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## Changes in the Role of Lawyers and Corporate Governance in Japan—How Do We Measure Whether Legal Reform Leads to Real Change?

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# CHANGES IN THE ROLE OF LAWYERS AND CORPORATE GOVERNANCE IN JAPAN—HOW DO WE MEASURE WHETHER LEGAL REFORM LEADS TO REAL CHANGE?

BRUCE E. ARONSON\*

There are certain Western schemers, envious of Japan's ability to keep moving ahead . . . . These schemers have plans for infesting our society with hundreds of thousands of men cunningly trained in the arts of stopping all constructive activity, of bringing entire societies to a dead standstill. Yes, I speak of lawyers.<sup>1</sup>

[Due to numerous reasons, including] expansion of the role of the legal profession as “doctors for the people's social lives,” . . . greatly increasing the legal population is an urgent task . . . . The essential task is to secure and improve, both in quality and in quantity, the legal profession needed by the people of Japan.<sup>2</sup>

## INTRODUCTION

Japan's dramatic rise as the first non-Western nation to modernize successfully and to compete economically with the United States had a tremendous impact on American thinking in the 1980s. Japanese automobile manufacturers out-competing Detroit's car makers somehow seemed more threatening than any effort by similar German companies. In addition, Japan seemed to be addressing issues of modern society more effectively than the United States, and numerous American commentators began to search for the “secret” to Japan's success. Unfortunately, many of the “secrets” uncovered by popular commentators involved supposedly ingrained Japanese cultural traits, such as informality, cooperation, and

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1. Supposed response of the Japanese “Minister of Motion” to a tongue-in-cheek proposal by columnist Russell Baker that we trade American lawyers for Japanese cars in order to even the playing field in trade between the United States and Japan. Russell Baker, *Lawyers for Cars*, N.Y. TIMES, June 8, 1983, at A23.

2. JUSTICE SYSTEM REFORM COUNCIL, RECOMMENDATIONS OF THE JUSTICE SYSTEM REFORM COUNCIL, ch. III, pt. 1–1 (2001), available at <http://www.kantei.go.jp/foreign/judiciary/2001/0612/report.html> (report of a special legal reform council created by the Japanese Cabinet).

consensus, which were allegedly much more efficient and productive than our complicated systems of checks and balances, markets, and legal rules. This unchanging culturalism frequently substituted for, rather than provided, any real analysis of Japan's strengths. It was also of little value as a prescription for America, as it was impossible to import. It did, however, sell many books and newspapers.

Fortunately, John Haley met this critical need for scholarship reflecting a more reasoned and thoughtful analysis. He was uniquely qualified to undertake this daunting task and to light the way for a generation of scholars to follow his path. Starting in the 1970s, well before our current emphasis on empirical and interdisciplinary approaches, Haley utilized a number of current methodologies to challenge cultural stereotypes and analyze the Japanese legal system and society.

His seminal work, *The Myth of the Reluctant Litigant*,<sup>3</sup> remains the gold standard for comparative studies due to its integration of three highly useful approaches. First, Haley used empirical data to challenge conventional wisdom. His data indicated that it was a lack of legal infrastructure rather than a cultural predisposition against the use of litigation that accounted for relatively low litigation rates in Japan. Second, he employed a historical perspective, arguing, for example, that if conciliation procedures were made mandatory in the interwar years for the purpose of suppressing litigation and societal upheaval dating from the 1920s, it was unlikely that a cultural reluctance to litigate was the cause of a decline in litigation in the postwar years. Third, he looked beyond a bilateral comparison between the United States and Japan to examine available data on litigation from a variety of countries, concluding that while Japanese litigation rates were low, they were not extraordinarily so; if anything, the United States was the outlier due to its unusually high rate of litigation.

Even after slaying the culturalism dragon (in the academy, even if not necessarily in popular discourse), Haley has continued to examine the relationship between the legal system and society (and has not shied away from using the term "culture"). He has valiantly attempted to describe what makes Japan different from the United States and other countries, and has also spent a great deal of thought on the question of continuity versus change in Japan.<sup>4</sup>

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3. John Owen Haley, *The Myth of the Reluctant Litigant*, 4 J. JAPANESE STUD. 359 (1978).

4. See, e.g., JOHN O. HALEY, *AUTHORITY WITHOUT POWER: LAW AND THE JAPANESE PARADOX* (1991); JOHN O. HALEY, *THE SPIRIT OF JAPANESE LAW* (2006).

While often reminding us of continuity when others emphasized change, Haley has also been active in the debate about what would constitute real change in Japan. In a 2005 article on the subject of whether there is a “Heisei transformation” (the “*Heisei* article”),<sup>5</sup> Haley identifies three areas—electoral politics, the legal profession, and corporate governance—that would need to change in order to effect a transformation of Japanese society.<sup>6</sup> He defined what would be a transformational change in each of these areas and concluded that while we may be in an era of Heisei reform, there has been no Heisei transformation.

While I do not necessarily disagree with any of Haley’s conclusions in his *Heisei* article, that article highlights the difficulties we encounter in discussing the question of continuity versus change. One difficult challenge, which Haley has begun to address in his recent work, is the appropriate method for measuring and evaluating such change.<sup>7</sup> Research efforts either tend to focus rather narrowly on case studies and emphasize change that has occurred, or, conversely, look for a complete systemic transformation and, finding none, conclude that all of the new laws and activities do not constitute any significant change. In either case, the choice of a focus or standard for measuring change seems highly outcome determinative.

One result of this binary approach is that conclusions are fairly predictable depending on the standard or lens employed: there is much reform, but never any transformation. This is an unsurprising and likely accurate result if we only view change through a very narrow or very wide lens. Systems rarely, if ever, transform in the absence of war and occupation: evolution, rather than revolution, is the norm. On the other hand, in reality, incremental change may be highly significant to individual actors (businesses, consumers, etc.) in a society. The perplexing challenge is to find a way to reconcile the “macro” view of systems with the “micro” view of real world actors.

