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Problems of the Closely Held Corporation:  
A Comparative Study of the Japanese and  
American Legal Systems and a Critique of the  
Japanese Tentative Draft on Close  
Corporations

INTRODUCTION

A. *Types of Small Enterprises and Election of Legal Form*

Although the legal forms for business enterprises available in Japan and the United States differ greatly, the practical tendency of small enterprises to favor the corporate form raises parallel issues and problems in both the United States and Japan. On their face, the legal forms for businesses in Japan are more similar to the forms of West Germany. However the overriding preference of Japanese enterprises for the corporate form, a form not originally intended for small businesses, represents a departure from legislative intent that makes the problems of the Japanese closely held corporation very similar to those of their American counterparts.<sup>1</sup> This paper will compare and contrast the Japanese and American legal approaches to closely held corporations. It will further critique the Japanese new tentative draft on close corporations.<sup>2</sup>

Although there are seven types of enterprises in Japan, the

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1. More than 95% of all Japanese corporations have less than 50 million yen of capital (About \$333,000 when we assume 1 U.S. dollar equals 150 yen. Hereinafter we shall use the same base of calculation.) *Department of Justice Statistics* (1983).

In the U.S., around 94% of corporations have less than \$1 million in assets. Alfred Conard, *Corporations in Perspective* 99 (1976).

2. *Hōmushō [Department of Justice]*, *Shōhō-Yūgengai-sha-Hō Kaisei Shian [Tentative Draft on the Commercial Code and G.m.b.H. Act]* of 1986. The enactment of most of the Tentative Draft recently was postponed for various reason. Nevertheless, there is still significant theoretical value to studying the Draft.

most important types are Kabushikigaisha and Yūgengaisha.<sup>3</sup> Kabushikigaisha is known in the U.S. as a corporation and in West Germany as Aktiengesellschaft. Yūgengaisha is equivalent to the West German Gesellschaft mit beschränkter Haftung (G.m.b.H.). There is no equivalent form in the U.S.

Kabushikigaisha is the only corporate form designed for large publicly held corporations. The remaining six categories, including Yūgengaisha, are intended to be used by small enterprises, typically family enterprises.

In Japan, however, entrepreneurs have ignored the intention of their legislators. Many small enterprises have chosen the Kabushikigaisha form, although it is not suitable for closely held corporations. This is mainly because the appellation Kabushikigaisha affords a more prestigious image than that of Yūgengaisha. Roughly speaking, approximately half of all existing small enterprises in Japan are Kabushikigaisha and the other half are Yūgengaisha. Kumiai, Tokumeikumiai, Gōmeigaisha and Gōshigaisha enterprises exist only in very limited numbers.<sup>4</sup>

For this reason, the Japanese legislators are currently planning to divide the corporate form (Kabushikigaisha) into two parts: a large corporation form and a small corporation form. Once this new law is implemented, small enterprises seeking limited liability will have a choice of two basic legal forms: the Yūgengaisha and the small Kabushikigaisha.<sup>5</sup>

In the sense that even a small enterprise may choose Kabushikigaisha (the corporation form), the situations in Japan and the United States are similar. There are many closely held corporations in the United States,<sup>6</sup> just as in Japan. The movement of more and more American states regulating statutory close corporations<sup>7</sup> also

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3. The other five types of enterprise are following: the Kojin Kigyō, is known as the Proprietorship in the U.S. Both the Kumiai, and the Gōmeigaisha are analogous to the U.S. Partnership in terms of the mutual rights and duties among the participants and their relations to third parties. The differences are that the latter is recognized as a legal entity through formal "incorporation" procedures under the Commercial Code, while the former is a creature of contract regulated by the Civil Code. In the same way, the Tokumeikumiai and the Gōshigaisha are analogous to the U.S. Limited Partnership, the latter having formal entity status under the Commercial Code and the former being a creature of contract regulated under the Civil Code with "anonymous" or "silent" partners who are not liable to third parties.

4. *Department of Justice Statistics* (1983).

5. Actually, the Tentative Draft does not create a new form of Kabushikigaisha, but it makes different rules for a small corporation depend upon problems.

6. More than ninety percent of corporations in the United States have not more than ten shareholders. Melvin Eisenberg, *The Structure of the Corporation* 42, Table 5-1 (1976).

