

# JAPANESE COMMERCIAL TRANSACTIONS AND SANCTIONS REVISITED: *SUMITOMO v. UFJ*

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## INTRODUCTION

As Japan's "bubble economy" collapsed in 1989, Japanese government and industry turned to deregulatory policies as a way of restructuring the economy. As part of that process, formal law, legal institutions, and lawyers were all elevated as regulatory techniques. Rule-based, hierarchical controls became more visible.<sup>1</sup> At the same time, informal regulation through changing social norms, industry practices, and self-regulation tools such as codes of conduct and ethics emerged in new forms. I call this process the "re-regulation" of Japan.<sup>2</sup>

My approach to understanding the last two decades of regulatory reform in Japan owes much to John Haley's theories of the Japanese legal system.<sup>3</sup> Haley argues that, despite its highly developed legal system, the Japanese state has relied heavily on informal social ordering and norm enforcement in order to achieve its policy goals.<sup>4</sup> Moreover, he argues, this mix of formal and informal legal sanctions is the result of strong historical continuity in the evolution of social, economic, and legal institutions in

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1. For an analysis of how Japanese governance changed in response to global geo-political and economic shifts, see NAOKI TANAKA, *NIHON NO ATARASHII RŪRU [JAPAN'S NEW RULES]* (2004).

2. Veronica L. Taylor, *Re-regulating Japanese Transactions: the Competition Law Dimension*, in *JAPANESE GOVERNANCE: BEYOND JAPAN INC.* (Peter Drysdale & Jennifer Amyx eds., 2003).

3. JOHN O. HALEY, *AUTHORITY WITHOUT POWER: LAW AND THE JAPANESE PARADOX* (1991). A related paradigm that has been highly influential and remains salient is Frank Upham's focus on litigation as an avenue of social protest. See FRANK K. UPHAM, *LAW AND SOCIAL CHANGE IN POSTWAR JAPAN* (1987). See also Eric Feldman's application of Upham's approach to the contemporary area of health policy. ERIC FELDMAN, *THE RITUAL OF RIGHTS IN JAPAN: LAW, SOCIETY AND HEALTH POLICY* (2000). The third dominant paradigm from the same generation of Japanese law scholars is, of course, Mark Ramseyer's application of Chicago School economics to Japan. For his full bibliography, see [http://www.law.harvard.edu/faculty/directory/follow "Ramseyer; J.Mark"](http://www.law.harvard.edu/faculty/directory/follow%20Ramseyer%20J.Mark) hyperlink; then follow "View Bibliography" hyperlink; then follow "full bibliography" (last visited Feb. 10, 2009). All three scholars employ different normative stances and very different methodologies, with Ramseyer's preference for statistical data and regression analysis fitting neatly with trends in U.S. political science that emphasize "big N" style research. This Essay is not an intellectual history of the field, and so I limit my analysis to themes from Haley's thesis.

4. HALEY, *supra* note 3.

Japan. In his depiction of mutually interdependent formal and informal modes of ordering within Japan, Haley seems to anticipate the pluralism that is the focus of much contemporary regulatory theory.<sup>5</sup> However, he articulated this paradigm in *Authority Without Power*<sup>6</sup> at precisely the time when Japan's high growth economy began to slump and many modes of regulation thought to be distinctively Japanese started to unwind. What has followed is a series of debates across different disciplines about whether, and to what extent, Japanese regulation since the 1990s represents a paradigm shift, and, if so, towards what. Within the field of law, Haley argues that the twenty-first-century legal and regulatory mechanisms of governance in Japan represent, on balance, continuity, rather than a dramatic rupture between the present and past.<sup>7</sup>

In this essay I examine Haley's claim that we see more regulatory continuity than change in Japan, testing it against a case study of the failed banking merger between Sumitomo and UFJ financial groups (as they were then known) in 2004. The breakdown of this transaction made international headlines when Sumitomo sought a court injunction against UFJ and, when that failed, sued UFJ for breaching its agreement to negotiate.<sup>8</sup> On appeal from that lawsuit in 2006, the parties settled, with Sumitomo receiving ¥2.5 billion (USD 21 million) in damages.<sup>9</sup> On one hand, the failed merger illustrates the salience of Haley's paradigm of Japanese law. Two major Japanese banking groups wind up in atypical litigation, and, as the attempted merger unravels, we see them choosing from both the "informal" and the "formal" sides of Haley's model of strategies and sanctions. The courts, in turn, invoke familiar legal and social norms as they frame the dispute. Consistent with Haley's thesis, we also see a "private" commercial transaction overlaid with a "public" concern about the future shape of a key Japanese industry and debates about the appropriate form and pace of deregulation. On the other hand, the transaction underscores the limitations of Haley's model when applied

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5. *Id.* For a survey of regulatory theory, see Christine Parker & John Braithwaite, *Regulation*, in OXFORD HANDBOOK OF LEGAL STUDIES 119 (Peter Cane & Mark Tushnet eds., 2002) (surveying regulatory theory); BRONWEN MORGAN AND KAREN YEUNG, AN INTRODUCTION TO LAW AND REGULATION: TEXT AND MATERIALS (2007).

6. HALEY, *supra* note 3.

7. John O. Haley & Veronica L. Taylor, *Rule of Law in Japan*, in DISCOURSES ON RULE OF LAW IN ASIA 446, 467 (Randall Peerenboom ed., 2004).

8. Martin Fackler & Henny Sender, *Court Limits Japan Bank Merger Talks*, WALL ST. J., July 28, 2004, at C5.

9. Press Release, Mitsubishi UFJ Financial Group, Settlement Agreed with the Sumitomo Trust & Banking Co., Ltd. (Nov. 21, 2006), available at <http://www.mufg.jp/data/current/pressrelease-20061121-001-e.pdf>.

to a globalized and now re-regulating Japan. The parties to this dispute operate in a financial market that is subject to both global and domestic regulation at multiple levels. New elements emerge from the transaction, including a host of new regulatory actors, such as foreign investors and lawyer intermediaries. These new elements, in turn, prompt the parties to turn to the courts as arbiters of the dispute—a move that is both deliberate and likely to endure. Together these elements suggest that Haley’s “law without sanctions” needs to be re-thought in twenty-first-century Japan.

#### HALEY’S JAPAN AND LEGAL AND REGULATORY REFORM SINCE 1989

Haley’s Japan is a complex place, full of light and shade. His Japanese state is characterized by “authority without power,” possessing a highly developed system of legal rules, standards and mechanisms for formal adjudication but choosing to harness social norms and rely heavily on informal social ordering and norm enforcement in order to achieve its policy goals:

Legislators, bureaucrats and judges may continue to articulate and apply, and thus legitimate, new rules and standards of conduct. The norms thus created and legitimized may have significant impact. To the extent that legal sanctions are weak, however, their validity depends upon consensus, and thus as “living” law, they become nearly indistinguishable from nonlegal or customary norms.<sup>10</sup>

The weakness of legal sanctions is thus a feature of the system and the corollary to the “myth of the reluctant litigant,” which holds that relatively low levels of litigation can be explained by the state’s rationing of formal legal adjudication and sanctions through institutional design.<sup>11</sup> A highly credentialed and independent Japanese judiciary, procuracy, and bar are deliberately constrained by the state so that both their capacity to deliver formal sanctions and their accessibility to citizens is limited. This, in turn, feeds the social stigma associated with using litigation as a dispute resolution mechanism. Haley argues that this controlled mix of formal legal sanctions and informal social ordering represents a strong historical continuity in the evolution of social and legal institutions in Japan. While stressing these historical antecedents, Haley also acknowledges that culture is fluid and that the norms underpinning these policy decisions and institutional design choices are subject to change.

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10. HALEY, *supra* note 3, at 169.

