Berkeley Business Law Journal

Volume 2 | Issue 1 Article 5

January 2005

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Link to publisher version (DOI)
http://dx.doi.org/https://doi.org/10.15779/Z38Q572

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I. INTRODUCTION

It is my great honor to have the opportunity to submit my essay for this conference in honor of Professor Klein. Although I have studied corporate law under a different legal system and academic environment, Professor Klein's work has always been enlightening. I understand the raison d'être, if any, for my participation in this conference is to add diversity through my observations as an academic from another country. Therefore, in this short essay, I will present the implications of this project as to recent Japanese corporate law reform and my own writing. Of course, Professor Klein is not exporting his project and therefore need not be concerned whether the project is likely appreciated in different countries. But high academic scholarship, including an unfinished project, often has an impact in different academic cultures and that is the reason why I submit an outsider's view.

In Part II, I make some general remarks regarding this entire project. I argue that the lack of explicit discussion in corporate law scholarship regarding criteria for good laws is more or less a universal phenomenon. To explore the reasons behind this, I ask what effect this Criteria Project could have had on the recent Japanese corporate law reforms. In Part III, I review arguments in my previous writings, applying the specific criteria suggested by Professor Klein in his introductory Article, *Criteria for Good Laws of Business Association* (hereinafter "Criteria Paper").[1] In doing so, I examine whether the present list is workable as a descriptive tool.

II. WHY HAVE CORPORATE LAW SCHOLARS NOT DISCUSSED CRITERIA?

A. Absence of "Criteria" as a Universal Phenomenon?

At the beginning of the Criteria Paper, Professor Klein suggests that academics debating various aspects of business associations fail "to identify goals or objectives."[2] He argues that there has been a general "failure to weigh proposals against explicitly stated criteria and to engage in effective cost-benefit analysis."[3] Although Klein undoubtedly had American academics in

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1. William Klein, *Criteria for Good Laws of Business Association*, 2 BERKELEY BUS. L.J. 13 (2005).
2. *Id.* at 15.
3. *Id.*

mind, I find that despite the significant differences in academic flavor, his critique also applies to Japanese corporate law scholarship. No Japanese corporate law scholar has ever attempted to identify the criteria of good corporate law. This, in contrast to the reality that choosing among different criteria, has always been the core issue in other legal fields such as constitutional law, tax, or criminal procedure. To the best of my knowledge, the same is true in other countries.

If the absence of explicit discussion on criteria for better corporate law is a universal phenomenon, then two natural questions arise: why has this been the case in corporate law, and how have corporate law scholars been discussing the subject without a set of analytic criteria? Fortunately, Japanese corporate law is now experiencing an unprecedented era of reform[4] and there has been intensive academic debate on this subject. Therefore, I naturally ask the following question: would there have been any impact on our recent debate at home if the Klein project had been complete and we had a comprehensive list of criteria? For the following reasons, the answer is negative.

B. Is the Choice among Different Criteria a Core Issue of Corporate Law Reform?

Reviewing the recent debates on corporate law reform, the first thing I found was that the choice among different criteria was not a core issue in many cases. The following example illustrates this point. During the past decade in Japan, the regulations governing stock repurchases have been completely changed. Ten years ago, stock repurchases were, with some minor exceptions, generally prohibited. These restrictions, however, were subsequently dismantled, step-by-step, and today have been completely removed.[5] There has been much academic debate on this "Americanizing" process of Japanese corporate law. Some claim that stock repurchases can serve a useful purpose, such as the return of "free cash flow" to investors or some sort of "signaling," which cannot be achieved through dividends.[6] Others are more wary of potential misuses by management, such as the manipulation of the stock market or the possible transfer of wealth between shareholders. The issue here is whether these claims are supported by empirical data. Unfortunately there has

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4. *See* Tomotaka Fujita, *"Modernizing Japanese Corporate Law": Ongoing Corporate Law Reform in Japan*, 16 SING. J. ACAD. L.J. 321, 353 (2004).

5. The 1994 Revision of the Commercial Code lifted the prohibition on stock repurchases for the purposes of employee stock plans or the cancellation of stock. The 1997 Revision simplified the procedure by which public corporations can repurchase shares either from the market or by way of tender offers. The 1998 Revision expanded the available funds for a stock repurchase allowed for in the simplified procedure. The 2001 Revision finally abolished the prohibition on stock repurchases altogether.

