-related work. Toward that end, in 1980 he recruited computer scientist Yuichi Takada to head the new division. In time, Fukui

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[31] Nara shinrin kaihatsu, K.K. v Matsumoto, 437 Hanrei taimuzu 160 (Nara D. Ct. Dec. 5, 1980).

[32] See also, e.g., Sekisui jushi kyappu ai shissutemu, K.K. v. K.K. A no, 1875 Hanri jiho 19 (Tokyo High Ct. June 24, 2004); [No names given], 1686 Hanrei jiho 117 (Osaka High Ct. May 29, 1995).

[33] Korumu boeki, K.K. v. Sanrei yamako, K.K., 1084 Hanrei jiho 122 (Osaka High Ct. Mar. 3, 1983).

[34] Takada v. Nihon setsubi, K.K., 1989 WLJPCA 10260007 (Tokyo High Ct. Oct. 26, 1989); see http://www.moresoft.co.jp. Kanda & Milhaupt, supra note, at 896, refer to it as a "landmark case"; to us, by contrast, the case seems consistent with the bulk of Japanese precedent.

promised, Takada could move to his (Takada's) own firm. Takada agreed to come, and brought others to Japan Equipment with him.

The new computer division maintained a cohort of skilled programmers and system engineers. As needed, it seconded these specialists to its clients on a temporary basis. The division did well, and by 1983 Fukui named Takada to the Japan Equipment board.

A few years later, Takada and Fukui quarreled over space. Takada quit, and formed a firm named MoreSoft instead. To it, he recruited several Japan Equipment employees. For luring four of the employees to MoreSoft, the Tokyo High Court held him liable. Japan Equipment had treated Takada well. It had given him stock, and a voice in management. In accepting his place on the board, he accepted a duty of loyalty:

> [Tokyo Equipment] seconded programmers and systems engineers to clients. Those employees were a crucial part of the firm. Locating and training them was its biggest problem. For a director of the firm to lure them away for his personal profit ... constituted a major violation of the duty of loyalty.

Sometimes courts cite neither 355 nor 356, but hold directors who steal employees or customers liable anyway. In 2006, the Tokyo District Court held a former director liable to his earlier firm in tort.[35] The director had moved from one propane gas distributor to a rival, and taken with him both favored employees and over 1000 customers. Directors who leave and take staff do not always commit the tort of unfair competition, said the court. After all, "once a director resigns, he no longer owes the same duty of loyalty and non-competition that he owed while in office." But here, the court declared the ex-director's tactics beyond the pale. He had disrupted his former firm's business, and then exploited the resulting confusion to his private benefit. For that, the court held him liable in tort.

III. Fiduciary Duties in Other Spheres:

A. Introduction:

Fiduciary duties follow when two parties agree that one (the principal) will appoint another (the agent) to take legally binding actions on his behalf. At that point, Japanese courts require the agent to behave by fiduciary principles. The courts generally state the rule as a default, of course. Should the two parties want to deviate from the standard terms, the courts usually give them the scope to do so. But absent that agreement to the contrary, the courts enforce the general principles.

The courts impose the duty of faithful care through the general rules of agency. The Corporate Code imposes an apparently parallel set of duties for corporate personnel. The overlap creates some troubling logical puzzles.

B. The Duty of Loyalty Before 1950:

Section 644 of the Civil Code imposes on agents the duty to exercise "the care of a faithful manager"; Section 355 of the Corporate Code imposes on directors a duty of loyalty. Section 644 dates from 1899; Section 355 dates from 1950. By ordinary canons

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[35] [No names given] 1981 Hanrei jiho 53 (Tokyo D. Ct. Dec. 12, 2006).

of interpretation, Section 644 must not have included a duty of loyalty. If it had, Section 355 would have been redundant from the start.