11. See John O. Haley, *The Myth of the Reluctant Litigant*, 4 J. JAPANESE STUD. 359 (1978).

In the commercial sphere, the paradigm involves a kind of legal dualism: Japanese domestic transactions need a relatively small number of legal professionals, if any, and rely on minimalist design in contract transactions and avoidance of commercial litigation and arbitration. “International” transactions, by contrast, are export-oriented and have controllable international inputs of standards, services, and capital. Haley represents the duality thus:

The demand for ways to reduce the risk and costs intrinsic to a volatile social and economic environment is also manifest in the prevalence of dependency and relational contracting. The oft-repeated Japanese penchant for informal, long-term contractual relationships, in which “goodwill” and personal trust are more important than written contracts, is symptomatic of transactional relationships in which the parties rely more on morals and markets than laws for enforcement. . . . On the other hand, when contracting abroad within legal systems Japanese believe are likely to enforce their agreements, they negotiate and draft with extreme care. Similarly a Japanese firm will assiduously abide by adverse commitments to its contract partners in cases where sanctions—either informal, arising out of either their relative bargaining positions or the promise of an ongoing relationship, or formal, such as the likelihood of legal action—are perceived to be strong.<sup>12</sup>

This observation raises the question whether, as Japan’s high growth economy began to slump after 1989 and policy-makers began to rethink regulation, these dualist transactional preferences and practices changed. The *Sumitomo v. UFJ* dispute described below suggests that they have.

The 1990s were called the “lost decade” by many Japanese and foreign scholars because of the perceived failure by the governing triumvirate of the Liberal Democratic Party, career bureaucrats, and big business to deregulate a stalled economy.<sup>13</sup> By 2008 many commentators agreed that the Japanese government and industry *had* significantly restructured key political, economic and social institutions since 1989,<sup>14</sup> but they continue

12. HALEY, *supra* note 3, at 181.

13. *See, e.g.*, EDWARD J. LINCOLN, ARTHRITIC JAPAN: THE SLOW PACE OF ECONOMIC REFORM (2001); Luke Nottage & Leon Wolff, *Corporate Governance and Law Reform in Japan: From the Lost Decade to the End of History?* (Comparative Research Law & Political Econ., Research Paper No. 3/2005, 2005). Others argued that the deregulatory push in Japan, albeit fitful between the Nakasone (1982–1987) and Koizumi cabinets (2001–2006), induced important and enduring institutional changes. *See also* JAPANESE GOVERNANCE: BEYOND JAPAN INC., *supra* note 2.

14. *See, e.g.*, Gregory Noble, *Koizumi and Neo-liberal Economic Reform*, SOC. SCI. JAPAN 34

to disagree about the pace and effect of regulatory reform and whether Japan has been “remodeled,”<sup>15</sup> “reprogrammed,”<sup>16</sup> or has adopted “aggressive legalism”<sup>17</sup> in spheres such as industrial policy, technology, and trade.

My own hypothesis is that Japan has shifted from being a “developmental state” to being a “new regulatory state”<sup>18</sup> and the interesting question is how the contours of the new regulatory arrangements are being laid in different areas of the economy. For the purposes of this Essay, I limit this argument to the *Sumitomo v. UFJ* case study and four regulatory shifts that it seems to illustrate: (i) diffusion of state regulatory functions to private actors or quasi-state actors; (ii) new modes of corporate self-regulation; (iii) the impact of globalization on factors (i) and (ii); and (iv) a turn to formal law, or juridification. Below I outline the facts and the legal strategies used in *Sumitomo v. UFJ* and then consider how this dispute may illustrate these regulatory shifts.

#### THE PROPOSED SUMITOMO-UFJ MERGER

The transaction began as a consensual merger negotiation between two major financial institutions in Japan in the wake of its banking crisis of 1997-1998.<sup>19</sup> This crisis had prompted the government to re-regulate the industry by stripping banking supervision from the Ministry of Finance in 1998 and creating an independent regulator, the Financial Supervision Agency (“FSA,” later known as the Financial Services Agency).<sup>20</sup> The FSA was charged with applying stringent global standards, including new accounting rules to implement the Basel capital adequacy requirements for banks.<sup>21</sup> A wave of industry restructuring followed: between 2000 and

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(NewsI. of Inst. Soc. Sci., Univ. of Tokyo), Mar. 2006, at 6–9; see also STEVEN K. VOGEL, JAPAN REMODELED (2006).

15. VOGEL, *supra* note 14.

16. MARIE ANCHORDOGUY, REPROGRAMMING JAPAN (2005).

17. Saadia M. Pekkanen, Aggressive Legalism: The Rules of the WTO and Japan’s Emerging Trade Strategy, 24 WORLD ECON. 707 (2001); SAADIA M. PEKKANEN, JAPAN’S AGGRESSIVE LEGALISM: LAW AND FOREIGN TRADE POLITICS BEYOND THE WTO (2008).

18. Parker & Braithwaite, *supra* note 5, at 119.

19. Three large financial institutions failed in 1997, including city bank Hokkaido Takushoku Bank. Hiroshi Ōta, *Economic Forum: Learning the Painful Lessons of the Financial Crisis*, DAILY YOMIURI, Nov. 24, 1999, at 7. These failures were followed by the 1998 collapse of the Long-Term Credit Bank of Japan and Nippon Credit Bank. Takahisa Ishii, *Megabanks in the Making: Sense of Banking Crisis Precipitated Alliances*, DAILY YOMIURI, Oct. 16, 1999, at 1.

20. Kaoru Hosono, Koji Sakai & Kotaro Tsuru, *Consolidation of Banks in Japan: Cause and Consequences* 11–12 (Nat’l Bureau of Econ. Research, Working Paper No. 13399, 2007), available at <http://www.nber.org/papers/w13399.pdf>.

21. *Id.*

2002 seven mergers had occurred among major banks.<sup>22</sup> In 2004, at the tail end of this process, Sumitomo and UFJ were looking for merger partners, and the stakes were high. Within a domestic banking industry that had chalked up ten consecutive years of losses, UFJ was one of two city banks at the time that was severely undercapitalized (and possibly substantively insolvent).<sup>23</sup> Analysts predicted that the Japanese market could only support a finite number of truly global banks.

On May 21, 2004, Sumitomo announced its intention to purchase UFJ's trust banking unit, one of UFJ's only profitable operations.<sup>24</sup> The value of the transaction was ¥300 billion (USD 2.76 billion).<sup>25</sup> A letter of intent between Sumitomo Trust and Banking Company<sup>26</sup> ("Sumitomo") and the UFJ Holdings Group ("UFJ") regarding the UFJ Trust Bank was formally drafted and reviewed by the parties' attorneys. Article 8 of the agreement provided that each party was to negotiate in good faith to conclude a basic agreement on the detailed terms of the business integration by the end of July 2004 and conclude a final agreement on integration as soon as practicable.<sup>27</sup> Article 12 of the agreement further (a) obliged the parties to negotiate in good faith on matters stipulated in the letter of intent and any matters arising from but not stipulated in the agreement and (b) prohibited the parties from either directly or indirectly providing information to, or negotiating with, third parties in relation to any matters that were the subject of the agreement.<sup>28</sup>

Significantly, the agreement contained no penalties for non-performance.<sup>29</sup> "We suggested a breakup fee to Sumitomo Trust's says one

22. *Id.* at 12.

23. Takeo Hoshi & Anil K. Kashyap, *Solutions to Japan's Banking Problems: What Might Work and What Definitely Will Fail* 25 (Aug. 27, 2004) (draft prepared for the US-Japan Conference on the Solutions for the Japanese Economy), available at [http://www.ier.hit-u.ac.jp/%7Eiwaisako/solutions/Hoshi-Kashyap\\_final.pdf](http://www.ier.hit-u.ac.jp/%7Eiwaisako/solutions/Hoshi-Kashyap_final.pdf).

24. *UFS to Sell Trust Bank Unit*, DAILY YOMIURI, May 21, 2004, at 1.

25. *Id.*

26. Sumitomo Trust and Banking Company was, and remains, a separate entity from Sumitomo Mitsui Financial Group, although both are part of the Sumitomo corporate group. See [http://www.sumitomotrust.co.jp/IR/company/en/about\\_html/group.html](http://www.sumitomotrust.co.jp/IR/company/en/about_html/group.html); <http://www.smfg.co.jp/english/aboutus/profile/>.

27. *Compare* Fackler & Sender, *supra* note 8 (reporting that the banks agreed to a two-year negotiation period), *with* Sumitomo Trust & Banking Corp. v. UFS Holdings Corp., 1928 HANREI JIHŌ 3 (Tokyo D. Ct., Feb. 13, 2006) (stating that the agreed upon term was one year and ten months).

28. Sumitomo Trust & Banking Corp. v. UFS Holdings Corp., 1708 SHŌJI HŌMU 22, 24 (Sup. Ct., Aug. 30, 2004). The undertakings to negotiate in good faith were, of course, applications of the Japanese Civil Code, which states that "[t]he exercise of rights and performance of duties shall be done in faith and in accordance with the principles of trust," and which applies to all legal acts in Japan, whether explicitly incorporated in the terms of the agreement or not. MINPŌ, art. 1, para. 2, *translated in* 2 EHS LAW BULL. SERIES, No. 2100-01 (2005).