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5. John O. Haley, *Heisei Renewal or Heisei Transformation: Are Legal Reforms Really Changing Japan?* 19 J. JAPANESE L. 5 (2005) [hereinafter Haley, *Heisei*]. See also John O. Haley, *Japanese Law in Transition* (paper presented at Change, Continuity, and Context: Japanese Law in the Twenty-First Century, a conference held at The University of Michigan Law School, Apr. 6–7, 2001, on file with author). A “Heisei transformation” refers to the possibility that Japan is currently (i.e., during the current emperor Akihito’s reign, which is the Heisei Era) undergoing a major societal transformation equivalent to earlier changes during the Meiji Era (beginning in 1868, as Japan restructured society in order to modernize and catch up with the West) and the post-World War II period.

6. Haley, *Heisei*, *supra* note 5, at 7.

7. See *supra* note 5.

This Essay explores the criteria for judging the significance of change brought about by legal reform through the examination of two significant areas in Japan about which Haley has written in the *Heisei* article and elsewhere: the role of lawyers and corporate governance. Although the prevalent view is that no transformational change has taken place in either area, altering the criteria or the weight assigned to them can significantly affect the conclusion. If we focus on the role of elite lawyers and the expansion of their role in society, there arguably is a significant change occurring in the legal profession in Japan. With respect to corporate governance, a greater emphasis on the monitoring of management, rather than on the often used maximization of shareholder value, might still lead to the same conclusion that there has not been any system-wide transformation, but may also better highlight important changes in specific areas of corporate governance in Japan.

#### I. THE ROLE OF LAWYERS

The legal profession has been an ongoing focus of Haley's work. In *The Myth of the Reluctant Litigant*, Haley characterized the traditionally small number and limited role of lawyers in Japan as parts of the lack of legal infrastructure that formed an institutional barrier to litigation.<sup>8</sup> More broadly, one of his consistent themes has been that, due to a lack of formal enforcement power and mechanisms, many actors (the state, the judiciary, business) resort to informal, extralegal measures to conduct their activities, and that this phenomenon is a distinguishing characteristic of Japanese society. The Japanese legal profession and legal education system have recently undergone a great deal of reform,<sup>9</sup> creating a pressing need to evaluate the significance of such reform.

What would constitute a transformation of the legal profession? In his *Heisei* article, Haley mentions three criteria: (1) a significant increase in the number of lawyers and demand for entry into the legal profession; (2) an improved professional legal education, provided by new graduate-level law schools that go well beyond mere preparation for the bar exam; and (3) societal recognition of the expertise and value of the new law school graduates, as compared with generalists who have completed an

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8. Haley, *supra* note 3, at 381–83.

9. For an overview of the legal reform process, see, e.g., Setsuo Miyazawa, *Law Reform, Lawyers, and Access to Justice*, in *JAPANESE BUSINESS LAW* (Gerald Paul McAlinn ed., 2007); Kahei Rokumoto, *Overhauling the Judicial System: Japan's Response to the Globalizing World*, 20 *J. JAPANESE L.* 7 (2005).

undergraduate degree in law, so that these law school graduates will find new avenues of employment in business and government.<sup>10</sup>

This is a reasonable set of criteria for attempting to measure any transformation in the importance of lawyers and the law in Japanese society. However, the first criterion, the supply of lawyers, should be supplemented by incorporating a corresponding element for the demand for legal services. The second criterion, legal education, which measures an important cause or condition of possible change, could be de-emphasized in favor of an attempt to look at actual results. The third criterion, new positions in business and government for law school graduates, clearly considers results but looks at long-term issues that would represent a complete “transformation” of the legal profession. In order to think about the possibility of current or ongoing significant change in the legal profession, I would instead focus more narrowly on the role of lawyers, specifically on the question of whether the role of lawyers and the range of their activities have expanded significantly.

The demand for legal services is a critical factor that underlies any significant change in the legal profession.<sup>11</sup> Lawyers tend to be conservative and “follow the client”; it is unlikely that the supply of legal services would increase in anticipation of a future increase in demand.<sup>12</sup> The legal profession is important precisely because of this phenomenon—the legal profession would gain in importance only as a result of other societal changes that create new, significant demand for legal services.

An expansion of the role of lawyers and the range of their activities is probably the best proxy for measuring whether business and government use lawyers (and care about the law) as opposed to their traditional resort to informal, extralegal means for managing their operations and accomplishing their goals. Such an expansion would be evidence of a change from informal “administrative guidance”<sup>13</sup> to a more transparent,

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10. See Haley, *Heisei*, *supra* note 5, at 10–13.

11. Demand and supply are both important criteria, and their interaction is a significant aspect of law firm growth. Commentators have constructed academic theories concerning law firms’ economic incentives for growth from both supply-side and demand-side perspectives. For a summary of the literature, see Bruce E. Aronson, *Elite Law Firm Mergers and Reputational Competition: Is Bigger Really Better? An International Comparison*, 40 VAND. J. TRANSN’L L. 763, 773–76 (2007). To date, there has been an overemphasis in Japan on the low supply of lawyers and insufficient attention paid to the important demand aspect. See *infra* note 23.

12. For arguments that lawyers are generally conservative or risk-averse, see Aronson, *supra* note 11, at 776 n.28.

13. Although formulations differ, administrative guidance is generally described as government agencies obtaining informal cooperation from industries, companies, or individuals to take or refrain from taking some particular action. See generally Mitsuo Matsushita, *The Legal Framework of Trade and Investment in Japan*, 27 HARV. INT’L L.J. 361, 375–76 (1986). There is no clear legal definition of

rule-based form of administration in which businesses would consult lawyers rather than bureaucrats for advice on the permissibility of products and activities.

