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INTERNATIONAL CAPITAL MARKETS SECTION

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§ 1. INTRODUCTION

The Japanese overhauled their Securities and Exchange Law (S.E.L.) in 1988[1] in order to accomplish the following goals: (1) liberalize and internationalize their securities market; (2) regulate the securities futures, index, and option trade; (3) develop a healthier securities issue market; (4) change disclosure regulations; (5) encourage investor trust in the fairness of the Japanese securities market; and (6) reinforce the prevention of "insider trading."[2] In 1992, Japan further amended the S.E.L. to extend the restrictions on insider trading to the over the counter market as well as listed securities.[3] The 1992 amendments also created a Securities and Exchange Surveillance Commission with authority to investigate securities law violations, but, unfortunately, its powers are limited to reporting its findings to the Ministry of Finance.[4] This article focuses on the revised disclosure regulation and the effort to prevent insider trading addressed in the 1988 and 1992 amendments.

In 1988, the Japanese created an entirely new system of disclosure regulations. The major changes were as follows: (1) three types of registration procedures, including a shortened form of the registration procedure, whereas previously there was only one; (2) a new shelf registration

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1. Securities and Exchange Law No. 25 of 1948, *amended by* Law No. 75 of 1988.

2. WATARU HORIGUCHI, KAISEIHO NO ZENPANTEKI KOSATSU [A General Study of the Amendment], 806 KINYU SHOJI HANREI [FINANCIAL AND COMMERCIAL CASES] 7 (1988).

3. Securities and Exchange Law No. 25 of 1948, *amended by* Law No. 73 of 1992 [hereinafter S.E.L.].

4. See *infra* § 4.02.

system;[5] (3) a shorter waiting period; (4) reinstatement of disclosure requirements for secured bonds; (5) an increased offering amount exempt from registration; (6) an extended requirement for filing current reports; and (7) a required disclosure of segmental and geographic financial information. In 1992, the Ministry of Finance (M.O.F.) also amended the Disclosure Rule (D.R.).[6] These changes in the disclosure system are explored below.

§ 2. NEW DISCLOSURE REGULATIONS

§ 2.01 *Three Kinds of Registration*

The Japanese disclosure system is similar in many respects to that under the Securities Acts in the United States. An issuer must register securities with the M.O.F. and prepare a prospectus for the investors if the issuer wants to publicly offer securities.[7] The issuer, underwriter, or securities firm offering the securities must deliver a prospectus to the purchasers of securities in a public offering.[8] A public company must file periodic reports (annual, semi-annual and current) with the M.O.F. as well.[9] The registration statements relating to a securities offering and the periodic reports constituting the continuous disclosure system require some of the same information. Under the new system, companies that have filed periodic reports for three years may file a simplified registration statement incorporating periodic reports.

Under the current law, there are three types of registration disclosure: complete disclosure (kanzen kaizi), combined disclosure (kumikomu), and reference disclosure (sansho), which is the simplest.

[1] Complete Disclosure

An issuer must file a registration statement with the M.O.F. before publicly offering or selling securities if the amount offered exceeds 500 million yen (4.2 million U.S. dollars).[10] Offerings of less than 500 million yen are exempt from registration.[11] Some securities are exempted - for example, government and municipal bonds.[12] The issuer must complete and file Form 2 (Japanese companies) or Form 7 (foreign companies).[13] Complete disclosure is the most burdensome type of registration.

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5. 17 C.F.R. § 230.415 (1992) (Rule 415 of the U.S. Securities Act of 1933). *See generally* COX, HILLMAN & LANGERVOORT, SECURITIES REGULATION: CASES AND MATERIALS 269 (1991); LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 135 (1988).

6. Ministry of Finance Order No. 53 (1992) [hereinafter M.O.F.].

7. S.E.L., *supra* note 3, art. 13.

8. *Id.* art. 15.

9. *Id.* arts. 24, 24-5.

10. *Id.* art. 4 (based on an exchange rate of one U.S. dollar to 120 yen, which will fluctuate with the market).

11. See *infra* § 2.05 for the procedures relating to offerings of less than 500 million yen.

12. S.E.L., *supra* note 3, art. 3.

13. Kaijirei [Disclosure Rule], art. 8 (1992) [hereinafter D.R.].

[2] Combined Disclosure

A company that has been filing periodic reports for the previous three years can use combined disclosure if the company wants to issue or sell securities through a public offering.[14] The issuer completes the registration form to include all events that have taken place since the filing of the last periodic report. The issuer submits the registration form to the M.O.F. with copies of the most recent annual, semi-annual, and current reports. Combined disclosure enables the issuer to avoid duplicating information previously filed. The issuer must use either registration statement Form 2-2 (Japanese companies) or Form 7-2 (foreign companies).[15]

[3] Reference Disclosure

An issuer qualified for reference disclosure need only submit a list of the previously filed reports and the location of the reports before issuing or selling securities.[16] This is the simplest registration format. The eligibility criteria for reference disclosure are the same as those for shelf registration described below.[17] The issuer must use either registration Form 2-3 (Japanese companies) or Form 7-3 (foreign companies).[18]

§ 2.01 *Shelf Registration System (Hako Toroku)*

The two types of disclosure requirements that existed before the 1988 amendment — public offering registration disclosure and continuous disclosure — remain. The new shelf registration system integrates these two requirements, reduces the cost of issuing securities to large listed companies, and enables companies to issue securities within certain time periods, giving them the chance to select the most opportune time.

[1] Issuer's Qualification

In order to qualify to file a shelf registration, an issuer must satisfy the following conditions:[19]

1) the issuer must be a listed company and have filed disclosure reports for the three previous years; and

2) the issuer's average stock trading amounts on exchanges in the last three fiscal years must exceed 100 billion yen (830 million U.S. dollars),[20] AND the average market value of its listed stock in the last three years must exceed 100 billion yen; OR the average market value of its listed

14. S.E.L., *supra* note 3, art. 5; D.R., *supra* note 13, art. 9-2.
15. D.R., *supra* note 13, art. 9-2.
16. S.E.L., *supra* note 3, art. 5; D.R., *supra* note 13, art. 9-3.
17. See *infra* § 2.02[1].
18. D.R., *supra* note 13, art. 9-3.
19. S.E.L., *supra* note 3, arts. 5, 23-3; D.R., *supra* note 13, art. 9.
20. If the issuer's securities have been traded on an exchange for less than three years, the average trading amount or market value of the longer period (one or two years) should be used. M.O.F., *supra* note 6.

stock in the last three years must exceed 500 billion yen (4.2 billion U.S. dollars); OR the issuer must have issued bonds that constitute a secured privilege payment under law;[21] OR the issuer must have issued bonds that are rated at least single A by one rating institution.[22]

[2] Filing the Shelf Registration

An issuer proposing to offer securities on a delayed basis can file a shelf registration statement with the Ministry of Finance (M.O.F.). The registration statement must state the planned issuing or selling period, kind and price of the securities, and name of the major underwriter or securities firm selling the securities.[23] The registration must be on Form 11 (Japanese companies), or Form 14 (foreign companies), and include the same information required by the reference registration.[24]

The registration becomes effective fifteen days after it is filed.[25] The M.O.F. can shorten the waiting period to seven days at the issuer's request.[26] The planned offering or selling period must not exceed two years after the effective date.[27] The issuer may choose a one or two year period.[28] If the issuer has issued or sold the planned amount before the effective period expires, the issuer must file a statement terminating the shelf registration.[29] The issuer may cancel the shelf registration anytime by filing a cancellation statement.[30] If the issuer is no longer listed on the exchange, it is not eligible for the shelf registration and must file a cancellation statement with the M.O.F.[31] The shelf registration then loses effect immediately.[32] The issuer must also send copies of the cancellation statement to the exchanges with which the issuer was listed.[33]

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21. For example, both the Public Electricity Law and the Nippon Telephone & Telegram Corporate Law authorize the power and telephone companies to issue bonds with secured privilege payment. "Bonds with secured privilege payment" are bonds guaranteed by the government.

22. In 1992, the M.O.F. adopted a rating system and designated Standard and Poor's, Moody's, the Japan Investment Service, Japanese Bond Research Institution, and two other organizations as acceptable rating organizations for this purpose. M.O.F. Bulletin, No. 131 (1992).

23. S.E.L., *supra* note 3, art. 23-3.

24. D.R., *supra* note 13, art. 14-2. See *infra* § 2.01[3] for a discussion of reference registration.

25. S.E.L., *supra* note 3, arts. 8, 23-5.

26. Toriatsukai Tsudatsu [Administrative Guidance], arts. 8-1, 23-5-1 (1992) [hereinafter A.G.].

27. S.E.L., *supra* note 3, art. 23-6.

28. D.R., *supra* note 13, art. 14-5.

29. S.E.L., *supra* note 3, art. 23-7.

30. A.G., *supra* note 26, art. 23-7-2.

31. *Id.* art. 23-7-3.

32. S.E.L., *supra* note 3, art. 23-7.

33. A.G., *supra* note 26, art. 23-7-4.

[3] Amendments

After filing the shelf registration, the issuer must file an amended registration statement with the M.O.F. under the following conditions:[34]

(1) the entire planned amount of securities cannot be issued in the planned offering period;[35]

(2) the issuer selects a different underwriter or securities firm to sell the securities;[36] or

(3) the issuer delays the effective date.[37]

In addition, when the issuer deems any other change significant, an amended registration should be filed.[38] However, the issuer may not amend the registration statement to increase the amount offered, change the planned issuing period, or change the kind of securities.[39] The M.O.F. may suspend the shelf registration for up to fifteen days after the issuer files an amendment if such action is necessary in order to protect public investors.[40]

[4] Ordered Amendment

The M.O.F. may order the issuer to file a supplemental shelf registration statement, suspending the offering until the filing occurs.[41] The filing should be made on supplemental shelf registration Form 12 (Japanese companies) or Form 15 (foreign companies).[42]

The M.O.F. can order the issuer to file additional documents if it finds the issuer's statements are defective, misleading, or inconsistent with the disclosures required by the appropriate forms.[43] The M.O.F. may also suspend the shelf registration or delay the effective date at any time.[44]

§ 2.03 *Shorter Waiting Period*

Under the new law the waiting period has been shortened from thirty days to fifteen days.[45] This was possible because of the development of

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34. S.E.L., *supra* note 3, arts. 23-4, 197, 200.

