NOTES

THE PATHOLOGY OF INSIDER TRADING AND JAPAN'S AMENDED SECURITIES EXCHANGE LAW*

I. INTRODUCTION

Americans are investing abroad in increasing numbers,[1] lured by the low cost of foreign investment[2] and the opportunity to eliminate the systematic risk inherent in domestic investment.[3] But investors have encountered new risks, which include the global market's dependance on the strength of large institutional investors.[4] One failure in a global financial market may now effect other markets, including those in the United States.[5] Events which affected

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1. *See* Comment, *Exporting United States Law: Transnational Securities Fraud and Section 10(b) of the Securities Exchange Act of 1934*, 3 CONN. J. INT'L L. 373, 373 n.1 (1988); *see also* Gruson, *The Global Securities Market: Introductory Remarks*, 1987 COLUM. BUS. L. REV. 303, 305 (explaining many of the causes). American investment in foreign countries totalled $347.2 billion in 1976, $949 billion in 1985, and $1.068 trillion in 1986. *See* Comment, *supra*, at 373 n.1. The bulk of foreign investment consists of private assets in foreign securities. *See id.* (quoting Sloane, *The Lure of Investing Abroad*, N.Y. Times, Aug. 11, 1987, at D1, col. 2).

2. *See* Gruson, *supra* note 1, at 305. The lower cost of foreign investment is a result of improved telecommunications technology, deregulation of securities industries, worldwide growth in the availability and demand for capital, and the consequential explosion in the number of institutional intermediaries offering worldwide services and internationally diversified investment funds. *See id.* at 304-05. The Japanese markets were opened in part by the abolition of the "dual-audit principle," which had required that the financial statements of companies seeking capital in Japan be certified by a Japanese accountant. *See* Perlmutter, *Developments in the Japanese Securities Markets*, in INTERNATIONAL SECURITIES MARKETS 89, 92 (1987) (Practising Law Institute B4-6802). Japanese markets were also opened by the simplification of the annual reports that each issuer must file with the Japanese Ministry of Finance. *Id.*

3. *See* Gruson, *supra* note 1, at 305; Phalon, *The Gaijin Are Back*, FORBES, Dec. 26, 1988, at 37; *see also* Thomas, *Internationalization of the Securities Markets: An Empirical Analysis*, 50 GEO. WASH. L. REV. 155, 163-65 (1982).

4. *See* Gruson, *supra* note 1, at 307-8. An excellent example of how the policies of foreign governments may have a profound impact on domestic markets is provided by the losses that domestic banks have suffered as a result of loans to foreign banks and industries. *See id.*

5. *See* Meyer, Martin, Hoshiai & McKillop, *The "Crash of '88" Scenario*, NEWSWEEK,

only foreign markets are now capable of having a profound and immediate impact on any number of other markets.

Japan has one of the largest capital markets to actively seek a larger role in the international trade of securities.[6] In 1987 the Tokyo Stock Exchange passed the New York Stock Exchange to become the world's largest stock exchange in terms of the market value of all listed shares.[7] The Osaka Stock Exchange, which is one-sixth the size of the Tokyo Stock Exchange, has since passed the London Exchange to become the world's third largest.[8] Foreign investment in securities listed on these exchanges has also increased.[9] Foreign listings on the Tokyo Stock Exchange have increased from eleven in 1984 to fifty-eight in 1987,[10] and foreign membership in the Tokyo Exchange has also expanded due in part to pressure from the United States.[11] Foreign investors have nevertheless largely eschewed the Japanese markets in spite of their size and influence, believing them grossly overvalued and dangerously

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Nov. 23, 1987, at 49.

6. *See, e.g.*, Umemuri, *Looking to Tokyo for Finance*, EUROMONEY, Sept. 1987, at 2 (Special Supplement).

7. *See* Perlmutter, *Developments in the Japanese Securities Markets*, in INTERNATIONAL SECURITIES MARKETS, *supra* note 2, at 89.

8. *See id.*

9. *See* Thomas, *supra* note 3, at 160. In 1980 American transactions in Japanese stock involved an exchange of nearly $2.7 billion, exceeded only by transactions in Canadian stock of $6.7 billion and British stock of $2.7 billion. *See id.* These transactions comprised fifteen percent of all foreign transactions involving American investors. *See id.* In 1986 Japanese investors bought and sold American stock valued at nearly $27 billion. *See* TREASURY BULL., Dec. 1987, at 84. Total Japanese investment in the capital stock of American companies was exceeded only by British investment of $64 billion, Swiss investment of $37 billion and Canadian investment of roughly $35 billion. *See id.* Roughly 10% of all foreign transactions in American stock involved Japanese investors. *See id.*

10. *See* Perlmutter, *Developments in the Japanese Securities Markets*, in INTERNATIONAL SECURITIES MARKETS, *supra* note 2, at 91. Thirty-five of the foreign corporations whose stock is traded on the Tokyo Stock Exchange are based in the United States. *See id.* Although no foreign corporation is presently listed on the Osaka Stock Exchange, plans are being made that would open the exchange to foreign listings. *See id.*

11. *See* Graven & Swalen, *Tokyo Stock Exchange Opens Its Doors to Six U.S., 10 Other Foreign Firms*, Wall St. J., Dec. 17, 1987, at 5, col. 1; Rubinfien, *Tokyo Exchange's New Foreign Members Begin Trading, but With Little Fanfare*, Wall St. J., May 23, 1988, at 30, col. 1. The nine American firms with membership in the exchange include: Merrill Lynch & Co.; Goldman Sachs & Co.; and Morgan Stanley & Co. (all admitted in 1986); and Salomon Brothers Inc., Prudential-Bache Securities Inc.; Shearson Lehman Brothers Inc.; Kidder, Peabody & Co.; Smith Barney, Harris Upham & Co.; and First Boston Corp. (all admitted in 1987). *See* Graven & Swalen, *supra*, at 5, col. 1. Salomon Brothers and Morgan Stanley are also members of the Osaka Stock Exchange, but are limited to trade in futures. Perlmutter, *Developments in the Japanese Securities Markets*, in INTERNATIONAL SECURITIES MARKETS, *supra* note 2, at 90.

speculative.[12] This overvaluation is in part the result of the pervasive manipulation and insider trading in Japanese stocks.[13]

Japan's stock markets have been a source of inexorable scandal and conflict. The most recent scandal centered on the sale of Recruit-Cosmos[14] stock prior to a listed public offering. The shares were allegedly sold to seventy-six individuals,[15] including aides to former Prime Minister Noboru Takeshita[16] and other high ranking officials of Japanese government, and executives in leading Japanese brokerage[17] and communications companies.[18] The buyers

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12. *See* Rudinitsky, Sloan & Fuhrman, *Land of the Rising Stocks*, FORBES, May 18, 1987, at 139-40 (analogizing the Tokyo market to the Dutch tulip craze and the South Sea bubble); Shapiro, *Japan Puts Insider Rules into Effect*, Wash. Post, Aug. 24, 1988, at F1, col. 6.

13. *See* Abelson, *Up and Down Wall Street*, BARRON'S, Jan. 4, 1988 at 1, 41; Rudinitsky, Sloan & Fuhrman, *supra* note 12, at 140. Mr. Abelson believes that the imposition of any regulation to control market manipulation would suffocate the speculation responsible for the overvaluation of Japanese securities and trigger a collapse in stock prices. Abelson, *supra*, at 41.

14. *See* Lehner & Kanabayashi, *Japanese Aides Tied to Scandal on Stock Sales*, Wall St. J., July 7, 1988, at 18, col. 1. Recruit Cosmos Co. is the real estate subsidiary of Recruit Co., one of Japan's highest-flying service companies. The company was founded by Hiromasa Ezoe, who resigned along with one of the media executives who allegedly purchased the prelisted shares. *See id.* Mr. Ezoe founded the company in the early 1960's and, through charismatic leadership, created a conglomerate of 27 subsidiaries with consolidated sales of ¥424 billion. *See* Yoder & Kanabayashi, *Highflying Japanese Service Company Threatened by Stock Purchase Scandal*, Asian Wall St. J., July 18, 1988, at 11, col. 1. The company's sales are roughly equal to those of the Yamaha Motor Company. *See id.*

15. *See* Kanabayashi & Mark, *Tokyo Determines Recruit Share Sale Broke Trading Law*, Asian Wall St. J., Sept. 5, 1988, at 24, col. 2.

16. *See Stock Scandals May Encourage Japan to Speed Passage of Insider Trading Law*, Asian Wall St. J., Aug 11, 1988, at 10, col. 1. Implicated in the scandal were several aides to former Prime Minister Noboru Takeshita, Finance Minister Kiichi Miyazawa, former Prime Minister Yasuhiro Nakasone, and other senior politicians in the ruling Liberal Democratic Party. *See id.* Such favors are not uncommon in Japan, where politicians rely heavily on the support of large corporations. *See* Chira, *Japan 'Money Politics' Rears Its Head*, N.Y. Times, Aug. 8, 1988, at A3, col. 1 (quoting Gerald L. Curtis, professor of Political Science at Columbia University).

17. *See* Rubinfien, *Japan's Scandal on Stock Sales Widens to Banks*, Wall St. J., Jul. 19, 1988, at 25, col. 1. Among those implicated as having purchased the prelisted shares is an executive of the Sumitomo Trust and Banking Co., who admitted to purchasing 1,000 shares with ¥12 million borrowed from another Recruit subsidiary. *See id.* Diawa Securities, one of the underwriters of the Recruit Cosmos offering, denied that any its executives were involved, but agreed to cooperate with investigating officials. *See id.* Nomura Securities, Yamaichi Securities, and Nikko Securities are also cooperating in the investigation. *See International Corporate Report*, Wall St. J., Jul. 25, 1988, at 13, col. 1.

18. *See* Lehner & Kanabayashi, *Japan's Stock Scandal Taints Politicians and Executives*, Asian Wall St. J., July 11, 1988, at 10, col. 1. Ko Morita, the president and chief executive officer of the major financial daily Nihon Keizai Shimbum resigned in early July, 1988, citing "health and other reasons including trading" in Recruit Cosmos stock. *Id.* The chairman of Nippon Telegraph and Telephone, Japan's largest company, was also impli-

subsequently sold the shares at huge profits after the public offering.[19] Industry officials speculate that the prelisted stock was sold in exchange for political favors.[20] After an investigation, the Ministry of Finance announced that the sale had broken no law,[21] but later ruled that Recruit had violated law only to the extent that it failed to notify the Ministry of an advance sale to more than fifty parties.[22] The scandal prompted the significant revisions to the insider trading laws that are the subject of this Note, and eventually forced the resignation of Mr. Takeshita, three cabinet ministers, one member of the Diet,[23] and a leader of the opposition Socialist party.[24]

Another major controversy involved the announcement of a ¥20 billion extraordinary loss by Tateho Chemical Industries[25] on September 2, 1987.[26] Prior to the announcement, Nikko Securities, Tateho's underwriter, sold 1.4 million shares on the Osaka Stock

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cated in the scandal. *See* Hiatt & Shapiro, *New Justice Minister in Japan Quits Post*, Wash. Post, Dec. 30, 1988, at A21, col. 5.

19. *See* Lehner & Kanabayashi, *supra* note 14, at 18, col. 1. The shares were allegedly sold at prices exceeding four times the price originally paid. *See id.*

20. *See* Yoder & Kanabayashi, *supra* note 14, at 11, col. 1. New companies may find it very difficult to break into Japanese business and political networks built on long term relationships. *See id.; see also* Zoglin, *Insider Trading in Japan: Challenge to the Integration of the Japanese Equity Market into the Global Securities Market*, 1987 COLUM. BUS. L. REV. 419, 421. Recruit's success was largely a result of its ability to capitalize on markets overlooked by traditional businesses, and its success in novel markets made it even more difficult for the company to break into the corporate network. *See* Yoder & Kanabayashi, *supra* note 14, at 11, col. 1.

21. *See* Lehner & Kanabayashi, *supra* note 14, at 18, col. 1.

