Vanderbilt Journal of Transnational Law

Volume 6
Issue 2 *Spring 1973*

Article 6

1973

Securities Regulation in Japan

Mitsuru Misawa

SECURITIES REGULATION IN JAPAN

*Mitsuru Misawa**

I. HISTORY OF POST-WAR JAPANESE SECURITIES MARKETS

Japanese securities exchanges, which were closed at the beginning of the Allied Force occupation in 1945, were permitted to reopen in 1949. During the following two decades, the Japanese economy displayed vigorous growth. An expansion of the operations of the securities markets accompanied the expansion of the economy, but the expansion did not progress evenly. The development of the securities markets in the post-War period can be divided into a number of stages: (1) the period of confusion and frustration (August 1945 to August 1949); (2) the period of reorganization (May 1949 to January 1954); (3) the period of high growth (January 1954 to June 1961); (4) the period of stagnation (July 1961 to January 1968); and (5) the period of internationalization (January 1968 to the present).

A. *The Period of Confusion and Frustration (1945-1949)*

The defeat in World War II left the Japanese economy in a state of near breakdown. Termination of the War disrupted the control mechanism of the economy and for a while created a chaotic condition. The rate of price increases was alarming.

In order to counteract the sharp spiraling of inflation, occupation authorities (SCAP)[1] in 1946 directed the Japanese Government to enforce emergency financial measures. One of these measures was the issuance of a new currency, while old currency in excess of specified amounts was frozen in "blocked" accounts. Since it was permissible to use frozen funds to purchase corporate stocks,[2] there was a notable increase in securities transactions. These transactions were executed

*Economist and Legal Adviser, Industrial Bank of Japan (Tokyo). LL.B., 1960, Tokyo University; LL.M., 1964, Harvard University; M.B.A., 1965, University of Hawaii; Ph.D., 1967, University of Michigan. The author is most grateful to Dean Robert L. Knauss, School of Law, Vanderbilt University, who provided excellent advice and encouragement in the writing of this article. This article is part of a project sponsored by the American Society of International Law.

1. SCAP is the official name of the occupation authorities, the General Headquarters for the Supreme Commander for Allied Powers.
2. Ministry of Finance Notification No. 35 (Feb. 15, 1947) (Japan).

only in over-the-counter markets by securities dealers, since the old securities exchange system was dissolved after the surrender[3] and no new organized exchanges had yet been created.

The notable reforms of the period were the "Zaibatsu[4] Dissolution" in 1945[5] and the adoption of the Securities Exchange Law in 1948.[6] The measures directed against the Zaibatsu were some of the most crucial changes sought by the occupation authorities. The measures were directed, first, toward destroying the power and wealth of the Zaibatsu, secondly, toward reducing each group to a number of independent enterprises, and thirdly, toward encouraging competition as a permanent condition of the economy.[7]

The enactment of the Securities Exchange Law was ordered by the occupation authorities as a condition for the reopening of the securities exchanges. This Law is a modified version of the United States Securities Act of 1933[8] and of the Securities Exchange Act of 1934.[9] Like the United States Acts, the Japanese Securities Exchange Law requires an issuing company to make extensive disclosures to the exchange and to the Government before issuing securities and registering them on a stock exchange.

A provision borrowed from the United States that has exerted a

3. The securities exchange system in Japan was first established in 1878 when the Tokyo and Osaka Stock Exchanges were inaugurated as joint stock companies. This system endured for about 70 years until 1943, when the eight stock exchanges in the key cities of Japan were merged into a semi-governmental Japanese Security Exchange. For a discussion of the pre-War securities market see T. ADAMS, JAPANESE SECURITIES MARKET 1-15 (Seikei Okuyama 1953).

4. Zaibatsu, which literally means the "money clique" or plutocracy, should be translated as "large industrial and banking combinations." According to Bisson's definition, it is a collective designation equivalent to the "wealthy estate," which is customarily applied to the Japanese combines and to the persons or families controlling them. For a discussion of the size and makeup of Zaibatsu see T. BISSON, ZAIBATSU DISSOLUTION IN JAPAN 1-32 (1954).

5. SCAP Memorandum (Nov. 6, 1945) (Japan).

6. Law No. 25 of 1948 (Japan). Subsequent amendments to the Law reflected United States developments. Most recently the law was amended on March 3, 1971. Law No. 4 of 1971 (Japan).

7. For the legal base of the Zaibatsu dissolution see HOLDING COMPANY LIQUIDATION COMMISSION, LAWS, RULES AND REGULATIONS CONCERNING THE RECONSTRUCTION AND DEMOCRATIZATION OF THE JAPANESE ECONOMY (Jiyushobo 1947).

8. 15 U.S.C. §§ 77a-77mm (1934), *as amended,* 15 U.S.C. §§ 77a-77mm (1970).

9. 15 U.S.C. §§ 78a-78jj (1934), *as amended,* 15 U.S.C. §§ 78a-78hh(1) (1970).

considerable influence on the development of securities firms is that a bank or a trust bank may not engage in the underwriting of securities.[10] Before World War II, underwriting in Japan was handled by banks, trust companies and other financial institutions mostly auxiliary to the Zaibatsu organization. The securities business was concerned mainly with the current market, and underwriting was accomplished, if at all, on a subcontract basis. Thus the prohibition under the new law provided a significant contrast to the pre-War custom.

In 1949, the occupation authorities issued a retraction of the previous SCAP memorandum[11] suspending securities exchanges; stock exchanges in Tokyo, Osaka and Nagoya were registered with the Securities Transactions Commission and permitted to commence trading sessions in May 1949. Stock exchanges opened in Kyoto, Kobe, Hiroshima, Fukuoka and Niigata in July 1949, and the Sapporo exchange began operation in May 1950.

In May 1949, just prior to the reopening of the exchanges, SCAP established three basic rules for buying and selling securities:[12] (1) all transactions taking place at the exchange must be recorded in proper sequence; (2) members of the stock exchange must, in transactions involving listed stocks, do all trading on the exchange premises; and (3) no forward trading would be permitted.[13] These three principles were designed to protect investors by eliminating excessive speculation and unfair trading, and to facilitate the maintenance of fair stock prices. The basic difference between the pre-War securities exchanges and the new exchange was that the participants now became members of a nonprofit membership organization (*Shadan Hojin*), instead of being stockholders in a private organization.

B. *The Period of Reorganization (1949-1953)*

In February 1949, Mr. Joseph Dodge came to Japan as special financial adviser to General MacArthur and made a crucial study of Japanese economic conditions. A group of measures associated with Mr. Dodge's visit came to be identified as the Dodge Line. One of the purposes of these measures was to end inflation. Prior to the adoption

10. Securities Exchange Law art. 65 (1948) (Japan) [hereinafter cited as Securities Exchange Law].

11. SCAP Memorandum (Sept. 25, 1945) (Japan).

12. SCAP Memorandum (April 1, 1949) (Japan).

13. In 1951, however, a form of credit transaction modeled after margin transactions in the United States was introduced in the belief that speculation is to some extent necessary for the stock market to play its role efficiently.

of the Dodge Line, the Reconstruction Finance Bank (RFB)[14] had been granting industrial loans, mainly for equipment, at a rate of over 10 billion yen (approximately 33 million dollars) per month. These loans were thought to be one of the principal causes of inflation. As a result of the Dodge Line measures, RFB lending ceased, and emphasis was shifted to the accumulation of equity capital within business enterprises to make them less dependent on government assistance for industrial financing.

The occupation authorities used two means to encourage the accumulation of equity capital within enterprises. One was a general revaluation of assets introduced in 1950; the other was the Commercial Code[15] amendment of 1950. Under the asset revaluation program,[16] the increase in capital that resulted from the increase in book value of assets could be used only as a basis for stock dividends. This prevented the increase from being used as a basis for cash dividends and preserved the assets of corporations. At the same time, the increased book value of assets led to higher annual depreciation charges, which reduced the amount of cash earnings available for future dividends and led to an internal generation of investment funds. The final effects were that internal financing was increased, and the market for shares was improved.

The Commercial Code in Japan had been transplanted from Germany in 1899 as a part of the general acceptance of Western law during the Meiji era.[17] During the period of occupation, SCAP reformed the Commercial Code, intending to adopt the Anglo-American approach to corporate law. The amendments to the Commercial Code made in 1950 fall into three categories: (1) the rearrangement of

14. The Reconstruction Finance Bank was a quasi-banking institution established in January 1947 by the Japanese Government to provide post-War industrial funds. By 1949 almost all the key industries such as coal mining, electric power and shipping relied entirely on this bank for funds.

15. Law No. 48 of 1899 (Japan).

16. In 1949 the United States dispatched the Shoup Tax Mission to Japan. In close harmony with the Dodge Line, the Tax Mission made various recommendations concerning the basic revision of the Japanese tax system. The asset revaluation was one of these recommendations. *See generally* T. TOKOYAMA, PRESENTDAY PUBLIC FINANCE AND TRENDS IN HISTORICAL DEVELOPMENT 53 (The Science Council of Japan 1956).

17. Subsequent amendments to the Code in 1899, 1911 and 1938 in the field of corporation law mainly reflected German developments. *See* K. SHIDA, NIHON SHŌHŌTEN NO HENSAN TO SONO KAISEI (CODIFICATION OF JAPANESE COMMERCIAL CODE AND ITS AMENDMENTS) (Meijidaigaku Shuppanbu 1934).

corporate powers among shareholders, the board of directors and the corporate auditors; (2) the adoption of new ways of attracting capital into the markets; and (3) the increasing of the rights of individual shareholders. Although all three were significant in the subsequent development of the securities markets, the second factor was the most important. The concepts of authorized capital stock[18] and no-par value stock[19] were borrowed from American practice to provide flexibility in finance. Other introductions were redeemable stock,[20] stock dividends,[21] stock split-ups[22] and transfers from reserves to stated capital.[23]

During the first three to four years following the end of the War, there was no formal bond market. In June 1949, the Bank of Japan took steps to establish a limited market by agreeing to accept specified bonds as collateral for loans to commercial banks.[24] This step apparently was successful in expanding the volume of new bond issues, but the volume of bond trading remained relatively small, being limited chiefly to a few individuals, brokers and financial institutions.[25]

C. *The Period of High Growth (1954-1961)*

Japan's rate of economic growth increased very rapidly during the period between 1954 and 1961. During these years the Gross National Product grew at an annual rate of 9.9 per cent in real terms.[26] The major factor in the expansion of the domestic market was increased investment in equipment. The average annual growth rate of equipment investment reached 31.9 per cent in 1961.[27]

During the same period, stock quotations continued to advance at a rapid pace. The per share price average in 1957 (first section prices)

---

18. COMMERCIAL CODE art. 166 (1899) (Japan) [herinafter cited as COMMERCIAL CODE].
19. COMMERCIAL CODE arts. 166,199.
20. COMMERCIAL CODE art. 22.
21. COMMERCIAL CODE art. 293(2).
22. COMMERCIAL CODE art. 293(4).
23. COMMERCIAL CODE art. 293(3).
24. DAIWA SECURITIES CO., LTD., JAPAN STOCK EXCHANGE MANUAL 259-61 (Tokyo Printing Co. 1963).
25. JAPAN PRODUCTIVITY CENTER, SECURITIES MARKET IN JAPAN 18 (Japan Productivity Center 1959).
26. *See* THE ECONOMIC PLANNING AGENCY, KOKUMIN SHOTOKU HAKUSHO, 1964 NENBAN (NATIONAL INCOME WHITE PAPER, 1964) 280 (Okurasho Insatsukyoku 1964).
27. *Id.*

was 471.53 and reached 1,829.7 in 1961—a 288 per cent increase.[28] The turnover ratio[29] at the Tokyo Stock Exchange increased from 46.2 per cent in 1957 to 80.0 per cent in 1961.[30]

Another factor that favorably influenced the markets was stable corporate dividends. During the period, the pay-out ratio[31] remained low so that enterprises could pay dividends with ease and make investors feel safe. The low pay-out ratio also implied possibilities of greater capital expansion in the future. Capital expansion was further encouraged by rights offerings of new stocks to shareholders. In Japan any new shares issued are offered at par regardless of the current market price. This sizable underpricing encourages stock purchasing.

The establishment of the Second Section within the Tokyo Stock Exchange in October 1961 stimulated companies to "go public." More companies vied for the privilege of introducing their shares into the market. An average of 33 companies per year went public in the 1958-1960 period; 156 companies introduced their stocks to the market in 1961.[32]

Another factor favoring the expansion of the stock markets was the growth of investment trust funds. The "Big Four"[33] and ten smaller securities firms established new investment trusts in rapid succession. At the end of 1958, the outstanding capital of investment trust funds reached 200 billion yen (approximately 667 million dollars) and increased five-fold to 1,100 billion yen (approximately 3.667 billion dollars) by the end of 1961.[34]

In April 1956, bond trading markets were formally reopened in Tokyo and Osaka, but the volume of trading remained small relative to the volume of trading in the stock market. Although Japan was a

28. *See* TOKYO STOCK EXCHANGE, SHŌKEN NENPŌ (ANNUAL STATISTICS REPORT) (Tokyo Stock Exchange 1961); *id.* (1957).

29. The turnover ratio is the ratio of the number of shares sold to the total number of shares of listed stocks.

30. *See* TOKYO STOCK EXCHANGE, *supra* note 28.

31. The pay-out ratio is the ratio of the dividend per share to the profit per share.

32. *See* TOKYO STOCK EXCHANGE, SHŌKEN NENPŌ (ANNUAL STATISTICS REPORT) (Tokyo Stock Exchange 1952).

33. The big four securities firms in Japan are Nomura, Yamaichi, Nikko and Daiwa. These four companies account for about 60% of total sales of shares and about 80% of the outstanding capital of investment trusts. *See* THE PRINCIPAL EXCHANGES OF THE WORLD—THEIR OPERATION, STRUCTURE AND DEVELOPMENT (D. Spray ed. 1964).

34. TŌYŌ KEIZAI, SHOKEN SHIJŌ DOKUHON (SECURITIES MARKETS MANUAL) 364 (Tōyō Keizaishinposha 1965).

rapidly growing industrialized country with strong demands for financial capital, it had achieved only a partially developed bond market even in this period of high economic growth.

D. *The Period of Stagnation (1961-1967)*

From July 1961 through 1967 the securities market experienced a wide stock price decline and a notably long period of economic lethargy.[35] Throughout the period the daily volume of turnovers declined steadily. By 1965, the daily volume of transactions had decreased to the 1957 average. Moreover, the total number of shares listed on the Tokyo Stock Exchange increased from 18 billion shares to 1957 to 74 billion shares in 1965. Thus the scale of stock transactions actually declined to one-fourth of the 1957 level.[36]

As a result of these adverse market developments, efforts were made to control new stock issues. There was fear that if the total value of new issues was too large in proportion to the scale of the stock market, it would cause the market to be depressed. In order to avoid such undesirable results, the Capital Increase Coordinating Committee was formed. The Committee is a voluntary organization composed of representatives from the Ministry of Finance, the Bank of Japan, the Tokyo Stock Exchange, the major securities firms and other financial institutions.

If a listed company desires to increase its capital through the stock market, the company is expected to notify the Committee of its action. Although the Committee has no power to approve or disapprove proposed issues, it may persuade the issuing company to take such steps as delaying the issue. The activity of the Committee has caused a decline in the number of new issues.[37]

---

35. The First Section price average stood high at 1,829.74 in July 1961. Since then it has moved continuously down to a low of 1,020.74 in July 1965—a decline of 45%. TOKYO STOCK EXCHANGE, SHŌKEN NENPŌ (ANNUAL STATISTICS REPORT) (Tokyo Stock Exchange 1965); *id.* (1961).

36. These statistics are compiled from THE INDUSTRIAL BANK OF JAPAN, *Kōgin Chōsa Geppō (Monthly Research Bulletin of the Industrial Bank of Japan)* 57 (The Industrial Bank of Japan, No. 123, 1966); THE INDUSTRIAL BANK OF JAPAN, *Kōgin Chōsa Geppō (Monthly Research Bulletin of the Industrial Bank of Japan)* 100 (The Industrial Bank of Japan, No. 15, 1957).

37. As exceptional cases, new stock issues have been approved by the Coordinating Committee through rigorous screening since that time. This Committee is composed of the representatives from securities firms.

The protracted market slump also caused some deterioration in the financial condition of securities companies.[38] To stabilize market conditions and to restore normal stock market functions, a new securities company, the Japan Joint Securities Company, was established in 1964[39] by the Industrial Bank of Japan, the Fuji Bank, the Mitsubishi Bank and the four largest securities firms. Previously, Japanese banks had purchased stocks in the open market for their own accounts.[40] The high risk involved, however, made such purchases infeasible. The risk of investing in common stocks was reduced through the new company, since individual bank purchases were consolidated into a single channel and loans to the new firm were used for the purchase of shares. The new firm, with an authorized capital of 32 million dollars and initial paid-in capital of 11 million dollars concentrated on stock purchases in order to correct the supply and demand imbalance in the market. The establishment of the Japan Joint Securities Company and other related measures somewhat improved the condition of the Japanese stock market. The market, however, failed throughout this period to gain real strength and restore its functions as efficiently as was required.