35. A.G., *supra* note 26, art. 23-4-2.

36. *Id.* art. 23-4-3.

37. D.R., *supra* note 13, art. 14-4. Since the registration becomes effective 15 days after filing, the issuer may want to file a delaying amendment to postpone the effective date.

38. S.E.L., *supra* note 3, art. 23-4.

39. D.R., *supra* note 13, art. 14-4.

40. S.E.L., *supra* note 3, art. 23-5.

41. *Id.* art. 23-8.

42. A.G., *supra* note 26, art. 14-7.

43. S.E.L., *supra* note 3, arts. 23-9, 23-10. For example, additional documents would be ordered if an issuer failed to include the name of the firm acting as underwriter or to submit a list of the locations at which its disclosure reports are available. See *supra* § 2.01[3].

44. S.E.L., *supra* note 3, art. 23-11.

45. *Id.* art. 8.

computer and communication technology, which has accelerated information analysis. The M.O.F. can further shorten the period if the issuer's information is readily available to the general public.[46] Registration for an issuer eligible to use reference disclosure can become effective seven days after the filing.[47]

§ 2.04 *Reinstatement of Disclosure Requirements for Secured Bonds*

The registration requirements for issuing secured, legally guaranteed, and preferred bonds were temporarily waived in 1953,[48] but they exist again under the new law. The reasons for the temporary waiver of the registration requirement were as follows:[49] (1) most of the secured bonds were acquired by financial institutions; as a result, there was no need to protect public investors; (2) these bonds were secured, or legally guaranteed, and were thus safer than other securities; and (3) the issuers of these bonds continued to file periodic reports. It was unnecessarily burdensome for the issuers to file registration every time they wanted to issue such bonds.

The reasons for reinstating registration requirements for such bonds include the following: (1) the general public now purchases more than half of these bonds; (2) deregulation under the Commercial Code now means these bonds are no safer than unsecured bonds; and (3) the disclosure procedure has been simplified by the new law. As a consequence, registration of secured bonds is required under the current law for the protection of public investors with minimal burden on issuers.

§ 2.05 *A Higher Issuing Amount for Registration Exemption*

Under the old regime, an issuer had to file a registration statement if the issuing amount exceeded 100 million yen (830 thousand U.S. dollars). This had been the standard since the 1971 S.E.L. amendment.

As a result of inflation and currently large issuing amounts, 100 million yen is no longer an appropriate threshold for imposing the burden and cost of registration on issuers. Accordingly, the amount has been raised to 500 million yen (4.2 million U.S. dollars).[50] However, the issuer still has to file a notification with the M.O.F. if the issuing amount exceeds 1 million yen (8.3 thousand U.S. dollars).[51] If the issuing amount exceeds 500 million yen, the issuer must file a registration statement. If the amount is between 1 million and 500 million yen, the issuer has to file a notification with the M.O.F. If the offering is for less than one million

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46. *Id.*

47. A.G., *supra* note 26, art. 8-1.

48. Securities and Exchange Law No. 25 of 1948, *amended by* Law No. 142 of 1953, supp. provision item 7 (Kaiseiho Fusoku 7).

49. Kakuro Kanzaki, *"Kigyo Naiyo Kaiji Seido No Kaisei"* [*"Enterprise Disclosure Amendments"*], 806 KINYU SHOJI HANREI [FINANCIAL AND COMMERCIAL CASES] 24 (1988).

50. S.E.L., *supra* note 3, art. 4; D.R., *supra* note 13, art. 2.

51. S.E.L., *supra* note 3, art. 4; D.R., *supra* note 13, art. 4.

yen, the exemption is self-executing.

§ 2.06 *Expanded Requirements for Filing Current Reports*

Under the old regime, an issuer who had a duty to file periodic reports was required to file a current report under the following circumstances.[52]

(1) There was a change of the issuer's parent or an important subsidiary.

(2) There was a change of the major shareholder.

(3) An issuer met with a disaster.

(4) The issuer was issuing or selling securities other than bonds abroad in amounts exceeding 100 million yen (830 thousand U.S. dollars). Under the new amendment the amount has been increased to 500 million yen (4.2 million U.S. dollars).

(5) A decision was made by a shareholders' meeting or by the board of directors for private sale of securities, other than bonds, in amounts exceeding 100 million yen. Under the new amendment the amount has been increased to 500 million yen.

Under the new amendment, these requirements still exist,[53] and there are six additional circumstances under which an issuer must now file a current report.

(1) A law suit has been filed against the issuer, and the alleged damages exceeds five percent of total assets, or the issuer has paid damages equal to more than one percent of total assets as a result of a law suit.

(2) The board of directors signs a merger or a consolidation contract that will increase or decrease the issuer's sales or total assets by more than ten percent, or dissolve the issuer.

(3) The board of directors signs a contract for the purchase or sale of the business or assets that will increase or decrease the issuer's sales or total assets by more than ten percent.

(4) A change of the representative director occurs.

(5) The issuer's debtor or the guarantor of the debt defaults on a debt instrument to *any* party (emphasis added), OR the debtor or guarantor is undergoing reorganization. Such default or reorganization, however, need be reported only if it might result in a default or delay in paying a debt to the issuer in an amount that is more than ten percent of the issuer's total assets.

(6) Any event occurs that has a substantial effect on the issuer's financial situation or business.

The new disclosure requirements benefit the public, which now has

52. S.E.L., *supra* note 3, art. 24-5.
53. *Id.*

access to more accurate and up-to-date information about the issuer.

§ 2.07 *Disclosure of Segmental Information*

Full disclosure of business operations is required in both the initial registration and periodic reports. The issuer must disclose total sales of each product and quantities sold within the last two fiscal years. An issuer that exports most of its products overseas must disclose the importing countries or areas and, for each product, the percentage of sales in the respective country or area.

In addition to these requirements, under the new amendment, the issuer must disclose (1) sales and profit or loss of each business, (2) sales and profit or loss in different business locations, and (3) overseas sales.[54] Public investors thus have more information about the issuer's financial performance.

§ 2.08 *Penalties and Remedies*

There is a three year imprisonment or fine of three million yen[55] (25 thousand U.S. dollars), or both, for filing an untruthful registration statement.[56] If the issuer continues to offer securities without filing a supplemental registration when ordered to do so, a one year prison term, a fine of up to 1 million yen (8300 U.S. dollars), or both may be imposed.[57] Any issuer that fails to file a supplemental shelf registration when ordered to do so and continues to offer or sell securities is liable to the person who acquired the securities and sustained damage as a result.[58] If the M.O.F. issues an order suspending the registration and the issuer does not obey the order, the issuer faces a penalty of up to six months imprisonment or a fine no greater than 500 thousand yen (4.2 thousand U.S. dollars), or both.[59]

§ 2.09 *Disclosure Summary*

The new disclosure system integrates registration disclosure and continuous disclosure. It gives reporting companies that meet the criteria for shelf registration flexibility to choose the best time to issue securities and simplifies filing requirements for such companies. It also gives public investors more pertinent information relating to a company's finance and business operations. The requirements for segmental and geographic reporting of specified financial information will also facilitate the efforts by

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54. D.R., *supra* note 13, arts. 10, 14, 17.

55. S.E.L., *supra* note 3, art. 197.

56. *Id.* arts. 197, 202. S.E.L. Article 202 states: "A prison term and a fine may be imposed in parallel with one another on any person who commits any crime referred to in the preceding five articles depending on the circumstances relating to such crime." Capital Market Research Institute, S.E.L., 135 (1989).

57. S.E.L., *supra* note 3, art. 198.

58. *Id.* arts. 16, 23-12.

59. *Id.* art. 200.

Japanese issuers to gain access to foreign capital markets, including the United States. It should be noted, however, that the segmental and geographic reporting requirements in Japan are not as detailed as the requirements of Regulation S-K in the United States.

§ 3. INSIDER TRADING

The 1988 and 1992 amendments included a well publicized effort to prevent insider trading. The discussion below argues that this new development is illustrative of the Japanese genius for maintaining the status quo despite outward manifestations of reform — in fact, the law on the books may never be realized in practice.

§ 3.01 *Reasons for Reinforcing Insider Trading Regulations*

There were three reasons for reinforcing the insider trading provisions. First, because the Tokyo Stock Exchange is among the biggest listed markets in the world in terms of market capitalization, the Japanese want to build a fair trading market image. Since the creation of the Securities and Exchange Law in 1948, almost no insider trading cases have been exposed. The foreign media accuse Japan of being an "insider's haven."[60] The Japanese want to rid themselves of this image. Second, the prevention of insider trading is a world-wide trend. The United States enacted the Insider Trading Sanctions Act of 1984 and the Insider Trading and Securities Fraud Enforcement Act of 1988.[61] The latter Act was under consideration at the time of the adoption of the Japanese amendment. The United Kingdom enacted the Company Securities (Insider Dealing) Act of 1985 and the Financial Services Act of 1986. France, Germany, and Switzerland also reinforced their insider trading regulations.[62] Japan wanted to follow the trend in order to foster a new "fair trader" image, thereby further boosting the already fantastic growth of its securities markets. Third, the Tateho case focused Japan's attention on insider trading. As a result of this case, the Japanese government accelerated the reform of insider trading provisions.[63]

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60. Akio Takeuchi, *Insaida Torihiki Kisei No Kyoka* [*The Reinforcement of Insider Trading Regulation*], 1142 SHOJI HOMU [COMMERCIAL LAW JOURNAL] 3 (1988).

61. Securities Exchange Act of 1934, 15 U.S.C. § 78u-1(a)(2). Although the Insider Trading and Securities Fraud Enforcement Act of 1988 had not yet been adopted, the Japanese translated the bill and published it in their law journals. The Japanese found the American insider trading provisions to be more strict than their own.

62. Kakuro Kanzaki, *Naibusha Torihiki No Kisei Ni Kansuru Kakokuho No Doko* [*Foreign Countries' Insider Trading Regulation Trends*] 819 JURISUTO [JURIST] 79, 85-86 (1984) (Switzerland). The Germans created insider trading self-regulation in 1971, and amended it in 1976 and 1988. Sakamoto, *Sho Gaikoku Ni Okeru Kisei No Jokyo — Doitsu* [*Foreign Regulations, Germany*], 806 KINYU SHOJI HANREI [FINANCIAL AND COMMERCIAL CASES] 78 (1988).