29. See the summary of the transaction documentation in Mitsuru Claire Chino, Noboru

lawyer who worked on the deal. ‘But they rejected it, saying the business must be based on trust.’<sup>30</sup>

On July 13, 2004, UFJ unilaterally broke off merger talks with Sumitomo and on July 14 it entered into full merger talks with the Mitsubishi Tokyo Financial Group (“MTFG”).<sup>31</sup> Ultimately, MTFG acquired the UFJ Group, including the UFJ Trust Bank, creating the world’s largest bank with USD 1.75 trillion in assets.<sup>32</sup> That merger took place in 2005, creating the Mitsubishi UFJ Financial Group (“MUFG”), of which the Bank of Tokyo-Mitsubishi UFJ, Mitsubishi-UFJ Trust and Banking, and Mitsubishi-UFJ Securities are subsidiary units.<sup>33</sup>

Sumitomo responded to this breakdown in negotiation by calling the press. As a result, UFJ’s termination of the letter of intent was widely reported: “‘They just told us all of a sudden,’ Sumitomo Trust spokesman Naoki Sugihara said. ‘We were shocked that they would cancel something so critical without at least consulting us first.’”<sup>34</sup>

On the same day, July 14, 2004, UFJ and MTFG shares were suspended on the basis of the possible merger and Sumitomo’s share price subsequently fell by about fourteen percent.<sup>35</sup> Two days later, on July 16, 2004, UFJ and MTFG announced talks aimed at effecting a merger. Sumitomo issued a formal objection and immediately sought an interim injunction from the Tokyo District Court restraining UFJ from both providing information to, and negotiating with, third parties.<sup>36</sup>

#### SUMITOMO’S MULTI-TRACK APPROACH TO THE NEGOTIATION BREAKDOWN

Sumitomo responded to UFJ’s termination of the negotiation by pursuing a multi-track strategy. First, it sought injunctive relief to prevent UFJ from proceeding with merger talks with MTFG, a move that was

Kashiwagi & Ayako Okada, *Contract and Tort*, in JAPANESE BUSINESS LAW 173, 179 (Gerald McAlinn ed., 2007).

30. Fackler & Sender, *supra* note 8.

31. Confusingly, after the initial merger that created this bank, it was known in Japanese as Mitsubishi-Tokyo Bank (and is reported as such in the English language press coverage of this failed merger), but it is officially known in English as the Bank of Tokyo-Mitsubishi.

32. Fackler & Sender, *supra* note 8.

33. See Mitsubishi UFJ Fin. Group, About MUFG, <http://www.mufg.jp/english/profile/group> (last visited Feb. 10, 2009).

34. Fackler & Sender, *supra* note 8.

35. *Id.*

36. Kan Tsutagawa, *Economic Forum: UFS Battle Banks from Past*, DAILY YOMIURI, Aug. 4, 2004, at 4.

successful in the short term but overturned on appeal.<sup>37</sup> Second, it sought to convince UFJ's shareholders, through media announcements, that the Sumitomo merger, including a one-for-one share exchange, represented better value for UFJ than the proposed rival merger.<sup>38</sup> This effort was significant because any merger of a business of this size would require a special resolution (two-thirds approval) by shareholders at a general meeting.<sup>39</sup> At the time about one-third of UFJ's shares were reportedly owned by foreign investors.<sup>40</sup>

In support of its claim that it represented a better tie-up partner, Sumitomo launched a counter-offer to the MTFG proposal on August 9, 2004, announcing that it was ready to offer a ¥500 billion (USD 4.48 billion) tranche of fresh capital to help write off UFJ's bad loans, in addition to reserving management positions for UFJ executives in the new merged entity.<sup>41</sup> Then, on October 7, 2004, Sumitomo Mitsui Financial Group announced that it had purchased three hundred shares in UFJ Holdings, "raising the prospect of a proxy fight at the weaker rival's annual meeting."<sup>42</sup> Part of this strategy was aimed at influencing press opinion and encouraging foreign shareholder and outside director pressure on UFJ to consider Sumitomo's counteroffer and recommence negotiations. This maneuvering reportedly resulted in a letter writing campaign from shareholders to UFJ management, asking it to consider alternative proposals to the Mitsubishi Tokyo deal.<sup>43</sup>

At this point UFJ was under intense financial pressure. Having posted losses for three years in a row, it was carrying significant debt from bad loans, which were publicly declared to be 10.24% of its loan portfolio in August 2004.<sup>44</sup> Press reports speculated that UFJ would be subject to government pressure to resolve these problems quickly and seek a large capital infusion to prevent its capital levels from dwindling to dangerous lows.<sup>45</sup>

37. *Id.*

38. David Ibsan, *Final Ratio Will Determine Victor in Battle for the Banks*, FIN. TIMES, Feb. 16, 2005, at 16.

39. SHŌHŌ, art. 343, *translated in* EHS L. BULL. SERIES, No. 2200-01 (2005).

40. Andrew Morse, *Sumitomo Mitsui Raises Heat on UFJ*, WALL ST. J. (ASIA), Oct. 8, 2004, at A1.

41. Andrew Morse & Martin Fackler, *Japan Bank Fight Grows More Public*, WALL ST. J., Aug. 9, 2004, at A3.

42. Morse, *supra* note 40.

43. *Id.*

44. Morse & Fackler, *supra* note 41.

45. In October 2004 it also became the target of a criminal complaint against UFJ's banking unit and former executives for allegedly obstructing an investigation by hiding and destroying documents, resulting in the suspension of some of its banking operations by regulators. Morse, *supra* note 40.



When UFJ announced its plans to go with MTFG, Sumitomo turned to a third strategy—consideration of a hostile takeover of UFJ. This then prompted a ¥700 billion (USD 6.28 billion) capital injection into UFJ's commercial bank by MTFG, with UFJ issuing a new class of preferred shares of MTFG in return on September 10, 2004, giving MTFG veto power over UFJ's major business decisions—in effect a poison pill defense.<sup>46</sup> The fourth and final strategy was to commence Sumitomo's litigation for damages for losses suffered during the breakdown of the negotiation and its protracted attempt to restart it.<sup>47</sup>

#### THE COURT INJUNCTION TRACK

While the business strategies of the two parties played out, Sumitomo had initiated a parallel legal track, seeking formal injunctive relief from the courts in order to force UFJ back to the negotiating table.<sup>48</sup>

On July 27, 2004, the Tokyo District Court granted the injunctive relief sought by Sumitomo.<sup>49</sup> That decision was based on the idea that the parties had evidenced their agreement in writing, and therefore, in the absence of other compelling reasons, this agreement should be treated as binding.<sup>50</sup> Moreover, the draft of the letter of intent including the lock-in clause had been prepared by Sumitomo, reviewed by the lawyer for UFJ, modified by agreement of those responsible on behalf of the parties, and then signed and sealed by the parties' representative directors.<sup>51</sup> It should, therefore, be treated as legally binding. Clearly, negotiations between UFJ and a third party would cause serious damage and immediate danger to the applicant and to avoid this, injunctive relief was necessary.<sup>52</sup>

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46. *Id.*; Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171, 2178 n.21 (2005) (citing *Scramble for UFJ, Sumitomo Mitsui Seen at Dead End*, NIKKEI BUS., Sept 20, 2004, available at <http://nikkeibp.jp/wes/leaf/CID/onair/nbc/features/332662>). In substance this was a poison pill defense, but it was applied ahead of those adopted by other Japanese takeover targets and in advance of formal court consideration and ratification of the poison pill defenses in Japanese corporations law. For an extended discussion of these later developments, see *id.*; Cristina Alger, Note, *The Livedoor Looking Glass: Examining the Limits of Hostile Takeover Bids in Japan*, 3 N.Y.U. J.L. & BUS. 309 (2006).