The bond market that was opened in 1956 suspended operations in April 1962 due to a lack of trading.[41] In January 1966 long-term national bonds, the first of their kind since the War, were issued by the Government.[42] As a result of the flotation of national bonds, the market for bonds and debentures was reopened officially in February 1966 on the nation's two major stock exchanges (Tokyo and

38. The deterioration of Yamaichi Securities Company (one of the big four securities firms) was particularly acute. As a result, in 1964 the Ministry of Finance and the Bank of Japan offered to make unlimited unsecured loans through city banks to securities firms in financial difficulty. The financial difficulties were relieved, however, by the Bank of Japan's provision of about 50 billion yen (approximately $0.17 billion) in mid-1965.

39. *See Support from the Syndicate?*, 210 THE ECONOMIST 1141 (1964).

40. In Japan, unlike the United States, banks and insurance companies may acquire common shares for their accounts.

41. The only exception was the debentures issued by the Nippon Telegraph and Telephone Public Corporation, which continued to be traded in the exchanges.

42. Because the reckless issuance of national bonds during and after World War II had invited inflation, Japanese law prohibited the issuance of national bonds as revenue sources for government expenditures. Because of the pressure centering on business, the need for stimulation from the governmental sector, however, led to an amendment removing the prohibition on the issuance of national bonds. Law No. 34 of 1947, The Public Finance Law, art. 4 (Japan). The

Osaka).[43] Issuance of the national bonds, however, failed to stimulate the development of the bond market as anticipated; the market remained inactive throughout this period.[44]

E. *The Period of Internationalization (1967-)*

Japan is now in the process of liberalizing capital transactions in the wake of the Kennedy Round tariff negotiations held in Geneva in May 1967. The liberalization program calls for expanding the range of industries permitting foreign capital participation up to 50 per cent and for increasing the ratios of stocks of Japanese enterprises subject to acquisition by foreign investors by approval of the Bank of Japan. As a result of this liberalized policy, investments in Japanese stocks by foreign investors have been extremely brisk since 1968. The attention of overseas investors was encouraged by renewed growth in the Japanese economy. Moreover, the international currency unrest based on the pound sterling devaluation at the end of 1967 and the dollar crises in early 1968 and 1973 combined to offer additional incentive to foreign investment in Japanese stocks.[45]

Between 1966 and the 1971 decline in the market there was constant growth in new security issues (see Table 1). There were two reasons for the decline in 1971. First, business generally was poor and manufacturing industries were reluctant to invest in equipment because of the uncertain future outlook. Secondly, since credit was

---

amount of issues for the 1965-66 fiscal year (April through March) was 989 billion yen (approximately $3.3 billion). *See Treasury Bond Issue and Stock Market,* 34 THE ORIENTAL ECONOMIST 151 (1966).

43. The first issue of national bonds was listed on the two exchanges in October 1966. Of the 4,500 public and private brands of bonds circulating in Japan, only 30 brands of the top rating were listed on the Tokyo Stock Exchange's bond section. Similarly, 25 brands were listed on that of the Osaka Stock Exchange. The 30 varieties listed on the Tokyo Exchange consisted of one municipal and four public corporation bonds, three special bank debentures and 22 industrial bonds. Nihon Keizai Shinbun (The Japan Economic Journal), Feb. 15, 1966, at 5.

44. *Id.* Nov. 8, 1966, at 3.

45. Also responsible for the increasing interest shown by foreign investors in Japanese stocks was the relatively low price earnings ratio, which in 1970 stood at eleven to one as compared with twenty to one in the United States and sixteen to one in West Germany. MINISTRY OF FINANCE, SHŌKEN KANKEI SHUYŌ SANKŌ SHIRYŌSHŪ (MATERIALS CONCERNING SECURITIES) 68 (Ōkurashō Shōken Kyoku 1973). In 1972, however, the price index for the First Section of the Tokyo Stock Exchange stood at a new high of 5,208 yen for the old 225-issue price average. *Id.* at 65. Due to this rally, the average price earnings ratio is no longer low.

TABLE 1*

Capital Increases and Issuance of Corporate Bonds by Japanese Listed Companies, 1966-1971 (unit: 100 million yen)

	STOCKS			CORPORATE BONDS		
	With Subscription Payments	Without Subscription Payments	Total	Issuance	Redemption	Net Increase
1966	1,925	220	2,145	4,159	2,268	1,891
1967	2,527	116	2,643	5,498	3,502	1,996
1968	3,227	299	3,526	4,952	2,139	2,813
1969	5,280	242	5,522	4,951	2,241	2,710
1970	6,594	516	7,110	6,083	3,132	2,951
1971	5,410	531	5,941	8,535	3,130	5,405

*Source: MINISTRY OF FINANCE, SHŌKEN KANKEY SHUYŌ SANKŌ SHIRYOSHŪ (MATERIALS CONCERNING SECURITIES) 51, 85 (Okurashō Shōken Kyoku 1973).

easy, they relied mainly on bank loans rather than capital increases. The bond market has demonstrated dramatic growth in recent years, but is still underdeveloped as a source of corporate capital.

In 1972, the Securities Exchange Law was amended to reflect changes in the securities market that had taken place since the enactment of the Law in 1953. The amendments aimed to incorporate more fully the disclosure principle with the following results:

(1) during the waiting period, the registration statements have become available to the public, and offers may be made with a temporary prospectus;[46]
(2) instead of only issuers whose registrations have become effective, all issuers whose securities are listed on the stock exchanges or are traded in the over-the-counter markets are now required to file securities reports with the Ministry of Finance;[47]
(3) financial statements of an important subsidiary company are required to be attached to the securities reports of the parent company;[48]

46. Securities Exchange Law art. 15.
47. Securities Exchange Law arts. 24, 25.
48. Securities Exchange Law arts. 23, 24.

(4) companies whose accounting period is one year are required to submit semiannual reports to the Ministry of Finance;[49] and
(5) all directors, accountants, engineers and underwriters participating in an issue have become liable for misstatements or omissions in registration statements.[50] These persons were not liable before the amendments.

II. Characteristics of the Securities Markets

In general the securities markets in Japan have been influenced by three important factors: (1) an extremely high rate of saving by individuals; (2) relatively little reliance on equity in corporation finance; and (3) the absence of a developed bond market as a source of capital.

A. *Saving Rate*

The rate of Gross Domestic Saving compared to National Income in the post-War period (1946-1971) has been around 38 per cent, and that of Personal Saving compared to Disposable Personal Income has been about 17 per cent.[51] This ratio is much higher than that of the United States and Western European countries.[52] The high rate of saving in Japan is even more striking in light of the low level of per capita income throughout the long period of industrial development. In 1970, official statistics indicated a per capita income level in Japan of 1,536 dollars as compared with 3,886 dollars in the United

49. *See* note 47 *supra.*
50. Securities Exchange Law art. 21.
51. Ministry of Finance, *supra* note 45, at 13-14.
52. For the United States and Western European countries see Table 2 below:

TABLE 2*

Savings Ratios in 1970

	$\frac{\text{Gross Domestic Savings}}{\text{National Income}} \times 100$	$\frac{\text{Personal Savings}}{\text{Disposable Personal Income}} \times 100$
U.S.	18.5%	8.1%
U.K.	19.8%	8.2%
West Germany	28.4%	15.5%
France	28.2%	12.2%

*Source: Ministry of Finance, Shōken Kankei Shuyō Sankō Shiryoshū (Materials Concerning Securities) 13, 14 (Okurashō Shōken Kyoku 1973).

States.[53] How, then, has Japan been able to achieve such a high saving rate and supply the needed capital in spite of its lower standard of living? No doubt there are many reasons. Some that may be cited are the simplicity of Japanese living standards, the fact that Japan lagged far behind most industrial countries in public provision for social security and consumer services and the system of taxation, in which the Government relies heavily on regressive taxes (except personal and corporate income taxes).[54] Another plausible explanation is that Japan imitated everything from the Western world except consumption patterns, which remained intact owing to isolation from this aspect of Western culture.[55] We must also take into consideration the virtues of thrift and austerity that are peculiar to Japan and stem from tradition. In Japan that tradition embraces rigid, customary ways of living too strongly entrenched to be changed by external forces within a short period of time.

B. *Corporate Debt-Equity Ratio*

The major problem with corporate financing in Japan arises not from the inadequacy of the supply of funds but from the methods customarily used by Japanese companies to acquire them. First, let us compare typical capital structures of Japanese companies with those of American firms. In Japan during the period from 1969 to 1971, the equity ratio, *i.e.* the percentage of total assets attributable to equity from retained earnings and common stockholder investment,[56] was 17 per cent, a ratio substantially lower than the 54 per cent in the United States (see Table 3).

The low equity ratio characteristic of Japanese companies results in part from their inclination to finance growth by external funds—mainly bank loans. Japanese companies have resorted to external debt financing rather than utilizing internally generated capital (reserves and depreciation) or selling new common stock. In Japan reserves and depreciation during the period 1969 to 1971 constituted 46 per cent

53. MINISTRY OF FINANCE, *supra* note 45, at 15.

54. W. LOCKWOOD, THE ECONOMIC DEVELOPMENT OF JAPAN, GROWTH AND STRUCTURAL CHANGE 1868-1938, at 268-94 (1954).

55. Soviet Russia has been mentioned as another example of isolation. The Iron Curtain was, according to one opinion, a necessary measure for the maintenance of a high rate of savings and investment. *See* R. NURKSE, PROBLEMS OF CAPITAL FORMATION IN UNDERDEVELOPED COUNTRIES 75 (1953).

56. In Japan preferred stock investment is not considered to be an equity investment but a debt. Preferred stocks, however, are rarely used in Japan, so the matter is not of great importance.

TABLE 3*

Capital Structures of Non-Financial Major Companies and Sources of Corporate Funds in Japan and the United States, 1969-1971
(unit: per cent)

	JAPAN				U.S.			
Year	1969	1970	1971	avg.	1969	1970	1971	avg.
Equity Ratio	18.0	17.3	16.6	17.3	55.0	53.9	53.8	54.2
Debt/Equity	454.5	478.0	503.4	478.6	88.3	94.9	105.8	96.3
Sources of Corporate Funds								
Own Capital	(51.1)	(48.4)	(48.5)	(49.3)	(56.4)	(64.7)	(67.4)	(62.8)
Stocks	3.6	3.7	2.6	3.3	3.6	6.4	11.2	7.0
Reserves	17.6	15.4	14.8	15.9	16.8	11.6	12.1	13.5
Depreciation	29.9	29.3	31.1	30.1	40.5	51.0	48.0	46.5
Others	-	-	-	-	-4.5	-4.3	-3.9	-4.2
Borrowed Capital	(48.9)	(51.6)	(51.5)	(50.7)	(43.6)	(35.3)	(32.6)	(37.2)
Bonds	1.3	1.5	2.4	1.7	10.2	19.2	16.2	15.2
Bank Loans	39.6	42.6	41.3	41.2	9.2	1.1	2.8	4.4
Others	8.0	7.5	7.8	7.8	24.2	15.0	13.6	17.6
Total	100	100	100	100	100	100	100	100

*Source: Compiled and calculated from MINISTRY OF FINANCE, SHŌKEN KANKEI SHUYŌ SANKŌ SHIRYOSHŪ (MATERIALS CONCERNING SECURITIES) 33, 34, 43, 44 (Okurashō Shōken Kyoku 1973).

of total corporate funds, compared to 60 per cent for the same period in the United States (see Table 3). Perhaps Japanese companies had no alternative during the high growth period of the post-War economy since they lacked sufficient opportunity to build up reserves and depreciation. Capital surpluses of Japanese companies are also quite low, partly because of par value stock offerings and partly because of conservative asset revaluations.

In a survey made of 120 major companies in Japan,[57] questions

57. The author sent a questionnaire to 120 Japanese companies for the purpose of gaining insight into the attitude and position of Japanese companies on the various problems that now face the Japanese securities market. The distribution of this questionnaire was designed to cover all the main industries. Replies were received from 62 companies (52% of the total).

were asked concerning their financial decisions and their attitudes toward the securities markets. When answering the question "What has been the crucial reason for the low equity ratio?", 20 (33 per cent) of the 58 companies responding placed the blame on the tax system; 14 companies (23 per cent) answered that it was due to the high cost of stock issues, including the expensive financing custom of rights offerings at par; 13 companies (22 per cent) believed that it resulted from the underdevelopment of the stock markets; 3 companies (5 per cent) thought it was due to the competitive behavior of banks.[58]

Some 41.2 per cent of total corporate funds obtained during the 1969-1971 period came from bank loans. This figure is considerably greater than the 4.4 per cent obtained from this source in the same period in the United States (see Table 3). Terms for securing long- and short-term bank loans were liberal and the interest rates were low by comparison to the terms and cost of equity capital and bond borrowing. Bond issues provided about 1.7 per cent of the total supply of corporate funds in Japan during the period as compared with 15.2 per cent in the United States.

In answer to the question whether it is desirable to improve the low equity ratio in the capital structure, 54 (92 per cent) out of 58 companies answered "yes"; 1 company (2 per cent) answered "desirable, but impossible"; and 3 companies (6 per cent) answered "unnecessary." The companies that answered "unnecessary" stated that Japanese companies could operate even under low equity ratios. Of 54 companies that answered "yes," 27 companies (50 per cent) stated that the ratio should be increased to afford protection against business fluctuations. This concern about fluctuations in business activity may stem from the financial difficulties that faced firms with excessive loans during the 1964-1965 recession. Twenty companies (37 per cent) stated that increased equity was desirable to augment international competitiveness. With the liberalization of capital transactions, Japanese companies are recognizing the necessity of increasing their international competitiveness.

Why has the Japanese stock market failed to perform the function of guiding savings into corporate investment? Although there are many answers to this question, one is the attitude of investors. Financial institutions in Japan have been under such strict government

58. Of the companies that answered "others," some mentioned the too rapid growth of the Japanese economy and others called attention to the substantial loss of assets sustained by Japanese companies during the War. It is noteworthy that 27 (45%) of the 58 companies directly or indirectly placed the blame on stock market conditions.

protection and supervision that most savers prefer to deposit their funds in financial institutions.[59] It can be argued that investor protection under the Securities Exchange Law has not been as effective as intended, and the public's preference for bank deposits has been strengthened still further. More important perhaps is the attitude of the companies, and here the cost of raising capital through the stock market is of primary importance. The differences in the cost of raising capital by various means have been significant; the reasons relate to the tax situation as well as to the securities market. For example, the cost of raising capital in the 1963-1972 period was 12.5 yen per 100 yen when stock was issued, 7.6 yen per 100 yen when industrial bonds were issued, and 8.6 yen per 100 yen when funds were borrowed from banks (see Table 4). If the cost of flotation and

TABLE 4*

Comparison of Financial Cost in Japan, 1963-1972
(unit: per cent)

Year	Cost of Stocks (Average Dividends Rate)	Interest Rates of Bank Loans (Long-term Average)	Interest Rates on Bonds (Industrial Average)
1963	12.51	9.11	7.49
1964	12.51	9.01	7.48
1965	12.15	8.90	7.48
1966	11.83	8.70	7.49
1967	11.93	8.46	7.49
1968	12.17	8.40	7.56
1969	12.56	8.35	7.68
1970	13.10	8.41	8.02
1971	12.90	8.49	7.96
1972	13.11	8.42	7.44
AVG.	12.48	8.63	7.61

*Source: MINISTRY OF FINANCE, SHŌKEN KANKEI SHUYŌ SANKŌ SHIRYOSHŪ (MATERIALS CONCERNING SECURITIES) 7, 8, 69 (Okurashō Shōken Kyoku 1973).

59. Certainly it is true that financial institutions buy and hold large amounts of stocks but the percentage of their total resources so invested is too small to be significant to depositors. Under the Anti-Trust Law, financial institutions cannot buy or hold more than 10% of the outstanding stock of any company. *See* Law No. 54 of 1941, Anti-Trust Law, art. 11 (Japan).

the tax burden are taken into account, the total cost of raising capital through issuance of stock becomes twice these figures. For many companies these differences provided ample reasons for the decision to borrow from banks rather than to issue stocks or bonds.[60]

The problem, then, is how to reduce the cost of stock issues so that dependence on stock issues as a source of capital can be augmented. One solution might be to change the current tax system, which accords a more favorable treatment to borrowing. Since it is permissible for a business to deduct all interest payments under the present tax system, the cost of borrowing is the annual interest rate. This is about eight per cent at present. If funds are raised through equity issues, a sixteen per cent return must be earned in order to pay eight per cent dividends when the tax rate is 50 per cent. If it is desirable to increase the equity ratio of Japanese companies, then it would appear desirable to extend the preferential tax treatment of interest payments to dividend payments; or, as an alternative, to increase the tax rate on interest payments in the hands of recipients and/or reduce the tax rate applicable to dividends paid to stockholders, thus making stock more attractive relative to borrowing.

Dividend policy is another important factor in determining the cost of equity money. In this context, certain special features of Japanese custom should be pointed out. In both Japan and the United States, a declaration of dividends is based on business judgments of such factors as the desirable amount of reinvestment of earnings, the size and nature of earnings, the liquidity of assets and legal regulations.[61] If current earnings are not sufficient to pay the customary dividend or if liquid assets are not readily available, corporate management should be able to decrease the dividend. But there is a special circumstance in Japan that obligates corporate management to continue customary dividends. This is the so-called "dividend cartel" system, which

60. In answer to the question, "What is your company's criteria for selecting one source out of many sources of funds?," 43 companies (84%) replied "cost considerations," 8 companies (16%) answered "availability considerations," and 2 companies (3%) answered "risk considerations." These answers indicate the degree to which Japanese companies are cost-minded in selecting their source of funds.