63. TAKEJI YAMASHITA, JAPAN'S SECURITIES MARKETS 253-54 (1989); Kawamoto, *Hokaisei Ni Itaru Keii* [*The Texture of the Amendment*], 806 KINYU SHOJI HANREI [FINANCIAL AND COMMERCIAL CASES] 98-100 (1988); David I. Sanger, *Insider Trading, The Japa-*

Tateho is a listed company and a chemical manufacturer. In August 1988, the company suffered a loss of 24 billion yen (200 million U.S. dollars) against capitalization of only 2.5 million yen (21,000 U.S. dollars) because of speculation on the future bond market. On August 31, the management notified its eight banks to come to company headquarters for a conference, which was scheduled for the afternoon of September 1. After Tateho's announcement of its loss on September 2, the price of its stock dropped dramatically. Meanwhile, from August 11 to August 21, six of Tateho's high-level managers, including three officers, sold shares. One of these officers was "advised" by the Osaka Stock Exchange to return his profit from the tainted trade because of his violation of Article 189 (now Article 164) of the Securities and Exchange Law. Article 189 had been a copy of Section 16(b) of the American Securities Exchange Act of 1934. The Article requires corporate insiders to disgorge their short-swing profits to their corporations.

One of Tateho's eight banks, Hanshin Sogo Bank, sold all of its 337,000 Tateho shares on September 1. According to the bank's managers, the sale verdict was made on the morning of the first, but there was no connection with Tateho's conference that afternoon. Two of the top ten shareholders also sold their shares during August, but neither of them owned more than ten percent of the company's total shares. In all, seventy-six stockholders sold over 20,000 shares each in August. According to the Osaka Stock Exchange's investigation, these transactions had nothing to do with confidential information. However, there are strong suspicions to the contrary.[64]

How did the bank manage to avoid a loss by selling all of its Tateho shares? Japanese banks know their customers very well because they can access their customers' inside information. For example, a bank always checks its customer's financial and managerial activity through loans and other financial services, usually holds its important customers' shares in order to stabilize the relationship between them, and always monitors its customers' accounts to oversee any unusual activity. Therefore, Hanshin Sogo Bank may well have known about Tateho's financial crisis.

Why did so many shareholders sell their shares in August? Was there

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nese Way, N.Y. TIMES, Aug. 10, 1988, at 1.

64. The following statement was made by the Osaka Stock Exchange:

> The Osaka Stock Exchange has made every effort to investigate the true facts related to the possibility of insider trading of Tateho stock. According to our investigation, there is no evidence of insider trading. But we found trading which might cause misunderstanding. We feel very sorry about this incident, since it came right after our notification to all listed companies to monitor insider trading. We strongly point out that insider trading is unfair and damages investors' confidence in securities markets. Triggered by this incident, we want to make every effort to prevent the misuse of confidential information by insider trading, and to protect the trustworthiness of trading markets. We also hope listed companies, securities firms, and related persons will prevent insider trading. Kawamoto, *supra* note 63, at 98-100 (Author's translation).

any sign or rumor that made these shareholders act? These questions are left unanswered. However, because the case was widely reported by the Japanese press,[65] the Japanese public became sensitized to the reality of insider trading.

§ 3.02 *The New Regimen*

[1] Article 157

Article 157 prohibits any person in a securities, future, option, or index transaction, including future securities transactions on a foreign market, from (1) employing any device, scheme, or artifice to defraud; (2) making any untrue statement of a material fact or omitting to state a material fact; or (3) using a false quotation to induce another person[s] to buy or sell securities. Violations of this Article carry a penalty of up to three years in prison or a fine of up to 3 million yen (25,000 U.S. dollars), or both.[66]

Article 157 is similar to Rule 10b-5 adopted under the U.S. Securities Exchange Act of 1934.[67] Rule 10b-5 is a catch-all fraud provision in federal securities regulation, and it has been widely used in the United States.[68] In contrast to Rule 10b-5, Article 157 has seldom been used in Japan. Like Rule 10b-5, Article 157 prohibits "any" person from doing "any" fraudulent act in "any" kind of securities transaction. The 1988 amendment extends the Article's scope to trading in futures, options, and indexes. The scope of this Article is very broad, and it can be applied to any kind of security, whether listed, traded on the over-the-counter market, held privately, or issued by governments or foreigners.

The reason this Article has not been used much is that its wording is too vague and its scope too broad. The Article was substantially copied from the United States and is very difficult to apply in a Japanese court. Under the Japanese legal system, there is no jury at a criminal trial. The judge decides both the facts and the law. To protect defendants, very strict conditions are imposed upon the prosecution. A prosecutor must

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65. *Id.*

66. S.E.L., *supra* note 3, arts. 197, 202. Article 197 provides a penalty of no more than three years in prison, *or* no more than three million yen in fines, for the breach of Article 147. Article 202, however, reads, "Any person who has committed a crime as prescribed by the proceeding five Articles may be confined to imprisonment with hard labour *and* fined concurrently in consideration of circumstances." (emphasis added). *Id.*, *translated by* THE JAPAN SECURITIES RESEARCH INSTITUTE, JAPANESE SECURITIES LAWS 71 (1987). Nonetheless, these Articles stand for the proposition that if the crime is serious, the defendant may be punished by both prison and fines. CAPITAL MARKET RESEARCH INSTITUTE, S.E.L. 58 (1989).

67. KATSURO KANZAKI, SHOKEN TORIHIKIHO (Shinpan) [SECURITIES AND EXCHANGE LAW (New Edition)] 612 (1987); TAKEO SUZUKI & ICHIRO KAWAMOTO, SHOKEN TORIHIKIHO (Shinpan) [SECURITIES AND EXCHANGE LAW (New Edition)] 555 (1987); LOUIS LOSS ET AL., JAPANESE SECURITIES REGULATION 192 (1983). Article 157 was designated as Article 58 before the 1992 amendment.

68. ROBERT CLARK, CORPORATE LAW 309 (1986); LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 726-29 (1988).

prove the defendant's "intention" to commit the crime and "the definite cause and effect" of the crime. A prosecutor is considered a very "high authority" in Japan. Once a defendant is prosecuted, a guilty decision is expected. If a prosecutor accumulates too many "not guilty" judgments, s/he will be deemed incompetent. Because Article 157 does not specify what kind of defendant conduct falls under its aegis, prosecutors are reluctant to use it for fear that failure will hurt prosecutorial reputations. The Ministry of Finance itself stated that "the Article is too vague and too broad. There is a limitation to its use in an insider trading case."[69]

[2] Article 163

Article 163 was copied from Section 16(a) of the American Securities Exchange Act of 1934.[70] It requires a corporate insider (director, auditor,[71] or major shareholder who owns more than ten percent of the company's shares) to file a report with the Minister of Finance after purchasing or selling company securities.

[3] Article 164

Article 164 was copied from Section 16(b) of the American Securities Exchange Act of 1934.[72] It requires a corporate insider to surrender short-swing profits (made from the purchase and sale, or sale and purchase

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69. SECURITIES BUREAU (OF THE M.O.F.), THE SECURITIES AND EXCHANGE COUNCIL REPORT, May 11, Showa 51 (1976). The report states, "In the United States, our Article 58's [now Article 157] twin, Rule 10b-5, has been widely used and extended to insider trading cases. However, it is very difficult for us to precisely define the scope of insider trading. If a tippee should fall under this Article, that would be overreaching. Furthermore, the Article's purpose is to prevent fraud. There is a limitation on expanding it to insider trading cases." (Author's translation). *See also* KANZAKI, *supra* note 67, at 612; SUZUKI & KAWAMOTO, *supra* note 67, at 555; TATSUTA, in LOUIS LOSS ET AL., JAPANESE SECURITIES REGULATION 192 (1983).

70. Wataru Horiguchi, *Shoken Torihikiho Dai 189 Jo No Kenkyu* [*A Study of the Securities and Exchange Law, Article 189*] 39-6, IKYORONSO [HITOTSUBASHI UNIVERSITY REVIEW] 641 (1958); SUZUKI & KAWAMOTO, *supra* note 67, at 556; TATSUTA, *supra* note 69, at 107. Article 163 was Article 188 before the 1992 amendment.

71. Commercial Code Article 273 requires that every company must have at least one auditor to supervise the company's business operation. The auditor has the right to check the directors' management. The auditor can ask the directors or other employees to submit business reports and can check the business and property of the company. The auditor can oversee the company's subsidiaries' business. The auditor can forbid the directors' doing business if the auditor finds the directors' actions will harm the company. If litigation occurs between the company and one of its directors, the auditor will represent the company. The auditor cannot be a director of the company or its subsidiaries. If the auditor neglects his duty, he bears responsibility for the company's harm. An auditor, like a director, is an employee of a company. The auditor is not an independent, outside CPA. Only a big company (with capital over 0.5 billion yen ($4 million) or liability over 20 billion yen ($167 million)), or a listed company, is required to have an outside CPA auditor or an accounting firm. Kabushiki Gaisha No Kansato Ni Kansuru Shoho No Tokurei Ni Kansuru Horitsu [Commercial Code Special Law on Audit of Stock Companies] Article 2; S.E.L., *supra* note 3, art. 193-2.

72. See *supra* note 70. Article 164 was Article 189 before the 1992 amendment.

within six months) to the company. If the company does not ask the insider to surrender the profit, any shareholder can bring a stockholder derivative suit against the insider to disgorge the profit to the company on behalf of the company.

[4] Articles 163 & 164 in Tandem

Article 163 is a pure disclosure requirement. Article 164 uses this disclosure to make insiders return profits from insider trading. Article 164 contains the following provisions.

(1) If a corporate insider purchases and sells, or sells and purchases, his company's securities within six months and makes a profit, the company can request the insider to return the profit to the company.

(2) Any shareholder can demand that the company ask insiders to return profits to the company. If the company fails to ask insiders within sixty days after the shareholder's demand, the shareholder can request that insiders return short-swing profits to the company.

(3) If neither the company nor any shareholder requests the insider to return the profit, the request right will expire two years after the insider takes his short-swing profit.

(4) If the Minister of Finance, based on the insider's transaction report, finds that any insider received profit from the short-swing transaction, the Minister shall notify the insider. If there is no objection from the insider, the Minister of Finance shall notify the company with the insider transaction report. If the Minister of Finance knows that the insider has already returned the short-swing profit to the company, the Minister does not have to notify the company.

(5) If an insider denies his profit from the short-swing transaction, he shall file an objection with the Minister of Finance within twenty days after he receives the notification from the Minister.

