THE LIVEDOOR LOOKING GLASS: EXAMINING THE LIMITS OF HOSTILE TAKEOVER BIDS IN JAPAN

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INTRODUCTION

On February 8, 2005, Takafumi Horie shocked Japan by announcing that his Internet company, Livedoor, intended to acquire Nippon Broadcasting. Livedoor's aggressive, "American style" corporate culture and business tactics, its splashy CEO, and the scandals, which consumed the company, captured the attention of the Japanese business and legal communities, as well as worldwide media for over a year. However, Livedoor was more than just a great headline. This paper explores how the Livedoor hostile takeover attempt became symbolic of changing legal, social and corporate norms in Japan. Its failure has implications that extend beyond Japan's borders. Livedoor illustrates both the effects and, ultimately, the limitations of the worldwide convergence towards Anglo-American corporate practices and law.

Until very recently, hostile takeovers had been unprecedented in Japan. Consequently, corporations and courts have almost no guidance relating to if and how hostile takeover bids should be allowed to proceed. As such, the few bids that have occurred have garnered much curiosity. A number of scholars have interpreted these bids—and the courts' treatment of them—as an indication that Japan is converging on an Anglo-American corporate model. This paper investigates the Japanese takeover trend and the Livedoor bid in particular for evidence of such convergence.

Section I of this paper introduces a larger debate over how corporate systems are developing worldwide. Some scholars, such as Henry Hansmann and Reinier Kraakman, argue that near-complete convergence on the Anglo-American corporate model is not only inevitable, but is close to complete. Such scholars would view the rise in hostile takeover activity in

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Japan as indicative of such convergence. However, not all scholars agree with Hansmann and Kraakman's theory of "strong form" convergence. This paper posits that while, on the surface, the Japanese takeover trend supports a theory of convergence on the Anglo-American corporate model, it actually highlights several reasons why path dependence in Japanese corporate practices and law has, and should, occur. Ultimately, this paper argues that the failure of recent deals only support the case for a much more limited form of convergence than that suggested by Hansmann and Kraakman.

Section II of this paper describes elements of the Japanese corporate structure which traditionally served to resist takeovers, and examines why this structure has become increasingly susceptible to them in the last five years. The recent takeover trend clearly signifies a change in the Japanese corporate environment. However, the repeated failure of recent hostile takeover attempts is also significant. This paper argues that these failures highlight a resistance to Anglo-American-style practices. Several features of the Japanese corporate structure have impeded the success of takeover bids, which emphasizes the differences between the corporate environment in the United States and Japan. The resistance to the adoption of Anglo-American corporate practices, such as the hostile takeover, indicates that Japan may not be as ready to adopt Delaware law as anticipated. This section focuses specifically on Livedoor's hostile takeover attempt for Nippon Broadcasting, because its failure has large-scale implications for the Japanese economy. Its catastrophic outcome will most likely have an impact on the way hostile takeover practice develops in Japan. This paper interprets Livedoor as a symbol of both the movement towards, and, ultimately, the resistance to, Anglo-American corporate practices and law in Japan.

Section III of this paper examines the ways in which the Japanese legal structure has shifted in response to the rise in hostile takeover activity. Three significant changes have already occurred. The courts have begun to establish precedent as they rule on individual cases of hostile takeover bids. The legislature has passed a new Company law which introduces hostile takeovers into Japanese corporate law. And, perhaps most significantly, the METI and the MOJ have jointly promulgated Hostile Takeover Guidelines ("the Guidelines"), which many expect will result in the adoption of both new practices

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and, ultimately, new law. The Guidelines, as well as the Company law and the court holdings, show the clear influence of Delaware law. However, this paper argues that the change in corporate law should keep pace with the legal environment it is meant to regulate. As Japanese lawmakers contemplate the development of their corporate legal system, Delaware law may serve as a useful guide, but ultimately must be adapted to fit a corporate environment distinctly different from our own.

I.

In *The End of History for Corporate Law*, Hansmann and Kraakman argue that the "core legal features of the corporate form"[1] had already achieved a "remarkable degree of worldwide convergence at the end of the nineteenth century."[2] While acknowledging that recent scholarship has emphasized the institutional difference in governance and business culture between U.S.-based and Japanese-based corporations, Hansmann and Kraakman nonetheless contend that almost complete uniformity has already been achieved, and will continue to develop rapidly.[3] If Hansmann and Kraakman are correct, it follows those corporate practices, such as the hostile takeover, that are standard in the United States would proportionally increase as other countries adopt the same corporate model. The rise in hostile takeover activity in Japan could be understood to support this thesis. For example, Stephen Roach, the Chief Economist and Director of Global Economic Analysis at Morgan Stanley, cited the changes in Japan as a prime indicator of what he terms "global rebalancing": the current trend of a worldwide shift towards American economic norms.[4] Roach states that such convergence will be "a power-

1. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001).