47. Milhaupt, *supra* note 46, at 2178.

48. Fackler & Sender, *supra* note 8.

49. *Id.*

50. Milhaupt, *supra* note 46, at 2178.

51. Sumitomo Trust & Banking Corp. v. UFS Holdings Corp., 1708 SHŌJI HŌMU 22, 24 (Sup. Ct., Aug. 30, 2004).

52. MINJI HOZEN HŌ [JAPANESE CIVIL PRESERVATION CODE], Law No. 91 of 1989, art. 23, para. 2.

In response to UFJ's formal objection to the injunction, the Tokyo District Court confirmed its original injunction and issued an injunction for preservation on August 4, 2004.<sup>53</sup> UFJ appealed the original injunction to the Tokyo High Court, which set the injunction aside on August 11, 2004. Within hours, the boards of directors of MTFG and UFJ approved a merger of the two groups.<sup>54</sup>

In setting aside the injunction, the Tokyo High Court confirmed that article 12 of the letter of intent was legally valid and could be the basis for a restraining injunction.<sup>55</sup> Moreover, the declaration by UFJ dated July 14, 2004, stating that it was terminating the agreement had no legal basis.<sup>56</sup> However, the court found that:

In relation to the said agreement, the major precondition was a mutual trust relationship supported by good faith efforts to bring about a cooperative enterprise. When the applicants decided to overcome their difficult situation by setting aside the agreement [literally returning the agreement to a blank piece paper] and announced this publicly and when the respondent reacted by seeking the injunction and in that initial hearing and in this hearing both arguments have been in opposition, the trust relationship has significantly eroded and we are in a situation where it is difficult to bridge the parties' [differences]. As of today, viewed objectively, the trust relationship between the parties has already broken down; moreover, we have to assume that it is already impossible for the parties to negotiate in good faith to reach a final agreement. Consequently, at the very latest, we would view the final day of the examination, 10 August 2004, as being the point at which the article in question substantively has lost its prospective binding effect and at this point there is no leeway to allow a restraining injunction.<sup>57</sup>

On further appeal by Sumitomo, the Supreme Court, on August 30, 2004, affirmed the High Court decision to set aside the injunction.<sup>58</sup> First, the Supreme Court concurred with the High Court that the letter of intent was legally valid, that it could be the basis for an injunction, and that

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53. *See generally id.*

54. Milhaupt, *supra* note 46, at 2178. Presumably this was a directors' resolution subject to confirmation at a later shareholders' meeting.

55. *Sumitomo*, 1708 SHŌJI HŌMU at 23.

56. *Id.*

57. *Id.*

58. *Id.*

subsequent events did not cause it to lose its legally binding power.<sup>59</sup> The Court then noted that by this time, UFJ had announced a merger with Tokyo-Mitsubishi and a plan to complete that transaction by October 1, 2005.<sup>60</sup>

Next, on the question of whether the lock-in clause had lost its legal effect, the Supreme Court held that the purpose of the clause was to make good faith negotiation possible and that it was therefore intimately linked to the negotiation itself.<sup>61</sup> As a result, once the possibility of a final agreement no longer existed, the obligation underlying the lock-in clause was extinguished.<sup>62</sup> Reviewing the chronology of events to that point, the Court judged the likelihood of reaching a final agreement to be “low.”<sup>63</sup> Nevertheless, the Court then continued:

However, in light of the overall chronology in this case, it is not possible to say that all fluid factors have completely disappeared and so, from a social sense [*shakaisūnen*, literally the conventional wisdom of society] we cannot say that the possibility referred to above does not exist. Thus the obligation underlying the article in question must be treated as not having been extinguished.<sup>64</sup>

Thus the Court upheld the obligation to negotiate.

The Court then turned to the question of whether a sufficient dispute existed between the parties to justify injunctive relief in order to avoid serious damage or immediate danger to one of the parties. On this point, the Court held that the letter of intent did not compel the conclusion of a final agreement, but instead only made possible the conditions for the negotiations that might have that result.<sup>65</sup> Therefore, Sumitomo had simply a hope of reaching a binding agreement. Consequently, any damage suffered by Sumitomo should not be assessed as resulting from the loss of profits or benefits that would have accrued from a final agreement.<sup>66</sup> In light of the low likelihood of a final agreement being reached and the passage of time up until that point, the Court then found no serious

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59. *Id.* at 25.

60. *Id.* at 24.

61. *Id.* at 25.

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

66. *Id.*

damage or immediate danger sufficient to justify granting a restraining injunction.<sup>67</sup>

Against this background, UFJ and Mitsubishi finally concluded their contract of merger on February 18, 2005, merging to become MUFG on October 1, 2005.<sup>68</sup>

#### THE LITIGATED DAMAGES CLAIM

Once it became clear that the transaction was dead and that the injunctive track was exhausted, Sumitomo launched a suit for tort damages in the amount of ¥100 billion for breach of the duty of good faith created by the letter of intent on March 7, 2005, and for the failure to conclude a final agreement.<sup>69</sup> The case raised five issues:

- (a) Was there an obligation under the letter of intent to conclude a final agreement?
- (b) Could article 130 of the Civil Code be applied directly or analogously as the basis for an estoppel that required the UFJ group to conclude a final agreement?
- (c) Did UFJ have an obligation to negotiate in good faith and exclusively with Sumitomo?
- (d) Did UFJ's obligation to negotiate in good faith and exclusively with Sumitomo expire on July 13, 2004, had it breached these obligations, and was there a non-performance of an obligation or a tort?
- (e) If there was non-performance of an obligation or a tort, what was the amount of foreseeable damages?<sup>70</sup>

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67. *Id.*

68. Press Release, Mitsubishi Tokyo Financial Group et al., MTFG and UFJ Group Enter into an Integration Agreement, Which Sets Forth the Merger Ratios and Official Corporate Names of the New Group (Feb. 18, 2005), available at [http://www.mufg.jp/english/pressrelease/2005-mtfg/pdf/050218e\\_06.pdf](http://www.mufg.jp/english/pressrelease/2005-mtfg/pdf/050218e_06.pdf); Press Release, Mitsubishi UFJ Financial Group, Establishment of Mitsubishi UFJ Financial Group (Oct. 3, 2005), available at <http://www.mufg.jp/data/current/pressrelease-20051003-001-e.pdf>.

69. Sumitomo Trust & Banking Corp. v. UFS Holdings Corp., 1928 HANREI JIHŌ 3 (Tokyo Dist. Ct., Feb. 3, 2006).

70. *Id.* at 6.

The Tokyo District Court responded to those questions as follows:

(a) The letter of intent was concluded at a relatively early state in the parties' negotiations, on the basis of limited information exchanged. It included no provision that clearly required a final agreement to be reached, and so the parties could not be treated as having assumed an obligation to conclude a final agreement. Moreover, this was something that could only be done as the result of a decision reached after further negotiation and due diligence.<sup>71</sup>

(b) Since the content of a final contract was not determined and no final contract was validly created, the necessary prerequisite for the direct application or application by analogy to article 130 of the Civil Code was lacking.<sup>72</sup>

(c) The UFJ group was under an obligation to negotiate exclusively with Sumitomo and to negotiate in good faith.<sup>73</sup>

(d) Since the letter of intent was a process for forming a final agreement, when the possibility for creating a final contract through repeated negotiation between Sumitomo and the UFJ group no longer existed, their obligations would also be extinguished; however, in the case where the UFJ group had—without negotiation or consultation—announced that it would set aside the letter of intent, it could not be said that no possibility of forming a final contract existed.<sup>74</sup> Thus the obligation to negotiate exclusively and the obligation to negotiate in good faith could not be said to expire; moreover when UFJ group unilaterally took merger discussions to the Mitsubishi Tokyo Financial Group (MTFG), in doing so they assumed the burden of breaching these [obligations or committing a tort];<sup>75</sup>

(e) To the extent that a final contract did not exist, a foreseeable relationship between the breach of the obligations to negotiate exclusively and to negotiate in good faith and the profit that would have arisen under a final contract, could not be established, and since Sumitomo was unable to show or prove damages arising from

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71. *Id.* at 15. The decision uses the legal neologism *dyū dirijiensu*.

72. *Id.* at 19.

73. *Id.* at 19–20.

74. *Id.* at 20–22. The court also noted the relatively long period provided for the negotiation—the letter of intent was valid for a year and eight months. *Id.* at 3.