True to that interpretive logic, some corporate scholars argue that Sections 644 and 355 impose different rules: Section 644 imposes a duty of care, and 355 a distinct duty of loyalty. Before the Diet passed Section 355, directors faced no duty of loyalty. As one scholar summarized the argument, "the 1950 amendments to the Commercial Code introduced a wide range of distinctly American provisions . ... This section [355] follows the approach taken by U.S. corporate law to the distribution of board authority and shareholder oversight, ... and transplants a new duty to Japan."[36]

Yet at root the duty of loyalty bans theft -- and despite the absence of 355, pre-war directors could not plausibly have stolen from their investors without legal consequence. Rational investors would not have bought stock if directors could have stolen, and Japanese investors bought enormous quantities of stock. In 1920, they contracted to buy 37.5 million shares on the Tokyo Stock Exchange. On the Osaka exchange, they contracted for another 22.3 million. As a percentage of GDP, the value of the shares transferred came to 51.1 percent. Even in 1990 U.S., investors traded stock worth only 31.5 percent of GDP.[37] What is more, a broad range of investors bought this stock. Of the 511 firms listed on a 1919 national investor registry (nearly all of the exchange-listed firms), individuals held 76.2 percent of the shares. And they owned them as independent investors -- not members of any of the (widely pilloried) zaibatsu families.[38] Those families held barely 2 percent of the stock, and their banks (more broadly, the large "city banks") held only another 1.3-2.4 percent.[39]

So it came to be that in 1970 the Supreme Court declared that the 1896 Section 644 included within it the 1950 duty of loyalty. All agents, it said, owe both a duty of care and a duty of loyalty. Given that it made the point in a case involving corporate donations to a political party, the observation was dictum. Perhaps for that reason, some academics continue to debate the question.[40] Yet the Court decided the case en banc -- something it rarely does.[41] In the course of holding the donations valid, it explained the statutory framework:[42]

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[36] As discussed in Sakai, 118; see also Hideki Kanda, Kaisha ho [Corporate Law] 125 (Tokyo: Kobundo, 4th ed., 2004).

[37] Yoshiro Miwa & J. Mark Ramseyer, Banks and Economic Growth: Implications from Japanese History, 45 J.L. & Econ. 127, 136-40 (2002).

[38] The term itself was coined by muckraking journalists in the late 1920s looking for someone to blame for the depression. The idiomatic translation is not "financial clique." It is "robber baron." See Miwa & Ramseyer, supra note.

[39] Yoshiro Miwa & J. Mark Ramseyer, Banks and Economic Growth: Implications from Japanese History, 45 J.L. & Econ. 127, 136-40 (2002).

[40] For accounts of the debate, see, e.g., Egashira treatise at school; Minoru Tokumoto, Dai 330 jo [Section 330], in Kenjiro Egashira & Naoto Nakamura, eds., Ronten taikei: Kaisha ho [Systematic Debates: Corporate Code] 3, 5-6 (Tokyo: Daiichi hoki, 2012); Sakai, supra note, at 119-120 (Egashira book); Mitsuo Kondo, Dai 355 jo [Section 355], in Seiichi Ochiai, Kaisha ho komentaaru [Corporate Code Commentary] 51, 52-53 (Tokyo: Shoji homu, 2009).

[41] The Supreme Court's approach leaves the question of why the 1950 drafters would have added a duty largely covered already. A plausible answer is that the man responsible for the amendments did not know what he was doing. The 1950 changes were largely demanded -- often in non-negotiable form, by

> The [plaintiffs] argue that the [board members] violated the director duty of loyalty provided in Section [254-3] of the Commercial Code [now Section 355 of the Corporate Code] when they made the political contributions at issue. Yet Commercial Code Section [254-3] merely clarifies and details the duty of faithfulness established in Sections 254(c) and 644 of the Civil Code. It does not impose a separate, higher duty than the general duty of faithfulness required of all agents.

C. <u>The Duty of Loyalty in the Non-Corporate World</u>:

Consistent with the 1970 Supreme Court opinion, Japanese courts hold all agents -- corporate or not, pre-1950 or not -- to rigid standards of honesty. Section 644 of the Civil Code required all agents to fulfill their assignment "with the care of a faithful manager." By normal understandings of the words, a disloyal agent is a faithless one. So the Court declared in 1970 -- and so courts have held, both before 1970, and in non-corporate disputes.