2. *Id.* The authors define the core legal features as (1) full legal personality; (2) limited liability for owners and managers; (3) shared ownership by investors of capital; (4) delegated management under a board structure; and (5) transferable shares). *See id.* at 439-40.

3. *Id.* at 439.

4. Stephen Roach, Global: Testing Time for Rebalancing (May 9, 2001), http://www.morganstanley.com/GEFdata/digests/20010509-wed.html ("I continue to believe that 'Global Rebalancing' will be a powerful, overarching force shaping the global economy over the next five to ten years. It rests on the key premise that America's economic norms have become the standard

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ful, overarching force shaping the global economy over the next five to ten years."[5]

However, not everyone concurs with a thesis of strong-form convergence on U.S.-based norms. Wharton management professor Mauro Guillen has undertaken an empirical study, the findings of which refute this convergence theory. For example, he points out that 94% of worldwide hostile targets in terms of transaction value from 1980 to 1989 were still in the U.S. and the U.K; 79% between 1990 and 1998.[6] This substantial figure puts the recent trend in Japan largely in perspective. During this same period, Guillen also determined that the combined shares of the countries influenced by the German, French or Scandinavian legal traditions actually grew from 34% to 49%.[7] Based on his findings, Guillen concludes that it is more reasonable to see convergence in corporate governance worldwide as moving towards a "hybrid model," instead of the strict shareholder-centric model found in the U.S.[8]

The concept of an intermediate "hybrid" model has been embraced by a number of scholars. Bebchuk and Roe point out that the fundamental problem with Hansmann and Kraakman's more radical approach to convergence is that their argument posits a "frictionless" world where transitions always occur smoothly and efficiently. In reality, substantial sunk adaptive costs, complementarities, network externalities and interest group pressures make transitioning between structures or practices costly and, in some cases, inefficient.[9] If these factors indeed represent expensive costs of transition, they will impede complete convergence on an outside model. Bebchuk and Roe argue that Japan embodies this point; their analysis shows that while corporate practices have converged to some degree in the United States and Japan, corporate own-

to which other nations aspire. Convergence to those norms is what global rebalancing is all about.")

5. *Id.*

6. Mauro Guillen, *Corporate Governance and Globalization: Is There Convergence across Countries?*, 13 ADVANCES IN COMP. INT'L MGMT. 175, 196 (2000).

7. *Id.* at 196-97.

8. *Id.* at 189-90.

9. Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 69, 78-82 (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

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ership structures have remained largely different, and such differences will continue to persist.[10]

Schmidt and Spindler similarly disagree with the theory that convergence towards a "best" corporate governance system is rapidly occurring.[11] They emphasize that corporate governance is embedded in different elements of economic, social and legal systems, between which complementarities exists. Therefore, a substantive change in corporate governance or practice would have to be comprehensive, requires all the complementarities to shift in order to accommodate it.[12] Gilson has termed this effect "corporate governance plate tectonics."[13] A complementarity perspective on corporate governance reinforces the idea that in order to incorporate a single corporate practice, an appropriate infrastructure must also be in place in order to ensure it's effective functioning. Schmidt and Spindler illustrate this point with the following example: "It would not necessarily improve the British corporate governance system if important elements were introduced into it which observers, regulators or legislators find useful in the German system, and vice versa. It might only lead to an inconsistent and dysfunctional mixture."[14]

This more tempered approach to convergence theory may explain why hostile takeover bids have not been successful in Japan. Many have suggested that deep-rooted cultural differences have and will continue to affect the Japanese M & A market. According to Michael Buxton, Co-Chief Executive of Transaction Advisory Services for Ernst & Young in Tokyo, these differences cannot be undervalued. "The biggest barrier to hostile M&A deals (in Japan) is culture," he has stated. "Managers see their duty as to build a business, rather than dispose of it."[15] He also suggests that the Japanese emphasis

10. *See id.* at 76-77.

11. *See* Reinhard H. Schmidt & Gerald Spindler, *Path Dependence and Complementarity in Corporate Governance, in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 114, 124 (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

12. *Id.* at 124.

13. Ronald J. Gilson, *Corporate Governance and Economic Efficiency: When do Institutions Matter?*, 74 WASH. U. L.Q. 327, 332 (1996).

14. Schmidt & Spindler, *supra* note 11, at 122.

15. Nick Clark, *Japan Grapples with Hostiles*, FIN. NEWS ONLINE, Sept. 16, 2003, http://www.efinancialnews.com/index.cfm?page=mergers_acquisitions&contentid=1045489472&Source=1045488223.