75. *Id.* at 20–22.

the breach of obligation or the tort, the claim for damages was dismissed.<sup>76</sup>

The Tokyo District Court dismissed Sumitomo's damages claim on February 13, 2006.<sup>77</sup> On appeal to the Tokyo High Court on February 24, 2006, Sumitomo reduced its claim to ¥10 billion.<sup>78</sup> On November 21, 2006, Sumitomo and MTFG settled in the Tokyo High court for ¥2.5 billion (USD 21 million), payable by MTFG.<sup>79</sup>

#### SIGNIFICANCE OF THE LITIGATION

The ultimate obligation to pay damages could not have been a surprise for UFJ and its takeover partner, MTFG. When Sumitomo succeeded in attaining the 2004 injunction at first instance, "officials at UFJ and Mitsubishi Tokyo said the most likely outcome would be for UFJ to try to strike some out-of-court deal with Sumitomo Trust, possibly involving payment of compensation."<sup>80</sup>

This prediction was consistent with Japanese contract law, and specifically with jurisprudence on the Civil Code's article 1(2), which creates a duty of good faith that applies to all legal acts, regardless of whether the duty is directly referenced or documented by the parties.<sup>81</sup> It is well-established that this duty applies to the pre-contractual negotiation period.<sup>82</sup> Parties are at liberty to terminate a pre-contractual negotiation. However, if a party terminates unilaterally, in the absence of a serious reason that absolves it of fault, that party will be liable for damages. What distinguishes *Sumitomo v. UFJ* at first glance is that it makes clear that the breach of a duty to negotiate exclusively under a letter of intent (the lock-in clause in this case) is a breach of an obligation or a tort.<sup>83</sup> Many studies of Japanese courts suggest that the judge frequently takes an active role in

76. *Id.* at 24.

77. *Id.* at 4.

78. Press Release, Sumitomo Shintaku Ginko Corp., UFS Gurūpu (Gen Mitsubishi UFS Gurūpu) ni taisuru soshō ni kansuru kōso ni tsuite (Feb. 24, 2006), available at <http://www.sumitamo.co.jp/IR/company/jp/pdf/nr2006/c60224.pdf>.

79. Press Release, Mitsubishi UFJ Financial Group, *supra* note 9.

80. Fackler & Sender, *supra* note 8.

81. MINPŌ, art. 1, para. 2.

82. On precontractual liability, see Takashi Uchida, *Zadankai: Gendai keiyakuho no aratana tenkai to ippan jōkō* [Roundtable: New Developments in Contemporary Contract Law and General Clauses] 515 NBL 12 (1993) and WILLEM M. VISSER 'T HOOFT, JAPANESE CONTRACT AND ANTI-TRUST LAW (2002).

83. *Sumitomo Trust & Banking Corp. v. UFS Holdings Corp.*, 1928 HANREI JIHŌ 3, 4 (Tokyo Dist. Ct., Feb. 3, 2006).

encouraging settlement and in providing a clear indication of what the damages award is likely to be if the parties persist to judgment. Thus, although the appeal did not result in a damages award per se, it is likely to be read as a strong indicator of the court's stance in the case.

This transaction is atypical, since it is the first case in the postwar period in Japan (or perhaps ever) in which one Japanese financial institution sued another for breach of good faith in negotiation and the failure to consummate a consensual merger. Even in the deregulatory decade and a half since 1989, Japan has seen relatively little litigation around M&A activity and very few attempted hostile takeovers.<sup>84</sup> As Christina Ahmadjian comments, there is still a strong sense of stigma about overtly aggressive pressure toward corporate targets in Japan, even among foreign investors:

The propensity of foreigners to take a gentle approach to governance and not to rely on legal recourse or aggressive shareholder activism seems more a case of social norms than to [sic] institutional and legal barriers to action. Shareholder derivative suits were available for use, but though numbers of these suits had increased after a decrease in the filing fee in the early 1990s, foreign shareholders did not use them. . . . [F]oreign investors that I interviewed suggested that they were concerned about not appearing too aggressive and demanding . . . .

There was also, among foreign investors, especially the investment banks, a concern that over-aggressive behavior would be punished. . . . A fear of government reprisal was likely one of the reasons that foreign investors remained low-key in their activism.<sup>85</sup>

Thus, at one level *Sumitomo v. UFJ* provides an interesting twist on the perennial theme of Japanese litigiousness or lack thereof, with Sumitomo pressing forward with litigation that may or may not have been the direct preference of its foreign shareholders.<sup>86</sup>

Litigating commercial transactional breakdowns in a de-regulating Japan, however, is not at all unusual. Injunctions are used frequently as a

84. See Milhaupt, *supra* note 46; Alger, *supra* note 46.

85. Christina Ahmadjian, *Foreign Investors and Corporate Governance in Japan*, in CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY 125, 138 (Masahiko Aoki et al. eds., 2007).

86. See, e.g., Eric A. Feldman, *Law, Culture and Conflict: Dispute Resolution in Postwar Japan*, in LAW IN JAPAN: A TURNING POINT 50 (Daniel H. Foote ed., 2007).

tool by commercial lawyers and their clients in Japan.<sup>87</sup> From 1989 onwards, Japanese case reports are full of contract termination litigation as the economy slid into a prolonged downturn.<sup>88</sup> A parallel body of commercial litigation is also propelled by personal bankruptcy and corporate insolvencies, which reached historically high levels during the same period.<sup>89</sup> Yet *Sumitomo v. UFJ* is not the average unilateral termination case in which a vulnerable injured party pleads breach of good faith as a safety net argument because its very economic existence is threatened. Here we have commercial banking groups operating in a global market, subject to a host of global and domestic regulatory standards and statutory controls, and accustomed to calculating transactional risk. The latter feature of the transaction is reflected in its formal documentation, also characteristic of the banking sector.

What is interesting about the courts' analyses in both the injunction and damages claims, however, is that they view the fundamental obligations of the parties in relational terms: parties are to negotiate in good faith and build a trust relationship that would be the basis for the business integration. Thus, although the transaction breakdown occurred at the beginning of a potential merger, rather than mid-way through a continuing contract, the court acknowledged the extended duration of the negotiation and the likelihood (however slight) of the relationship being resuscitated. As it weighs the nature of the relationship, the Supreme Court invokes social norms (*shakaisūnen*, literally the conventional wisdom of society). Here we see considerable continuity in the Court's preference for preserving commercial relationships (or encouraging the parties to do so) if at all possible.

Doctrinally, the case is unremarkable because the background statute, the Civil Code, and related case decisions are relatively clear. This is not a situation in which new regulatory law is being tested.<sup>90</sup> What contributes

87. Personal Communication with Japanese attorney Yoriko Noma, 2004. This pattern has not attracted much analysis by foreign scholars, presumably because either the dispute settles and the case is not important enough to warrant case reporting, or the injunction is a very minor part of the overall litigation strategy.

88. For an analysis of the cases and jurisprudence on franchising and continuing contract breakdowns during the 1990s, see WILLEM M. VISSER 'T HOOFT, *JAPANESE CONTRACT AND ANTI-TRUST LAW* (2002).

89. This accounts for much of what Tom Ginsburg sees as a surge in voluntary litigation during the same period. See Tom Ginsburg & Glenn P. Hoetker, *The Unreluctant Litigant? An Empirical Analysis of Japan's Turn to Litigation*, 35 J. LEGAL STUD. 31, 36 (2006). I tend to view bankruptcy-propelled civil litigation as somewhat involuntary.

90. In the wake of a series of attempted hostile takeovers of non-banking corporations that followed this case, and the spread of deliberate poison-pill defenses, the Fair Trade Commission did promulgate a Takeovers Code in 2004. Salil K. Mehra, *Same Plant, Different Soil: Japan's New*



interest from a practice perspective is that the district court's treatment of the damages claim raises some uncertainty about how those damages should be calculated.<sup>91</sup> The court seemed to treat the calculation of damages as limited to Sumitomo's expectation interest in the to-be-negotiated "basic agreement" regarding the merger, because this was the basis on which the claim was argued. Predictably, the court found neither an obligation to finalize that agreement nor a high probability that the agreement could be reached, particularly as the negotiations and the parties' relationship began to unravel. A stronger basis for arguing the case would have been either the plaintiff's reliance interest or the damage incurred as a result of entering into the negotiation and having it unilaterally terminated. Presumably such considerations played a role in the eventual settlement.

This case is also unique because of the parties' inability (or unwillingness) to settle at an early stage of the dispute. While Sumitomo clearly suffered economic loss from the UFJ termination of the proposed merger, it also seems as though the damages litigation was intended to have a symbolic as well as substantive effect. In the section below I analyze in greater detail the regulatory background against which the parties formulated their dispute strategies.