7. See *N.Y. Bus. Corp. Law* §§ 514, 615, 620; *Del. Gen. Corp. Law* §§ 341-356; *Cal. Gen. Corp. Law* §§ 158, 186, 202, 204, 300, 418, 421, 706, 1111, 1201, 1800, 1904; *Model Stat. Close Corp. Supp.* §§ 1-55.

parallels the legislative movement in Japan.

The big difference is that in the United States, there are many partnerships, in contrast with the partnerships in Japan.<sup>8</sup> The major reason for the different use of the partnership form in the two countries is the different tax treatment afforded the corporate forms. In Japan, from a tax planning point of view, the corporate forms (Gōmeigaisha, Gōshigaisha, Yūgengaisha and Kabushiki-gaisha) are normally better than the non-corporate forms (Kojinkigyō, Kumiai and Tokumeikumiai). Income tax rates on individuals increase as the income level rises, with the maximum tax rate at 50%.<sup>9</sup> In contrast, there is only one income tax rate for corporations, 37.5%.<sup>10</sup> These tax advantages for corporate over non-corporate forms, however, are not present in the United States. Especially after the Tax Reform Act of 1986, the maximum income tax rate for corporations (34%)<sup>11</sup> is higher than the maximum tax rate for individuals (28%).<sup>12</sup>

Although the legal forms of enterprises and the relative distribution of each type differs in the U.S. and Japan, there are many similarities between the closely held corporations in the two countries. Because many small businesses in the United States and Japan have ignored the forms of enterprise best suited for them, and instead chosen the corporate form, issues of shareholder and creditor disputes<sup>13</sup> and internal relations problems<sup>14</sup> have arisen that are similar in both countries.

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8. According to the Internal Revenue Service, *Selected Statistical Series, 1970-1983*, 3 *Statistics Income Bull.* 54 (Table 4) (Fall 1983), there are nearly 1.5 million partnerships in the United States. Hillman, "Power Shared and Power Denied: A Look at Participatory Rights in the Management of General Partnerships," *U. Ill. L. Rev.* 865 (1984). Also, since the 1986 Tax Reform Act, which favors the partnership form over the corporate form, many more partnerships are expected to be organized.

9. *Shotokuzeihō [Individual Income Tax Code]* § 89. Before April 1989, the maximum tax rate was 75%.

10. *Hōjinzeihō [Corporate Income Tax Code]* § 66. There is a preferred rate of 28% only for small corporations with income less than 8 million yen (about \$57,000). Before April 1989, these rates were 42% and 30% each.

11. *Internal Revenue Code* § 11(b).

12. *Id.* § 1. Subchapter S is also used by many small corporations to lower the effective tax rate and to eliminate double taxation. 28% represents the maximum average tax rate for an individual, although some persons may be taxed at 33% at certain income levels. *Id.* § 1(g).

13. W. Cary & M. Eisenberg, *Cases and Materials on Corporations* 151-191 (6th ed. 1988); Robert C. Clark, *Corporate Law* 35-92 (1986); K. Egashira, *Hōjinkaku Hinin No Hōri [Doctrine of Piercing the Corporate Veil]* (1980).

14. See F. O'Neal & R. Thompson, *O'Neal's Oppression of Minority Shareholders* (2nd ed. 1985); Shishido, "Heisagaisha ni okeru Naibufunsō no Kaiketsu to Keizaiteki Kōsei" [Ways to Achieve Financial Fairness in Coping with Internal Disensions in the Closely Held Corporation], 101 *Hōgaku Kyōkai Zasshi* 505 (1984).

*B. The Normative Corporate Model and Problems of the Closely Held Corporation*

Four basic principles of the corporate model have been set forth: 1) limited liability for investors; 2) free transferability of investor interests; 3) legal personality (entity-attributable powers, life span, and purpose); and 4) centralized management (separate ownership and management).<sup>15</sup> It has also been pointed out that these four principles may need to be modified for closely held corporations.<sup>16</sup>

The problems of the closely held corporation may be divided into two categories: substantive problems and non-substantive problems. Non-substantive problems are the procedural problems which arise not from the nature of the closely held corporation, but from the distortions caused by the legal system. In particular, they arise from the disparity between actual disputes and the legal issues stressed in litigation. Such disparities may come either from problems with corporate laws or from problems related to the applicable legal procedures.