6. For the possible functions of stock repurchases, see generally RONALD C. LEASE ET AL., DIVIDEND POLICY: ITS IMPACT ON FIRM VALUE ch. 10 (1999).

been, as of yet, few empirical results.[7] But whatever the outcome of future research may be, it is not a question of a choice among different criteria.

The same probably applies to corporate governance reform, another important issue of the era.[8] There is broad consensus that a good corporate governance structure should allow for good corporate performance. Thus, the only question regarding proposed reforms is whether such reforms can satisfy this purpose. There is no need for discussion of the applicability or strengths of different criteria.

In short, a substantial part of the academic debate on recent corporate law reforms does not have much to do with the choice of criteria.

C. Cases for the "Criteria Project"?

Despite the observations made above, several issues do exist that involve the choice of criteria. For example, Japan's proposed corporate law reforms in 2006 will introduce the "cash-out merger," which is already common in the United States but not possible under current Japanese law. There has been much academic debate on this issue reflecting the commentators' different preferences regarding criteria for better corporate law.

Proponents of reform claim such freedom would facilitate corporate restructuring and promote economic efficiency. This assertion is probably based on one of the criteria in Category II of the Criteria Paper ("Criteria Concerned with Economic Goals").[9] However, some are not comfortable with the idea that investors can be excluded, against their will, from ownership in a company. Using the popular phrase coined by Calabresi and Melamed,[10] the interests of minority shareholders should be protected by "property rules" rather than "liability rules." This position reflects Criterion I(D) ("protection of expectations") or Criterion II(A) ("facilitation of exchange").[11]

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7. As a rare exception, see Sumio Hirose et al., *Equity Repurchases and Corporate Value: Evidence from Different Legal Procedures in Japan* (Univ. of Tokyo, CIRJE Discussion Paper 2003-CJ-88, 2003) (arguing that the motivation for stock repurchases by Japanese companies can be better explained by the return of "free cash flow" rather than "signaling"), *available at* http://www.e.u-tokyo.ac.jp/cirje/index.html.

8. For the recent important corporate governance reforms, see Ronald J. Gilson & Curtis J. Milhaupt, *Choice as Regulatory Reform: The Case of Japanese Corporate Governance,* AM. J. COMP. L. (forthcoming, 2005).

9. It is not clear to which specific criteria this argument is related. It may be a simple argument that more freedom in corporate transactions "facilitates exchange" (Criterion II(A)). Alternatively, the advocates may have "macro efficiency" (Criterion II(B)) in mind. If they believe that a "cash-out" merger would activate mergers and acquisitions in Japan and that reinforcement of monitoring by the capital market would reduce agency costs, the assertion falls under category Criterion II(C) (micro efficiency). Some may also implicitly assume a specific goal such as a possible rescue of firms in difficulty (Criterion II(E)).

10. Guido Calabresi & Douglas A. Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

11. It may sound paradoxical that the prohibition of a certain type of corporate transaction (cash-out mergers in this case) would "facilitate" the exchange. However "facilitation of exchange" also includes

There is also debate as to what extent minority shareholders should be compensated when they are "cashed out." Some argue that the share price before the merger is sufficient.[12] Others argue that more compensation is necessary, including a distribution of the gain produced by the synergy effect. The latter claim may be based on some sort of theory of equitable distribution, which taps into Criterion I(C) (fair dealing), Criterion I(D) (protection of expectations), or Criterion I(I) (evenhandedness and objectivity). It may also be based on an economic ground: the distribution of the surplus between majority and minority shareholders at a later stage could have an *ex ante* effect on the investors' incentive and the level of investment that lawmakers should take into account. This idea parallels Klein's Criterion II(C) (micro efficiency).

In the course of recent discussion, Japanese corporate law scholars have presented their own positions with different implicit criteria in mind. The debates have yet to reach a conclusion,[13] though, partly because they involve a difficult choice among different criteria. My suspicion is that this is exactly the kind of situation in which Professor Klein thought his project could contribute.

But how big of an impact would Klein's list of criteria have had on our discussion of this issue? Probably not much. As to the nature of the list, Professor Klein states "it is implicit in the list offered here that a ranking (e.g., fairness is more important than administrative feasibility) would not, in the abstract, be meaningful."[14] A simple list of criteria without any normative implications, however comprehensive it may be, would have done little to improve the situation. It is possible that communication efficiency might have been improved to a certain degree, but this seems too modest an outcome for the huge efforts to be expended on the project.