61. Under the Japanese Commercial Code, a company must set aside as earned surplus at least one-twentieth of the profit of each period until earned surplus equals one-fourth of the stated capital. If this condition is satisfied, the company is allowed to declare dividends whenever any excess of net assets exists in addition to the sum of the stated capital and surplus. *See* COMMERCIAL CODE arts. 288, 290.

provides that the companies in the same industry should maintain the same level of dividends.[62] For example, in the electric power industry, all nine companies (Tokyo, Chūbu, Kansai, Chūgoku, Hokuriku, Tōhoku, Shikoku, Kyūshū and Hokkaido) have maintained the same dividend rate not because they have identical profit margins, but because of a tacit dividend cartel among them. This type of tacit dividend cartel agreement is more or less characteristic of all Japanese industries.[63] When current earnings of a company do not warrant such dividends as are required by the cartel, the company is compelled to create profits by unsound accounting treatments such as reducing reserves, selling unnecessary assets, changing the method of computing depreciation or revaluing assets.[64] Maintaining dividend payments by such methods is not sound finance and actually deprives creditors of protection. The remedy for this ill is the education of management and perhaps the prescribing of accounting techniques for profit reporting. Another important consideration in the cost of equity is the traditional practice of companies to issue rights offerings at par regardless of current market prices. This is discussed in greater detail later.

C. *The Bond Market as a Source of Capital*

We have already noted that the bond market in Japan is still underdeveloped. Bond issues in Japan provide a relatively small proportion of corporate funds compared with the United States, providing about 1.7 per cent in recent years (see Table 3). Another indicator of the underdevelopment of the bond market is the relatively small number of companies that issue bonds. One hundred and seventy public and private bonds are now listed on the Tokyo Stock Exchange.[65] As of January 1973 there were 239 companies

62. Professor Eiteman has pointed out that managers of Japanese companies are dividend minded. *See* W. EITEMAN & D. EITEMAN, LEADING WORLD STOCK EXCHANGES 61 (1964). They are, however, much too dividend minded in this sense.

63. Other examples are banking institutions and railroads. *See* T. HOSOI, HAITŌ SEISAKU (DIVIDEND POLICY) 103-96 (Moriyama Shōten 1959).

64. For the details of this kind of accounting treatment see Y. AIDA, KAIKEI KIGYŌ KESSAN NO URAMADA (MANIPULATION IN CORPORATE ACCOUNTING) (Hakuto Shobo 1963).

65. MINISTRY OF FINANCE, *supra* note 45, at 29.

that successfully had made public offerings of bonds,[66] but this is a very low percentage of the 1,606 listed companies and the 1,058,102 incorporated establishments existing in Japan at the end of 1971.[67] Japanese commercial banks are the main purchasers and holders of bonds. Except for bank debentures, relatively few bonds are owned by individuals.[68]

Under present arrangements, the volume and terms of bond issues are determined by two main groups: the trustees for flotation and the large securities firms. Trustees for flotation are the banks that oversee

66. *See* Table 5 below:

TABLE 5*

Data for Companies Issuing Bonds
(As of January 1, 1973)

Rating		No.	Yield (%)	Maturity (yrs.)
AA	Electric Power	9	6.984	10
	General	16	6.984	10
A		20	7.027	10
BB		150	7.070	10
B		20	7.185	10
Others		24	-	-
Total		239	-	-

*Source: MINISTRY OF FINANCE, SHŌKEN KANKEI SHUYŌ SANKŌ SHIRYOSHŪ (MATERIALS CONCERNING SECURITIES) 82 (Okurashō Shōken Kyokū 1973).

67. MINISTRY OF FINANCE, *supra* note 45, at 99. The bond issue that is the most actively traded by the public is that of the Nippon Telegraph and Telephone Public Corporation, which issues two kinds of debentures: fixed-interest bearing and discount debentures. In Japan, people are able to have a telephone installed if they buy at least 150,000 yen ($500) worth of debentures. As a rule they do not hold the bonds until maturity but sell them on the market. This is the reason why the debentures are so actively traded on the market. The bulk of the transactions of bonds are executed in the over-the-counter market. In 1972 almost 92% of bonds traded were traded in the over-the-counter market (see Table 6 opposite).

68. Of total bonds outstanding, holdings by individuals at the end of 1967 amounted to only 8%, compared to 25% in the United States. MINISTRY OF FINANCE, SHŌKEN KANKEI SHUYŌ SANKŌ SHIRYŌSHŪ (MATERIALS CONCERNING SECURITIES) 119 (Okurashō Shōken Kyoku 1969).

the distribution of the securities and include commercial, trust and long-term credit banks, of which the Industrial Bank of Japan is the most important. The large securities firms[69] are those that transact the bulk of securities operations and serve as underwriters for bond issues other than governmental issues.

Representatives from the trustees for flotation and from the securities firms meet each month to decide on the volume and terms of each issue for the coming month. The Government exercises indirect control of the bond market at this meeting via the Industrial Bank of Japan. Because of this control of the market a dual pricing system has arisen with an administered price and an actual price.

The administered price is the price assigned under government control at the time of issue. The price is not influenced by changes in the money market unless there is a basic revision in the price and terms at the time of issue. One exception is the price of discount bonds, which increases constantly to its par at maturity. The actual price is determined by supply and demand conditions in the market and reflects conditions in money and capital markets. The actual price is determined within a reasonable range of the administered price since the negotiations between the brokerage firms and the customers

TABLE 6*

Trading of Public and Private Bonds
in Japan, 1968-1972
(unit: 100 million yen)

	Trading in the Exchanges [a]	Trading in the Over-the-Counter Market	Total
1968	1,099 (2.3%)	46,087 (97.7%)	47,186 (100%)
1969	1,853 (3.1%)	56,882 (96.9%)	58,735 (100%)
1970	2,585 (3.2%)	77,341 (96.8%)	79,926 (100%)
1971	5,235 (4.6%)	107,591 (95.4%)	112,826 (100%)
1972	13,414 (8.6%)	142,696 (91.4%)	156,110 (100%)

[a] includes all the exchanges in Japan.

*Source: MINISTRY OF FINANCE, SHŌKEN KANKEI SHUYŌ SANKŌ SHIRYOSHŪ (MATERIALS CONCERNING SECURITIES) 96, 97 (Okurashō Shōken Kyoku 1973).

69. Nomura, Nikko, Yamaichi, Daiwa and Shinnihon.

naturally take the administered price into consideration. As a result, the actual price is not really orderly. This indirect government control is said to be one of the reasons for the lack of a developed bond market. One noteworthy problem that would arise in the event of the liberalization of the bond market is the effect of the capital losses that bond holders would have due to larger price fluctuations. Just as American investors weathered a liberalization of the market in United States government securities in 1951, however, it is expected that Japanese investors would be able to do likewise. Furthermore, a liberalization of the bond market would not destroy any real values but would merely recognize actual values since bond prices at present are artificial.

A second factor that has hindered active trading of bonds in the market is the abnormal money rate system in Japan, which has led to relatively higher rates of interest in the call money market.[70] Connected with this is the tendency of banks and other financial institutions to hold bonds to maturity in order to avoid taking a relatively large capital loss that might result from an attempt to sell in an undeveloped market. Since the bonds can also serve as a source of funds from the Bank of Japan, either through sale with a repurchase contract or by serving as loan collateral, banks have little reason to sell them before maturity and possibly incur a capital loss. If industrial bonds were offered with a wider range of maturities, trading in bonds would increase. Furthermore, greater flexibility in the maturities tailored to investors' needs would make bonds more attractive to investors. This might also affect the tendency of banks to hold bonds to maturity. In a market where trading is active, banks would not be in danger of suffering substantial losses on sale. Here, as in other aspects of securities markets, investor behavior and inactive markets are interrelated.

Another factor hindering active bond trading is the paucity of information concerning their issuers. Since bonds are exempted from the disclosure requirements of the Securities Exchange Law, only limited information is available to investors. This lack of information

70. In the period from 1957 to 1964, call loan rates had generally been higher than the yield on private bonds. These relatively high yields in the call loan money market had hindered the flow of money into the bond money market. The unconditional call loan rate is supposedly subject to a maximum limit established on a voluntary basis by the National Federation of Bankers' Association. CALL MONEY ASSOCIATION, THE CALL MONEY MARKET AND THE CALL MONEY DEALER IN JAPAN 18 (Call Money Association 1963). This voluntary call loan ceiling has been breached frequently and call loan rates have moved substantially above bond yields.

makes it difficult to compare alternative investments and discourages investor interest. A final factor appears related to the dividend policy for equity securities. The dividend cartel results in many equity securities selling with a guaranteed annual return based on par. The investor is thus protected with a minimum yield, yet stands to profit through capital gains in a rising market.

III. DISTRIBUTION OF SECURITIES

A. *Types of Securities Available on the Markets*

During the occupation various new financing practices of Anglo-American origin were introduced into the Japanese Commercial Code. Before 1950, there were considerable differences in the types of security instruments used to raise capital in Japan and in the United States. The amendments of 1950, forced by the occupation authorities, had various aims. One was to introduce corporate democracy and another was to introduce new methods of attracting capital investment. Until the Zaibatsu were dissolved, the capital needs of large companies were almost entirely met by the issuance of shares either to the banks of Zaibatsu or to Zaibatsu holding companies. With the dissolution of the Zaibatsu and the separation of investment and commercial banking, this financing structure was eliminated. Thus substantial amounts of new capital could be raised only by appealing to the general public, and it was felt that new and more efficient financing methods on an open-market basis were a necessity.

An attempt was made to stimulate the use of new kinds of securities. No-par stock[71] and redeemable stock[72] were introduced. Although practically unknown, revisions of the Japanese Commercial Code in 1938 had provided for convertible securities,[73] nonvoting stock[74] and preferred stock.[75] Thus, legally, Japanese companies had a variety of means with which to seek their new capital.

In contrast to the United States, where most shareholders' rights are contractual, specific rights are provided in Japan in the Commercial Code. Preferred shares enjoy a preference in the distribution of profits as dividends and distribution of assets on liquidation.[76] The articles of incorporation usually provide that if a company decides to issue a new class of shares a shareholder may demand the conversion of the shares

71. COMMERCIAL CODE arts. 186, 199.
72. COMMERCIAL CODE art. 222.
73. COMMERCIAL CODE arts. 222(2)-(7), 341(2)-(5).
74. COMMERCIAL CODE art. 242.
75. COMMERCIAL CODE art. 222(1), (2).
76. COMMERCIAL CODE art. 222.

he holds into shares of the new class.[77] The conversion takes effect when the demand is made, but the articles of incorporation may provide that, for purposes of the distribution of profits, the conversion shall be deemed to have been made on the last day of the fiscal period in which the demand was made or on the last day of the preceding fiscal period.[78] Redeemable shares need not be, but in practice usually are, preferred shares. When redeemable shares are amortized, the total amount of stated capital is not decreased in sequence.[79] Nonvoting shares have preferred status in the distribution of profits.[80] The articles of incorporation may provide that a holder of shares having a preference with regard to the distribution of profits shall not be entitled to vote as long as he receives the preferred distribution, but under the Commercial Code the total number of nonvoting shares may not exceed one-fourth of the total number of issued shares.[81] Shares with preferred voting rights may not be provided even by the articles of incorporation. A company may issue debentures convertible into shares in accordance with the provisions of the articles or by a special resolution of a general meeting of shareholders.[82] A conversion into shares takes effect, as in the case of convertible shares, when the demand for conversion is made.[83] The company may issue shares having par value or shares without par value, or both, unless otherwise provided in the articles of incorporation.[84]

In spite of the wide range of securities available, efforts to obtain Japanese acceptance of various types of financing instruments of Anglo-American origin have been unsuccessful. There are many reasons why new financing methods of American origin, such as no-par stock, redeemable stock and the like, have not been well accepted in Japan. First, Japanese investors were not sufficiently sophisticated to be willing to accept such a variety of corporate financing instruments. Secondly, the new ideas were transplanted into the Japanese environment too hastily and without the benefit of general public discussion. Thirdly, the Commercial Code is deficient in making some of the new methods workable. Also, the companies can be called to account for their failure to educate investors properly.

77. COMMERCIAL CODE art. 222(2).
78. COMMERCIAL CODE art. 222(6).
79. COMMERCIAL CODE art. 222.
80. COMMERCIAL CODE art. 242.
81. COMMERCIAL CODE art. 242.
82. COMMERCIAL CODE art. 341(2).
83. COMMERCIAL CODE art. 341(5).
84. COMMERCIAL CODE art. 199.

The initiative must be taken by companies. Unless the new instruments are actually offered for sale on the market, investors will never be educated.

The cases of no-par stock and preferred stock illustrate the failure of the Japanese community to accept new ideas. No-par stock was introduced from American corporate law by the 1950 amendment to the Commercial Code. The amendment permitted the board of directors to determine the consideration that a company was to receive for no-par stock; one-fourth of the consideration paid for such stock was to be set aside as paid-in surplus.[85] Only three companies have issued no-par stock, one since 1962.[86] No-par stock is considered to be a strange species of financial instrument too hastily transplanted to Japan by the occupation authorities who paid insufficient attention to other related problems.[87] One such problem is whether no-par stock and par stock may be exchanged for each other.[88] A second stems from the opinion of the public that no-par stock is a device available to aid companies to obtain equity capital when the market prices of their stocks are at or below par.[89] Accordingly, no-par is not psychologically appealing to Japanese investors. Thirdly, Japanese investors have been accustomed to stock that bears a face value

85. COMMERCIAL CODE arts. 280(2), 284(2). According to articles 288(2) and 289, however, neither paid-in surplus, revaluation surplus, reduction surplus, nor other forms of capital surplus may be the source of dividends.

86. For the details of these cases see M. OKAMURA, KABUSHIKI KAISHA KINYŌ NO KENKYŪ (STUDY OF CORPORATE FINANCE) 172 (Mineruba Shobo 1962). Fuji Kankō Company issued no-par stocks four times between 1952 and 1957 in order to obtain equipment funds. Mitsubishi Warehouse Company issued no-par stocks in 1952 to its stockholders on the occasion of incorporating some of the revaluation reserve into stated capital. In 1962, Sumitomo Metals Company, one of the four large steel companies, issued no-par stock when it increased capital.

87. *See, e.g.*, THE SECURITIES EXCHANGE COUNCIL, *1960 nen 6 gatsu 22 nichi zuke Okurasho ni taisuru Repoto (The Report of June 22, 1960 to the Ministry of Finance)*, in SHŌJI HŌMU KENKYŪ (LEGAL STUDIES IN CORPORATE AFFAIRS) 2 (No. 181, 1960).

88. Although the Commercial Code provides that a company may have both outstanding at the same time, it does not say anything regarding their exchangeability. According to one jurist, they are not mutually convertible under the present Commercial Code. This problem could be resolved, of course, by adding a provision to the Commercial Code describing their exchangeability. Yoshida, *Mugakumen Kabushiki o Meguru Shomondai (Some Problems Surrounding No-Par Stock)*, in SHŌJI HŌMU KENKYŪ (LEGAL STUDIES IN CORPORATE AFFAIRS) 2 (No. 81, 1962).

89. M. OKAMURA, KIGYŌ KINYŪ RON (STUDY OF CORPORATE FINANCE) 152, 153 (Mineruba Shobo 1962).

imprinted on the certificates as a basis for determining the approximate worth of their stock, and as a basis for determining dividends since investors have been accustomed to having dividends expressed as a percentage of par value.

Since preferred stock was permitted by the pre-1938 Commercial Code, it is not a financing measure of pure American origin. Occupation authorities expected, however, that preferred stock so widely accepted in the United States would be equally utilized in Japan if they encouraged its use. Notwithstanding these expectations, the history of preferred stock has been unhappy. In the post-War period, only fifteen companies have issued preferred stocks, and the aggregate amount of their issuance is less than 60 million yen (about 200,000 dollars).[90] Only one preferred issue is traded on an exchange.[91] There are at least three reasons why preferred stock has not been well received. In the first place, preferred stocks have been issued only by companies involved in some financial difficulty, such as an inability to sell common stocks. This has made preferred stock unappealing to Japanese investors. Secondly, under the so-called dividend cartel, common stocks in Japan already have one of the main characteristics inherent in preferred stock, since dividends on common stock are often paid at a uniform rate regardless of earnings. Thus a promise of a fixed dividend on a preferred stock does not offer Japanese investors any privilege. Thirdly, a company may accomplish the result of preferred shares by issuing two or more classes of shares that may differ in respect to dividend preference, sharing additional income and asset preference.[92] Each company must describe in its articles of incorporation the characteristics of its stock and the number of each class of issued shares.[93]

---

90. Nihon Keizai Shinbun (Japan Economic Journal), April 30, 1966, at 11.

91. The stocks of the Osaka Port Development Company are traded on the Second Section of the Osaka Stock Exchange. *Id.*, April 14, 1967, at 7. This is quite different from the situation in the United States where many companies have both common stock and preferred stock outstanding. W. EITEMAN, C. DICE & D. EITEMAN, THE STOCK MARKET 96 (4th ed. 1966).