(6) If an insider challenges the short-swing trading assertion with legitimate grounds, the Minister of Finance may erase the allegation portion of the statement that will be sent to the company.

(7) If the insider does not deny the short-swing profit, the Minister of Finance shall make public the insider's transaction report thirty days after the Minister of Finance's notification to the company, and this disclosure shall last two years, until the date upon which the profit request right expires. If the Minister of Finance knows the insider has returned the profit to the company, the Minister will not make the report public.

(8) If a major shareholder was not a major shareholder at either the time of the purchase or the time of the sale, the shareholder shall not fall under the Article.

(9) The Minister of Finance shall set up a rule that provides a

method of calculating the short-swing profit of the insider.[73]

The purpose of these Articles is to prevent corporate insiders from trading on the basis of confidential information.[74] These Articles do not require proof that insiders have possessed and traded on confidential information.

Article 164 is related to Article 163. After an insider reports to the Minister of Finance, the Minister can ascertain whether the insider has breached Article 164. If the Minister finds that an insider profited from a short-swing transaction, he must notify the insider and his company and make public the name of the insider. This notification should give the company a chance to recover its loss. If the company does not ask the insider to return the profit from the insider trading, the company's shareholders can sue the insider and make him relinquish the profit to the company. Although the Japanese copied both Articles from the Americans after the Second World War, the Japanese deleted Article 163 in 1953. The reason for this elimination was that the Article was not deemed "effective." Perhaps it was too burdensome for the Ministry of Finance to check the reports.[75] As a result, without Article 163's reporting duty, Article 164 became worthless, thus the 1988 reform.

There was only one case brought under Article 164 before the 1988

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73. The method is provided by Showa 63 (1988), No. 40 M.O.F. Ordinance, art. 6. First, the profits are calculated by finding the difference between the two transaction prices, and multiplying by the matching number of the shares. Any securities exchange tax and commissions are then subtracted. The matching number of the shares is the number of the shares that are purchased and sold, or sold and purchased, within six months. For example, Insider A sold 1,000 shares at a price of 5,000 yen per share and bought 1,200 shares at a price of 3,000 yen per share within six months. The matching number is 1,000, so the profits are 2,000 x 1,000 = 2,000,000 yen, minus tax and commissions.

Second, if there is more than one transaction, the first purchase should match the first sale, or reverse. The rest of the transactions should be matched by the transaction order. For example, insider B bought 1,000 shares at a price of 3,000 yen per share on July 10; 1,300 shares at a price of 3,200 yen per share on July 20; 900 shares at a price of 3,500 yen per share on July 30. Then he sold 800 shares at a price of 6,000 yen on October 1; 1,600 shares at a price of 6,500 yen per share on October 11; 200 shares at a price of 6,300 yen per share on October 21. The profits from the first set of transactions are 3,000 x 800 = 2,400,000 yen. The profits from the second set of transactions are (3,500 x 200) (3,300 x 1,300) (3,000 x 100) = 5,290,000 yen. The profits form the third set of transactions are 2,800 x 200 = 560,000 yen. The total profits are 8,250,000 yen, minus tax and commissions.

Third, if there is more than one purchase or sale in a day, the lowest purchase price or the highest sale price should be used to calculate the first transaction. For example, if insider C sold his shares twice in one day, the higher price of the securities should be used to calculate the first transaction. If he purchased his company's securities twice in one day, the lower price should be used to calculate the first transaction.

74. CLARK, *supra* note 68, at 295; Loss, *supra* note 68, at 542; KANZAKI, *supra* note 67, at 618; SUZUKI *et. al.*, *supra* note 67, at 556; SEIJI TANAKA & WATARU HORIGUCHI, KONMENTARU SHOKEN TORIHIKIHO [COMMENTARY ON THE SECURITIES AND EXCHANGE LAW] 713 (1990).

75. KANZAKI, *supra* note 67, at 621; SUZUKI *et. al.*, *supra* note 74, at 557; TANAKA & HORIGUCHI, *supra* note 74, at 713.

amendment.[76] Togo was the founder and president of Shokusan Jutaku Sogo Company. He bought 560 thousand Shokusan shares at a price of 479 yen per share on July 20, 1972. He sold thirty thousand shares on September 14 and 530 thousand shares on October 2, 1972. He made a net profit of over 1.1 billion yen. One of Shokusan's shareholders requested that the company sue Togo to make him disgorge the short-swing profit under Article 164. The shareholder who asked the company to sue Togo is known as a "sokaiya."[77] A sokaiya is a shareholder who criticizes the company's management at the annual general meeting, if the company does not pay to keep him quiet, or one who is paid by the company to prevent other shareholders from speaking in the general meeting. Many sokaiya belong to gangs called "yakuza."[78] In this case, the sokaiya had attempted to blackmail Togo for a sum of money after Togo's short-swing transaction, but Togo refused to pay. As a consequence, the sokaiya requested that the company sue Togo under Article 164. Because the sokaiya belonged to a very notorious criminal group, the company reluctantly sued Togo. However, the case was settled out-of-court in December 1988. Togo had been found guilty of tax evasion in another case. The

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76. TANAKA & HORIGUCHI, *supra* note 74; SUZUKI *et. al.*, *supra* 74, at 557; KANZAKI, *supra* note 67, at 621. There are three cases related to Shokusan Jutaku, concerning tax evasion, bribery, and insider trading. Nihon (Japan) v. Togo, Saikosaibansho Saibanshu (Keiji) 236 Go 179 [236 Supreme Court Reports (Criminal Law) p. 179] (tax evasion); Nihon (Japan) v. Takata and others, Saikosaibansho Hanreishu Dai 42 Kan Dai 6 Go 861 [Supreme Court Reports, Volume 42, No. 6, p. 861] (bribery). Junji Abe, *Shokusan Jutaku Jikan Saikosaibansho Ketei Ni Tsuite* [*The Supreme Court Decision in Shokusan Jutaku*], 920 JURISUTO [JURIST] 4 (1988).

77. Isaacs writes: "In effect, the general meeting of shareholders merely approves management proposals . . . [S]hareholders are not expected to question management, or express any opinion . . . [T]he meetings are kept very short . . . [I]t was the general practice of a number of public companies to offer money and other benefits to a limited number of 'specialists' to ensure that they attended general meetings for the purpose of encouraging orderly proceedings and to support company management. . . . '[S]pecialists' could often guarantee that there would be no disruption of the meetings, as they used violence and other unlawful means of influence. . . . The 'specialists' who enjoyed the greatest reputations had come from a yakuza background (organized syndicates of gangsters) or right-wing political groups." He continues with an example: "In May, 1979, more than 500 shareholders attended an annual general meeting of shareholders of a company listed on the Tokyo Stock Exchange, 200 of whom were sokaiya taking up all the front row seating. . . . Not a single speech or question was presented to management by the ordinary shareholders present, and the meeting was wound up after 25 minutes." However, under a 1982 Commercial Code amendment, companies are not allowed to pay sokaiya. Sokaiya have set up many "economic study groups" to "study" companies' publicly disclosed documents. Sokaiya publish "economic study" periodicals at very high prices. For example, a periodical of three or four pages published once a month will cost a company 500,000 yen (about $3900). If a company does not subscribe to the periodical, the sokaiya might buy one share of the company's stock, attend the general meeting, and criticize the management violently. Issacs continues: "A report in January 1984 that Sony's annual general meeting of shareholders took more than 13 hours had a tremendously negative impact [on the company's image]." JONATHAN ISAACS, JAPANESE SECURITIES MARKET 123-128 (1990); ARON VINER, INSIDE THE JAPANESE SECURITIES MARKETS 91-92 (1988).

78. ISAACS, *supra* note 77.

Japanese government confiscated Togo's property and he became insolvent. After the company found that it was impossible to make Togo disgorge the profits from the tainted transaction, the case was tried in Tokyo District Court — from 1974 until 1987! There is a question as to how the shareholder, the sokaiya, could allege that Togo breached Article 164, even though the Article 163 duty to report had been deleted in 1953. This question remains unanswered. Nevertheless, *Shokusan Jutaku* was the only Article 164 case brought between the enactment of the Securities and Exchange Law in 1948 and its 1988 amendment.

Article 163, as revived, requires that a corporate insider must file a report with the Minister of Finance before the fifteenth day of the next month, after the insider's purchase or sale of his company's securities. If the transaction is executed by a securities firm, the report should be submitted to the securities firm by the insider. The securities firm then submits the report to the Minister of Finance on behalf of the corporate insider.

[5] Exceptions to Insider Filing Under Article 163

The important exceptions to the insider filing provisions under Article 163 include the following: (1) fractional shares and non-rounded units; (2) employee securities purchase plans; (3) employee trust funds; (4) stock-index future transactions; and (5) stabilizations under Article 125(3).[79]

[a] Fractional Shares and Non-rounded Units

A fractional share is a portion of stock that is less than one full share. In contrast, a non-rounded unit is a unit of stock that contains several shares but is not a full unit. Fractional shares and non-rounded units may be created by a stock dividend, share split, or a reverse share split; but non-rounded units could also be created in connection with a new issue.

The par value of most Japanese companies' stock is fifty yen (about 0.42 U.S. dollars), if the company was organized prior to 1981. Par values were so low due to the hyper-inflation that occurred during World War II and the post-war period. The low par value created a tendency for stocks to trade at relatively low prices, and it is inconvenient for the stock exchanges to trade such small-value stocks. Under the 1981 amendment to the Commercial Code, an older company's listed stock should be traded in the form of units that contain several shares since the exchange rules require that listed companies' stock should have a par value or unit par value of more than 50,000 yen (about 420 U.S. dollars).[80] Unlisted compa-

79. S.E.L., *supra* note 3, art. 163; Law No. 40 of 1988, Ministry of Finance Ordinance, art. 4.

80. Law No. 74 of 1981, Fusoku [Supplementary Provisions], art. 15. Another reason for raising the trading price was to block sokaiya because a non-rounded unit shareholder cannot attend the shareholders general meeting. If a sokaiya wants to attend the meeting he

nies can choose whether they want to use the unit system. The 1981 amendment also requires new companies to set up their stocks' par value at 50,000 yen or greater. As a result, many older companies set up before 1981 use 1,000 shares as a unit in order to comply with the amendment and to be in accord with the new companies' 50,000 yen par value. All listed companies' stocks are traded in either shares or units. Therefore, fractional shares and non-rounded units (i.e. with a unit par value of less than 50,000 yen) are not allowed to be traded on the stock exchange. Since fractional shares and non-rounded units are not easily liquidated, there is little fear of insider trading, and insiders are exempted from the duty to report.