In considering the criterion of an expanded role for lawyers, this Essay focuses on a relatively small number of “elite” law firms.<sup>14</sup> Although this focus could be questioned, it is consistent with Haley’s emphasis on creating a more important role for the legal profession with respect to business and government—it is the elite lawyers who are in a position to interact with big business and government and to potentially increase the range of lawyers’ activities. Significant change in the legal profession could also theoretically occur from an entirely different source, such as a large increase in public interest law activities that would pressure government and business from the outside rather than work with them on the inside. However, while the elite law firms rapidly expand, there is no evidence of an upsurge in public interest law.<sup>15</sup>

Considering these criteria, has there been a significant change in the legal profession in Japan? In his *Heisei* article a few years ago, Haley seemed unimpressed by recent changes in the legal profession. He viewed the large Japanese corporate law firms as a result of consolidation, not natural growth, and the recent increase in the number of lawyers and the demand to become lawyers as not very significant.<sup>16</sup> Similarly, he saw changes in legal education as insufficient to change the basic direction of

administrative guidance, as attempts to formulate a definition often wind up characterizing it by what it is not—it is not formal administrative action (i.e., *shobun*, or disposition), which would be subject to judicial review. See generally John O. Haley, *Japanese Administrative Law*, 19 LAW IN JAPAN 1 (1986).

14. “Elite” law firm is intended as a neutral term of art that is widely used in the literature analyzing the structure and functioning of law firms. It refers to firms that provide general legal services to large corporations (i.e., not boutique firms) and use specialized skills to handle large, complex matters on a national scale for these clients. In most countries they correspond closely with large corporate law firms. See Aronson, *supra* note 11, at 782 (discussing this functional definition of elite law firms and comparing such firms with a smaller subset of the highest ranking first-tier law firms).

15. This Essay does not address the normative question of what form of change in the legal profession is desirable from a societal perspective. It focuses on the market for corporate legal services which may lead to an expanded role for lawyers, that is, on the rapidly expanding and changing area of elite lawyers, rather than on societal needs. Although some new consumer litigation has emerged recently in Japan, and there is potential for further development in that area, significant difficulties remain in increasing the number and activities of public interest lawyers. See, e.g., Bruce E. Aronson, *The Brave New World of Lawyers in Japan: Proceedings of a Panel Discussion on the Growth of Corporate Law Firms and the Role of Lawyers in Japan*, 21 COLUM. J. ASIAN L. 45, 75, 78 (2007) (speaker: Toshiro Ueyanagi, the leading plaintiffs’ lawyer for shareholder litigation in Japan). For data on the rapidly increasing number of elite lawyers, see *infra* note 24 and accompanying text.

16. Haley, *Heisei*, *supra* note 5, at 10–11.

such education from one of bar preparation to something more professionally and socially beneficial.<sup>17</sup>

However, one could construct a persuasive argument that significant change has occurred, or at least is occurring, if my additional suggested criteria are incorporated into the analysis. An important focus of this inquiry would be consideration of whether there has been an expansion in the role and range of work activities of elite lawyers.<sup>18</sup> This approach would also involve some disagreement over the pace and extent of change, since change has occurred rapidly at elite law firms over the last few years.

In examining change in the legal profession, let us begin with the demand for new legal services from elite lawyers. In the past, there was a traditional division between Japanese corporations' use of Tokyo-based "international" lawyers for cross-border transactions and their internal handling of domestic transactions without resort to lawyers. This division of labor, based on the use of non-legal "relational contracting" in Japan, has significantly eroded. The large Japanese law firms no longer refer to themselves as international firms (*shogai jimusho*), as the bulk of their work has changed over the last decade from cross-border work to domestic work.<sup>19</sup> This surge in domestic work has come from a number of new areas, including new financial products, compliance and corporate governance, and domestic litigation. Currently, domestic litigation includes large domestic Japanese institutions suing each other and tax litigation by both individuals and corporations against the government.<sup>20</sup> Most significantly, Japanese lawyers consistently claim that there has been a real change in the Japanese style of administration—businesses now consult lawyers on legal rules and procedures rather than consulting informally with government bureaucrats.<sup>21</sup>

This increase in demand for domestic corporate legal services also has an international aspect. In some cases, this new domestic legal work

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17. *Id.* at 11–13.

18. The potential for Japanese lawyers in leading urban areas to expand their role beyond traditional litigation-oriented activities was recognized by some at an early stage. See Takao Tanase, *The Urbanization of Lawyers and Its Functional Significance: Expansion in the Range of Work Activities and Change in Social Role*, 13 *LAW IN JAPAN* 20 (Bruce E. Aronson trans., 1980) (arguing that the high concentration of lawyers in the metropolises of Tokyo and Osaka was due to the attractive prospect of expanding their traditional range of work activities and social role).

19. See Aronson, *supra* note 15, at 56 (speaker: Hisashi Hara). See also Zadankai: Daikibo Hōritsu Jimusho no Gendai to Shōrai [Roundtable: The Present and Future of Large-Scale Law Firms] 57 *Jiyū To Seigi* 12, 46–49 (May 2006) [hereinafter Zadankai].