Thus the next question arises: do corporate law scholars want to use a list of criteria with normative implications? As is shown below, there seems to be a serious incentive problem.

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the adequate protection of one's property, and "property rules" may be justified on that ground. Indeed, it is sometimes argued "property rules," which require one's *ex ante* consent for the transfer of property, are of a "market encouraging" character. *See* Saul Levmore, *Explaining Restitution*, 65 VA. L. REV. 71, 79-81 (1985); Richard Craswell, *Property Rules and Liability Rules in Unconscionability and Related Doctrines*, 60 U. CHI. L. REV. 1, 15 n.28 (1993). For a thorough examination of this argument, see Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713, 724-47 (1996).

12. For simplicity, it is assumed that the merger is "value increasing" such that the share price rises after its announcement.

13. Although the reform bill finally incorporated the "cash-out merger," it intentionally adopted vague language as to the amount of compensation for the minority shareholder. Current corporate law provides that shareholders who opposed the resolution for merger may require the company to purchase their shares "at a fair price that such shares would have been worth but for such resolution." SHŌHŌ (Commercial Code) Art. 408-3. The proposed amendment drops the latter part of the provision and simply states "at a fair price." This suggests that there has been no decision, by the drafter, as to whether a gain produced by the synergy effect should be included, leaving this issue for judgment in the future by the courts.

14. Klein, *supra* note 1.

D. Do Corporate Law Scholars Wish to Reveal Their General Preference as to Criteria When Making a Specific Proposal?

If proponents choose to add some normative implication to a list of criteria, they should not only make explicit which criterion they relied on, but should also explain why they embrace that specific criterion. But do corporate scholars, or even lawyers in general,[15] really care to do this? My belief is that they have little incentive to do so, as they are often more interested in making specific proposals, appealing to the courts, legislators, or other practitioners, rather than establishing a general coherent theory of methodology. For their purpose, exposition of their general preferences regarding appropriate criteria would be useless or even harmful. The optimal strategy for lawyers is simple: use any criteria available to persuade the audience and do not reveal your hand in advance. Few except for a handful of academic maniacs would care about internal consistency in your choice of criteria.

Let me take an old example from securities regulation. Insider trading was a favorite topic of the 1980s in the United States. Assume someone would like to advocate for strict regulation of insider trading or for enhancing enforcement of such regulations. An experienced lawyer would justify his assertion in the following manner:[16] insider trading should be prohibited and the rule should be strictly enforced. Why? First, it can harm the liquidity of the underlying security's market. The literature on financial economics shows that the coexistence of informed traders and uninformed traders explains the bid-and-ask spread.[17] Even with the prohibition of insider trading, the spread would still exist, and deregulation would certainly widen it. The result would be a negative effect on market liquidity.

Contrary to the assertions made by some deregulationists,[18] lifting the prohibition against insider trading does not contribute to the informational efficiency of the market. Insider trading does not necessarily convey private information efficiently.[19] Even worse, without regulation, insiders have

15. Except for legal philosophers of course.

16. The following analysis is partly based on Tomotaka Fujita, *Mikoukai-jyoho wo Riyo-shita Kabushiki-torihiki to Ho* [*Stock Transactions Using Private Information and the Law*], *in* SHOJI-HO NO TENBO [PERSPECTIVES ON COMMERCIAL LAW] 575 (Shinsaku Iwahara & Hideki Kanda eds.). However, I have made no normative claim in the article.

17. *See* Lawrence R. Glosten & Paul R. Milgrom, *Bid, Ask and Transaction Prices in a Specialist Market with Heterogenously Informed Traders*, 14 J. FIN. ECON. 71, 71-100 (1985); Lawrence R. Glosten & Lawrence E. Harris, *Estimating the Components of the Bid/ Spread*, 21 J. FIN. ECON. 123, 123-42 (1988); Lawrence R. Glosten, *Insider Trading, Liquidity, and the Role of the Monopolist Specialist*, 62 J. BUS. L. 211 (1989).

18. HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 77 (1966); Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 867 (1983); Hayne E. Leland, *Insider Trading: Should It Be Prohibited?*, 100 J. POL. ECON. 859 (1992); Dan Bernhardt, Burton Hollifield & Eric Hughson, *Investment and Insider Trading*, 8 REV. FIN. STUD. 501 (1995).

