

# THE REGULATION OF INSIDER TRADING IN JAPAN: INTRODUCING A PRIVATE RIGHT OF ACTION

## I. INTRODUCTION

Insider trading involves the sale or purchase of securities while in possession of material, non-public information.<sup>1</sup> Due to the large sums of money often involved, the incentives to trade on inside information are great.<sup>2</sup> Therefore, effective regulation is essential to the deterrence of insider trading. Such regulation helps ensure a fair and efficient market in which investors may invest more securely, without the fear of fraud or other market abuses.<sup>3</sup> Recent years have witnessed a growth in the amount and severity of insider trading regulations worldwide.<sup>4</sup>

In Japan, recent stock trading scandals and international pressure have also led to a tightening of insider trading regulations.<sup>5</sup> The Securities

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1. This is the common definition used by most scholars, courts and attorneys. *See, e.g.*, DONALD C. LANGEVOORT, *INSIDER TRADING: REGULATION, ENFORCEMENT, AND PREVENTION* § 1.01 (1994).

2. Perhaps the most famous case of insider trading in the United States involved arbitrageur Ivan Boesky, who earned a reported \$80 million from illegally trading on inside information that he received from investment banker, Dennis Levine. *See* James Sterngold, *Boesky Sentenced to 3 Years in Jail in Insider Scandal*, N.Y. TIMES, Dec. 19, 1987, at A1. Boesky settled civil charges by agreeing to pay \$100 million in damages. After cooperating with authorities, he was sentenced to three years in prison and fined \$250,000. SEC v. Boesky, No. 11288, 1986 WL 15283 (S.D.N.Y. Nov. 14, 1986).

3. Inadequately regulated markets may be costly in terms of both number of investors and share prices. *See, e.g.*, James D. Cox, *Regulatory Competition in Securities Markets: An Approach for Reconciling Japanese and United States Disclosure Philosophies*, 16 HASTINGS INT'L & COMP. L. REV. 149 (1993) (suggesting a framework for regulatory enforcement negotiations between Japan and the United States). Cox writes that "[C]ountries with lax regulations will be seen as a modern day Barbary Coast to which some investors will be unwilling to launch their investment." *Id.* at 157. Securities in regulated markets will also realize higher trading prices because those "which enjoy an overall lower likelihood of abusive practices will ex ante trade at prices slightly higher than those of less regulated markets." *Id.* at 158. Some analysts have taken issue with the idea that insider trading results in inefficient markets. *See infra* note 15.

4. For an overview of regulatory actions affecting insider trading worldwide, see generally *INSIDER TRADING: THE LAWS OF EUROPE, THE UNITED STATES AND JAPAN* (Emmanuel Gaillard ed., 1992).

5. In 1991, Japan's big four securities firms (Daiwa, Nikko, Nomura, and Yamaichi) compensated certain investors for losses sustained in securities transactions. Some of this compensation was actually tied to organized crime figures. The scandal escalated when the media reported that members of the Ministry of Finance had known and approved of the scheme. The Minister of Finance resigned over the matter. As a punishment, the Ministry of Finance ordered each of the firms to suspend activities for four days. The lenient punishment imposed upon these companies induced outrage, both in and outside of Japan. For a commentary on the regulatory response to these scandals, see C. Jeffrey Char, *Reforming*

Fairness Law of 1992<sup>6</sup> revised several regulations and created a market watchdog, the Securities and Exchange Surveillance Commission (SESC).<sup>7</sup> As an arm of the powerful Ministry of Finance,<sup>8</sup> the commission is far from the equivalent of the United States Securities and Exchange Commission (SEC) in either manpower or scope of activities.<sup>9</sup> Despite these shortcomings, the SESC could prove an effective instrument for curbing some market abuses.<sup>10</sup>

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*Japan's Securities Markets: The Loss Compensation Scandal*, 10 INT'L TAX & BUS. LAW. 173 (1993); David B. Hoppe, Note, *Reform and Resistance, East and West: Regulators Respond to Financial Scandal in Japan and the United States*, 24 LAW & POL'Y INT'L BUS. 181 (1992); Masahisa Ikeda, *The Legality of Compensating Investors in the Japanese Securities Market—An Examination of the 1991 Amendments to the Japanese Securities and Exchange Law*, 33 HARV. INT'L L.J. 592 (1993). The judiciary's response was also noteworthy. In a civil action, the Tokyo District Court found no violation. The existing law only prohibited promises of loss compensation used to solicit customers. Thus, the actual compensation was not illegal. Judgment of September 16, 1993 (Ikenanaka v. Tabuchi), Tokyo Chisai, (translated by Curtis J. Milhaupt). For an account of the judiciary's response, see Seiji Tanaka, *The Banking and Securities Scandals and Fundamental Theories of Commercial Jurisprudence*, 1 PAC. RIM L. & POL'Y J. 349 (Yutaka Nakamura trans. 1993) (finding fault with the ruling and emphasizing the need for corporate responsibility in maintaining trust in the international community).

6. Shokentorihiki tonu Kosei o Kakuhosuru Tame no Shokentorihikiho tonu Ichibu o Kaiseisuru Horitsu [Law to Partially Amend the Securities and Exchange Law and Other Laws to Ensure the Fairness of Securities and Other Transactions], Law No. 73 of 1992 [Securities Fairness Law].

7. Shokentorihiki to Kanshi Iinkai [Securities and Exchange Surveillance Commission], Law No. 73 of 1992.

8. The Ministry of Finance is widely considered the most powerful member of the Japanese bureaucracy. For a history of the Ministry of Finance and an analysis of its regulatory powers over the securities industry, see Curtis J. Milhaupt, *Managing the Market: The Ministry of Finance and Securities Regulation in Japan*, 30 STAN. J. INT'L L. 423 (1994). Professor Milhaupt notes that the "[Ministry of Finance] is perceived, both by itself and by the public, as the nation's most elite civil service, as guardian of the nation's economic health, and as a breeding ground for prime ministers - in short, as the pinnacle of the Japanese state." *Id.* at 444.

9. The SESC is composed of approximately 200 members, one thirteenth the size of the SEC. *Id.* at 470. It has the power to investigate illegal activities, but it cannot bring actions independently. *Id.* at 470-71. Rather, it is empowered to make recommendations to the Ministry of Finance, which then decides whether to prosecute. *Id.* The Commission was established under Article 8 of the National Government Organization Law. Law No. 120 of 1948. See Milhaupt, *supra* note 8, at 469-70 n.216.

10. Thus far, the SESC has launched two investigations into alleged insider trading violations. The first began in March of 1994 against employees of Nippon Shoji, employees of that company's sales agent, and one individual investor. See *24 Fined for Insider Trading of Pharmaceutical Shares (24 Fined)*, NIKKEI WKLY., Dec. 26, 1994, at 20, available in LEXIS, News Library, Nikkei File. A drug produced by Nippon Shoji, a pharmaceutical company, caused the death of several consumers. *Id.* All of the parties under investigation had sold stock in the company shortly before the damaging information regarding the product became public. *Id.* In December of 1994, the Osaka summary court found twenty four people guilty of insider trading and fined each of them between 200,000 and 500,000 yen (\$2,000 - \$5,000). *Id.* The SESC also launched an investigation of Shimizu Bank, whose chairman admitted to insider trading of shares of Shin Kokusai Kokudo Kogyo, a construction company. See *Bank Focus of Insider Trading Investigation*, NIKKEI WKLY., Dec. 12, 1994, at 19, available in LEXIS, News

The 1992 Act did not, however, address the major stumbling block of regulating illegal market practices. The problem rests not in the regulations themselves, but in the limited methods available for their enforcement.<sup>11</sup> Specifically, the absence of a private right of action in the regulation of insider trading leaves enforcement solely in the hands of the Ministry of Finance, the organization charged with promoting the very industry which it should regulate.<sup>12</sup> In order to protect the securities industry as a whole, the Ministry usually caters to large firms associated with the national interest.<sup>13</sup> This policy of protectionism traditionally excludes small and foreign investors.<sup>14</sup> By failing to provide or even encourage a private right of action, the Ministry of Finance effectively prevents these investors from taking an active role in the regulation of the Japanese securities market.

This Note examines the development of the private right of action in United States securities regulation and analyzes the effects of the absence of such a right in Japan. Part II traces the development of insider trading regulations in the United States and Japan. Part III explores enforcement mechanisms in Japan and the history of the use of private actions in general. Part IV examines the Securities Fairness Act and its probable effect on insider trading in Japan. Part V proposes the institution of a private right of action in order to properly ensure the enforcement of

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Library, Nikkei File.

11. Enforcement of most laws in Japan is reserved almost entirely to government bureaucrats. See *infra* notes 82-86 and accompanying text.

12. Whereas the SEC focuses on enforcement, the Ministry of Finance emphasizes its promotional role. Milhaupt, *supra* note 8, at 445. This promotional stance, often referred to as "industrial policy" is the rule among Japanese bureaucracies and has been widely credited with Japan's post-war economic success. See CHALMERS JOHNSON, *MITI AND THE ECONOMIC MIRACLE* (1982) (tracing the development of Japan's Ministry of International Trade and Industry (MITI) from pre-war until 1975); Robert Reich, *Why the U.S. Needs an Industrial Policy*, 60 HARV. BUS. REV. 74 (1982).

13. This is not a phenomenon unique to the securities industry or the Ministry of Finance. MITI is probably the most renowned ministry for using protectionist policies to develop Japanese industry. See JOHNSON, *supra* note 12. One negative manifestation of this policy occurred when the Ministry of Finance gave tacit approval to the securities firms that paid compensation to large investors. See *supra* note 5.

14. See Nicole J. Ramsay, Note, *Japanese Securities Regulation: Problems of Enforcement*, 60 FORDHAM L. REV. 255 (1992) (analyzing the clamor for change in Japanese securities regulation after the 1991 scandals and calling for an independent market watchdog). Ramsay explains that "Japan's enforcement problems are clouded by Ministry officials' beliefs that the benefit of capital flow into the domestic securities system outweighs the costs of bias against small investors." *Id.* at 277. A more recent article suggests that the Ministry of Finance has actually injured small investors and profited by floating stock prices in the privatization of several government enterprises. Roger Shiro, *How Greedy Bureaucrats Scalp Private Investors*, TOKYO BUS. TODAY, Jan. 1995, § 3, at 17, available in LEXIS, News Library, Tokbus File.

Japanese securities regulations and effectively deter insider trading. A private right could develop either through the efforts of private litigants and the judiciary, or through bureaucratic or legislative implementation. The introduction of civil liability for insider trading would boost investor confidence and help to reinvigorate the troubled Japanese securities market.