Substantive problems are the problems which arise from the nature of the closely held corporation. They may be divided into two parts: problems between shareholders and corporate creditors (external relationships) and problems among shareholders (internal relationships).

As to external relationships (the relationships between shareholders and corporate creditors), abuse of limited liability by shareholders may occur in a closely held corporation. Therefore, some modification of limited liability of shareholders may be necessary.

As to internal relationships, that is, the relationships among shareholders, the problems are twofold: the problem of struggles for control and the problem of economic unfairness to minority shareholders. Each problem is especially likely to occur where an enterprise has passed by inheritance.

The potential problem of struggle for control in a closely held corporation is a motivation for modification of the corporate model as to internal relationships. In particular, shareholders of a closely held corporation may want to modify the free transferability of stock and the principle of majority control.<sup>17</sup> The latter modifica-

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15. R. Clark, *supra* note 13 at 2; W. Cary & M. Eisenberg, *supra* note 13 at 91-95.

16. R. Clark, *supra* note 13, at 761.

17. The principle of majority control is the rule that gives anyone who owns majority voting stock or who can control majority voting rights the right to monopolize all board members and to manage the corporation as he/she likes within the business judgment rule. See F. O'Neal & R. Thompson, *supra* note 14 § 1.02.

tion will naturally affect the principle of centralized management (the separation between ownership and management).

The problem of economic unfairness in the closely held corporation must lead to protection of minority shareholders by giving them some device to recoup their investment. Such a device, however, runs afoul of the principle that the corporation is an independent legal personality distinct from each shareholder.

In summary, the problems of closely held corporations in the United States and Japan, and the effect of Japan's new legislative draft on closely held corporations will be discussed in the following four sections: 1) Different ways of disputing corporate problems—the disparity between actual disputes and the legal disputes that arise in litigation, 2) Protection of corporate creditors and restrictions on shareholders' limited liability, 3) The modification of internal relationships by shareholders agreements, and 4) Protection of minority shareholders and ways to liquidate investments.

#### 1. Different Ways of Disputing Corporate Problems: The Disparity Between Actual Disputes and the Legal Disputes That Arise in Litigation

Anyone who compares the reported cases in the U.S. and Japan on internal disputes of closely held corporations will notice the following contrasts. On the one hand, the American cases are set forth in a straightforward manner and the actual problems involved are easily recognized. On the other hand, the Japanese cases are highly technical, and the actual problems are not recognizable from the case law.

American judicial opinions not only describe the legal disputes involved but also present the background facts in great detail, like novels. Japanese judicial opinions, however, present very little of the background facts. For example, although one may know that the plaintiff is suing to void the shareholder meeting, in many cases there are no clues as to the background dispute or the plaintiff's ultimate goal in litigating the case.<sup>18</sup>

This difference comes not only from the different descriptive styles of judicial opinions, but also from the differing legal systems in the two countries. The major dissimilarity between the legal systems is the differing legal process.<sup>19</sup>

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18. A good contrast can be obtained by reading two typical internal dispute cases of closely held corporations in both countries: *Donahue v. Rodd Electrotpe Co.*, 367 Mass. 578, 328 N.E.2d 505 (1975) and *Sekiguchi v. Sekiguchi Honten K.K.*, 22 Minshū 2402 (Sup. Ct., P.B., Nov. 1, 1968) (its English translation is available in 2 M. Tatsuta & R. Kummert, *U.S./Japan Corporate Relations* 7-109 (1989) (locally produced textbook for the Asian Law Program, University of Washington School of Law).

19. The delay of the Japanese legislature in coping with the problems of closely

The Japanese system is a civil law system that is quite rigid. One can basically bring any kind of suit in order to demand payment or transfer a good (performance claims).<sup>20</sup> However, in the case of suits involving a corporation, one must modify the actual request in order to fit it into one of the categories of suits provided for in the Commercial Code, otherwise the claim will be dismissed because of no proper interest to sue (*uttae no rieki*).<sup>21</sup> Furthermore, courts are limited to addressing the legal problems raised by the parties themselves, as they are bound by plaintiff's requests for relief.<sup>22</sup> Courts have no way to balance the conflicting interests of the parties except through the procedure of compromise (i.e., agreed settlement).<sup>23</sup>