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on social relationships means that foreign companies must adapt to a much longer "courting process" than exists in the United States.[16]

The complementary nature of the corporate governance system suggests that Anglo-American practices such as the takeover cannot merely be grafted onto the Japanese corporate environment. Ronald Gilson suggests that empirical studies tend to demonstrate "functional but not formal" convergence between the United States and Japan is more likely, as each system's governance institutions are sufficiently flexible to incorporate solutions "within their path-dependent limits."[17] Curtis Milhaupt interprets what is currently occurring in Japan along these same lines. According to Milhaupt, incorporating hostile takeover practice into Japan's legal and corporate institutions is not convergence per se, but rather a process of selective adaptation because "[s]uccessful economies do not abandon their institutions for foreign models."[18] . Instead, they adopt "features of other systems that offer the potential to address emergent shortcomings in their own systems."[19] Hostile takeovers may be such a feature. This interpretation of the recent trend does not, then, support a case of rapid adoption of U.S. based corporate practices and law. In fact, it highlights the necessity of adapting such practices to fit in with the surrounding complementarities inherent in the Japanese corporate environment.

II.

The Japanese state-oriented model has long been characterized by a few features which strongly influence corporate practices and law. First, large Japanese firms have an ownership structure that is significantly different than that found in American firms. Large firms in Japan typically belong to a *keiretsu*, or "corporate group." *Keiretsu* members both invest

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16. *Id.*

17. Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 128, 138 (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

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

19. *Id.*

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heavily and trade heavily with one another.[20] Within each group, a main bank will own approximately 5%[21] of the stock of the *keiretsu*'s industrial firms, which in turn own stock in the main bank. Typically, four other banks and insurers will also own blocks of stock in the industrial firms of around 5%, thereby creating a cumulative coalition holding of 20% which surrounds the firm.[22] These cross-shareholdings are almost always reciprocal; a firm will tend to purchase stock in those firms which hold stock in them, and usually the investment amounts are roughly corollary.[23] This pattern of concentrated ownership has persisted in Japan for over 35 years in small, mid-sized and large firm structures.[24]

The historic lack of hostile takeovers in Japan has been often been attributed to this extensive cross-shareholding among firms.[25] Parties wishing to acquire a controlling block of stock must contend at the outset with a large voting block of shares held within the *keiretsu*. As *keiretsu* groups are generally concerned with stability and cooperation among all the members of the group, takeovers within the group are highly unlikely.[26] The *keiretsu* relationship can be seen as running deeper than economics. Indeed, many commentators believe that Japanese cross-shareholdings "serve primarily a culturally embedded symbolic role," which "reflects and cements" the relationship between two firms.[27] The social and cultural significance of the *keiretsu* relationships are illustrated by the "lunch clubs" where the presidents of the firms regularly meet in a

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20. J. Mark Ramseyer, *Cross-shareholding in the Japanese Keiretsu*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 348, 348 (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

21. Japanese antitrust law prevents banks from holding more than 5% of any debtor's stock. An Act Concerning Prohibition of Private Monopolization and Maintenance of Fair Trade, Act No. 54, § 11 (1947).

22. Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927, 1939 (1993).

23. *See* Ramseyer, *supra* note 19, at 349-50.

24. *See* Roe, *supra* note 21, at 1943.

25. Luke Nottage, *Japanese Corporate Governance at the Crossroads: Variation in Varieties of Capitalism?*, 27 N.C. J. INT'L L. & COM. REG. 255, 266 (2001).

26. M. Evan Corcoran, *Foreign Investment and Corporate Control in Japan: T. Boone Pickens and Acquiring Control Through Share Ownership*, 22 LAW & POL'Y INT'L BUS. 333, 338 (1991).

27. Ramseyer, *supra* note 19, at 351.

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social context.[28] Similarly, *keiretsu* President Council meetings are often thought to have a large social component to them.[29] The social and cultural significance of the *keiretsu* holds two implications for hostile takeovers. First, it indicates that no one member of the group will try to exert control. Roe explains this phenomenon: "No one member can withstand the ire of a coalition of others; moreover, in a culture that values consensus, no one member should be willing to risk the ire of the others."[30] Second, an outside party attempting to obtain control is also not only concerned with upsetting stability that is culturally valued among the other shareholders, but is facing the technical obstacle of entering into a pool of shares where a large block already exists.

Managers are likewise concerned with supporting the stability which cross-shareholding creates. While managers in the U.S. use techniques such as the "poison pill" to stave off hostile takeovers, it is cross-shareholding that affords managers similar protection in Japan.[31] Therefore, they would clearly support its persistence. This preservationist support of cross-shareholding on the part of managers could amount to an interest group pressure, which is a factor that Bebchuk and Roe argue will contribute to path dependence by increasing the cost of transitioning to a new system. Therefore, the structural feature of cross-shareholding, as long as it persists, has and will continue to have a dampening effect on hostile takeover practice in Japan for technical, social and cultural reasons.

Another salient feature of the Japanese corporate model is the practice of lifetime employment. After World War II, a labor surplus led to rapid unionization and worker activism in the form of strikes and plant takeovers.[32] This movement resulted in politically imposed lifetime employment, a feature of corporate culture that persists in Japan today. Under the state-oriented model, consideration of the employees is of great importance. As Nottage explains, "The conventional wisdom has been that Japanese corporate governance was profoundly in-

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28. *Id.* at 349.