#### THE DIFFUSION OF REGULATORY ACTORS AND GLOBALIZATION

In Japan, as in other "new regulatory states" an expansion of the mechanisms of regulation allow the state to separate and delegate some of its traditional functions and services to private actors or quasi-state actors.<sup>92</sup> State reliance on private actors, as Haley points out, is not a new phenomenon in Japan.<sup>93</sup> What changes in the 1990s, however, is both the mode of harnessing private actors and the language used to describe this phenomenon.

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*Merger Guidelines* 26 Nw. J. INT'L L. & BUS. 515 (2006). Corporations law jurisprudence on the poison pill also developed rapidly.

91. The doctrinal aspects of this case are discussed by Doshisha University Law School scholar Koji Takahashi (unpublished paper, on file with author).

92. A key example in the field of regulatory studies is the regulatory pyramid employed in responsive regulation. IAN AYERS & JOHN BRAITHWAITE, *RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE* 161 (1992). This construct encourages changes in state-initiated governance by building in a range of public and private stakeholders, providing mechanisms for each to monitor the other, and employing techniques such as enforced self-regulation.

93. HALEY, *supra* note 3 (describing the historical antecedents of the Japanese state's co-option of individuals and social groups to advance state social ordering objectives).

Banks and public companies in Japan were at the forefront of a new wave of self-regulation in the 1990s. What Japanese corporations had previously termed “*jisei*,” or self-regulation, had been critiqued by foreign commentators as a technique for closing markets and dividing market share;<sup>94</sup> the concept had now, however, been re-framed as a range of borrowed Anglo-American concepts and techniques of regulation. Thus “corporate governance” was operationalized through legislative reform to corporate vehicles and governance structures, the introduction of consolidated accounting, and the enhancement of the role of the statutory auditor. “Transparency” was bolstered by lowering court filing fees to permit shareholder actions against company directors and auditors.<sup>95</sup> The “contract” came to be understood as a regulatory institution,<sup>96</sup> and, as in *Sumitomo v. UFJ*, formalization of high-value contracts through the intermediation of attorneys became the norm. Banks and corporations were also subject to new legislative intervention by the state emphasizing consumer protection, efficiency, and formal dispute resolution.<sup>97</sup> “Due diligence” procedures were adopted, as in *Sumitomo v. UFJ*, in a market in which M&A activity, both friendly and hostile, had begun to grow after a long period of relative corporate stability in Japan. “Risk management” was embraced by Japanese corporations battered by record levels of corporate insolvency and facing new challenges ranging from dependence on information technology to the aggressive use of intellectual property rights by U.S. trade competitors. “Compliance” was suddenly in vogue as banks and corporations established compliance departments, either to supplement or function as in-house legal departments, in order to cope with new regulatory legislation or older statutes that were now being

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94. See, e.g., ULRIKE SCHAEDE, COOPERATIVE CAPITALISM: SELF-REGULATION, TRADE ASSOCIATIONS AND THE ANTIMONOPOLY LAW IN JAPAN (2000); MARK TILTON, RESTRAINED TRADE: CARTELS IN JAPAN’S BASIC MATERIALS INDUSTRIES (1996).

95. A counterpart public example is the successful use of litigation, for instance, in establishing bureaucratic liability for Japan’s HIV epidemic. ERIC FELDMAN, THE RITUAL OF RIGHTS IN JAPAN: LAW, SOCIETY AND HEALTH POLICY 70–72 (2000).

96. See HUGH COLLINS, REGULATING CONTRACTS (1999).

97. Takashi Uchida & Veronica L. Taylor, *Japan’s “Era of Contract,”* in LAW IN JAPAN: A TURNING POINT 454 (Daniel H. Foote ed., 2007). Pilot interviews that I conducted in 1996–1997 with ten Japanese corporations suggested that the shape and norms of Japanese contracts were not immutable. Instead, they were affected by factors such as the parties’ power differentials, perception of risk, new legislation (e.g., the then-new Product Liability Law), the perceived threat of litigation, price fluctuations in the market, and interference from professional cohorts such as lawyers and insurers. This phenomenon was particularly well illustrated in Willem M. Visser’t Hooft’s study of distribution contracts in the luxury cosmetics sector, where contract and competition policy intersect. VISSER’T HOOFT, *supra* note 88, at 81–129.

enforced more vigorously.<sup>98</sup> Reinforcing this trend, a new line of corporate law cases spelled out consequences for listed companies failing to implement internal corporate controls.<sup>99</sup>

The “formal” re-regulation of Japanese banking had been effected through the new independent regulator, the FSA, created in 1998.<sup>100</sup> The FSA was charged with addressing governance weaknesses in banks after a decade of malaise in Japan’s banking sector. Takeo Hoshi and Anil K. Kashyap argue, however, that these economic woes were not caused principally by the inability to recover bad loans made during the “bubble” period, but rather by the fact that the Japanese banking industry has never been globally competitive.<sup>101</sup> They suggest that the core weaknesses of the industry (lack of private capital, misallocation of credit and continuous renewal of non-performing loans, a sector that is too large to allow adequate returns, and an inability to make profit because of government restraints on types of financial products) had been visible since at least the 1980s.<sup>102</sup> When Japan’s economic downturn predictably resulted in bank failures and hollowing out of assets, the government’s response was a “muddling through” strategy of forbearance, injections of public funds, and—through the FSA—selective and intermittent application of global banking standards and procedures.<sup>103</sup>

The “informal” channel of regulation encompassed extensive communication between banks and their regulator, with the government signaling its preferred results by, for example, offering public funds to banks through subordinated debt and preferred shares of major banks:

The banks were not forced to recapitalize, but were strongly encouraged to apply for the funds. The banks, however, are expected to “return” the public funds eventually by accumulating enough internal funds to buy-back the shares and debt. Bank of Tokyo Mitsubishi and Sumitomo Trust and Banking have already

98. A key example of the latter is the Antimonopoly Law.

99. The explicit reference to internal corporate control is first made in *Nishimura v. Abekawa*, 1573 SHOJI HOMU 3 (Osaka Dist. Ct. 2000), discussed in Bruce 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 (2003), but is then applied in subsequent directors’ liability cases.

100. By placing the FSA and banking supervision under the direct control of the Prime Minister and Cabinet, the government directly penalized the Ministry of Finance and also elevated the Prime Minister to a new regulatory status, one of the hallmarks of the Koizumi administration.

101. See generally Hoshi & Kashyap, *supra* note 23.

102. *Id.* at 1.

103. *Id.* at 24–28.

bought-back the government's holdings of their subordinated debt.<sup>104</sup>

These measures, however, underscored the limits of regulatory turnaround in the absence of new sources of capital or dramatic improvement in the economy. Thus, foreign investment became important for the sector. The three banking groups featured in this case study were all globalized banks.

In the case of Sumitomo Trust Bank, foreign ownership was reported as representing thirty percent of its issued shares at the time of the dispute.<sup>105</sup>

The Sumitomo-UFJ transaction illustrates multiple dimensions of global regulatory pressures. At the macro level, legal sociologist Shiro Kashimura stresses that “globalization” in twenty-first century Japan is a very different phenomenon from the “internationalization” of the 1980s; it means a faster, deeper integration of Japan into the global economy in ways that are not entirely controllable, with regulatory results that provoke intense anxiety.<sup>106</sup> At the industry level, Japanese government policy action in encouraging “market-based” mergers or in applying capital adequacy standards was directly influenced by global industry standards. At the institutional level, all three banking groups traded in the United States<sup>107</sup> and had significant foreign share ownership.<sup>108</sup> They shaped the transaction and documented it in line with global standards and devised their negotiating strategies with an eye on how their techniques would play with global observers. Not surprisingly, then, we see statements by Sumitomo and UFJ during this period emphasizing (i) shareholder value—a relatively new corporate norm for Japan at that time—and (ii) the impact of the failed transaction on foreign perceptions of the market. For example, UFJ said:

“We have explained to the court that Sumitomo Trust & Banking’s request for a provisional injunction has no legal basis and that our

104. *Id.* at 10.

105. Fackler & Sender, *supra* note 8.

106. Shiro Kashimura, *Legal Dynamics: A Multi-Disciplinary Inquiry into Law in the Era of Globalization*, in HORIZONTAL LEGAL ORDER: LAW AND TRANSACTION IN ECONOMY AND SOCIETY 3, 4–8 (Shiro Kashimura & Akito Saito eds., 2008).