In contrast, the American system, particularly in the areas where the law of equity applies, is flexible and works well. A plaintiff can bring almost any kind of suit. Therefore, what a plaintiff really wants can be presented in the litigation process. Courts are not necessarily bound to plaintiff's requests, and they may issue any injunctive or other equitable relief necessary to solve the dispute.<sup>24</sup>

These different approaches to the legal process are very apparent when applied to the internal disputes of a closely held corporation. A good example is the squeeze-out case, where a majority shareholder schemes to pay out no dividends despite large corporate profits, instead siphoning off the profits in the form of officers' salaries to force the minority shareholder to sell his shares at a distress price.<sup>25</sup>

If this scenario arose in the United States, the minority shareholders could seek accounting of the excessive salaries received by the majority shareholders.<sup>26</sup> If they sought issuance of a reasonable

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held corporations and its failure to revise the Japanese Commercial Code are the major reasons for the large discrepancy between the actual and legal disputes of the parties that arise in closely held corporations. Although Japanese legal scholars presently debate whether the problem is one of technical procedure or one of substantive corporate law, it can at least be said that it is a problem of the Japanese legal process as a whole.

20. T. Hattori & D. Henderson, *Civil Procedure in Japan*, § 4.03[4] (1985).

21. Taniguchi, *Kaishasoshō ni okeru Utaenorieki* [The Interest-to-sue in Corporate Litigations] 82 (2-3-4) *Hōgakuronso* 302 (1968). On the interest-to-sue, see generally T. Hattori & D. Henderson, *supra* note 22, § 7.02[7].

22. *Minjisoshō Hō* [Civil Procedures Code] § 191 II. See T. Hattori & D. Henderson, *supra* note 22, § 7.06[5].

23. *Minpō* [Civil Code] §§ 695, 696; *Civil Procedures Code* §§ 136, 203, 356.

24. *Restatement of Judgments* § 112 comment c, § 127 comment a (1942).

25. See, F. O'Neal & R. Thompson, *supra* note 16 §§ 3.04, 3.06, 3.07.

26. *Raynolds v. Diamond Mills Paper Co.*, 69 N.J. Eq. 299, 60 A. 941 (Ch. 1905); *Carr v. Kimball*, 153 (A.D. 825, 139 N.Y.S. 253 (1st Dep't 1912), *aff'd mem.*, 215 N.Y. 634, 109 N.E. 1068 (1915); *Barrett v. Smith*, 185 Minn. 596, 242 N.W. 392 (1932); *Keough v. St. Paul Milk Co.*, 205 Minn. 96, 285 N.W. 809 (1939); *Baker v. Cohn*, 42 N.Y.S.2d 159 (Sup. Ct. 1942), *mod. and aff'd*, 266 A.D. 715, 40 N.Y.S.2d 623 (1st Dep't 1943), *aff'd as modified*, 292 N.Y. 570, 54 N.E.2d 689 (1944); *Ruets v. Topping*, 453 S.W.2d 624 (Mo. App. 1970); *Hori-Rest, Inc. v. Treloar*, 217 N.W.2d 517 (Iowa 1974);

dividend, they could also bring suit to seek the dividend.<sup>27</sup> If the court were to find the salaries excessive and a waste of corporate assets, the court would order the majority shareholders to account for the amount over which the court considered reasonable.<sup>28</sup> If the court were to consider the restrictions on the dividends as a violation of the business judgment rule,<sup>29</sup> the court could order the board to declare a dividend setting forth a specific amount.<sup>30</sup> Also, the court could issue injunctions or distributions, if necessary, to solve the dispute, even if the plaintiffs had not asked for such relief.<sup>31</sup>

If the same scenario were to happen in Japan, and if the minority shareholders were to bring the same suits, the cases would not be heard by the court. The minority shareholders must first sue for abuse of discretion based on the resolution of a shareholder meeting to ratify the excessive salary or that of not to issue the dividend. If the minority shareholders win, and the resolution to ratify the salary is voided,<sup>32</sup> the defendant has to account the entire salary because he/she loses the legal basis to retain it.<sup>33</sup> The court has no authority to declare what amount is a reasonable salary. Even if the minority shareholders win in the dividend suit and the resolution not to issue dividends is voided,<sup>34</sup> the plaintiffs still cannot obtain any dividends until shareholders decide to pay a specific dividend at a new shareholder meeting. The Japanese courts have no authority to order affirmative acts such as payment of a dividend.<sup>35</sup>

Among the lawsuits based on corporate actions in Japan, the largest number of cases deal with the setting aside of resolutions at shareholder meetings<sup>36</sup> [as well as the § 266-3 cases on a director's liability to a third party, to be discussed later]. The biggest reason for such a large number of cases on shareholder meetings is that a

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Cole Real Estate Corp. v. Peoples Bank & Trust Co., 160 Ind. App. 88, 310 N.E.2d 275 (1974).