20. See Aronson, *supra* note 15, at 56–58.

21. Zadankai, *supra* note 19, at 56–57 (speaker: Takashi Yoneda). This has also reportedly resulted in an expanded role for lawyers in corporate governance activities. See *id.* at 78–79 (speaker: Toru Ishiguro).



involves the Japanese domestic version of long and complicated groups of contracts (in areas such as asset securitization and project finance) used overseas but hitherto unknown in Japan. The new focus on domestic legal services has also been spurred by an opening up to, and increased competition from, foreign law firms, which are now permitted to form domestic partnerships with Japanese law firms, and which are increasingly successful in competing with domestic Japanese firms for cross-border transactions.<sup>22</sup>

Let us next turn to the question of the supply of lawyers. This is a serious issue, although it has often been overemphasized as the key constraint on the growth of Japanese law firms.<sup>23</sup> Looking at the number of (elite) lawyers and law firm size, we find that within the last few years members of the top group of Big Four Japanese law firms increased their size from around one hundred attorneys to three hundred or more.<sup>24</sup> One factor was a series of mergers which surprised the legal profession.<sup>25</sup> However, of equal importance was a substantial increase in the hiring of new attorneys.<sup>26</sup> During the past decade, a typical entering class of newly minted attorneys for a Big Four law firm has grown from less than ten to somewhere in the twenties or thirties.<sup>27</sup> The ratio of associates to partners has increased from roughly 1:1 to 3:1.<sup>28</sup> This rapid expansion has fueled

22. *Id.* at 65 (speaker: Hisashi Hara).

23. The issue of the supply of lawyers has been emphasized in Japan due to both the small absolute number of Japanese lawyers and complaints by Japanese lawyers that the limited supply is the most important constraint on the growth of Japanese law firms. For more information on the latter argument, see, e.g., Yasuharu Nagashima & E. Anthony Zaloom, *The Rise of the Large Business Law Firm and Its Prospects for the Future*, in *LAW IN JAPAN: A TURNING POINT* 136 (Daniel H. Foote ed., 2007) (in which the founding partner of one of the leading Japanese law firms in Tokyo argued that the shortage of lawyers is “the most fundamental problem” facing Japanese law firms in light of the recent rise in demand for business lawyers).

24. For data on the largest Japanese firms from 1998, 2001, and 2005, see Aronson, *supra* note 15, at 83. According to their websites, the number of Japanese attorneys at the Big Four firms is currently as follows: Nishimura & Asahi had 407 attorneys as of Oct. 1, 2008; Nagashima Ohno & Tsunematsu had 312 Japanese attorneys as of Oct. 1, 2008; Anderson Mori & Tomotsune had “over 240” attorneys as of Jan. 1, 2008; and Mori Hamada Matsumoto had “over 260” attorneys. Nishimura & Asahi, Firm Overview, <http://www.jurists.co.jp/en/firm/outline.html> (last visited Oct. 17, 2008); Nagashima Ohno & Tsunematsu, Firm Profile, <http://www.noandt.com/english/summary/firm/profile.html>; Anderson Mori & Tomotsune, What’s New, [http://www.andersonmoritomotsune.com/en/whatsnew/index\\_080101\\_2.html](http://www.andersonmoritomotsune.com/en/whatsnew/index_080101_2.html) (last visited Oct. 17, 2008); Mori Hamada Matsumoto, Lawyers, [http://www.mhmjapan.com/home\\_en/lawyers/](http://www.mhmjapan.com/home_en/lawyers/) (last visited Oct. 17, 2008).

25. See generally Aronson, *supra* note 11, at 810–22.

26. See Aronson, *supra* note 15, at 63 (speaker: Toru Ishiguro).

27. See Zadankai, *supra* note 19, at 39 (speaker: Akira Kosugi). The trend of larger incoming classes has continued as the largest law firm, Nishimura & Asahi, had a class of forty-two new associates in January 2008. Nishimura & Asahi, Topics: News, [http://www.jurists.co.jp/en/topics/others\\_5129.html](http://www.jurists.co.jp/en/topics/others_5129.html) (last visited Oct. 17, 2008).

28. See Aronson *supra* note 15, at 86 tbl. 3.

intense competition among the firms to hire the best new attorneys and has significantly increased the number of elite Japanese attorneys who actively engage in these new areas of legal services.

There is little argument concerning Haley's point that Japan's new graduate level law schools have not initially achieved their goal of a new professional legal education that would be valued by business and government even if the law school graduate did not pass the national bar exam and become a licensed attorney. If this had occurred, it would have been an important indicator of transformative change in the legal profession since professional legal expertise would be more important and highly valued than in the past.<sup>29</sup>

However, the absence of such an indicator of the value of a law school education may not be decisive to our analysis. If it is the elite lawyers who are the agents of change, the question can be rephrased as follows: To what extent have elite lawyers come to play a larger role in business and government? As noted above, the role of elite law firms acting as outside counsel appears to have expanded substantially.<sup>30</sup> What about the activities of lawyers within business and government? Here the evidence is less clear. In recent years the number of qualified lawyers has increased both in corporations and the government, albeit from a very low base. Additionally, there has been little study of the role of these new lawyers in business and no study of their role in government.

Surveys by the Japan In-House Lawyers Association indicate that the total number of in-house lawyers has increased from 64 in 2001 to 242 in 2007.<sup>31</sup> For the central government, the number of in-house government lawyers increased from 40 in 2004 to 69 in 2006.<sup>32</sup>

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29. There is a long-standing argument in Japan about the definition of legal professionals and the importance of lawyer substitutes. This is particularly true in the corporate context, as some claim that the real issue is the overall importance of the legal division or section within a corporation, rather than the number of qualified Japanese attorneys employed. For a comparative discussion of the various categories of legal professionals in Japan, see, e.g., Masanobu Kato, *The Role of Law and Lawyers in Japan and the United States*, 1987 *BYU L. REV.* 627.