22. *See* Kanabayashi & Mark, *supra* note 15, at 24, col. 2. Recruit argued that the sale did involve 76 buyers, but that the stock was actually distributed in two separate sales with subscriptions of 39 and 37 parties each. *See id.* The Ministry determined that the arrangement, which involved a total of 125,600 shares at ¥1,200 each, actually constituted one sale. *See id.*

23. *See* Hiatt & Shapiro, *supra* note 18, at A21. The resignations include those of Justice Minister Takashi Hasegawa on December 30, 1988, *see id.;* Finance Minister Kiichi Miyazawa in December 1988, *Milestones*, TIME, Dec. 19, 1988, at 66; and Opposition Leader Takumi Ueda on November 4, 1988, Hiatt, *Japan's Stock Scandal Bags First Victim*, Wash. Post, Nov. 5, 1988, at A14, col. 1; and former Prime Minister Noboru Takeshita in April of 1989, *see* Hiatt & Shapiro, *Japanese Politics Shaken—Scandal, Resignation May Change the Rules*, Wash. Post., Apr. 26, 1989, at 1, col 1.

24. *See* Chira, *Tokyo Opposition Leader Quits in Stock Scandal*, N.Y. Times, Feb. 8, 1989, at A3, col. 1.

25. *See* Schoenburger, *Tateho Inquiry Shows Japan's Struggle to Define and Combat Insider Trading*, Wall St. J., Sept. 14, 1987, at 38, col. 1. Tateho is a medium-sized manufacturer of insulating materials. *See id.*

26. *See id.* Tateho's losses were allegedly the result of unauthorized speculation in securities by company executives. *See id.*

Exchange in a series of transactions.[27] Officials stopped all trading in Tateho stock after the share price had fallen ¥300, the maximum daily decline allowed by exchange rules.[28] Industry experts speculated that company executives and securities analysts sold the stock with the benefit of Nikko's access to inside information about the company's finances.[29]

The failure of insider trading regulation in Japan is the product of social acceptance, traditional business structure, and the political self-interest. These factors explain why recent amendments to Japan's securities laws, adopted as a response to public outrage over government involvement in the Recruit-Cosmos scandal, are not a significant improvement. Part II will explain the limitations on the United States' ability to police foreign markets. Part III will compare insider trading regulation in the United States with the insider trading regulation that existed in Japan prior to the implementation of the new law in 1989. Part IV will explore the three primary causes for the failure of insider trading and market manipulation regulation in Japan. Part V will examine the recent changes in Japanese regulation. This Note will conclude that new legislation adopted by the Japanese Diet is unlikely to provide any significant improvement, but that some change is necessary to protect other participant markets from the speculative excesses in the Japanese markets.

II. Japan's Duty to Police Its Markets

International agreements notwithstanding, limitations imposed by international law make it impossible for any single country to police the world's markets. Consequently, as the Japanese role in international markets increases, so must its responsibility to protect them from the fraud and abuse that threaten global financial security.[30] Countries are unable to control those activities in

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27. *See id.*

28. *See id.*

29. *See* Graven, *Tokyo Moves Timidly on Insider Trading*, Wall St. J., Aug 18, 1988, at 8, col. 1. "It's a case where a big securities company had to know a little manufacturer was speculating on securities. And they knew how bad their finances were and then they went and sold off shares. But then Japanese don't really know what insider trading is." *Id.* (quoting Masakazu Kobayashi, author and critic of Japan's securities industry).

30. *See supra* notes 4-5 and accompanying text. *But see* Interview with Professor Sandra N. Hurd, Associate Professor of Law and Public Policy, Syracuse University School of Management, in Syracuse, New York (March 4, 1989) [hereinafter Hurd Interview]. Professor Hurd argues that the market integrity theory, which holds that insider trading impairs the long term efficiency of the market, may be misguided. *See id. See also* T. Manne, In-

the foreign markets that affect them indirectly, and must rely on the domestic law of other nations for protection. Those countries whose domestic markets play the largest role in the international capital market must protect their own markets to ensure the stability of the global market.

A. Subject Matter Jurisdiction

In spite of the expansionist efforts of American courts, the protection of American markets from the effects of insider trading and price manipulation in foreign countries remains limited by fundamental principles of subject matter jurisdiction.[31] The first is the principle of territoriality, which provides every state with "the right freely to organize and develop its social and economic system. . . ."[32] Absent an agreement to the contrary, a state is free to act within its own jurisdictional boundaries in response to events occurring outside them, but no state can exercise its power within the jurisdiction of another state.[33] Although the territoriality principle has imbued many nations with extensive discretion in the extraterritorial application of their laws,[34] it has suffered a predictable lack of recognition among the countries against which it is exercised.[35]

The principle of nationality is another recognized basis of jurisdiction for the extraterritorial application of domestic law.[36] The principle is embodied in the doctrine of active nationality, which permits jurisdiction over all nationals,[37] and passive nationality, which allows jurisdiction over foreign nationals who injure a foreign or domestic national.[38]

SIDER TRADING AND THE STOCK MARKET (1969) (legalized insider trading might promote efficiency as a form of executive compensation). Given the lack of consensus, the United States is unjustified in its effort to compel other countries to conform with its stance against insider trading. *See* Hurd Interview, *supra*.

31. *See* Comment, *supra* note 1, at 375-76.

32. *European Communities: Comments on the U.S. Regulations Concerning Trade with the U.S.S.R., reprinted in* 21 I.L.M. 891, 893 (1982); *see* Comment, *supra* note 31 at 375-76.

33. *See* S.S. Lotus (Fr. v. Turk.) 1927 P.C.I.J. (ser. A) No. 10, at 19 (Sept. 7, 1927); Comment, *supra* note 31, at 375-76.

34. *See* Comment, *supra* note 1, at 378.

35. *See id.* at 376.

36. *See id.* at 377.

37. *See id.* at 377 & n.16.

38. *See id.* at 377. The passive nationality principle is widely criticized as a basis for jurisdiction. *See id.* at 377 n.17. The failure of many nations to recognize the passive nationality principle is one reason much of the responsibility for policing international markets

Before holding United States securities law applicable to frauds committed in a foreign country, American courts must first decide that Congress intended the law to be so applied.[39] While they are powerless to invalidate an act of Congress because it conflicts with general principles of international law, the courts rarely find Congressional intent to be inconsistent with international law.[40] Although Congress did not explicitly provide for the extraterritorial application of the Securities Exchange Act of 1934, the courts have applied the Act in a manner consistent with the doctrines of conduct and effect[41] in light of its general purpose[42] and construction.[43]

The United States has expanded the traditional principle of territoriality through the application of two common jurisdictional doctrines.[44] The conduct doctrine permits the exercise of jurisdiction over foreign nationals as a result of conduct occurring within the territory of the United States.[45] The effect doctrine permits United States courts to attach reasonable legal consequences to conduct occurring outside of the geographic jurisdiction of the United States that has a substantial impact on persons or property located in United States territory.[46]

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depends upon those nations whose domestic markets comprise the largest part of the international market. *See infra* note 55 and accompanying text.

39. *See* Comment, *supra* note 1, at 380.

40. *See* Vermilya-Brown Co. v. Connell, 335 U.S. 377, 389-90 (1948) (holding the Fair Labor Standards Act applicable to contracts performed on property leased from Great Britain). "It is a matter of statutory interpretation as to whether or not statutes are effective beyond the limits of national sovereignty." *Id. See also* Tag v. Rogers, 267 F.2d 664, 666 (D.C. Cir. 1959) (upholding the 1943 confiscation of property owned by a German national in violation of a treaty with Germany).

41. *See* Comment, *supra* note 1, at 384.

42. *See id.* The Act was intended "to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and the Federal Reserve system and to ensure *the maintenance of fair and honest markets*." Securities Act of 1933, 15 U.S.C. § 78(b) (1982) (emphasis added).

43. *See* Comment, *supra* note 1, at 384. Portions of the Act expressly preclude extraterritorial application. The provisions of Chapter 78d, for example, were not to "apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States. . . ." 15 U.S.C. § 78d(b)(1982). Congress' failure to provide similar exemptions for section 10(b) indicates an intent that it be applied extraterritorially. *See* Comment, *supra* note 1, at 384.

44. *See* Comment, *supra* note 1, at 379.

45. *See* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 402(1)(a) & comment c (1986).

46. *Id.* §§ 402(1)(c) & comment d, 403(2). United States courts have limited this expansion of the territoriality principle to cases in which the effect is "substantial, direct, and forseeable," *id.* § 403(2)(a), and the rule is not otherwise inconsistent with principles of law of a jurisdiction with a greater interest in the conduct or its effect, *id.* § 403(3) & comment

The conduct and effect doctrines provide little protection from the inascribable consequences of extraterritorial securities fraud and its effect on market stability. Many events capable of having a profound effect on United States markets have been beyond the control of United States law.[47] Because it is limited to cases involving particularized harm to American investors, the effect doctrine expands federal jurisdiction to include only international securities fraud involving securities listed on a domestic exchange[48] or which produces a discernable injury to American investors.[49] The conduct doctrine permits the extraterritorial application of United States securities law only when the fraud was successful as a direct result of substantial misrepresentations made in the United States, but does not require that the fraud have injured American nationals or that the securities involved have been listed on an American exchange.[50] Although it may extend the application of United States

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e. In insider trading cases, the courts have extended the protection of United States law to fraud involving securities listed on United States exchanges, but have refused to extend jurisdiction to cases involving securities not listed in the United States even if they are heavily subscribed by American investors or their performance is closely tied to that of domestic securities. *See* Comment, *supra* note 1.

47. Such effects include, but are not limited to, the withdrawal of foreign capital, *see, e.g.*, IIT v. Cornfeld, 619 F.2d 909 (2d Cir. 1980); the demise of international financial organizations with extensive international relationships, *see, e.g.*, Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir. 1975); and other events that would destabilize the international securities markets.

48. *See* Des Brisay v. Goldfield Corp., 549 F.2d 133 (9th Cir. 1977) (a foreign plaintiff was permitted to sustain an action under Rule 10b-5 involving shares listed on an American exchange even though none of the fraudulent activity occurred in United States territory); *see also* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 403(1), 416 (1986).

49. *See Cornfeld*, 619 F.2d at 909; Fidenas AG v. Compagnie Internationale Pour L'Informatique CII Honeywell Bull S.A., 606 F.2d 5 (2d Cir. 1979); *Bersch*, 519 F.2d at 974; Schoenbaum v. Firstbrook 405 F.2d 200 (2d Cir. 1968) (similar action brought by an American national); *see also* IIT v. Vencap, Ltd., 519 F.2d 1001, 1016-17 (2d Cir. 1975) (the court found that American ownership of one-half of one percent of a company defrauded by foreign defendants was too insignificant to justify extraterritorial application of 10b-5); *see also* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 416 (1986).

50. *See* Comment, *supra* note 1, at 380. The Second Circuit has been less reluctant to apply United States law in cases involving a United States plaintiff even when the fraud was not the direct result of substantial misrepresentations made in the United States. *Compare Bersch*, 519 F.2d at 974 (foreign plaintiff) *with* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972) (American plaintiff). Other courts have made no distinction between foreign and American plaintiffs and have found any domestic activity that significantly furthers a fraud to be basis for the extraterritorial application of United States securities law. *See, e.g.*, Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409 (8th Cir. 1979); SEC v. Kasser, 548 F.2d 109 (3d Cir. 1977). *But see* Zoelsch v. Arthur Andersen & Co., 824 F.2d 27 (D.C. Cir. 1987) (criticizing *Kasser* and *Continental Grain* and requiring that both foreign and domestic plaintiffs demonstrate that the alleged

law to a few instances of conduct having an inascribable impact on the United States markets, the conduct doctrine does not provide any control over those transactions that do not involve substantial representations in the United States, but that may have a tremendous impact on the stability of United States markets.

B. Evidential Problems

Even when permitted by the doctrines of territoriality and nationality, the application of United States law is often occluded by foreign laws designed to prevent the public disclosure of private financial information.[51] These laws permit foreign and domestic nationals to fraudulently buy or sell American securities through foreign intermediaries and avoid conviction under United States securities laws by foreclosing judicial access to critical evidence.[52] Specific agreements notwithstanding, American courts are powerless to compel the cooperation of the Japanese government in efforts to investigate illegal trading activity by foreigners in American markets.