27. *Hiscock v. Lacy*, 9 Misc. 578, 30 N.Y.S. 860 (1894); *Dodge v. Ford Motor Co.*, 204 Mich. 459, 170 N.W. 668 (1919); *Keough v. St. Paul Milk Co.*, 205 Minn. 96, 285 N.W. 809 (1939); *Cole Real Estate Corp. v. Peoples Bank & Trust Co.*, 160 Ind. App. 88, 310 N.E.2d 275 (1974).

28. See *supra* note 26.

29. Of course, even in the United States, issuance of a dividend is a business judgment issue, and therefore the likelihood that the minority shareholders would win in such a suit is quite small. See, e.g., *Gottfried v. Gottfried*, 73 N.Y.S.2d 692 (1947). *W. Cary & M. Eisenberg*, *supra* note 13 at 1369-72.

30. E.g., *Miller v. Magline, Inc.*, 76 Mich. App. 284, 256 N.W.2d 761 (1977).

31. E.g., *Lidia E. Pinkham Medicine Co. v. Gove*, 303 Mass. 1, 20 N.E.2d 482 (1939); *Smith v. Atlantic Properties, Inc.*, 12 Mass. App. 201, 422 N.E.2d 798 (1981).

32. *Commercial Code* §§ 269, 252.

33. *Civil Code* § 703.

34. *Commercial Code* §§ 283I, 252.

35. See generally, Taniguchi, "Kenrigainen no Seisei to Uttae no Rieki [The Creation of the Concept of the Right and the Interest-to-sue]", in 2 *Kōza Minjishosho [Lectures on Civil Procedures]* 163 (1984).

36. *Commercial Code* §§ 247-252.

plaintiff has a great likelihood of winning such a suit.<sup>37</sup> Such a phenomenon arises from the disparity between corporate law and the actual realities of closely held corporations in Japan.

In a closely held corporation which has a limited number of shareholders, the formal shareholder meetings required to be held by the Commercial Code are,<sup>38</sup> in fact, not necessary. Therefore, in most closely held corporations, shareholders usually agree not to hold shareholder meetings but to keep records as if they do. Normally, there is no problem with these illegal acts because all the shareholders agree to it. Once an internal dispute occurs among shareholders, however, such procedural defects are a good bargaining weapon for minority shareholders. This is the situation underlying many of the lawsuits on the setting aside of resolutions of shareholder meetings ("suits for rescission (*torikeshi*)",<sup>39</sup> "suits for declaration of invalidity (*mukō kakunin*)",<sup>40</sup> and suits for declaration of non-existence (*fusonzai kakunin*)"<sup>41</sup>). In such cases, courts have no choice but to affirm the plaintiffs' demand and set aside the resolutions.

However, nothing is solved by such judgments allowing plaintiff to win since the real disputes are not the legal issues discussed in the suit. If the plaintiff is a reasonable person, the real object of proposing such a lawsuit is not the setting aside of the resolution of the shareholder meeting, but the obtaining of an advantageous settlement with the majority shareholders. Specifically, the plaintiff is likely to be seeking to force the majority shareholders to buy his stock at a higher price.

One major significance of the Tentative Draft is that it simplifies the regulations on closely held corporations, and proposed rules are more closely applicable to the specific nature of a closely held corporation. For example, it allows small entrepreneurs to dispense with compliance in form, but not in substance. Thus it does away with many of the deceptive practices that have been developed in order to meet requirements designed for larger corporations.<sup>42</sup> With regard to shareholder meetings in particular, the Tentative Draft

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37. Among the 112 lawsuits appearing on the setting aside of resolutions of shareholder meetings in Japanese case reporters from 1950 to 1982, in closely held corporations, 59 cases were affirmed and 53 cases were dismissed. Shishido, *supra* note 14 at 541.

38. *Commercial Code* §§ 232, 234.

39. *Commercial Code* § 247.

40. *Id.* § 252.