[b] Employee Securities Purchase Plans

If a company has an employee securities purchase plan, a contract with a securities firm to buy the company's securities on a well-planned and regular basis, and if the purchase decisions are not based on a case-by-case investment judgment, company insiders are not required to file transaction reports. In these situations, there is a limitation of one million yen for every employee in each purchase. If the purchase is over this limit, insiders must file transaction reports.

[c] Employee Trust Funds

Conditions and limitations upon employee trust funds are the same as those imposed upon employee securities purchase plans. Both employee securities purchase plans and employee trust funds are part of employee welfare programs. Purchases of employee welfare programs are intended to raise pension funds, to improve the relationships between employers and employees, and to give employees incentives to work hard. There is little danger of insider trading because (1) the amount of each employees' purchases is limited; (2) the purchases are executed by a third party (securities firm or trust company) on a planned and regular basis, and (3) the purchase decisions do not involve case-by-case investment judgments. Such transactions are also exempted from a duty to report because the government seeks to encourage employee stock purchase programs.

[d] Stock-Index Future Transactions

A stock-index future transaction is based on the average price of many stocks in the future — the stock-index future — and is considered a package of all stocks. For instance, the "Stock Future 50" is an average price of fifty kinds of different stocks' future prices on the Osaka Stock Exchange. Since a stock-index future involves stocks of so many companies, a price change of the stock of one company will not have a substan-

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must buy a round unit (higher price), compared with the lower price of one share of non-rounded unit. ISSACS, *supra* note 77, at 127.

tial impact on the stock-index future. Even an insider who trades stock-index futures that include his company's stock future price is exempted from the duty to report.

[e] Stabilizations Under Article 125(3)

Securities stabilization is a policy designed to prevent a new-issue stock price decline. In a securities stabilization, the issuer must disclose to the general public that the company is under stabilization. There are also many restrictions on the company's securities price and on the time limit for the stabilization.[81] There is no fear of insider trading and insiders are exempted from the duty to report.

[6] Scope of Articles 163 and 164

The scope of Articles 163 and 164 is limited to public companies, which include listed companies and companies whose securities are traded on over-the-counter (OTC) markets.[82] Before the amendment, there were different opinions about the scope of Article 164 because there was no clear definition as to what kinds of securities fell under the Article. The amendment ended this disagreement. As a result of the amendment bringing future and option transactions within the Article, the securities covered include stocks, convertible bonds, bonds with warrant, warrants, options, and future transactions of the securities described above. If a corporate insider does not file a report required by Article 163, or files a false report, or if an insider makes a false objection under Article 164, there is a fine of up to three hundred thousand yen (2,500 U.S. dollars).[83]

Some argue that an astute major shareholder can evade Article 164 by selling his securities twice. For example, if a shareholder has 10.2 percent of a company's shares, he can sell 0.3 percent of the company's shares and return the short-swing profit to the company. Then he can sell the rest of the 9.9 percent of the company's shares without returning the short-swing profit to the company. It is true that the major shareholder can evade Article 164, but one must consider its legislative purpose. Since it is very difficult to prove that an insider traded on confidential information, this Article uses a very objective standard — ten percent of the company's securities — to settle the threshold of proof. Any shareholder who owns more than ten percent of a company's securities falls under Article 164. As long as s/he is no longer a major shareholder, s/he is outside of

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81. TANAKA & HORIGUCHI, *supra* note 74, at 562-72; SUZUKI *et. al.*, *supra* note 67, at 535-48; KANZAKI, *supra* note 67, at 639-56.

82. In the 1988 amendment, only listed companies' insiders were subject to these two articles. Many commentators argued that the scope was too narrow. In the 1992 amendment, insiders of companies whose securities are traded on OTC markets were included. See Shen-Shin Lu, *Are the 1988 Amendments to Japanese Securities Regulation Law Effective Deterrents to Insider Trading?*, 1991 COLUM. BUS. L. REV. 179, 224.

83. S.E.L., *supra* note 3, art. 205.

the restriction of Article 164. However, if any shareholder commits fraud or makes a false statement, s/he falls under Article 157.

[7] Article 165

Article 165 prohibits any corporate insider from short-selling his company's securities.[84] Short-sales are legal in Japan, but short-sales will accelerate securities price decline in a falling market. The Securities and Exchange Law does not preclude everyone from short-selling. There are some Ministry of Finance and stock exchange rules to restrict exchange members, usually broker/dealers, from short-selling.[85] However, corporate insiders are not allowed to short-sell because they can access confidential information. For example, suppose a company has a loss, and before the information is disclosed, the insiders short-sell the company's securities. They then buy securities for the settlement at a lower price after the disclosure of the bad news. The insiders can take advantage of their trading counterparts by trading on confidential information. Short-sale by insiders is a kind of insider trading.

Before the 1988 Amendment, Article 190 (now Article 165) read: "A listed company's officers and major shareholders shall not sell their company's stock, if they do not have their stocks."[86] The content of the Article was not clear. If a major shareholder did not have shares of a company, how could s/he be the company's major shareholder? The Article could also have been interpreted to mean that if an officer or a major shareholder had only one share of company stock, s/he could short-sell

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84. Article 165 was Article 190 before the 1992 Amendment.

85. Yukashoken No Karauri Ni Kansuru Kisoku [Securities Short-Sale Rule], Showa 23 (1948); Shoken Torihiki Iinkai Kisoku 16 [Securities and Exchange Commission Regulation 16]; Tokyo Stock Exchange Gyomukitei [Operational Rules] Article 72; Osaka Stock Exchange Gyomukitei [Operational Rules] Article 70. These rules define "short-sale" as a transaction in which either a stock exchange member or his client does not possess the securities, and the member borrows securities for settlement of the client's account. Securities future trading, margin trading, and issue-day settlement trading are excluded from the scope of short-sale. The rules require stock exchange members to state whether a transaction is short-sale or not. The sale price cannot be lower than the last sale price. An exchange member must state that a transaction is a short-sale unless the following apply: (1) he knows that he or his client has the securities and there is no inconvenience or expense in delivering the securities promptly; (2) he has the securities in the client's account or will receive the securities in a pending transaction; or (3) he bought the securities in the same exchange but the settlement has not been completed. These rules are copied from Rules 3b-3, 10a-1, and 10a-2 of the U.S. Securities Exchange Act of 1934. However, there are small differences. For example, U.S. Rule 10a-1 requires that the short-sale price cannot be lower than the two last sale prices, while the Japanese rules only require that the price cannot be lower than the last sale price.

86. The Japan Securities Research Institute translated Article 190 (now Article 165), before the 1992 Amendment, as follows: "No officer nor major shareholder of a corporation, the shares of which are listed for trading on a securities exchange, shall sell such portion of the same shares as he does not actually have." JAPANESE SECURITIES LAWS 64 (1987). "[S]uch portion of the same shares" should read "such stock." The ambiguity of the Article is manifest.

any amount of the company's stock.

In order to clarify the content of the Article, the amended Article reads "[a] listed company's officer/major shareholder shall not (a) sell his company's securities, when he has less 'value' of the same class of the securities than the securities he wants to sell; or (b) put or call an option of sale of his company's securities, when he has less 'value'[87] of the same class of the securities than the securities he wants to sell." Since future and option transactions are now within the Article, the "securities" include stocks, convertible bonds, bonds with warrant, and warrants. As some of the securities do not have prices, the Article uses "value" to evaluate prices of securities.

To illustrate, although a class of stock has a price on the daily stock exchange, a conversion right of a convertible bond or a warrant does not have a price. Even if a stock has a price every day, the price will change drastically in a fluctuating market. It is very difficult to determine the value of the right of a convertible bond or warrant because no one can prejudge whether or not the right will be executed. If not, the right is worth nothing. Similarly, an option that is not exercised is worth nothing. The method of calculating the value of such securities is promulgated by a Ministry of Finance ordinance.

Article 165 does not prohibit insiders from doing future transactions because insiders can future-trade as a way of risk hedging. As a result, the Article precludes a public company's insiders from selling or putting/calling a sale option worth more than the value of the securities they hold, and if they sell or put/call a sale option worth more than the value of the securities they hold, they fall under this Article because they have sold short. There is a fine of up to three hundred thousand yen (2,500 U.S. dollars) for breach of this Article.[88]

[8] Article 166

[a] Introduction

Articles 166 and 167 were added by the 1988 amendment.[89] Article 157, the general anti-fraud provision, is too vague and too broad to be used in an insider trading case. The Japanese wanted to clarify the concept of insider trading and to make it illegal. These Articles describe who is an insider and what kind of act shall fall under insider trading provisions. They constitute the first Japanese laws that clearly prohibit insider trading since the Securities and Exchange Law was created in 1948. Arti-

87. S.E.L., *supra* note 3, art. 165.

88. *Id.* art. 205.

89. The Japanese created these two articles as Articles 190-2 and 190-3 in 1988. The numbers were changed to Articles 166 and 167 in 1992. The substance of these Articles has not been changed by the 1992 Amendment. However, since there was much criticism from many commentators, the scope of the Articles was enlarged to include public companies, compared with only listed companies in the 1988 Amendment. *See* Lu, *supra* note 82.

cle 166 prevents "corporate-related parties" and "primary tippees" from insider trading, while Article 167 regulates them in the case of a tender offer. These Articles have the same content; the only difference is that Article 166 covers ordinary securities transactions, while Article 167 covers tender offers.

[b] Proscriptions

Article 166 prescribes that if "corporate-related parties" know the "material facts" of an issuer's business, the parties shall not purchase or sell the issuer's securities until the "material facts" are disclosed. This Article also prescribes that any person, a "primary tippee," who directly knows the "material facts" of an issuer from the "corporate-related parties," shall not purchase or sell the issuer's securities until the "material facts" are disclosed. The securities covered by this Article include a public company's stocks, bonds, warrants, and options.