1. Bilateral Agreements

While multilateral agreements designed to create diplomatic exceptions to secrecy laws would best enhance each nation's ability to obtain the information necessary to police its markets, enforcement has been limited to bilateral agreements and unilateral enforcement.[53] The most effective means of acquiring information has been through bilateral agreements, most often in the form of Memoranda of Understanding ("MOU") between the United States Securities and Exchange Commission ("SEC") and similar agencies of foreign governments.[54] Most MOU facilitate the exchange of information necessary for the prosecution of insider trading by establishing detailed procedures for processing requests

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conduct in the United States was the direct cause of harm to the plaintiffs).

51. *See* Begin, *A Proposed Blueprint for Achieving Cooperation in Policing Transborder Securities Fraud*, 27 VA. J. INT'L L. 65, 68 (1986). These include blocking statutes as well as bank secrecy laws. The statutes impose penalties on institutions and individuals that disclose the information, but fail to protect them from the penalties imposed by United States courts as the result of their failure to provide the requested information. *See id.*

52. *See id.*

53. *See id.* at 94-95.

54. *See id.* at 69; *Memorandum of the Securities and Exchange Commission in Support of the International Securities Enforcement Cooperation Act of 1988*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,240 (June 3, 1988) [hereinafter *Memorandum in Support*].

for information[55] and providing for unilateral enforcement[56] should either party to the agreement fail to process certain requests.[57]

MOU are less abrasive on foreign sovereignty than strict unilateral enforcement,[58] but are not without some disadvantages, including the drain of protracted negotiations on the Commission's limited enforcement resources[59] and the inconsistencies among agreements.[60] These inconsistencies weaken imbricated agreements by allowing insiders to avoid United States law by trading through an intermediary in a country whose laws are more permissive of insider trading and whose agreement with the United States restricts the SEC's access to the information needed to prosecute for violations of United States law.[61] MOU are also limited to the extent that foreign governments are willing to waive their secrecy laws.[62] To mollify foreign governments and secure more relaxed informational barriers, Congress recently considered legislation that would have expanded the SEC's authority to protect the confidentiality of foreign evidence, investigate alleged violations of foreign law in United States territory, penalize securities professionals

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55. *See* Pitt, Hardison & Shapiro, *Problems of Enforcement in the Multinational Securities Market*, 9 U. PA. J. INT'L BUS. L., 375, 435 (1987); *Memorandum in Support*, *supra* note 54.

56. *See infra* notes at 78-81 and accompanying text.

57. *See* Pitt, Hardison & Shapiro, *supra* note 55, at 435.

58. *See id.* at 435; *Memorandum in Support*, *supra* note 54.

59. *See* Begin, *supra* note 51, at 75.

60. *See id.* at 76.

61. *See id.*

62. *See* Comment, *supra* note 1, at 680. The SEC's ability to prosecute insider trading involving securities purchased with funds from Swiss banks was once limited by Swiss secrecy statutes and a 1977 treaty providing for the assistance of Swiss process only where the suspected activity involves a possible violation of Swiss Law. *See* Treaty on Mutual Assistance in Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.A.I.S. No. 8302. Since insider trading was not a violation of Swiss law, *see* Memorandum of Understanding to Establish Mutually Acceptable Means for Improving International Enforcement Cooperation in the Field of Insider Trading, Aug. 31, 1982, *reprinted in* 22 I.L.M. 1 (1983) [hereinafter Swiss MOU], the Swiss MOU was necessary only because insider trading fell outside the criminality requirement of the Treaty on Mutual Assistance. *See, e.g.*, 22 I.L.M. 785-98; *see also* SEC v. Certain Unknown Purchasers of Santa Fe Stock and Stock Options, Exchange Act Release No. 21,186 [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,648 (July 30, 1984). The agreement was appreciably strengthened only as the result of a private agreement between the SEC and the Swiss Banker's Association in which the bankers agreed to comply with requests for information regarding mergers and acquisitions that met certain requirements, including evaluation by an independent Swiss board of inquiry. *See* Agreement XVI, *reprinted in* 22 I.L.M. 7 (1983). When the Swiss prohibited insider trading, the Treaty became applicable and the MOU expired. *See Problems with the SEC's Enforcement of U.S. Securities Laws in Cases Involving Suspicious Trades Originating From Abroad*, H.R. REP. No. 1065, 100th Cong., 2d Sess. 22-3 (1988) [hereinafter H.R. REP. No. 1065].

based on the findings of foreign authorities, and provide foreign authorities with access to SEC records.[63] Of the four proposals initially contemplated, the only one adopted expanded the SEC's authority to assist foreign governments in the investigation of violations of foreign securities law.[64]

The United States-Japan Memorandum on the Sharing of Information,[65] prompted by the mutual expectation that the "interaction of American and Japanese markets will continue to grow,"[66] is a vague agreement between the SEC and Japan's Ministry of Finance to "facilitate each agency's respective requests for surveillance and investigatory information on a case-by-case basis."[67] The agreement provides each agency with a contact in the other country,[68] but unlike the former Swiss MOU[69] or the British MOU,[70] provides no procedure for the handling of requests for information. It is also limited by the Japanese government's "low priority for pursuing insider trading violations in [its] own exchanges."[71] In re-

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63. *See* H.R. REP. No. 4945, 100th Cong., 2d Sess. (1988); *Memorandum in Support*, *supra* note 54.

64. *See* 15 U.S.C. § 78u(a) (1982), *as amended by* Insider Trading and Securities Fraud Enforcement Act of 1988 § 6(b), Pub. L. No. 100-704, 1989 U.S. CODE CONG. & ADMIN. NEWS (102 Stat.) 4677, 4681-82.

> On request from a foreign securities authority, the Commission may provide assistance in accordance with this paragraph if the requesting authority states that the requesting authority is conducting an investigation which it deems necessary to determine whether any person has violated, is violating, or is about to violate any laws or rules relating to security matters that the requesting authority administers or enforces. The Commission may, in its discretion, conduct such investigation as the Commission deems necessary to collect information and evidence pertinent to the request for assistance. Such assistance may be provided without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States. In deciding whether to provide such assistance, the Commission shall consider whether (A) the requesting authority has agreed to provide reciprocal assistance in securities matters to the Commission; and (B) compliance with the request would prejudice the public interest of the United States.

Id. at 4681-82; *See* H.R. No. 910, 100th Cong., 2d Sess. 28-31, *reprinted in* 1989 U.S. CODE CONG. & ADMIN. NEWS (102 Stat.) 6065-68.

65. Memorandum on the Sharing of Information, May 23, 1986, United States-Japan, *reprinted in* 25 I.L.M. 1429 [hereinafter Japanese MOU].

66. *Id.* This prediction has proven very accurate. *See Ruder, Japanese Agree to Facilitate Greater Cooperation Among Exchanges*, [Jan.-June] Sec. Reg. & L. Rep. (BNA) No. 8, at 292 (Feb. 26, 1988) [hereinafter *Cooperation*].

67. Japanese MOU, *supra* note 65, at 1429-30.

68. *Id.* at 1429-30.

69. *See* Swiss MOU, *supra* note 62, at 1.

70. *See* Memorandum of Understanding on Exchange of Information in Matters Relating to Securities and Futures, Sept. 23, 1986, United Kingdom-United States, *reprinted in* 25 I.L.M. 1431.

71. H.R. REP. No. 1065, *supra* note 62, at 23-4 (1988) (citing the testimony of Sandra N.

sponse to these weaknesses,[72] the SEC has pressured the Japanese government for stronger insider trading laws[73] and has met regularly with officials from the Ministry of Finance.[74] Although these meetings facilitated the control of the interactions between the two markets,[75] the SEC's ability to protect domestic markets against insider trading through Japanese intermediaries is not significantly enhanced by the Japanese MOU because of the significant weaknesses of Japan's insider trading regulations.[76]

2. *Unilateral Enforcement*

The SEC has often extracted information for prosecution through the unilateral enforcement of United States securities laws. Courts may impose contempt sanctions on foreign institutions and individuals that refuse to surrender financial records[77] after balancing the injury to interests of the United States caused by the refusal and the injury to the interests of the foreign state caused by the disclosure based on the the importance of the information to be disclosed, the specificity of the request, the origin of the information, and the existence of alternate means to secure the information.[78] Efforts to compel disclosure are time consuming and expensive, and, although "viewed by foreign countries as infringing on their sovereignty, . . . achieve[] little in a long term solution to international enforcement problems."[79] Recent efforts to expand the unilateral jurisdiction of courts failed largely because they are too great a burden on foreign sovereignty and too likely to deter

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Hurd, Associate Professor of Law and Public Policy at Syracuse University).

72. *See* Hurd Interview, *supra* note 30. The vague language of the MOU allows the Japanese government to be flexible in how it chooses to respond to SEC requests, but gives it the opportunity to refuse a request outright. *See id.*

73. Sanger, *Insider Trading, the Japanese Way*, N.Y. Times, Aug. 10, 1988, at D1, col. 1.

74. *See, e.g., SEC, Japanese Officials Meet, Reaffirm "Cooperative Relationship"*, [Jan.-June] 21 Sec. Reg. & L. Rep. (BNA) No. 3, at 128 (Jan. 20, 1989).

75. *See id.* The two agencies recently agreed to promote greater cooperation between Japanese and American self-regulatory organizations, *see Cooperation*, *supra* note 66, at 292, and created a task force "to ensure the coordination of market oversight and enforcement of both United States and Japanese securities laws . . . ." *Id.*

76. *See* H.R. Rep. No. 1065, *supra* note 62, at 24.

77. *See* Restatement (Third) of the Foreign Relations Law of the United States § 442(1)(b) (1986); Begin, *supra* note 51, at 84.

78. *See* Restatement (Third) of the Foreign Relations Law of the United States § 442(1)(c) (1986).

79. SEC v. Banca della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981); *see* Begin, *supra* note 51, at 76.

foreign investment in United States markets.[80]

III. Insider Trading Regulation in Japan

Incidental to the limitations imposed by international law, the protection of American markets against the effect of Japanese insider trading is entirely dependent on Japanese securities regulations, which were modeled after the American system of regulation after World War II and continue to bear the characteristics of their American origin.[81] In spite of the similarities between American and Japanese insider trading regulation, each is applied very differently.[82]

Unlike their American counterparts, Japanese market regulators have avoided aggressive enforcement of insider trading laws, preferring instead to use more informal measures, including private "warnings," administrative "guidance," and market "self-regulation."[83] The Japanese laws are unenforced because their Ameri-

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80. *See* Begin, *supra* note 51, at 89-90 (citing letters commenting on the legislation that would hold those who engage in the act or conduct of trading securities in the United States to have waived foreign secrecy laws by the nature of their conduct).

81. *See* Perlmutter, *Developments in the Japanese Securities Markets*, in International Securities Markets, *supra* note 2, at 94; Tsunematsu, Yanese, Yasuda & Takuoka, *Japan*, in International Securities Regulation 63 (R. Rosen ed. 1986); J. Scott, Capitalist Property and Financial Power 164 (1986); M. Tatsuta, Securities Regulation in Japan 10 (1970). The original Securities Exchange Law passed by the Diet, Japan's national legislature, in 1947 included many features common to Japanese regulation, including the licensing of broker-dealers. *See* M. Tatsuta, Securities Regulation in Japan 10 (1970). Unlike the Securities and Exchange Commission, the regulatory body created by the Act served only an advisory function and had no rule-making or administrative authority. *See id.* The Occupation forces advised amendments to the Act before it would permit reopening of the exchanges, and in 1948 the Diet approved a new law which copied "almost verbatim [the] main provisions from the Securities [Exchange] Act of 1934 of the United States." *Id.*

The Minister of Finance, who is appointed by the Prime Minister, bears responsibility for enforcing Japanese securities law. *See* Tatsuta, *Japan*, in 10A International Capital Markets and Securities Regulation § 11.02 (H. Bloomenthal ed. 1980). Like the SEC, the Securities Bureau, which is one of seven bureaus in the Ministry, is charged with conducting investigations designed to uncover violations of the securities laws and, although it has less rule-making authority than its American contemporary, *see id.*, it has significant influence over the drafting of new securities legislation. *See infra* note 224 and accompanying text.