19. Ronald J. Gilson & Reinier H. Kraakman, *The Mechanism of Market Efficiency*, 70 VA. L. REV. 549, 629-34 (1989).

undesirable incentives to keep private information secret for as long as possible.[20] In addition, the prohibition is justified because insider trading would also disincentivize market professionals from generating useful information.[21]

As to the proper allocation of property rights related to a company's private information, rational shareholders (the principals) would not allow the management (the agent) to use such property for their own benefit rather than for the benefit of the corporation. Arguing that insider trading creates an incentive for better corporate management[22] is not persuasive because there are already many kinds of compensation schemes for that purpose, and there is no need to use such an unclear and uncontrollable one. Even worse, it could provide an adverse incentive for the management to sell short based on private information.[23] Although some defend insider trading as a signaling device,[24] that argument ignores the possibility that insider trading may sometimes reveal valuable information at an undesirable time, such as in *Texas Gulf Sulphur.*[25]

Finally, and above all, most people would agree such a transaction is unfair This statement rests on several different criteria. The first and second reasons relate to the general efficiency of the market (liquidity and informational efficiency) and fall under the category of "macro efficiency" (Criterion II(B)). The arguments regarding the proper allocation of property rights are related to "micro efficiency" (Criterion II(C)) in that they focus on the optimal contract between shareholders and management. The nature of the "fairness" argument is not clear at all but it most likely draws on conceptions of "fair dealing" (Criterion I(C)), "protection of the weak" (Criterion I(F)), or mechanisms that "limit the use, and punish the abuse, of power" (Criterion III(F)).

Does our "experienced lawyer" wish to reveal his own preference on the above criteria when he makes his proposals on corporate law? It seems unlikely as it does not help his goal, which is to persuade lawmakers to strictly regulate insider trading. Rather, revealing his preference as to the proper criteria may

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20. Saul Levmore, *In Defense of the Regulation of Insider Trading*, 11 HARV. J.L. & PUB. POL'Y 101, 103 (1988); Robert C. Clark, *Agency Costs versus Fiduciary Duties*, *in* PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 268 (John W. Pratt & Richard J. Zeckhauser eds., 1985). As a formal model, see Jean-Jacques Laffont & Eric S. Maskin, *The Efficient Market Hypothesis and Insider Trading on the Stock Market*, 98 J. POL. ECON. 70 (1990).

21. Michael J. Fishman & Kathleen M. Hagerty, *Insider Trading and the Efficiency of Stock Prices*, 23 RAND J. ECON. 106 (1992). *See also* Naveen Khanna et al., *Insider Trading, Outsider Search, and Resource Allocation: Why Firms and Society May Disagree on Insider Trading Restrictions*, 7 REV. FIN. STUD. 575 (1994).

22. MANNE, *supra* note 18, at 131; Carlton & Fischel, *supra* note 18, at 870-71.

23. Levmore, *supra* note 20, at 104; Clark, *supra* note 20, at 274 n.15.

24. Carlton & Fischel, *supra* note 18, at 868.

25. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (1968). When Texas Gulf Sulphur found a promising copper mine, management and employees purchased its stock and call options before the news was released. The company kept the news confidential to facilitate the acquisition of land. However, it is unclear whether the particular information was really revealed by the insider trading in this case.

even be harmful because he would have to give up one or more potential grounds if he fixes his favorite "criteria" beforehand. Therefore our hypothetical lawyer would simply keep silent about his preference on the criteria and retain all the above grounds.

If the success of an academic lawyer is assessed based on the number of his proposals that are adopted or that influence real practice, as is the case in the current academic climate in Japan, there is little incentive for individual corporate law scholars to make their preferred criteria explicit when they make a proposal.

E. List of Criteria as a Descriptive Tool

Even if the list of criteria does not help the discussion on corporate law reform, the project still could have significance. It can work as a descriptive tool if it is comprehensive and systematically organized. With the list, we can describe which criteria are predominant among contemporary corporate law scholars. We can make historical reviews tracing the change of dominant criteria. Comparative studies would become possible if there were any differences in preferred criteria among jurisdictions. This work would help us understand where we stand, even if they would not directly lead us to where we want to go.

However, even for the purpose of using it as a descriptive tool, the current list needs further examination. In Part III of this paper below, I try to identify several points that can be improved.