29. Roe, *supra* note 21, at 1943.

30. *Id.*

31. Nottage, *supra* note 24, at 267.

32. Ronald Gilson & Mark Roe, *Lifetime Employment: Labor Peace and the Evolution of Japanese Corporate Governance*, 99 COLUM. L. REV. 508, 521 (1999).

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fluenced by the orientation of companies first towards "people" (i.e. employees), then "products" (i.e. technically excellent goods) and then "profits" (for shareholders)." This is a direct contrast to the Anglo-American model that ranks profits and products ahead of people, which re-emphasizes how fundamentally different the two corporate environments are.[33]

The practice of lifetime employment, much like the practice of cross-shareholding, contributes directly to the "expansive views of corporate purpose that go well beyond shareholder wealth maximization, and [the] abiding concern for the preservation of harmonious relationships" that characterize Japanese business practices.[34] These concerns are often cited as lying at the root of Japan's enduring disdain for U.S.-style takeovers. Therefore, the incorporation of hostile takeovers into the toolbox of Japanese corporate techniques would require more than a mere change on the law books. Instead, it would have profound implications for the cultural and social values of stability and harmony that are embedded in the Japanese corporate structure. This is an illustration of Bebchuk and Roe's theory of complementarities. The cultural elements, cited by Michael Buxton as impediments to the M & A market, would have to erode substantially to allow for hostile takeover practices to become acceptable.

Indeed, Japan's corporate sector has undergone a number of changes since its bubble economy collapsed in 1990. Some scholars argue that the resulting changes have allowed, and will continue to allow, for convergence toward Anglo-American corporate practices.[35] The most noticeable change is the decline in cross-shareholding of publicly traded shares.[36] Shareholding by financial institutions has declined more than 10% from the early 1990's, and within this group, shareholding by commercial banks is down from 16% in 1992 to less than 6% in 2004.[37] These declines are in direct correlation with an increase in foreign—mainly institutional—investors.[38] This shift in shareholder composition has had several notable

33. Nottage, *supra* note 24, at 281-82.
34. Milhaupt, *supra* note 18, at 2172.
35. *See generally* Millhaupt, *supra* note 18.
36. *See* Nottage, *supra* note 24, at 268; Milhaupt, *supra* note 18, at 2184.
37. Milhaupt, *supra* note 18, at 2184.
38. *See id.*; *See generally* Nottage, *supra* note 24.

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effects that may give rise to hostile takeovers in Japan. First, Japanese shareholder activism is becoming increasingly commonplace.[39] Second, the new shareholder demographic has forced managers to pay more attention to the efficient use of capital and returns on investment.[40] This could be interpreted both as a trend towards an increased emphasis on "profit", and therefore away from "people" under the traditional Japanese model, and as a trend towards increased rights for shareholders—including minority shareholders.[41]

Both of these trends would support a rise in hostile takeover practice. On a related note, directors are also now finding themselves under increased scrutiny from shareholders and courts.[42] There has been a rise in shareholder derivative litigation since the 1990's, which has pushed courts to create new laws clarifying directorial duties and obligations.[43] This litigation has been coupled with several occurrences of Japanese courts rendering decisions with "striking parallels to important Delaware court decisions."[44] Finally, many companies have begun to consider reducing the size of their boards and including outside directors: structural changes which mimic U.S.-style boards. The new Company Law now allows for firms to opt out of the traditional board structure. These changes not only demonstrate an increased acceptance of Anglo-American corporate practices, but evince an erosion of the traditional bulwarks against hostile takeovers. As Milhaupt contends, these changes are not sufficient to drive merger activity, but they can help to facilitate it.[45] These shifts in the Japanese corporate environment explain why the few hostile takeover bids in recent months have garnered so much attention. By examining them more closely, we are able to see both the limits and the effects of convergence. The bids, analyzed as a trend, demonstrate that hostile takeovers in Japan are currently a largely unsuccessful practice. This is due, in great part, to the traditional corporate features which continue to persist.

39. Milhaupt, *supra* note 18, at 2184-85.
40. Nottage, *supra* note 24, at 269.
41. *Id.* at 274.
42. Milhaupt, *supra* note 18, 2188.
43. *Id.*
44. *Id.*
45. *Id.* at 2188-89.

