

A Symposium - Talk with Professor Eisenberg –

Opening Comment

Professor Tatsuo Uemura:

Ladies and gentlemen, we would like to begin the research meeting of the 21st century COE program. It is a great pleasure to have Professor Eisenberg who is the authority in the world on the American corporate law. He will talk to us on American corporate legal system and civil society. Today we are going to present all the perceptions and issues that we have in the field of corporate law to Professor Eisenberg. Younger researchers also present voraciously their views to Professor Eisenberg. Time is limited but we would like to absorb his wisdom to the extent possible. Over lunch, Professor Eisenberg and I were talking about today's meeting. He said that it needed three days to cover all the issues raised by us. In fact, if we can have him for three days, we would be happier, but we can only have him for a short period of time. We would like to learn as much as possible from Professor Eisenberg.

Unfortunately, Mrs. Eisenberg became a little ill in Kyoto a couple of days ago. In the morning, Professor Eisenberg moved from Kyoto and this evening he will have to catch a bullet train to go back to Kyoto immediately. His schedule is very tight today. Despite this difficulty, he has agreed to come our research meeting. We would like to organize this meeting so that he will feel rewarded by being part of this research gathering. I will not make any introduction about the COE and our organization. We would like you to refer to our website on our research projects. But our issues of awareness are that corporate laws or legal system are based upon agreement of civil society or that the legal system and corporate law system must function in order to maintain the agreement of civil society. If you only read the surface of legal texts, it is only superficial understanding of the occidental legal system. We must not repeat the mistakes that the Western nations experienced over years. So we must know their organization of mechanism or their social consensus so that we can avoid their mistakes.

Regarding program detail, Professor Eisenberg required us no introduction. He has a very long career of drafting or formulating various regulations and so forth. He played a leading role to draft ALI's principle. Professor Eisenberg is the most experienced authority in this area.

Time is so precious, so we will go to the actual program of today. First I will spend 20 minutes to explain issues of this area, and then Professor Eisenberg will make his presentation responding my questions. In the latter part of the program, younger scholars will presents their issues and awareness in their research field to Professor Eisenberg and Professor Eisenberg will respond to their questions. If time allows, we will have general questions from the audience.

Part I Issues raised by Professor Uemura

< Tatsuo Uemura, Professor of Law, Waseda University, Director of Waseda Institute of Corporate and Society >

The U.S. and Europe have had a long history in corporation system and securities market. They have

had experience of successes as well as mistakes and failures. In order for Japan to establish the full-fledged corporation system that would have full-fledged securities market, I think we need to have more logical understanding of Western views on company, corporation, self-regulatory organization and so on, which have grown naturally in Western society and culture. Japan has to overcome lack of experience with that knowledge and logical understandings. So I would like to ask Professor Eisenberg about the relations between American corporation, capital market, and civil society. It is quite an honor for us, and for Japan, to have Professor Eisenberg's insightful thoughts today.

1. Relations between corporate law and securities regulations

It seems that the state of corporation system depends on the degree of development of the securities market and the degree of reliability associated with it. Under the system where securities market is widely used, corporate governance has to have enough tense in order to respond market requirement appropriately. This means that corporations must have internal organizations to implement disclosure, accounting, and audit. In the U.S., how the relations between corporate law and securities regulation can be viewed?

2. Shareholders or Investors

In This sense stated above, public corporations must have already obtained "corporate governance" when actually issuing their stocks to the public at the market. Is it possible to say the subject that corporate law approaches firstly could be "investors" who have not become shareholders yet? Is it correct to see "investors" as the most basic concept for public corporation? Does the rule of US Wall Street represent that buying and selling in the securities market precede the actual buying and selling? When people use the word of "shareholder" in the U.S., do they suppose the concept of investors precede the shareholders in the meaning? There seem two ideas such as corporate governance based on shareholder and investors/shareholders based on corporate governance, indicating the difference between the nature of public corporation and that of non-public corporation. How does Professor Eisenberg see this idea?

3. History of Corporate Governance in the U.S.

Is it right to understand corporate governance in the U.S. as the following statements?

1) There exist state corporate laws whose regulations to management were relatively loose. 2) Since 1930's, Federal Securities Regulation including strict policies on disclosure, accounting system, and auditing, has been implemented based on securities regulation reform. In the primal landscape of the U.S. corporate governance, there was a contradiction between strict policies on disclosure and accounting by Federal Securities Regulation, and weak governance of state corporate laws that were supposed to implement these policies. To solve this contradiction, the SEC rules such as enforcement of audit committee of independent directors were enacted or Federal Securities Regulation itself has

taken a role of Federal corporate law. (For example, enforcement of disclosure even if the company has not gone to public under Section 12(g) of the 1934 act, proxy voting policies, right of stockholder proposals, SEC rule 10b-5 and so on.) 3) To deal with such circumstances, management control based on state corporate laws has been strengthened. The principle of ALI corporate governance can be one of the major results. Are these trends indicating that the state of corporate laws should be changed under the pressure from the securities market?

At the same time, the NYSE set its rules not only for an audit committee but also for a nominating committee or a compensation committee after the Sarbanes-Oxley Act (SOA) was enacted. By doing this, are the NYSE rules becoming to play a role of a federal corporate law regulating corporate governance in general?

4. Corporate Society and Civil Society

The U.S. stock market is always aiming to compose the majority of individual investors or institutional investors who own strict fiduciary duty as its majority. It results in creating corporations focusing on individuals, or citizens in other words. American people's anger toward Enron case and so forth must show how deeply the stock market is relating with people's lives in the U.S. Capital market focusing on individuals will create corporations focusing on individuals. This seems to have connection with the civil society where individuals are playing major parts. How does Professor Eisenberg view this opinion? In other words, there seems to be ideological and philosophical consensuses of society regarding the state of civil society. Can we understand that this kind of philosophies to respect individuals since the Enlightenment or Civil Revolution still remain within the U.S. corporate society, influencing systems and practices related with capital market and corporations?

5. A Sense of Caution against Corporation

With this respect, is there a sense of caution against association, organization, corporation, and company in the U.S. corporate society, which is often observed in Europe? In Japan, both a human and a corporation are treated as the same in terms of the subject owning rights. That has made Japanese economy and society focused only on corporations instead of on individuals. Although Japanese postwar corporate society has achieved a rapid economic growth, a gap between civil society and corporate society has become enormous as a result. Without real civil society, Japan tends to be very tolerant to corporations. How does the U.S. think of it? We would like to have your thoughts on this.

In Japan, more than 70 % of shareholders are corporate shareholders who do not have fiduciary duty to individuals. The U.S. seems to have a certain method to exclude corporate shareholders except institutional investors. For example, when the companies execute corporate separation in the U.S., new stocks are issued to shareholders. So the ratio of individual shareholders is not changed. In Japan, companies executing separation will own new stocks in many cases, increasing the ration of corporate shareholders. In addition, Wakabayashi Lecturer will ask the same question, but is it allowed to issue new stocks to particular corporations? If so, what case is it? Should Issuing new stocks at public

corporations be based on public offering in the U.S.?

6. Roles of Institutional Investors

The U.S. institutional investors take strict fiduciary duty to investors. The word of "investors" refers to citizens including pension workers, public officers, farmers, contractors of insurance, or depositors. So can we say that the U.S. institutional investors have fiduciary duty to the U.S. civil society itself? If so, outside directors or independent directors can be representatives of citizens as investors before stating them as representatives of stakeholders in obscure meaning. In the U.S., institutional investors are often called as shareholder or owners of corporation. They are not actually investing, but are called as such. Does this mean it is only a historical way to call them so and can we understand they are perceived as parties that have fiduciary duty to citizens? At general meetings of stockholders in the U.S., is it common that outside directors or independent directors take seats of shareholders' side?

7. What is the way to seek American type of freedom?

If the state of corporate governance at corporation should reflect attitude and behavior to securities market, the U.S. has more trust on the market and allows it to have more freedom, compared to Europe. This kind of freedom is supported by methods such as plea bargain, undercover investigation, tapping, class action, the SEC, reward, discovery, and civil sanction. Without them, it is better to regulate the freedom of activities in the stock market. If we choose the way such as prohibiting treasury stocks like Europe, discouraging stock options, regulating freedom of financial product development, and maintaining the principle concentrating on the market and the minimum capital, we do not have to have full-scale corporate governance that the U.S. has. This might offend you, but the U.S. way is just like the Western movie style that needs sheriffs or John Wayne to control. Can we recommend this U.S. way to Japan, who does not have those methods to control? I would like to have your opinions on it. How about China having less than 10-year history of securities transaction law?

8. Corporate Reorganization and the Status of Workers

The methods of corporate reorganization in the U.S. are quite freely admitted. Different from Europe and the U.S., Japan has labor unions based on company organization, not on industrial organization. Because of this structure, if reorganization is executed freely, the labor unions and their activities will be divided. Those countries of industry-based unions and those of company-based unions have to have different approach to this problem. From the perspective of corporate law, how is this issue viewed?