III. APPLYING KLEIN'S LIST OF CRITERIA: A CASE STUDY

A. Bond Restructuring by Majority Voting

In this Part, I will attempt to identify the implicit criteria in my previous writings with respect to the list in the Criteria Paper. Among my past writings, I have chosen to analyze a piece entitled, *Bond Restructuring by Majority Voting at the Bondholders' Meeting* (hereinafter "the Article").[26] The Article was written almost a decade ago at the beginning of my academic career, but I believe it is useful for the present purpose because of its simplicity in argumentation. In the analysis below, I first present a brief description of the argument I made[27] and then try to apply the criteria listed in the Criteria Paper

26. Tomotaka Fujita, *Shasai-kensha-shukai to Tasuketsu niyoru Shasai no Naiyo no Henko* [*Bond Restructuring by Majority Voting at the Bondholders' Meeting*], *in* GENDAI KIGYO-RIPPO NO KISEKI TO TENBO: OHTORI TSHUNEO SENSEI KOKI-KINEN [MODERN LEGISLATION FOR ENTERPRISE: RETROSPECTIVE AND PROSPECTIVE—FESTSCHRIFT FOR PROFESSOR TSHUNEO OHTORI ON HIS 70TH BIRTHDAY] 215-46 (Kenjiro Egshira et al. eds., 1995).

27. Unfortunately the accuracy of the description is "non-verifiable" by most readers because of the language problem. In this case, let us simply assume such an article as I describe was in fact written.

to that argument.

The Article examines the legal procedure for bond restructuring under Japanese law. Unlike the regulation provided under the Trust Indenture Act of 1939 in the United States,[28] the Japanese Commercial Code permits bondholders to modify their bond terms by majority vote, including the reduction of interest and principal payments as well as the extension of the term of maturity (Art. 309-2(1)(i)). The Code regulates the requirements and procedures for such majority voting (Art. 319 et. seq.). The Article thus examines the role and function of bondholders' majority voting for bond restructuring and its proper regulation.

B. Saving Bankruptcy Costs: Minimizing Costs of Administration as an Independent Criterion?

The Article begins with the basic question: why does bondholder majority voting exist at all? The obvious answer is to facilitate bond workouts. Why, then, are private workouts useful? Again the obvious answer is to save "bankruptcy costs," which are a dead weight loss caused by the use of the formal bankruptcy procedure.[29] Creditors sometimes voluntarily abandon a part of their claims in order to avoid the formal bankruptcy procedure and thereby save the "bankruptcy costs." If rational bondholders can cooperate without costs, they might agree to modify bond terms—including the reduction of interest or principal payments—depending on the probability of a successful workout, expected bankruptcy costs, and expected loss caused by the modification of the bond terms. However, if the unanimous consent of bondholders is required for a modification, it is quite probable that the optimal bond modification will fail due to the "holdout problem."[30] Majority voting can be understood as a device to overcome this problem.[31]

What do we make of the idea of avoiding "bankruptcy costs" by facilitating private workouts under the list of criteria offered by Professor Klein? Saving bankruptcy costs may be understood to serve the goal of Criterion IV(B) ("self-

28. *See* Shōhō, art. 316(b) (Japan).

29. As to the meaning and possible reason of "bankruptcy costs," see RICHARD A. BREALEY & STEWART C. MAYERS, PRINCIPLES OF CORPORATE FINANCE 511 (6th ed., 2000). For an empirical study, see Jerold Warner, *Bankruptcy Costs, Some Evidence*, 32 J. FIN. 337, 337-47 (1977); Lawrence Weiss, *Bankruptcy Resolution: Divert Costs and Violation of Priority of Claims*, 27 J. FIN. ECON. 285 (1990).

30. Mark Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 236-50 (1987).

31. The Article also noted the possibility that the reduction of bond modification costs could, at least in theory, harm the bondholders. Fujita, *supra* note 26, at 245 n.51. Considering the relatively weak bargaining power of the bondholders, they may want unanimous consent for bond modification to make the bond contract "re-negotiation proof." While the point is closely related to one of the most interesting questions of inconsistency, as to an efficient *ex post* solution (here, less costly modification) and an efficient *ex ante* contract, which economists call "dynamic inconsistency," the Article simply assumed that, despite the theoretical possibility to the contrary, easy bond modification would in practice generally benefit the bondholders. *See also infra* note 43 and accompanying text.

enforcement and private enforcement") although it is not as apparent as the example of enforcement by an private attorney general under Rule 10b-5 mentioned in the Criteria Paper.