107. Fackler & Sender, *supra* note 8.

108. *Id.* As Christina Ahmadjian notes in relation to Sumitomo Trust Bank’s sister institution: “In 2003, Goldman Sachs purchased \$1.27 billion of preferred shares, convertible into regular shares in a number of years, in Sumitomo Mitsui Bank. These more concentrated stakes by single funds suggested that foreign ownership would become increasingly influential over time.” Ahmadjian, *supra* note 85, at 130.

group, MTFG, and Japan's economy and financial markets would suffer greatly if an injunction was granted." The group's comments came in response to a claim from Atsushi Takahashi, Sumitomo's President, that trust in Japanese law and the country's economy would be undermined if UFJ was able to pull out of the sale.<sup>109</sup>

These claims seem aimed at foreign investors who were likely to be more mobile in the market, rather than at the banks' domestic institutional investors or shareholders from their own industrial groups. Such statements are a significant departure from the Haley paradigm—when *Authority Without Power* was published, foreign share ownership by market value of all listed companies in Japan was still in single digits: about 4.2% in 1990.<sup>110</sup> By the time of our case study dispute, foreign ownership had climbed steadily so that it was at 21.8% in 2004 and 28.0% in 2007.<sup>111</sup>

A study by Christina Ahmadjian from the early 2000s identifies foreign shareholder influence in Japan in the corporate governance terms of "voice" or "exit."<sup>112</sup> Ahmadjian argues that "exit" represented a powerful option for foreign investors in the 1990s, who "had an influence over Japanese share prices far in excess of their actual stakes."<sup>113</sup> They were far more likely to buy and sell than Japanese investors and "propped up share prices at a time when banks and other long-term shareholders were selling their holdings."<sup>114</sup> For banks in particular, "lowered stock prices also had an impact on banks' shareholdings—and if the share prices went too low, they threatened to affect their capital adequacy ratios."<sup>115</sup>

Foreign shareholders also used their "voice" to exercise their voting rights against management proposals in 43.7% of companies surveyed in 2003, compared with 19% in 1999.<sup>116</sup> In 2003, however, foreign investors had seldom escalated that voice to the point of being protagonists in litigation such as derivative suits.<sup>117</sup> More often, they exercised informal

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109. Barney Jopson, *UFJ Hits Back As Sumitomo Seeks Injunction*, FIN. TIMES, July 21, 2004, at 18.

110. TOKYO STOCK EXCH. GROUP, TOKYO STOCK EXCHANGE FACT BOOK 1998, at 115 (1998), available at [http://www.tse.or.jp/english/market/data/factbook/fact\\_book\\_1998.pdf](http://www.tse.or.jp/english/market/data/factbook/fact_book_1998.pdf).

111. TOKYO STOCK EXCH. GROUP, TOKYO STOCK EXCHANGE FACT BOOK 2008, at 61, available at [http://www.tse.or.jp/English/market/data/factbook/fact\\_book\\_2008.pdf](http://www.tse.or.jp/English/market/data/factbook/fact_book_2008.pdf) (last visited Feb. 10, 2009).

112. Ahmadjian, *supra* note 85.

113. *Id.* at 133.

114. *Id.*

115. *Id.* at 134.

116. *Id.* at 135 (citing a 2003 survey by leading legal publisher *Shōji Hōmu*, but not listing it in the bibliography).

117. *Id.* at 138.

voice in meetings with corporate CEOs and corporate investor relations departments, and through representative bodies such as the American Chamber of Commerce in Japan (“ACCJ”).<sup>118</sup> If Ahmadjian’s argument accurately captures foreign investor postures in 2003, it would suggest that Sumitomo’s commitment to litigation, both at the injunctive relief stage and in the later damages claim, could be read as an attempted show of strength, possibly for the benefit of foreign investors and/or industry analysts.

Thus, in *Sumitomo v. UFJ* we see the diffusion of regulation among a range of players who compete in what Colin Scott has termed “the regulatory space.”<sup>119</sup> The metaphor is useful because it suggests a suspended sphere with multiple planes and influences, rather than older regulatory images such as an “iron triangle” of fixed players, a vertical channel of state-citizen “command and control,” or a purely horizontal axis of private actor interactions. This is also consistent with studies that demonstrate the greater prominence of new regulatory players, including consumer advocates, non-governmental organizations, and shareholder activists.<sup>120</sup>

This range of state and private actors engaged in voluntary and induced regulatory techniques is consistent with both Christine Parker and John Braithwaite’s observation that studies of post-industrial states tend to show pluralization of regulation<sup>121</sup> and with Haley’s earlier work on the mix of formal and informal social ordering in Japan. The *Sumitomo v. UFJ* case study, however, introduces the idea that the Japanese “regulatory space” has become porous. Certainly, mobilizing *gaiatsu* (foreign pressure) has been a standard play in Japanese regulatory politics in the postwar period, as has been the invocation of the threat of foreign domination, takeover, or destruction.<sup>122</sup> What seems to have changed is that the foreign stakeholders—in our case global regulators and foreign shareholders—are now *inside* the regulatory space and likely to stay there.

118. *Id.* at 136.

119. Colin Scott, *Analysing Regulatory Space: Fragmented Resources and Institutional Design*, 2001 PUB. L. 329.

120. Although the categories existed prior to 1989, the players have benefitted from legislation and policy changes that endow them with a new status or the ability to organize more effectively. *See, e.g.*, ROBERT PEKKANEN, *JAPAN’S DUAL CIVIL SOCIETY* (2006).

121. Parker & Braithwaite, *supra* note 5.

122. HALEY, *supra* note 3, at 179.

## JURIDIFICATION OF JAPAN?

*Sumitomo v. UFJ* further seems to signal a departure from the Haley paradigm of regulation in Japan in the way the players turn to the courts—what we might call the juridification of the dispute.<sup>123</sup> In line with Haley’s writings, many accounts of the Japanese state to date have depicted courts, independent regulatory agencies, and legal professions as playing a marginal role.<sup>124</sup> In those narratives, bureaucrats either dominate politicians, or, according to Mark Ramseyer and Frances Rosenbluth’s agency theory, are controlled by them.<sup>125</sup> In either case, bureaucrats exercise “authority without power,” harnessing informal social norms to achieve their desired regulatory objectives, including dispute resolution.<sup>126</sup> Business is steered through administrative guidance and government-supported self-regulation,<sup>127</sup> or through “cooperative regulation,”<sup>128</sup> “cooperative capitalism,”<sup>129</sup> or “communitarian capitalism.”<sup>130</sup> Emphasizing the minimal traction of direct legal regulation on corporations, Seigo Hirowatari calls this policy setting “corporatism,” or law restrained in the service of economic growth.<sup>131</sup> The resulting relative lack of litigation—including commercial litigation—has become a dominant characterization of Japan in the varieties of capitalism literature,<sup>132</sup> comparative regulatory studies,<sup>133</sup> as well as in older literature

123. Gunther Teubner, *Juridification: Concepts, Aspects, Limits, Solutions*, in JURIDIFICATION OF SOCIAL SPHERES: COMPARATIVE ANALYSIS IN THE AREAS OF LABOR, CORPORATE, ANTITRUST AND SOCIAL WELFARE LAW (Gunther Teubner ed., 1987). Juridification is not really a regulatory theory per se, but it may be a useful conceptual tool for exploring the ways in which formal law and formal dispute resolution processes are being deployed and understood by a range of regulatory players in Japan.

124. HALEY, *supra* note 3.

125. J. MARK RAMSEYER & FRANCES M. ROSENBLUTH, JAPAN’S POLITICAL MARKETPLACE (1993).

126. HALEY, *supra* note 3.

127. *See, e.g.*, MARK TILTON, RESTRAINED TRADE: CARTELS IN JAPAN’S BASIC MATERIALS INDUSTRIES (1996).

128. *See* Veronica L. Taylor, *Consumer Contract Governance in a Deregulating Japan*, 27 VICTORIA U. WELLINGTON L. REV. 99 (1997).

129. SCHAEDE, *supra* note 94.

130. ANCHOROGUY, *supra* note 16.

131. Seigo Hirowatari, *Post-war Japan and the Law: Mapping Discourses of Legalization and Modernization*, 3 SOC. SCI. JAPAN J. 155 (2000).

132. *See, e.g.*, PETER A. HALL & DAVID SOSKICE, VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE (2001).