## II. THE HISTORY OF INSIDER TRADING REGULATION IN JAPAN AND THE UNITED STATES

Although the merits of insider trading have been proclaimed in some circles,<sup>15</sup> it is generally considered unfair and harmful to financial markets.<sup>16</sup> In order to ensure the rights of the buying public, and as a response to the financial scandals of the time, the U.S. Congress passed the Securities Act of 1933<sup>17</sup> and the Securities Exchange Act of 1934 (Exchange Act).<sup>18</sup> The latter included one section specifically designed to eliminate insider trading, section 16(b),<sup>19</sup> and another general provision which has evolved into the most important tool for curbing such activities, section 10(b).<sup>20</sup>

Japanese securities regulation relies upon the American model, with the Securities Exchange Law of 1948 (SEL)<sup>21</sup> based largely upon the

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15. See, e.g., JONATHAN R. MACEY, *INSIDER TRADING: ECONOMICS, POLITICS AND POLICY* (1991) (arguing that insider trading is neither unfair nor inefficient and that governments should not regulate it); HENRY MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966) (arguing that insider trading compensates managers and is economically beneficial); but see Roy Schotland, *Unsafe at Any Price: A Reply to Manne*, 53 VA. L. REV. 1425 (1967) (arguing against property rights theorists by noting that insider trading would result in random and unpredictable compensation unrelated to corporate performance or compensation programs).

16. The argument against insider trading is advanced by such luminaries as Professor Louis Loss. See Louis Loss, *The Fiduciary Concept as Applied to Trading by Corporate Insiders in the United States*, 33 MODERN L. REV. 34, 36 (1970) (stressing insider trading's immorality and the importance of an appearance of market equity to the general public). This argument has also been taken up in Japan. See Takayasu Okushima & Nobuo Nakamura, *An Act Partially Amending the Securities Exchange Act*, 9 WASEDA BUL. COMP. L. 17, 19-20 (1990) (stating that trading on inside information "is an unfair transaction, comparable to a rigged horse-race, and it ruins the public's reliance on the securities market."). One modern approach from the law and economics school argues that regulation of insider trading reduces transaction costs and produces market liquidity. See Nicholas L. Georgakopolous, *Insider Trading as a Transactional Cost: A Market Microstructure Justification and Optimization of Insider Trading Regulation*, 26 CONN. L. REV. 1 (1993).

17. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1988).

18. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1988).

19. 15 U.S.C. § 78p(b).

20. 15 U.S.C. § 78j.

21. Shokentorihikiho [Securities and Exchange Law], Law No. 25 of 1948, as amended through 1992 [hereinafter SEL], reprinted in Securities Exchange Law and Foreign Securities Firms Law of

Securities Act and the Exchange Act.<sup>22</sup> In fact, the language of articles 58 and 189 of the SEL parallels sections 10(b) and 16(b) of the Exchange Act.<sup>23</sup> However, while the U.S. securities market is generally considered to be well regulated, the Japanese market has been widely criticized as being an “insider haven.”<sup>24</sup> Notably, in the United States, approximately 300 actions are filed annually by the SEC alone.<sup>25</sup> In Japan, only three cases of insider trading have ever gone to trial.<sup>26</sup>

Japan, 1-162 (Christopher P. Wells ed., 1993) [hereinafter SEL & FSFL].

22. Japan adopted the U.S. acts almost in their entirety. Makoto Yazawa, *A Synopsis of Securities Regulation in Japan*, in JAPANESE SECURITIES REGULATION, 24 (Louis Loss et al. eds., 1983).

23. It is helpful to note here that the insider trading provisions in Japan's SEL have been recodified under different article numbers. In 1992, Articles 58 and 189 were redesignated as Articles 157 and 164. Law No. 73 of 1992. In addition, a 1988 amendment introduced two new provisions, Articles 190-2 and 190-3 and reinstated the former Article 188 as Article 154. Law to partially amend the Securities and Exchange Law, Law No. 75 of 1988. These articles were also recodified by the Securities Fairness Law in 1992. Law No. 73 of 1992. Articles 190-2 and 190-3 became Articles 166 and 167 and Article 154 became Article 162. The following chart may clarify the number scheme and serve as a reference. The American equivalents of the Japanese articles are included.

	U.S. SEA	Original SEL	1988 Amendment	1992 Amendment
General Anti-Fraud Provision	10(b)	58	58	157
Short-Saving Provision	16(b)	189	189	164
Disclosure Requirement	16(a)	188	154	163
Specific Insider Trading Provisions			190-2	166
			190-3	167

24. Shen-Shin Lu, *Are the 1988 Amendments to Japanese Securities Regulation Law Effective Deterrents?*, 1991 COLUM. BUS. L. REV. 179, 194 (1991). In a similar vein, journalist James Sterngold refers to Japan's market as a “rigged casino.” James Sterngold, *Japan's Rigged Casino*, N.Y. TIMES, Apr. 26, 1992, § 6, at 24. Shortly after the loss compensation scandal, another problem emerged. Daiwa, one of the big four securities firms, conducted a scheme in which it sold securities to a prominent customer for an amount well over the market price by promising to buy it back later. *Id.* The scheme, called tobashi, or “flying” involves the repeated sale of the stock by Daiwa patrons at increasingly higher prices. *Id.* When the market price becomes sufficiently inflated, Daiwa repurchases the stock and reimburses the original buyer. *Id.* It can then resell the stock at an artificially high price. *Id.* If the plan works Daiwa and each of its customers clears a profit. *Id.* Unfortunately for Daiwa, the plan failed because of depression within the market, and the original customer, a large department store, alerted the Ministry of Finance. *Id.*

25. Ramsay, *supra* note 14, at 262 n.64.

26. The first case brought to trial was the Shokusan Jutaku case. *See infra* note 71. After the 1988 Amendment, one insider trading case was decided. *See Japanese Executive Found Guilty of Insider Trading*, WALL ST. J., Sept. 29, 1992, at A13. The former managing director of Macross Corporation was found guilty of insider trading under Article 166 and fined 500,000 yen (about \$5,000). *Id.* Article 166 was first introduced in 1988. *See infra* note 77. In another case, a finance firm official settled

*A. The Development of Insider Trading Regulation in the U.S.*

Although insider trading is assumed to be among the vices addressed by U.S. securities regulations, it is not explicitly mentioned anywhere in the 1933 and 1934 Acts.<sup>27</sup> Rather, Congress' enumerated goals included "full and fair disclosure of the character of securities" and the prevention of "frauds in the sale thereof."<sup>28</sup> Sections 16(b) and 10(b) were drafted to meet these goals, and insider trading has effectively been prosecuted under both provisions.<sup>29</sup> Officially, the SEC has the power to enforce these and other securities regulations,<sup>30</sup> but the development of a private right of action has been crucial to the deterrence of insider trading.

Section 16(b) requires that insiders return to the corporation any profits gained through the purchase and sale of stock within a six month period.<sup>31</sup> The law requires no showing of intent to profit.<sup>32</sup> Rather, it simply calls for the disgorgement of any profits made through transactions within this time frame.<sup>33</sup> As the primary weapon against insider trading, this provision has obvious weaknesses. An insider waiting longer than six months to sell is beyond the scope of section 16(b).<sup>34</sup>

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without going to trial. *Id.* The Nippon Shoji affair is the most recent case. *See supra* note 10.

27. Insider trading was not, in fact, explicitly defined until 1988. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (1988) (codified in scattered sections of 15 U.S.C.).

28. Securities Act of 1933, Pub. L. No. 73-22, Preamble (1933).

29. Section 10(b) has been the more effective weapon. *See infra* notes 35-45 and accompanying text. Section 16(b) has not been invoked as frequently, but it is arguably a greater deterrent. Parties are less willing to challenge § 16(b) because of its mechanical construction. *See* 5 ARNOLD S. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10B-5, § 3.02(g)(iii)(A) at 1-154.119 (1990).

30. 15 U.S.C. § 78c.

31. Section 16(b) reads:

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial, director, or officer . . .

15 U.S.C. § 78p.

32. *Id.* This provision is enabled by § 16(a), which requires that corporate directors, officers, and beneficial owners of ten percent or more of any equity security file a registration statement with the SEC within ten days of becoming an owner, director or officer. Such parties are also required to file a registration of any changes in these holdings. *Id.*

33. *Id.*

34. Kanji Ishizumi details this and other enforcement problems under Section 16(b) in an article comparing the regulation of insider trading in Japan and the United States. Kanji Ishizumi, *Insider Trading Regulation: An Examination of Section 16(b) and a Proposal for Japan*, 47 FORDHAM L. REV.

The scope of section 10(b) and its supplement, rule 10b-5,<sup>35</sup> is not quite so limited. Section 10(b) forbids the use of manipulative and deceptive devices to defraud, but courts interpreted it to affect only the *sale* of securities.<sup>36</sup> To curtail fraud in the *purchase* of securities, the SEC instituted rule 10b-5 in 1942.<sup>37</sup> Its development into a vast means of civil liability has led to its characterization as "a judicial oak which has grown from little more than an acorn."<sup>38</sup> Although its purpose has been questioned and its scope decried,<sup>39</sup> rule 10b-5 has proven to be the most effective weapon against insider trading.<sup>40</sup>

While debate continues as to whether Congress intended to allow a private right of action under section 10(b), it is clear from the language of the provision that Congress did not explicitly provide for a private right of action.<sup>41</sup> Rather, the judiciary granted this right. In *Kardon v. National Gypsum Co.*,<sup>42</sup> the District Court for the Eastern District of Pennsylvania ruled that violating rule 10b-5 was a wrongful act and, as such, could provide the wronged party with a private remedy.<sup>43</sup> The court recognized that the legislature did not provide for a private right of action.<sup>44</sup> It held, however, that civil liability in such situations is fundamental and is therefore imputed unless explicitly denied by statute.<sup>45</sup>

449, 472-85 (1979).

35. Rule 10b-5, Employment of Manipulative and Deceptive Devices, Exch. Act Release No. 3230, 17 C.F.R. § 240.10b-5 (1993).

36. Section 10(b) reads:

It shall be unlawful . . . to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j.

37. 17 C.F.R. § 240.10b-5.

38. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975).

39. Recently, some have argued against the use of the anti-fraud provision in private suits. Legislators introduced bills in both the House and Senate in 1992 to restrict litigation under Rule 10b-5. See H.R. 5828, 102d Cong., 2d Sess. (1992); S. 3181, 102d Cong., 2d Sess. (1992). Professor Michael Kaufman argues that the creation of the private right of action under Section 10(b) is an unconstitutional creation of law and expansion of subject matter jurisdiction. Michael J. Kaufman, *A Little "Right" Musick: The Unconstitutional Judicial Creation of Private Rights of Action Under Section 10(b) of the Securities Exchange Act*, 72 WASH. U. L. Q. 287 (1994).

40. Jacobs, *supra* note 29, § 8.01, at 1-228.

41. 15 U.S.C. § 78j.

42. 69 F. Supp. 512 (E.D. Pa. 1946).

43. *Id.* at 513.

44. *Id.* at 514.