30. See *supra* notes 19–22 and accompanying text.

31. See Nihon Soshikinai Bengoshi Kyōkai [Japan In-house Lawyers Ass'n], Kigyōnai Bengoshi no Ninzū to Shozoku Kigyō ni kan suru Chōsa 2001nen [2001 Report on the Number and Corporate Affiliation of In-house Lawyers], available at [http://www.in-house.jpn.org/in-house\\_statistics\\_2001\\_.pdf](http://www.in-house.jpn.org/in-house_statistics_2001_.pdf) (last visited Oct. 17, 2008); NIHON SOSHIKINAI BENGOSHI KYŌKAI [JAPAN IN-HOUSE LAWYERS ASS'N], KIGYŌNAI BENGOSHI NO NINZŪ TO SHOZOKU KIGYŌ NI KAN SURU CHŌSA 2007 NEN SHIMOHANKI [SECOND HALF 2007 REPORT ON THE NUMBER AND CORPORATE AFFILIATION OF IN-HOUSE LAWYERS], available at [http://www.in-house.jpn.org/in-house\\_statistics\\_2007\\_2.pdf](http://www.in-house.jpn.org/in-house_statistics_2007_2.pdf) (last visited Oct. 17, 2008). This 2007 figure also represents a substantial increase from 165 at the end of 2006. See NIHON SOSHIKINAI BENGOSHI KYŌKAI [JAPAN IN-HOUSE LAWYERS ASS'N], KIGYŌNAI BENGOSHI NO NINZŪ TO SHOZOKU KIGYŌ NI KAN SURU CHŌSA 2006 NEN [2006 REPORT ON THE

This recent trend was facilitated by a regulatory change in 2005 that was part of legal reform efforts. An amendment to article 30 of the Practicing Attorneys Law changed a provision that required advance bar association approval of a licensed Japanese attorney (*bengoshi*) going to work for a profit-making enterprise to one that now contains only a notification requirement.<sup>33</sup> It also removed a restriction on *bengoshi* acting as civil servants. Corporations' and the government's increasing willingness to make lateral hires has added to this trend.

Corporate use of in-house attorneys began with the hiring of foreign attorneys to deal with cross-border transactions and foreign law issues. Over time, however, law department personnel came to focus on domestic matters and corporations tended to use outside counsel for cross-border transactions. The recent influx of in-house *bengoshi* has in fact consisted of attorneys used primarily for domestic matters.<sup>34</sup>

As noted above, the Big Four law firms have rapidly increased the number of their associates and have created a pyramid structure. One result is that new associates can no longer expect to make partner,<sup>35</sup> thus creating a new pool of talented and experienced attorneys with the potential to enter into new career paths outside of law firms in business and government. In addition, the increase in the number of newly admitted attorneys each year has made it easier for corporations to hire talented attorneys directly.<sup>36</sup>

With respect to attorneys employed by the central government, the largest number is at the Financial Services Agency.<sup>37</sup> It has also become increasingly common for lawyers at large Japanese law firms to work temporarily for a government agency for a few years on "secondment"

NUMBER AND CORPORATE AFFILIATION OF IN-HOUSE LAWYERS], available at [http://www.in-house.jpn.org/in-house\\_statistics\\_2006.pdf](http://www.in-house.jpn.org/in-house_statistics_2006.pdf) (last visited Oct. 17, 2008).

32. See Nihon Soshikinai Bengoshi Kyōkai [Japan In-house Lawyers Ass'n], Gyōsei Chōnai Bengoshi no Ninzū to Shozoku Chō ni kan suru Chōsa 2004nen [2004 Report on the Number and Agency Affiliation of In-house Government Lawyers], available at [http://www.in-house.jpn.org/gv\\_lawyer2004.pdf](http://www.in-house.jpn.org/gv_lawyer2004.pdf) (last visited Oct. 17, 2008); NIHON SOSHIKINAI BENGOSHI KYŌKAI [JAPAN IN-HOUSE LAWYERS ASS'N], GYŌSEI CHŌNAI BENGOSHI NO NINZŪ TO SHOZOKU CHŌ NI KAN SURU CHŌSA 2006NEN [2006 REPORT ON THE NUMBER AND AGENCY AFFILIATION OF IN-HOUSE GOVERNMENT LAWYERS], available at [http://www.in-house.jpn.org/gv\\_lawyer2006.pdf](http://www.in-house.jpn.org/gv_lawyer2006.pdf) (last visited Oct. 17, 2008) [hereinafter THE 2006 REPORT].

33. See Bengoshi Hō [Practicing Attorney Law], Law No. 205 of 1949, art. 30.

34. See Toshimitsu Kitagawa & Luke Nottage, *Globalization of Japanese Corporations and the Development of Corporate Legal Departments: Problems and Prospects*, in RAISING THE BAR: THE EMERGING LEGAL PROFESSION IN EAST ASIA 201, 246 (William P. Alford ed., 2007).

35. See Aronson, *supra* note 15, at 63 (speaker: Hisashi Hara).

36. See Kitagawa & Nottage, *supra* note 34, at 254.

37. See THE 2006 REPORT, *supra* note 32.

from their law firms. In addition, government agencies, which have in the past sent employees with an undergraduate law degree overseas to study in Master of Law programs, have recently begun to send employees to Japanese law schools where they might take the bar exam and qualify as lawyers in Japan.

The significance of this recent increase in attorneys working for corporations and the central government is difficult to assess, since it depends both on the willingness of business and government to continue to expand their hiring of legal professionals and on the function and work activities of the attorneys within these organizations. Since there are indications that *bengoshi* in corporations engage primarily in domestic matters,<sup>38</sup> this might herald the beginning of a trend of gradually replacing generalists with qualified legal professionals.<sup>39</sup> Further research is needed on the role of lawyers in government. It appears that their primary role is not to create a governmental enforcement function, the absence of which Haley has long cited as a distinguishing characteristic of Japan.<sup>40</sup> However, to the extent they are engaged, at agencies like the Financial Services Agency, in drafting and interpreting rules and regulations, such activities could serve to help increase transparency through clearer rules-based administration.