The restructuring accompanied by a layoff has a certain reasonable reason if it results in increasing stock price, with allocation of its gain to citizens including laborers through securing the profit by institutional investors. If we know the profit only goes to corporate shareholders and does not allocate to the civil society in Japan, should we still encourage the corporate restructuring? We would like to have your opinion.

9. Evaluation of Law and Economics

Do laws and economics contribute to improving corporate laws? We would like to have your thoughts in this respect. Issues in our mind are to consider the state of capital market, to consider corporate system related with capital market, and to consider the state of civil society. From these perspectives, we are questioning the contribution of laws and economics in terms of public corporation at least since those two are only analyzing transaction costs or agency costs all the time. What affect the laws and economics has to the society in the U.S.? What degree the judiciary has effect on the society? We would like to have your thought.

10. The Nature of Norms of Accounting Principles

In the U.S., what extent the nature of norm of accounting principles is perceived? A person can be in prison for an untrue entry in the financial statement. Does this occur if it is certified as violation of securities acts and laws? Or is there any other ground to guarantee legal effect only by accounting principles?

11. Please share any issues in which you have interests currently in the U.S.

Professor Eisenberg:

Thank you very much, Professor Uemura and thank you for inviting me here to Waseda. Those who have already known me know that I tend to speak fast. I am going to try to speak little more slowly to accommodate a translator. Corporate law, as I think Professor Uemura indicates, is the reflection of the society or some more particularly the social norms of the society. So I want to talk a little first bit about the norms that are relevant to corporate law in the United States and also the way in which the legal system in the United States. Peculiarly the legal system in the United States impacts on corporate law. I am going to speak sometimes in generalities, or I should say in very general terms. Some people might disagree what I have to say but I will tell you what I think.

There is an implicit norm in the U.S. of a pyramid of rules or organization. The pyramid begins with private action so that I think normally Americans favor solving problems with private action rather than government action when that is possible. When it does not seem possible, the next step in the pyramid is considered to be state law. Of course, we have a federal system with states and federal government. Therefore, the first recourse when the institutions' private action fails is state law. Again, I am speaking very generally, only when state law fails, do we go to federal law. We have to recourse federal law. Now that pyramid has lots of impact on American law. To begin with, there is a tradition of American law that corporations are governed by state law. That is not legal requirements. Under the commerce close, federal government could completely regulate corporations. However, the tradition is that states regulates at least, in the first instance. There is a well-established rule in the U.S., which is actually called as choice of law rule, rather than corporation law rule. The internal affairs of corporation are

governed by the state in which it incorporates. It can incorporate wherever it pleases without regard to whether it has any contact with that state. So that more than 50 percent of American corporations, large publicly held corporations are incorporated in Delaware although most of them have no contact with Delaware whatsoever. But under the choice of law rule, they nevertheless, govern their internal affairs, at least in the first instance, by Delaware law.

What motivates the states in making corporate law? Normally states wish to attract corporation. They wish to do that for two reasons. First, they get taxes from corporations that incorporate in the state. Delaware gets about 20 percent of revenues from incorporated corporation. There is no cost for these corporations. So it is pure profit. Secondly, there is some sort of prestige, which I can never figure out. So states like to have corporations incorporated locally. The bar, lawyers like to have corporations incorporated locally because they will get the corporate business. So Delaware lawyers get a lot of business from corporations incorporated in Delaware even though those corporations are maybe headquartered in New York or Nevada, or wherever. Now who makes the decision where to incorporate or reincorporate? Because in America, you can incorporate in one state, and later change your mind and reincorporate in another state. For number of reasons which I won't go into, managers make a decision where to incorporate and where to reincorporate. That is de facto, effectively. Legally shareholders make the decision but they normally simply ratify the manager's choice. Well, if you are a state and you want to attract incorporation, and managers make the decision where to incorporate, you make laws that managers like. Now American corporation law does not concern the rights of labor, the rights of creditors, and the rights of communities with a very few exception. American corporation law is about two things, managers and shareholders. Therefore, a state law that is somewhat pro-managerial, somewhat friendly to managers, as opposed to shareholders will attract corporations to incorporate in that state. This is what sometimes called as the race to the bottom, meaning every state is trying to reward than next states by giving more and more incentives to managers to incorporate there. I do not want to exaggerate that. Nevertheless, the political economy of a state corporation law, it is essentially not regulatory but facilitative and it seldom addresses the most important issues in corporation law. The most important issues in corporation law are usually addressed by the courts and it determines fiduciary duties and as I discussed at moment, by the federal government.

Now let me talk about the federal law. The federal incentives are different from the state incentives. Each state is trying to compete against other states. Federal government does not compete against anybody except internationally. States have no interest in profitability of corporations. Because taxes they impose on local corporations are not determined normally by profitability but by other factors. The federal government has an interest in healthy national market and general profitability because if you look at altruistically it has an interest in welfare of the whole people and if you look at cynically, it raises its taxes based on profits. So more corporate profits, more federal taxes. Now in theory, not as matter of law, but as matter of practice, based on the pyramid that I suggested earlier, federal law has come into a picture not to regulate internal affairs of corporation but rather to regulate the markets and corporate stocks such as original issues or initial public offering and subsequence trading. That's the theory. So

there has been a sort of tacit normative allocation since the 1930s where the states regulate internal affairs and federal government regulates only the national markets and trading of corporate stock in those markets. But the practice is different. The practice is that when we have had major problems in the United States, which the states' major problems concerning corporate law on practice, which the states had not addressed for whatever reasons, federal government steps in, in order to make more healthy national market and greater wealth. So the first wave of these interventions, if I could call them that, began in 1930s with what we called as Security Acts. Either under those acts or under the rules, federal government began to regulate such crucial matters as disclosure which the states did not and still do not require, insider trading which the states have never seriously regulated, and proxy voting. All these are very critical matters. The states never had regulated them when federal government stepped in. This is sometimes called federal corporation law although federal government reaches these issues through apparent links to trading in stock and it is really regulating internal affairs of corporation. Proxy voting, for example, certainly regulates internal affairs.

Now, two years ago, we had another crisis with Enron situation and other corporations. Enron was, I think, the fifth largest corporation in the United States by market value. Other corporations had similar scandals, corporations in the top 100 or 50 even of largest corporations. Again, federal government stepped in with the Sarbanes-Oxley Act, and regulated the internal affairs of corporation in important ways including the audit committee, internal controls, and disclosure systems and especially heavily the position of the accountants. Now there is a parallel level of rules, which is sometimes called soft law. Soft law is a law that is made by private organizations or rules that private organizations recommend which are not mandatory in theory. We can divide soft laws into two basic categories. First, rules of Exchanges, and particularly New York Stock Exchange and NASDAQ. NYSE and NASDAQ always had some corporate governance rules, some important rules but only a few. The way those rules were imposed was that if a corporation wanted to list its stock on these Exchanges, it had to agree to follow these governance rules. In the aftermath of Enron and I doubt there would be prodding from the SEC but just prodding, the NYSE and NASDAQ adopted very comprehensive systems of governance as condition to listing. So these are sometime called self-regulatory organizations or SROs. Now these are soft laws, these rules of governance by the SROs. Soft laws in a limited sense that corporation can choose not to list but it loses a lot. A big publicly held corporation wants to be listed in either NYSE or NASDAQ. Shareholders would not easily stand for it. So these rules are voluntarily and soft in one sense, but quite hard in another sense. As a matter of form, voluntarily, as a matter of practice, it is voluntarily for large publicly held corporations. Fortunately, one time it looked as if there would be a race to the bottom between the Exchanges. Each Exchange tried to make its rules easier for managers and now the Exchanges coordinated. So NASDAQ rules are not identical to the NYSE rules. By governance rules, they are quite similar. The second category of soft laws is consistent recommendations by somewhat authoritative groups, but private groups. For example, the American Law Institute's Principles of Corporate Governance stated a number of legal rules but also stated a number of good corporate practices having to do with the board of audit committees and nominated

committees and so forth. The American Bar Association puts out the corporate director's guidebook. That has many such rules. There was also a sense by institutional investors, as a community, concerning what constitutes good corporate practice. Corporations that do not hear this kind of soft laws are put under shareholder pressure by institutional shareholders to conform. For example, you may have read about Disney Company. Michael Eisner is CEO. He had a vote of 43 percent against the renewing his term of director. That was incredibly adverse. One option for that was that Eisner stayed his office but the board has now conformed to accept more governance rules by getting more independent directors and by splitting the roles of Chief Executive Officer and Chairman of the Board. So again, this kind of soft law is not mandatory and not as strong as Stock Exchange Rules. Nevertheless, it has a lot of weight. The bottom line is that we have a very complex system of corporate law in America, which consists of state law, federal corporation law, and soft law, which in turn consists of these two components as SRO's governance rules and authoritative statements by leading institutions. I should have also mentioned about business round tables as a source of these practices. There is a very large and very significant conformity with the principles that these groups recognized as good corporate practices. Now these remarks are quite general and introductory but they addressed Professor Uemura's first and third point.