82. *See* Tatsuta, *Proxy Regulation, Tender Offers & Insider Trading*, in Japanese Securities Regulation 192 (1983). No more than one case involving insider trading case has ever been subject to an administrative or judicial proceeding in Japan, *id.* at 192; Sanger, *supra* note 73, at D1, col. 1.; Zoglin, *supra* note 20, at 420, even though insider trading is pervasive. *See* Perlmutter, *Developments in the Japanese Securities Markets*, in International Securities Markets, *supra* note 2, at 94; Schoenburger, *supra* note 25, at 38, col. 1. Insider trading in the United States, however, has been the source of much litigation and subject of intense public and Congressional attention. *See also infra* notes 91, 94.

83. *See* Perlmutter, *Developments in the Japanese Securities Markets*, in International Securities Markets, *supra* note 2, at 94. For a description of these informal con-

can origin is inconsonant with the structure of Japanese government, which permits the bureaucracy to control social change,[84] and because they erroneously presuppose the same historical events that prompted the United States to adopt the regulations on which they are based.[85] The effect of each demonstrates the futility of uniform law as a method of eliminating the unique risks of a global securities market[86] and exposes the recent amendments to Japanese law as incapable of controlling insider trading in Japan.

A. Formal Controls: Structural Dissimilarities

1. General Anti-Fraud: Article 58

Prior to the passage of new legislation in 1988, the centerpiece of Japanese insider trading legislation was Article 58 of the Securities Exchange Law:

> No person shall commit an act set forth in the following Items: (1) [t]o employ any fraudulent device, scheme or artifice with respect to buying, selling or other transactions of securities . . . (2) [t]o obtain money or other property by using documents or by any representation which contain an untrue statement of a material fact or any omission to state a material fact necessary to make the statements therein not misleading . . . [or] (3) [t]o make use of false quotation for the purpose to solicit buying selling or other transactions of securities.[87]

Although the scope of the law is similar to section 17 of the

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trols, *see infra* notes 119-36 and accompanying text.

84. *See* F. UPHAM, LAW AND SOCIAL CHANGE IN POSTWAR JAPAN (1987). The Diet's first Securities Exchange Law is evidence that social change is largely controlled by a system of "bureaucratic informality." Systems of informal guidance and mediation are symptoms of a government that is controlled by the bureaucracy interested in preserving its power from control by the judiciary or legislature. *See id.; see also infra* notes 196-215 and accompanying text.

85. *See* F. UPHAM, *supra* note 84. Japan's regulation came not as the result of depression brought about by market abuses, but as the result of losing World War II. Japan endured a brief market crash in 1964, but it was the exclusive result of the Interest Equalization Tax imposed on American investors. *See* Rudnitsky, Sloan & Fuhrman, *supra* note 12, at 143. Insider trading has always been more acceptable in socially-ordered Japan than in the fairness-minded United States. *See infra* text and accompanying notes 125-44.

86. *See* Gruson, *supra* note 1, at 306-7 & n.6 (quoting KUBLER, REGULATORY PROBLEMS IN INTERNATIONALIZING TRADING MARKETS 10 (1985)).

87. Securities Exchange Law art. 58 (translation provided by the Ministry of Finance in New York); *cf.* Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.10; Tsunematsu, Yanese, Yasuda & Takuoka, *Japan*, in INTERNATIONAL SECURITIES REGULATION, *supra* note 81, at 62.

Securities Act of 1933 and section 10(b) of the Securities Exchange Act of 1934,[88] the laws differ significantly in the way that they are applied. Although American courts have fashioned a unsettled definition of insider trading,[89] the lack of judicial interpretation in Japan[90] has spurred critics to argue that Article 58 is too broad.[91]

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88. *See* Zoglin, *supra* note 20, at 420; Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.10. Specifically, Rule 10b-5 is worded similarly:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange (1) to employ any device, scheme, or artifice to defraud, (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading, or (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1988). Securities Exchange Law art. 58 does not mention interstate commerce, because Japan's system of government is unitary; all authority is vested in the national government and local government does not have any power, unless expressly delegated to it by the Diet.

89. *See* Dirks v. SEC, 463 U.S. 646 (1983); Chiarella v. United States, 445 U.S. 222 (1980). Courts in the United States have succeeded in fashioning a mutable definition of insider trading through frequent interpretations of Rule 10b-5, which, by the first time it was interpreted by the Supreme Court, was already one of "the most litigated provisions in the federal securities laws." SEC v. National Securities, Inc., 393 U.S. 453, 465 (1969). The rule was initially applied to a wide variety of fraud cases, *see, e.g.*, Superintendent of Insurance of New York v. Bankers Life & Casualty Co., 404 U.S. 6 (1971), but as a result of disagreement between Justice White, who thought a narrow application of the law justified by its limited purpose of ensuring "full and fair disclosure" and the existence of state remedies, Santa Fe Industries v. Green, 430 U.S. 462, 477-79 (1976), and Justice Marshall, who gave more credence to the "broad anti-fraud purposes of the . . . rule," *National Securities*, 393 U.S. at 467, the rule was construed to apply only to fraud involving "deception, [or the] misrepresentation or nondisclosure" of a material fact. *Santa Fe*, 430 U.S. at 476. The courts further defined insider trading by limiting the definition of insider. The Court, while not expressly adopting the definition, considered an insider to be any person possessing material inside information and who, by reason of a his or her position as a director, officer, fiduciary, constructive insider or tippee, is under an affirmative duty to disclose the information or refrain from trading. *See Chiarella*, 445 U.S. at 235-36 (rejecting a cause of action based on mere possession of inside information); *see also Dirks*, 463 U.S. at 646 (no tippee liability when the tipper receives no personal gain).

In his dissent, Chief Justice Burger argued that the duty arises from possession of knowingly misappropriated information. *See Chiarella*, 445 U.S. at 240 (Burger, C.J., dissenting). Although the Court has yet to completely embrace it, Burger's definition has been used more often than the one briefly considered in Powell's majority opinion. *See, e.g.*, United States v. Newman, 664 F.2d 12, 17 (2d Cir. 1981), *aff'd on remand*, 772 F.2d 729 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983); United States v. Carpenter, 791 F.2d 1024, 1029, *aff'd*, 108 S. Ct. 316 (1987) (the court was evenly divided on the appeal of the conviction under Rule 10b-5). *See also* H.R. REP. No. 910, 100th Cong., 2d Sess. 10, *reprinted in* 1989 U.S. CODE CONG. & ADMIN. NEWS 6043, 6047 (commending the use of Burger's misappropriation theory in *Carpenter*).

90. The only insight into the meaning of trading is the ordinance, which prohibits com-

Unlike section 10(b) of the Securities Exchange Act and Rule 10b-5,[92] Article 58 does not permit an implied cause of action.[93]

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panies, their directors and employees, from buying or selling securities based upon confidential information obtained by reason of their business. *See* Zoglin, *supra* note 20, at 420. The ordinance was issued under the authority of Article 50 of the Securities Exchange Law. *See id.*

91. *See* Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.10; M. TATSUTA, SECURITIES REGULATION IN JAPAN 10 (1970). "Theoretically speaking, Article 58, notwithstanding its location, has a broad range of application because of the phrases 'any person' and 'any other transaction.' " Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.10. *See* Sanger, *supra* note 73, at D1, col. 1 (discussing the inadequate definition of "insider" under Article 58). The law approved last year provides a more thorough definition of insider trading. *See id.;* Securities Exchange Law arts. 190-2, 190-3 (T. Shaw & Y. Shaw trans. 1989); *see also infra* notes 227-39.

92. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). Unlike Article 58, Rule 10b-5 is self-enforcing; the plaintiff need not argue that his or her injury is the result of a tort or breach of contract involving the violation of Rule 10b-5. *See id.* at 730. The inefficacy of state tort law in cases involving securities fraud is thought to be one of the major reasons for the courts' willingness to imply a private cause of action. *See* R. HAMILTON, CORPORATIONS 879 (3d ed. 1986).

The first case to construe Rule 10b-5 as including an implied cause of action held that "although not expressly provided for in [Section 10(b) of the Securities Exchange Act of 1934], a remedy by civil action to enforce such duties and liabilities [created by the Act] was available to plaintiffs." Kardon v. National Gypsum Co., 73 F. Supp. 798, 800 (E.D. Pa. 1947). Individual standing under Rule 10b-5 was quickly adopted in the lower courts and was eventually accepted by the Supreme Court "with virtually no discussion [of] the overwhelming consensus. . . ." *Blue Chip Stamps*, 421 U.S. at 730 (citing Superintendent of Insurance of New York v. Bankers Life & Casualty, 404 U.S. 6, 13 n.9 (1971); Affiliated Ute Citizens v. United States, 406 U.S. 128, 150-54 (1972)).

In 1952, the Court of Appeals for the Second Circuit restricted the liberal standing conferred by *Kardon* to purchasers and sellers in cases involving "misrepresentation usually associated with the sale or purchase of securities rather than [the] fraudulent misrepresentation of corporate affairs." Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir. 1952). In *Birnbaum*, the court refused to apply the rule because the plaintiffs neither purchased nor sold their shares during the period between the misrepresentation and its eventual disclosure. *See id.* at 508-509. Although some courts advocated a more liberal standard, *see, e.g.*, Eason v. General Motors Acceptance Corp., 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 416 U.S. 960 (1974), the Supreme Court eventually adopted the rule, closing the door on 10b-5 claims by plaintiffs dissuaded from purchasing or selling shares by the misrepresentation or omission, and others who might suffer a loss in the value of their investments as a result of a purchase or sale. *See Blue Chip Stamps*, 421 U.S. at 737-38. The rule was adopted to limit the use of the rule in nuisance suits and facilitate the consideration of proof, *id.* at 741, 744, by limiting "the class of plaintiffs to those who have at least dealt in the security to which the . . . representation or omission relates." *Id.* at 751. The rule does not "limit the standing of the SEC to bring actions for injunctive relief . . . ." *Id.* For a more enlightened discussion of implied causes of action under Rule 10b-5, *see* Ashford, *Implied Causes of Action Under Federal Laws: Calling the Court Back to* Borak, 79 NW. U.L. REV. 227 (1984).

93. *See* Tsunematsu, Yanese, Yasuda & Takuoka, *Japan*, in INTERNATIONAL SECURITIES REGULATION, *supra* note 81, at 63; Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.12.

Persons victimized by violations of Article 58 may seek an injunction from the court on application to the Ministry of Finance and may seek civil remedies "based on general civil liability provisions relating to torts and contracts [and] contained in the Civil Code and Commercial Code."[94] To recover damages under the Civil Code, a plaintiff must establish that the defendant acted illegally and did so willfully, and that this action was the cause of the plaintiff's injury.[95] The stigma attached to the use of litigation[96] and the difficulty of proving injury and causation in cases involving securities traded on a public exchange[97] explain the lack of private action under Article 58 and the pervasion of insider trading in Japanese markets.

2. *Market Manipulation: Article 189*

Market manipulation is much more acute in Japan than in the United States because of the extremely thin float in Japan's largest exchanges. Sixty to seventy percent of the outstanding shares on the Tokyo Stock Exchange are held by companies in long-term reciprocal arrangements to cement trade relationships.[98] The thin float allows Japan's four largest securities firms, whose transactions account for more than fifty percent of the volume on the Tokyo Stock Exchange,[99] to influence an issuer's share price by controlling a small percentage of its outstanding shares.[100]

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94. *See* Tsunematsu, Yanese, Yasuda & Takuoka, *Japan*, in INTERNATIONAL SECURITIES REGULATION, *supra* note 81, at 63; Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.14; *see also* MINPŌ [Civil Code] arts. 96, 709; SHŌHŌ [Commercial Code] art. 266-3, ¶ 2.

95. *See* Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.12.

96. *See infra* note 141 and accompanying text.

97. *See* Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.14. Violations of Article 58 were not subject to criminal penalties, but violations of Rule 10b-5 are substantial. *Compare* Zoglin, *supra* note 20, at 420 *and* Securities Exchange Law art. 200 (T. Shaw & Y. Shaw trans. 1989) *with* 15 U.S.C. § 78ff(a) (Supp. IV 1986), *as amended by* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 1989 U.S. CODE CONG. & ADMIN. NEWS (102 Stat.) 4677, 4678. A person who willingly violates Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 "shall upon conviction be fined not more than $1,000,000 or imprisoned not more than ten years or both, except that when such person is a person other than a natural person, a fine not exceeding $2,500,000 may be imposed. . . ." 15 U.S.C. § 78f(a) (Supp. IV 1986), *amended by* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 1989 U.S. CODE CONG. & ADMIN. NEWS (102 Stat.) 4677, 4678.