92. COMMERCIAL CODE art. 222(1).

93. In the United States the convertible covenant has been a prominent feature of stock financing since World War II. R. OSBORN, BUSINESS FINANCE, THE MANAGEMENT APPROACH 330-31 (1965). Although the convertible covenant is allowed under the Japanese law, it has not been used. COMMERCIAL CODE art. 222(2)-(7). No convertible preferred stock has ever been issued in Japan. Preferred stock without the voting privilege, or with the voting privilege only when dividends have not been declared, may be issued in Japan if described in the articles of incorporation, but this feature has not added to the popularity of preferred stock. COMMERCIAL CODE art. 222.

B. *Methods of Financing*

A major portion of new equity financing by Japanese companies is by allotments to stockholders (see Table 7). "Par value offering to stockholders," or as sometimes called "rights offering at par," is the common financial practice in Japan. Under the Commercial Code the directors may determine the issuing price of stock, although stockholders' approval is required if preemptive rights are to be granted to persons other than stockholders.[94] Near market value offerings as used in the United States, whether made to stockholders or to the

TABLE 7*

Allotments to Stockholders vs. Public Offering in Japan and the United States, 1966-1971

(unit: 100 million yen for Japan and one million dollars for the United States)

	Allotments to Stockholders	Public Offering	Others	Total
JAPAN[(a)]				
1966	3,610 (79.6%)	295 (6.5%)	630 (13.9%)	4,535 (100%)
1967	3,766 (80.9%)	249 (5.4%)	639 (13.7%)	4,654 (100%)
1968	4,793 (80.8%)	256 (4.3%)	881 (14.9%)	5,930 (100%)
1969	7,508 (84.0%)	393 (4.4%)	1,033 (11.6%)	8,934 (100%)
1970	9,136 (83.7%)	656 (6.0%)	1,128 (10.3%)	10,920 (100%)
1971	7,729 (81.1%)	419 (4.4%)	1,376 (14.5%)	9,524 (100%)
UNITED STATES				
1966	1,187 (53.5%)	993 (44.8%)	38 (1.7%)	2,218 (100%)
1967	674 (45.4%)	793 (53.4%)	17 (1.2%)	1,484 (100%)
1968	729 (25.5%)	2,088 (73.2%)	37 (1.3%)	2,854 (100%)
1969	875 (14.7%)	5,025 (84.5%)	49 (0.8%)	5,949 (100%)
1970	1,273 (17.2%)	6,032 (81.7%)	78 (1.1%)	7,383 (100%)
1971	2,522 (22.8%)	8,529 (77.1%)	10 (0.1%)	11,061 (100%)

[(a)] Japanese data is for all incorporated establishments.

*Source: MINISTRY OF FINANCE, SHŌKEN KANKEI SHUYŌ SANKŌ SHIRYOSHŪ (MATERIALS CONCERNING SECURITIES) 53 (Okurashō Shōken Kyoku 1973).

94. COMMERCIAL CODE art. 280(2).

public, are also legally possible in Japan.[95] Offering new stocks at par value to stockholders, however, is the more common practice. Public offerings that directly or indirectly solicit subscriptions for stocks at near market value from "many unspecified persons" who lack preemptive rights are seldom made. In the cases in which new stocks have been offered to the public on a near market value basis, an accompanying offer of a substantial par value offering to stockholders also has been made.[97] The prevailing practice in the United States is to offer new shares at a price as close to market value as feasible, due allowance being made for the possibility of a decline in market value. This practice of offering shares at something less than full market price is called "underpricing." It should be noted that rights offerings in the United States are made on a basis of underpricing market value whether the offer is to stockholders or to the public.

This financing custom of offering new shares to old stockholders at par is one of the important factors that makes the cost of equity funds very high in Japan. There are many reasons why this is done. Companies fear that changing to some other basis might undermine the stock price, and there is pressure from stockholders and from securities firms to maintain the custom. The principal reason that rights offerings at par are continued, however, is merely because it is the custom. This fact suggests that it might not be too difficult to convince companies to change if ample reason for change can be cited.

The difference between a rights offering to old shareholders and a public offering of new shares is not the problem at issue. The real problem is that companies selling shares at par instead of at near market value are passing over the opportunity to maximize their equity ratio with a minimum of dilution.

In an offering at near market price or at a premium the issuing company receives more funds from the sale of fewer shares than when an issue is sold at par. The issuer, therefore, improves its equity-capital ratio with less dilution of the book value of the shares. Also, the

95. Use of this type of offering, "jika hakko" (market price offering), has actually increased rapidly since 1970, and this tendency is expected to continue. For instance, in 1970, 21 companies increased their capital in this way and the total amount was 74 billion yen ($0.247 billion). *See* TOKYO STOCK EXCHANGE, SHŌKEN NENKAN, 1971 (SECURITIES YEAR BOOK, 1971) 25-26 (Tokyo Stock Exchange 1971).

96. "Indirectly" here indicates the situation in which underwriters subscribe to the stock from the issuing company and then resell to the public.

97. *See* Yamaichi Securities Company, *Zōshi Keitai no Kaiko to Tenbō (The Past and Future of the Forms of Capital Increase),* in SHŌJI HŌMU KENKYŪ (LEGAL STUDIES IN CORPORATE AFFAIRS) 2-35 (No. 253, 1962).

necessity of reducing dividends per share due to the increase in the number of the shares is greatly lessened. With near market price offerings, fewer shares are issued relative to the consideration received so that the ensuing dividend burden is naturally less than when par value offerings are made. Stock prices are affected by various factors such as dividend rates compared to interest rates, corporate earning power and expected growth rates. Nevertheless, rights offerings at par make the Japanese stock market more volatile, and the introduction into the Japanese market of market price offerings, or at least premium offerings,[98] would tend to reduce its volatile character.

Despite the demonstrated merits of near market value offerings, business managers have some qualms about departing from rights offerings at par, for the premium over par resulting from rights offerings at par is a strong inducement for investors to buy the new shares. It should be noted that stock splits, which are common in the United States, are seldom used in Japan. If stock splits should become popular in Japan, investors might view the new split shares as a dividend in much the same manner as they are now inclined to view the difference between the market price and the par offered by a rights offering at par. Although in the long run the merits of market price offerings certainly offset any disadvantage to stockholders, a hasty and complete conversion from rights offerings at par to rights offerings at near market price might be upsetting to Japanese investors.[99]

Although Japanese stockholders are guaranteed preemptive rights, stockholders sometimes waive these rights and thereby free directors to make a public offering. Public offerings of new stock issues in Japan, however, are not large and are generally accompanied by a rights offering at par to the stockholders. Public offerings in Japan are used customarily only to obtain funds not forthcoming from the round sale of shares to the existing stockholders. For example, assume that a firm desires to raise ten million yen and that it has stock with par value of nine million yen outstanding. A one-for-one offer to stockholders would raise nine million yen and the company would resort to a public offering to raise the additional one million yen.

98. The premium offering is a method of offering shares whose issuing price is set somewhere between the market price and the par value.

99. As a compromise, the premium offerings widely used in West Germany might now be introduced into Japan. It is said that premium offerings when first introduced in West Germany caused much protest but that the number of investors who now favor the practice has been increasing. THE PRINCIPAL EXCHANGES OF THE WORLD—THEIR OPERATION, STRUCTURE AND DEVELOPMENT 124 (D. Spray ed. 1964).

The crucial problem with any public offering in Japan is to avoid offering the issue to a favored few on unreasonable terms. The object of public offerings is, of course, to obtain as much money as possible from the general public by setting the issuing price as close to the market price as possible. The Commercial Code requires that the issuing price be determined fairly. It provides that if a company issues shares at a grossly unfair price, shareholders who claim a pecuniary damage may demand suspension of the issue.[100] Any person who, in collusion with directors, subscribes for shares at a grossly unfair price must pay to the company an amount equivalent to the difference between the fair issue price and the price he paid.[101] A director or stockholder may bring an action for nullification of the issuance of new shares within six months of their date of issuance.[102]

What constitutes a fair price is a serious problem in making a public offering. The questions concern the price, the standard by which it is determined and the time as of which its fairness is evaluated. The Japanese Commercial Code does not define fair price. There has been only one case dealing with the question, and that represented an extreme situation.[103] In the United States "fair market value" of stock is usually defined as what willing purchasers pay to willing sellers in an open market.[104] The vagueness of the words indicates

100. COMMERCIAL CODE art. 280(10).

101. COMMERCIAL CODE art. 280(11).

102. COMMERCIAL CODE art. 280(15).

103. According to the *Ginza Matsuya* decision the fairness of the price must be determined as of the date the price is determined by the directors, not as of the payment date to the company by the underwriter nor the date the public purchases from the underwriters. 4-2 Kakyu Minshu 253 (Tokyo, District Court, Feb. 23, 1953) (No. 127). The *Ginza Matsuya* case represented an extreme situation where the market price jumped from 260 yen on the date that the price was fixed at 250 yen (4% discount) to 650 yen on the payment date. Also, according to the *Matsuya* decision, directors and underwriters are not to be held responsible for changes in market price that occur between the date the offering price is fixed and the date the shares are paid.

The *Ginza Matsuya* case did not specify the standard by which a fair price is to be determined. The average discount in public offerings in Japan is around 10% but there have been exceptions that run as high as 20%, none of which have invited attack as grossly unfair, and none of which have been nullified under the Commercial Code. Court decisions in the United States are not clear as to what constitutes fair market value.

104. Hazeltine Corp. v. Commissioner, 89 F.2d 513, 519 (3d Cir. 1937). For a similar case see Housing Authority v. Title Guarantee Loan & Trust Co., 243 Ala. 157, 160, 8 So.2d 835, 837 (1942).

why courts hesitate to interfere with the judgment of directors. The guiding principle appears to be that the offering price of new shares must be exercised for the benefit of the company and in the interests of all of the stockholders. As a criterion, it may safely be said that an offering of new stock to outsiders at a price substantially below market would be presumptively unfair and that a price approximately equal to the market price should be considered presumptively fair.

C. *Investment Banking Functions in Japan*

Although various definitions of investment banking are possible, it can be defined as the intermediary activities carried on by institutions (such as securities firms and commercial banks) in the sale of new securities. The new issues markets play a central role in facilitating long-term external financing by companies and governmental units. The institutions serving as investment bankers help to marshal and allocate the country's resources from economic units with a surplus of funds to units with the ability to use such funds productively. In an economy in which saving and real investment in capital goods are not necessarily performed by the same units, the investment banking operation is an essential part of the capital market.

Prior to 1948, underwriting activities in Japan were performed by very few banks and trust companies. The system was modeled after that of Germany, where it still is the custom to request a single bank to head an underwriting syndicate when stockholders approve a new securities issue. The underwriting syndicate is then charged with the duty of distributing the new shares at the price determined by the shareholders.[105]

Under the Japanese Securities Exchange Law, banks and trust companies may not engage in any securities business, except to buy or sell securities for the account of a customer, or to buy or sell securities for their own investment purposes.[106] Banks may engage in underwriting only for bonds issued by the Government, or for bonds whose interest payments are guaranteed by the Government. This exclusion of banks and trust companies from all other investment banking functions is modeled after the situation in the United States.[107]

---

105. *See* THE PRINCIPAL EXCHANGES OF THE WORLD—THEIR OPERATION, STRUCTURE AND DEVELOPMENT 135 (D. Spray ed. 1964).

106. Securities Exchange Law art. 65.

107. T. ADAMS, *supra* note 3, at 112. The reason why occupation authorities denied banks and trust companies the right to engage in underwriting corporate securities was that they felt that the essentially risky business of underwriting corporate securities was not consistent with the fiduciary nature of the business of

Investment banking functions in the distribution of new issues of securities (other than government obligations) are now performed by securities firms, although such firms do not confine their activities exclusively to investment banking.

The principal activities of investment banking firms in Japan (as in the United States) include origination, underwriting and distribution of new securities. "Origination" means the initiation and completion of negotiations between an issuing company and one or more investment banking firms preliminary to the sale or distribution of a new issue. Origination thus includes the advice, policy decisions and mechanics entailed in the development and disclosure of the required information and in the specification of the type of security, the terms of the offering and the nature of the subsequent underwriting and distribution. Two different methods exist for underwriting.[108] Under one, the investment banking firm or group buys the issue outright, agreeing to pay on a specified date. Under the other, the investment banking firm or group guarantees the sale of the issue by agreeing to purchase it if the issue is not sold when offered to the public. The latter method is the more common procedure in Japan, and without exception bonds are underwritten in this way. Distribution relates to the ultimate selling activities of the investment banking firms. In this process, investment banking firms may be called on to provide expert financial advice both to the issuers and, to some extent, to the public purchasers of the new issue.

The investment banking procedures of Japan and the United States are quite similar. There are, however, some minor differences. For

---

banks and trust banks. The function of a bank was, in their opinion, to lend money for financing the short-term needs of industry. In the United States, banks usually lend money for financing the short-term needs of industry, but this is not the case in Japan. In Japan there are so-called long-term credit banks such as the Industrial Bank of Japan and the Long-Term Credit Bank of Japan. Although the latter bank was established after the War, the former has been engaged in long-term financing for more than 70 years. If the prohibition of underwriting by banks is only for the purpose of confining bank activities to lending money for financing the short-term needs of industry, no reason exists for prohibiting "long-term credit banks" from underwriting. Furthermore, the fiduciary nature of the banking business in Japan is not the same as that of banks in the United States. Banks in Japan are allowed to purchase securities, including common stock, for their own accounts, and this practice is quite common. This is a great contrast to the banking operations in the United States. Since purchasing common stocks for purposes of investment is considered consistent with the fiduciary nature of banking business in Japan, it is difficult to see why engaging in underwriting activities is not equally consistent.

108. COMMERCIAL CODE arts. 301, 302.

example, in the United States one or a few firms engage in the originations, while a much greater number participate in the underwriting function and still more join in the distribution activities. Moreover, underwriting syndicates frequently sell securities to distributors (dealers) who resell them to public purchasers. Rarely does a syndicate sell all of the securities directly to the investing public. In Japan the number of participants in the investment banking process does not increase as the process advances, and the division of investment banking functions is not as systematic. Underwriting participants act as wholesalers and also as retailers since they sell most of the securities to their own clients or directly to the investing public. Investment banking operations involve substantial risk. The efficiency of the investment banking functions would be increased if the risk and selling effort could be appropriately diversified among the parties concerned. In the United States, the number of participants in a syndicate is large, especially for large issues, and the underwriting function is separate from the dealer function; thus the risk and selling effort are dispersed among a relatively large number of banking firms. This is not the case in Japan.

IV. Regulation of the Distribution of Securities

A. *Regulatory Structure*

The Securities Exchange Law in Japan was enacted as a condition imposed by the occupation authorities for the reopening of the securities exchanges. The Japanese law is a modified version of the Securities Act of 1933 and the Securities Exchange Act of 1934 of the United States and contains provisions substantially similar to those found in the United States laws for the disclosure of corporate information and for the regulation of the securities markets. However, the pattern of securities regulation in Japan differs somewhat from that of the United States since the Commercial Code also contains disclosure and regulatory provisions. That regulatory provisions in Japan emerged from these two different sources has had a substantial influence on the regulatory mechanism.

In Japan the supervision of the securities markets is entrusted to the Ministry of Finance, which exercises its control through the Ministry's Securities Division. The Securities Division exercises executive, quasi-judicial and quasi-legislative powers similar to those of the Securities and Exchange Commission (SEC) in the United States.

Disclosure of corporate information through the registration system is required when securities are to be sold to the public.[109]

109. Securities Exchange Law art. 4.

Public corporate securities issues are generally subject to the law, but all bond issues, bank securities and small issues under 100 million yen (approximately 0.33 million dollars) are exempted from the requirement.[110] Registration statements must contain adequate information for the benefit of the investors.[111] If the Ministry of Finance finds that a registration statement includes false information, fails to include information covering important matters or is misleading, it may deny registration.[112] Before a formal "stop order" is issued, however, the company is entitled to a hearing at which it may present clarifying information and amend its registration statement.[113] If the Ministry of Finance deems the amendment appropriate and satisfactory, it proceeds to register the issue.[114] Not until registration is completed may the securities be issued to the public.[115] The Law also requires that a prospectus containing essentially the same information as the registration statement be presented to every subscriber of the corporate issue.[116] All information that the Ministry of Finance deems essential and appropriate to the public interest, or for the protection of investors, must be included in the prospectus.[117] The Ministry of Finance also has authority to regulate the trading of securities, and to study and investigate matters in the public interest in the entire field of securities issuance and trading. The Ministry may investigate securities dealers,[118] securities exchanges,[119] securities dealers associations,[120] issuing companies and companies submitting securities reports.[121] It may examine corporate books, require submission of reports on business or property and require the attendance of witnesses.[122] On the application of the Ministry of Finance, courts may order any person engaged or about to engage in any act violative

110. Regulation Concerning Registration of Offers and Sales of Securities, Ministry of Finance, No. 32, art. 1 (1972) (Japan). This regulation was promulgated pursuant to the 1972 amendments in the Securities Exchange Law.
111. Securities Exchange Law art. 5.
112. Securities Exchange Law art. 10.
113. Securities Exchange Law art. 10.
114. Securities Exchange Law art. 10.
115. Securities Exchange Law art. 11.
116. Securities Exchange Law art. 13.
117. Securities Exchange Law art. 13.
118. Securities Exchange Law art. 55.
119. Securities Exchange Law art. 154.
120. Securities Exchange Law art. 76.
121. Securities Exchange Law art. 26.
122. Securities Exchange Law arts. 182-84, 186.
123. Securities Exchange Law art. 187.

of the law to cease such action.[123] Through its quasi-legislative powers, the Ministry of Finance may specify auditing standards for the certification of public accountants.[124] It also has authority to regulate insider trading[125] and the solicitation of proxies.[126]

The Securities Division of the Ministry of Finance has a staff of about 140 and is composed of six sections. The General Administrative Section handles general policy-making and pricing problems. Licensing problems are delegated to the Securities Operation Section. Inspection of the general business and financial condition of securities investment trust management is assigned to the Investment Trust Section. The Securities Inspection Section is in charge of making inspections of securities exchanges and securities financing companies. The reviewing and scrutinizing of financial statements is assigned to the Corporate Finance Section. The Capital Market Section, which is in charge of investigating and policy-making for new issue markets, was added in 1972.