41. *Id.* § 252. On the structure of the lawsuits setting aside of resolutions of shareholder meetings, see Iwahara, "Kabunushisōkai Ketsugi o Arasou Soshō no Kōzō (The Structure of Lawsuits Contesting Resolutions Adopted at General Shareholders' Meetings)" 96 *Hōgaku Kyōkai Zasshi* 669 (1979) (its English translation is partly available in 2 M. Tatsuta & R. Kummert, *supra* note 18 at 7-141).

42. Opinion of Takeuchi in *Shōhō Yūgengaihashō Kaiseishian o Megutte* [Panel



simplifies the notice procedure and allows resolutions to be passed by paper agreement and without formal meetings.<sup>43</sup> With this reformation, one may expect the number of lawsuits on setting aside shareholder resolutions to decrease.

The Tentative Draft has some other provisions that attempt to prevent deceptive practices. For example, it allows one-person-corporations to be created<sup>44</sup> by abandoning the current rule requiring seven promoters.<sup>45</sup> The former rule caused the "phantom stock" phenomenon and often led to later internal disputes. The Draft also proposes to eliminate investigations by an inspector nominated by the court<sup>46</sup> where 1) only small amounts of investment in property are involved, and 2) a corporation contracts to buy small amounts of property from a promoter after the incorporation.<sup>47</sup> The current regulations have induced many attempts at evasion of the investigation rules and fuzzy investments.<sup>48</sup> The draft ends the requirement for a supervisor<sup>49</sup> in small corporations which cannot find an adequate person for the position,<sup>50</sup> and the requirement for public notice of accounting statements of small corporations,<sup>51</sup> instead, requiring their disclosure in commercial register offices.<sup>52</sup>

Although such reforms of the corporate regulations based on the size of a corporation help to fill the gap between the actual and the legal disputes of a closely held corporation to a certain degree, they do not resolve the intrinsic problems of the closely held corporation. Suits for setting aside shareholder resolutions have in fact taken on the role of expressing the dissatisfaction of minority shareholders. If the reforms close the minority shareholders' only avenue for expression of dissatisfaction, they will ultimately only have a negative influence on the solving of the intrinsic problems of the closely held corporation.<sup>53</sup> The Tentative Draft does, however, as carefully discussed later, allows minority shareholders in a closely held corporation the right to compel the majority to buy shares,<sup>54</sup>

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*Discussion on the Tentative Draft of Commercial Code and G.m.b.H. Act*], 1080 *Shōjihōmu* 12 (1986).

43. *Tentative Draft* § II 19.

44. *Id.* § I 1.

45. *Commercial Code* § 165.

46. *Id.* § 173, 168I(5)(6).

47. *Tentative Draft* § I 4.

48. The current regulations on investment in property can be avoided by buying the property from a promoter after the incorporation without prior contract. Cf. *Commercial Code* § 168I(5)(6). See also *id.* § 246.

49. *Commercial Code* § 273.

50. *Tentative Draft* § II 2.

51. *Commercial Code* § 283 III.

52. *Tentative Draft* §§ IV 1, 2.

53. Shishido, *supra* note 14 at 551.

54. *Tentative Draft* § III 8. It is the equivalent to the buyout right in the United States.

which may taken on the role of providing an avenue for expression of the dissatisfaction of minority shareholders and may be helpful in allowing the real disputes between shareholders to emerge in litigation.

## 2. The Protection of Corporate Creditors and Restrictions on the Limited Liability of Shareholders

Among the four basic principles of the corporate model mentioned earlier, the most important is the limited liability of investors. Limited liability for shareholders began in order to attract substantial amounts of capital from large numbers of investors who were strangers to each other. Therefore, this principle of the corporate model was probably originally intended only for large, publicly held corporations.<sup>55</sup> In actual practice, however, there are many closely held corporations with a small number of known investors which take advantage of limited liability by using the corporate form. Indeed, the limited liability of shareholders in closely held corporations has been recognized by most advanced industrialized countries, as evidenced, for example, by the West German G.m.b.H.