2. Let me now turn to his second point. Let's take three terms, investors, shareholders and owners. In the private or closely held or close corporation in the United States, which is owned by just a few shareholders, shareholders are typically managers as well as shareholders. Obviously they are the owners of the corporation, and have invested in the corporation. Therefore, the corporation represents both investment of capital and active ownership of role. In a publicly held corporation, individual shareholders, for variety of reasons, are passive investors. They take virtually no role in the corporation. Then, it is rational for them to do so because there is nothing they could get accomplished as individuals. Question arises what we should call these people. Shall we call them owners? Some people say they own corporations the way people own factories or lands. They own close corporations. Should we call them investors? Of course they have put money into the corporation. They have invested in the stocks, but did not invest or did not injected capital into the corporation. Now my own view is that we should treat shareholders despite of all the problems. We should treat shareholders either as owners or as if they were owners. I have several reasons for that to position. It is part of American civil society that corporations exercised vast powers and these powers are in turn hands off small group of managers. There is no or almost no government guidance on these managers. So we have enormous concentration of power in hands of a very few privately appointed people. One of justifications for that is that these managers are running institutions, which are run by private ownership, and they are accountable to ownership. It might be a myth, but it is a useful myth. Secondly, although individual shareholders are passive investors, fifty percent of publicly held stocks owned in the America is owned by institutional investors, who are becoming increasingly active. So it is certainly not inappropriate to think of institutional investors as shareholders and owners. Not traditional owners, of

course, but owners in various senses. Now finally, a second premise of this American corporate system in which so much power are concentrated on so few hands, private hands, is the premise that total social wealth would be maximized if corporations maximize shareholder wealth. This is sometimes called shareholder primacy. It is that corporations should be run in the interest of the shareholders, not labor, not community. All I was saying was it is a very widely accepted premise. If you believe this premise is correct, if you believe total social wealth is maximized, if corporations try to maximize shareholder wealth, then treating shareholders as if they were owners is a means to that end, in other words, we say, okay, maybe shareholders aren't owners, but let's pretend they are so, then the directors have directions which take the company namely to maximize the wealth of this group, and therefore to run the corporation at maximum efficiency.

4. I turn out to point four. Enron was a financial failure with moral dimensions. As Professor Uemura said, there was great anger about Enron. That anger had two sources. First of all, much wealth in the United States is held directly or indirectly in form of corporate stock. Americans are risk-takers and they own lots of equities. Equity means stock. They own it either in their own name, pension funds, or through mutual funds. Therefore, any systematic threat of stock market has a widespread effect on the wealth of American citizens. Enron was a systematic threat because people started thinking we can't trust the data, financial figures. Enron was really bankrupt when it was said Enron was the fifth largest corporation as the market said. Maybe the sixth largest, seventh, or eighth largest in the United States will be all bankrupt. How do we know? So the market plunged. As I say, there was not only Enron. There were others. The second source of the anger was moral. In American civil society, vast disparities of wealth are tolerated. Advantage taking is tolerated as long as it is considered proper. It is considered proper if it is within the rule. Now what sources of all these norms are? I am not sure, but there they are. People do not mind too much that others are much wealthier than they are. Maybe because they think someday they win a lottery and will be wealthier, whatever. Maybe because there is a lot of social mobility. I think my children will be very wealthier or can be. Whatever the reason is, there are a lot of tolerations of disparities of wealth. If those disparities result from playing within the rules, if you play within the rules and you get very wealthy, good for you. But advantage-taking that is not within the rule is morally bad. That is how Enron was perceived. It was perceived all the managers were making great sums of money by cheating and lying. There was great moral anger as well as great financial anger. I was saying more generally, there is a certain moral dimension to American corporate law. That is, insider trading is turned down not only because it has adverse effect, inefficiency of national market, but also because it is thought to be morally improper. If you have access to some information I cannot get access, you should not be able to use that access.

5. I turn out to point five. America has a long tradition of pragmatism. Pragmatism is a complicated philosophy, but to oversimplify questions to America to larger extent what works. If something works, we will use it. America has also traditionally focused not solely on individual and not solely on

associations, but on the both. American cultural values promote both individualism and communitarianism although there are some legal rules that are more oriented to individuals and another that are oriented more to associations. Where association is important, association is facilitated and associations are governed as such. Where individual action is important, individual action is facilitated and individuals are governed as such. Therefore, for example, in the United States, it is incredibly easy to start a new business. Individuals start new businesses, governed by laws relating to individuals like tort laws, contract law, and so forth. As the business expands, individuals must associate to gather more capital. At that point, the law of business associations comes into play. But I would say there is no emphasis on individuals or associations to be betterment on the other.

Now another question in five is issuing stocks, patterns of issuing stocks by publicly held corporations. Under American Law, new stock can be issued by publicly held corporations to anyone who wants to. They can issue it to individuals, and to institutional investors. They can issue it to other corporations, but that does not happen. The reason that does not happen is nothing to do with the law. There are two or three reasons it does not happen. First, managers of one corporation do not want a large block of their corporation stock in hands of somebody else because that might form nuclear of a takeover. They do not want to issue 10 percent of their stock to one corporation so as 20 percent. Secondly, managers don't want to hold a large block of stock in another corporation. Managers of American corporations do not want to be passive investors. They want to manage the money themselves. The market would probably punish the corporation if they took a large block in another corporation, which it could not manage. The market would say you are wasting our money. If you cannot have use for this money in a corporation that you are running, make it dividend. So there is no legal barrier to cross-ownership. However, there are normative barriers and market barriers.

6. I turn to point six. Under American Law, the fiduciary duties of any given institutional investor run only to the owners or beneficiaries of that invest and no one else. For example, in the case of mutual funds, which are owned by shareholders, the fiduciary duty of managers runs only to the shareholders. In the case of public pension funds, manager's fiduciary duty runs only to the employees. Accordingly, no individual and institutional investor owes a duty to society generally, or even to any segment of society in American Law. Because of the widespread ownership of institutional investors, as a practical matter, very large portion of society will find one institutional investor or another owing some fiduciary duties. On the second point of issues in point six, outside directors might not even attend at shareholders meetings in America. If they do, they would sit in front with the managers, facing the shareholders.

7. Point seven. It is correct, as Professor Uemura said, that under American corporate law, corporations have almost unlimited freedom to design their own capital structure. For example, there is no minimum capital requirement, stock repurchases are freely permissible, and a corporation can

design its securities in any way it wants to as long as it has little common stock. That is a product of state corporate law, not securities law. Securities law does not regulate the design of corporation capital. It only regulates the way in which the capital is issued to investors and later traded. If a corporation wants to create a crazy kind of investment and it can sell it, it can do it. Of course, as I indicated, securities law does put constraints on how these financial interests in the corporation are marketed, originally how they are traded later, for example, matters as fraud, disclosure, manipulation and so forth. It is very true as Professor Uemura said that this enormous freedom of corporations to design their own capital structures under state law would not be tolerable without the constraints on trading imposed by federal law. Somebody wants to say that Wall Street is like a river of money. People on the banks of the river shovel it to try to get the money out. If there is no John Wayne to keep them from getting money out, the river will never reach the ocean. So, yes, as Professor Uemura suggested, freedom to design capital structures is balanced by the regulation of trading capitals after the design is created.

8. Point eight. As Professor Uemura states, American labor unions are not based on companies with extremely rare exceptions. Instead, they are based either on craft, that is a kind of work worker does such as metal workers, or on general industry, not particular company, but general industry such as automobile industry. Therefore, a hostile takeover, a corporate combination that is resisted by management, or negotiated merger, a voluntary combination, does not necessarily cause the union in half. However, as a practical matter, hostile takeovers and mergers usually result in a loss of jobs because one reason for these takeovers or even mergers is to gain efficiency partly by cutting cost. One way to cut cost in America is discharging employees. Typically employees can be discharged for economic reasons without notice. For this reason, labor unions have opposed to takeovers. The theory of freely permitting hostile takeovers is that they promote efficiency in the general economy. They do that in two ways. First, the company that is taken over may now be operated more efficiently. That is the theory. Secondly, managers of other company may now think I will get taken over if my company is not operated efficiently and no longer can I have a private airplane and all that stuff. If the unemployment rate is low, layoff workers in the recent United States will often find out other jobs although frequently at lower wages and with psychological dislocation. Are hostile takeovers desirable? No one can know because, on one hand, you have benefit of increasing shareholder wealth, which is undeniable. Shareholders always gain from takeovers. On the other hand, you have effects on labor. There is no way to quantify it. You can easily quantify shareholders wealth, but cannot easily quantify the lost of labor at the corporation. So no one can say that hostile takeovers are, in the end, good or bad. Generally speaking, in the United States, corporate academics favor hostile takeovers. They think it is a desirable unbalance. Manager and labor oppose hostile takeovers. Today it is very difficult to accomplish a hostile takeover in the United States because of variety of public and private responses. However, it is not possible and there are still a lot of negotiated merger activities. So there are still a lot of combinations, but it tends to be negotiated rather than hostile.