A crucial difference between regulatory agencies in the United States and in Japan exists in their status as institutions. In the United States the SEC is an independent regulatory agency, and it functions outside the three traditional branches of the federal system.[127] In Japan the Securities Division of the Ministry of Finance is a component of the executive branch of the Government. This was not the case at its inception. Originally, a Securities Exchange Commission was created by the Securities Exchange Law to serve as an independent agency distinct from the Ministry of Finance. The three Commissioners were to be appointed by the Prime Minister and could not be dismissed except for cause. In August 1951, however, as a result of manpower problems, the Securities Exchange Commission was abolished and its staff and functions absorbed into the Ministry of Finance. This conversion was not considered substantially important, since the Securities Exchange Commission had recruited its staff from the Ministry of Finance, and the Commission and its staff for administrative purposes were within the framework of the Ministry of Finance. That the Ministry of Finance is a component of the executive branch means that there is greater danger that its decisions can be influenced by political pressure from other government branches.

124. Securities Exchange Law art. 193(2).

125. Securities Exchange Law art. 189.

126. Securities Exchange Law art. 194.

127. For a discussion of the independent character of such regulatory commissions in the federal government scheme see Humphrey's Executor v. United States, 295 U.S. 602 (1934).

Although there is no evidence that such pressure has actually been brought to bear in the Ministry of Finance, the potential for such abuse is present.

When securities are to be sold to the public, the principal protection afforded investors is the disclosure of information through the registration process at the Ministry of Finance. The functioning and efficacy of this disclosure system depends on the ability of the regulatory agency to examine intelligently the information contained in the registration statement. In Japan the real problem was whether an independent agency or a component of the executive branch could hire the more competent men. It is reported that the SEC in the United States has consistently been able to attract able and dedicated public servants.[128] In Japan it was difficult for an independent agency to appeal to such persons to the same degree as could a more prestigious branch of the Government. Thus it is generally agreed that the change in authority to the Ministry of Finance has resulted in a better staff that now enjoys enhanced status.[129]

---

128. Cary, *Administrative Agencies and the Securities and Exchange Commission,* 29 LAW & CONTEMP. PROB. 653 (1964).

129. There continues to be criticism, however, of the staff of the Ministry of Finance. Regulatory work in this field requires a specialized knowledge of corporate finance and accounting, and the staff of the Ministry of Finance is criticized for being too legal-minded. This is probably due to the educational training of the personnel the Ministry attracts. The orthodox training of lawyers begins early and is concentrated overwhelmingly in one academic institution: Tokyo University. Ambitious young men congregate in the law school of this university for the purpose of acquiring a highly technical legal education. In order to pass the national civil service examinations, they must spend most of their time memorizing the Six Codes (Roppō) (Constitution, Civil Code, Criminal Code, Code of Civil Procedure and the Code of Criminal Procedure), to the practical exclusion of courses in economics and business administration. Thus they enter government service trained as legal technicians with the rigid ideology of bureaucracy. Although few would deny that the staffs of the Ministry of Finance are composed of learned men, their backgrounds are definitely legalistic: they relate all administrative decisions to laws, codes and regulations. It is significant that no course in Securities Regulation is offered at the Tokyo University Law School, the best law school in Japan. In addition, personnel rotation in the divisions of the Ministry of Finance does not guarantee that the Securities Division will always receive men with the needed special training. For the details of bureaucratic aspects of the Japanese Government see K. TSUJI, NIHON KANRYŌSEI NO KENKYŪ (RESEARCH ON THE JAPANESE BUREAUCRACY) (Kobundo 1952).

B. *Registration Requirements*

Under the Japanese Securities Exchange Law, the following are classified as securities: government bonds, local government bonds, bonds issued by a juridical person established under a special law, stocks, certificates representing the right to subscribe to stocks to be issued, beneficiary certificates of a securities investment trust or loan trust, securities or certificates issued by foreign countries or foreign juridical persons and such other securities or certificates as may be prescribed by Cabinet Order.[130] Unlike the more comprehensive provisions in the United States securities acts, the provisions do not apply to securities issued by natural persons, partnerships, committees and trusts.[131]

Under the Japanese Securities Exchange Law an issue with a total face value not exceeding 100 million yen (approximately 333,000 dollars) is exempted from registration requirements.[132] Also exempted are government bonds, local government bonds, bonds issued by a juridical person established under a special law and securities or certificates issued by foreign countries or foreign juridical persons.

An important difference between the exemption provisions in Japan and those in the United States and other countries with security laws is that in Japan all bonds, both those secured with property and those guaranteed, are exempted from registration.[133] The arguments given for denying to purchasers of bonds the protection of the Securities Exchange Law are as follows: first, that the main purchasers of bonds have been financial institutions capable of investigating the financial condition of the issuing companies; secondly, that almost all of the companies issuing bonds are listed companies so that information concerning the issuing company is available, thirdly, that disclosure of financial information about a company is less essential to bondholders than to stockholders since the former are secured by liens on specific company properties.[134] These liens are said to offer bondholders sufficient protection in the event of

---

130. Securities Exchange Law art. 2.

131. Securities Act of 1933 §§ 2(1), 2(2), 15 U.S.C. §§ 77(b)(1),77(b)(2) (1970).

132. This compares to United States law prior to 1970 that exempted issues having an offering price less than $300,000. This exemption was raised recently to $500,000. 15 U.S.C. § 77c(b) (1964), *as amended,* 15 U.S.C. § 77c(b) (1970).

133. Law No. 240 of June, 1951, Concerning Supplementary Provisions of the Securities Exchange Law art. 7 (Japan).

134. O. KAN, KAISEI SHOKENTORIHIKIHŌ (REVISED SECURITIES EXCHANGE LAW) 23-24 (Minato Shuppangassakusha 1954).

financial difficulties. Probably, however, the real reason for exempting bond issues from registration is that the buying and selling that does occur in the relatively undeveloped bond market is done by institutions who are not in need of the added protection. It is uncertain whether this fact justifies the exemption.

Another exemption in Japan that is not found in the United States arises from the different structure of the corporate laws in the two countries. In the United States closely held companies are incorporated under the same corporate statute as are publicly held companies. In Japan companies are divided into "closely held" and "publicly held," and different sets of statutes, decrees and codes apply to each. For regulatory purposes, the two are distinguished in the United States by the manner in which the securities are sold. A company that offers securities to the public (interstate or through the mail) and does not have an available exemption is subject to the securities laws and to the regulatory powers of the SEC. Mere nonnegotiability of securities does not provide an exemption. Under the Japanese laws, companies may choose between two types of corporate form, each having regulatory requirements established by statute. The two corporate forms are a limited liability company (*yugen kaisha*) and a stock company (*kabushiki gaisha*). Only a stock company, which is comparable to the general corporation in the United States, may issue and sell securities to the public. A limited liability company, under the Limited Liability Company Act[135] is not authorized to issue negotiable securities,[136] and thus does not have recourse to the public market for the placement of its securities. Since the limited liability company does not sell securities on the market, it is not subject to the Securities Exchange Law and is not required to disclose information. The theory is that the limited liability company should have a simplified structure to permit a small number of investors to avoid the elaborate stock company laws and to avoid disclosing significant information during the company's formative years.[137]

As we have seen, rights offerings are an ingrained custom in Japan. It is problematic whether registration of rights offerings is legally required under the Securities Exchange Law of Japan. The overall question is whether rights offerings are "public offerings." A company

135. Law No. 74 of 1938, Limited Liability Company Act (Japan).

136. Law No. 74 of 1938, Limited Liability Company Act art. 21 (Japan).

137. There are two other corporate forms permitted under the Japanese Commercial Code (arts. 62-164). They are a commercial partnership (*gōmei-kaisha*) and a limited partnership (*gōshi-kaisha*), neither of which has recourse to the public market for the placement of shares.

planning "to invite subscription to securities" must register the stock issue. An invitation of subscriptions is defined to be any offer to sell or solicitation of an offer to buy securities already issued to "many and unspecific persons."[138] Thus if stockholders are considered to be "many and unspecific persons," registration is required in rights offerings. If not, registration is not required. In practice, rights offerings are usually registered, but there has been much disagreement on the matter. One position maintains that stockholders are specific and thus registration is not required for rights offerings.[139] The opposite position holds that stockholders are always changing and, therefore, not specific.[140] Since most offerings are rights offerings, almost no registrations would be required in connection with capital increases if one takes the former position. The practice of requiring registration is sound. There is no compelling reason for regarding stockholders as different from ordinary investors. Stockholders, as such, have no advantage over ordinary investors with respect to corporate information. The purpose of the registration requirement in connection with rights offerings is to provide full and truthful information to the stockholders who will be exercising the rights. Neither is there adequate authority on the question of what constitutes a "public offering." In the United States the determination whether a particular transaction involves a public offering depends not on any one factor but on all the surrounding circumstances. The important criterion is whether the offerees may need the protection of registration.[141] In Japan, however, it is generally agreed that the number of offerees is a rather important criterion; generally, an offering to fewer than 50 persons is not a public offering. The "fifty offerees" rule of thumb is applied to the number of ultimate offerees in case of secondary offerings. Therefore, registration is required for a resale that finally involves more than 50 persons, even though the number of initial offerees is fewer than 50 persons.

C. *Disclosure Required for Offerings of Securities*

Prior to the enactment of the Securities Exchange Law in 1948, the Commercial Code was the only law that regulated security issues in

138. Securities Exchange Law art. 2(3).

139. Yoshida, *Yūkanshōken Todokedeseido no Kaizen ni tsuite (The Reform of the Registration System)*, in SHŌJI HŌMU KENKYŪ (LEGAL STUDIES IN CORPORATE AFFAIRS) 2-4 (No. 85, 1957).

140. Yazawa, *Mokuromisho no Kaisei Mondai (The Reform of the Prospectus System)*, in SHŌJI HŌMU KENKYŪ (LEGAL STUDIES IN CORPORATE AFFAIRS) 2-8 (No. 81, 1957).

141. Securities Act Release No. 4552 (Nov. 6, 1962).

Japan. Even though Japan now has its Securities Exchange Law, all companies except limited liability companies still must comply with the requirements of the Commercial Code.

Under the Commercial Code, a corporation must publish its articles of association at the time of incorporation in the official Gazette or in a daily newspaper.[142] The articles of association must contain the object of the corporation, the trade name, the total number of the authorized shares, the amount of par value shares, the total number of shares to be issued at the time of incorporation, the minimum issue price of no-par value shares, the seat of the principal office, the manner in which the company is to give public notices and the full name and permanent address of each promoter.[143] The Code also prescribes the contents of subscription forms to be used when a new issue is offered.[144] This form, prepared by the promoters, must state the number of shares in each class of stock, a statement whether shares subscribed by each promoter are par or no-par, their class, the number and price at which such shares are being subscribed, the bank or trust company that is to receive the payments and a statement that a subscription for shares may be rescinded in the event the constituent general meeting[145] is not terminated by a fixed date.

The disclosure requirements of the Commercial Code are insufficient for investor protection, and the Securities Exchange Law is a great advance in requiring publicity and in supplying some details concerning publicly held companies whose securities do not meet the requirements of "exempted securities" or "exempted transactions."

Under the Japanese Securities Exchange Law the disclosure mechanism is the registration statement filed with the Ministry of Finance and the prospectus that summarizes the more detailed registration statement. A registration statement becomes effective on the 30th day after it is filed or on the 30th day after the filing of an amendment, during which period the Ministry of Finance reviews the statement and determines whether full and fair disclosure has been set

142. COMMERCIAL CODE art. 166.

143. COMMERCIAL CODE art. 166.

144. COMMERCIAL CODE art. 175.

145. If the shares are to be exchanged for property, the court appoints an inspector to investigate whether delivery of the property has been effected properly (art. 173). At the constituent general meeting, directors and auditors are appointed (art. 183). The directors and auditors investigate whether all the completed procedures meet the statutory requirements and report to the constituent general meeting (art. 184). After all the stock has been subscribed, registration of the incorporation is effected at the registry office (art. 188).

forth.[146] While the Ministry of Finance examines registration statements, it does not guarantee the security or approve or disapprove of it. The law requires that sufficient and truthful facts for investor judgment be made available to the public. The ultimate responsibility for adequate and accurate disclosure belongs to the issuer.[147] In the event of a deficiency, amendments to the statements are required, in which case the registration statement becomes effective on the date of the lapse of the period designated by the Ministry of Finance.[148] This interval enables underwriters, prospective purchasers and other interested parties to familiarize themselves with the nature of the offering. The criteria for determining the essentiality of the required information are provided by a Ministry of Finance ordinance.[149] On or after the effective date, the registered securities may be offered to the public, but each purchaser must receive a prospectus at or before the sale or delivery of the securities, or at the time of confirmation of his purchase.[150] Offers using a temporary prospectus during the waiting period that precedes the effective date, however, are permitted.[151]

D. *Financial Information and Accounting Practices*

A comparison between the information required in the typical S-1 registration statement in the United States and that required by Japanese registration statements discloses that the information contained in the latter is more comprehensive. Although there is not much difference in the nonfinancial information such as "Description of Business," "Plan of Distribution" and "Treatment of Proceeds from Stocks Being Registered," the information included in the financial statements is quite different. Japanese Securities Reports submitted (usually twice a year) to the Ministry of Finance include special items such as "specifications of holding securities" (securities held by the company for temporary or long-term investment), "current term changes in each reserves," and "breakdown of deprecia-

146. Securities Exchange Law art. 8. The effective date may be accelerated by order of the Ministry of Finance, however, if information about the issuer is adequately available for the protection of investors.

147. Securities Exchange Law arts. 16-18.

148. Securities Exchange Law art. 9.

149. Securities Exchange Law art. 5, which provides that matters necessary and appropriate for the protection of public interest or investors are prescribed by a Ministry of Finance ordinance. *See* note 154 *infra.*

150. Securities Exchange Law art. 15.

151. Securities Exchange Law art. 15.

tions," none of which is disclosed periodically in the United States.[152]

Accounting regulations in Japan also come from both the Commercial Code and the Securities Exchange Law. This duality of accounting regulations is due to historical developments. The Commercial Code regulates corporate accounting procedures[153] for the primary purpose of accurately determining the amount available for dividends, so that the position of creditors will not be jeopardized via an impairment of corporate properties from excessive dividend distributions. In 1950, pursuant to the Securities Exchange Law, "Regulations Concerning Terminology, Forms and Method of Preparation of Financial Statements" were promulgated ("Ministry of Finance Ordinance").[154] Then, in 1963, a separate set of regulations, "Regulations Concerning Balance Sheet and Income Statements of Corporations" ("Ministry of Justice Ordinance"),[155] was issued to complement the accounting regulations specified in the Commercial Code. The Ministry of Justice Ordinance is applicable to all companies under the control of the Commercial Code.

The accounting regulations are probably more sophisticated than in any other country including, in some respects, the United States. Unfortunately, serious problems arise in Japan because of discrepancies between the dual accounting regulations. The nature and detail of the regulations and problems created by the dual system can be seen in a few examples: first, consistency of accounting methods; and secondly, equity structure requirements. The Ministry of Finance Ordinance clearly provides for consistency over time regarding matters of content and format in financial statements,[156] but the Ministry of Justice Ordinance permits changes in accounting methods providing that the changes are noted in a footnote.[157] Under the provisions of the Ministry of Justice Ordinance, furthermore, two opposite views are possible. One is that the footnote is required in order to maintain consistency. The other is that, although consistency does not permit

152. For a listing of items that are contained in the computer data files on Japanese companies, of one of the major banks in Japan, see the Appendix. All this information can be compiled from the Securities Reports.

153. COMMERCIAL CODE arts. 281-95.

154. Japan, Ministry of Finance Ordinance No. 18 (Sept. 28, 1950), *as amended,* Japan, Ministry of Finance Ordinance No. 59 (Nov. 27, 1963) [hereinafter cited as Ministry of Finance Ordinance].