45. *Id.*

The private right of action for rule 10b-5 cases has been endorsed by the SEC<sup>46</sup> and addressed by the Supreme Court. In *J.I. Case Company v. Borak*,<sup>47</sup> the Court ruled that a private right of action exists under section 14(a) of the Exchange Act.<sup>48</sup> The Court held that because the Exchange Act's primary goals included protection of investors, it was the Court's duty to effectuate this purpose by providing for civil liability under the Act.<sup>49</sup> Other courts have used the *Borak* court's reasoning to imply a private right of action under other sections of the Exchange Act, including rule 10b-5. Almost twenty years after *Borak*, Justice Marshall recognized the existence of a private right of action under rule 10b-5 as being settled and "beyond peradventure."<sup>50</sup>

### B. *The SEL and Enforcement in Japan*

The Japanese SEL was among the laws that the Supreme Commander of Allied Powers imposed during the post-war occupation.<sup>51</sup> As such, it was not propelled by the kind of anti-Wall Street populism present in Washington during the early 1930s.<sup>52</sup> Soon after the American occupation, the

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46. As David Ruder has noted, the SEC proved instrumental in the development of a private right of action under section 10(b), filing amicus briefs in *Kardon* and many subsequent circuit court cases. David S. Ruder, *The Development of Legal Doctrine Through Amicus Participation: The SEC Experience*, 1989 WIS. L. REV. 1167, 1172-75 (1989). The SEC first applied section 10(b) and rule 10b-5 to trading on inside information in 1961. In re Cady, Roberts & Co., 40 S.E.C. 907 (1961). Chairman Cary ruled that "anti-fraud provisions are not intended as a specification of particular acts or practices which constitute fraud, but rather are designed to encompass the infinite variety of devices by which undue advantage may be taken of investors and others." *Id.* at 911.

47. 377 U.S. 426 (1964).

48. *Id.* at 430-31. Section 14(a) makes unlawful the use of false or misleading proxy statements. 15 U.S.C. § 78n.

49. 377 U.S. at 432.

50. *Herman & McLean v. Huddleston*, 459 U.S. 375, 380 (1983). Justice White further supported the idea in 1988, stating that "judicial interpretation and application, legislative acquiescence, and the passage of time have removed any doubt that a private cause of action exists for a violation of section 10(b) and rule 10b-5, and constitutes an essential tool for the enforcement of the 1934 Act's requirements." *Basic, Inc. v. Levinson*, 485 U.S. 224, 230-31 (1988).

51. The first Supreme Commander of Allied Powers in post-war Japan was General Douglas MacArthur. SCAP is the name generally used to refer to the group headed by MacArthur which sought to rebuild Japan along democratic lines from 1945 until 1952. See generally KYOKO INOUE, MACARTHUR'S JAPANESE CONSTITUTION (1991). Japan has retained most of the laws imposed by SCAP, although they have been selectively implemented. For a variety of views on SCAP from both American and Japanese scholars, see DEMOCRATIZING JAPAN: THE ALLIED OCCUPATION (Robert E. Ward & Sakamoto Yoshikazu eds., 1987).

52. The Securities Act and the Exchange Act were enacted in response to the speculative and often deceptive practices which caused the crash of the stock market in 1929, triggering the Great Depression. For a background on this reform movement, see MICHAEL E. PARRISH, SECURITIES REGULATION AND



Japanese government was able to ignore or remove those provisions it deemed unnecessary.<sup>53</sup> Consequently, administrative enforcement of insider trading regulations developed slowly, and private enforcement was stillborn.<sup>54</sup>

Although Japanese regulation of insider trading has begun to tighten in recent years, Japan does not share the historic American aversion toward the activity.<sup>55</sup> Commentators have elaborated on the value government and industry leaders place upon inside information as a conduit for establishing valuable relationships.<sup>56</sup> Perceptions aside, it is clear that enforcement of the regulations affecting insider trading did not begin in earnest until after the internationalization of Japan's markets in the 1980s.<sup>57</sup> Prior to 1988, the Ministry of Finance routinely ignored fraudulent activities and the legal mechanisms drafted to prevent them.<sup>58</sup> The Ministry of Finance simply removed from the SEL those provisions it considered potentially burdensome.<sup>59</sup>

Two aspects vital to regulation in the United States quickly disappeared in Japan: the Japanese Securities and Exchange Commission (JSEC) and the disclosure requirement of article 188, the equivalent of section 16(a) of

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THE NEW DEAL (1970).

53. See *infra* notes 60-68 and accompanying text.

54. Only one case was prosecuted prior to 1988, and it took thirteen years to be resolved. See *infra* note 71.

55. Misao Tatsuta, *Proxy Regulations, Tender Offers, and Insider Trading*, in JAPANESE SECURITIES REGULATION, *supra* note 22, at 159-95. Tatsuta wrote that "Although insider trading is generally condemned in the United States, and although U.S. cases imposing civil liability for such trading have drawn attention in Japanese business circles, most Japanese do not believe that insider trading is immoral." *Id.* at 191-92.

56. See, e.g., David E. Sanger, *Insider Trading, The Japanese Way*, N.Y. TIMES, Aug. 10, 1988, at D1 (citing several anonymous sources who attest to the ubiquity of insider trading in the Japanese market). Sanger explains that "[b]uying and selling shares based on advance information is a time-honored tradition to cement relationships between brokers and their biggest clients." *Id.* Professor Ramseyer claims that insider trading is built into the structure of Japan's corporate environment. J. Mark Ramseyer, *Columbian Cartel Launches Bids for Japanese Firms*, 102 YALE L.J. 2005 (1993). Ramseyer asserts that Japanese banks buy stock in client companies in order to capitalize on inside information they have already gained through credit investigations of those clients. *Id.* at 2013.

57. The number of foreign firms listed on the Tokyo Stock Exchange more than quadrupled between 1985 and 1987. See Lu, *supra* note 24, at 193.

58. Because only one suit was brought prior to 1988, it appears that the Ministry of Finance did not place priority on the punishment and prevention of insider trading. Larry Zoglin asserts that this results from limited resources and a focus of these resources on the larger problem of market manipulation. Larry Zoglin, *Insider Trading in Japan: A Challenge to the Integration of the Japanese Equity Market into the Global Securities Market*, 1987 COLUM. BUS. L. REV. 419, 421-22 (1987).

59. See *infra* notes 60-68 and accompanying text.

the Exchange Act.<sup>60</sup> The removal of the independent JSEC in 1952<sup>61</sup> left enforcement solely in the hands of the Ministry of Finance,<sup>62</sup> an organization disinclined to impose restrictions on an industry whose mission it was to rebuild.<sup>63</sup> The JSEC's powers were delegated internally to the Securities Bureau of the Ministry of Finance.<sup>64</sup> The Ministry also decided that the Bureau's staff was underequipped to deal with the volume of information being supplied as required under article 188.<sup>65</sup> Thus, the ministry removed article 188 one year later.<sup>66</sup> Without a duty to report, the monitoring of short-swing activity became difficult and article 189, Japan's version of section 16(b),<sup>67</sup> became ineffective.<sup>68</sup>

The Ministry of Finance's non-use of article 58<sup>69</sup> has proven even more

60. Article 188 required the filing of registration statements with the Ministry of Finance. It has since been reinstated as Article 162. See SEL & FSFL, *supra* note 21, at 103-04.

61. Law No. 270 of 1952.

62. Dealers associations and stock exchanges are theoretically required to oversee the operations of securities dealers and provide punishments under SEL Articles 79-6 and 98, respectively. SEL, arts. 79-6, 98, *reprinted in* SEL & FSFL, *supra* note 21, at 76, 84. However, these parties have not played a significant role in enforcing regulations. See Yazawa, *supra* note 21, at 25-26. The Tokyo Stock Exchange has issued statements to firms regarding alleged insider trading activities, but did not punish the parties involved. BARRY ALEXANDER K. RIDER & H. LEIGH FRENCH, *THE REGULATION OF INSIDER TRADING* 362-63 (1979). For an example of regulatory failure by the Tokyo Stock Exchange, see *infra* note 81.

63. Milhaupt, *supra* note 8, at 444.

64. The Securities Bureau is one of seven bureaus within the Ministry of Finance. *Id.* at 446. It is also the second smallest and has historically been regarded as less important than the Banking Bureau within the financial arena. *Id.* at 447.

65. See Lu, *supra* note 24, at 190 n.43.

66. Law No. 142 of 1953.

67. Part one of article 189 read:

To prevent any officer or major shareholder of a listed company from improperly using confidential information acquired through their duties or status, if such person realizes at the person's own account through sale of Specified Securities, Etc., of the said Listed Company, Etc., within six (6) months after his/her purchase of the same, or through purchase within six (6) months after sale of the same, the said Listed Company, Etc. may demand that such person tender the said profits to the said Listed Company, Etc.

SEL, art. 189(1), (recodified at art. 164(1)), *reprinted in* SEL & FSFL, *supra* note 21, at 104.

68. Because of the removal of article 188, only one case was ever brought under old article 189. See *infra* note 71. Just as under section 16(b) of the Exchange Act, an insider may also avoid liability by waiting longer than six months between transactions. See *supra* note 31 and accompanying text. Nihon Netsugaku, a Japanese corporation which allegedly participated in insider trading was able to avoid liability under article 189 for precisely this reason. For a discussion of this case, see Katsuro Kanzaki, *Legal Analysis of the Nihon Netsugaku Case*, 11 *KOBE L. REV.* 21 (1977).

69. See *supra* note 23. Article 58 read:

No person shall commit an act set forth in the following items:

- (1) To employ any fraudulent device, scheme or artifice with respect to buying, selling or other transactions of securities.
- (2) To obtain money or other property by using documents of or by any representation which

detrimental to insider trading regulation than the removal of article 188 and the JSEC. While the U.S. anti-fraud provision, section 10(b), became the most effective weapon against insider trading, the Ministry of Finance considered its equivalent, article 58, "too vague" to apply.<sup>70</sup> Without article 58, insider trading was virtually unpunishable for many years. In fact, only one case was prosecuted before the 1988 Amendment to the SEL.<sup>71</sup>

### C. Recent Legislation

During the 1980s, both the United States and Japan enacted measures aimed at insider trading. In the United States, the Insider Trading Sanctions Act of 1984<sup>72</sup> set massive penalties for violations,<sup>73</sup> while the Insider Trading and Securities Fraud Enforcement Act of 1988 codified certain private rights and established mandatory "Chinese walls" between the underwriting and trading departments of investment banks.<sup>74</sup> Japan also

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contain an untrue statement of a material fact or any omission to state a material fact necessary to make the statements therein not misleading.

(3) To make use of false quotation for the purpose to solicit buying, selling or other transactions of securities.

SEL, art. 58, *reprinted in* JAPANESE SECURITIES REGULATION, *supra* note 22, at 266. The Securities Fairness Law recodified article 58 as article 157. Law No. 73 of 1992. *See supra* note 23. Some modifications have been made. SEL, art. 157, *reprinted in* SEL & FSFL, *supra* note 21, at 100.