When I wrote in the Article that I did not count reduction of administrative costs as an independent goal by itself, I meant that I saw it instead as a concern related to the goal of efficiency. To put it more broadly, many, if not all, of the criteria listed under the category of "criteria concerned with minimizing costs of administration and compliance" (Category IV) can be understood as an application of economic efficiency. It seems questionable whether Category IV has any independent substance relative to Category II ("efficiency consideration") if minimizing costs of administration and compliance is the only issue here.[32]

C. Collective Action Problems and Inefficient Decisions: Ex Ante and Ex Post Micro Efficiency

The Article discusses at considerable length the possible collective action problems among bondholders. The possible holdout problem referred to in Part III(B), *supra*, is one of them.

Majority voting, which acts as a solution to the holdout problem, creates other types of collective action problems. Several scenarios are identified and analyzed in which bondholder majority voting, like other types of decision making by investors, causes an inefficient modification of the bond terms. These include "rational apathy" and "free riding" on the part of the investors. The rules on disclosure and quorum can be explained as responses to these problems,[33] although their effect seems rather limited.

The bondholders' inability to make a rational decision will induce a strategic reaction by the debtor (issuing company). For instance, the issuing company might give the bondholders an incentive to make unnecessary concessions when they propose the modification by majority voting. The Japanese Commercial Code includes prohibitions against voting procedures which could cause a distortion in bondholders' decision-making.[34] A proposal giving a benefit only to consenting bondholders is a typical example.[35] Although these regulations may also be justified by "fairness" or "justice,"[36]

32. Criteria under Category IV may be justified by other considerations than minimizing costs. For example, "self enforcement and private enforcement" may be founded on "individual freedom" (Criterion I(H)) or "limit[ing] the use, and punish[ing] the abuse, of power" (Criterion III(F)) rather than cost minimization.

33. These regulations may also be justified by such criteria concerned with fairness as "protection of the weak" (Criterion I(F)) or "full disclosure" (Criterion I(J)).

34. SHŌHŌ Art. 326(2) ("The court should not approve the bondholders' decision in cases where the resolution has come to be adopted in an inappropriate manner.").

35. *See* Kass v. Eastern Air Lines Inc., 1986 WL 13008, 12 DEL. J. CORP. L. 1074 (Del. Ch. 1986).

36. Using the terminology of the Criteria Paper it might be "fair dealing" (Criterion I(C)) or

the Article again finds grounds for the regulation exclusively in the fact that the value of the bonds, as a whole, may not be maximized due to the distorted decision.

Finally, there is a concern that wealth transfer occurs from minority bondholders to the majority, without increasing the total benefit to the bondholders, when the majority has a conflicting interest.[37] Although the issue can also be addressed as one of "fairness,"[38] my analysis in the Article focuses primarily on efficiency. It argues that such a bond modification is not desirable because it does not maximize the total value of the bond. Moreover, the possibility of an *ex post* wealth transfer also decreases the *ex ante* value of the bond.

The problem is more subtle in a case where the bondholders as a whole are better off, but the distribution of the benefit is not proportional.[39] It is not obvious whether this type of situation should be regulated. Some sort of "fairness" consideration[40] might mandate regulation, but one might also argue that such modification is desirable because it would allow the total size of the pie to increase.[41] The Article examines the possible justifications of regulation given efficiency considerations.

The criterion underlying the above arguments regarding the bondholders' collective action problems is, no doubt, "micro efficiency" (Criterion II(C)). However, I believe further refinement is possible and desirable for the application of this criterion. In applying the "micro efficiency" criterion, we have to distinguish between *ex ante* efficiency and *ex post* efficiency. Consider the above hypothesis where the bondholders as a whole are better off by the modification, but the distribution of the benefit is not proportional. If we simply focus on *ex post* efficiency, we may conclude that the modification is efficient because the total amount of the bond has increased. However, this analysis is not sufficient, as the distribution at the stage of modification could have *ex ante* effects for the bondholders or other interested parties.[42] If the wealth transfer

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"evenhandedness and objectivity" (Criterion I(I)).

37. A typical example is found in *Aladdin Hotel Co. v. Bloom*, 200 F.2d 627 (8th Cir. 1953), where the majority bondholder who was also a large shareholder approved the extension of maturity.

38. Using the terminology of the Criteria Paper, it might be "fair dealing" (Criterion I(C)), "protection of the weak" (Criterion I(F)), or "evenhandedness and objectivity" (Criterion I(I)).