98. *See* Perlmutter, *Developments in the Japanese Securities Markets*, in INTERNATIONAL SECURITIES MARKETS, *supra* note 2, at 93.

99. *See id.* The four largest firms are Nomura, Daiwa, Nikko and Yamaichi. *See id.*

100. *See id.* at 93. The extent of Japanese institutional investment in the securities

Market manipulation is regulated in the same manner that it is controlled in the United States.[101] Securities Exchange Law Article 189 requires directors, officers and ten percent shareholders to disgorge profits resulting from a purchase and sale occurring within a six month period.[102] Like section 16(b) of the Securities Exchange Act of 1934, the provision does not apply to a shareholder who is neither an officer nor a director and holds less than ten percent at the time of sale or at the time of purchase.[103]

The law was weakened, however, by the repeal of Article 188 in 1953, which like section 16(a), required insiders to report changes in their holdings to the Ministry of Finance.[104] Market regulators were unable to prevent market manipulation because they could no longer monitor trades by corporate insiders.[105] Not surprisingly, one element of the Diet's response to the Recruit scandal was the reenactment of a significant portion of Article 188.

B. Informal Controls

1. Market Exchanges

Limited control of Japanese markets has been achieved through administrative guidance and the threat implicit in the Ministry's ability to revoke or suspend the licenses required of all securities companies[106] and the exchanges to which they belong. The Ministry of Finance issues licenses to securities firms on the condition that they continue to meet abstract criteria.[107] The crite-

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markets is in sharp contrast to the extent of Japanese individual investment. *See* M. TATSUTA, SECURITIES REGULATION IN JAPAN 2 (1970). Savings deposits account for more than 44% of individual pecuniary assets, while investment in securities is less than 16%. *See id.*

101. *Cf.* Securities Exchange Act of 1934, § 16(b), 15 U.S.C. § 78p(b)(1982).

102. *See* Securities Exchange Law art. 189; Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.13.

103. *See* Securities Exchange Law art. 189; Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.13.

104. *See* Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.13; Tatsuta, *Proxy Regulation, Tender Offers & Insider Trading*, in JAPANESE SECURITIES REGULATION, *supra* note 82, at 194. The Article was repealed because it did not require disclosure by beneficial owners and invited insiders to trade in shares using the names of other persons. *See* Tatsuta, *Proxy Regulation, Tender Offers & Insider Trading*, in JAPANESE SECURITIES REGULATION, *supra* note 82, at 194.

105. *See* Zoglin, *supra* note 20, at 420. To combat market manipulation, the Ministry was forced to consume resources that would have been used to combat insider trading under Article 58. *See id.* at 421-22.

106. *See* M. TATSUTA, SECURITIES REGULATION IN JAPAN 84 (1970); Securities Exchange Law art. 35. A firm which does not possess a license is barred from membership in any exchange. *See* M. TATSUTA, SECURITIES REGULATION IN JAPAN 84 (1970).

107. *See* M. TATSUTA, SECURITIES REGULATION IN JAPAN 71 (1970). The criteria include

ria give the Ministry broad discretion to revoke or suspend a licenses if the licensee violates the law, an administrative order pursuant to the law, or any other qualification attached to the license.[108]

The Ministry can also influence market behavior through the licensing requirements established for securities exchanges.[109] The Ministry must approve the original version and any subsequent alteration[110] of the exchange's constitution, business regulations and entrustment contract.[111] The Ministry retains the power to revoke or suspend an exchange license[112] and may order an exchange to change its operation.[113] The Ministry of Finance is empowered to revoke or suspend the license of any exchange or order the dismissal of any of its officers for failure to discipline any member that has violated securities laws, regulations, or exchange rules.[114]

While the efficacy of administrative guidance enforced by the implicit threat of the revocation should not be underestimated, the Ministry's ability to sanction firms that defy its guidance is limited by the impracticality of revokation and suspension and the need for more flexible penalties. While informal regulation is capable of controlling complex markets, any system which lacks enforceable sanctions is likely to be ineffective as the number of market participants increases.[115] The Ministry's inability to enforce securities

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assurances that the applicant has (1) sufficient financial ability to carry out its proposed business, (2) sufficient knowledge and experience to carry out its business fairly and adequately and has good social standing, and (3) services that are necessary and appropriate in light of the economic circumstances. *See id.* at 70. The last criterion should be read "to prevent excessive competition among securities companies." *Id.* at 70.

108. *See id.* at 71.

109. *See* Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.02. Exchanges can not be incorporated if they do not possess a license granted by the Ministry of Finance. *See id.*

110. *Id.; see* Securities Exchange Law arts. 82 ¶ 2, 85-1 ¶ 3.

111. *See* M. TATSUTA, SECURITIES REGULATION IN JAPAN 83-84 (1970). The exchange's constitution must provide for the discipline of its members, by means of expulsion, suspension, or the imposition of fines, for conduct inconsistent with just and equitable principles of trade or which is a violation of securities laws, administrative orders, or the rules of the exchange. *See id.* at 83; Securities Exchange Law art. 98.

112. *See* M. TATSUTA, SECURITIES REGULATION IN JAPAN 83-84 (1970); *see* Securities Exchange Law art. 155.

113. *See* Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.02; Securities Exchange Law art. 156.

114. *See* Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.02; Securities Exchange Law art. 155.

115. *See* Bornstein & Dugger, *International Regulation of Insider Trading*, 1987 COLUM. BUS. L. REV. 375, 378.

laws in the public interest[116] is evidence that the Japanese market, now one of the largest in the world, has outgrown the usefulness of administrative guidance.

2. *Over-the-Counter Markets*

Notwithstanding its tremendous growth, the Japanese over-the-counter ("OTC") market is very small by American standards.[117] The market is supervised by members of the Japan Federation of Securities Firm Associations.[118] Its regulatory authority is less comprehensive than that exercised by the National Association of Securities Dealers ("NASD") in the United States[119] in part because firms trading in the OTC market are not required to be members.

The Ministry of Finance, which supervises associations in much the same way it supervises the exchanges, requires each member association to register its constitution, Rules of Fair Practice, a Uniform Practice Code, and resolutions of its board of directors.[120] Although associations have never sought to expel a member on their own initiative, they have not hesitated to expel members whose licenses have been revoked by the Ministry or whose membership in an exchange has been terminated.[121]

IV. Reasons for the Failure of Insider Trading Regulation

Before the likely consequences of the Diet's newest proscriptions against insider trading can be fully understood, consideration

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116. *See* S. Sethi, Japanese Business and Social Conflict 118 (1975). In the only insider trading case to date, government prosecutors had enough evidence in 1973 to indict three of the four largest brokerage firms for alleged manipulation of the stock of Kyodo Shiryo Co, a leading food producer, but were dissuaded by the Ministry of Finance because the executives of the brokerage firms involved promised to stop all manipulative practices. *See id.* The case was finally concluded in July 1988, and resulted in suspended sentences and $3,200 fine for two Kyodo Shiryo executives and four brokers from Diawa and Nikko Securities. *See* Sanger, *supra* note 73.

117. *See* Perlmutter, *Developments in the Japanese Securities Markets*, in International Securities Markets, *supra* note 2, at 95. One hundred forty stocks are traded in Japan's over-the-counter market, but more than five thousand are traded in the American over-the-counter market. *See id.*

118. *See id.*

119. *See* M. Tatsuta, Securities Regulation in Japan 78-79 (1970). This may be because the associations function more as interest groups representing the securities industry than professional organizations legitimately concerned with self-regulation. *See id.* at 80.

120. *See id.*; Tatsuta, *Japan*, in 10A International Capital Markets and Securities Regulation, *supra* note 81, § 11.02; Securities Exchange Law arts. 67-78.

121. *See* M. Tatsuta, Securities Regulation in Japan 80 (1970).

must be given to the weaknesses that explain the government's inability to effectively enforce existing regulation. The failure is largely the result of three features unique to the Japanese political and economic system. First, the existing laws, which are largely the product of American experience, are insensitive to Japan's traditional tolerance of insider trading and unique distaste for litigation. Second, the historical development of Japanese business has produced a network of tight business relationships inimical to effective regulation. Finally, the bureaucracy's interest in preserving its broad control over social change has forced it to abandon all but the most informal means of controlling insider trading.

A. Tolerance and Social Relativism

A frequent justification for the failure of insider trading regulation in Japan is that it was drafted by the occupation forces at the end of World War II and embraces American concepts of individuality and unfettered competition, which are an anathema in a society built on social relativism and cooperation.[122] This tension limits the government's ability to control insider trading within the unique and traditional structure of Japanese business, which makes inside information very accessible, or within a society whose tolerance of insider trading eliminates the risk of using it.

Japanese business and legal philosophy place the goals of harmony and cooperation above all others[123] and much of Japanese behavior is structured to avoid conflict. This philosophy is manifest in the unmitigated significance of seniority[124] in individual advancement in government[125] and business,[126] and the practice of

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122. *See* F. UPHAM, *supra* note 84; T. LEBRA, JAPANESE PATTERNS OF BEHAVIOR (1976). For example, much of American securities litigation is brought under private causes of action, a means that is encouraged by a dominant sense of individualism and private rights, but which would be unworkable in a society in which individualism is discouraged. *See supra* text accompanying notes 61, 63.

123. B. DEMENTE, JAPANESE ETIQUETTE & ETHICS IN BUSINESS 37 (5th ed. 1987). The concept is called *wa*, and is roughly translated as "peace and harmony." *Id.* at 36.

124. *See id.* This relationship is best defined by the terms *sempai*, meaning "senior," and *kohai*, meaning "junior." *Id.* The basis for the *sempai-kohai* relationship is based on a number of factors, which include schools attended, year of graduation, educational level achieved, location of experience, company worked for, time with the company, and its size and significance, among others. *See id.* This relationship has more significance in Japanese business relationships than in American business relationships. *See id.*

125. *See* C. YANAGA, BIG BUSINESS IN JAPANESE POLITICS 10 (1968).

126. *See id.* at 24-25. More emphasis is placed on seniority than on talent or accomplishment when entertaining candidates for advancement to new bureaucratic posts or to new positions in Japanese business. *See id.*; *see also infra* note 224 and accompanying text.

masking truths that would embarrass another or oneself.[127] Such behavior would not only compromise harmony but would embarrass the individuals involved.[128]

Another manifestation is the significance of group-minded behavior, which emphasizes the functions and the goals of the group and minimizes the experience, qualifications, and responsibilities of the individual.[129] This type of behavior is most common in Japanese business[130] and is responsible for the Western perception that all Japanese industry functions as a single economic unit.[131] With the exception of a few isolated circumstances,[132] the Japanese have maintained the traditional sanctions against competitive behavior and continue "to promote the concept and practice of group action and team spirit."[133] The greatest dishonor is to bring dishonor

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This may explain the conduct of Recruit president Ezoe, which may have been designed to win the recognition of Japan's business and political elite for his firm, which, despite its phenomenal success, was young and operated in a business that was not widely respected. *See supra* note 16.

127. *See* C. YANAGA, *supra* note 125, at 20.

128. *See id.* "It is a serious breach of etiquette in Japan to criticize someone . . . or to disagree . . . in public, or to be right when [another] is in error." *Id.* at 107; *see* T. LEBRA, *supra* note 122, at 42.

129. B. DEMENTE, *supra* note 123, at 35; *see* T. LEBRA, *supra* note 122, at 25.

130. "The company is the community, and home is just where [the employees] sleep." B. DEMENTE, *supra* note 123 at 9 (quoting Yamamoto).

131. *See* Spencer, *Japan: Stimulus or Scapegoat*, 62 FOREIGN AFF. 123, 128 (1983).

132. *See* B. DEMENTE, *supra* note 123, at 56. These circumstances include, but are not limited to, competition in school, in sports, and to some extent, between rival groups. *See id.* The traditional attitudes toward cooperation has gradually eroded antitrust law in Japan, and resulted in most Japanese companies having an allegiance to one of several loosely organized enterprise groups, or *kigyoshudan. See infra*, note 190 and accompanying text. Competition between these groups, and among unaffiliated companies, is very intense, "often going beyond what Western businessmen consider rational behavior." B. DEMENTE, *supra* note 123, at 62.