70. Kanzaki, *supra* note 68, at 27. Old article 58 was applied in one case, but the case did not involve insider trading. *See* Tomoko Akashi, Note, *Regulation of Insider Trading in Japan*, 89 COLUM. L. REV. 1296, 1298 n.14 (1989) (citing Judgment of July 10, 1963 Tokyo Kosai (Tokyo High Court) 14-7 Tokyo Keijiho 116, *aff'd*, Judgment of May 25, 1965, Saikosai (Supreme Court), 155 Saiko Saibansho Saibanshu Keiji 831).

71. In the Shokusan Jutaku Case, the company's president made a profit of over one billion yen by selling company shares within three months of purchasing them. *See* Lu, *supra* note 24, at 191-92. A suit was brought under article 189, now codified as article 164 in a Tokyo District Court in 1974. *Id.* It was settled in 1987. *Id.*

72. Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified in scattered sections of 15 U.S.C.).

73. Under the new laws, civil liability for insider trading may include disgorgement of profits plus three times the profit gained or loss avoided. 15 U.S.C. § 78u-1(a)(3). However, the treble damage provision applies only to commission actions, not to private actions. 15 U.S.C. § 78ff(a). The 1988 act also increased the maximum criminal fine for insider trading from \$100,000 to \$1,000,000. *Id.* The maximum prison sentence was also increased from five to ten years. *Id.*

74. Pub. L. No. 100-704, 102 Stat. 4677. "Chinese walls" prevent insider trading by physically separating employees, thus denying them access to any inside information. Many American corporations have voluntarily established such barriers for some time. It is notable that in Japan, until recently, the underwriters and traders often worked together and could sometimes be the same person. *See* Winifred Swan, Note, *The 1988 Japanese Insider Trading Amendments: Will Japan See Results from These Tougher Laws?*, 12 U. PA. J. INT'L BUS. L. 275, 297-98 (1991).

enacted legislation.<sup>75</sup> In 1988, the government reinstated the disclosure requirement of the former article 188 in a new provision, codified as article 154.<sup>76</sup> The government also explicitly prohibited insider trading for the first time through articles 190-2 and 190-3.<sup>77</sup>

Although both nations followed the worldwide trend toward increased insider trading legislation,<sup>78</sup> even a cursory examination of the Acts reveals a wide gap in effect, especially in the area of deterrence. While the U.S. laws act to both prevent violations and threaten violators with increased penalties,<sup>79</sup> the Japanese amendments simply provide the Ministry of Finance with the opportunity to enforce existing regulations.<sup>80</sup> Because the Ministry had never strenuously acted upon these regulations in the first place, the deterrent effect of the amendments was questionable and enthusiasm for them was somewhat limited.<sup>81</sup> Furthermore, the establish-

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75. Law No. 75 of 1988. The Diet, Japan's Legislative Body, further amended the SEL in 1990. Act to Partially Amend the Securities and Exchange Law, Law No. 43 of 1990. The 1990 act did not significantly affect insider trading. Rather, it introduced a system for disclosure of share ownership, revised procedures for tender offers, and encouraged cooperation between the Ministry of Finance and foreign regulatory bodies. *Id.* For a review and analysis of the 1990 amendment, see Atsuko Hirose, Recent Development, *Changes in Japanese Securities Law—Act to Partially Amend the Securities and Exchange Law, Law No. 43 of 1990 (June 22, 1990)*, 32 HARV. INT'L L. J. 508 (1991).

76. See *supra* note 23.

77. Law No. 73 of 1992. Article 190-3, which was recodified as article 166 prohibits the purchase or sale of securities by any person aware of any material fact before the fact is publicly announced. SEL, art. 166, *reprinted in* SEL & FSFL, *supra* note 21, at 106-09. Now codified as article 167, article 190-3 prohibits the purchase of shares in a public tender offer by any person possessing inside information. SEL, art. 167, *reprinted in* SEL & FSFL, *supra* note 21, at 109-12.

78. See INSIDER TRADING: THE LAWS OF EUROPE, THE UNITED STATE AND JAPAN, *supra* note 4.

79. *Supra* note 73.

80. The reinstatement of the disclosure requirement of former article 188 at article 154, which is now codified at article 163, allowed the Ministry of Finance to monitor short-swing activity by corporate insiders. SEL, art. 163, *reprinted in* SEL & FSFL, *supra* note 21, at 103-04. Articles 166 and 167 formerly articles 190-2 and 190-3, were introduced in order to define insider trading and provide a provision under which to punish the activity. SEL, arts. 166, 167, *reprinted in* SEL & FSFL, *supra* note 21, at 106-112. However, the new Japanese insider law sets relatively light penalties. While the maximum U.S. criminal penalties are 10 years imprisonment and a one million dollar fine, a violation of the Japanese law only results in six months imprisonment and a 500,000 yen fine. SEL, art. 200, *reprinted in* SEL & FSFL, *supra* note 21, at 124-26.

81. The 1988 Amendments produced a significant amount of commentary in the American legal community. See, e.g., Harold Baum, *Japanese Capital Markets: New Legislation*, 22 L. JAPAN 1 (1989); Akashi, *supra* note 70; Lu, *supra* note 24; Laura Merkler, Comment, *Japanese Securities Regulations*, 3 TEMPLE INT'L & COMP. L. J. 75 (1989); Swan *supra* note 74. Japanese authorities were embarrassed when the first prosecution under the new law was initiated not by the Ministry of Finance or the Tokyo Stock Exchange (who had already investigated and declared the defendants innocent), but by the police. Wataru Horiguchi, *Securities Malfeasance in Japan: The Need for an Independent Organization to Monitor Insider Trading, Price Manipulation, and Loss Compensation*, 16 HASTINGS INT'L & COMP.

ment of civil liability under both the new articles and the anti-fraud provision was ignored.

### III. PRIVATE RIGHTS AND THE ROLE OF LAW IN JAPAN

Whereas private citizens play an important role in the enforcement of laws in the United States, the rate of private litigation in Japan is significantly lower.<sup>82</sup> Some scholars argue that private action is limited by an innate Japanese cultural aversion to litigation.<sup>83</sup> While this argument may have some merit, others argue that Japanese history has actually produced a bureaucratic monopolization of enforcement.<sup>84</sup> Most often, enforcement is conducted by the powerful Japanese ministries as part of the overall policy mechanism of administrative guidance.<sup>85</sup> This system has yielded few incentives for private parties to seek redress. Moreover, structural barriers to litigation are common.<sup>86</sup> When such barriers are removed and incentives are provided, the Japanese citizen may be as likely to seek judicial remedies as any American.

#### A. Japan's Bureaucracy

Professors Hideo Tanaka<sup>87</sup> and Akio Takeuchi<sup>88</sup> provide a valuable

L. REV. 223, 224-25 (1993). The Tokyo Summary Court eventually fined the president of a finance company 200,000 yen for violating Article 190-2. *Id.*

82. For a detailed comparison of litigation rates in the United States and Japan, see Masanobu Koto, *The Role of Law and Lawyers in Japan and the United States*, 1987 B.Y.U. L. REV. 627 (1987) (also comparing attitudes toward judges and lawyers, pay scales, and other areas).

83. The foremost proponent of this theory is Professor Takeyoshi Kawashima. TAKEYOSHI KAWASHIMA, *THE LEGAL CONSCIOUSNESS OF THE JAPANESE* (1967). See also Takeyoshi Kawashima, *Dispute Resolution in Contemporary Japan*, in *LAW IN JAPAN* 41-72 (A.T. Von Mehren, ed. 1963). Kawashima argues that the Japanese prefer reconciliation over litigation as a form of dispute resolution because the latter disrupts the communal harmony so valued by the Japanese. *Id.* at 45. He notes that "resort to litigation has been condemned as morally wrong, subversive and rebellious." *Id.* Another prominent Japanese scholar, Professor Noda, follows this cultural argument, claiming that Japanese homogeneity, village-bent behavior, and lack of norm consciousness lead to a desire for conciliation over adjudication. Yosiyuki Noda, *The Character of the Japanese People and Their Conception of Law*, in *THE JAPANESE LEGAL SYSTEM* 295-310 (H. Tanaka, ed. 1976).

84. See *infra* notes 90-92 and accompanying text.

85. See *infra* notes 90-92 and accompanying text.

86. See *infra* notes 110-13 and accompanying text.

87. Professor Hideo Tanaka, a Japanese scholar of comparative law, authored works in both English and Japanese. See 24 L. JAPAN vii (1991) (dedicating the volume to the late Tanaka).

88. Professor Akio Takeuchi is a leading scholar of Japanese corporate law. See West, *infra* note 112.

study on the role of private actions in Japan.<sup>89</sup> In their article, they analyze a basic difference between the historical development of Japanese and American law.<sup>90</sup> While American law developed largely as a means of solving disputes between citizens, Japanese law was created in response to the West and has traditionally been implemented as a means for the rulers to rule.<sup>91</sup> As the drafters of over ninety percent of all legislation and the primary enforcers of that legislation, the bureaucrats seem to have inherited the power to rule.<sup>92</sup>

In Japan, the bureaucrats within the government ministries are respected as the elite of the country.<sup>93</sup> Most are graduates of the Law Faculty of Tokyo University, the nation's most prestigious school.<sup>94</sup> In many ways, it is the bureaucrats, not the elected politicians, who are responsible for guiding the policies of Japan.<sup>95</sup> One consequence is that the bureaucrats are often reluctant to allow others, especially the public at large, to affect

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89. Hideo Tanaka & Akio Takeuchi, *The Role of Private Persons in the Enforcement of Law: A Comparative Study of Japanese and American Law*, 7 L. JAPAN 34 (1974).

90. *Id.* at 37-39.

91. Dutch author and journalist Karel van Wolferen supports this view of the role of law in Japan. KAREL VAN WOLFEREN, *THE ENIGMA OF JAPANESE POWER*, 202-12 (1989). Like Tanaka and Takeuchi, van Wolferen contrasts the historical development of law in Japan and the West, concluding, that "[o]n the whole, Japanese still think of law as an instrument of constraint used by the government to impose its will. Japanese officials are free to pick and choose among laws, using them to further their own causes." *Id.* at 210.

92. A study by Professor T.J. Pempel shows that bureaucrats have dominated the drafting of legislation since the end of the second world war. T.J. Pempel, *The Bureaucratization of Policymaking in Postwar Japan*, 18 AM. J. POL. SCI. 647 (1974). Analysts argue that Japanese politicians who gain votes by providing favors to their constituents, are too concerned with politics to delve into policy issues. See, e.g., Teresa Watanabe, *Tumult at the Top: Who Really Runs Japan?*, L.A. TIMES, Dec. 26, 1994, at A1. For an opposing view, see GERALD L. CURTIS, *THE JAPANESE WAY OF POLITICS* (1988) (arguing that bureaucrats no longer dominate, and that politicians now share in the policymaking process). According to Curtis, the breakdown of a national consensus toward growth of Japan's gross national product and the liberalization of the economy have forced political involvement. *Id.* at 109-10.