Prior to the 1970 opinion -- prior even to the 1950 corporate law amendments -- disloyal agents who stole committed the tort of conversion and violated the terms of their agency. Early in the 20th century, Kazuo Okukubo fooled the elderly Rie Okukubo into assigning him her cause of action against a third party. He collected on the claim, and spent the money. When Rie's son sued Kazuo for the funds, the Supreme Court (in 1906) held Kazuo liable. The lower court held him liable in tort. The Supreme Court held him liable too, but under agency rather than conversion: it ordered him to convey the money promised under his agency (Civil Code, Secs. 646, 647):[43]

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occupation staffer (and Illinois lawyer) Lester Salwin. Salwin did not read Japanese, and would not have known how the courts understood Section 644's requirements. What he did do was read a translation of the corporate provisions in the Commercial Code, and demand that the Japanese committee assigned to the task include the provisions he liked it in the 1933 Illinois Business Corporations Act -- including provisions like cumulative voting, appraisal rights, and preemptive rights.

Salwin's account of the process appears in Lester N. Salwin, The New Commercial Code of Japan: Symbol of Gradual Progress Toward Democratic Goals, 50 Geo. L.J. 478 (1960). University of Tokyo law professor Makoto Yazawa and long-time Tokyo resident (and U.S. lawyer) Thomas Blakemore described the process as one that would "interest the legal scholars of other countries ... like the medical data obtained from German concentration camp experimentation during World War II." Thomas L. Blakemore & Makoto Yazawa, Japanese Commercial Code Revisions Concerning Corporations, 2 Am. J. Comp. L. 12 (1953); for the literature in English, see also Hideki Kanda & Curtis J. Milhaupt, Examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law, 51 A. J. Comp. L. 887 (2003); Mark D. West, The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States, 150 U. Pa. L. Rev. 527 (2001); Makoto Yazawa, The Legal Structure for Corporate Enterprise: Shareholder-Management Relations Under Japanese Law, in Arthur Taylor von Mehren, ed., Law in Japan 547 (Cambridge: Harvard University Press, 1963).

[42] Arita v. Kojima, 596 Hanrei jiho 3 (Sup. Ct. June 24, 1970).

[43] Okukubo v. Okukubo, __ Daishin'in minji hanketsu roku 383, 390 (Sup. Ct. Mar. 16, 1906). The Court remanded the case for a determination of the proper statutory basis for the claim.

> Suppose a party tricks another into assigning her claim to him. If the assignee does not transfer the recovered amount to her, she may demand payment of the amount under [the terms of the agency].

Other pre-1950 cases reached similar results. For private business reasons, a stockbroker in the early 20th century sold his client's shares without authorization. The Tokyo High Court in 1910 held him liable for all foreseeable damages.[44] A guardian took advantage of his beneficiary. The Supreme Court in 1924 held the beneficiary bound to innocent third parties, but noted that he had a claim against his dishonest guardian.[45]

In spheres where Section 355 of the Corporate Code does not apply, modern courts continue to enforce a duty of loyalty through Section 644. In 2009, for example, two directors of a non-profit organization stole 29 million yen from its bank account ($1 was about 95 yen in mid-2009). The Corporate Code with its Section 355 does not apply to non-profits, so the organization sued the directors under Section 644 of the Civil Code. The Tokyo District Court held the directors liable: they had violated they duty of faithful care, and failed to carry out the terms of their agency. They owed their organization the money they had stolen.[46]

In 2011, the Cultural Agency of the national government discovered that the unincorporated Tokyo Chamber Opera had fraudulently collected over 200 million yen in subsidies. It demanded repayment, and the opera then sued its chairman. Again, the Corporate Code did not apply, but the Tokyo District Court held the chairman liable to the opera anyway: he had violated his Section 644 duty of faithful care.[47]

D. <u>Selected Recent Developments:</u>

1. <u>Nonprofits.</u> -- The 1896 Civil Code had vested the creation of charitable organizations with the government: organizers could place a non-profit within a legally distinct entity only with government approval. Through the late 20th century, critics complained of this bureaucratic control. They urged the government to take a less restrictive tack. Only then, they declared, would Japan have the "civil society" that it needed.