[c] Definitions of Terms

[i] Corporate-Related Parties

"Corporate Related Parties" include:

(a.) an issuer's director, auditor, agent, or employee who knows the issuer's business' "material facts" through his work;

(b.) an issuer's shareholder who has the right to examine the issuer's books and records under Commercial Code Article 293-6, and knows the issuer's business' "material facts" through exercise of the right;[90]

(c.) a person who has the legal right to oversee, or has authority over the issuer, and knows the "material facts" of an issuer's business through exercise of the right or authority;

(d.) a person who has a contract with the issuer and knows the issuer's business' "material facts" because of the contract; or

(e.) an officer of any entity employing persons in categories (a.) and (b.) above, if such officer has learned of any material fact in connection with the performance of his duties.

The "corporate-related parties" remain subject to this Article for a period of one year after they have terminated their duties, employment, or contracts.

Under this Article, people in categories (a.) and (b.) are "insiders," while those in categories (c.) and (d.) are "quasi-insiders." Category (a.) includes everyone who has connections with the issuer. Even a part-time worker who cleans the issuer's office may fall under this Article. Category (b.) includes the shareholder's agents or employees, if they exercise the

90. A shareholder who has over ten percent of his company's stock can ask the company to let him examine or copy the company's books and records. SHOHO [COMMERCIAL CODE], art. 293-6.

examination right. If the shareholder is a company, and one of its directors, auditors, agents or employees exercises examination rights, s/he may fall under this Article. A secondary party who knows the issuer's "material facts" from any person who exercises the examination right in such a company may fall under this Article.

To illustrate, X company is a major shareholder of Y company. X's employee Z exercises the examination right to learn Y business' "material facts." Instead of taking advantage of the information himself, Z tells W, another of X's employees, the "material facts," and W does the insider trading. W will fall under this Article. In this case, W is also a "primary tippee." Category (c.) includes all persons who can examine, license, or have authority over the issuer, for example a government bureaucrat who receives the issuer's application for producing a very effective anti-AIDS medicine, or who receives an issuer's application for registering its new patent, or a Ministry of Finance officer who just examined the issuer's books or records. Category (d.) includes all persons who have contracts with the issuer, such as the issuer's attorneys, accountants, bankers, and underwriters. For example, a printing company that has a printing contract with the issuer, or an interpreting company that sends interpreters to the issuer would both be controlled by this Article. If the entity that has a contract with the issuer is a company, the conditions stated in category (b.) will apply — the company's directors, auditors, agents, employees, and their primary tippees will fall under this Article. For example, X securities firm is the underwriter of issuer Y. Z, one of X's employees, knows the "material facts" of Y's business through the underwriting contract. Z passes this confidential information to W, and W does the insider trading. W falls under this Article.

[ii] Primary Tippee

Any person who receives the "material facts" of an issuer's business directly from the "corporate-related parties" is a "primary tippee." Article 166 prohibits any "primary tippee" from trading the issuer's securities before the "material facts" of the issuer's business are disclosed. This restriction is effective within one year after the "corporate-related parties" have terminated their duties, employment, or contracts. For instance, X company's former employee Z, out of his job for ten months, knows the "material facts of Y's business through his former work; Z tells his friend W the confidential information and W trades Y's securities before Y's disclosure of the "material facts;" Z falls under this Article. However, if W received the confidential information within one year of Z's termination but traded one year after Z's termination, W does not fall under this Article.

According to the Ministry of Finance's explanation,[91] the reason this

91. Akio Takeuchi, *Insaida Torihiki Kisei No Kyoka [The Reinforcement of Insider Trading Regulation]*, 1144 SHOJI HOMU [COMMERCIAL LAW JOURNAL] 9, 15 (1988). Professor

Article prevents only "primary tippees" from insider trading is to make the scope of the Article clear. If all tippees fell under the restriction, no manageable limits would exist. For example, in the case above, if W, instead of taking advantage of the confidential information by himself, told M, then M told N, and N did the insider trading before Y's disclosure, W, M and N are all tippees. It is impossible to restrict all tippees because anyone could be called a tippee. To narrow this Article's scope, only "primary tippees" are prohibited from insider trading.

[iii] Material Facts

"Material Facts" include the following:

(a.) Management decisions relevant to the execution of the following matters:

(1) issue of stocks, convertible bonds, and bonds with warrants;

(2) capital reduction;

(3) share splits;

(4) dividends;[92]

(5) mergers or acquisitions;

(6) disposing of all or a part of the company's business; as well as acquiring all or part of another company's business;

(7) dissolution;[93]

(8) bringing a new product or new technology into the market; or

(9) entering into a joint venture, or other matters similar to (1) — (8) above which are prescribed by ordinance.

(b.) When any of the following happen:

(1) a disaster, or other damage occurs to the company;

(2) a change of a major shareholder;

(3) an event which will unlist the company; or

(4) any events, like (1) — (3) above, that are prescribed by ordinance.

(c.) A new estimate indicating that the company's sale, ordinary profits, or net profits will be different from the previous estimate, as this new estimate may have an impact on the investor's judgments.

(d.) In addition to (a.) through (c.), any important facts about the

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Takeuchi is the Chairman of the "Unfair Trading Special Department" of the Securities and Exchange Council. The Securities and Exchange Council is an advisory council in the Securities Bureau. The Unfair Trading Special Department consists of five scholars, one bureaucrat of the Justice Department, one Tokyo Stock Exchange assistant director, one drug company president, one president of a securities research firm, one trustee of an economic study fund, and a director of a Japanese economic newspaper.

92. Only if the management decides to change the amount or the method of the preceding dividend does this decision fall under the scope of "material facts."

93. The only exception is dissolution by merger.

company's operation, business, or property that will have an impact on investor judgment.

[d] Disclosure of Material Facts

There is a disclosure of material facts if:

(a.) the company complies with an ordinance to make "material facts" public, or

(b.) the company files a statement or a report under Article 25.[94]

An order of the M.O.F.[95] requires a company to publicize material facts in at least two forms of mass media. Disclosure is complete twelve hours after the publication. The mass media include a national daily paper, a national industry or economic newspaper, or a national radio or television broadcast. The twelve hour requirement commences with the publication in the second medium.

[e] Exceptions

The following persons, securities, and transactions are beyond the scope of this Article:

(a.) a person who obtains stock by exercising a warrant;

(b.) a person who obtains stock by exercising his conversion right under a convertible bond;

(c.) a person who trades securities to complete his mandatory obligation or requests the issuer to buy his shares under the Commercial Code;[96]

(d.) a person who follows a decision of the board of directors to buy securities against a tender offer;

(e.) a person who trades securities under a stabilization that is regulated by an ordinance;[97]

(f.) a person who trades bonds or options on bonds, unless these

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94. S.E.L., *supra* note 3, art. 165-2. Under Article 25, the Ministry of Finance must make public the company's disclosure document for a special period of time — for example, five years for annual and supplemental reports.

95. S.E.L. Operation Order, art. 30, ¶ 1.

96. Appraisal Right: under the Commercial Code a shareholder can ask the issuer to buy his shares in the following circumstances: (1), if a shareholder opposes the issuer's important managerial decision, such as disposing of an important property, he can ask the issuer to buy his shares (Article 245-2); (2) if the issuer decides to make restrictions on the qualification of its shareholders, any shareholder who opposes this decision can ask the issuer to buy his shares (Article 349). However, this situation should not arise, because once the issuer makes this decision, its securities will be removed from the list or the OTC market and only a public company is within the scope of Article 166; or (3) a shareholder can ask the issuer to buy his shares if s/he opposes the issuer's merger decision (Article 408-3).

97. A stabilization is a way of preventing a sharp price drop of a newly issued security under the supervision of the Ministry of Finance. TANAKA & HORIGUCHI, *supra* note 74, at 749; SUZUKI *et. al.*, *supra* note 67, at 595; KANZAKI *supra* note 67, at 639.

bonds or options come with warrants or conversion privileges;

(g.) a transaction among insiders and primary tippees not on an over-the-counter market or a stock exchange;[98]

(h.) an execution of a securities transaction by the issuer; either the transaction had been decided/contracted before the "material facts" happened or other similar transactions that are prescribed by an ordinance.

[9] Article 167

Article 166 prohibits any insider, quasi-insider, or primary tippee from insider trading in an ordinary securities transaction, while Article 167 prohibits them from insider trading in the case of a tender offer. Article 167 has almost the same content as Article 166. The only difference between these two Articles is that the term "material facts" in Article 166 is replaced by the term "tender offer facts" in Article 167. Under Article 167 no insider, quasi-insider, or primary tippee of the offeror can buy or sell the target company's securities if he knows the offeror has made a decision to execute or withdraw a tender offer. The concept of insiders, quasi-insiders, and primary tippees is the same as that in Article 166. The exceptions to Article 167 are the same as those to Article 166.

[10] Article 154

Article 154 gives the Minister of Finance the right to order both the stock exchanges and listed companies to file reports about their business or properties or to submit documents. The Article permits the Minister to examine only the stock exchanges' business, properties, books, and records, not the listed companies'. Before the amendment, the Minister had the right to order or examine only the stock exchanges. The new law gives him the additional right to order listed issuers to file reports.[99]

§ 4. THE 1992 AMENDMENT: SECURITIES AND EXCHANGE SURVEILLANCE COMMISSION

§ 4.01 *History of the Law Reform*

The Unfair Trading Special Department[100] (hereinafter, the Department) of the Securities and Exchange Council in M.O.F. was set up in 1987. It began major reform against insider trading in 1988. As a result of the creation of this agency, the Japanese hoped additional securities

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98. There is no danger of abuse of confidential information among insiders and primary tippees because they all know the confidential information. However, in this case, if the seller knows the buyer would resell these securities to a third party, the seller should not sell the securities to the buyer. For instance, A and B are both insiders or primary tippees. If A knows that B would resell the securities bought from A to C, an outsider, A should not sell B the securities because B would take advantage of C by using confidential information. S.E.L., *supra* note 3, art. 166.