39. To be more precise, there are two different subcategories. First is the case where every bondholder's wealth increases compared with the situation before the modification, but majorities gain more than minorities. The second is where minorities suffer from certain losses although the majorities gain and the aggregate amount of the bondholders' wealth increases. The latter case is more problematic.

40. More specifically, "fair dealing" (Criterion I(C)), "protection of the weak" (Criterion I(F)), or "evenhandedness and objectivity" (Criterion I(I)).

41. For the argument for unequal division of the gain from corporate control transactions, see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW ch. 5 (1991).

42. *See also supra* note 31.

from the minority to the majority in the future is broadly allowed, even if the modification itself increases the total pie at that stage, it would have a negative impact on investors' *ex ante* incentive to buy such bonds and would lead to a suboptimal level of investment. Thus the efficient modification at the latter stage could harm *ex ante* efficiency.[43]

D. Court Intervention as a Response to Inefficient Modification

The Article examines the role of court intervention in relation to the possible inefficient decision making referred to in the section above. The Japanese Commercial Code requires court approval for modification of bond terms by majority voting, just as with a corporate reorganization plan (Article 326). Among the requirements for approval, the modification should not be approved "in cases where the resolution is significantly unfair" (Article 326(3)) or "in cases where the resolution is against the interests of the bondholders as a whole" (Article 326(4)). Taken literally, these provisions provide courts with significant discretion in approving bondholders' decisions. If the court exercises its discretion perfectly, it may avoid most of the potential inefficiencies caused by collective actions.

Of course, the problem is that these rules place too great a burden on the court. With its limited information and lack of proper incentives, a court, like investors, can easily make a mistake. Indeed, it is exceptional for the court to examine the substance of investors' decisions in the absence of procedural problems or specific situations which suggest conflict of interests under Japanese corporate law.[44] In addition, the approval process requires a quick decision; otherwise part of the advantage of a private workout would be lost.[45] Under these circumstances, courts might be inclined to rubber-stamp a proposed modification.

In order to address this concern, the Article examines the optimal scope of the court's discretion, taking into account its limited information, lack of proper incentives, and time constraints on issuing its decision. The Article gives a negative assessment of the broad discretion accorded to courts under current Japanese law, but this conclusion itself is not the issue here. Our concern is to identify the criterion or set of criteria that the Article's argument belongs under.

To the extent that the argument is related to the costs of a court's decision,

43. This can be understood as an example of "dynamic inconsistency." *See supra* note 31. Note this is not a choice between "macro efficiency" (Criterion II(B)) and "micro efficiency" (Criterion II(C)). Even for the efficient allocation between parties, the *ex ante/ex post* distinction matters.

44. For instance, Article 247(1)(iii) provides that the decision made during the shareholders' meeting is voidable if the resolution is substantially unfair and is affected by the votes of interested parties. The votes by the interested parties are required for the court's intervention here.

45. Recent experiences as to bond restructuring underscores this concern. Court approval takes only one or two days.

including the cost of potential error, it might fall under Category IV ("criteria concerned with minimizing costs of administration and compliance").[46] As I have already mentioned,[47] these considerations could better be integrated under Category II (efficiency). Another possible viewpoint for looking at the problem would be through Criterion III(F), which seeks to "limit the use, and punish the abuse, of power," although I personally do not support the position that the control of political power, in and of itself, has an independent value.

IV. CONCLUSION

As I explained in Part II, the absence of an explicit discussion on criteria for better corporate law seems quite a universal phenomenon for which I suspect there is good reason. I am still not completely certain that corporate law scholarship really needs a comprehensive list of criteria. Of course, fairness requires us to remember that it is only too easy to be skeptical about a truly original and innovative project when it is first launched.

Setting this general skepticism aside, I have tried to apply the list of criteria to my own writing in Part III. The result suggests that the current version of the list still has room for improvement in two respects. First, the criteria in Category IV ("criteria concerned with minimizing costs of administration and compliance") need significant revision, including the possible deletion of the entire category. Second, further classification would improve the analytic power of Criterion II(C) ("micro efficiency"). In this regard, I propose distinguishing between *ex ante* and *ex post* efficiency.

46. More specifically, "self enforcement and private enforcement" (Criterion IV(B)) is the most relevant criterion.

47. *See supra* note 33 and accompanying text.