93. See Milhaupt, *supra* note 8.

94. Johnson details the prevalence of Tokyo graduates within the ministries, noting that they tend to maintain their college ties. JOHNSON, *supra* note 12, at 57-61.

95. Professor Chalmers Johnson is perhaps the most famous proponent of the bureaucratic dominance model of Japanese government. See JOHNSON, *supra* note 12. Other scholars have taken a more moderate view which recognizes the importance of private party input into the policy making process. See Milhaupt, *supra* note 8, at 424-26. Curtis argues that power is actually shared by bureaucrats and politicians. CURTIS, *supra* note 92, at 111. Professor Kent Calder favors an approach that relies on a "hybrid public private system" which also recognizes the growing role of politicians in the policy making process. KENT E. CALDER, *STRATEGIC CAPITALISM: PRIVATE BUSINESS AND PUBLIC PURPOSE IN JAPANESE INDUSTRIAL FINANCE* (1993).

policy.<sup>96</sup> The development of close relationships between bureaucrats and the private parties they govern is also a source of concern to small investors.<sup>97</sup>

The preferred operational method for Japanese bureaucrats is administrative guidance. This extra-legal process allows each ministry to guide policy flexibly by informally offering advice, warnings, and information to parties within its purview.<sup>98</sup> Overall, this method has proven very successful for Japanese industry.<sup>99</sup> One problem with administrative guidance is that enforcement of laws is often carried on behind closed doors and thus is not subject to public scrutiny.<sup>100</sup> Another problem is that laws are often not

96. Johnson characterizes the ministries as constantly trying to defend their interests by holding on to or expanding upon the power they possess. JOHNSON, *supra* note 12, at 74. Van Wolfereen goes further, arguing that the bureaucrats maintain a monopoly on the law:

The professors of the law department of the University of Tokyo, the nearly exclusive breeding ground for top administrators, appear to view the law as essentially an aid to administration. They still blindly accept the centuries-old premiss that the government is automatically superior to the people, believing that 'by nature, the people cannot understand the political realm and therefore should not criticize the administration's policies.' Conversely, laws are deemed legitimate by the populace only because they are administered by a class of people who have always had the right to do so, and not because they conform to any popular sense of justice.

VAN WOLFEREN, *supra* note 91, at 211.

97. One relationship-cultivating mechanism is "amakudari." Literally meaning descent from heaven, amakudari involves the hiring of retired ministers by private businesses within the former minister's jurisdiction. "The most senior amakudari position . . . are bases from which to coordinate the strategic sectors. At this level the Western distinction between public and private loses meaning." JOHNSON *supra* note 12, at 71. The Ministry of Finance's close relationship with those it regulates is also evidenced in the methods it employs to research and draft legislation. *The Wall Street Journal* reports that when the MOF was designing its insider trading laws in 1988, its officials requested help from Japan's big four securities houses in researching the laws of other nations. Marcus W. Brauchli, *Swamped Agency: As Japan's Economy Gains Clout, Ministry of Finance Struggles*, WALL ST. J., Dec. 20, 1989. One firm, Daiwa, reportedly spent tens of thousands of dollars to hire a Wall Street law firm to research U.S. provisions. *Id.*

98. Johnson, *supra* note 12, at 265.

99. Much has been written on the Japanese use of administrative guidance. See, e.g., John O. Haley, *Administrative Guidance Versus Formal Regulation: Resolving the Paradox of Industrial Policy*, in LAW AND TRADE ISSUES OF THE JAPANESE ECONOMY, 107-28 (Gary Saxonhouse & Kozo Yamamura, eds., 1986) (arguing that, as an essentially weak means of enforcing policy, administrative guidance has allowed firms to avoid more restrictive policies and helped to enhance competition in Japan, not suppress it); JOHNSON, *supra* note 12, at 242-74 (detailing the development and employment of administrative guidance within the Ministry of International Trade and Industry); Yoriaki Narita, *Administrative Guidance*, 2 L. JAPAN 45 (James L. Anderson trans., 1968) (defining administrative guidance and describing its strengths and weaknesses as an alternative to formal regulation in Japan).

100. Administrative guidance is also traditionally immune to judicial review. See, e.g., FRANK UPHAM, LAW AND SOCIAL CHANGE IN POSTWAR JAPAN, 198-202 (1987).

enforced at all.<sup>101</sup> A ministry responsible for the promotion of firms within that industry may be hesitant to seek official sanctions against those firms for wrongdoing when informal actions may suffice.

Within the hierarchy of the Japanese bureaucracy, the Ministry of Finance stands alone at the top.<sup>102</sup> Its wide-ranging powers and control over the national budget ensure its dominance.<sup>103</sup> As the elite among Japan's elite, the Ministry of Finance displays many of the strengths and flaws for which the bureaucracy is famous. Among the problems are the close relationships between Ministry of Finance bureaucrats and private industry leaders,<sup>104</sup> a reliance on informal methods of regulation,<sup>105</sup> and a stubborn reluctance to relinquish its role as the sole overseer of the varied industries it regulates.<sup>106</sup>

### B. Structural Barriers to Litigation

It is often said that Japan is an inherently non-litigious society due to its harmonious and homogeneous culture.<sup>107</sup> Under this analysis, a private right of action is not as important in Japan, because mediation is the preferred method of dispute resolution.<sup>108</sup> However, this idea of an innately non-litigious Japanese character has come under significant

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101. The recent Administrative Procedure Law addressed the potential for abuse under administrative guidance, although many of its provisions are simply hortatory in nature. Administrative Procedure Law, Law No. 88 of 1993.

102. See Milhaupt, *supra* note 8, at 444. Ministry of Finance predominance stems from its broad range of powers, which includes oversight of the national budget and the banking, securities, and insurance industries. One problem is that the Ministry of Finance has tended to focus its financial regulation on the banking industry. *Id.* at 440-49. Ministry of Finance's overwhelming dominance in policymaking has led to calls for its disempowerment and even its dissolution. See, e.g., Shigeki Kakinuma & Hiroshi Fukunaga, *Yes, We're Serious—BREAK UP the Ministry of Finance*, TOKYO BUS. TODAY, Jan. 1995, § 1 at 6, available in LEXIS, Nexis Library, Tokbus file.

103. See Takao Toshikawa, *Inside the MOF: The Men from the Ministry*, TOKYO BUS. TODAY, Jan. 1995, § 2, at 13, available in LEXIS, News Library, Tokbus File (showing the prominence of the Budget Bureau within the Ministry of Finance and the Ministry of Finance's domination of Japan's less powerful ministries).

104. Milhaupt, *supra* note 8, at 426. "Informality and cooperation, born partly of historical accident, have dominated securities regulation in Japan both because they serve important economic and political purposes and because they maintain the centrality of [the Ministry of Finance] in the political economy." *Id.*

105. *Id.*

106. *Id.*

107. See KAWASHIMA, *supra* note 83.

108. *Id.* at 50.



attack.<sup>109</sup> Some argue that the dearth of litigation is more closely related to institutional barriers to litigation.<sup>110</sup> Examples of such barriers include the lack of provisions for class actions,<sup>111</sup> the absence of effective discovery procedures,<sup>112</sup> and the incredibly expensive litigation fees required to file a civil action.<sup>113</sup>

Recent developments in the area of financial regulation support the theory that Japanese citizens would pursue litigation if it were economically feasible. For example, until very recently shareholder derivative litigation was extremely rare.<sup>114</sup> Traditionalists attributed this to the famed Japanese cultural preference for harmony and aversion to litigation.<sup>115</sup> Others cited

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109. See John O. Haley, *The Myth of the Reluctant Litigant*, 4 J. JAPANESE STUD. 359 (1978) (countering that members of most societies have an aversion to litigation, and that the relative lack of litigation in Japan is more attributable to inadequate judicial relief and access to the courts than to any inherent cultural aversion); J. Mark Ramseyer & Minoru Nakazoto, *The Rational Litigant: Settlement Amounts and Verdict Rates in Japan*, 18 J. LEGAL STUD. 263 (1989) (employing a wealth maximizing model in claiming that the Japanese are actually rational players who have little reason to sue in Japan's more predictable legal system).

110. See, e.g., J. Mark Ramseyer, *The Costs of the Consensual Myth: Antitrust Enforcement and Institutional Barriers to Litigation in Japan*, 94 YALE L.J. 604 (1985). Ramseyer studied Japanese antitrust law and concluded that institutional barriers to litigation have eliminated private antitrust suits and removed any meaningful deterrent to price-fixing. *Id.* These kinds of barriers help to preserve the myth of the non-litigious Japanese society. *Id.* at 605.

111. Tanaka & Takeuchi, *supra* note 89, at 44.

112. Actions in Japan are judge centered, and there is not system of pre-trial discovery. Mark D. West, *The Pricing of Shareholder Derivative Actions in Japan and the United States*, 88 NW. U. L. REV. 1436 (1994).

113. Some have chosen to follow a middle of the road approach, noting the existence of some cultural aversions to litigation, but also recognizing barriers such as the small number of lawyers and poor access to courts. See, e.g., Koto, *supra* note 82; Hideo Tanaka, *The Role of Law in Japanese Society: Comparisons with the West*, 19 U. BRIT. COLUM. L. REV. 375 (1985).

114. The mechanisms for shareholder derivative litigation were instituted after World War II and are very similar to U.S. regulations. For a complete background of derivative actions in Japan and an analysis of the recent litigation explosion, see West, *supra* note 112 (arguing that limited economic incentives prevented shareholders from filing claims until the recent changes in the Commercial Code made such actions profitable).

115. See KAWASHIMA *supra* note 83. West reports that even those with less traditional views subscribe to this theory when derivative suits are involved:

Although in his writings Professor Akio Takeuchi, Japan's preeminent company law scholar, usually attaches some degree of significance to institutional barriers to litigation, when pressed during a roundtable discussion, he remarked that, derivative litigation has been sparse chiefly because of "the most typical feature of Japanese society - the distaste for litigation."

West, *supra* note 112, at 1440-41 (quoting Roundtable, *The Present State of and Problems Relating to the Preliminary Draft of the Commercial Code Revision*, 1133 SHON HOMU (Commercial Law Journal) 8, 23 (1988) (statement of Akio Takeuchi)).

economic barriers such as litigation fees.<sup>116</sup> In 1993, following American pressure<sup>117</sup> and a rare case of judicial activism,<sup>118</sup> the Ministry of Justice instituted a flat litigation fee of 8,200 thousand yen (approximately eighty-two dollars) for those filing derivative actions.<sup>119</sup> The result, as expected by fearful corporate directors, was a flood of shareholder derivative suits.<sup>120</sup>

#### IV. THE SECURITIES FAIRNESS ACT OF 1992

The loss compensation scandals of 1991 involved all of Japan's major securities firms and drew worldwide attention to the nation's troubled securities industry.<sup>121</sup> In response to mounting foreign and domestic pressure,<sup>122</sup> the Diet, Japan's legislative body, amended the SEL once

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116. The filing fee for compensation claims was about 0.5% of the claim itself. "Though ostensibly for the purpose of preventing strike suits, the actual effect of the pre-1993 litigation fee rules was to discourage meritorious suits." West, *supra* note 112, at 1463. West also cites other economic barriers, such as high attorneys fees, limited access to information, and Japan's abuse of rights doctrine. *Id.* at 1456-70.