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The recent wave of hostile takeover bids was launched in 2000 by M & A Consulting, a Japanese boutique specializing in takeovers. M & A Consulting unsuccessfully attempted an unsolicited tender offer for Shoei Corporation (a company within the Fuji Bank *keiretsu* group), and followed later that year with a proxy fight at Tokyo Style. The failure of both these attempts was widely attributed to large shareholders who remained friendly to management of the target firms.[46] In 2003, Steel Partners, a U.S. buyout fund, also failed in unsolicited bids for two Japanese firms after shareholders did not tender into their bids. In July of 2005, Yumeshin Holdings also failed in its hostile tender offer for Japan Engineering Consultants after shareholders opted not to tender into the bid. In May, 2004, Japan witnessed the highly publicized hostile takeover attempt by Sumitomo of UFJ. Sumitomo unsuccessfully employed a U.S.-style takeover tactic know as a "bear hug," but instead UFJ merged with Mitsubishi Tokyo Financial Group (MTFG).

Even more than the UFJ-Sumitomo deal, the Livedoor-Fuji TV debacle captivated legal and business communities worldwide. Nippon Broadcasting System, Inc. (Nippon) is a subsidiary of Fuji Television Network, Inc, (Fuji), Japan's largest media company. In an unusual cross-shareholding arrangement, Nippon held 22.5% of Fuji's's outstanding shares, while Fuji held only 12.4% of Nippon's shares. To remedy this, Fuji announced an all-cash offer for all the outstanding shares of Nippon on January 17, 2005. The bid was approved; however, the Internet service provider Livedoor, with Takafumi Horie, a 32 year old college dropout, at its helm, was quietly acquiring Nippon shares in after-hours trading. On February 8, 2005, in the middle of the tender offer period, Livedoor announced that it now held 38% of Nippon shares, and intended to acquire all shares outstanding. On February 23, Nippon announced in response that it would issue to Fuji a type of warrant—authorized in a 2002 Commercial Code amendment—that allows directorial issuance without shareholder approval at a price determined by the board. The effect of the warrants would be to give Fuji majority control and sufficiently dilute Livedoor's stake to less than 20%. Livedoor promptly sued to enjoin the issuance of the warrants. The Tokyo District Court

46. *Id.* at 2180.

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enjoined the warrant issuance, saying it was "grossly unfair" and the High Court affirmed. Livedoor did obtain a majority of shares of Nippon, but ultimately the contest ended civilly, with Livedoor agreeing to sell its Nippon shares to Fuji in April of 2005. In exchange, Fuji TC obtained a 12.5% stake in Livedoor for a capital infusion of around $440 million, and a relationship was established between the companies.

The Livedoor deal continues to garner attention for three reasons significant to the convergence debate. First, like UFJ-Sumitomo, it was highly scrutinized as an indicator of how hostile takeover practice might develop in Japan.[47] The Livedoor litigation was particularly essential, as it forced the court to "decide a question at the heart of any takeover law: [w]hen is it permissible for a target's board to erect a virtually impenetrable barrier to an unsolicited bid?"[48] In enjoining Nippon's warrant issuance as "grossly unfair," the court promulgated a rule that not only what defines that standard, but also lays out circumstances under which a hostile bidder may not be protected as a shareholder.[49] The High Court affirmed because it concluded that Nippon's board had issued the warrants for the primary purpose of preserving management's control.[50] Commentators were quick to draw parallels between the holdings of both *Unocal Corp. v. Mesa Petroleum Co.*[51] and *Revlon, Inc. v MacAndrews & Forbes Holdings, Inc.*[52] Milhaupt contends that any similarity to these cases was not a coincidence, but rather, the court had been specifically briefed as to how the issue would be resolved under Delaware law. Additionally, there is a large body of comparative analysis available which draw parallels between the recent takeover activity and Delaware precedent.[53] While the ruling generated indicates a conscious convergence towards Delaware jurisprudence on the part of the

47. *See* Ken Siegel & Jeff Schrepfer, *An Assessment of the UFJ Merger and Integration Protective Provisions Under U.S. Law*, Morrison & Foerster: Legal Updates & News (Jan. 2005), http://www.mofo.com/news/updates/files/update1422.html; Milhaupt, *supra* note 18, at 2193.

48. Milhaupt, *supra* note 18, at 2193.

49. *See* Nippon Hoso K.K. v. Raibudoa K.K., 1173 Hanrei Taimuzu 125 (Tokyo High Ct., Mar. 23, 2005).

50. Milhaupt, *supra* note 18, at 2194.

51. 493 A.2d 946 (Del. 1985).

52. 506 A.2d 173 (Del. 1986).

53. Milhaupt, *supra* note 18, at 2194.

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court, such an analysis leaves unconsidered the two aspects of the deal that could highlight the path dependence of Japanese corporate practices. Both the controversial financing of the deal and the company's ultimate failure demonstrate significant resistance on the part of the Japanese business community to Anglo-American corporate practices.