99. Telephone interview with Wataru Horiguchi by the author, February 1, 1993.

100. See *supra* note 91 and accompanying text.

problems could be addressed. One such scandal occurred in July of 1991, when the "Big Four" (Nomura, Daiwa, Nikko and Yamaichi) securities houses illegally compensated their large clients.[101] Nomura Securities and Nikko Securities were also found to have manipulated the stock price at a railway company on behalf of an organized crime boss.[102] Following this chain of events, the presidents of Nomura Securities and Nikko Securities resigned.[103] Subsequently, a top aid to Finance Minister Hashimoto resigned after admitting he had helped arrange a loan-fraud scandal[104] worth U.S. $93 million. Following this, the Minister of Finance himself resigned.[105]

In an attempt to consider the impact on U.S. investors and markets, the S.E.C. sent queries to Japanese securities firms regarding the stock scandal.[106] Two large U.S. pension funds also reacted by sending notice to the Big Four to request reforms of the Japanese brokers.[107] The extent of this outside pressure forced the Japanese Prime Minister to commence with financial reform.[108] Many scholars criticized the abolition of the U.S. S.E.C.-style regulator that was imposed after W.W.II.[109] The Japanese business leaders, after all of the aforementioned scandals, strongly urged their government to set up an American S.E.C.-type of independent securities watchdog.[110] The Prime Minister responded by asking the M.O.F. to propose establishing a new institution that would oversee the securities markets as well as the securities industry. The M.O.F. then submitted a proposal for the "Securities and Exchange Surveillance Commission" to be designed within the M.O.F., despite the fact that an independent institution outside of the M.O.F. was demanded by the Administration Reform Council.[111] The M.O.F. did not want to give up its power.

The Japanese also adopted the "honest" and "fair" principles recommended by the International Organization of Securities Commissions

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101. Christopher J. Chipello & Masayoshi Kanabayashi, *Japan's 'Big Four' Firms Try to Cool Payment Furor*, WALL ST. J., July 30, 1991, at A13.

102. Clay Chandler, *Tokyo is Scrutinizing Allegation of Nomura Stock Manipulation*, WALL ST. J., June 27, 1991, at A11.

103. *Trapped in the Rubble*, THE ECONOMIST, June 29, 1991, at 65.

104. *Top Japanese Aid Quits in Loan Scandal*, BOSTON GLOBE, Aug. 4, 1991, at 14.

105. Quentin Hardy, *Hashimoto's Exit, New Securities Laws Are Just A Drop in Japan Reform Bucket*, WALL ST. J., Oct.. 4, 1991, at A10.

106. Michael R. Sesit et al., *SEL Sends Queries to Japanese Firms on Stock Scandal*, WALL ST. J., Aug. 1, 1991, at C1.

107. Kathryn Graven, *Pension Funds Ask Japanese Brokers To Make Reform*, WALL ST. J., Aug. 5, 1991, at B6a.

108. Chuck Freadhoff, *Japan Scandal May Hasten Financial Reform*, INVESTOR'S DAILY, Aug. 7, 1991, at 1; Weisman, *Scandals Prompt Kaifu Offer Securities Reform*, N.Y. TIMES, Aug. 8, 1991, at A6.

109. Lu, *supra* note 82, at 235.

110. *Japanese S.E.C. Is Urged*, N.Y. TIMES, July 4, 1991, at D11.

111. *Shoken Torihikiho Kanshi Iinkai No Hasoku* [*The Start of the Securities and Exchange Surveillance Commission*], 470 TEGATA KENKYU [BILL STUDY] 70 (1992).

(I.O.S.C.O.) in 1991.[112] The new amendment binds securities firms and their employees to be honest and fair with their clients at all times. The securities firms were then prohibited from offering any compensation to clients, and the penalties for this were raised in the new amendment.[113]

§ 4.02 *The Securities and Exchange Surveillance Commission*

The Securities and Exchange Surveillance Commission (S.E.S.C.) consists of three commissioners with one serving as the chair.[114] The commissioners are appointed by the Minister of Finance after gaining the approval of both chambers in the Diet.[115] Their term is three years and can continue by reappointment.[116] The commissioners cannot be dismissed against their will.[117] The S.E.S.C., including these commissioners, presently employs 118 people.

The Minister of Finance's right to ask for reports under Article 154 is delegated to the S.E.S.C..[118] The S.E.S.C., as structured, has the right to investigate all securities crimes, including insider trading and market manipulation.[119] The S.E.S.C. can subpoena information of individuals, as suspects or as witnesses, to assist in its investigations.[120] The Securities and Exchange Surveillance Commission also has the power to check items in the possession of the *suspect*, when actually questioning him, but cannot similarly examine items in the possession of a witness.[121] The S.E.S.C. cannot search the suspect's office or home without a court warrant because Article 35 of the Japanese Constitution requires a warrant in order to conduct a search. If necessary, the S.E.S.C. can request the courts to issue warrants for searches and to have access to property to confiscate relevant evidence.[122] The S.E.S.C. also can request information and cooperation from other government departments.[123] The S.E.S.C., in other words, investigates all facets of the securities firms and self-regulation organizations.[124]

The S.E.S.C. must report to the M.O.F. when the S.E.S.C. discovers illegal activities.[125] The S.E.S.C. does not have the power to discipline one who violates the laws or to initiate a proceeding. The S.E.S.C. can only

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112. S.E.L., *supra* note 3, art. 49-2.
113. *Id.* arts. 50-3, 199, 207.
114. Okurasho Sechiho [Ministry of Finance Establishment Law] art. 10 [hereinafter MOFEL].
115. *Id.* art. 11.
116. *Id.* art. 12.
117. *Id.* art. 13.
118. S.E.L., *supra* note 3, art. 154-2.
119. *Id.* art. 210.
120. *Id.*
121. *Id.*
122. *Id.* art. 211.
123. *Id.*
124. *Id.* arts. 55, 56, 79-14, 79-15.
125. *Id.* art. 226.

advise the Minister of Finance.[126] The Minister, then, is expected to give serious consideration to the S.E.S.C.'s advice.[127] The S.E.S.C. can follow up with a request for the report on any action taken by the Minister of Finance after the S.E.S.C. recommendations have been given.[128] The S.E.S.C. then can make further suggestions to the Minister of Finance.[129] Given the Japanese cultural norms, the S.E.S.C. cannot be expected to act independently or to challenge the M.O.F. in the event the M.O.F. does not follow the S.E.S.C.'s recommendations. This new watchdog, which is under the aegis of the M.O.F. and has a position similar to an inside council, observes, investigates, and reports, but it does not have the teeth to bite into the securities market.

§ 5. CASES AFTER THE 1988 AMENDMENT.

Since the 1988 Amendment, there have been two major cases related to Article 164's short-swing profit. In these cases, the insiders either returned the short-swing profit privately or were ordered to do so by the court.[130] There also have been two Article 166 (insider trading) cases. In the first Article 166 case, the Tokyo District Court fined a president of a finance company 200,000 yen (1,667 U.S. dollars) by summary judgment for breach of Article 166 in September 1990.[131] The second case, the *Macros* Case,[132] was decided by Tokyo District Court in 1992. Here the defendant, who was the director of a listed company, "window-dressed" the company's sales and sold the company's stock before the scheme was exposed. He made a profit of 18,000,000 yen (150,000 U.S. dollars), but was later fined 500,000 yen (4,167 U.S. dollars) with no prison sentence, despite the fact that the Court found him extremely malicious (akushitsu). The court fined him without further penalty because he had donated half of the profit to a pro bono legal service and he had suffered enough social sanction.[133]

These new insider trading laws obviously carry too light of a penalty. Also of import is the point that in Japan, defendants will not be sentenced to imprisonment unless they have a previous criminal record.[134] The new law, therefore, is not an effective deterrent to insider trading.

§ 6. PROBLEM AREAS

The 1988 and 1992 amendments reinforce the proscription upon in-

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126. MOFEL, *supra* note 114, art. 19.
127. *Id.*
128. *Id.*
129. *Id.* art. 20.
130. Lu, *supra* note 82, at 206.
131. *News*, 1229 SHOJI HOMU [COMMERCIAL LAW JOURNAL] 130 (1990).
132. *Makuros No Insaida Torihikijiken Hanketsu* [*Macros Insider Trading Judgment*] 1306 SHOJI HOMU [COMMERCIAL LAW JOURNAL] 27 (1992).
133. Tokyo District Court Judgment, Sept. 25, 1992.
134. Lu, *supra* note 82, at 231.

sider trading, but some important problems have not been solved.

§ 6.01 *Bribes to Politicians*

In the gift-giving society, important politicians receive scores of invitations to many kinds of ceremonies every day. Their aides send flowers, money, or other gifts to cover events that they cannot attend. Politicians need money. Gift-giving is a strong Japanese tradition, especially among those who help each other. Japanese politicians spend a lot of money giving gifts — and, like some politicians in every country, a number of them receive gifts as bribes. Japanese companies bribe politicians in return for profitable favors. The *Recruit Scandal* is one such example of a Japanese company bribing politicians through insider trading.[135]

Under the Japanese life-employment system, job hunting for a senior university student is very important because it will have a critical influence on his whole life. "Recruit" magazine, published by Recruit Company, is the most popular job-hunting magazine, sponsored by thousands of private companies. The magazine, widely read by students, gives seniors private company job information. The students use the magazine as a "job hunting Bible," and it makes Recruit large profits every year. Private companies and the Japanese government alike want the best university graduates to join them. The two entities always compete with each other, trying to get the best new employees. The government uses a bureaucratic examination system to find the highest level of university graduates, while private companies use an interview system. The government and many private companies have an agreement that prohibits senior students from visiting the companies for interviews before the government examination results. However, many companies do not follow the agreement.

In 1984, the government changed the examination schedule to better compete with private companies, and there was a rumor that the government was going to abolish "the agreement." Without the agreement Recruit would have lost significant business.[136] Recruit proceeded to bribe the Chief Cabinet Secretary and other congressmen to put pressure on the administration to follow the agreement. As Recruit was a listed company and had many shareholders, it was preferable to use the stock of its subsidiary — Recruit Cosmos Real Estate Co. — to bribe the politicians.

When a company goes public its stock price often trades at a sub-

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135. Sanger, *supra* note 63; *Seijika Yonjuyonin Ni Shikin* [*Money Given to Forty-four Politicians*], ASAHI SHINBUN [NEWS], June 13, 1989, at 15, col. 2; Asano, Kawamoto, Shibahara, Nishita, & Yasuhara, *Rikuruto Jiken No Horitsu Mondai* [*The Legal Problem of the Recruit Case*], Zadankai [Conference], 947 JURISUTO [JURIST] 16 (1989); ISAACS, *supra* note 77, at 138-39.

136. If the agreement had been broken, Recruit's sponsors would have gone out to advertise themselves as soon as possible because there would have been no time restriction. Since these companies would not have advertised themselves at the same time, Recruit would have lost much advertising business.

stantial premium above the offering price. Recruit Cosmos gave confidential information to politicians regarding the company going public and sold company stock to them to complete the bribe. Here is how it worked.