117. The frustration expressed by Texas entrepreneur T. Boone Pickens after buying shares in a Koito, a Japanese corporation, was widely publicized. This led the United States government to demand changes in the Japanese corporate structure during the Strategic Impediments Initiative of 1990. For an analysis of the Pickens affair, see M. Evan Corcoran, Note, *Foreign Investment and Corporate Control in Japan: T. Boone Pickens and Acquiring Control Through Share Ownership*, 22 L. & POL'Y INT'L BUS. 333, 350-54 (1991).

118. West *supra* note 112, at 1497 (citing Judgement of Aug. 11, 1992 (Asai v. Iwasaki [hereinafter the *Nikko Securities Case*]), Tokyo District Court, 101 Shiryoban Shoji Homu 37, rev'd, Judgement of Mar. 30, 1993, Tokyo High Court, 109 Shiryoban Shoji Homu 70). In the *Nikko Securities Case*, the Tokyo High Court ruled that because damages in derivative actions are indeterminable, litigation fees should be set at 8,200 yen (about \$82). If the court had based the fees upon the damage claim, plaintiffs would have had to pay 235 million yen instead (over two million dollars). *Id.* at 1464-65. The litigation fee for other compensation claims remains at 0.5% of the claim.

119. Law to Revise Part of the Commercial Code, Law No. 62 of 1993. This amendment essentially codified the judgement in the *Nikko Securities Case*. See West, *supra* note 112, at 1497.

120. Masayuki Tamura & Toyoki Sakata, *Shareholders Turning to Lawsuits to Assure Executive Accountability*, NIKKEI WKLY., May 9, 1994, at 1, available in LEXIS, News Library, Nikkei File.

121. See *supra* note 5.

122. United States Under Secretary of the Treasury David C. Mulford publicly criticized the Ministry of Finance's anticompetitive and opaque regulatory regime after the 1991 scandals. James Sterngold, *Treasury Official Rebukes Japan*, N.Y. TIMES, Oct. 18, 1991, at D1. Former SEC Chairman David Ruder joined the debate by advocating the establishment of an independent market watchdog. Yas Idei, *Independent Securities Watchdog Urged; Staff, Budget Among Keys, Says Former U.S. Official*, NIKKEI WKLY., Nov. 16, 1991, at 19, available in LEXIS, News Library, Nikkei File. Japanese Prime Minister Toshiki Kaifu also advocated a commission modeled after the American SEC. See Hidetaka Tomomatsu & Yas Idei, *Securities Watchdog: Hunter or Housepet*, NIKKEI WKLY., Aug. 10, 1991, at 1, available in LEXIS, News Library, Nikkei File.

more the following year.<sup>123</sup> In addition to revising disclosure requirements, the Securities Fairness Law addressed the problem of insider trading by establishing the SESC.<sup>124</sup>

Despite calls for an independent regulatory body, the Ministry of Finance chose to maintain a prominent role in capital markets by making the new watchdog a part of the Ministry of Finance.<sup>125</sup> The SESC is composed of approximately two hundred members drawn primarily from the Ministry of Finance.<sup>126</sup> The Ministry of Finance also appoints the SESC's chairman and two commissioners.<sup>127</sup> The SESC has the power to launch investigations of any parties suspected of wrongdoing and has the duty to report such illegal activities to the Ministry of Finance.<sup>128</sup>

On the surface, the new agency appears to be a breakthrough in the regulation of Japanese securities. The lack of a market watchdog had long been criticized as the major stumbling block to a fair and efficient Japanese market.<sup>129</sup> Indeed, the SESC has already launched investigations into charges of insider trading and market manipulation.<sup>130</sup> One investigation has even resulted in convictions for insider trading.<sup>131</sup> On further analysis, however, one may conclude, as one critic has, that the SESC is "illustrative of the Japanese genius for maintaining the status quo despite outward manifestations of reform."<sup>132</sup>

Although the commission's small size is often cited as a major

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123. Law No. 73 of 1992.

124. Law No. 73 of 1992. For an examination of the modified disclosure regulations as well as the SESC, see Shen-Shin Lu, *Securities Regulation in Japan: An Update*, 22 DENV. J. INT'L L. & POL'Y 121 (1993) (finding the Securities Fairness Act strict in appearance, but limited in practical effect).

125. See *supra* note 7-10.

126. See *supra* note 9.

127. Such appointments are subject to approval by the Diet. Milhaupt, *supra* note 8, at 470.

128. See *supra* note 9.

129. See e.g. Horiguchi, *supra* note 81; Ramsay, *supra* note 14, at 282-83; Yazawa, *supra* note 22, at 26. See also *supra* note 122.

130. The SESC acted quickly. Shortly after its inception in 1992 it raided a company suspected of market manipulation. See Yo Makino & Akira Ikeya, *Watchdog Raid Targets Illicit Speculation*, NIKKEI WKLY., Dec. 14, 1992, at 1, available in LEXIS, News Library, Nikkei File. The SESC has also investigated two cases of insider trading. See *supra* note 10. This has led to optimism on the part of some observers. "[T]he vigor of the SESC's initial investigatory program suggests that SESC officials perceive themselves to be independent, and this may be the most critical factor in ensuing proper distance between the SESC and other [Ministry of Finance] organs." Milhaupt, *supra* note 8, at 475.

131. See *supra* note 10.

132. Lu, *supra*, note 124, at 129. This statement expresses one of the common criticisms leveled at the Japanese government.

shortcoming,<sup>133</sup> the biggest problem for the agency is its affiliation with the Ministry of Finance. The SESC has no authority to levy administrative punishments or even bring charges against a party it believes guilty.<sup>134</sup> Rather, it is confined to making recommendations to the Ministry of Finance or asking the public prosecutor's office to bring charges.<sup>135</sup> Obviously, as the SESC's overseer, the Ministry of Finance has a voice in whether such requests are made. Given the long-established bureaucratic preference for extra-judicial means of regulation, the frequency of prosecutions initiated by the Ministry of Finance should not rise significantly.

The deterrent effect of the SESC on insider trading is dubious. Ultimate control is still within the purview of the Ministry of Finance, and the ministry's cozy relationship with the largest firms in the industry continues. Fear that smaller players would become the sacrificial lambs appears to have been born out by recent developments.<sup>136</sup> It seems that the major firms in the Japanese securities market will encounter few problems from the new watchdog unless they commit particularly egregious acts.<sup>137</sup> Because of the flaws in the 1992 Securities Fairness Law, Japan should examine other forms of regulation.

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133. See e.g. Masato Hotta, *Securities Watchdog Chained by Limited Staff; Successes Evident, But Much Still Left Undone*, NIKKEI WKLY., Aug. 2, 1993, at 2, available in LEXIS, News Library, Nikkei File (referring to the SESC as "grossly understaffed" and possessing "insufficient resources to deal with insider trading").

134. See *supra* note 9.

135. The SESC's enforcement powers are further limited by the fact that reporting a violation to the prosecutor's office does not necessarily ensure prosecution. Prosecutors in Japan have a great deal of discretion in determining whether to prosecute. See B.J. George, *Discretionary Authority of Public Prosecutors in Japan*, in *LAW AND SOCIETY IN CONTEMPORARY JAPAN* 263-88 (John O. Haley ed., 1988) (arguing that a system of checks and balances on this discretion prevents abuse of it).

136. Because of the consensual nature of the relationship between the Ministry of Finance and the industry, many feared that small players without such relations would be sacrificed to appease public pressures. The first party convicted due to SESC action was labeled a "small fry operator" by one foreign journalist who quoted sources as not expecting impartial action by the new watchdog. Michael Hirsh, *Japan: A Regulator's Dubious Debut*, INSTITUTIONAL INVESTOR, Jan. 1993, at 21.

137. The larger players have certainly been punished in the past. See *supra* note 5. However, this seems to occur only when the acts are so blatant as to achieve notoriety from the public, politicians and the international community. Further, even in instances such as the loss compensation scandal, punishments have been incredibly lenient. See *supra* note 5.

The recent Nippon Shoji case involved the death of several consumers caused by a drug which the company produced. See *supra* note 10. It is that information which caused the stocks of the company to plummet and insiders to gain a windfall before public disclosure. *Id.* Such a flagrant abuse of inside information had to be punished.

## V. CREATING A PRIVATE RIGHT OF ACTION

The Tokyo stock market did not assume a truly international presence until the 1980s.<sup>138</sup> During the inflation of Japan's bubble economy,<sup>139</sup> the value of shares traded on the market soared, realizing an increase of over 400 trillion yen.<sup>140</sup> Throughout that growth and the subsequent deflation, scandals involving politicians,<sup>141</sup> large companies,<sup>142</sup> and even gangsters<sup>143</sup> repeatedly rocked the securities industry. The scandals have been followed consistently by the Ministry of Finance's inability or unwillingness to levy adequate punishments or prevent further misdeeds.<sup>144</sup> Although some are optimistic about the inception and recent activities of the SESC, responsibility for true reform should lie with another group, as yet unempowered. Because the Ministry of Finance has proven that it cannot be counted on to provide sufficient protection, Japanese and foreign investors should be given the power to challenge abuses themselves.

Similar to most Japanese litigation, the current approach to the prosecution of securities violations relies on criminal sanctions.<sup>145</sup>

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138. See *supra* note 57.

139. Tokyo's financial market experienced an unprecedented bull run during the 1980s. This was partially fueled by overspeculation in land and stock prices. See David E. Sanger, *Hard Landing in Tokyo*, N.Y. TIMES, Jan. 24, 1993, at § 7, 14. This speculative "bubble" burst in the early 1990s and has led Japan into a deep recession. *Id.* For an account of this boom and bust, see CHRISTOPHER WOOD, *THE BUBBLE ECONOMY: JAPAN'S EXTRAORDINARY SPECULATIVE BOOM OF THE 80'S AND THE DRAMATIC BUST OF THE 90'S* (1993).

140. Sterngold, *supra* note 24.

141. In perhaps Japan's most notorious scandal, the Recruit Company sold shares to politicians as gifts shortly before the company went public. See Lu, *supra* note 124, at 149-50. The politicians, including the sitting Prime Minister and Minister of Finance, made a handsome profit of over 730 million yen. *Id.* All resigned when the scandal broke, but two of the involved politicians were subsequently elected to serve as Prime Minister. *Id.*

142. Nomura admitted that one of the preferred clients compensated for losses was a well-known organized crime figure. Sterngold, *supra* note 24.

143. Some of the parties illegally compensated in the 1991 scandals included organized crime figures. See *supra* note 5.