The controversial financing that fueled the deal illustrates the complementarities which differentiate Japanese corporate culture. Lehman Brothers financed Livedoor's purchase of Nippon shares in exchange for what has been termed "death spiral" convertible bonds, wherein Lehman retained the right to convert the bonds into shares at a constant discount to the share price.[54] This effectively reduced the value of Livedoor's shares to the detriment of its shareholders. While such a financing tactic might be acceptable in the United States, in Japan it was met with hostility. The move generated so much controversy that in March 2005, Eisuke Sakakibara, a former top finance ministry official, abruptly resigned from Lehman's advisory board, apparently as a result of the deal. In a March 2005 edition of the *Economist*, it was speculated that "because of its Livedoor role, Lehman will struggle to find new clients in Japan" with the caveat that, "if Mr. Horie triumphs, such talk will surely end."[55] A year later, it is clear that not only did Mr. Horie fail in his takeover attempt, but he and his company have been publicly disgraced by scandal.

The financing controversy is a cautionary tale for Lehman Brothers and others hoping to employ U.S. business practices in Japan. As noted before, Japanese negotiations and corporate relationships are notably different than those in the United States.[56] The resignation of Mr. Sakakibara is an indication that Lehman's imposition of certain U.S.-style corporate tactics amounted to a disregard, or lack of understanding, of Japanese cultural norms that were not well-received. The "death spiral" financing might have made economic sense for Lehman, but not if the loss of future business is factored into the equation.[57] If Lehman does lose business, other firms, may

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54. *Shaking Up Corporate Japan*, ECONOMIST, Mar. 23, 2005, *available at* http://www.economist.com/business/displaystory.cfm?story_id=3793297.

55. *Id.*

56. *See* Siegel & Schrepfer, *supra* note 46.

57. *Shaking Up Corporate Japan*, *supra* note 53.

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be more cautious in introducing aggressive and unfamiliar corporate practices to Japan.

Much as the Lehman financing generated shockwaves throughout the Japanese business community, so has the scandal which has plagued Livedoor and its CEO in recent months. Even before the scandal surfaced, the clash between the 32 year-old Horie and the "slow and sleepy men twice his age"[58] who run major Japanese corporations holds deep social and cultural significance for Japan. Horie has been widely criticized for his "unconventional, American-style"[59] of doing business. Toyota Motor Corporation Chairman, Hiroshi Okuda, explained the negative reaction of the Japanese public to the attempted Nippon takeover, when he said, "[Horie] has been criticized by people in political and business circles for having done something morally wrong, because it is the worst thing in Japanese society to think that if you have money, you can do anything."[60] Milhaupt contends that young men like Horie—and their Anglo-American practices—strike a "deep chord in the Japanese consciousness—not only on a corporate level, but politically and socially well. . . these deals are an allegory on old versus new Japan."[61] *Time* Magazine categorized Livedoor as a "battle of the Hills Tribe and the Square Tribe," pitting young entrepreneurial residents of the chic Roppongi Hills district against the traditional Japanese business establishment.[62] With his "silver-blue Ferrari," "bikini-model girlfriend" and his penchant for "thumbing his nose at Japan's business elite",[63] Horie represented a challenge to Japan's traditional social, cultural and corporate values.

The negative reaction to Horie has only deepened in recent months. The market was sent reeling last January when suspicions of securities fraud triggered an investigation into

58. *Id.*

59. *Stirred by Flashy Entrepreneur, Tokyo Market Hits Panic Mode,* N.Y. TIMES, Jan. 19, 2006, at A1.

60. Takuya Karube, *Livedoor Ushers in an Era of Hostile Takeover,* JAPAN TODAY, Nov. 7, 2006, *available at* http://www.japantoday.com/news/jp/e/tools/print.asp?content=comment&id=731

61. Milhaupt, *supra* note 18, at 2181.

62. Jim Frederick, *The Livedoor Scandal: Tribe vs. Tribe,* TIME.COM, Jan. 20, 2006, http://www.time.com/time/world/article/0,8599,1151722,00.html.

63. *Stirred by Flashy Entrepreneur, Tokyo Market Hits Panic Mode, supra* note 58, at A1.

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Livedoor. The investigation spurred a near panic in the Tokyo stock market, with investors withdrawing billions of dollars in only two days. Trading was so heavy that the Tokyo Stock Exchange was forced to close early to avoid overloading its computers, an act characterized by the N.Y. Times as a "blow to the nation's pride."[64] Markets around the world fell, triggering what the Japanese news and media termed "Livedoor shock." Following his January arrest, Horie and four other Livedoor executives were charged with falsifying financial reports, artificially inflating stock prices through stock swaps and splits, and giving false information about the earnings of a subsidiary. The Tokyo District prosecutor's office said that the company's pretax profits were falsified by about 5.35 billion yen ($45 million). The scandal continues to be highly publicized, both in Japan and worldwide. In many ways, Livedoor was being closely scrutinized as a test case. The company's collapse, therefore, is bound to have a profound effect on Japan. Horie's critics appear to have been justified in their concerns; clearly, some of Horie's business methods proved to be both a legal and an economic failure. *Time* Magazine noted a deep sense of both relief and *schadenfreude* on the part of the "Square Tribe" at Livedoor's collapse. If Livedoor is a litmus test for Japan's tolerance for change, its failure may indicate that American-style business tactics will meet deep-seated resistance in Japan.