In sum, the greatest change to date is the expansion of the range of work activities of elite lawyers due to an increase in demand for their services. If we accept this as an important criterion, then arguably there has been a significant change in the legal profession. Activities of lawyers in business and government have recently begun to increase, but further evidence is necessary to evaluate whether such activities are contributing to significant change.

## II. CORPORATE GOVERNANCE

Like the legal profession, Japan's early economic success also had a profound impact on our view of comparative corporate governance. There has similarly been a great deal of legal reform of corporate governance in Japan, including recent overhauls of corporate and securities law.<sup>41</sup> Unlike

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38. See Kitagawa & Nottage, *supra* note 34, at 247.

39. A related point is the apparent change in how corporations select and utilize outside law firms, with a reported trend toward retaining outside counsel on a case-by-case basis in accordance with its expertise and experience, rather than through the traditional methods of introductions and long-term personal relationships. See *id.* at 249.

40. See *supra* note 4.

41. See, e.g., Luke R. Nottage et al., *Japan's Gradual Transformation in Corporate Governance*,

change in the legal profession, however, there is substantial literature on comparative corporate governance, including articles analyzing corporate governance reforms and change in Japan.

The typical approach is to classify corporate governance systems in accordance with one or more of the following bases: (1) the social role of corporations (a narrow focus on maximization of shareholder wealth versus a broader focus on stakeholders and society), (2) ownership structure (diversified shareholders and the issue of agency costs versus concentrated shareholders and the problem of the protection of minority shareholders), and (3) monitoring of management (independent directors plus institutional investors and a market for corporate control versus monitoring by banks or other financial institutions).

The United States and the United Kingdom are generally classified into one type of system characterized by diversified ownership; an emphasis on maximization of shareholder value; and monitoring of management by independent directors, institutional investors, and a market for corporate control. Japan and Germany are generally placed on the other side of the divide, with stakeholder systems having concentrated ownership and monitoring by banks or other large financial institutions that are also shareholders.<sup>42</sup> Commentators who have looked at legal reform and its effects generally start with the basic assumption that either corporate governance systems will converge through globalization and competition (which usually means that other systems will become more like the United States) or, conversely, that the systems will continue to go their separate ways due to path dependence.<sup>43</sup>

Japanese corporate governance has typically been characterized by Japan specialists consistently with the above comparative corporate governance classification scheme, i.e., as a stakeholder system (with an

in CORPORATE GOVERNANCE IN THE 21ST CENTURY: JAPAN'S GRADUAL TRANSFORMATION, app. (forthcoming 2009), available at <http://ssrn.com/abstract=1121510> (last visited Oct. 17, 2008), for an updated list of legal reforms in Japanese corporate governance.

42. For a classification of corporate governance systems along these lines, see, e.g., Marc Goergen et al., *Recent Developments in German Corporate Governance*, 28 INT'L REV. L. & ECON. 175, 177 tbl.1 (2008). However, not all commentators accept this traditional classification of corporate governance systems. A notable exception is a group of corporate law academics who adopt a law and economics approach and emphasize the functional similarities among corporate governance systems in dealing with common problems. See REINIER R. KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* (2004).

43. See, e.g., Henry Hansmann & Reiner Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001) (advocating convergence); Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999) (advocating path dependence).

emphasis on lifetime employment) with concentrated ownership (due to *keiretsu* and cross-shareholding) and bank monitoring.<sup>44</sup>

The result is a very clear dichotomy of the type mentioned earlier: some articles, which focus more narrowly on case studies in Japan, emphasize ongoing or potentially significant change, while other articles, which take a broader, systemic view, typically look for a significantly greater emphasis on the maximization of shareholder wealth as the standard (or, at least, primary criterion) for measuring significant change, and find none.<sup>45</sup>

Corporate governance is not Haley's main area of research, but the criteria for measuring transformational change set forth in his *Heisei* article are generally compatible with the mainstream corporate governance literature: less control by entrenched career managers and more shareholder democracy. Achieving these goals would, in turn, require changes in the employment structure (i.e., an end to the hiring of new graduates as generalists to become core managers, centralized personnel offices, lifetime employment, and the lack of any real lateral market for managers). In addition, any such change would also likely reduce the role of friendly, stable shareholders, whose managers are similarly entrenched and share a similar view of appropriate corporate structure and operations.<sup>46</sup>

In his *Heisei* article, Haley finds that, despite the long list of corporate law reforms, Japanese corporate governance has not fundamentally changed: large public companies "continue to be controlled by career managers who view themselves as the primary stakeholders and actively prevent shareholders from exercising either rights of control or claims to their residual share."<sup>47</sup> Like his criteria, Haley's conclusion is typical of the comparative corporate governance literature on Japan.

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44. See, e.g., MASAHIKO AOKI, INFORMATION, CORPORATE GOVERNANCE, AND INSTITUTIONAL DIVERSITY: COMPETITIVENESS IN JAPAN, THE USA, AND THE TRANSITIONAL ECONOMIES (Stacy Jehlik trans., 2000) (1995). This view has been consistently challenged by the work of Mark Ramseyer, who believes that *keiretsu*, bank monitoring, and other features often attributed to Japanese corporate governance are myths. See, e.g., YOSHIRO MIWA & J. MARK RAMSEYER, THE FABLE OF THE KEIRETSU: URBAN LEGENDS OF THE JAPANESE ECONOMY (2006).

45. For a good example of the latter, see Curtis J. Milhaupt, *A Lost Decade for Japanese Corporate Governance Reform?: What's Changed, What Hasn't, and Why* (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 234, 2003), available at [http://www.law.columbia.edu/center\\_program/law\\_economics/wp\\_listing\\_1/wp\\_author#83138](http://www.law.columbia.edu/center_program/law_economics/wp_listing_1/wp_author#83138) (last visited Oct. 17, 2008) (noting that while corporate law reform has been extensive, it has not yet resulted in a new set of good corporate governance practices).