While some critics complained of too many restrictions, others complained of regulatory favoritism. Fairly or no, they attributed embezzlement scandals among non-profits to inadequate and biased government oversight. In 2000, for example, journalists disclosed such a scandal at the nonprofit KSD firm. Former Labor Ministry bureaucrat Tadao Koseki had run the firm nominally as a not-for-profit educational and insurance

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[44] Miyazaki v. Ogai, 686 Horitsu shimbun 19 (Tokyo Ct. App. Oct. 22, 1910).

[45] Shibata v. Shibata, __ __ 303 (Sup Ct. July 9, 1924).

[46] [No names given], 2014 WLJPCA 11068011 (Tokyo D. Ct. Nov. 6, 2014).

[47] [No names given], 2015 WLJPCA 03238008 (Tokyo D. Ct. Mar. 23, 2015). See generally Hojokin fusei jukyu, opera dantai naze aitsugu no ka [Fraudulent Subsidy Receipts, Why Do They Continue Among Opera Companies?], Yomiuri shimbun, Aug. 16, 2011; available at http://blogs.yahoo.co.jp/tea_time1/62701881.html; Geijutsu 2 dantai ga hojokin fusei jukyu [Two Arts Groups Receive Subsidies Fraudulently], Nikkei shimbun, Aug. 5, 2011. http://www.nikkei.com/article/DGXNASDG05023_V00C11A8CR8000/

organization. In fact, he had hired other retired bureaucrats, paid politicians lavishly for political and bureaucratic advantage -- and embezzled massive amounts for himself. In time, the courts would convict him and several others on criminal charges.[48]

The two groups of critics pushed in opposite directions, and the Diet tried to respond to both. It passed a series of statutes that purportedly both streamlined the formation of nonprofit firms and provided more stringent and independent oversight.[49] Through the new structure, the Diet separated the creation of a firm from the determination of its tax status. To form a new nonprofit, organizers no longer needed government approval. Instead, once they filed papers meeting a series of simple requirements, they had their legal entity. Only to obtain favorable tax treatment did they need a formal government determination. At the same time, however, the Diet also created a new supervisory agency. The new nonprofit firms answered directly to this agency on ethical matters.[50] At least as planned, it was an agency that was both independent and stringent.

Note that the men and women who run the new nonprofits face two sets of fiduciary standards. First, they face the standard fiduciary duties as agents under the Civil Code. Second, the new statutes add an explicit duty of loyalty, and specific rules governing conflict of interest transactions.[51]

2. <u>Guardians for the elderly.</u> -- The increasing longevity and declining birthrate in Japan have together created a new problem: handling financial and other major decisions for demented elderly men and women living apart from their children. Given the steady progress in modern medicine, many Japanese now live to very old age: currently, about 32 million Japanese are 65 or older. As they age, many people begin to have cognitive weaknesses, and a few turn simply senile. Yet a large fraction of them live apart from any children they may have.

For this problem, the guardian rules in 19th century Civil Code offered an awkward match. The impaired elderly thought the process demeaning. Their families found the system cumbersome. And everyone found the public process embarrassing.

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[48] [No names given], 1832 Hanrei jiho 39 (Tokyo D.Ct. May 20, 2003), aff'd, 62 Saihan keishu 507 (Tokyo High Ct. Dec. 19, 2005), aff'd, 1457 Hanrei jiho 6 (S. Ct. Mar. 27, 2008).

[49] By 2012, there were 5,484 nonprofits under the new system, and they had collected contributions of 216 billion yen. See Koeki hojin seido kaikaku no shinchoku to seika ni tsuite [Regarding the progress and Accomplishment of the Reform of the Nonprofit Firm System]. Cabinet office, Aug. 2014. Available at: https://www.koeki-info.go.jp/pictis_portal/other/pdf/sintyoku_seika.pdf. All this ignores what in Japan is called a "NPO hojin," or "NPO firm." These non-profits are based on their own statute. They require local government approval to form, and carry tax advantages.

[50] Koeki shadan hojin oyobi koeki zaidan hojin no nintei to ni kansuru horitsu [Act Regarding the Certification of Public-Interest Organizations and Foundations], Law no. 49 of 2006.

[51] Ippan shadan hojin oyobi ippan zaidan hojin ni kansuru horitsu [Act Regarding General Organizations and Foundations], Law. No. 48 of 2006Secs. 83, 84.