Mr. Ezoe's behavior is more understandable in light of the intense competition among companies that are not members of the group and the disadvantages that he suffered as a result of not being an executive in one of the affiliated companies. Success largely depends upon getting into the right group. B. DEMENTE, *supra* note 123, at 28. "Since both the grouping and advancement-by-seniority systems put everything on a personal basis," personal relationships among executives are extremely important. *Id.* at 30. "One company will not do business with another until the managers who would be involved . . . have developed personal relations. . . [a] process [that] is prescribed, meticulous, and time consuming." *Id.*; *see* Zoglin, *supra* note 20, at 419; Yoder & Kanabayashi, *supra* note 14, at 11. One way of speeding up the process is through the practice of *o'tsukaimono*, or the exchange of favors, *see* B. DEMENTE, *supra* note 123, at 51, by which stock is offered in exchange for introductions, which can be used to get new business clients. Unlike business introductions in the United States, requests made by business with a proper referral are rarely refused, especially if the introduction is "from a valued friend, superior, or important business contact," for fear of embarrassing the person making the introduction. *Id.* at 46.

133. B. DEMENTE, *supra* note 123, at 56.

upon the group, either by acting dishonorably, or by exposing the dishonorable acts of another inside[134] or outside the group.[135]

Unlike legal systems based on Judeo-Christian foundations, the Japanese system does not view laws as having an absolute value.[136] Instead, the Japanese believe that *ningeusei* is the only absolute[137] and that positive law fails to "bind people by a hundred percent. . . . [B]oth conscious dissention and dictatorial suppression are alien" to the function of law in Japan.[138]

The importance of harmony and the repudiation of legal absolutism explain, in part, the failure of Japanese insider trading regulation. The difficulties engendered by the lack of an independent cause of action are only exacerbated by public hostility to victims seeking judicial remedies, who are thought to violate harmony by resorting to legal conflict.[139] As a result, the Ministry's informal controls remain the only means by which to regulate insider trading.

B. The Kigyoshudan and Modern Japanese Free Enterprise

Another justification for the failure of Japanese insider trading regulation is the importance of cooperation[140] and close relationships among leading corporations and executives[141] in the same enterprise group.[142] The relationships provide an incentive for executives to trade inside information and have made insider trading an acceptable, if not expected, way of doing business.

The unique relationships among Japanese businesses began shortly after the industrial revolution.[143] To foster industrialization, the government took an active role in the economy by estab-

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134. T. LEBRA, *supra* note 122, at 36. The story most often used to illustrate this concept is that of a child whose family was ostracized by the citizens of the town in which they lived because the child wrote a letter to a local newspaper exposing the corruption of a town official. *See id.*

135. *See id.* at 11. The result is that "[t]he Japanese tend to hold everyone involved in a conflict responsible for it." *Id.; see supra* note 104 and accompanying text.

136. T. LEBRA, *supra* note 122, at 11.

137. *See id. Ninensei*, the law of "humanity" is the "law behind law, . . . words behind words [and] reason behind reason. . . ." *Id.*

138. *See id.* at 30 (quoting I. BENDASAN, JAPANESE AND JEWS 81 (1972)).

139. S. SETHI, *supra* note 116, at 107, 113 (describing the difficulties that the victims of industrial pollution encountered in litigation for personal injuries).

140. *See supra* notes 105-12 and accompanying text.

141. *See supra* note 105.

142. *See supra* note 105.

143. *See* T. ADAMS, A FINANCIAL HISTORY OF MODERN JAPAN 10 (1964).

lishing nationalized companies.[144] The companies were eventually sold to families, which supported the state policy of industrialization.[145] The families quickly consolidated their interests into large financial and industrial groups, called *zaibatsu*, which were controlled by family-owned holding companies charged with the responsibility of marketing the group's products and supported by a bank with the requisite capital.[146] The *zaibatsu* grew in size primarily because the lack of efficient stock markets forced new companies seeking capital to align with one of the four large *zaibatsu* or to pool resources to form smaller groups.[147] By World War II, the "Big Four" *zaibatsu* controlled more than twenty-four percent of Japan's paid-in capital.[148]

After World War II, the Allies blamed the *zaibatsu* for Japan's militarization and quickly realized they were incompatable with their plans for economic democratization.[149] General Douglas

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144. *See id.* Industrialization was part of the policy of *fokuku kyohei*, which embodied the imperial government's conscious decision to adopt Western capital techniques to achieve military and economic parity with the West. *See id.* The nationalized companies provided postal, telegraph and railway service, and manufactured ships, armaments, iron, steel, textiles and beer. *See id.*; J. SCOTT, *supra* note 81, at 159.

145. *See* T. ADAMS, *supra* note 143, at 2. The families included Mitsubishi, Mitsui, Sumitomo and Yasuda. *See id.* The sales were accomplished with the help of subsidies and low interest loans. *See id.* at 3.

146. *See* J. SCOTT, *supra* note 81, at 159.

147. *See id.* at 160.

148. *See* C. YANAGA, *supra* note 125, at 38, n.17; T. ADAMS, *supra* note 143, at 171. The *zaibatsu* controlled more than 49% of Japan's financial industry and more than 32% of Japan's heavy industry. T. ADAMS, *supra* note 143, at 171.

149. *See* Basic Initial Post-Surrender Directive, *reprinted in* 2 THE JAPAN READER 79 (1973); T. ADAMS, *supra* note 143, at 166. The terms for Japan's surrender included the elimination of the "authority and influence of those who have deceived and misled the people of Japan into embarking on world conquest," the destruction of Japan's war-making power, the complete disarmament of the Japanese military forces, and the removal of all obstacles to the revival and strengthening of democratic tendencies among the Japanese people. T. ADAMS, *supra* note 143, at 164 (quoting the Potsdam Declaration). "Japan shall be permitted to maintain such industries as will sustain the economy and permit the exaction of just reparations in kind, but not those which would enable her to re-arm for war. To this end, access to, as distinguished from control of, raw materials shall be permitted. Eventual Japanese participation in world trade relations shall be permitted." *Id.* (quoting the Potsdam Declaration).

> Policies shall be favored which permit a wide distribution of income and of the ownership of the means of production and trade. To this end it shall be the policy of the Supreme Commander . . . [t]o prohibit the retention or selection for places of importance in the economic field of individuals who do not direct future Japanese economic effort solely toward peaceful ends . . . and [t]o favor a program for the dissolution of the large industrial and banking combinations which have exercised control of a great part of Japan's trade and industry.

Basic Initial Post-Surrender Directive, *reprinted in* 2 THE JAPAN READER, *supra*, at 79.

MacArthur, encouraged by American ambivalence,[150] ignored protests by the Far Eastern Commission ("FEC")[151] and rebuilt the Japanese economy using a distinctly American pattern.[152]

In October 1945, MacArthur approved the Yasuda Plan,[153] which transferred *zaibatsu* holdings to the Holding Company Liquidation Commission ("HCLC") for liquidation.[154] The Occupation forces also required that fifty-six designated members of the four primary *zaibatsu* families transfer their personal holdings to the HCLC for liquidation,[155] and demanded the resignation of all holding company directors and auditors.[156]

In 1947, inconsistencies in American policy[157] paved the way

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150. *See* T. ADAMS, *supra* note 143, at 165. "Although every effort will be made by consultation and by constitution of appropriate advisory bodies, to establish policies for the conduct of the occupation and the control of Japan which will satisfy the principle Allied powers, in the event of any differences of opinion among them, the policies of the United States will govern." Basic Initial Post-Surrender Directive, *reprinted in* 2 THE JAPAN READER, *supra* note 149, at 8.

151. The FEC was charged with formulating "policies, principles and standards in conformity with which the fulfillment by Japan of its obligations under the Terms of Surrender may be accomplished," T. ADAMS, *supra* note 143, at 164-165, and was empowered to review the directives and activities of MacArthur, who retained administrative authority. *See id.*

152. *See id.* at 165.

153. *See id.* at 169. Ironically the Yasuda *zaibatsu* was the only one of the four groups that failed to reemerge from the dissolution. Livingston, Moore & Oldfather, *Annotation*, in 2 THE JAPAN READER, *supra* note 149, at 79; J. SCOTT, *supra* note 81, at 162. Fuji Bank, the primary bank in the Yasuda *zaibatsu*, nevertheless became the center of a new group shortly after the war. *See* J. SCOTT, *supra* note 81, at 162; *see infra* note 146 and accompanying text. Democratization was ordered even though the bureaucracy and business groups were successful in shifting much of the blame for militarization to the military. Livingston, Moore & Oldfather, *Annotation*, in 2 THE JAPAN READER, *supra* note 149, at 79.

154. *See* T. ADAMS, *supra* note 143, at 170-71; *see* The Yasuda Plan, *reprinted in* 2 THE JAPAN READER, *supra* note 149, at 80. "Of the eighty-three designated holding companies, thirty were completely dissolved and the remaining were effectively stripped of their character as holding companies." T. ADAMS, *supra* note 143, at 170-71. Following democratization, the "Big Four" *zaibatsu* controlled only little more than 10% of Japan's paid-in capital, less than 24% of the financial industry and less than 15% of heavy industry. *See id.* at 171.

155. *See* J. SCOTT, *supra* note 81, at 161. In compensation for the securities surrendered to the HCLC, shareholders were issued non-negotiable government bonds. *See id.* A total of 200 million shares where liquidated through the HCLC. *See* T. ADAMS, *supra* note 143, at 170.

156. *See* T. ADAMS, *supra* note 143, at 169-70.

157. *See id.* In 1947, under the authority of General MacArthur, the Japanese government enacted the Law for the Elimination of Excessive Concentration of Economic Power to abrogate "private monopoly and restraint of trade, . . . interlocking directorates, [and] intercorporate security ownership . . . as will provide equal opportunity to firms and individuals to compete . . . on a democratic basis." *Id.* at 169. The law "prohibited firms, with the exception of financial institutions, from acquiring the stock of other firms; . . . financial institutions with more than five million yen in assets were forbidden from acquiring more than five percent of the stock of any other firm. Interlocking directorates . . . were restricted." *Id.* at 171. Under pressure from Japanese business and as the result of the need

for the reconsolidation of enterprise groups destroyed by democratization during the American Occupation.[158] Although the large *zaibatsu* had been destroyed, Japan's largest financial institutions remained intact and retained much of their equity holdings in old *zaibatsu* corporations.[159] The banks became a catalyst for the reemergence of many of the prewar enterprise groups, now called *kigyoshudan* or *kieretsu*,[160] which retained the names of the *zaibatsu* that they replaced.[161] With the end of the Occupation on September 8, 1951,[162] the government was free to relax the anti-monopoly law[163] and satisfy the interests of businesses eager to join a burgeoning global economy.[164] The revision of the anti-mo-

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for a strong ally in the Pacific, *see* Livingston, Moore & Oldfather, *Annotation*, in 2 THE JAPAN READER, *supra* note 149, at 4, the United States ceded to pressure to limit the application of the regulation to excessive concentration. *See* C. YANAGA, *supra* note 125, at 35. In the end, fewer than 11 of the original 325 firms targeted were ordered split or divested. *See id.* at 36.

158. *See* Letter from Acting Political Advisor Atcheson to President Truman, November 5, 1945, *reprinted in* 2 THE JAPAN READER, *supra* note 149, at 12, 13 (1973).

159. *See* J. SCOTT, *supra* note 81, at 162.

160. *See* S. SETHI, *supra* note 116, at 35-36. The term applied to those groups that reemerged as a result of banking relationships. *See id.* Japanese firms are closely tied to their group banks: "Among the 118 enterprises affiliated to *kigyoshudan*, there were only six in which the group bank was not the primary source of borrowing." J. SCOTT, *supra* note 81, at 186. While they are not as closely tied to their member banks as the member firms of the prewar *zaibatsu*, because of the increased capital demands required by the growth of high technology, *see id.* at 162; T. ADAMS, *supra* note 143, at 257-58, in most of the cases where a second lender was involved, the second lender was the Industrial Bank of Japan, an unaffiliated central bank, and not the bank of a rival group. *See* J. SCOTT, *supra* note 81, at 186.

161. *See* J. SCOTT, *supra* note 81, at 186. The Mitsubishi and Mitsui *zaibatsu* reemerged through a process involving numerous mergers and consolidations after having been broken into nearly 200 successor companies. *See* S. SETHI, *supra* note 116, at 36.