9. Point nine. Potentially, law and economics, that is the economic analysis of law, has much to offer to improve corporation law. The problem is, in practice, this area has become dominated by what is known as "Chicago" economics that is very rigorously pro-market and anti-regulation. It depends on what is called as "rational-actor" model. "Rational-actor" in a view of Chicago economics, has only one motive in life that is to make money, has complete knowledge and perfectly adjust his/her every action to increase wealth. Well, you meet very few rational-actors. If I met one, I do not think I want to be one of his friends. The problem is that Chicago economics and rational-actor model ignore social norms, ignore psychology, ignore sociology and ignore morals. So today, there is a counter movement in law and economics, known as socioeconomics, which says we think economics is important, but we want correct economics and correct economics cannot be based on rational-actor model because rational-actor model excludes very real elements in a way people act and are motivated.

The second issue in point nine is the effect of judges in corporation laws in the United States. Judges have an enormous effect on corporation law in the United States. So we have in the United States, what is called common law, which means judge made laws, not by legislatures. Nominally, that is theoretically, corporation laws are statutory laws. But in practice, many areas of corporation laws are left judicial development. So it is sort of common law within statutory framework. Almost entire area of fiduciary obligations is judge-made law. Almost entire duty of loyalty and great part of duty of care is judge-made. Recently, statues have started addressing to a certain extent fiduciary duties. Until thirty years ago, they did not address them at all. Even now, the most important aspect is fiduciary obligations, judge-made law, although statutes are important. The law of takeovers is to larger extent, a judge-made law. Because takeovers are such hot political issues, no legislature can do anything about it. One legislature wants to do this, and other legislature wants to do that. So basically, the Delaware courts have made most important rules about takeovers.

10. Accounting fraud is subject to different kinds of controls. One is a fraud of criminal prosecution, which could occur without a prior certification that the fraud is in violation of securities law, that is, a prosecutor can make that determination himself/herself. The second is civil liability to shareholders for their lawsuits. The third, control, that is a role of accountants. Now the problem is, if the accountants prior to Enron have allowed their roles to degrade, that is they had become a really clerks, not independent accountants. The reasons are complex. I can talk about that for few minutes, but I can also stop that.

Professor Uemura:

Why don't we take a break this moment? We have just had very interesting comments. I understand there would be more comments and questions to the comments that Professor Eisenberg just made. But as I mentioned, it will take three days to cover all the questions that are raised. Unfortunately, we will not be able to cover all the points. I myself have several questions but we have a program to follow.

So I would like to ask several my colleagues if they have any comments or questions. Professor Egashira, if you have any comments, please go ahead.

<Questions from the audience>

1. Professor Egashira, Faculty of Law, University of Tokyo

Professor Eisenberg talked about the philosophy of American corporate law, which was comprehensive and easy to understand. Thank you very much, Professor Eisenberg. Professor Uemura is an excellent scholar on corporate law because he has a philosophy, which makes a scholar excellent and outstanding. It seems to see crash of two philosophies today. It was so interesting to listen to them presenting philosophies. I am not a philosophical person. However, as I grew older, I have to admit that I tend to want to say something philosophical. According to Professor Eisenberg, at the very base of the pyramid, private action came first and foremost. I think that came to great impression to me. I think that makes American society and Japanese society very different. That is really a differentiating factor. I wonder why private action is so weak in Japan. I thought about it. This is only my personal view, but let me tell what the reason is. For one thing, those who want to take private action are intermediary investors. In the case of the United States, they try to maximize the wealth of investors. But in Japan, those aspects are lacking or at least weak. One thing is something to do with class action. And as another element, in Anglo-Saxon countries, Professor Eisenberg mentioned, investors are owners, or they are treated as if they were owners. I think Anglo-Saxon owners are stronger than Japanese owners. For example, Anglo-Saxon owners are landowners. They have expelled landlord peasants by enclosure. But Japanese owner are weak-minded. They were dominated and controlled by samurai warriors who had nothing. There are fundamental and radical differences between two countries. Professor Uemura said many things, but probably there is a fundamental difference. And I share his sentiment. This is my personal impression. Thank you very much.

Professor Eisenberg:

Thank you very much Professor Egashira. He is very philosophical.

Professor Uemura:

I agree with Professor Eisenberg. He said he was not philosophical, but he was ideological as well as philosophical although this is something that I cannot find in his papers. Whenever he attends an academic meeting in local cities, he visits local landmarks without fail. So he is really philosophical. So there is a different role played by intermediaries in two countries. That role is driven by the pressure of civil society as well as individuals. The pressure is also different as well. Educating investor in Japan has become popular in Japan. But before providing education to investors, I think we might need to have intermediary education. Professor Eisenberg said that shareholders are treated "as if" they were owners. Shareholders and investors are individuals as long as corporations are facing the individuals who take main part of civil society. They ought to be considered as owners in the United States. In

contrast, here in Japan, the majority of shareholders are corporations. I wonder it can be the same. It does not necessarily apply to Japan, perhaps. US corporation law, as Professor Eisenberg said, is a system that has federal law, state law, Exchange rules, and soft law. There are many elements in it. How we should follow it? That is not easy, it is more complex. I am sure there are lots of questions. This is a golden opportunity to ask questions to Professor Eisenberg. Yes, Professor Inaba, please.

Professor Inaba, Waseda Law School

Thank you very much for your presentation. I used to be a judge. In that sense, the rule of the court is very large as you said. Private action is the base of American society. In Japanese society, people think that the government is handling the society right. That is a premise to Japanese society. I think that is major difference between two societies. Putting that aside, I would like to ask a question about shareholders. Shareholders' profit must be maximized and that will be leading to maximize the profit of the society. Is it true or is it a dogma? In American way of thinking, which way is true? Shareholders obtain profit, which is not necessarily leading to maximize the profit of society, or country, or the whole world. It may not necessarily be the case. So how is the control about that? How should we juxtapose about that element. Is it truth or is it a dogma. How do you juxtapose?

Professor Eisenberg:

Before I answer that directly, I want to make clear that I only describe American corporate system. I do not in any way suggest any elements of the system to be adopted in Japanese culture or any other culture. Because I believe that law has to be proceeded from social norms. Now you can change social norms perhaps. I do not think you can just say, even if you think it works in the United States, that does not mean it would work in other settings. Now to answer the question directly, well, the simplest answer is that I do not know, truth or dogma. But I elaborate on that. The idea, which cannot be proved, is not really to make shareholders wealthy. The idea is to make corporations more efficient. So the idea is that corporations are run at the most efficient way as possible. Generally, if private part of economy is run at the most efficient way as possible, that will increase social wealth. Well, how do we do that? Again, the idea is to tell directors to maximize shareholders' wealth so that they know they have a single goal. They can be accountable. So the director, who fails to maximize shareholders or fails to maximize the wealth for corporation, cannot then come and say "yes, well, I did not really make a lot of profits, but I really helped a community". But that might be a good idea to make the director accountable to community, labor force and shareholders. The concern in America is that directors who are accountable to several interests would be accountable to no interests. Because they can always say I did not do well to this interest, but I did well to that interest. So I am not saying this is true because I cannot. Two ideas are running here. One is efficiency in the economic system will, in the end, be good for everybody. The second, is that a way to promote more efficiency in the economic system is by telling managers that your job is to be efficient to make profits. Now, America tolerates a lot of imposition of harm on workers, which other societies would not tolerate. That is, we have no security of employment. There is a very

wise American columnist called Thomas Friedman. Yesterday I heard him say that the unemployment rate is maybe four or five percent, whatever it is. But for the employee who loses his job, it is 100 percent. America, for right or wrong, tolerates a lot of harm done to individual employees on the ground, which maybe right or wrong, it is done in the long run for everybody's benefit. It is true? I don't know. I can only say that's what I believe to be the underlining theory. It might be a dogma.

Professor Uemura:

Thank you very much, Professor Eisenberg. It was such an insightful comment. Professor Inaba has engaged in legislation of corporate law for longer time and also served as a charge of Hiroshima district court. He is now a Professor in Waseda University. That is why he asked this question. I think maximizing shareholder wealth would lead to maximization of the society wealth to some extent because a shareholder is a person who is a member of the civil society. There are a lot of things we have to think before adopting it to Japan.

Part II Questionnaires from younger researchers

1. Hiroyuki Watanabe, Associate Professor, Graduate School of Law, Waseda University, Waseda COE Institute

I would like to ask three questions focused on "Law and norms (social norms)".

1. Corporate Governance and Norms

Most of leaders of Japanese companies think that each company should handle with its corporate governance issue. It is acceptable for them to comply with regulations based on positive laws, but they tend to refuse more regulations by self-regulatory organizations and so forth.