In response, in 2000 the Diet introduced a distinct set of guardianship rules for the elderly. It graduated the level of care by the level of incompetency. It introduced durable powers-of-attorney. And it stopped public recordation.[52]

Japanese have begun to use the new institutional structure. Since 2010, they have routinely filed over 30,000 applications a year. By 2015, they filed 34,782..[53] Of the elderly people involved, 40 percent are male and 60 percent female. Of the men, 34 percent are in their 80s and 24 percent in their 70s; of the women, 63 percent are in their 80s, and 19 percent in their 70s. In the early 2000s, most of the guardians under the new system were family members. Today, only about half are. Of the non-family guardians, lawyers and "judicial scriveners" (analogous to British solicitors) are among the most common.[54]

These guardians (usually the family-member guardians) under the new system have sometimes stolen from their elderly wards. In 2013, police reported 662 cases of fraud; in 2014, they reported 831. In 2013, this fraud totaled 4.49 billion yen ($1 was about 100 yen in mid-2013). By 2014, it came to 5.67 billion..[55] Apparently, some family members rationalize the theft (perhaps reasonably) as taking money they would soon inherit anyway.[56]

As one way to reduce the fraud, in 2012 the courts introduced a special guardianship trust. Under the new structure, the court would place some of the ward's funds in a savings account, and the rest in trust at a trust bank. The guardian could pay the ward's ordinary costs through the savings account. For larger expenses, he would apply to the family court for permission to reach the trust fund. In 2012, courts organized 98 of these trusts, and they held 4.3 billion yen. By 2015 they formed 6,563 trusts with 211 billion yen.[57]

3. Investment Advisors. -- During the 1980s and 90s, the Japanese government tried increasingly to transform Tokyo into an international financial center along the lines of New York and London. It sought to pry individual savers from their bank savings

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[52] Civ Code 7-10, 839-75, 11-14, 876, 876-5, 15-18, 876-6 to -10. The new guardian system is based in revisions to Civil Code and Nin'i koken keiyaku ni kansuru horitsu [Act Regarding Consensual Guardianship Contract], Law No. 150 of 1999.

[53] Saiko saibansho, infra, and Shibukawa, supra note, at tab. 1.

[54] Saiko saiban sho, Seinen koken kankei jiken no gaikyo [Outline of Senior Guardian Cases] (Tokyo: Saiko saibansho, 2016), available online at: http://www.courts.go.jp/vcms_lf/20160427koukengaikyou_h27.pdf; Shibukawa, supra note, at fig. 1.

[55] Noriko Shibukawa, Seinen kokennin ni yoru hanzai no genjo to taisaku [The Circumstances and Policies Regarding Crimes by Guardians of Adults], Toshi shakai kenkyu 83 (2014), tab. 5. Seinen koken seido riyo sokushin iinkai, Katei saibansho ni okeru fusei boshisaku no genjo to kongo no arikata to ni tsuite [Regarding the Current State and Prevention Plans Against Fraud in the Family Court], Oct. 19, 2016, available at: http://www.cao.go.jp/seinenkouken/iinkai/wg/huseibousi/1_20161019/pdf/siryo_3.pdf

[56] On the ground that the family court should have noticed the theft by a family-member guardian, the Miyazaki District Court in 2014 ordered the government to repay to the ward the 26 million yen that the family members had stolen. [No names given], 2247 Hanrei jiho 92 (Miyazaki D. Ct. Oct. 15, 2014).

[57] Saiko saibansho, Koken seido shien shintaku no riyo jokyo to ni tsuite [Regarding the Use of the Guardian Assistance Trust], 2016, available at: http://www.courts.go.jp/vcms_lf/20160518sintakugaikyou_h27.pdf.

accounts and entice them into the securities market. Toward that end, it made -- and continues to make -- fiduciary duties a prominent part of its strategy.

For the most part, investment advisers owe their clients the standard fiduciary duties as agents under the Civil Code. In addition, however, since 2006 they owe express duties of care and loyalty under the securities statute, and specific bans on the most common conflict-of-interest transactions.[58] Statutes governing investment trusts and retirement plans repeat these duties, and sometimes add specific bans on the most common conflict-of-interest transactions.