The problem with such a trend is that for closely held corporations, there are two areas with great potential for abuse of limited liability: fraudulent conducts<sup>56</sup> and undercapitalization.<sup>57</sup> In both Japan and the U.S., many abuses have occurred and thus modification of the limited liability of shareholders has been necessary in each country.<sup>58</sup>

Although both countries have needed to modify the limited liability of shareholders of close corporations, the means for such modifications have been different. In the U.S., judicial case law has created the doctrine of piercing the corporate veil.<sup>59</sup> In Japan, the Commercial Code provision on the liability of directors to third par-

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55. See J. Davis, *Essays in the Earlier History of American Corporations* 349, 383, 447 (1917); Horwitz, "Santa Clara Revisited: The Development of Corporate Theory," in *Corporations and Society: Power and Responsibility* 41 (W. Samuels & A. Miller eds. (1987)); Blumberg, "Limited Liability and Corporate Groups," 11 *J. Corp. L.* 573, 586, 595, 604 (1986).

56. For example, a majority shareholder may: make the corporation pay a large salary to himself as president while his corporation is in red ink; make the corporation transfer its important assets to himself when he knows his corporation will be bankrupt; deceive creditors of the corporation to give it credit when he knows his corporation cannot pay the debt.

57. For example, a majority shareholder may run his corporation with just \$100,000 capital and with tens of millions of dollars debt.

58. R. Clark, *supra* note 13 at 35-39; K. Egashira, *supra* note 13 at 15.

59. *Minton v. Cavaney*, 15 Cal. Rptr. 641, 364 P.2d 473, 56 C.2d 576 (1961); *Walkovsky v. Carlton*, 18 N.Y.2d 414, 223 N.E.2d 6, 276 N.Y.S.2d 585 (1966). Although, to be exact, we should say that the American prescription for abuses of the limited liability of shareholders is composed of fraudulent conveyance law, equitable subordination doctrine, the doctrine of piercing the corporate veil and statutory

ties (§ 266-3 of the Commercial Code)<sup>60</sup> has taken almost same role as the doctrine of piercing the corporate veil.<sup>61</sup>

When, in America, a situation exists that would be inequitable if the shareholders were allowed limited liability, the doctrine of piercing the corporate veil strips away the fiction of incorporatedness, and treats the corporation as a proprietorship or a partnership.<sup>62</sup> This means that the controlling shareholder is individually liable for corporate debts.<sup>63</sup> In Japan, section 266-3 of the Commercial Code was originally intended to make a director pay damages to third parties if he did not use due diligence, and was not intended to modify the principle of the limited liability of shareholders.<sup>64</sup> However, section 266-3 has become the Japanese version of piercing the corporate veil, since the controlling shareholder and the representative director are the same person in most closely held corporations. Section 266-3 also makes non-owner directors actual guarantors of the corporation.<sup>65</sup>

In the U.S., the necessity of modifying the limited liability of shareholders has led to the development of the doctrine of piercing the corporate veil, which straightforwardly denies limited liability to a controlling shareholder in certain circumstances.<sup>66</sup> In Japan, how-

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restraints on dividends, the relationship among those rules has not been clarified (R. Clark, *supra* note 13 at 91).

60. *Commercial Code* § 266-3I says, "When the directors are severely negligent in fulfilling their duty, the directors will be jointly liable for the damage even to third parties."

61. *Izuo Kōzai K.K. v. Mutō*, 23 Minshū 2150 (Sup. Ct., G.B. Nov. 26, 1969) (its English translation is available in 2 M. Tatsuta & R. Kummert, *supra* note 18 at § 8-294). Also in Japan, the fraudulent conveyance laws (Civil Code § 424) and the statutory restraint on dividends (Commercial Code § 290) are much stricter than American statutes. Even the doctrine of piercing the corporate veil has been admitted by case law (*Yamayoshi Shōkai K.K. v. Hoshihara*, 23 Minshū 511 (Sup. Ct., P.B., Feb. 27, 1968) (its English translation is available in 1. M. Tatsuta & R. Kummert, *supra* note 18 at § 3-6). However, it is seldom used in Japan because of the overruling influence of §§ 266-3 case law.

62. See R. Clark, *supra* note 13 at 37.

63. It has been pointed out that the doctrine of piercing the corporate veil may be somewhat punitive because "if the personal assets of the defendants exceed either the amount of funds improperly transferred to them from the corporation or the size of the inadequacy of the corporation's capitalization, piercing the veil and imposing liability to the full extent of their personal assets will overcompensate the creditors for the harm traceable to the defendants' provable or wrongful acts." R. Clark, *supra* note 13 at 82.