133. *See, e.g.*, ROBERT KAGAN, ADVERSARIAL LEGALISM: THE AMERICAN WAY OF LAW (2001); ROBERT KAGAN & LEE AXELROD, REGULATORY ENCOUNTERS: MULTINATIONAL CORPORATIONS AND AMERICAN ADVERSARIAL LEGALISM (2000).

such as Chalmers Johnson's account of the Japanese "developmental state."<sup>134</sup>

Running as a counterpoint to the "low litigation" narrative is a long history of active litigation in Japan when commercial, private, and public interest matters are contested publicly as protests against dominant social norms or as challenges to government or powerful interests.<sup>135</sup> The *Sumitomo v. UFJ* case, however, is not part of that "protest" litigation stream—it is instead commercial disputation between two powerful financial institutions. In this sense it seems to depart from the minimal litigation thesis and, rather, to align with the values espoused in the 2001 Justice System Reform policy.

In 2001, the Japanese government suddenly announced that law and legal institutions—including litigation—are the "final linchpin" in the restructuring of "the shape of our country."<sup>136</sup> On the streets, public slogans, campaigns, and banners announced that formal regulation ("rules") will now govern, instead of informal social ordering ("manners").<sup>137</sup> This is a top-down reform that nevertheless aims to engage and empower citizens in the processes of law and litigation.<sup>138</sup> Within the commercial sphere, the new policy sought to harness the technologies of law to bolster the operation of markets. It presented economic actors with a range of enhanced procedural tools for asserting their rights against the state and against each other.

The Justice System Reform agenda is also consistent with a second element of juridification, which is the way in which ordinary transactions, whether commercial or consumer, now are regulated as self-consciously "legal" transactions that require support from professional intermediaries; place cost and risk on the parties or the consumer; require a documentary output; and channel disputes to a formal legal institution, whether institutionalized mediation or civil litigation.<sup>139</sup>

134. CHALMERS A. JOHNSON, *JAPAN: WHO GOVERNS? THE RISE OF THE DEVELOPMENTAL STATE* (1995).

135. UPHAM, *supra* note 3; FELDMAN, *supra* note 3.

136. JUSTICE SYS. REFORM COUNCIL, *RECOMMENDATIONS OF THE JUSTICE SYSTEM REFORM COUNCIL—FOR A JUSTICE SYSTEM TO SUPPORT JAPAN IN THE 21ST CENTURY (2001)*, available at <http://www.kantei.go.jp/foreign/judiciary/2001/0612report.html> (available in Japanese as: SHIHŌSEIDO KAIAKAKU SHINGIKAI, SHIHŌSEIDO KAIAKAKU SHINGIKAI IKENSHO: 21 SEIKI NO NIHON WO SASAERU SHIHŌSEIDO (HEISEI 13 NEN 6 GATSU 12 NICHU)), available at <http://www.kantei.go.jp/jp/sihauseido/dai63/63gaiyou.html>.

137. See, e.g., Chiyoda-ku seikatsu kankyō jōrei [Chiyoda Ward Ordinance on Living Environment] (2003), <http://kugikaicity.chiyoda.tokyo.jp>.

138. See Haley & Taylor, *supra* note 7.

139. See Uchida & Taylor, *supra* note 97.



*Sumitomo v. UFJ* fits only partially within this second dimension of juridification. It would make for a neater re-regulatory parable if *Sumitomo v. UFJ* stood unambiguously for routine use of formal law, dense documentation, lawyers, and litigation in business. At the time, I was tempted to see it as representing “a paradigm shift on the legal side. . . . It shows a more legally aware business mindset in commercial dealings. The days of unspoken understandings underpinned by personal relationships are fading away.”<sup>140</sup>

But the real significance of the case seems more ambiguous. Reaction to Sumitomo’s actions was divided, both at home and abroad. In some quarters, Sumitomo’s litigation was seen as vindication of a domestic deregulatory discourse, a symbolic marker of “a more confrontational and legalistic society.”<sup>141</sup> In other circles, Sumitomo was castigated for seeking an injunction, because it opened the door to “court intervention” in what was potentially a more lucrative rival deal for UFJ. In this case, the first Japanese court treatment of a bank merger, some observers saw “court intervention” as arresting a shift from developmental state-style planning to market-driven transactions. Some questioned whether halting this trend was an appropriate role for a court. Yet other observers saw Sumitomo’s actions—bringing a banking industry transaction into the glare of public and legal scrutiny—as immoral, a reaction that aligns with the Haley paradigm.<sup>142</sup>

The contractual aspects of *Sumitomo v. UFJ* also straddle the divide between older, socially embedded social norms and newer, juridical forms of contract as a regulatory technique. So, for example, both the district court decision and the appellate court-brokered settlement also invoke older business and legal norms about contract termination, calibrating damages according to factors such as the process followed in termination of the basic agreement, party motive and objectives, the degree of bad behavior, what legal benefits were protected under the basic agreement, etc.<sup>143</sup>

The result in this particular case is somewhat inconclusive, which is likely to reignite a normative debate from the 1990s<sup>144</sup> in which some

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140. Fackler & Sender, *supra* note 8.

141. *Id.*

142. Interview with Bank of Tokyo Mitsubishi Employee, Seattle, 2004.

143. *Sumitomo Shintaku GimKo Corp. v. Mitsubishi UFJ Financial Group*, 1928 HANREI JIHŌ 3, 4 (Tokyo D. Ct., Feb. 13, 2006).

144. Key essays from this period include Uchida, *supra* note 82, at 14; Noboru Kashiwagi, *Nihon no torihiki to keiyakuhō: kyōdō kenkyū—keizokuteki torihiki wo kangaeru* [*Japanese Transactions and*

lawyers urged that “free competition should be permitted,” and asserted that large, established businesses have no need of this kind of court paternalism, since they both are capable of devising their own transactional norms and should be permitted to do so.<sup>145</sup> *Sumitomo v. UFJ* seems to suggest a false dichotomy within the debate, since the parties draw freely from elements of both “formal” and “informal” legality and dispute resolution strategies.

The Sumitomo-UFJ merger agreement and the litigation that followed are widely recognized as one of the high water marks in business disputation in Japan in the 2000s.<sup>146</sup> Quantitatively, however, one race to the courthouse does not constitute a legal system transformation. So the task remains to create a better data set of commercial disputes from the same period in order to gauge the degree to which Japan’s regulatory patterns may have changed and to pinpoint where they replicate or deviate from those of other new regulatory states.

From a theoretical standpoint, adjusting the Japanese regulatory paradigm to emphasize law and legal institutions has the appeal of putting law and lawyers where we like to be—in the center of things.<sup>147</sup> It may also offer a new platform for comparative institutional studies between Japan and lego-centric states such as the United States. But as Scott cautions, both legalization and juridification are “dead-end” concepts.<sup>148</sup> The danger of elevating legal rules, legal institutions, and legal professionals as the “new” governance element in Japan is that this may lead us into a fairly narrow reading of regulation, dictating that it be effected primarily through state law and state institutions—at precisely the time when the state seems to be diversifying its regulatory modes, the globalized Japanese market has become porous, and market actors have a wider range of norms and stakeholders to consider. Ultimately the new, post-Haley, regulatory reality underscored by *Sumitomo v. UFJ* seems to

*Contracts: Join Research—Continuing Contracts Considered*] 500 NBL 20, 22–23 (1992), and Hiroyasu Nakata, *Keizoku baibai no kaishō* [*The Termination of Continuing Sales Contracts*].

145. Presumably including the freedom, as here, for one of the banking market’s larger players to deliberately invoke the court’s role as arbiter from an early point in the transaction.

146. Mitsuru Claire Chino et al., *Contract and Tort*, in *JAPANESE BUSINESS LAW* 173, 180 (Gerald McAlinn ed., 2007).

147. Milhaupt and West argue, approvingly, that this elevation of law is also mirrored in the shifting career choices of professional elites, many of whom now choose to become practicing lawyers rather than bureaucrats. See Curtis J. Milhaupt & Mark D. West, *Law’s Dominion and the Market for Legal Elites in Japan* (Univ. of Mich., John M. Olin Ctr. for Law & Econ., Research Paper No. 02-006; Columbia Law Sch., Ctr. for Law & Econ. Studies., Working Paper No. 206, 2002), available at <http://ssrn.com/abstract=316120>.

148. Scott, *supra* note 119, at 331.

be the expansion of the formal side of Haley's paradigm, within a re-regulated Japan that presents a broader menu of choices for dispute strategies and sanctions.