4. Contract claimants. -- As in the U.S., directors in Japan do not generally owe fiduciary duties to a firm's contract claimants. They owe them to its shareholders. When this leads to outcomes that a court thinks wrong, it chooses among the approaches outlined above.

Consider a recent case involving pension claimants. A dishonest manager pushed the firm into bankruptcy. The court held the manager liable in tort, held his board supervisor liable in tort, and absolved the other board members of any liability under a duty of care.

The All Japan Liquor Retailers Association had run a pension plan for its members. When Japanese asset prices collapsed in the early 1990s, it found itself in dire straits. By the middle of the decade, its expenses exceeded its income, and by 2000 that gap had grown to 3 billion yen ($1 was about 108 yen in mid-2000). Its customer base eroded in tandem. From 42,000 in 1995, its pension holders fell to 22,000 by 2002. Given the hemorrhaging, the Association's outside investment advisor Mitsubishi Trust urged its directors to liquidate.

Hideo Seki ran the AJLRA's internal investment office, and saw no need to shutter it. Personally, he seems to have found the firm extraordinarily profitable. Facing electoral pressure to liberalize alcohol retailing, the AJLRA had secretly bribed politicians for years. Seki regularly asked his staff for cash with which to pay the bribes, and then kept some of it for himself.[59] Prosecutors eventually estimated he stole nearly 200 million yen.[60]

To forestall the AJLRA's liquidation, Seki gambled big. The firm had held assets worth 32.1 billion in 2001. By 2003 they had fallen to 18.5 billion. Seki opted to invest this remainder in what the Osaka District Court would politely call "alternative" investments. He would park it with the British litigation finance firm Invaro, he decided. And he would route the investment through bonds nominally issued by the Canadian firm of Chancery & Leadenhall. Invaro was run by the British businessman Terry Lindon. The British government had already prosecuted him for (it claimed) stealing 360,000 pounds from his firm in 1994, but the court had acquitted. In turn, Chancery was run by the South African businessman Bill Godley. Godley had earlier operated the Imperial Consolidated ponzi scheme, and the man who introduced Seki to Chancery had earlier

[58] Kin'yu shohin torihiki ho [Financial Products Transactions Act], Law No. 25 of 1948, Sec. 41.

[59] Sankei shimbun, Nov. 21, 2005.

[60] Asahi shimbun, Dec. 27, 2005.

solicited funds for Imperial. In due course, the British government would prosecute Godly too, and the court would sentence him to 3-1/2 years in prison.[61]

Of the AJLRA's 18.5 billion yen in assets, Seki invested 14.4 billion -- 78 percent -- in Chancery bonds. AJLRA had invested in Invaro in 1997, but the investment had done so badly that Seki knew the board would balk at any plan to invest more. Rather than report his plan to the entire board as required, he told only his supervising director. The director deferred to his judgment and let him proceed.

For routing the funds to Invaro, Seki demanded -- and obtained -- a kickback. In return for executing the investment, he took 1 percent of the total: 138 million yen. With another 11 million in retirement benefits, he promptly disappeared. His supervisor on the board also received a kickback, but he apparently worried that it might constitute tax fraud and returned the money a month later.

Invaro failed in June 2004, and Chancery made its last payment to AJLRA that December. Prosecutors brought criminal breach of trust charges against Seki, and in 2007 the Tokyo District Court sentenced him in seven years in prison.[62] The pensioners sued Seki and the board for the money due them,[63] and the Association eventually filed for bankruptcy reorganization.[64]

In the ensuing judgment, the Osaka District Court held Seki liable to the firm's policy holders in tort. In exchange for a bribe, he had invested 80 percent of the pension assets in a single high-risk investment. That, the court explained, constituted a tort against its policy holders. Under Sec. 429 of the Corporate Code, corporate officers are liable to third parties when they injure them intentionally or through gross negligence.[65] Seki was liable.