162. Treaty of Peace with Japan, Sept. 8, 1951, 3 U.S.T. 3169, T.I.A.S. No. 2490, 136 U.N.T.S. 45.

163. *See* C. YANAGA, *supra* note 125, at 167. The law was relaxed by exemptions enacted by the Japanese Diet, and indifferent enforcement by the Ministry of International Trade and Industry and the Ministry of Agriculture and Forestry. *See id.* A revision enacted on August 6, 1953, limits the application of the law to "actions that restrain competition in certain transactions in violation of the public interest and actions involving unfair methods of competition [and] permit[s] agreements in the case of necessity, provided they do not run counter to the public interest." *Id.* at 158. The repeal of the Trade Association Law also fostered the reemergence of the *zaibatsu*. *See id.* at 159-61. In spite of weaker antitrust laws, hostile takeovers are rare in Japan because of the stigma of unharmonious behavior. *See* Zoglin, *supra* note 20, at 421; PRICE WATERHOUSE, DOING BUSINESS IN JAPAN 19 (1983). "[T]he impetus for stronger enforcement of insider trading laws, which largely arose in the United States as a result of dramatic market movements preceding public announcement of such activities, has been absent in Japan." Zoglin, *supra* note 20, at 421.

164. *See* C. YANAGA, *supra* note 125, at 139; T. ADAMS, *supra* note 143, at 257. Japan thought the revision of the law necessary to help her compete in international trade and while the law might have served a purpose in the United States, where history and tradition advocated unfettered competition, the law served no purpose in Japan, where public senti-

nopoly law gave legitimacy to the enterprise groups.

The *kigyoshudan* differ from prewar *zaibatsu* in ways which explain the impotency of Japanese insider trading regulation. Like the *zaibatsu*, the postwar *kigyoshudan* consist of a symbiosis of industries, which typically include a bank, trust company, insurance company, real estate brokerage, trade company and heavy industries, that compete intensely with firms outside the group.[165] Unlike *zaibatsu* firms, which were related through family-owned holding companies, the postwar groups are related by a system of horizontal relationships that include interlocking directorates, reciprocal shareholdings, and personal relationships among executives.[166] The reciprocal shareholdings in Japan, unlike the typically vertical relationships among American companies,[167] exist not for the purpose of investment, but to enhance the stability and strength of the group.[168] The largest shareholders in a large Japanese company are the other firms in its group, and they typically control a larger percentage of shares than majority shareholders in American and British companies.[169] Effective control is vested in the group even when no single firm has a dominant interest.[170]

In addition to these groups, economic organizations[171] and social groups also play a significant role in the management of Japanese business. While the purpose of the economic organizations is primarily political, their influence in government is much more sig-

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ment favored consolidation in part due to the prewar prosperity enjoyed as a result of the *zaibatsu*. *See* C. YANAGA, *supra* note 125, at 166-68.

165. *See* C. YANAGA, *supra* note 125, at 38-39.

166. *See id.* at 39-40; J. SCOTT, *supra* note 81, at 162.

167. *See* J. SCOTT, *supra* note 81, at 163. While the predominant intercompany relationships in the United States are vertical, in the form of a parent and a subsidiary, this form of control in Japan is limited to a few groups, including Nissan and Toyota, that share attributes of both horizontal and vertical control. *See id.*

168. *See id.* at 168.

169. *See id.* at 167-68, 178.

170. *See id.* Modernization may erode many obstacles to effective enforcement, but the trend is likely to be more gradual than the growth of Japan's securities markets will permit. *See* T. LEBRA, *supra* note 122, at 257. Among the changes, which could improve the efficacy of insider trading regulation, is an increase in individualism, *see id. But see* S. SETHI, *supra* note 116, at 44-45 (minimizing the probable consequences), and the proliferation of high technology companies that, because of their capital demands and untraditional nature, are not affiliated with any enterprise group. *See* Packard, *The Coming U.S.-Japan Crisis*, 66 FOREIGN AFF. 348, 353 (1987); *see also supra* note 161.

171. *See* S. SETHI, *supra* note 116, at 34. The organizations include the Federation of Economic Organizations, the Japan Federation of Employer's Associations, the Japan Committee for Economic Development, Japan Chamber of Commerce and Industry, and the Japan Industrial Club. *See id.*

nificant than similar organizations in the United States.[172] Even more influential are the social clubs, or *shacho-kai*, which are organized as the ruling bodies of the enterprise groups.[173] Membership in the clubs includes the presidents of the major member enterprises, who meet regularly to set group policy.[174] Each president has the power to vote his company's shares, giving the group effective control over the policy of each individual member corporation. The club is dependent on cooperation between its members to protect the financial interests of its members,[175] who by the nature of their reciprocal shareholdings, are very dependent on one another.

The traditional structure of the Japanese enterprise groups is designed to foster the exchange of inside information among its member firms and their executives, and may be the single greatest contributor to the failure of Japanese insider trading regulation. While the exchange of this information improves access to scarce resources[176] and makes Japan more competitive in world markets,[177] it also provides firms with access to valuable information, which, as the result of the large position that each must take in the shares of other members, can be used to make or save considerable sums of money. Cooperation among member firms not only facilitates but encourages insider trading. The structure is most frightening because the four largest brokerage firms, which are responsible for almost half the total sales in the industry,[178] are themselves members of groups that include companies whose shares they actively trade.[179]

Contributing to the insider trading problem is the failure of the government to enforce the formal and informal mechanisms of control. This may be the result of pervasive influence of business

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172. *See* F. UPHAM, *supra* note 84, at 206-07. *See infra* notes 201-02 and accompanying text.

173. *See* J. SCOTT, *supra* note 81, at 168. Many groups have little to do with the management of the enterprise groups. *See id.*

174. *See id.*

175. *See id.*

176. *See id.* at 163.

177. *See id.* "[E]nterprise grouping reflects an attempt to counter the uncertainty of a rapidly changing environment by maximizing the flow of information between associated enterprises." *Id.*

178. *See* Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.04. The four largest firms, Nomura, Nikko, Yamaichi and Diawa, account for almost half the sales in the industry and more than 90% of all underwriting. The top 12 firms account for two-thirds of all sales in the industry. *See id.*

179. *See* J. SCOTT, *supra* note 81, at 192. The increase in the number of unaffiliated high technology companies may be reducing the importance of the *kigyoshudan*. *See id.*

in Japanese politics.[180] The influence is both latent, as evidenced by the dominance of four securities firms in the Japanese market,[181] and patent,[182] as evidenced by the involvement of trade groups and business organizations in politics. Corporate political contributions are regarded as investments to preserve the interests of business and to ensure profits for its enterprises.[183] Big business has the power of life and death in Japanese politics; it helps to decide the makeup of the bureaucracy, legislation that does not have its approval is never introduced, and candidacy for Prime Minister is "unthinkable without its tacit approval."[184] Japanese business "holds a virtual veto over all important economic decisions."[185] The importance of business in Japanese politics, coupled with the social[186] and political[187] preferences for informal control, have produced sanctions too weak to prevent repeated corporate misconduct.[188]

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180. *See* J. SCOTT, *supra* note 81, at 159. Business has always had close ties to Japanese politics. *See id.* In the 1930s, the major force behind the Seiyukai party was the Mitsui *zaibatsu*, whose representatives included Prime Minister Ito. *See id.* The rival party, the Kenseikai, was supported by the rival Mitsubishi *zaibatsu*. *See id.*

181. *See supra* note 157. While informal sanctions are available for the discipline of these firms, they are limited to reprimand and the suspension or revocation of license, and the resulting expulsion from organized exchanges. *See supra* note 120-21 and accompanying text. Few would expect the government to suspend any firm whose involvement in the market is so essential.

182. *See* Zoglin, *supra* note 20, at 422. The same large securities firms are strong political allies of the ruling Liberal Democratic Party ("LDP"). *See id.*

183. *See* C. YANAGA, *supra* note 125, at 80.

184. *Id.* at 33. The nature of the relationship is perhaps best exemplified by the fight between two economic organizations for the leadership of the business community. The Sanken, now the largest organization, was able to defeat its opponent, the FEO, by advocating close ties with the government to the point of becoming a corporate state. *See* S. SETHI, *supra* note 116, at 34-35.

185. S. SETHI, *supra* note 116, at 36.

186. *See supra* note 145 and accompanying text.

187. *See infra* note 209 and accompanying text.

188. *See* S. SETHI, *supra* note 116, at 109, 112. Sethi argues that these factors have made many forms of corporate misconduct more pervasive in Japan than in the United States. *See id.* Japanese regulation, especially in the form of consumer and environmental protection, usually lags similar American regulation by up to two years, perhaps to avoid one-time losses in Japanese markets by avoiding the increased costs of unilateral regulation until similar regulations are enforced in other countries. *See id.* at 107-9. Not wishing to appear indifferent in its efforts to combat the problem, the two year lag is filled with lots of rhetoric, enlarging the gap between the regulations' expected and actual efficacy. *See id.* at 123.

C. Bureaucratic Informalism[189]

Many of the cultural and structural justifications for the unabashed tolerance of insider trading fail to completely explain why the government, with all its tools for affecting social change, has only recently made an effort to rectify the problem of insider trading.[190] The bureaucracy, which drafts almost all legislation for approval by the Diet,[191] has always had tremendous power in Japan, even before World War II.[192] This power, combined with the peculiar structure of Japanese government, has given the bureaucracy an incentive to embrace many of the traditional informal systems as a means of preserving its control over social change.

The Japanese bureaucracy was nearly unaffected by the democratization that so deeply affected the structure of Japanese business.[193] Its importance in prewar Japan[194] left it well suited to assume a significant amount of political control in postwar Japan, which it shares in a triumvirate with the leaders of the Liberal Democratic Party[195] and top business management.[196] Most legislation, although it must be approved by the Diet, is subject to little modification after it is drafted by the middle level bureaucrats who are ultimately responsible for enforcing it.[197] Traditionally, the bureaucrats have tended to favor abstract regulatory legislation that

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189. *See* F. UPHAM, *supra* note 84.

190. See recent amendments to Securities Exchange Law approved by the Diet in 1988 and scheduled to be implemented in April 1989, *infra* notes 222-23 and accompanying text.

191. *See* F. UPHAM, *supra* note 84, at 14; R. Brown, *A Lawyer by Any Other Name: Legal Advisors in Japan*, in LEGAL ASPECTS OF DOING BUSINESS IN JAPAN 201, 319 (1983) (Practising Law Institute A4-4052).

192. *See* F. UPHAM, *supra* note 84, at 14.

193. *See* Maki, *The Role of Bureaucracy in Japan*, in 2 THE JAPAN READER, *supra* note 149, at 28-29.

194. *See* C. YANAGA, *supra* note 125, at 7-8; *see* R. Brown, *A Lawyer by Any Other Name: Legal Advisors in Japan*, in LEGAL ASPECTS OF DOING BUSINESS IN JAPAN, *supra* note 191, at 319.

195. *See* J. SCOTT, *supra* note 81, at 193 n.4. The LDP has dominated Japanese politics since its creation in 1955. *See id.* It was created by the merger of the Seiyukai, Progressive, and Democratic parties. *See id.* The Progressive and Democratic parties split from the Minseito Party, which was the predecessor of the Mitsubishi-controlled Kenseikai Party. *See id.*

196. *See* T. ADAMS, *supra* note 143, at 14. The Japanese system of unitary government differs significantly from the American federalism: local authority is delegated from the national government to the local government through specific acts of the Japanese legislature or Diet. *See* Tatsuta, *Japan*, in 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION, *supra* note 81, § 11.01; M. TATSUTA, SECURITIES REGULATION IN JAPAN 4 (1970). Japan also uses a parliamentary system of government. *See* J. MAKI, COURT AND CONSTITUTION IN JAPAN (1964).