III.

Currently, Japan is at a critical juncture. The recent wave of hostile takeover bids has prompted three important legal responses in Japan. First, the judiciary has begun to establish precedent as they rule on individual cases of hostile takeover attempts. As discussed, Japanese courts have drawn lessons from U.S. cases as they navigate these uncharted waters. Second, the government has passed a new Company Law, which replaced all company-related provisions in the Commercial Code. Pertinently, the new Company law will be to introduce flexibility in merger-consideration and cash squeeze out

64. *Id.*

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merger procedures.[65] While the Company Law came into effect this past May, the enactment of its merger provisions was intentionally delayed for one year. Despite criticism from both foreign practioners and academics, the legislature rationalized the delay as necessary in order to allow Japanese companies to familiarize themselves with M & A practice under the new law.[66]

In addition to the new Company Law, the Ministry of Economics, Trade and Industry (METI) created a Corporate Value Study Group with the intention of formulating a policy response to hostile takeover activity. The Study Group itself consisted of legal and business representatives, and conducted extensive research with outside experts on Anglo-American takeover defenses and legal practices.[67] In March, 2005, just as the Livedoor takeover controversy was beginning, but before any news of the securities fraud scandal emerged, the Study Group issued its report. Based on this report, METI and the Ministry of Justice jointly issued "Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholder's Common Interest."[68] The Guidelines are non-binding, but it is expected that they will set the standard for companies engaging in M & A in Japan.[69] Additionally, their adoption will require a number of amendments and adaptations of corporate and securities laws.[70]

The extent to which the Guidelines are based in Delaware law is remarkable. A number of principles enunciated in the guidelines stem directly from the holdings of U.S. case law such as *Unocal, Unitrin, Revlon* and *Toll Brothers*.[71] For example,

65. Ken Kiyohara & Robert Watson, *Changing Takeover Practice in Japan*, Ashurst Publications (Sept. 2005), http://www.ashursts.com/doc.aspx?id_Content=1966#search=%22METI%20takeover%20guidelines%20%22.

66. *Id.*

67. Milhaupt, *supra* note 18, at 2195-96.

68. Ministry of Economy, Trade, and Industry, M&A Rules in Japan (May 2005), http://www.meti.go.jp/policy/economic_oganization/pdf/ronten koukai_gaiyou_eng.pdf.

69. Kiyohara & Watson, *supra* note 64.

70. Milhaupt, *supra* note 18, at 2200.

71. Curtis Milhaupt, Professor of Law, Columbia Law School, Address to the Research Institute of Economy, Trade, and Industry BBL Seminar, Is the Poison Pill Good for Japan?: A Preliminary Analysis of the New Takeover Guidelines (July 28, 2005), *available at* http://www.rieti.go.jp/en/events/

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the study group proposed that the appropriate standard by which to assess a defensive measure should be a "corporate value standard," which takes into consideration: (i) whether there was an existing threat to corporate value; (ii) whether the defensive measures were proportionate to the threat; and (iii) whether the board's actions were prudent and appropriate.[72] This standard appears to have been drawn directly from the holding of *Unocal Corp. v Mesa Petroleum Co.*[73] The study group also recommended that: (i) the defensive measures be adopted before a specific hostile takeover occurs and the board disclose its details in advance; (ii) the defensive measures be redeemable depending on the result of a proxy contest; and (iii) certain appropriate devices be implemented to ensure that the defensive measures will not be used to allow the incumbent board members to entrench themselves.[74] All of these principles are rooted in Delaware law. In fact, the reliance of Delaware law is so great that METI hired both a U.S.-based financial firm and a U.S. law firm to explain the introduction of these new policies to the outside world.[75]

The dependence on Delaware law can be explained, at least in part, from the fact that one-third of the Study Group was comprised of lawyers or law professors trained in the U.S.[76] As a result, the Study Group was likely most familiar with Delaware law (as opposed to other international approaches to M & A law, such as the U.K.'s London City Code),

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bbl/05072801.html?mode=print. Milhaupt elaborates on this point: "For example, *Unocal* basically says that in erecting defensive measures, management should be responding to some threat to corporate policy and effectiveness and not primarily to protect themselves in office. Similarly, *Unitrin* emphasizes the shareholders' right to replace the board of directors as their critical protection against overly broad defensive measures. "*Revlon* duties" are the obligations of the directors to step aside in effect and become an auctioneer for the firm when faced with competing bids for control of the firm. Finally, *Toll Brothers* was a case that struck down what is known as a dead-hand poison pill which effectively forecloses the opportunity for shareholders to replace the board and eliminate the pill. Each of these basic principles finds some parallel in the Japan's new Takeover Guidelines." *Id.*

72. Hiroshi Mitoma & Yuko Okamoto, *Livedoor Takeover Bid Prompts Defensive Action*, *in* THE INTERNATIONAL FINANCIAL LAW REVIEW GUIDE TO JAPAN 2006 *available at* http://www.iflr.com/?Page=17&ISS=21187&SID=605804.