The court held Seki's supervisor on the board liable too. As a member of the board, the man chaired the pension committee. He directly monitored Seki's work and held final power over his proposals. He knew that Seki's Invaro plan required full board approval. He knew that the Association should diversify its investments. He knew that he should retain experts to advise on the investment. He knew that here -- where Seki

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[61] See generally Liquor Group Sues Over Pensions, Japan Times, Aug. 23, 2006, available at://www.japantimes.co.jp/news/2006/08/23/business/liquor-group-sues-over-pensions/#.Wbc3da2ZOwA; Paul Lashmar, Liverpool Firm's Failure Brings Police Raids in Japan, Independent, Jan. 15, 2006, available at://www.independent.co.uk/news/business/news/liverpool-firms-failure-brings-police-raids-in-japan-6111671.html; Beth Hale, Down of Britain's Madoff, Daily Mail, Aug. 6, 2010, available at://www.dailymail.co.uk/news/article-1300577/Britains-Madoff-William-Godley-jailed-150m-Ponzi-scheme.html; Bengoshi Yamaguchi Takashi oi ni kataru [Lawyer Takeshi Yamaguchi recounts], http://yama-ben.cocolog-nifty.com.

[62] Koku v. Seki, 1288 Hanrei taimuzu 298 (Tokyo D. Ct. Sept. 28, 2007).

[63] They also sued the firm and the man who solicited the money from Seki. [No names given], 2184 Hanrei jiho 74 (Osaka D. Ct. July 25, 2011); see also [No names given], 2104 Hanrei jiho 62 (Tokyo D. Ct. Nov. 30, 2010) (suit against intermediary Credit Suisse and its personnel).

[64] Zenkoku kouri shuhan kumiai chuokai [AJLMA], Ryutsu nyusu, July 13, 2012, available at://ryutsuu.biz/strategy/e071335.html.

[65] See generally Hidefusa Iida, Nihon kigyo no risuku teiku to torishimariyaku no minji sekinin ruuru [Risk-taking by Japanese Firms and the Civil Liability of Directors], in Zen'ichi Shishido & Gen Goto, eds., Kooporeeto gabanansu kaikaku no teigen [Corporate Governance: A Proposal for Reform] 279 (Tokyo: Shoji homu, 2016).

proposed to bypass their outside investment adviser Mitsubishi Trust -- the board needed to assemble even-more-than-usual information and exercise more-than-usual care. He did none of this, and simply approved Seki's proposal. Again, concluded the court, this "clearly constituted a tort with respect to the plaintiffs."

On two grounds, the court absolved the other directors. First, they did not directly owe their policy holders a fiduciary duty. If they breached a fiduciary duty, they were liable to the firm. But (given that they did not harm the policy holders intentionally or through gross negligence), they were liable to the policy holders only (by the industry-specific statute governing the AJLRA) if they violated "the charter or the law."[66] In this context, reasoned the court, "law" referred only to specific statutes. It did not include a director's general fiduciary duties. Given that the directors did not violate the charter and did not violate specific statutes, they were not liable.

Second, the directors had not breached their fiduciary duties anyway. They had assigned one of their members (the chair of the pension committee) the job of monitoring Seki. Never mind Daiwa Bank (Section II.D.2.). He had indeed failed to monitor Seki, but the others were not to blame. Given their backgrounds, they were not investment specialists. Given contemporary politics, they had focused on halting the deregulation of alcohol retailing. Given Seki's deliberate deception, they did not know what he was doing. They did not notice the Invaro investment, but the court refused to call it a fiduciary duty breach.

IV. Conclusion

Through the general principles of agency, Japanese courts apply both the duty of care and the duty of loyalty. Should an agent cause a large loss through apparent carelessness, they hold him liable. Indeed, they hold him liable even where an American court would have deferred through the business judgment rule. Should an agent cause a loss through self-dealing, they hold him liable. Indeed, they held agents liable even before the occupation imposed an explicit duty of loyalty in the corporate code. Legal circumstances have changed dramatically over the course of the past decades, of course. Yet throughout the period, the courts kept the principles largely -- not entirely, but largely -- unchanged.

[66] Shuzei no hozen oyobi shuruigyo kumiai to ni kansuru horitsu [Law Relating to the Preservation of the Liquor Tax and the Alcohol Trade Associations], Law No. 7 of 1953, Sec. 30(b) (as of 2017, Sec. 30(c)).