155. Japan, Ministry of Justice Ordinance No. 31 (March 30, 1963) [hereinafter cited as Ministry of Justice Ordinance].

156. Ministry of Finance Ordinance art. 7.

157. Ministry of Justice Ordinance art. 3.

changes of accounting method without due reason, the Ministry of Justice Ordinance may permit such changes, even without due cause, if a footnote is added. The question of consistency is also confused in the United States.[158]

Under the Commercial Code, companies must set aside in each period, in an earned surplus reserve, at least one-tenth of the profits subject to cash dividends until this earned surplus reserve reaches one-fourth of their capital.[159] Companies also must set aside in a capital surplus reserve funds derived from such sources as the issuance of par value stock at prices above par.[160] Based on these reserve requirements (earned surplus and earned capital surplus reserve), the Ministry of Justice Ordinance provides that capital accounts must be divided into statutory reserves (earned surplus reserve and capital surplus reserve) and surplus.[161] The statutory reserves may not be disposed of except to repair deficiencies in capital or as a transfer to capital.[162]

The Ministry of Finance Ordinance adopted the concept of capital surplus prescribed in the Commercial Code,[163] but added revaluation reserves resulting from the Assets Revaluation Law[164] and "other capital reserves," which can be an arbitrary reserve and is disposable.[165] "Surplus," as defined in the Ministry of Finance Ordinance, includes earned surplus reserves prescribed by the Commercial Code,[166] voluntary reserves and unappropriated profit surplus or undisposed loss for the period.[167] Thus earned surplus, other than

158. In the United States, Regulation S-X provides that any change in accounting principles or practices affecting comparability of financial statements must be disclosed by a note in the appropriate financial statement. Therefore, it is questionable whether Regulation S-X is based on the principle of consistency specified by the American Institute of Certified Public Accountants. During the past decade an average of 65 reports (11%) were found not to be consistent with the preceding year. THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, ACCOUNTING TRENDS AND TECHNIQUES 289 (20th ed. 1966). For a discussion of the consistency problem in the United States see Kell, *Auditor's Responsibilities in Financial Reporting,* 19 MICH. BUS. REV. 29-30 (1967).

159. COMMERCIAL CODE art. 288.

160. COMMERCIAL CODE art. 288(2).

161. Ministry of Justice Ordinance art. 34.

162. COMMERCIAL CODE arts. 289, 293(3).

163. COMMERCIAL CODE art. 288(2).

164. Law No. 110 of 1950, Assets Revaluation Law, art. 102 (Japan).

165. Ministry of Finance Ordinance art. 63.

166. COMMERCIAL CODE art. 288.

167. Ministry of Finance Ordinance art. 65.

earned surplus reserves prescribed by the Commercial Code, is disposable. By comparison, SEC Regulation S-X in the United States requires that separate captions be used to designate paid-in surplus, surplus arising from revaluation of assets, and other capital surplus and earned surplus (appropriated and unappropriated).[168] The effect of Regulation S-X is thus almost the same as that of the Ministry of Finance Ordinance, except that Regulation S-X contains no concept equivalent to "statutory reserves" in the Commercial Code in Japan.[169]

Consolidated financial statements are not required by any accounting regulations in Japan. The Ministry of Justice Ordinance requires, however, that stocks of subsidiary or affiliated companies be listed by that title in the investment section.[170] In the Ministry of Justice Ordinance, a "subsidiary company" is defined as one in which 50 per cent or more of its stock is held by the parent company.[171] The Securities Exchange Law requires that the financial statements of an "important subsidiary company" be attached to the securities report of the parent company.[172] The Ministry of Finance Ordinance definition of a "subsidiary company" is the same as that in the

168. SEC Reg. S-X, 17 C.F.R. § 210.3-01 (1972).

169. For income determination there exists some difference between the American and Japanese practice. Under the Ministry of Justice Ordinance, the amount of retained earnings voluntarily reserved for a particular purpose must be shown on the income statement as a special gain when no longer required for that purpose. Ministry of Justice Ordinance arts. 37, 42. The result of this treatment, based on the so-called "all-inclusive theory," is that income statements frequently include amounts that previously have been included in periodic income. The Ministry of Finance Ordinance adopts the so-called "current-performance theory" so that this "drawn-out profit" is not included in the income statement.

Discussions of the merits of the all-inclusive theory versus those of the current-performance theory also have occurred in the United States. The Executive Committee of the American Institute of Accountants supports the current-performance theory. Before 1950, the SEC had maintained a policy based on the all-inclusive theory but assumed a conciliatory attitude toward the current-performance theory in its Accounting Series Release issued in 1950. Therefore, Regulation S-X as it now stands requires a statement of each item of profit and loss not included in the determination of net income or loss. For a discussion of the controversy between the SEC and CAIA see Accounting Series Release No. 70 (Dec. 20, 1950).

170. Ministry of Justice Ordinance art. 23.

171. Ministry of Justice Ordinance art. 9.

172. Securities Exchange Law arts. 23, 24. *See* Ministry of Finance Regulation of June 1, 1972, Concerning Registration of Offers and Sales of Securities No. 32, art. 15 (Japan).

Ministry of Justice Ordinance, but an "important subsidiary" is defined as one whose assets or sales are large enough to have a great effect on the financial situation of the parent company.[173] Since different information concerning a subsidiary is required by the two ministries, what information is to be disclosed will depend on which ordinance is followed. Although it is true that consolidated statements are most useful to the board of directors and operating officials of the controlling company,[174] such statements also have great significance to stockholders of the dominating company, and it is generally recognized that consolidated statements ought to be introduced into Japan as soon as possible.[175]

Under the Securities Exchange Law of Japan, all financial statements of issuing companies listed on a securities exchange and filed in accordance with the provisions of the Law must be certified by an independent public accountant.[176] This requirement brought about improvements in auditing practices in Japan, since under the Commercial Code there was no requirement that auditors be independent and professional accountants. The only disqualification contained in the Code was that auditors should not be directors or employees of the company.[177] Under the Commercial Code, auditorship was in practice a sinecure, often used as a training ground for young executives.

Competent accountants are considered a prerequisite to the effectiveness of the disclosure mechanism. Although in Japan the accounting regulations are sophisticated in their approach, the accounting profession itself is not as well developed as that in England or in the United States. Before the enactment of the Securities Exchange Law, there was no profession in Japan equivalent to the English "Chartered Accountant" or the American "Certified Public Accountant." There was a body of "keirishi" (accountants) but it included a great number of persons whose knowledge of accounting

173. Japan, Ministry of Finance Ordinance No. 32, art. 15 (June 1, 1971).

174. W. PATON & W. PATON, JR., CORPORATE ACCOUNTS AND STATEMENTS 574 (1964).

175. The following caution should be noted: "The formation of such statements, however, presents many opportunities for concealing rather than revealing the truth. A poorly prepared consolidated statement may be misleading and thus may be worse than nothing." THE SECURITIES MARKETS 589 (A. Bernheim & M. Schneider eds. 1935).

176. Securities Exchange Law art. 193(2); Japan, Ministry of Finance Ordinance, *Ministerial Order Concerning the Certified Audit of Financial Statements* No. 12 (1957).

177. COMMERCIAL CODE art. 276.

was at best elementary.[178] Since the Certified Public Accountants' Law[179] was passed in 1948, this profession has advanced greatly, but to date it has not matched the progress made in the United States and England.[180] It has been noted that one of the reasons why Japanese CPA's certify erroneous financial statements is that CPA's as individuals are too weak to oppose their clients by stating that the financial statements are improper.[181] If this is so, then the status of CPA's could be improved by establishing accounting partnerships. These partnerships are now being introduced into Japan. Before this could be accomplished, some modification of law was required to make this new legal concept of "partnership" acceptable to Japanese practice. Accordingly, the Certified Public Accountants' Law[182] was amended to allow the establishment of CPA partnerships as legal entities under the control of the Ministry of Finance.[183] This may be the beginning of the strengthening of the accounting profession, but the problem remains of making accountants realize the advantage to the profession of establishing partnerships.

---

178. This group is probably responsible for the observation that financial statements available to stockholders were "curiosities in obscurity and evasion." U.S. DEP'T OF STATE, *Report of the Mission on Japanese Combines,* in 14 FAR EASTERN SERIES 26-27 (1946).

179. Law No. 103 of 1948 (Japan).

180. The following case throws some light on the underdevelopment of accountancy in Japan. The Sanyo Steel Company, one of the largest in this industry, went bankrupt in 1965. The proceedings revealed a long existing window dressing of financial data by the company. This revelation caused the Ministry of Finance to begin a careful inspection of the financial statements of other companies that had already submitted financial statements to the Ministry. Based on the findings of this investigation, the Ministry of Finance ordered thirteen companies to revise financial statements already submitted. For four of the companies, there were drastic changes of net profit that resulted from the revisions (see Table 8 opposite). In each of these cases Japanese CPAs had certified thes erroneous financial statements to be "proper" or "approximately proper." Obviously, financial statements certified by incompetent accountants may be more misleading than statements that are not certified since "certification" tends to encourage investor reliance. The number of companies that "dress up" their financial data is not decreasing. In 1970, the financial statements of 614 companies were carefully inspected and 48 were reported to have altered their data (see Table 9 on page 492).

181. Nihon Keizai Shinbun (Japan Economic Journal), Jan. 12, 1967, at 5.

182. Law No. 103 of 1948 (Japan).

183. MINISTRY OF FINANCE, OKURASHO SHOKENKYOKU NENPPO, 1966 NENBAN (ANNUAL REPORT—THE MINISTRY OF FINANCE, 1966) 73-78 (Kinyu Zaisi Jijyo Kenkyukai 1967).

TABLE 8*

The Revised Net Profits of the Four Companies in Japan
(unit: million yen)

	Before Revision (A)	After Revision (B)	Difference (B-A)
Kyokutō Hogei Co.			
Oct. 1961	502	295	-207
Oct. 1962	1	-2,411	-2,412
Oct. 1963	-22	-446	-424
Oct. 1964	520	717	217
Oct. 1965	768	768	0
Nittō Spinning Co.			
April 1962	-107	-920	-813
Oct. 1962	-17	-1,182	-1,165
April 1963	150	-830	-980
Oct. 1963	288	-377	-665
April 1964	237	-126	-363
Oct. 1964	255	-153	-408
April 1965	-2	-183	-181
Topy Industries Co.			
March 1962	200	150	-50
Sept. 1962	151	52	-99
March 1963	150	77	-73
Sept. 1963	177	87	-100
March 1964	175	69	-106
Sept. 1964	281	-528	-809
March 1965	224	-294	-1,018
Ricoh Co.			
March 1962	566	290	-276
Sept. 1962	653	105	-548
March 1963	412	-181	-593
Sept. 1963	567	-285	-852
March 1964	587	308	-279
Sept. 1964	492	60	-432
March 1965	-221	-267	-46
Sept. 1965	11	60	-49

Note: The differences of dates are due to the differences of the accounting periods of the companies.

*Source: Nihon Keizai Shinbun (Japan Economic Journal), Jan. 25, 1967, at 5.

E. *Regulation of Investment Trusts*

The investment trust system has developed since the births of stock investment trusts in 1951 and of bond investment trusts in 1961; the total principal outstanding reached 1,371 billion yen (4.6 billion dollars) in 1964 (see Table 10). Due to the sluggish market situation, the principal outstanding, however, decreased after 1964 and slipped to about 888 billion yen in 1968. Since then, it has been increasing and reached the historical high of 2,122 billion yen (7.0 billion dollars) in 1972.

There are three types of investment trusts in Japan. They are the open-end type stock investment trusts, resembling mutual funds in the United States; the unit type stock investment trusts; and the open-end type bond investment trusts. All investment trusts in Japan are of the contractual type. The corporation type popular in the United States and in European countries does not exist in Japan. The prospect of introducing the corporation type investment trust, however, is currently provoking active debate.

The investment trust system in Japan is regulated by the Securities Investment Trust Law.[184] Under this law, the Ministry of Finance, as the supervisory and regulatory power, is responsible for investor protection. Accordingly, the Ministry of Finance is provided with

TABLE 9*

Window-Dressing in Securities Reports

	1966	1967	1968	1969	1970	1971
No. of Companies that Submitted Securities Reports	2,332	2,349	2,357	2,395	2,458	2,580
No. of Companies Carefully Inspected	127	2	76	194	614	172
No. of Companies that Dressed up the Data	52	2	32	23	48	12

*Source: MINISTRY OF FINANCE, SHŌKEN KANKEI SHUYŌ SANKŌ SHIRYOSHŪ (MATERIALS CONCERNING SECURITIES) 47 (Okurashō Shōken Kyoku 1973).

184. Law No. 198 of 1951, Securities Investment Trust Law (Japan) [hereinafter cited as Securities Investment Trust Law]. This law was modeled after the U.S. Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-52 (1940), *as amended,* 15 U.S.C. §§ 80a-1 to 80a-52 (1970).

TABLE 10*

Investment Trusts
(unit: 100 million yen)

	STOCK INVESTMENT TRUSTS			BOND INVESTMENT TRUSTS			TOTAL
Year	Established	Redeemed or Cancelled	Principal Outstanding	Established	Cancelled	Principal Outstanding	Principal Outstanding
1962	3,471	2,433	11,306	838	1,072	1,327	12,633
1963	3,319	2,921	11,704	1,099	711	1,715	13,419
1964	3,302	3,390	11,616	1,223	848	2,090	13,706
1965	1,968	3,921	9,663	1,207	1,101	2,196	11,859
1966	2,041	3,696	8,008	874	750	2,320	10,328
1967	2,154	3,457	6,705	1,207	775	2,752	9,457
1968	2,318	3,869	5,154	2,109	1,134	3,726	8,880
1969	3,889	3,442	5,601	2,524	1,358	4,892	10,493
1970	3,434	1,718	7,317	2,590	1,646	5,836	13,153
1971	3,611	1,920	9,008	2,917	1,576	7,177	16,185
1972	6,256	2,860	12,404	3,383	1,742	8,818	21,22

*Source: MINISTRY OF FINANCE, SHŌKEN KANKEI SHUYŌ SANKŌ SHIRYOSHŪ (MATERIALS CONCERNING SECURITIES) 154-55 (Okurashō Shōken Kyoku 1973).

broad authority such as licensing the trustors,[185] canceling their licenses,[186] demanding materials or reports relative to the trust and inspecting the trust property or books and documents of the trust, trustor or trustee.[187]

F. *Civil Liabilities*

Under the Japanese Securities Exchange Law, there are three types of civil liability in connection with securities transactions:[188] liability for violation of the registration or prospectus provisions;[189] liability for general misstatements or omissions in connection with sales of

185. Article 4 of the Securities Investment Law provides that only a trustor company that is a corporation capitalized at more than 50 million yen ($138,888) may enter into a contract of securities investment trust. The same article provides that the trustee must be a trust company or a bank doing trust business. Securities Investment Trust Law art. 4.

186. Securities Investment Trust Law art. 7.

187. Securities Investment Trust Law art. 21.

188. Securities Exchange Law arts. 16-21.

189. Securities Exchange Law art. 16.

securities;[190] and liability for misstatements or omissions in registration statements.[191] The statutory language of the Japanese Act is modeled after the Securities Act of 1933 in the United States but is not exactly the same. The Commercial Code of Japan also provides civil liability. The result is a number of differences in the liability provisions of the two countries.

As a practical matter, litigation as a means of enforcing disclosure has proved to be completely ineffective in Japan. There have been no reported cases of civil suits or of criminal prosecutions arising from misstatements or omissions, although there have been some cases in which the validity of the issuance of shares before registration with the Ministry of Finance was at issue.[192] The lack of litigation in this area is due partially to the nature of Japanese people, who do not like litigation. Settlements of disputes in Japan often have little or nothing to do with the law as such but are frequently effected completely outside the formal court structure.[193]

Lack of litigation in Japan may also be due to certain defects in the civil liabilities system. In the United States, aside from the express civil liability provisions in the securities acts under the implied liability doctrine, the courts have held that violations of other provisions of the federal securities laws give rise to liability for injuries to those persons for whose protection the statutes are intended, even in the absence of an express statutory remedy.[194] Japanese courts have not been willing as yet to develop such implied liability. In an important case, Japanese courts ruled that since there was no express provision of civil liability, an issuance of shares before registration with the Ministry of Finance is not void even if the issuance violates the Securities Exchange Law.[195] An implied liability doctrine is difficult to introduce because the Japanese legal system is based on statutory law. Under this system, the doctrine of "legal safety," meaning that any act not clearly mentioned in the statute is outside legal control, carries great weight.

---

190. Securities Exchange Law art. 17.

191. Securities Exchange Law art. 18.

192. *See, e.g.,* Kawase v. Godo Shoken Kabushiki Kaisha (United Securities Co.), 7 Kakyu Minshu 2625 (Tokyo High Court, Sept. 26, 1956).

193. For the problems of application and law enforcement in Japan see A. BURKS, THE GOVERNMENT OF JAPAN 170-73 (2d ed. 1964).

194. *See generally* 3 L. LOSS, SECURITIES REGULATION 1757-1804 (2d. ed. 1961).

195. Kawase v. Godo Shoken Kabushiki Kaisha (United Securities Co.), 7 Kakyu Minshu 2625 (Tokyo High Court, Sept. 26, 1956).