Cosmos registered its stock on the over-the-counter market on October 30, 1986. Before registration it sold 242,000 shares to forty-four Japanese politicians at a price of 3,000 yen (25 U.S. dollars) per share. After registration, its stock was traded on the over-the-counter market at a price of 5,270 yen (44 U.S. dollars); then it rose to 7,250 yen (60 U.S. dollars). The forty-four politicians sold their shares and took a total profit of 730,000,000 yen (6 million U.S. dollars). In addition to the trading profit, the Recruit Group also gave these politicians money donations, entertainment, and other benefits such as quantity purchases of tickets for party fund-raising events. By May of 1988, the total Recruit bribes to the politicians, including the trade profit, was over 1,330,000,000 yen (11 million U.S. dollars).

Prime Minister Takeshita received about 201,000,000 yen (1.7 million U.S. dollars) during his service as Minister of Finance and later Prime Minister. The former Minister of Foreign Affairs, Abe, gained 137,000,000 yen (1.2 million U.S. dollars). The Minister of Finance, Miyazawa, received 122,000,000 yen (1 million U.S. dollars). Former Prime Minister Nakasone made a 110,000,000 yen profit (0.9 million U.S. dollars).

After the scandal was exposed, the politicians denied knowledge of the stock transactions and donations because these transactions and donations were executed in the names of their wives, children, aides or others. However, all of the politicians were found to have had connection with the plot. Most of them resigned from office and their political parties for a period of time but subsequently were re-elected. One of the Prime Minister's aides, Aoki, committed suicide on April 26, 1989.[137]

Although over twenty persons who had connections with the scandal were prosecuted for bribery, most of them were company directors or officers. Only two congressmen and four aides of politicians were prosecuted. Nakasone, Takeshita, Abe, and Miyazawa were not prosecuted. There were no prosecutions for breach of Article 157.

In another insider trading case, *Meitanco Co.*, an electric appliance manufacturer, announced that the company had invented a "highly effi-

137. The reason for Aoki's suicide was that this was his only way out. There is no plea-bargain system in Japan. Even if he had testified in the Diet, no immunity to avoid prosecution would have been available. As a consequence, he would have gone to jail even if he had testified. His family would have lost his support. By proving his loyalty to his "master" — by committing suicide — his master became committed to the care of his family, and of course would himself be spared the consequences of unfavorable testimony. If the aid had betrayed his master, society would have criticized him for his disloyalty! In the Lockheed Scandal, in which the aircraft manufacturer bribed former Prime Minister Tanaka to push Japanese airlines to buy Lockheed products, Tanaka's driver committed suicide for the same reasons. *Lokido Jiken Nisshi* [*Lockheed Case Diary*], 676 JURISUTO [JURIST] 169, 171 (1978).

cient device" to save electricity, registered the device, and received a patent. The president of Meitanco bought a large stake of the company's stock before the new invention's announcement. He also bribed politicians with the company's stocks and with money. After the announcement, the company's stock price soared, and the president asked "his" politicians to speak in the Diet to push government departments to buy the company's new device. Ironically, government test reports proved that the new device could not save any energy at all.[138]

Article 157 should apply to scandals like *Recruit* and *Meitanco*. However, Article 157 is too vague and too broad for the Japanese legal system. Since it has been a dead letter for over forty years, there is little anticipation that it will be used in the future. As a result, things have not yet changed. Although Articles 166 and 167 specifically make insider trading unlawful, it is unlikely that Japanese courts will impose penalties of the magnitude necessary to serve as a deterrent.[139]

Politicians (and others) also can still take advantage of public companies in order to engage in insider trading. For instance, a listed company A's insider B tells C, one of politician D's aides, A company's "material facts," and D buys A company's securities and profits. D is not restricted by Article 166 because D is not a primary tippee. D is a secondary tippee. There is no insider or primary tippee penalty for passing "material facts." As a result, if a tippee other than a primary tippee does insider trading, no one in the scheme will be sanctioned.

It is a reasonable conclusion that Japanese politicians do not intend to ban all insider trading. They have left seams in the net in order to allow the astute to pass through. The politicians passed a very strict-looking law in order to convince foreigners that Japan would no longer be an "insider's haven," but at the same time they also allowed room for evasion of the law. The Japanese call this "getting two birds with only one marble."

§ 6.02 *Civil Remedies and Legal Fees*

It is very difficult to secure a remedy for losses resulting from insider trading. The Securities and Exchange Law does not provide for civil liabilities in insider trading. The only way for an insider trader's victim to get a private remedy is to sue the insider in tort on the basis of Civil Code Article 709. For example, insider A bought XYZ company's stocks from B and made a substantial profit. B can sue A; however, B has the burden of proof. Usually, it is very difficult to prove that A knew the business' "material facts" through his work or duty. It is also very difficult to prove how much B lost in a fluctuating market. The Japanese law does not recognize implied liabilities.

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138. *Nagaseko Ni Jikei Sannen* [*Nagaseko Sentenced to Three Years*], ASAHI SHINBUN [NEWS] (Yukan [ev. ed.]), May 9, 1989, at 1.

139. See *supra* § 4.

A shareholder who sues an insider under Article 164 has to pay his own legal fees. Article 164 prescribes that if a company does not ask an insider to return his profits from insider trading, any shareholder can sue the insider to disgorge the profits to the company on behalf of the company. However, even if the plaintiff wins he must pay the legal fees, and profits will be returned to the company. Thus, shareholders rarely want to sue insiders on behalf of their companies.

§ 6.03 *Bureaucratic Ambivalence*

There is no independent public regulator with adequate authority to oversee the securities market in Japan. The Japanese do not have an American-style Securities and Exchange Commission. The S.E.S.C. does not have the bite. It can only advise or make suggestions to the Minister of Finance. The new law appears to give the S.E.S.C. extensive power, but actually the S.E.S.C. is still dependent upon the M.O.F. as it cannot initiate any proceeding. The M.O.F. is unwilling to give power to an S.E.C.-like independent regulator.

Another reason for the bureaucrats' failure to expose insider trading is that personnel of the Ministry have been involved in scandals. Two Prime Ministers and two Ministers of Finance were involved in the *Recruit Scandal.* The fact is that when Nakasone was Prime Minister, Takeshita was the Minister of Finance; when Takeshita became the next Prime Minister, Miyazawa became the Minister of Finance. During these two recent terms of cabinet both the Finance Ministers were involved in insider trading. Ministry of Finance bureaucrats are not in the habit of exposing their bosses.

Finally, whether the Japanese government has the mind-set to effectively regulate securities markets is questionable. The Wall Street Journal, in January of 1993, reported that the Japanese government was using "vast amounts of money from the postal system and other funds" to purchase securities in an effort to stem "the relentless slide in the Nikkei 225-stock index."[140] The Journal reported that "the objective is apparently to keep stock prices high enough that banks and other corporations with big stock portfolios won't have to declare major losses on their investments when the fiscal year ends March 31." Although the government "officially says its intention isn't to prop up the Nikkei," the Journal cites convincing evidence of massive purchases by the government through the banks that largely offset the fact that institutional investors were large net sellers during the fourth quarter of 1992. "What happens after the critical March 31 date passes," the Journal continues, "is anyone's guess."[141] Nor is the denial by the government that it is supporting the market credible, since it publicly announced, in August of 1992, an emer-

140. Quentin Hardy, *Japan Fights Uphill Battle to Aid Stocks*, WALL ST. J., Jan. 25, 1993, at C1.

141. *Id.*

gency package of economic measures that included a promise to invest more public funds in the stock market."[142] This was all against the continued decline during 1992 in the Nikkei and an eighty five percent reduction during 1992 in net purchases by international investors in securities traded on the principal Japanese stock exchanges.[143]

§ 7. CONCLUSION

The Japanese recently amended their Securities and Exchange Law in order to convince foreigners that their securities market is a fair one. Article 157 is the general anti-fraud provision, but this Article is a dead letter because it is too vague, too broad, and has yet to be used in an insider trading case. There is little hope that the Japanese will use this Article in the future. Article 163 requires corporate insiders to file reports with the Minister of Finance after they trade their company's securities. Article 164 requires corporate insiders to disgorge profits from tainted transactions to their companies. Article 163 (relating to the filing of insider reports), while inactive for a long time, was revived in the new amendment. Article 165 prohibits insiders from short-selling. Articles 166 and 167 are new Articles, and they look very strict on paper. Article 166 prohibits insiders, quasi-insiders, and primary tippees from insider trading in ordinary transactions, while Article 167 regulates them in tender offers. Article 154 reinforces the right of the Minister of Finance to examine stock exchanges, and to order issuers to file reports with him. The S.E.S.C. was created and delegated powers of the M.O.F. under this Article to serve as a new watchdog. The S.E.S.C. is not an independent regulator. Therefore, securities regulation in Japan still depends on the old M.O.F., which has not been an effective enforcer of the laws.

The new amendments seem like a great advance in preventing insider trading in Japanese securities markets, but they certainly have not yet changed things to any significant degree. Insider trading has been too inherent in the Japanese political scene to expect Japanese politicians to ban all insider trading. On the one hand, they have created very strict-looking rules in order to convince foreigners that the Japanese market is fair. On the other hand, they conveniently preserve ways that permit evasions of the regulatory scheme.

There is no provision for civil liabilities against insider trading in the Securities and Exchange Law. An insider's trade "victim" has to sue the insider under Civil Code Article 709. The burden of proof lies with the plaintiff, and it is very difficult to prove the amount the plaintiff lost, or that the insider knew the "material facts" through his work or duty. If a shareholder sues an insider for the return of profits to a company under Article 164, that shareholder has to pay his own legal fees. As a result,

142. Robert Thompson, *Fall in Foreign Purchases in Tokyo*, FIN. TIMES, Jan. 13, 1993, at 13.

143. *Id.*

few shareholders will sue an insider on behalf of a company. There is no U.S.-style S.E.C. in Japan. The past involvement of certain high level personnel of the Ministry of Finance and other politicians in insider trading, makes it unlikely that lower level bureaucrats will strive to expose insider trading that may involve the highest levels of government. Even the recent change of leadership in Japan, from the long-standing Liberal Democrats to a nascent coalition, dismantles little of the historic fabric throughout which insider trading penetrates.

Although it seems that the new law has reinforced anti-insider trading provisions, it leaves many loop-holes. The new amendments to the Securities and Exchange Law are neither severe nor effective enough to prevent insider trading in Japan.