This year, Tokyo Stock Exchange issued the Principles of Corporate Governance for Listed Companies. An objection against establishing such principles remains through the process of discussing issues. As a result, the Principles are positioned as "a guideline with no obligation".

Based on these issues, I would like to ask Professor Eisenberg about the following questions. What kind of norms should the corporate governance related norms be based on, for example, legal norms, norms of self-regulatory organization, social norms, any combination of these norms, and so on? In addition, should a "desirable model of corporate governance" be converged to one model theoretically if we discuss the same era or the same places such as nations or states? Otherwise, should a model of corporate governance be selective as its nature with diverse characteristics?

2. "Fairness" and "efficiency" of corporate management

As you described in your thesis, it is unavoidable to see whether or not fairness of corporate management is directly related with efficiency of corporate management when discussing corporate governance. As far as I know, most of Japanese business leaders think there is no direct relation between them. In addition, even Japanese scholars insisting on the direct relation between them think it

impossible to prove this proposition.

Can we prove this proposition logically or theoretically? Should it be treated purely as a proposition of norms since it is not a matter of proof? I would like to have your view on this issue. Furthermore, I am much obliged if I can learn general views of American business leaders and scholars on this issue as well.

3. Adoption of social norms in legal interpretation by judges

Recently, the collapse of traditional contract jurisprudence is often pointed out. If it is premised on contracts and business styles of modern age, it becomes important to adopt "social norms" to legal interpretation. Furthermore, judges must have already engaged in such works in legal interpretation.

However, if judges do "adoption of social norms in legal interpretation" systematically, the following issues are expected.

1. Frequent occurrence of dispute caused by easily and carelessly prepared contract
2. Possibility that stable social norms would exist in totally different shape, separated from the current social norms
3. Judges are required to understand "structure of social norms". However, that requirement might be beyond judges' role or capacity.

How should we deal with these issues? Or should it be predicated upon the adoption of social norms in legal interpretation strongly, supposing these issues are inevitable. I would like to have your view on it.

Professor Eisenberg:

Your questions include very profound issues which I can hardly justice. The first question concerns my other things, as you said, what kinds of norms should corporate governance related to rules be based upon legal norms, norms of SROs, or social norms. It is a very difficult question to answer that fully. We would need a theory when mandatory rules are more or less desirable than private rules. Now I have indicated that what I have been called soft law plays a very important role. Private action, which also takes the form typically of rules, for example, in the certificates of corporation on shareholders' agreements, is so important in American society. Given the norms of American society, the basic norms, not corporate norms, with the preference for voluntary action, there is a lot to be said for soft law because it originates its echo with the preference. A manager who believes that he is doing something in voluntary way may do it more whole-heartedly than if he believes it is being forced upon him in American culture. It is interesting to me that apparently here the situation is different. People would rather have the rule to force that than they do it voluntarily. So I can only speak of American culture. But at least, in the culture we use them, perhaps better to use, as Professor Egashira said, Anglo-Saxon culture because I think it is true in England too. There is a great acceptance of rules that seems to be voluntarily. So that is one advantage of soft law, social norms, SRO norms and so forth. Second advantage is that it is easy to change quickly. American statutory law is very difficult to change. That is

just a fact. The legislature has certain amount of time. Most of the time would be devoted to budgets and taxes, things like that. Very little time to be devoted to corporate law. So these soft law, both kinds of laws, that is, the NYSE type soft law and generally accepted best practice can change very quickly as we see things happen. Those are two advantages of soft law, social norms. Disadvantage is that it is voluntary and therefore, even if widely followed, may not be followed by everybody who should be following it. Therefore, the point may come when you need a mandatory legal rule because there is too much failure to adhere to good practice. Also we might believe that something is just too important to leave to good practice. We might think, for example, that director's duty to be fair, to deal fairly is too important to just leave to a voluntarily cause of action. So that is on the first point of Professor Watanabe's questions.

The second point is fairness and efficiencies. This is what you say is correct here. You ask whether it can be proved theoretically that fairness of corporate management is directly related with efficiencies of corporate management. No. However, in my analysis of various areas of corporation law and contract law over many years, I have usually concluded that fairness and efficiency are pointing to the same direction, not always, but usually. So I would say that, my own view would be that as an empirical fact, verified by the observation, there is a tendency to align fairness and efficiency considerations. In addition, it can often be shown by a stronger proof. The fairness is efficient because it is, so to speak, cheaper, that is to say if I can get managers to internalize moral rules, it is a much cheaper way to get fairness. If the only way I can get managers that fairly is by lawsuit and criminal prosecutions, those are expensive to bring and they depend on the external observation as opposed to internal motivation. Furthermore, most people generally respond better fully and whole-heartedly to rules that they believe to be fair than rules that seem to be only justified by efficiency considerations. You ask what a view of business leaders and scholars on this, relation between fairness and efficiencies is. Business leaders, as far as I know, have had very little to say on this issue. At least, it was very little as concrete and operational. There are not too much scholars treating this issue although Kaplow and Shavell, two very good economists at Harvard law school, Law and Economics have this book coming out that says we should disregard fairness. I think that is completely wrong, but if you want to know what treatment is by some scholars. I am not the only one who thinks it is completely wrong. There is, in other hand, an emerging scholar's literature in the United States, important academic literature on social norms. A lot of them are by economists. I think this literature would be, part of it at least in agreement to my view that fairness and efficiencies will often align.

The third point is problems of contract, which is my other subject. It is a very large point. The traditional approach of contract law in the United States, known as classical contract law, which prevails thorough 1952 to the 1940s in England as well, was quite rigid. It was based on a sort of axiomatic system, logical deduction. My own view is that legal rules can only be justified on the basis of morality and policy. The court might be justifying the following legal rules because it is adopted by legislatures but that does not justify the legal rule itself. Modern contract law does adopt rules that are based on social norms, that is, morality and policy. Efficiency. But that does not mean that each case is decided

by applying social norms. It means the rules that the court uses, are developed by applying social norms. So I cannot speak of course Japanese contract law. But I think modern American corporate law does not apply social norms directly but only uses them as the base of the rules. Now it is true as you said social norms change. Therefore, modern contract law and I think all modern law are not written in stone, but it is highly dependent on social norms of the times. But that does not bother me too much. How the judges determine the social norms? Well, that becomes relevant only when the judge is making law as opposed to when the judge is applying law. But I would say, the judge, as a member of the civil society, will normally have a very good understanding of the moral principles of the society and policy principles of the society and he or she must be acting in good faith on his/her best understanding of those norms. If the judge gets it wrong, there should be mechanisms to correct them.

Yasuhiko Kubota, Associate Professor, Faculty of Commerce, Waseda University

I heard questions and comments so far. So my questions might be answered already, however I would appreciate if you can provide answers in more detail.

1. What is the legitimacy of corporation system as a social system, which allows large-scale capital concentration, based on? For what purpose is corporate governance of large-scale public corporation needed?

(Supplementary question)

Historically in the U.S., people have held strong fear against huge economic power of corporations for long time. However, corporation system has been accepted since there has been a certain view that corporations meet public interest. For example, in 19th century of the U.S., each state government adopted legislative policies to prevent abuse of corporation privilege through strict regulation on contents of charter while seeing that corporation is necessary for national economic development. Also, at the beginning of the 20th century, proposed federal incorporation act aimed to secure a governance system to make corporations comply with laws such as anti-trust law, which protects people as consumers, and securities regulation, which protects people as investors. This history perhaps shows that the state of governance system has been discussed from the perspective that large-scale public corporations meet "public interests" in the U.S... The issue here is; what is "public interest" as basement for legitimacy of corporation system. Currently, what does this "public interest" mean specifically in the U.S.?

2. It is generally said that "the owner of corporation is a shareholder" in today's US, just as it was said that in the 19th century. What reasons have maintained this perspective of corporate ownership?

(Supplementary question)

In the U.S., case law of the 19th century had shaped the view that "the owner of corporation is a shareholder" based on partnership jurisprudence. The rights of shareholders were determined based on this view of corporate ownership, for example, shareholders' meeting as a universal organization, unanimity rule on reorganization of corporation, and subscription right of shareholders. However, the rights of shareholders' meeting have been decreased since the end of 19th century. Majority rule was

adopted for reorganization of corporation, and excluding shareholders' right to subscription of new stocks was admitted. Thus, the rights of shareholders were largely changed. Do these changes represent deviation from the traditional partnership jurisprudence? ALI's "Principles of Corporate Governance" 2.01 states that a corporation should have an economic objective, operating to increase corporate profits and shareholder gains. It is said corporate profit stated here should be judged by long-term perspective. Does this mean to make substantial modification on the view of corporate ownership? If so, the current meaning of "corporate ownership" in the U.S. might differ from the one in the 19th century. What kind of difference is it?