73. 493 A.2d 946, 955 (Del. 1985).

74. Milhaupt, *supra* note 70.

75. *Id.*

76. *Id.*

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as well as more likely to endorse it.[77] Additionally, interest group pressures from U.S. law and financial firms may have influenced the decision making process.[78] Whatever the reason, the Guidelines demonstrate a clear endorsement of Delaware law as the "global standard" on which Japanese M & A practices should be based.[79]

As a result of these changes, Japanese corporate law could develop in two directions. The combination of the new legal precedent, Company Law and Takeover Guidelines could result in a corporate environment which bears distinct resemblance to the United States. This environment would be characterized by a more active takeover market, the adoption of defensive measures by Japanese corporations, and a judiciary that is more involved in settling takeover disputes. Such an environment would clearly support theories of strong-form convergence on the Anglo-American corporate model.

However, the transplantation of Delaware law should be seen as highly experimental. As Milhaupt explains, "Japan is not trying to adopt a specific rule; they are trying to adopt 20 years of highly complex judicial doctrine developed at a very different era in the U.S." That is an extraordinary experiment, and it is not clear how it will turn out, particularly because the Delaware law itself is vague, highly fact-specific and gives a lot of discretion to the courts to do what is 'fair.'[80] Milhaupt stresses that history has shown that the successful transplantation of a legal regime requires a surrounding complementarity structure, which, at present, Japan does not have.[81] The examination of the bids themselves, particularly the Livedoor example, highlights the lack of certain complementarities. Without the necessariliy complementarities in place, it seems hasty for Japan to begin to incorporate Delaware law in response to the trend. To do so may result in the "inconsistent and dysfunctional mixture" of law which Schmidt and Spindler suggest occurs when regulators attempt to incorporate certain elements of outside systems. While the Takeover Guidelines are cer-

77. *Id.*

78. *Id.*

79. *See id.*

80. *Id.*

81. Milhaupt cites a more robust M&A market, more independent directors, and the SEC as complementary institutions which support hostile takeovers in the United States. *See id.*

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tainly useful in a landscape devoid of precedent, a formal legal response should only occur when it becomes clear how hostile takeovers will be adapted to what is clearly a very different corporate environment.

CONCLUSION

Transplanting corporate practices and law from one environment to another without regard for the need for supporting complementarities is both experimental and risky. Milhaupt reminds us of the "basic truth" that we "simply do not know how Delaware takeover jurisprudence and the poison pill will operate in Japan."[82] Predicting any outcome would be a complex process requiring the assessment of multiple complementarities, ranging from cultural norms to corporate structure, and from fundamental legal principles to interest group politics. While the takeover trend itself appears to embody a rising acceptance of Anglo-American corporate norms, assessments of the individual takeover cases highlight the resistance to this change. Livedoor was a company at the forefront of the convergence trend, embracing Anglo-American corporate culture, practices and financing techniques. Yet, it was poorly received by the Japanese business and legal communities, and ultimately, a catastrophic failure. In hindsight, it reads as a failed experiment to transplant elements of the Anglo-American model into the Japanese corporate environment. In its attempt to takeover Nippon, Livedoor showed the world how much Japan had changed, but also how much it has stayed the same.

The hurried legislative response to the takeover trend is understandable. Corporations and courts were clamoring for guidance. However, while the adoption of new law and legal precedent is permanent, this trend may not be. The failure of Livedoor, among others, may cause hostile bidders to withdraw from the Japanese marketplace, at least until the bulwarks against takeovers such as cross-shareholding and lifetime employment have eroded further. As such, it seems hasty for the Japanese legislature to continue to incorporate Delaware law. Instead, legislators could wait to see how hostile takeovers are "functionally" adapted into this different corporate envi-

82. Milhaupt, *supra* note 18, at 2209.

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ronment. This would allow for laws which not only address the practice itself, but also the complementarity structures which will effect its utilization.

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Errata

Emily Berkman, Note, Microloans as a Community Reinvestment Act Compliance Strategy, 3 N.Y.U. J. L & Bus., 329 (2006)

The following quoted material should appear in block-indent format:

1. Immediately following footnote 78: From "[Developing-world] Banks" through "pursuit of profits" (just before FN 79).

2. Immediately after FN 102, from "[B]anks and thrifts that care" through "earned high CRA ratings" (just before FN 103).

3. After FN 118, from "a bank shall address" to "business strategy" (just before FN 119).

4. After FN 121, from "a concern that consolidation" to "new leverage" (before FN 122). Additionally, ellipses should be included as follows: "…a concern that [etc]."