144. One critic referred to the punishments administered in relation to the 1991 compensation scandals as "so inadequate as to be almost laughable." Hoppe, *supra* note 5, at 213.

145. Japanese securities regulation relies almost entirely on criminal sanctions to punish offenders. A person convicted of insider trading under Article 157 formerly codified as Article 58, may be punished by up to three years in prison and a three million yen fine, or both. SEL, art. 197, *reprinted in* SEL & FSFL, *supra* note 21, at 121-22. Articles 166 and 167 introduced in 1988 as Articles 190-2 and 190-3, carry lesser penalties including a maximum of only six months imprisonment and not more than a 500,000 yen fine (about \$5,000), or both. SEL, art. 200, *Id.* at 124-26. There is no provision for compensation for the injured investors. Furthermore, violations of the SEL rarely result in prison sentences. Tradition holds that first time offenders receive probation. Lu, *supra* note 24, at 231.

Usually, some form of induced “voluntary” retribution on the offender’s part is also involved.<sup>146</sup> The recent Nippon Shoji case<sup>147</sup> showcases this “correctional emphasis.”<sup>148</sup> Small fines were levied, most of which did not approach the illegal earnings which were made.<sup>149</sup> This retribution was accompanied by public apologies<sup>150</sup> and internal changes within the companies of those convicted.<sup>151</sup> Compensation for the victims of the abuse was not even considered.

In the United States, the SEC may also seek criminal sanctions against offenders of insider trading laws,<sup>152</sup> but fines are usually much larger<sup>153</sup> and the commission also relies upon the actions of private investors suing under Rule 10b-5.<sup>154</sup> Private enforcement under Rule 10b-5 can result in large damage awards against parties perpetrating fraud,<sup>155</sup> serving to both deter potential abuses and reimburse injured parties.<sup>156</sup> Further use of the rule by private parties promotes efficient markets and boosts investor confidence. Indeed, by its own admission, the SEC lacks the manpower and budget to completely police the market by itself.<sup>157</sup>

The Ministry of Finance has yet to concede such a fact. Even with a watchdog that is a fraction of the size of the SEC, the Ministry refuses to share its enforcement powers with investors. This is the main reason for the

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146. The Japanese criminal justice system follows a paternalistic model based on the goals of rehabilitation and reintegration of the suspect into society without incarceration. See Daniel H. Foote, *The Benevolent Paternalism of Japanese Criminal Justice*, 80 CAL. L. REV. 317 (1992). Within this system, acceptance of moral responsibility carries great weight in the sentencing process. *Id.* at 352.

147. See *24 Fined*, *supra* note 10.

148. The term “correctional emphasis” is used by Professor Haley to refer to the Japanese goal of having guilty parties express regret to pay for their crimes. John O. Haley, *Introduction: Legal v. Social Controls*, in *LAW AND SOCIETY IN CONTEMPORARY JAPAN*, *supra* note 135, at 2. Expressions of regret are usually preferred to the imposition of prison sentences. *Id.*

149. The maximum penalty for violation of Article 166 is 500,000 yen (about \$5,000). SEL, art. 200, reprinted in SEL & FSFL, *supra* note 21, at 124-26. One party involved in the Nippon Shoji case allegedly earned four million yen. See *Briefing*, DALLAS MORNING NEWS, Oct. 15, 1994, at 5F.

150. See *24 Fined*, *supra* note 10.

151. The President of Nippon Shoji resigned shortly after the investigation was launched. See *32 Charged for Insider Trading of Drugmaker Shares*, JAPAN ECON. NEWSWIRE, Oct. 14, 1994, available in LEXIS, News Library, Non-US File.

152. See *supra* note 73.

153. See *supra* note 73.

154. 5 JACOBS, *supra* note 29, § 8.01, at 1-228,29.

155. See *supra* note 73.

156. One writer’s economic analysis of insider trading constraints shows that U.S. case law has been much more effective in deterring violations than regulations or administrative acts. H. Nejat Seyhun, *The Effectiveness of Insider Trading Sanctions*, 35 J. L. & ECON. 149 (1992).

157. 5 JACOBS, *supra* note 29, § 8.01, at 1-228.

continued scandals. The Ministry of Finance's refusal to share enforcement powers has also arguably contributed to the drastic decline in value of shares listed on the Tokyo Stock Exchange.<sup>158</sup> A private right of action would help to reverse these trends.

#### A. Implementation by Litigation

One group that could play a role in initiating a private right for insider trading is private attorneys. After all, it was "the ingenuity of members of the private bar" which developed civil liability under Rule 10b-5 in the United States.<sup>159</sup> Although Japan has traditionally had few attorneys specializing in securities,<sup>160</sup> protection of small investors is becoming more popular.<sup>161</sup> The plaintiff in *Kardon*<sup>162</sup> recovered under the theory that congressional intent provided for private recovery under the Exchange Act.<sup>163</sup> No legislative intent accompanied the SEL in Japan, but a private right could be developed under a tort theory similar to that cited in *Kardon*.<sup>164</sup>

Article 709 of the Japanese Civil Code<sup>165</sup> provides that "a person who has intentionally or negligently violated the right of another is bound to compensate any damages resulting in consequence."<sup>166</sup> The Code further defines an unlawful act as that "which violates the right of another and

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158. Sterngold, *supra* note 24. From the end of 1989 until April of 1992, the market's value declined by fifty percent. *Id.*

159. Milton Freeman, *Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 922 (1967). Mr. Freeman was an employee of the SEC and a drafter of Rule 10b-5. He admitted that nobody involved with its implementation foresaw its use in private litigation. *Id.*

160. As West argues, this is due largely to the limited number of private attorneys and lower economic incentives to litigate securities cases in Japan. See West, *supra* note 112, at 1458-63.

161. Lawyers supporting free markets are beginning to question the Ministry of Finance's monopolization of enforcement. See Kathryn Graven & Marcus W. Brauchli, *Shareholder Rights Idea Grows in Japan*, WALL ST. J., Aug. 28, 1989, § 1, at 6. Presumably, they are also becoming aware of the high awards available, at least in derivative suits.

162. 69 F. Supp. 512 (E.D. Pa. 1946).

163. *Id.* at 514. See *supra* notes 42-45 and accompanying text.

164. 69 F. Supp. at 513. Although *Kardon's* logic provides the basis for private rights of action under Rule 10b-5, former SEC Chairman Joseph Grundfest finds a gap in the logic. Joseph A. Grundfest, *Disemploying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961 (1994) (urging the SEC to become involved in the current debate over the existence of a private right under Rule 10b-5). Grundfest claims that under current Supreme Court doctrine, *Kardon* was incorrect and should not be used to support a private right under Rule 10b-5. *Id.* at 989-91.

165. Minpo, (Civil Code), Law No. 89 of 1896 and Law No. 9 of 1898, Art. 709, translated in J.E. DE BECKER, ANNOTATED CIVIL CODE OF JAPAN 273-74 (1979).

166. *Id.*

inflicts damage upon him."<sup>167</sup> The Ministry of Finance has declared article 157 of the SEL too vague to apply to insider trading, but articles 166 and 167, instituted in 1988 as articles 190-2 and 190-3, may provide recourse.<sup>168</sup> These laws specifically target insider trading.<sup>169</sup> Any violation of these provisions should, therefore, result in compensation awarded to the victim.<sup>170</sup>

In theory, this may seem simple, but there are other factors with which to contend. Any tort action places the burden of proof on the plaintiff, and Japan's discovery procedures make proving a violation of insider trading laws extremely difficult. The best opportunity would seem to arise after the trial of a related criminal case. For instance, if private investors were to file a claim against the recently convicted members of Nippon Shoji,<sup>171</sup> the burden of proving a violation would be much lighter for the private plaintiff. This consequence is not totally satisfactory to injured investors, as it means further reliance on the Ministry of Finance or, at least, on the SESC. However, the threat of civil liability will result in some deterrence of illegal acts, benefitting investors as a whole.

Excessively high litigation fees also pose a problem for potential litigants.<sup>172</sup> While the Ministry of Justice revised the amount required for derivative suits, litigation fees for other actions remain high.<sup>173</sup> However, this may also be challenged. The 1993 revision of litigation fees in derivative suits actually stemmed from the *Nikko Securities Case*,<sup>174</sup> in which the Tokyo High Court overruled a lower court decision and ruled that a flat rate is applicable in shareholder derivative actions.<sup>175</sup> Insider trading litigants could request a similar fee schedule.

Private attorneys would also have to rely on an activist judiciary.

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167. *Id.* at 272.

168. *See supra* note 77.

169. SEL, arts. 166, 167, reprinted in SEL & FSFL, *supra* note 21, at 106-112. *See also supra* note 77.

170. Victims of insider trading could also conceivably bring actions against the employers of those perpetrating illegal acts. Civil Code, art. 715, translated in DE BECKER, *supra* note 165, at 281. Article 715 of the Civil Code provides in pertinent part: "A person who has employed another for a certain business is bound to make compensation for any damages caused to a third party by the person employed in the execution thereof, . . ." *Id.* This provision has also yet to be used in securities actions. Attorneys would thus run into the same problems as those attempting to invoke article 709.

171. *See supra* note 10 and accompanying text.

172. *See supra* note 116.

173. *See supra* note 118.

174. West, *supra* note 112, at 1497.

175. *Id.*



Unfortunately, the Japanese bench does not have a long history of making independent decisions.<sup>176</sup> Despite receiving criticism for not straying from the status quo, some Japanese courts have nevertheless made controversial decisions in the past.<sup>177</sup> The *Nikko Securities Case* is one such recent example.<sup>178</sup> Other courts could follow the same activist approach, especially if they are influenced by the current widespread discontent with the securities industry.

### B. Pressuring the Ministry of Finance

If private litigants do not act or are not successful in pursuing a private right of action, direct action by the Ministry of Finance be another means of change. Based upon that Ministry's historic intransigence to relinquishing enforcement power,<sup>179</sup> this proposition seems untenable. However, the recent developments in shareholder derivative<sup>180</sup> and products liability regulation<sup>181</sup> indicate that bureaucrats could possibly relinquish their enforcement power. Evidence suggests that either acute pressure on the Ministry, or the persuasion of its leadership as to the benefits of private enforcement is needed to bring about such a reversal.<sup>182</sup> If popular

176. Elliott Hahn attributes this partially to the fundamental differences between common and civil law systems:

Acting under the civil law traditions of Japan, the judge will simply call the attention of the public to the specific statute which he is invoking as authority. In contrast, under the common law system the judge enjoys more free-wheeling powers . . . . Often an American judge will issue an opinion changing the law because he sees the court as the vehicle to do so; rarely, if ever, will a Japanese judge so view the court. In fact, an analysis of Japanese opinions leads one to believe that many Japanese judges see their roles as guardians of the values of Japan that have guided that country for hundreds of years.

ELLIOTT J. HAHN, *JAPANESE BUSINESS LAW AND THE LEGAL SYSTEM* 22 (1984).