3. In the U.S., many states enact anti-takeover statutes (control share acquisition statutes, business combination statutes, and so on). ALI's "Principles of Corporate Governance" also adopts the expanded constituency statute. These anti-takeover statutes are thought to prevent unfair transfer of wealth from stakeholders except for stockholder to stockholder after hostile takeover. However, for example there are strong criticisms of the expanded constituency statute as follows. 1) Under the expanded constituency statute, directors have only vague duty to every constituency, and it follows that directors have no duty to anyone. 2) Directors have not the qualifications for that task since by stockholders they are elected and have company management entrusted. How does Prof. Eisenberg see these criticisms? With respect to the first (1), can courts give a rational judgment about the director's responsibility that acted under the expanded constituency statute? How should we see other types of anti-takeover statute?

Professor Eisenberg:

Ok, so question one, is; what is the justification of the corporation system as a social system, which allows large scale of capital concentration based on? It is even worse than that, not only allows large scale of capital concentration but in private hands. So it needs a lot of justification. There is a general social issue of legitimacy when an institution is legitimate. There are two ways that legitimacy can be derived. It can be derived through certain processes like voting or rules like constitution. But at least in the U.S., legitimacy can also be derived by effectiveness. So when I am on an airplane, I do not want to take a vote, who is going to fly the airplane. I want the person who is qualified to fly an airplane will fly that plane. He derives his legitimacy because he knows how to fly the plane. The belief, right or wrong, in America, is that public interest includes although it is not limited to the maximization of total social wealth. You are right. I agree with most of what you say. There is a certainly benefit to change social norms in terms of how a large-scaled enterprise is viewed in the United States. As you said, if you look the 19th century corporate law, it was much more restrictive. Anti-trust law was perceived as part of protecting individuals not just the market and so forth. So now, there are differences that social norms have shifted. So there was, first in the United States, the norms to believe that there was nothing wrong with large-scaled enterprises. Again I am talking about social norms, not what is right or wrong. Particularly in area of the High-Tech, and globalization, large-scale may be a condition to efficiency, to maximum efficiency, and therefore, the maximization of social wealth. Is that the case? I do not know. I

am explaining there is a shifting perception.

Let me say that in the ALI principles, which you properly mentioned, there is 2.01 section, which you mentioned has several aspects. I am going to get back in a moment because it is a very important question you raised, why emphasize shareholder wealth rather than corporate wealth, why not include labor in corporate wealth. For now, I want to say that 2.01 in the Principles of Corporate Governance states that in maximizing shareholder wealth or corporate wealth, corporations are obliged to act within the law so that it is not permissible to break the law even if you can make calculate the judgment you can have more wealth by doing so. Secondly, it may take ethical considerations into account. Third, it may devote reasonable amount of resources to public welfare purposes. So there is a wide spread agreement I think about this principle. So the objective may be maximization. It flows within this channel of law and ethics. Its maximization, not just you should make money as much as you can. But you should make money as much as you can within the law, within the limits of ethics and morality, and it is appropriate to use certain amount of money you make for social welfare purposes, not unlimited amount, but reasonable amount.

In point two, related to point one, you addressed the difference in the view of shareholders and you pointed out quite accurately that a view of shareholder was like a view of partners. Where shareholders were the owners as in partnership, unanimous agreement was required for fundamental changes. We have different perspective where it is put into question whether shareholders are owners and majority rules are enough. That is all correct. I think it arises from two factors. One is again that there is shifting social norms to different view on shareholder. But second is basic economic difference. That is, when you get publicly held corporations, you cannot have a partnership model if it won't work. You cannot have unanimous approval of many shareholders. So that in tern may have someone driven to change social norms. But you are quite right in saying there is this very fundamental change from the view of the 19th century about ownership to the view of the 20th and 21st century in this respect, as in connection with the first point, large scaled ownership.

In the third point, your questions really break down to several points. The first point is, there are many statutes in many states, none of Delaware, which is the most important corporate law state, which allows managers to take into account the interest of other constituencies because constituencies are being a code word for that is a disguise for so to speak stakeholders for other interests, particularly labor and community. Now these statutes are very hard to interpret. It is clear that they were put in not because legislature wanted to promote labor, but because legislature wanted to make takeovers harder and you properly called them Anti-takeover statutes. Why do these statutes make takeovers harder? Because they allowed managers to say in response to hostile takeover, that "oh yes, we understand that the bidder who wants to takeover the company is offering a lot of money to the shareholders and that looks very attempting, but the bidder would not treat labor as well as we do so, so we will resist takeover". So accuse the in-company management another arrow to shoot at the bidder. The arrow is that in-company management would protect labor whereas new managers discharge a lot of employees. The fact is that these statutes give labor no rights. It is not possible to bring an action, to

bring suit under these statutes, for labor or employee to bring suit under these statutes and say, "it did not give me enough attentions". So they are only designed to allow managers more discretion. Many people believed these statutes should be interpreted narrowly to allow managers to take into account other constituencies only if they give the other constituencies in limited weight or benefiting other constituencies would benefit the corporation. For example, there is an example of 2.01, where managers are allowed to reject one offer for taking over the corporation and favor another offer with second offer treats employees somewhat better, but not allowed to favor an offer that really trace a lot of wealth to the employees. Similarly, you may benefit the corporation, as you question applies, by doing good things for labor. So that also is within the corporate statutes. But what the statutes mean has not been definitively determined.

Now there is a very hard question you ask is, why shareholder wealth, not corporate wealth, and if corporate wealth, is labor part of corporate wealth? It is a very difficult question to answer. Let me answer the first one. The reason that most corporate academics in the United States tend to favor shareholder wealth or shareholder wealth over corporate profitability is the shareholder wealth can be measured objectively by market prices whereas profitability can be manipulated by accounting tricks. So it is simply a functional issue, that is, if we are confident with financial statements with accurate, we use those corporate wealth. But we are not. We think management manipulated those financial statements. Therefore, as Enron, management may show enormous profit, but in fact, corporate wealth is not increasing. On the other hand, the market is usually more accurate although more than that in case of Enron. That is one issue. The Second issue is, doesn't labor contribute to value? Isn't that value of corporate wealth? The answer is yes. Again, there is a problem of instability. It is hard to measure how much wealth labor contributes to corporation A. They would not be contributed by replacing the same labor force. Usually you can say this Chief Executive. I can identify how much value a Chief Executive is adding to the corporation as opposed to another executive. If much more difficult to say how much value these two thousand blue-collar employees are contributed to the corporation as opposed another two thousand blue-collar employees. Nonetheless, I teach at Berkeley and University of Columbia and one of my colleagues of Columbia, Jeff Gordon, is trying to formulate measurement of labor contribution or ways to do it just because he basically agreed with the views you put forward. I say the answer to the view you put forward is not we do not want labor to take into account, more, we are not sure how to do it. The last thing I say is that traditionally American corporation law has taken into the view that the labor and creditors deal with the corporation by contract. So it is not in code of corporation law question. But questions of bargaining between the unions and the companies. In fact, at least in the past, the union representatives have shown virtually no interest in the United States in going at corporate boards because it would be going over to the enemy. That changed a little. Again I am not justifying this. I am just explaining perhaps the reasons why we have the systems.

Tamaki Kakizaki, Associate Professor, Faculty of Management, Atomi University

Regarding to SOA(the Sarbanes-Oxley Act of 2002), which includes new sections for internal control, I would like to ask questions about its relations with internal control provision in the Securities and Exchange Act of 1934, and also about the way how SOA clarify the mechanism of constructing internal control structure system.

1. The significance of internal control legislation by SOA

First, SOA 302 and 404, and also corresponding regulations of the SEC, show the new process of establishing internal control system. With respect to its significance, I would like to ask about the relations with the Securities and Exchange Act of 1934, 13-(b)(2), which is ruled by the Foreign Corrupt Practices Act of 1977. According to the SEC release, "internal control over financial reporting" in SOA 404 is positioned as an extension of a concept of "internal control" in 13-(b)(2). Its effectiveness is required to be proved based on both management's assessment and report, and auditor's certification toward CEO's report. On the other hand, it seems 302 and the SEC rules required management to certify establishing, maintaining, and assessing disclosure controls and procedures as a system of collecting, handling, and disclosing wider corporate information in addition existing financial information. How do we understand the reason this kind of new rules of internal control was placed in Act of 1934?

In traditional concept framework of internal control, maintaining financial statements followed by GAAP rules was sufficient. However, scandals like Enron bankruptcy revealed that concept was insufficient to secure timeliness of information disclosure to the securities market and disclosure of important non-financial information. A public corporation has accountability for fair information disclosure to the securities market. In my opinion, it is important to have the point of view that management is required to construct internal control as a precondition of such accountability. Securing efficiency and fairness of each company's management as management's duty of care is not enough. Each management is required to establish internal control system to contribute fully to improve "quality" of information to the securities markets as base of accountability to the market. Responsibility to establish governance system to hold such an internal control system is required to management.

Recently requirement of internal control system to directors and CEO seems to be established. What effect is expected to director's responsibility and corporate governance in terms of state corporate laws by SOA regulation of new internal control?