1. *Liability for Violation of Registration or Prospectus Provisions (Article 16).*—The issuer, the seller, the underwriter and the securities firm that offers to sell a security in violation of the registration requirement or the prospectus requirements[196] become liable to the purchaser.[197] This provision was modeled after section 12(1) of the United States Securities Act of 1933.[198] The liability is absolute; the plaintiff need only allege and prove that the defendant was a seller, that he failed to comply with either the registration or the prospectus requirements and that the act of the defendant inflicted damage on the plaintiff. A seller's intent and knowledge of the violation is irrelevant.[199]

In connection with article 16, it must be remembered that an offer prior to the effective date of the registration statement was illegal in Japan until quite recently. The lack of legitimation of "offers" during the waiting period made "beating the gun" a problem. Underwriters in Japan were convinced that it was essential to the fulfillment of their function, at least if an underwriting was to be done with reasonable safety, that they test the market before committing themselves. Market testing was done orally and in reliance on a gentleman's word, or as an offer in the usual contract sense. Underwriters were careful not to make binding sales, but they and dealers solicited and accepted "indications of interest" shortly after the registration statement was filed and before it became effective. If the issue was attractive, dealers gave "indications of interest" to the underwriters and then solicited and accepted "indications of interest" from investors. The "indication of interest" practice made the provision of Japanese law prohibiting

196. Securities Exchange Law art. 15.

197. Securities Exchange Law art. 16.

198. Securities Act of 1933 § 12(1), 15 U.S.C. § 77*l*(1) (1970).

199. There is a difference between the two countries in the liability of dealers: In the United States, dealers are exempted from the liability after a lapse of 40 days from the date on which the security was offered to the public. Securities Act of 1933 § 4(s)(A), 15 U.S.C. § 77d(3)(A) (1970). In Japan, the period is three months (until the recent amendment, one year). Securities Exchange Law art. 15.3(3). Thus a dealer in Japan has to expose himself to the longer risk. Another difference is that the tender of the certificates as evidence, if the plaintiff owns the securities, is not required under the Japanese law, although it is required under American law. Securities Exchange Law art. 16; Securities Act of 1933 § 12(2), 15 U.S.C. § 77*l*(2) (1970). Further, there is a difference as to the liability of controlling persons. Under the American law, every person who (by or through stock ownership, agency, or otherwise) controls any person liable for violation of a registration or prospectus provision is also liable jointly and severally. Securities Act of 1933 § 15, 15 U.S.C. § 77o (1970).

preeffective date offers quite meaningless. Reflecting this situation, the law was amended so that offers can now be made legally during the waiting period.[200]

2. *Liability for General Misstatements or Omissions in Sales of Securities (Article 17).*—Any person who sells a security by means of a prospectus or other representation that includes an untrue statement, or that omits a material fact, is liable to the purchaser.[201] A defense is available if the seller can prove that he did not know, and that in the exercise of reasonable care he could not have known, of such untruth or omission.[202] This provision, modeled after section 12(2) of the Securities Act of the United States,[203] applies to all sales of securities, except exempted securities, even though unregistered and even though the particular transaction is exempted from the registration requirement.

If a seller in Japan is the issuer or underwriter of a registered security, there is some overlap of article 17 and article 18, which provides for liability for misstatements or omissions in the registration statement. But, in the orthodox distribution, as far as the ultimate investor is concerned, article 17 is vital even when there is registration, since the ordinary dealer, even if he is a member of the selling group, is not covered by article 18.

A plaintiff must prove that there was a misrepresentation or omission of fact, that he did not know of the misrepresentation or omission and that he suffered damages because of the misrepresentation or omission. There is no definite answer to the question how a seller satisfies the burden of proving "reasonable care" since as yet there has been no legal case or administrative opinion on the matter.

3. *Liability for Misstatements or Omissions in Registration Statements (Article 18).*—If any part of an effective registration statement contains a misstatement of a material fact or fails to include a fact necessary to make statements not misleading, the issuer who filed such registration statement is liable to compensate any person or persons who acquired the securities and suffered damage. This provision does not apply if the person who acquired the securities knew of such untruth or omission at the time of the acquisition.[204] Article 18 was modeled after section 11 of the United States Securities Act of 1933.[205] Until recently, however, there was an important difference

200. Securities Exchange Law arts. 13, 15.
201. Securities Exchange Law art. 17.
202. Securities Exchange Law art. 17.
203. Securities Act of 1933 § 12(2), 15 U.S.C. § 77*l*(2) (1970).
204. Securities Exchange Law art. 18.
205. Securities Act of 1933 § 11, 15 U.S.C. § 77k (1970).

in the extent of liability in the two countries since in the United States all those who signed the registration statement, the directors at the time of filing, and every accountant, engineer or appraiser who certified any part of the registration statement, as well as all underwriters, may be liable; under Japanese law, only the issuer or notifier was liable.[206] The law was amended recently, however, so that all these persons are also liable in Japan.[207] The liability of these persons is absolute and the burden of proof rests on the defendants to show that there were, after reasonable investigation, reasonable grounds to believe that the statements were true.

V. REGULATION OF TRADING

A. *Statutory Framework*

The statutory framework for the licensing of stock exchanges and brokers and the regulation of trading is similar to that in the United States. All stock exchanges must obtain a license from the Ministry of Finance.[208] The statute provides that the Ministry of Finance is to investigate and determine whether such an exchange is in the public interest or necessary and appropriate for the protection of investors.[209] If an exchange fails to enforce the law or violates the law, the Ministry of Finance has the power to cancel the registration of the

206. Securities Exchange Law art. 4. Before the amendment, the liability of these persons was left to the Commercial Code or to the general tort rules of the Civil Code. COMMERCIAL CODE art. 266(3); CIVIL CODE art. 709 (1896) (Japan). Under the Commercial Code, if directors are guilty of wrongful intent or of gross negligence in respect of the assumption of their duties, they are jointly and severally liable for damages to third persons. This liability also applies when material false statements have been made in application forms for shares or debentures, or a prospectus, or when a false registration or public notice has been made. In cases in which an act mentioned above has been done pursuant to a resolution of the board of directors, the directors who assented to such resolution are deemed to have done the act. COMMERCIAL CODE art. 266(2). In this case, directors who have participated in the resolution but who did not express their dissent in the minutes are presumed to have assented to such resolution. COMMERCIAL CODE art. 266(3). Thus if directors can allege and prove that they opposed the resolution they escape liability. The general tort rules of the Civil Code apply to the liability of accountants, engineers, appraisers or underwriters. A person who has intentionally or negligently violated the right of another is bound to compensate for the resulting damages. In this case the plaintiff has to prove "intention" or "negligence" by the defendants.

207. Securities Exchange Law art. 21.

208. Securities Exchange Law art. 81.

209. Securities Exchange Law art. 83.

exchange, or to suspend all or any part of the exchange's activities for a period not exceeding twelve months.[210] In case the activities of an exchange or of trading on an exchange are deemed to be harmful, contrary to the public interest, or lacking in protection to investors, the Ministry of Finance may suspend trading for a period not exceeding ten days or, with the approval of the Cabinet, may suspend all business for a period not exceeding 90 days.[211] The Ministry also is empowered to suspend trading of specific securities or to delist the issue.[212]

The functions of the Ministry of Finance cover registering securities dealers and supervising their activities. No person other than a stock company registered at the Ministry may engage in the securities business.[213] The liabilities of a dealer may not exceed twenty times his net worth and a lower multiple may be prescribed by the Ministry when it is appropriate and in the public interest for the protection of investors.[214] The Ministry of Finance may suspend or cancel a registration if a dealer is not able to meet the specified standards.[215] This authority, and a provision that gives customers a prior claim against the business guaranty funds that every dealer must deposit, is designed to protect the customers' funds.[216]

Securities and funds of clients in the hands of dealers are protected by a provision denying dealers the right to pledge customers' securities unless the dealer has the written consent of the customers concerned in a form prescribed by the Ministry of Finance Ordinance.[217] Even then the dealer must not pledge such securities in an amount greater than the credit extended to the customer.[218]

Provision is also made for self-regulation, and under the Securities Exchange Law a securities dealers' association must be registered with the Ministry of Finance.[219] The articles of the association must contain provisions designed to prevent fraudulent and manipulative acts, to prevent unreasonable charges and excessive profits and to punish members for violation of the laws or rules of the associations

210. Securities Exchange Law art. 155.
211. Securities Exchange Law art. 155.
212. Securities Exchange Law art. 119.
213. Securities Exchange Law art. 28.
214. Securities Exchange Law art. 34.
215. Securities Exchange Law art. 35.
216. Securities Exchange Law art. 41.
217. Securities Exchange Law art. 51.
218. Securities Exchange Law art. 51.
219. Securities Exchange Law art. 67.

or for acts that are contrary to just and equitable principles of transaction.[220] After a hearing the Ministry of Finance may order such changes in the articles of association and bylaws as it deems necessary to protect investors.[221]

The intention of the regulation is to rely to some extent on the stock exchanges. All trading in listed securities must in principle be conducted on the exchanges. Trading is conducted over the counter, however, in odd-lot stocks and block transactions. The latter is approved only when the quantity of orders is so large that trading on the exchanges is undesirable for fear of causing a wild price fluctuation. Curb market and time transactions are conducted in transactions with distant dealers and with foreign residents. The over-the-counter market in Japan, however, handles only a marginal portion of the stock transactions that take place in Japan and this marginal function has been decreasing in recent years (see Table 11).

TABLE 11*

The Size of Over-the-Counter Stock Market
(unit: one million shares and one billion yen)

	1967	1968	1969	1970
Market Transactions				
Shares	84,317 (75.7%)	130,657 (77.9%)	136,203 (94.7%)	112,812 (94.6%)
Amount (yen)	12,565 (76.5%)	23,340 (79.3%)	36,967 (94.8%)	23,794 (94.5%)
Over-the-Counter Transactions				
Shares	27,013 (24.3%)	37,175 (22.1%)	7,657 (5.3%)	6,486 (5.4%)
Amount (yen)	3,855 (23.5%)	6,105 (20.7%)	2,011 (5.2%)	1,396 (5.5%)
Total				
Shares	111,330 (100%)	167,832 (100%)	143,860 (100%)	119,298 (100%)
Amount (yen)	16,420 (100%)	29,445 (100%)	38,978 (100%)	25,190 (100%)

*Source: TOKYO STOCK EXCHANGE, SHŌKEN NENKAN, 1971 (SECURITIES YEAR BOOK, 1971) 232-52 (Tokyo Stock Exchange 1971).

220. Securities Exchange Law art. 71.
221. Securities Exchange Law art. 74.

B. *Restrictions on Broker-Dealers*

Segregation of broker and dealer functions is not required, but some regulatory provisions directed toward the problem exist in Japan and were modeled after similar provisions in the United States.[222] One such provision makes it unlawful for any member of an exchange who is both a dealer and a broker to effect any transaction in a security unless he makes a written disclosure to his customer at or before the completion of the transaction that he is acting as a dealer for his own account or as a broker for one side or the other.[223] Secondly, no member of an exchange can act both as a principal and as an agent or broker at the same time in the same transaction.[224] Thirdly, excessive transactions by a member of an exchange for his own account are regulated by the administrative authority if they are deemed detrimental to the public interest, to the protection of investors or to the maintenance of an orderly market.[225]

In recent years around 30 per cent of the total sales by members of the Tokyo Stock Exchange were traded for their own accounts (dealer function) (see Table 12). The problems associated with the trading activity of broker-dealers are somewhat different from similar prob-

---

222. A dealer sells securities that he has purchased elsewhere to his customer or buys securities from his customer with a view to dispose of them elsewhere. He receives no brokerage commission but relies for his compensation on the difference between his buying and selling price. The risk of loss is entirely his own. In each transaction he acts for his own account and not as agent for his customer. On the other hand, a broker employed to execute an order for the purchase or sale of securities is the agent of his customer. He does not undertake to sell to or buy from his customer but rather to negotiate a contract of purchase or sale between his client and a third party. The broker has no beneficial interest in the transaction itself; his remuneration is derived from a commission received for his services. The relationship between broker and customer is fiduciary in nature; a broker is required to act solely for the benefit of his principal in all matters connected with his agency.

If the broker and dealer functions are combined in one person, his own interests may conflict with the interests of those to whom he owes a fiduciary duty. In order to safeguard the investor from dangers of this type, segregation of the broker and dealer functions has been proposed.

223. Securities Exchange Law art. 46; Securities Act of 1934 § 11(d)(2), 15 U.S.C. § 78k(d)(2) (1970).

224. Securities Exchange Law art. 47; New York Stock Exchange Rule 91, in NEW YORK STOCK EXCHANGE CONSTITUTION AND RULES (CCH 1968).

225. Securities Exchange Law art. 127; New York Stock Exchange Rules 108-110, in NEW YORK STOCK EXCHANGE CONSTITUTION AND RULES (CCH 1968).

TABLE 12*

The Composition of the Broker and Dealer Transactions
on the Japanese Stock Exchange
(unit: 100 million yen)

	1967-1969 (Average)	1970	1971	1972
Broker Function	136,054 (63.0%)	221,319 (65.3%)	230,218 (65.0%)	338,188 (71.2%)
Dealer Function	79,801 (37.0%)	117,444 (34.7%)	123,948 (35.0%)	136,841 (28.8%)
Total	215,855 (100%)	338,763 (100%)	354,166 (100%)	475,029 (100%)

*Source: MINISTRY OF FINANCE, SHŌKEN KANKEI SHUYŌ SANKŌ SHIRYOSHŪ (MATERIALS CONCERNING SECURITIES) 136 (Okurashō Shōken Kyoku 1973).

lems in the United States, where objections have focused on the trading of "floor traders" and "specialists."[226]

"Floor traders" who trade for their own account on the floor do not exist in Japan. Furthermore, specialists such as those on the New York Stock Exchange do not exist on the Japanese stock exchanges. There is a somewhat similar type of member called a "nakadachi" who acts as an intermediary between regular members in the execution of orders on the floor,[227] but these members do not trade for their own accounts.

It is possible, however, to find situations in Japan in which a conflict of interest between a broker-dealer and a customer exists to the disadvantage of the customer. A broker who trades for his own account often furnishes his customers with investment advice called "suishō hanbai" (the recommended sale). Securities firms have been accused of secretly purchasing for their own account specific issues, which they later recommend to their customers. As soon as they announce their recommendation, they proceed to buy more of the issue, thus forcing the price up. As a result, customers are forced to

226. SEC, REPORT ON THE FEASIBILITY AND ADVISABILITY OF THE COMPLETE SEGREGATION OF THE FUNCTIONS OF DEALER AND BROKER 14-16 (1936).

227. For the difference between "nakadachi" and specialist see W. EITEMAN & D. EITEMAN, *supra* note 62, at 64.

purchase the stock at a higher price.[228] Furthermore, it is argued that the securities and credit balances of customers are often endangered by the risks incurred by broker-dealers when they make excessive commitments for their own accounts.[229] Speculation may be necessary and desirable to achieve a continuous market; however, excessive speculation by broker-dealers, or even the opportunity to engage in excessive speculation, is detrimental to the best interests of the market.

While statutory provisions exist to provide minimum protection to investors, they do not operate well in practice. For instance, although members of an exchange are required to disclose to their customers at or before the completion of a transaction whether they are acting as a dealer or a broker,[230] there is no provision calling for civil and criminal sanctions against persons guilty of violating the provision.[231] The lack of civil and criminal sanctions in Japan makes this disclosure provision practically ineffective.

Secondly, although members of an exchange are prohibited from acting both as a principal and as an agent at the same time in a single transaction, the legitimacy of crossing transactions renders the prohibition ineffective. Frequently, securities firms have both buying and selling orders in similar amounts for the same issue. Rather than execute separate contracts at greater cost to their customers, these buying and selling orders are matched, with the security firms generally serving as an agent for both customers. Sometimes the order of a customer is matched by an order of the security firm for its own account. Crossing transactions are not illegal in themselves.[232]

---

228. The mechanisms of "suisho hanbai" (the recommended sale) by big four companies is clearly explained in Kawai, *Sengo Keizai no Kozohenka to Kabukahendo (The Structural Change in the Post-War Economy and the Stock Price Fluctuations)*, in KEIZAI HENDO (ECONOMIC JOURNAL) 91 (Feb. 1959).

229. NIHON SHOKENSHIJO NO KOZO BUNSEKI (A STUDY OF THE JAPANESE SECURITIES MARKETS) 234 (Ichiro Kawai ed., Yuhikaku 1966). The main cause for the financial difficulties of the Yamaichi Securities Company is said to have been excessive commitments for its own account.

230. Securities Exchange Law art. 46.

231. By contrast, American law provides for civil actions and/or criminal prosecutions against persons who violate the provision. *See* 17 C.F.R. § 240. 15c 1-4 (1972).

232. Before 1967, when members of an exchange had both buying and selling orders in similar amounts for the same issue, the members were allowed to match the buying and selling orders outside the exchange. This way of executing

According to a Tokyo Stock Exchange rule, such transactions can be consummated on the conditions that the transactions are advantageous and fair to customers and that the price determined is within a reasonable range of the regular, quoted market price.[233] These protective provisions in the Tokyo Stock Exchange rule are almost the same as those specified by the New York Stock Exchange rule on the crossing of orders, but the latter is worded much more precisely.[234]

C. *Regulation Against Manipulation*

Since the Japanese Securities Exchange Law is modeled after the American Securities Exchange Act of 1934, there are many similarities between the two countries with regard to regulations designed to prohibit the manipulation of securities prices.[235] Wash sales and matched orders designed to create false and misleading impressions of active trading are prohibited.[236] It is unlawful for dealers or brokers or other persons selling or purchasing a security to make false or misleading statements for the purpose of inducing a purchase or a sale

---

transactions was called "bai-kai" (sell-buy). The problem was serious in Japan because a substantial proportion of trading on the exchange consisted of "bak-kai" transactions. For example, in 1965, "bai-kai" transactions were equivalent to 46% of the transactions executed on all the exchanges in Japan and to 64% of the total transactions carried out on the Tokyo Stock Exchange by the four largest securities firms (Nomura, Nikkō, Daiwa and Yamaichi). Therefore, "bai-kai" transactions, far from being exceptional, were the norm. In order to correct this abuse, "bai-kai" transactions were prohibited in 1967 by an administrative measure of the Ministry of Finance.