197. *See* C. YANAGA, *supra* note 125, at 7-8. The drafting process usually involves discussion of proposed legislation with private primarily business. *See id.*

leaves many important administrative decisions and detailed application to be worked out by subsequent regulation, much of which is written by the same bureaucrats.[198] The bureaucracy's ability to draft legislation also enables it to control public policy by ensuring that controversies are decided with the use of informal administrative orchestration, and that private causes of action, which would shift the power of interpretation to the courts, are avoided.[199] Thus traditional Japanese systems of government built upon informal control may be no more than an excuse for preserving bureaucratic policymaking. "Japanese resistance [to aggressive regulation] is not necessarily because of tradition but because of the ability of those in power to consciously use it through the disguise of consensus to advance social change."[200]

The informalism, which the bureaucracy has embraced to ensure its control over social policy, has produced the ineffective legislative and judicial changelings that are at the root of the insider trading problem in Japan. Instead of clear statutory norms, the law is replaced by "moral exhortation" and administrative guidance that may be well-suited to bureaucratic control, but lacks the realistic sanctions necessary to make it effective.[201] The informality makes new policies appear to be the inevitable product of custom and consensus,[202] and minimizes the opportunity for individuals to use formal judicial processes to challenge the dominant social consciousness.[203]

To avoid losing control over securities regulation, the Ministry of Finance has erected substantial barriers to shareholder litigation, which include the inability to bring class action suits, the high costs of litigation,[204] and the limitations imposed by seeking

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198. *See* D. HENDERSON, FOREIGN ENTERPRISE IN JAPAN: LAWS AND POLITICS 197 (1973); R. Brown, *A Lawyer by Any Other Name: Legal Advisors in Japan*, in LEGAL ASPECTS OF DOING BUSINESS IN JAPAN, *supra* note 191, at 319.

199. *See* F. UPHAM, *supra* note 84, at 211. "[T]he maintenance of legal informality . . . would be seriously compromised, if not rendered impossible, by simultaneous judicial activity in the same policy areas." *Id.* at 226.

200. *Id.* at 220-21. The bureaucrats, who are responsible for drafting legislation, have a considerable incentive to conform and play safe. *See* C. YANAGA, *supra* note 125, at 99. Under the system of automatic escalation, a civil servant is assured of a promotion to the level simply by serving time, provided he commits no serious blunder. *See id.*

201. *See* F. UPHAM, *supra* note 84, at 14, 209.

202. *See id.* at 208. Japanese law seldom leads but often recognizes or declares social change. *See id.*

203. *See id.* at 207.

204. *See* Zoglin, *supra* note 20, at 422.

damages under the Commercial Code or the Civil Code.[205] Although rarely used in securities regulation, one alternative has been the use of administrative mediation[206] when informal controls fail to prevent serious conflict.[207] Litigation, on the other hand, has rarely been the source of substantive change; instead it has been used only when the bureaucracy has underestimated the extent of discontent or the availability of litigation.[208]

V. The New Legislation

A. The Regulatory Call to Arms

In response to foreign[209] and domestic[210] pressure, the Japanese Stock and Security Trade Review Committee recently appointed a special commission, chaired by a Tokyo University professor, and gave it "high priority and emergency status [to] examine and propose reform recommendations in the matter of insider trade regulation."[211] The commission's recommendations included requirements designed to promote timely disclosure, overhaul existing barriers to insider trading and minimize market manipulation.[212] The commission also suggested the use of criminal penalties against trading company officials, stockholders, attorneys and others who influence investors' decisions with the help of inside information.[213]

The Ministry of Finance and the Diet responded by drafting

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205. *See supra* note 105 and accompanying text. "[U]sing various doctrinal and institutional devices . . . the Japanese government has attempted to prevent the development of litigation into an effective and ongoing vehicle for social change." F. Upham, *supra* note 84, at 18.

206. *See* S. Sethi, *supra* note 116. Rule 10b-5 claims are arbitrable in most jurisdictions, and are always arbitrable when they involve international contacts. *Compare* Sherk v. Alberto-Culver, 417 U.S. 506 (1974) (in a 10b-5 action the Court upheld an arbitration clause in a contract between a German national and an American corporation) *with* McMahon v. Shearson/American Express, Inc., 778 F.2d 94 (2d Cir. 1986) (domestic arbitration).

207. *See* F. Upham, *supra* note 84, at 18.

208. *See id.* at 27. When faced with a judicial ruling, the bureaucracy will usually attempt to reassert informal control. *See id.* It must recognize the new direction established by the decision, but need not include the judiciary in crafting a new administrative remedy. *See id.*

209. *See* Sanger, *supra* note 73, at D1, col. 1.

210. *See* Rubinfien, *supra* note 17, at D7, col. 2.

211. Stock and Security Trade Review Committee Report Regarding Insider Trade Regulation, § I(2) (T. Shaw & Y. Shaw trans. 1989) [hereinafter Stock Report] (original Japanese text furnished by the Japanese Ministry of Finance).

212. *See id.* § II.

213. *See id.* § III.

and approving amendments to the Securities Exchange Law.[214] The reforms included the definition and prohibition of insider trading,[215] the creation of new reporting requirements to assist the Ministry in the prevention of market manipulation,[216] the expansion of the Ministry's power to investigate suspected violations,[217] and the imposition of criminal penalties for violations.[218]

B. Finished Product: Amended Articles 190, 190-2, and 190-3

Amended Article 190 provides a general definition of insider trading not unlike that advocated by United States courts in their interpretation of Rule 10b-5.[219] Article 190 prevents certain individuals with access to and knowledge of important information concerning corporate activities from trading on it unless it has been publicly announced.[220] But unlike Rule 10b-5,[221] and perhaps in response to pressure for an unequivocal definition of insider trading,[222] Article 190-2 enumerates the specific circumstances and persons to which the Article is intended to apply.[223] Access or knowledge will be imputed in employees, attorneys, messengers or business associates "who have access or obtain information through [their] duties or [in the course of] performing [their] works;"[224] major stockholders who have the power to make corporate decisions, their attorneys, appointees, and trustees;[225] executive officers with knowledge of important information prior to public announcement;[226] contracting agents and their attorneys, representatives and employees with knowledge of contracts or ne-

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214. *See* Summary of Reformed Security Trading Procedures (T. Shaw & Y. Shaw trans. 1989) [hereinafter Summary] (original Japanese text furnished by the Japanese Ministry of Finance).

215. *See id.* § 3; Securities Exchange Law arts. 190, 190-2, 190-3. (T. Shaw & Y. Shaw trans.).

216. *See* Summary, *supra* note 214, § 2; Securities Exchange Law art. 188. (T. Shaw & Y. Shaw trans. 1989).

217. *See* Summary, *supra* note 214, § 1; Securities Exchange Law art. 154. (T. Shaw & Y. Shaw trans. 1989).

218. *See* Summary, *supra* note 214, § 3(1)(3); Securities Exchange Law art. 200, 205. (T. Shaw & Y. Shaw trans. 1989).

219. *See, e.g.*, Securities Exchange Law art. 190-2(3) (T. Shaw & Y. Shaw trans. 1989).

220. *See* Securities Exchange Law art. 190-2 (T. Shaw & Y. Shaw trans. 1989).

221. *See supra* note 89 and accompanying text.

222. *See* Sanger, *supra* note 73, at D5, col. 1.

223. *See* Securities Exchange Law arts. 190-2(1-5) (persons to whom the statute applies), 190-2(2)(A) (situations in which the statute applies).

224. *See id.* art. 190-2(1).

225. *See id.* art. 190-2(2).

226. *See id.* art. 190-2(3).

gotiations;[227] and the attorneys and employees of employees, company attorneys or major stockholders who have actual knowledge of important information by reason of their duties.[228]

The list of circumstances in which the information is not to be disclosed is equally strenuous. During "normal business" and unless "publicly announced prior to the transaction," information may not be revealed concerning possible incorporation, bankruptcy, public offering, divestiture, spin-offs, dividend payments, consolidation, merger or acquisition, liquidation or the commercialization of new products.[229] In addition, information that concerns disasters, changes in principal owners, and the withdrawal of shares from the market must be publicly announced.[230] Nevertheless sanctions are not to be imposed against those who adhere to the general purpose of the law or those trading on speculation.[231] Article 190-3 prescribes similar restrictions on the use of important inside information by traders, their attorneys and employees.[232]

Articles 200 and 205 impose criminal penalties for violations of the new insider trading laws.[233] Anyone found to have violated Article 190-2 is subject to no more than six months imprisonment and no more than a ¥500,000 fine.[234] On their face, the amended regulations are much more strict than Article 58. Unlike both Article 58 and Rule 10b-5, the amended laws mark more clearly the definition of insider trading. While the criminal sanctions are lenient by American standards,[235] they represent a dramatic step for a country where insider trading is so widely accepted. The regulation contains anomalies that reflect that its genuine function is not to curb insider trading but serve to show domestic vociferants and foreign trade partners that something is being done to combat insider trading.[236] For example the proscription of trading on inside

227. *See id.* art. 190-2(4).

228. *See* Securities Exchange Law art. 190-2(5) (T. Shaw & Y. Shaw trans. 1989).

229. *See id.* art. 190-2(2)(A).

230. *See id.* art. 190-2(2)(B).

231. *See* Summary, *supra* note 214, § 3(5); Securities Exchange Law art. 190-2(5)(3).

232. *See* Securities Exchange Law art. 190-3.

233. *See id.* arts. 200, 205.

234. *See id.* art. 200.

235. *Compare* 15 U.S.C. § 78f(a) (Supp. IV 1986), *amended by* Insider Trading and Securities Enforcement Act of 1988, Pub. L. No. 100-704, 1989 U.S. CODE CONG. & ADMIN. NEWS (102 Stat.) 4677, 4678 (maximum sentence of ten years and maximum fine of $1 million) *with* Securities Exchange Law art. 200 (T. Shaw & Y. Shaw trans. 1989) (maximum sentence of six months and maximum fine of ¥500,000). Five hundred thousand yen is roughly equivalent to $4,000. *See* Wall St. J., Mar. 3, 1989 at C13, col. 1.

236. *See* Hurd Interview, *supra* note 30.

information in connection with mergers and acquisitions is anomalous in a culture where mergers and takeovers are extremely rare.[237] This would seem to indicate that, like Article 58, Articles 190-2 and 190-3 are intended more for show than for practical enforcement.

Articles 190-2 and 190-3 are also handicapped by their reliance on a narrow definition of insider trading. The greatest strength of Rule 10b-5 is that it is definitive enough to provide the courts with a sufficient basis for judicial interpretation but flexible enough to apply to a variety of unanticipated situations.[238] The ambiguity of Rule 10b-5 forces traders to be especially careful not to violate the rule.[239] By comparison, Japanese market regulators, faced with the widespread intolerance of litigation and consequential improbability of judicial interpretation,[240] are limited to using the law to communicate their expectations to the market and to facilitate informal control. The SEC would be improvident to expect that the law will have much impact on the prosecution of insider trading in Japan. It should rely, however, on the improved compliance with the laws, which will certainly result from enhancements to the Ministry's ability to collect information concerning specific transactions.[241]

VI. Conclusion

The failure of insider trading regulation in Japan under Article 58 is the consequence of the American origin of the law. Because it was based largely on Securities Exchange Commission Rule 10b-5, Japan's Article 58 is best suited to function in a legal system that is more accustomed to the use of litigation as a means of enforcement and poorly suited to one where, to ensure bureaucratic autonomy in the field of securities regulation, the market is controlled by more informal means. Neither Rule 10b-5 nor Article 58 could be effective without providing courts the opportunity to test the application of the rules; although access to Japanese courts is available, a significant stigma remains attached to its use. The law is insensitive to the dramatic differences between Japanese and American corporations. The sharing of information is generally

237. *See id.*
238. *See id.*
239. *See id.*
240. *See supra* note 134 and accompanying text.
241. *See, e.g.*, Securities Exchange Law arts. 188, 154.

more common in Japan because Japanese businesses are closely related though a complex network of interlocking directorates, large and permanent reciprocal shareholdings, and long term personal relationships.

Japan's recent amendments to their insider trading laws are no more likely to be strictly enforced than the old provisions, but unlike Article 58, they are better suited to help the Ministry of Finance with the administration of informal market control. The elaborate definition of insider trading in the amendments, specifically Articles 190-2 and 190-3, may make formal enforcement more difficult, but will enhance the efficacy of informal controls by demonstrating the government's determination to rectify the problem and constructing a more effective framework for informal dialogue between the Ministry of Finance and Japanese business. In addition, improvements to the investigatory powers of the Ministry of Finance should improve informal compliance with the laws.

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