2. Role and position in organization of internal auditors in establishing internal

SOA does not regulate directly internal auditors. However, as Professor Eisenberg points out in the thesis of "The Board of Directors and Internal Control", internal auditors will play an important role in communication between management, audit committee, and external auditors. SOA made an audit committee take direct responsibility relating to appointment, compensation and oversight of external auditors. Is it necessary for federal securities laws to have similar regulation on internal auditors in the future? I think this is related to soft law, Professor Eisenberg mentioned today. I would like to hear your views. For example, IIA, Institute of Internal Auditors has raised proposals including internal auditor's

duty of direct report to audit committee, request of audit committee's consent about dismissal of internal auditor, and assessment of internal auditor's independence by external auditor. For the purpose of securing independence and effectiveness of internal auditor, how should we consider internal auditor's position in organization and what extent should the law be involved with its regulation? I think there is a dilemma here, so how are we going to have reconciliation between tow and what should be the relevance of the law in this regard. In Japan, we have very weak enforcement capability of self-regulatory organizations. Can you give us any advice regarding self-regulating body as well?

Professor Eisenberg:

Thank you. These are very good questions. These are technically very important and very interesting. Before Sarbanes-Oxley, 13-(b) of the Security Exchange Act required companies to divide and maintain the system of internal accounting controls to sufficiently provide reasonable insurances when certain things would happen. For example, transactions were executed in accordance if management sold the organization. Now, as is pointed out by Professor, Sarbanes-Oxley does the same thing. It is said the financial controls do the same thing. So why were these Sarbanes-Oxley provisions adopted? I tell you differences, which are, I think, motivating the reason. Section 13-(b) says every corporation must have internal controls XYZ. But it does make anybody responsible for internal control. Just the corporation. Now Sarbanes-Oxley says, I should according to the rules under Sarbanes Oxley and SEC rules, each management must evaluate, with participation with CFO, Chief Financial Officer, the effectiveness of issuer's internal controls and has to certify the effectiveness. Now we have got somebody we can appoint to. You have got CFO has to sign this and he can be in a lot of trouble civilly and criminally if he has no good basis for saying these control are effective. I think this is taken very seriously. So Sarbanes-Oxley is a way of saying we really mean it. That's one thing. It points the finger of it, you, you got make sure things happen and you got certified every year that is happening.

It also expands somewhat on the concept of controls. Not for what I would like, but it introduces the concept of disclosure control in addition to the concept of internal control of financial reporting. Disclosure controls means controls got designed to ensure the information reported by the issuer to the public is correct as opposed to internal financial controls. That is, internal information generated is correct. Internal financial information is correct because external information may differ from internal information. It is because it produces all kinds of data internally and gets aggregated for external reports. For example, you might report internally, data and performance with provisions but externally just might report total profitability. So this is a new idea of points of managers and new kind of disclosure control. Those are two most differences, I think. In addition, the accountants are required to evaluate these controls which was only required in a minimum way under 10 A of SEC Acts. This was a very good question and I have to tell you that I did not really focus on it until you raised the question. It is an excellent question.

Next question is, will this a fact that liability of directors...that is a paraphrase, there has been a

general movement in the United States to extend a duty of care of directors to include requirement, this is state law duty now, not federal law duty, that directors ensure that internal control systems are in place. The concept of internal control is much larger than the concept of the financial control although we include that concept. The new version of model act, which is the next most important statute after Delaware, will specifically require the board to pay attention to that. I think Sarbanes-Oxley will also have an affect on state law in reinforcing the concept that the director not only needs to make careful decisions, not only needs to carefully review the facts that come naturally, but must in soul the systems to make sure the right facts are coming, internal control systems.

Now as your last point, yes, I completely agree with you. The issue is whether internal auditors should be placed in regime very much like external auditors with a report at least in part of audit committee whether they are retained or discharged by the audit committee. The Principles of Corporate Governance may have some more modest suggestion, but I think the suggestions you proposed are excellent and I personally would like to see them to adopt it. Why would they not adopt it? I think Sarbanes-Oxley is very radical act in the United States and did a lot and was not going to do everything at one time. This is a very logical and proper suggestion.

Kenji Kawamura, Lecturer Faculty of Economics, Kanto Gakuin University

1. Since the Sarbanes-Oxley Act of 2002 was legislated in the U.S., compliance cost in public corporations has increased. What amount of cost is used for compliance? How many companies are going private? How should legal regulation to large-scale closed corporation including wholly owned subsidiary be?

2. As a result of the compensation scandal of former NYSE chairman, full separation of market management function and self-regulatory function of securities exchange has been sought more intensely. What is the latest discussion on this? In the U.K., London Stock Exchange became a public company and its role of the U.K. Listing Authority transferred to the Financial Services Authority (FSA). How do you evaluate this? How should roles of legal regulation and self-regulation be allocated in general?

3. Professor Eisenberg said earlier that there were a lot of focuses on voluntary regulations. From my point of view, there seems difference between the U.K. and the U.S. I think UK has a stronger focus on voluntary and the U.S. has more based on written rules. How do you evaluate best practice approach (comply or explain approach) in British combined code? Personally, I would like to know the difference and similarity between the U.S. and the U.K. as well as the U.S. and Japan.

Professor Eisenberg:

Thank you. The first question is the cost of compliance of Sarbanes-Oxley. I did get some data on this. I don't completely trust the data, but I give it to you. The source that I am using breaks down the differences among first corporations with less than one billion dollar revenue and second corporations with more than one billion dollar revenue. There are a number of categories that are employed but I think some of them have nothing to do with Sarbanes-Oxley. For example, directors and officers' liability insurance, I am not sure that is Sarbanes-Oxley. So I want to concentrate on things that I think are directly Sarbanes-Oxley. For companies with less than a billion dollars in revenue, billion dollars, that is a many dollars, according to this source; legal costs went from annually from 212 thousand to 468 thousand. Accounting went from 524 thousand to 824 thousand. I think accounting would have gone up anyway because accountants do not want to get in the same position that Enron accountants found themselves in. Then, there is a category here called lost productivity, which is very hard to really pin out. Now again, with the corporations with up to a billion dollars in assets, the accounting and legal is about another 500 thousand dollars a year, 300 more thousand for accounting and 200 something for legal. Disregarding lost productivity. For corporations with a billion dollars in assets, even a half of a billion dollars in revenue, that is nothing. That is just loose changes floor to floor and you do not even calculate up. Now for companies with more than one billion dollars, the source I am using, that is the only source I know of, does not give a comparative table but just gives expenses post Sarbanes-Oxley, caused being public, and it says legal 841 thousand and accounting 1.2 million, and that is 2 million dollars so far. Then there is another category, lost productivity, 2.5 million dollars. Of course, some of what these managers considered loss of productivity, I myself consider highly productive. I mean they might think spending time in internal controls is lost productivity, but I think it very productive. But even you add up all that, it is only 4.5 million dollars that is post Sarbanes-Oxley, and if you say 2 million dollars, pre, and add another 2.5 million dollars, very small amount. I have not heard of any company that is going to private to avoid Sarbanes-Oxley. I can't say it has not happened, but it has not been put in Wall Street Journal.

The second question. Yes, there was a terrible scandal of Richard Grasso, the former chair of NYSE. The issue is, should there be before separation of the market management function, soft regulatory function of Security Exchanges. Now I am going to say something about this, but I am not really an expert on it. In the U.S., there usually is a division between corporate law and securities law. My field is corporate law although I also study those aspects of securities law, which concerns internal governance issues. So I am not an expert on Stock Exchanges. In general, from what I have seen, the answer would be desirable to have some division. There is a little problem, maybe more than a little, because Exchanges are now taking two kinds of regulatory functions. First, they regulate the governance of holistic corporations. Secondly they regulate their own traders. There are trading practices on their own members. There is an issue whether or not both should be split up. As a part of my evaluation, I will give you a political reading. I think it will take one more scandal before it happens. I think it does not going to happen now.

Then finally, how do I evaluate the best practice approach of British combined code? This is a very

interesting question and you added very interesting comments just now about comparative voluntariness of the U.K. and the U.S. Yes, it is very true the soft law rules in the U.S. are not that voluntary. As I already mentioned that, large publicly held corporations cannot avoid governance rules of Exchanges. It has no alternatives to listing. If a large corporation does not follow best practices in America, press does come down on it, investors come down on it. There is a lot of pressure. I know the combined code, but I do not know how much it works in practice. Probably true as you say that, it is more voluntarily more than American soft law. Now despite the fact that you pointed out, American soft law is not completely voluntarily. I think the form is important. People are allowed to think it is voluntarily. They are allowed to tell themselves they are acting voluntarily. That is the form can be important. The U.K. approach, in which in effective you got to say, either easy in following the rules as design of standard or here is why I would not be following it, seems to me almost invite not following the rules by inviting it giving an explanation. I am not sure it is sufficiently strong but I really have to know more about total business culture of the U.K. that I do, to give you a complete answer.