46. See Haley, *Heisei*, *supra* note 5, at 13–15.

47. *Id.* at 13.

Although an increased emphasis on maximization of shareholder wealth is the most popular criterion in comparative corporate governance generally and in studies of Japanese corporate governance reform, it is not a universally accepted precondition to achieving significant reform. For example, the OECD principles of corporate governance take no view on the social role of corporations and are broad enough to encompass different governance systems.<sup>48</sup> They both emphasize the importance of the maximization of shareholder value and accommodate the principle of governance on behalf of stakeholders. In this sense, corporate governance can be understood as a means to fulfill corporate goals, however they may be defined in a particular system. Accordingly, emphasis on the maximization of shareholder wealth could be seen as analyzing change in a stakeholder system through an inappropriate application of the central element of a shareholder system.<sup>49</sup>

To the extent that many countries with stakeholder systems, such as Japan and Germany, have accepted a greater emphasis on the maximization of shareholder value as one goal of corporate governance reform, it may be fair to measure the actual implementation of such rhetoric. It is difficult, however, to imagine a country radically transforming its corporate governance structure or fundamental approach from a stakeholder to a shareholder-centered system. The social role of corporations is the most fundamental of the three bases for classification of corporate governance systems noted earlier. It is also the most resistant to dramatic change. In both Japan and Germany, there has been substantial legal reform and some change in practices, placing a somewhat greater emphasis on shareholders and somewhat lesser emphasis on company employees—a partial reprioritizing of the importance of various stakeholders within stakeholder systems.

In both countries, the vast majority of commentators unsurprisingly finds that the fundamental structure and approach of the corporate governance system remains intact.<sup>50</sup> It is interesting to note that the few

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48. See OECD, OECD PRINCIPLES OF CORPORATE GOVERNANCE (2004), available at <http://www.oecd.org/daf/corporate/principles.htm>.

49. More precisely, the agency costs typically associated with a shareholder-oriented system result from the conflict between managers and shareholders, with managers acting in their own self-interest rather than in the interests of shareholders. By way of contrast, stakeholder systems often have block shareholders. The basic conflict in stakeholder systems is often described as being between these block shareholders and minority shareholders, rather than between management and shareholders generally. See, e.g., Goergen et al., *supra* note 42.

50. See, e.g., Milhaupt, *supra* note 45; Andreas Hackethal et al., *Banks and German Corporate Governance: On the Way to a Capital Market-Based System?*, 13 CORP. GOVERNANCE: INT'L REV. 397 (2005).

commentators who do find significant systemic change in both Japan and Germany focus on employment and labor law, rather than on corporate law.<sup>51</sup> This focus acts to emphasize the significance of change that results from even a relative lowering of priority for employees compared to other stakeholders.

Is there a middle ground for measuring change that is “significant” but does not fundamentally change the underlying corporate governance system? What would be the criteria for measuring such change?<sup>52</sup>

One could argue that we should abandon the traditional classification of corporate governance systems as a basis for measuring change because of a number of problems inherent in utilizing this approach.<sup>53</sup> A number of recent efforts have moved in that direction.<sup>54</sup>

If, however, we accept the mainstream approach of classification and analysis of corporate governance systems, we can consider the relevance and appropriate weight assigned to all three of the bases of classification of corporate governance systems. The emphasis in the literature, which focuses primarily on the criterion of the social role of corporations and maximization of shareholder value, may be misplaced. A more balanced

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51. See Takashi Araki, *Corporate Governance Reforms and Labor and Employment Relations in Japan: Whither Japan's Practice-Dependent Stakeholder Model?* 1 U. TOKYO J.L. & POL. 45 (2004); Christel Lane, *Changes in Corporate Governance of German Corporations: Convergence to the Anglo-American Model?* (ESRC Ctr. for Bus. Research, Univ. of Cambridge, Working Paper No. 259, 2003), available at [www.cbr.cam.ac.uk/pdf/WP259.pdf](http://www.cbr.cam.ac.uk/pdf/WP259.pdf) (last visited Oct. 17, 2008).

52. Corporate governance scholars have introduced a number of intermediate views on the question of the possible convergence of corporate governance systems. See, e.g., Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329 (2001) (emphasizing functional convergence over formal convergence); John C. Coffee, Jr., *The Future As History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641 (1999) (arguing for functional convergence through stock market cross-listings).

53. Comparisons of corporate governance systems often rely on idealized, static stereotypes, and in some cases include implicit value judgments concerning what constitutes the “best” system. See Bruce E. Aronson, *Reconsidering the Importance of Law in Japanese Corporate Governance: Evidence from the Daiwa Bank Shareholder Derivative Case*, 36 CORNELL INT'L L.J. 11, 53–56 (2003) [hereinafter Aronson, *Daiwa*]. In addition, corporate governance reform may be motivated by a number of purposes that relate to economic objectives, such as a desire to emulate the economic dynamism of a country like the United States or to increase investment by foreign institutional investors, rather than a desire to improve corporate governance per se. See, e.g., Bruce E. Aronson, *What Can We Learn from U.S. Corporate Governance? A Critical Analysis*, 2 U. TOKYO J.L. & POL. 41 (2005).

54. Commentators on Japanese corporate governance, particularly those outside the United States, have recently emphasized that the gradual or incremental reform arguably occurring in Japan is typical of institutional change and should not be subject to an “all-or-nothing” transformational standard. See, e.g., Masahiko Aoki, *Whither Japan's Corporate Governance?*, in CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY 427 (Masahiko Aoki et al. eds., 2007); Nottage et al., *supra* note 41.



approach would consider all of the bases for classification as criteria in arriving at a conclusion as to whether significant change has occurred.