233. Tokyo Stock Exchange Rule of April 1, 1949, arts. 35, 36 (Japan).

234. Under New York Stock Exchange Rules, a broker who receives an order to sell may himself buy the stock from his customer, provided (1) he shall have offered the same in the open market at a price which is higher than his bid by the minimum variation permitted in such securities, (2) the price is justified by the condition of the market, and (3) the member who gave the order shall after prompt notification accept the trade directly or through a broker authorized to act for him. New York Stock Exchange Rule 91(b), in NEW YORK STOCK EXCHANGE CONSTITUTION AND RULES (CCH 1968). The converse rule governs with respect to a member's supplying his own securities to meet a buy order. *Id.* Rule 91(c).

235. Securities Exchange Law art. 125; Securities Exchange Act of 1934 § 9, 15 U.S.C. § 78i (1970).

236. Securities Exchange Law art. 125.1(1)-(3); Securities Exchange Act of 1934 § 9(a)(3), 15 U.S.C. § 78i(a)(3) (1970).

of a security.[237] It is also unlawful for any person selling or purchasing a security to induce the purchase or sale by the circulation or dissemination of information that the price will rise or fall because of the market operations of one or more persons.[238] It is equally unlawful for any person to induce the purchase or sale of a security for a consideration received from any person selling or purchasing a security.[239]

A provision in the Japanese law not found in the United States declares it to be unlawful for any person in the act of inviting subscriptions, or engaged in any other transaction regarding a transfer of securities, to directly or indirectly circulate false rumors or use deceptive schemes, or employ threats of an assault and battery or intimidation for the purpose of inducing fluctuation in the quotations of any security.[240] This provision originated in the old Japanese Exchange Law[241] rather than in the United States securities acts.

The Japanese Securities Exchange Law has equivalent fraud provisions to those found in the United States except that there is no language similar to the language in section 10b of the Securities Exchange Act referring to any manipulative, deceptive, or otherwise fraudulent device or contrivance. There are, however, specific provisions providing that at the time of inviting subscriptions, it is unlawful for any person to suggest that he will rebuy the securities sold or resell securities bought at a price previously specified or at a

237. Securities Exchange Law art. 125.2(3); Securities Exchange Act of 1934 § 9(a)(4), 15 U.S.C. § 78i(a)(4) (1970). Here, there is a difference between the two countries. Under the United States law it is unlawful to make a statement if one knows or has reasonable grounds to believe that the statement is false or misleading. But the clause "had reasonable ground to believe" is not found in the Japanese law. Thus it is unlawful for Japanese brokers and/or dealers to make statements only when they actually know that the statements are false or misleading.

238. Securities Exchange Law art. 125.2(2); Securities Exchange Act of 1934 § 9(a)(3), 15 U.S.C. § 78i(a)(5) (1970). In the United States, manipulators may be held responsible for the transactions of their friends, relatives, business associates and others acting on tips and rumors traceable to the manipulators. Since the provisions of the Act regarding prohibition of manipulation do not contain explicit language to this effect, the interpretation rests on the common law doctrine of "aider and abetter." By contrast, Japanese law provides that it is unlawful to entrust or to be entrusted with manipulative acts, hence the prohibition stems from the wording of the law itself. Securities Exchange Law art. 125.1(4). This was necessary since Japan is a civil law country without the common law doctrine of "aider and abetter."

240. Securities Exchange Law art. 197.

241. Exchange Law No. 5 of March 4, 1893, art. 32(4).

price above such price, or make any statement liable to be so interpreted.[242] It is also unlawful for any issuer of a security or for any person selling a security by public offering, or for any officer, adviser, counsellor, or employee to imply at the time of a public offering that a specified amount of money can be obtained by resale.[243]

In Japan, as in the United States, penal sanctions are present for violation of the manipulation provisions.[244] In addition, if a securities dealer engages in a manipulative practice, the Ministry of Finance may cancel his registration or may order suspension of the whole or any part of his business.[245] Some provision is also made for civil liability (equivalent to section 9(e) of the Securities Exchange Act of the United States).[246] Recognizing that the most important measures designed to prohibit manipulation should be preventive in nature, the Securities Exchange Law of Japan provides that courts, on application of the Ministry of Finance, may enjoin persons who engage in acts violating the law.[247] As the premise of this preventive measure, the Ministry of Finance is empowered to make necessary investigations,[248] a power also possessed by the SEC in the United States.[249]

Thus the structure of the antimanipulation provisions of the Japanese Securities Exchange Law is much the same as the federal securities acts in the United States. But the implementation of the provisions in Japan is quite different from that in the United States. In Japan there have been no legal cases involving civil liability arising from manipulation and no criminal cases assigning a penalty. Also there have been no cases in which a court on application of the Ministry of Finance has entered an order prohibiting or suspending manipulative acts. It is difficult to believe that there has never been manipulation in the Japanese markets.

It is said that antimanipulation provisions in the United States have been markedly effective.[250] The SEC has expressed the belief that manipulation is no longer an appreciable factor in American mark-

242. Securities Exchange Law art. 191(3).
243. Securities Exchange Law art. 191(4).
244. Securities Exchange Law arts. 197(2), 207.
245. Securities Exchange Law art. 59.
246. Securities Exchange Law art. 126.
247. Securities Exchange Law art. 187. This provision is modeled after section 21(e) of the Securities Exchange Act of 1934 in the United States. 15 U.S.C. § 78u(e) (1970).
248. Securities Exchange Law art. 183.
249. Securities Exchange Act of 1934 § 21(a), 15 U.S.C. § 78u(a) (1970).
250. L. Loss, *supra* note 194, at 1568.

ets.[251] A large part of the Commission's success in this field has been due to continual improvement in its procedures for the systematic surveillance of the markets. The SEC's market surveillance staff, in cooperation with major stock exchanges, studies tickertape quotations of securities listed on the national exchanges, the sales and quotations sheets of the various regional exchanges, and the bid and asked prices of unlisted securities for unusual or unexpected price variations or for signs of manipulative market activity. When no apparent explanation can be found for an unusual movement in prices, the SEC is empowered by law to conduct an investigation.[252] This investigation may extend to every transaction in an issue executed during a month or six weeks. The Ministry of Finance is empowered to do the same,[253] but has not chosen to utilize its power.

Why has the Ministry of Finance not chosen to regulate manipulation? First, like other provisions of the law, the antimanipulation provisions of the Japanese law were introduced by the United States. Therefore, the provisions did not emerge from actually experienced manipulation occurring in Japan. This fact weakens the feeling that it is necessary to rigorously enforce the provisions. Secondly, the Ministry of Finance is continually confronted with budget and staff shortages. Therefore, it does not maintain the continuous surveillance of trading necessary to discover manipulation. Thirdly, it is difficult to prove intention to manipulate under the Japanese law. This is also a problem in the United States, but the SEC takes the position that since it is impossible to search the depths of a man's mind, findings of manipulation can be supported by inferences drawn from circumstantial evidence. The American point of view holds that a motive to manipulate prima facie establishes a manipulative purpose.[254]

The most common type of manipulation found in Japanese markets today involves a peculiar form of "corner" not a part of the current American experience. An outsider may slowly and secretly accumulate shares in the market. Then when he has enough shares to cause management trouble, he offers to sell his shares to management at higher than market prices, as a condition for not making trouble. This is certainly a violation of the manipulation provision in the law,[255] but manipulative intent in these cases typically has been quite difficult to prove.

---

251. SEC, ANNUAL REPORT No. 16, at 37 (1950).

252. Securities Exchange Act of 1934 § 21(a), 15 U.S.C. § 78u(a) (1970).

253. Securities Exchange Law art. 133.

254. *See, e.g.*, Halsey, Stuart & Co., 30 S.E.C. 106, 124 (1949); Federal Corp., 25 S.E.C. 227, 230 (1947).

255. Securities Exchange Law art. 125.2(1).

D. *Continuous Disclosures*

The disclosure requirements under the Securities Exchange Law for initial issues are extended to subsequent disclosures.[256] As in the United States, issuers whose registrations have become effective must file periodic and annual reports that include the same type of financial statements as are contained in a registration statement. These periodic reports filed with the Ministry of Finance are available for public inspection. The periodic reports are just as extensive as those required for a new registration statement, although this is not yet true in the United States. Also, as indicated by the Appendix, the content of the financial statements is more extensive than the content of those common in the United States.

E. *Insider Trading*

As to insider trading, Japanese law provides that for the purpose of preventing any officer or major stockholder of a company from availing himself of secret information obtained through his office or position, the company may recover all profits made by the insider from purchases of company stock made within six months after sale or from a sale of company stock made within six months after purchase.[257] No legal case involving insider trading, however, has been reported in Japan. Since it is difficult to believe that there has never been insider trading in Japan, it may safely be said that there are problems with the methods for enforcing this provision.

APPENDIX
DISCLOSURE ITEMS BY JAPANESE COMPANIES

The following information can be ascertained through examination of a typical Japanese financial statement.

1. BALANCE SHEET (ASSETS): Current assets; quick assets; cash; trade notes receivable; trade notes receivable from affiliated companies; trade accounts receivable; trade accounts receivable from affiliated companies; marketable securities; allowance for doubtful accounts; inventories; finished goods; merchandise inventories; semi-finished goods; work in process; raw materials; supplies; other current assets; advances to suppliers; advances to affiliated companies; prepaid expenses; other accounts receivable; other accounts receivable from affiliated companies; accrued receivables; accrued receivables from affiliated companies; short-term loans receivable; short-term loans to affiliated companies;

256. Securities Exchange Law arts. 24, 25.
257. Securities Exchange Law art. 189.

advances in process of clearance; allowance for doubtful accounts; fixed assets; property, plant and equipment; buildings; structures; machinery and equipment; vessels and other water equipment; transportation equipment; tools, furniture and fixtures; other property, plant and equpment; land; construction in progress; intangible assets; industrial property rights; right to use facilities; other intangible assets; investments; investment securities; investment in affiliated companies; noncurrent trade accounts receivable; noncurrent receivables; noncurrent loans to affiliated companies; investment property; other investments; allowance for doubtful accounts; deferred charges; prepaid expenses expiring after one year; organizational expenses; bond discounts and costs of stock and bond issues; research and development expenses; deferred losses; total assets.

2. BALANCE SHEET (LIABILITIES AND STOCKHOLDERS' EQUITY): Liabilities; current liabilities; trade notes payable; trade notes payable to affiliated companies; notes payable on property purchase; trade accounts payable; trade accounts payable to affiliated companies; short-term loans; short-term loans in foreign currency; long-term debt payable within one year; long-term debt payable within one year in foreign currency; bonds redeemable within one year; bonds redeemable within one year in foreign currency; other accounts payable; accounts payable to property purchases; accrued expenses; advances from customers; other advances received; deposits received from employees; deferred income; unrealized gross profit on installment sales; other current liabilities; accrued bonuses; corporate income taxes payable; long-term liabilities; debentures; debentures in foreign currency; long-term debt; long-term debt in foreign currency; long-term notes payable; other long-term accounts payable; other long-term debt; accrued retirement allowances; reserves; reserve for price decline; reserve for doubtful accounts; reserve for special depreciation; reserve for excess of cost of property over book value; reserve for special repairs and maintenance; reserve for return of goods; reserve for loss from market development; reserve for loss from overseas investment; other reserves; stockholders' equity; capital stock; capital stock subscribed; capital surplus; statutory capital surplus; appraisal surplus; other capital surplus; retained earnings; statutory reserve; appropriated retained earnings; unappropriated retained earnings; retained earnings at beginning of period, less current appropriation; net increase in retained earnings; bonuses to officers and dividends; discounted notes; discounted notes accepted from affiliated companies; notes pledged as security; endorsed notes; contingent liabilities.

3. INCOME STATEMENT: Sales; gross sales; sales discount and returns; cost of sales; inventories at beginning of period; cost of finished goods manufactured; purchases of merchandise inventories; inventories at end of period; commodity tax and other sales taxes; transfers-in and transfers-out and other inventory adjustments; gross profit on sales; other operating revenues; net realized gross profit on installment sales, and provision for possible returns; gross profit on sales after adjustments; selling and administrative expenses; sales commissions; packing and delivery expenses; advertisement expenses; other selling expenses; royalties; provision for doubtful accounts; officers' remuneration; salaries and wages; provision for retirement allowances; welfare; travel and communication; entertainment; depreciation; rent; taxes and dues; enterprise tax; research and development; other selling and administrative expenses; operating income; nonoperating income; interest and dividend income; interest and dividends received from

affiliated companies; interest on installment sales; gain on sales of assets; credit from reversal of reserve for price declines; credit from reversal of allowance for doubtful accounts; credit from reversal of allowance for special depreciation; other nonoperating income; nonoperating expenses; interest and discounts; amortization of bond discounts and issue costs; taxes and dues; loss on sales and/or disposal of assets and loss on writedown of assets value; provision for price declines; provision for doubtful accounts; provision for special depreciation; special depreciation; other nonoperating expenses; net income before income taxes and extraordinary items; extraordinary income; income from sales of fixed assets; income from sales of investment securities; credit from reversal of reserve for price declines; credit from reversal of reserve for special depreciations; credit from reversal of other reserves; adjustment of prior periods' income; other increases in retained earnings; return to retained earnings of earnings appropriated for certain specific purposes; extraordinary charges; loss from disposal of fixed assets; loss from devaluation and/or sales of securities; provision for price declines; provision for special depreciation; special depreciation; provision for other reserves; adjustment of prior periods' income; other decreases in retained earnings; net income before income taxes; provision for income taxes; net income; dividends; stock dividends; bonuses to officers; retained earnings; internal sales included in sales; sales to affiliated companies included in sales.

4. STATEMENT OF COST OF GOODS MANUFACTURED: Cost of raw materials used; beginning inventories of raw materials; purchases of raw materials; ending inventories of raw materials; transfers-in and transfers-out and other adjustments; labor costs; salaries and wages; provision for retirement allowance; welfare; other manufacturing costs; subcontracting fees; electricity; gas and water; factory supplies; freight; royalty; depreciation; repairs; insurance premiums; rent; taxes and dues; travel and communication; other manufacturing expenses; manufacturing costs; beginning inventories of work in process; ending inventories of work in process; transfers-in, transfers-out and other adjustments; cost of finished goods manufactured.

5. OTHER FINANCIAL AND OPERATING INFORMATION: (a) *Status of Capital:* Par value of capital stock; total number of shares issued; average amount of paid-in capital; percentage of shares held by financial institutions and governmental bodies; percentage of shares held by foreign companies and individuals; highest stock price during the current period; (b) *Status of Employees:* Number of employees as of end of period; number of male workers; average age of employees; average monthly salary for employees working at end of period; (c) *Audit Opinion;* (d) *Method of Pricing Inventories:* Raw materials; work in process; finished goods; (e) *Details of Securities:* (i) *held for temporary investment*—Stock; government, local government and governmental corporation bonds; (ii) *held for long-term investment*—Stock; government, local government and governmental corporation bonds; (f) *Increase and Decrease in Property, Plant and Equipment:* Increase in property, plant and equipment; decrease in property, plant and equipment; decrease in construction in progress; (g) *Details of Depreciation and Amortization:* Depreciation and amortization; special depreciations; depreciation of property, plant and equipment; depreciation of buildings; depreciation of structures; depreciation of machinery and equipment; depreciation of vessels and other equipment; depreciation of transportation

equipment; depreciation of tools, furniture and fixtures; depreciation of other plant and equipment; amortization of intangible assets; amortization of investment property; amortization of deferred charges; accumulated depreciation and amortization; accumulated depreciation of property, plant and equipment; accumulated depreciation of buildings; accumulated depreciation of structures; accumulated depreciation of machinery and equipment; accumulated depreciation of vessels and other water equipment; accumulated depreciation of transportation equipment; accumulated depreciation of tools, furniture and fixtures; accumulated depreciation of other plant and equipment; accumulated amortization of intangible assets; accumulated depreciation of investment property; accumulated amortization of deferred charges; depreciation method; (h) *Changes in Bonds, Long-term Debt and Capital Stock:* Bonds issued during period; bonds redeemed during period; convertible bonds outstanding; long-term debt incurred during period; long-term debt repaid during period; capital stock issued for cash; premiums of capital stock issued for cash; factors which give rise to changes in capital; (i) *Details of Reserves and Allowances:* Increase in reserve for bonus; decrease in reserve for bonus; increase in reserve for corporate income taxes; decrease in reserve for corporate income taxes; amount paid out for decrease in reserve for corporate income taxes; increase in reserve for retirement allowance; decreases in reserve for retirement allowance; amount paid out for decrease in reserve for retirement allowance; increase in reserve for price declines; decrease in reserve for price declines; increase in reserve for doubtful accounts; decrease in reserve for doubtful accounts; amount of offsets against receivables; increase in reserve for special depreciation; decrease in reserve for special depreciation; amount for assets retired; increase in reserve for excess of cost of property over book value; decrease in reserve for excess of cost of property over book value; increase in reserve for special repair and maintenance; decrease in reserve for special repair and maintenance; increase in reserve for returns of goods; decrease in reserve for returns of goods; increase in reserve for loss from overseas market developments; decrease in reserve for loss from overseas market developments; increase in reserve for loss from overseas investment; decrease in reserve for loss from overseas investment; increase in other reserves; decrease in other reserves; (j) *Details of Cash:* Cash on hand; cash in banks—checking accounts; savings accounts; deposits at call; time deposits; other deposits; (k) *Others:* Number of months in operation; classification of information source; date of merger.