Yasunobu Wakabayashi, Lecturer, Faculty of Law, Kokugakuin University

In Japan, crossholding of shares has widely occurred in the market by public corporation's issuance of common stocks to other corporations. This crossholding among big corporations has had an adverse influence on corporate governance and pricing of stock market.

The crossholding occurred not only in buying stocks in the secondary market, but also in issuing new stocks. There are two method of crossholding by new stock issuance. One is direct allotment to corporations. Another is the way called 'Oyabike' in which issuer asks underwriter to allocate its new stock to specific companies in public offering. My question is concerning these two different methods. Regarding to direct allotment to corporations, you said that you did not have that kind of systems because of two reasons. So I will change my question.

On condition that management of corporation has discretion to decide stock allocation theoretically in corporate law, stock issuance like these has been admitted. There has been no idea to regulate such an issuance of stock in traditional Japanese corporate law and securities regulation theory. As a result, large-scale crossholding of shares occurred in the market.

As my field of interest, I am researching on how we should regulate issuance of stock to corporation, resulting in crossholding, and establishing a theory for it.

1. Direct allotment to corporations

When the U.S. public companies issue common stocks by any reason except for responding to hostile takeover or reorganizing corporation, is there any case to issue common stocks to specific corporations other than public offering or rights offering? I assume there is no such a practice in the U.S. If so, what is legal (or economic) reason to hold such a customary practice? In relation with this respect,

when US public companies issue common stocks by any reason except for responding to hostile takeover or reorganizing corporation, can we say public offering is a method to issue common stocks in principle in the U.S.?

If you do not have the system of direct allotment to corporations, can we definitely say that American public companies when issuing common stocks usually take a method of public offering? Is it the well established practice in American business community? If that is the case, public companies' stocks will be distributed broadly in the market. The investors should own those common stocks broadly and widely. Is that an idea strongly existing in American community? If so, what is the reason for that kind of strong belief or concept?

2. Oyabike

In Japan, "Oyabike" means that issuer orders underwriter to allocate stocks. When I research on a customary practice like Oyabike in the U.S., I found out there was a custom to allocate specific parties in case of hot issues. I have three questions here. Although it is similar to the previous question, the first question is as follows. SEC or NASD strongly emphasize that public offering should allocate to the public. Does an idea that new stock issuance should be allocated to the public investor, exist in the U.S.? If so, what ideological background or past experience is that idea based on? Second, do you agree a custom that issuer order underwriter to allocate stocks should be legally prohibited? If so, what are the reasons and how should we regulate? If not, what kind of allocation can be allowed? Allotment to whom is allowed? What is the reason? Third, do you agree that the discretion of underwriter regarding stock allotment should remain quite wide as it is currently? Or do you think we should deny or regulate the discretion? What is the reason for it?

Is there a similar practice in the U.S.? I actually looked into that and found out that in the case of hot issues, there is a practice making allotment to specified parties or specified people. Now I have questions relating to that. In the case of a public offering, there are individual investors or public investors. Stocks and securities must be allocated to the public. I have read that SEC or NASD strongly emphasize that public offering should allocate to the public. Does the concept that new stock issuance should be allocated to the public investor, first and foremost, exist in the U.S.? Is that the well-established social practice in the U.S.? If so, what ideological background or past experience is that idea based on? Second, do you agree the practice of issuer instructing underwriter to allocate stocks should be legally prohibited? I heard in the United States, there is a similar practice. Do you think that kind of practice should be prohibited? If so, what are the reasons and how should we regulate? If not, what kind of allocation can be tolerated and allowed? Allotment to whom should be allowed? What is the reason? Third, do you agree that the discretion of underwriter regarding stock allotment should remain quite wide as it is currently so? What should be the modality of this question of underwriter? Related to that, I would like to a very important point. In terms of company law, should

directors have rights to receiving allotment of new stocks and also, the right of new stocks allotment to underwriters? Should they be regarded on continuation or securities law or corporate law treat allotment in separate way and different way? What is the legal treatment on corporate law and securities law?

Masato Shimizu, graduate student of Waseda University

Thank you very much for giving me an opportunity to ask you a question. I would like to ask you about a monitoring model.

I heard monitoring model took the role of mutual fund independent directors as a model. Does this mean mutual fund independent directors are a good example for board of directors of large publicly held corporations? In addition, should their experience be used as best practice for corporate governance of large publicly held corporations? Thank you.

Professor Eisenberg:

I will begin with the first question. As I indicated earlier and as you recognized, companies do not normally like to issue large block of stocks to other companies with one limited exception that is where there is a tender offer and the block issued to friendly corporations, which will vote with management. That does not occur too often. Now a company might issue stocks to become public. That is initial public offering. Or to raise more capital after it is public. In either case, there is no control or very little control who would issue stock to. As I said earlier, it does not issue stock to large corporations simply for economic reasons or reasons of management selfinterest of vote. Underwriting is not the only way issuing the stock. What you could conduct was called private placement. You could sell to limited number of investors, normally sophisticated investors. You could do anything you want.

Allotment issue, if I am talking about a company that is already public certainly, my impression is, that companies normally do not issue or order underwriter to allocate the stock. And one reason is that hot issues as you properly describe them and normally in initial public offerings. An offering new stock by corporation that is already public is normally not a hot issue. It is normally going to be pretty close to the market price. So the allocation problem tends to arise in initial public offering much more than later public offering. The problem with initial public offering is that the reasons are not clear. Lots of academics approach this issue. I do not know the cases in Japan, but in the U.S., the price at which initial public offering is made is usually much less than the price of the stock very shortly thereafter. So if you can get an allotment at public offering, you usually make money provided but you sell it quite fast because the price usually goes down eventually. Well, there is an asset here. The asset is hot stock. Who is going to get benefit of it? My impression is that it is not the issuers who control allotment to underwriters. I cannot say it for sure, but that is my strong impression. The underwriters control allotment in two ways. One way is very common and the other way seems to be very new. The first way is an underwriter gives allotment to people it favors because it is doing business with them in other

areas, typically institutional investors. So it is very hard for individuals to get a significant allotment on IPO unless he is a very wealthy individual who does a lot of business with the underwriter or the broker.

There is a new phenomenon in the U.S. called spinning. In spinning, the underwriter gives the allotment back to the executives of the issuing corporation. It is bribe because the executives now bribe to give their stock issuance to the underwriter. Remember they are playing with corporate money in issuing stock, but they get back for themselves personally this hot stock, either their own stock or other stocks, not necessarily their own stock. In a fact, there is an implicit deal that the underwriter says the corporation, if you do underwrite your corporate stocks through us, we will give the executives an allotment of hot issues in another corporation. It is just like paying money to. But that money properly belongs to the corporation that is underwriting at least at the recent Delaware court. I think the best system would be a system in which the allocation is based on some objective criteria, takes the total number of order placed, divide them into the total number of shares being issued and allocate the issue pro ladder. That is why I think the best system would prevent this favoritism. Again, I am not an expert on securities laws but I know about something about it. As I understand, that is not required now and is not done now. However the SEC might think it is a best practice.

On the last question, actually the monitoring models are preceded mutual fund independent chairs, independent directors although that was some evidence that was used for developing a model. However, in fact, mutual fund independent directors were not in very effective. In fact, it was highly ineffective. There have been a number of scandals lately in mutual funds in the United States, which you may have read about. Mutual funds are allowed certain shareholders to engage in illegal or improper practices. Independent directors either did not know or did not care or certainly did not do anything about it. So yes, you are right. There were requirement of some of independent directors for long-term mutual funds although I used that idea really went beyond the particular institution. You look like to have another questionnaire? Ok, so that is it.

Professor Uemura,

Did the governance model of mutual fund have a large impact on governance model of ordinary companies?

Professor Eisenberg:

It is now going the other way around. Now there are calls that mutual funds to adopt the governance model that other companies have adopted. The problem with mutual funds, first of all, they are only required to have less than majority independent directors. You got have majority of independent directors to be effective. They were required to have audit committees, nominating committees, and compensation committees. Now these scandals. There was a call for require, and SEC maybe require, mutual funds to adopt practices that most companies adopted. That's the direction in which it is going.

Professor Uemura:

I understand. He might have additional questions, but we are running out of time. I am sorry but we have to close at this moment. We want to hear as much Professor Eisenberg. That's why we organize this today. If time allows, we would like to have questions from the floor as well, but of course, for that we have had the schedule for longer hours, my apologies to people in the audience for not being allowed to ask questions. You must be frustrated. Please understand that there were some constrain we have to close. Professor Eisenberg kindly spent more than three hours responding all kinds of questions we raised. Of course, there are lots of questions we want to raise, but if do so any longer, we have to ask physical limitation of Professor Eisenberg, so we should not. I would like to express my sincere gratitude to Professor Eisenberg. It is so gracious of you to respond to all the questions. Please give him a big round of a pose. Thank you very much for responding questions so diligently. We would like to conclude this meeting. Thank you very much to everyone for joining us today.