In terms of the criterion of ownership structure, over the past decade there has been substantial change in the ownership structure of public corporations in Japan. The percentage of shares held by the traditional group of management-friendly shareholders, i.e., banks and insurance companies, has declined steadily, while the percentage held by foreign investors has increased dramatically.<sup>55</sup> This is one factor in the rise of M&A transactions and hostile takeover attempts in Japan over the last few years. Although this area contains considerable potential for change, it may be too early to contradict the conclusion of Haley's *Heisei* article that the traditional cross-shareholding system continues to function to protect entrenched management in Japanese corporations. Foreign shareholders have yet to ally with domestic Japanese institutional investors to create a functioning market for corporate control, although this is an area that bears close watching.

The most useful criterion for measuring meaningful change may be the monitoring of management. This approach is based on viewing corporate governance as an attempt to achieve an appropriate balance between providing management with the discretion to make decisions and achieve good business performance with the conflicting desire to constrain management, i.e., to provide a reasonable set of incentives to encourage management to act in good faith to fulfill its fiduciary duties to act primarily on behalf of the corporation and its shareholders.

Discussion of the monitoring of management typically begins with the role of independent directors. However, the effectiveness of independent directors is questionable. Countries like China and Korea are willing to embrace the concept of independent directors for listed corporations precisely because the inclusion of a number of nominally independent directors is unlikely to have a real impact on managerial authority. In addition, corporations in those countries may actually be aiming at an important collateral benefit derived from the introduction of independent directors—a greater willingness of large institutional investors (mostly from the United States and the United Kingdom) to invest in companies that incorporate familiar governance devices such as independent directors while operating in an otherwise weak corporate governance environment.

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55. See Tokyo Stock Exchange Group, 2007 Shareownership Survey (June 18, 2008), <http://www.tse.or.jp/english/market/data/shareownership/english2007.pdf>.

Accordingly, rather than focus primarily on the identity of the particular actors who are assigned to fulfill this monitoring function (e.g., independent directors, institutional investors, or main banks), it might be more productive to consider the extent to which a corporate governance system provides any would-be monitor of management the necessary environment and tools to be effective. In this sense, if the corporate governance system in the United States generates more effective monitoring of management than that of countries such as Japan, that result may be attributable primarily to two underlying features of the American system—greater information disclosure and enforcement, particularly private enforcement—rather than to the particular formal mechanisms that are thought to monitor management.

Does a greater focus on the monitoring of management lead to a different result when evaluating whether there has been significant systemic change in corporate governance in Japan? Viewed from this perspective, Japan has arguably still not done enough to create a systemwide environment conducive to the effective monitoring of management.<sup>56</sup> At the same time, however, there are a number of specific areas within corporate governance where change arguably has resulted in an altered operating environment and created a partial constraint on management behavior. Therefore, the more difficult question remains: How do we evaluate the areas in which important changes have occurred not only in law, but also in corporate practices?

One such area is corporate compliance and internal controls, which began with a court decision in the Daiwa Bank shareholder litigation in 2000<sup>57</sup> and was incorporated into Japan's Corporation Codes in 2005. Another would probably be the area of mergers and acquisitions and defensive measures.<sup>58</sup> Hostile takeovers remain difficult and no one claims that Japan has established an effective market for corporate control. However, this was an area of only theoretical concern just five years ago. Today, hundreds of Japanese companies have adopted defensive measures; all large corporations follow the area closely and incorporate it into their decision-making.

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56. It should be noted, however, that recent overhauls of both the corporate and securities laws have the potential to be a force for significant change, particularly the increased information disclosure provided under the securities law (the so-called Japanese version of Sarbanes-Oxley, or "J-SOX"). See *Kaisha Hō* [Corporation Code], Law No. 86 of 2005; *Kinyū Shōhin Torihiki Hō* [The Financial Instruments Exchange Law], Law No. 65 of 2006.

57. See generally Aronson, *Daiwa*, *supra* note 53.

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

Are there enough specific areas where important changes in actual corporate governance practices, and not just in formal law, add up to a significant change in corporate governance, i.e., a significant increase in the monitoring of management and/or a meaningful constraint on management discretion and authority? Emphasis on this monitoring criterion arguably leads to a closer call than the standard analysis, which looks for a new, significant emphasis on the maximization of shareholder value and finds no significant change in Japanese corporate governance.

#### CONCLUSION

There can be considerable debate and differences of opinion as to whether legal reforms in Japan have led to significant “real” change. This Essay’s examination of the legal profession and corporate governance emphasizes that the answer will depend on the criteria used to analyze the significance of such change. And that is a methodological point that deserves far more serious consideration than it has received to date.

Haley’s criteria for measuring change are well within the mainstream of comparative studies and constitute a reasonable approach for measuring transformational change. However, this Essay suggests that it might well be useful to change our focus from the extremely rare case of systemic change to a set of criteria that is arguably more suitable for measuring significant change. This Essay’s application of a new set of criteria does, indeed, lead to different results than the standard analysis. In the case of the legal profession, a focus on demand, as well as supply, and an expansion in the role of lawyers arguably point to significant change in the legal profession. In the area of corporate governance, a greater emphasis on the monitoring of management and change in ownership structure, rather than on maximization of shareholder value, may result in a closer question than generally acknowledged, with important changes in corporate practice in a number of areas.

Today, Japan might be willing to engage in Russell Baker’s tongue-in-cheek trade of cars for lawyers. Anyone with a serious interest in how this change came about and the limits of change in Japan could do no better than to read the works of John Haley. Given Haley’s unique and extensive background in Japanese and comparative law and comparative studies, he is ideally situated to extend his work on continuity and change to devise new, more nuanced approaches to meaningfully measure legal reform and societal change. His work will continue to light the path for the rest of us to follow.