Ramseyer and Rosenbluth find different reasons for the alleged judicial inactivism. J. MARK RAMSEYER & FRANCES MCCALL ROSENBLUTH, *JAPAN'S POLITICAL MARKETPLACE* (1993). They define the relationship between judges and the politicians that appoint them as one of agent and principal. *Id.* at 142-82. Political leaders use direct control over their appointments and indirect control over the Secretariat (the judiciary's administrative body) to affect judicial decisions. *Id.*

177. See West, *supra* note 112, at 1497 (citing Judgment of Aug. 11, 1992) and accompanying text. See also *infra* note 196 and accompanying text.

178. West, *supra* note 112.

179. Recent evidence of this is the Ministry of Finance's refusal to allow an independent securities watchdog. See *supra* note 96.

180. See *supra* notes 114-20 and accompanying text.

181. See *infra* notes 191-200 and accompanying text.

182. Although the effect of public and political pressure on financial policymaking is less significant in Japan than other nations, interest groups have enjoyed some success since the 1970s. See CALDER, *supra* note 95, at 232-37. The most obvious response to a public outcry was the Securities Fairness Act. Law No. 73 of 1992.

frustration with the securities industry does not abate, more changes could be forthcoming.

Revisiting the 1993 amendments to the Commercial Code,<sup>183</sup> one may see that a variety of pressures produced significant changes in the law.<sup>184</sup> The first was the Strategic Impediments Initiative,<sup>185</sup> through which the United States pressured Japan to amend its policies affecting shareholders. A second force was the public outrage over rampant scandalous activity within the securities industry.<sup>186</sup> A third type of pressure was the increase in shareholder litigation,<sup>187</sup> including the *Nikko Securities Case*, in which crafty private attorneys and an activist court found a loophole in the otherwise prohibitive litigation fees.<sup>188</sup> These factors led to the Ministry of Justice's revision of the Code,<sup>189</sup> which has allowed further shareholder litigation, and arguably improved corporate responsibility.<sup>190</sup>

Product liability litigation was also very limited until recently.<sup>191</sup> Plaintiffs attempting to sue for injuries caused by defective products faced an almost insurmountable burden of proof.<sup>192</sup> Finally, in 1993, worldwide changes in products liability laws,<sup>193</sup> consumer frustration,<sup>194</sup> and another

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183. Law No. 62 of 1993.

184. See *infra* notes 185-90 and accompanying text.

185. JOINT REPORT OF THE U.S. - JAPAN WORKING GROUP ON THE STRATEGIC IMPEDIMENTS INITIATIVE, Introduction (June 28, 1990).

186. See Sterngold, *supra* note 24.

187. See Tamura & Sakata, *supra* note 120.

188. See *supra* notes 114-20 and accompanying text.

189. Law No. 62 of 1993.

190. It has at least induced corporate directors to seek liability insurance in large numbers. See Katsuhide Takahashi, *More Companies Exploring Directors Liability Insurance*, NIKKEI WKLY., Feb. 7, 1994, at 17, available in LEXIS, News Library, Nikkei File.

191. See Zentaro Kitagawa, *Products Liability*, in 7 DOING BUSINESS IN JAPAN § 4.01 (Zentaro Kitagawa ed., 1989).

192. Before 1994, plaintiffs usually sued in tort under article 709 of the Civil Code. See *supra* notes 165-70 and accompanying text. Plaintiffs had difficulty proving both negligence and causation under the Civil Code's provision. See Yasuhiro Fujita, *Japan*, in 1 PRODUCTS LIABILITY: A MANUAL OF PRACTICE 1, 16-17 (W. Freedman ed., 1987).

193. The Council of the European Community sought to create uniform products liability laws within Europe by issuing a directive. Council Directive 85/374 of 25 July 1985 on the Approximation of Laws, Regulations and Administrative Provisions of the Member States Concerning Liability for Defective Products [Directive], 1985 O.J. (L210) P29 [hereinafter EC Directive]. This directive called for the protection of consumers through strict liability laws. *Id.* at Article 1.

194. In recent years, a number of consumer groups have advocated many changes in Japanese law. See Nobuyuki Oishi, *Consumer Groups: Advocates of What?*, NIKKEI WKLY., Aug. 23, 1993, at 2, available in LEXIS, News Library, Nikkei File. Former Prime Minister Hosokawa pledged to change Japan from a producer to a consumer oriented society. *Id.*

er case of judicial activism<sup>195</sup> in Japan led the Ministry of Justice to reexamine a proposal which had been shelved for twenty years.<sup>196</sup> When a committee appointed by Prime Minister Hosokawa advocated passage of the law,<sup>197</sup> the Ministry of Justice finally relented. The new products liability law<sup>198</sup> removes the need for the plaintiff to prove negligence by the defendant.<sup>199</sup> It provides, in effect, a strict liability theory of recovery.<sup>200</sup>

These recent events in shareholder derivative and products liability laws suggest that the ministries can be nudged toward enacting changes that they initially opposed. Some combination of foreign, judicial, public or political pressure<sup>201</sup> could arguably induce the Ministry of Finance to legitimate a private right under either article 157 or articles 166 and 167. As the self-proclaimed guarantors of Japan's well-being,<sup>202</sup> the bureaucrats do have an interest in securing the most fair and efficient market possible.<sup>203</sup> They must therefore be convinced to elevate market concerns above their

195. In March of 1994, the Osaka District Court ruled that negligence must be assumed in the case of an injury caused by a defective product during normal use of that product. See *Japan: Product Liability Ruling Saddles Makers with Burden of Proof*, NIKKEI WKLY., Apr. 4, 1994, at 20, available in LEXIS, News Library, Nikkei File. A television set manufactured by the defendant exploded, causing injuries to the plaintiff. *Id.* In essence, the court imposed a strict liability standard upon the defendant, Matsushita Electronics. *Id.*

196. A model law of products liability was drafted in 1975 in response to several mass tort incidents during that era. See Fujita, *supra* note 192, at 2.

197. Hosokawa was elected Prime Minister of Japan in 1993 on a pro-consumer platform. After his election, he continued the push for reform by advocating a new products liability law. See, e.g., Mihoko Iida, *Hosokawa Cabinet OKs Landmark Product Liability Bill*, NIKKEI WKLY., Apr. 18, 1994, at 7, available in LEXIS, News Library, Nikkei File.

198. Seizobutsu Sekinin Ho [Product Liability Law], Law No. 85 of 1994.

199. Law No. 85 of 1994, art. 3.

200. *Id.*

201. Lu argues that Diet intervention is unlikely, because corporate leaders rely on insider trading as a way to bribe politicians. Lu, *supra* note 124, at 149-51. "It is a reasonable conclusion that Japanese politicians do not intend to ban insider trading. They have left seams in the net in order to allow the astute to pass through." *Id.* at 151. Lu's assertion is supported by Rosenbluth, who cites "several pieces of circumstantial evidence of this activity. Politicians, for example, have consistently refused to tax capital gains, and support freedom for stock owners not to register. Thus there is no way to trail stock ownership." Frances Rosenbluth, *The Political Economy of Financial Reform in Japan: The Banking Act of 1982*, 6 UCLA PAC. BASIN L.J. 62, 67 (1989).

202. Johnson reports that bureaucrats "claim to be above politics and speak only of the national interest." JOHNSON, *supra* note 12, at 52.

203. The 1988 amendments to the SEL were drafted after four consecutive years of declining foreign investment in Japanese stocks. The market responded positively to the new laws. Eduardo Recio, Comment, *Shareholders Rights in Japan*, 10 UCLA PAC. BASIN L.J. 489, 515 (1992) (advocating and accurately predicting an increase in shareholder rights in Japan).

relationships with larger firms in the industry.<sup>204</sup>

### C. *The Ministry of Justice*

Finally, it is not inconceivable that the Ministry of Justice<sup>205</sup> could intervene on behalf of investors by amending the Commercial Code or choosing to enforce article 157, the equivalent of old article 58, on its own.<sup>206</sup> The Ministry of Justice is susceptible to the same pressures as the Ministry of Finance but is not constrained by the same relationships within the securities industry.<sup>207</sup> In fact, the Ministry of Justice distributed questionnaires addressing insider trading in the 1970s.<sup>208</sup> The results indicated that most respondents favored a provision that reinforced insider trading regulations and transferred old articles 58 and 189 to the Commercial Code.<sup>209</sup> That the Ministry of Justice was considering such bold action long before the recent scandals is encouraging to those seeking change in the current regulatory regime.

Floating a questionnaire and actually intervening in the Ministry of Finance's affairs are of course two different actions. The more powerful Ministry of Finance would resist such a maneuver, viewing it as a threat to its autonomy.<sup>210</sup> However, the Ministry of Justice successfully implemented the reduction of derivative litigation fees, an act which certainly affected the Ministry of Finance's internal affairs.

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204. Curtis argues that it is not intransigence but painfully slow decision making that often keeps bureaucrats from enacting change:

Foreign pressure is often effective in getting the Japanese government to make a policy decision, not because Japanese are peculiarly responsive to threats and hectoring . . . but because it drives issues into the political arena and thus brings into play the view of political leaders attuned to the game of deal making, compromise and getting things done.

CURTIS, *supra* note 92, at 247.

205. The Ministry of Justice basically serves as legal counsel for the state. TAKAAKI HATTORI & DAN FENNO HENDERSON, *CIVIL PROCEDURE IN JAPAN*, § 2.06, 2-35-38 (1985).

206. The Ministry of Justice includes a litigation division which is empowered to represent public interests in actions before the courts. *Id.*

207. The MOJ may also supervise other ministries in the handling of suits in which that ministry is a party. *Id.* Presumably, it could thus direct the MOF to pursue actions under chosen articles of the Securities and Exchange Law.

208. Ishizumi, *supra* note 34, at 492.

209. *Id.*

210. Johnson claims that the bureaucrats are constantly waging turf battles. See JOHNSON, *supra* note 12. "The greatest threat to a bureaucrat's security comes not from the political world . . . but from other bureaucrats." *Id.* at 321.

## VI. CONCLUSION

For almost fifty years, private rights of action have played a major role in the regulation of insider trading in the United States. In Japan, a number of factors have combined to prevent such a right of action. Thus far, the Ministry of Finance, left virtually alone to police the market, has been inadequate in preventing and deterring insider trading. While culturalists will continue to argue that a private right of action would be wasted on the non-litigious Japanese people, other evidence suggests that aggrieved investors are quite willing to file suits when avenues to litigation are made economically viable.

Japan has responded to scandals and the subsequent calls for reform of the securities industry by introducing the SESC. Understaffed and under the aegis of the Ministry of Finance, the SESC appears determined but limited. Unfortunately, even an independent market watchdog could not solve the problems of Japan's securities industry by itself. The goals of investor confidence, efficient markets, compensation of injured parties, and criminal deterrence require the inclusion of private parties in the regulatory process.

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