64. See generally T. Suzuki & A. Takeuchi, *Kaishahō [Corporation Law]* 280 (1987).

65. *Kobayashi v. Hashimoto*, 24 Minshū 1305 (Sup. Ct. P.B., May 22, 1973) (its English translation is available in 2 M. Tatsuta & R. Kummert, *supra* note 18, at § 8-299); *Nippon Sutadeo v. Nakamura*, 26 Minshū 984 (Sup. Ct. P.B., June 15, 1972); *Nagakita Shōkai K.K. v. Koyanagi*, 32 Kakyū Minshū 465 (Tokyo High Ct., Apr. 28, 1977); Tatsuta, "The Risks of Being an Ostensible Director under Japanese Law," 8 *J. Comp. Bus. & Cap. Mkt. L.* 445 (1986).

66. It should be noted, however, that there are even fewer cases where a veil was pierced solely because of undercapitalization, even though it is a relevant factor.

ever, the same necessity has led to many cases which induce almost the same result, but which uses the statutory provision of section 266-3 on directors' liability to third parties.

One reason for such a difference may be in dissimilarities of the two legal processes, discussed in Section I. In the U.S., a plaintiff and a defendant can directly argue the actual dispute in question in court and the court can use its discretion to balance the conflicting interest of both parties. In the Japanese legal process, a plaintiff must rely on a specific provision of the Code, and the court can decide based only on legal arguments surrounding that provision. For this reason, a statutory provision may sometimes play a role which the Japanese legislators never imagined, nor desired.

In addition to dissimilar legal processes, the differing levels of emphasis given to the principle of the limited liability of shareholder may be a cause for the separate approaches of each country. These emphases are evident after reading many American cases on piercing the corporate veil and many Japanese cases on the Commercial Code section 266-3. Generally speaking, in the U.S., adherence to the concept of shareholders' limited liability is more important than the protection of creditors. In Japan, the reverse is true. Because of the existence of section 266-3, Japanese corporate creditors, particularly contract creditors, may reach the private assets of entrepreneurs much more easily than their American counterparts.

Although there are many more cases which have held the majority stockholder liable for corporate debt by piercing the corporate veil in the U.S. than in Japan,<sup>67</sup> the general rule is that the shareholders are not personally liable for corporate debts, unless there is no fraud or the necessity of protecting a paramount equity has been maintained and the corporate veil has been pierced fairly reluctantly and cautiously,<sup>68</sup> particularly in contract cases rather than in tort cases.<sup>69</sup> Actually, "the law permits the incorporation of a business

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R. Clark, *supra* note 13 at 74. See *Carpentry Health & Welfare Fund of Philadelphia and Vicinity v. Gray v. Kenneth R. Ambrose, Inc.*, 727 F.2d 279 (3d Cir. 1983); *West v. Costen*, 558 F. Supp. 564 (W.D. Va. 1983).

67. *Consumers Time Credit, Inc. v. Remark Corp.*, 227 F. Supp. 263 (E.D. Pa. 1964); *Glassman v. Glassman*, 19 A.D.2d 801, 243 N.Y.S.2d 194 (Sup. Ct. 1963); *DeWitt Track Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681 (4th Cir. 1976); *Kilpatrick Bros., Inc. v. Pointer*, 205 Kan. 787, 473 P.2d 33 (1970). Cf. *Yamayoshi Shōkai, K.K. v. Hoshihara*, 23 Minshū 511 (Sup. Ct., P.B., Feb. 27, 1968); *Honma v. Asahikawa Shōji, K.K.*, 28 Minshū 1306 (Sup. Ct., P.B., Sept. 26, 1974).

68. *Amoco Chemicals Corporation v. Bach*, 222 Kan. 589, 567 P.2d 1337 (1977); *Energy Resources Group, Inc. v. Superior Oil Co.*, 460 F. Supp. 483 (D.C. Kan. 1978); *CM Corp. v. Oberer Redevelopment Co.*, 631 F.2d 536 (CA 7, 1980); *Ramsey v. Adams*, 4 Kan. App. 2d 184, 603 P.2d 1025 (1979); *Properties v. Sagebrush Sales Co.*, 598 S.W.2d 1 (Tex. Civ. App. 1979).

69. *Hanson Southwest Corp. v. Dal-Mac Const. Co.*, 554 S.W.2d 712 (Tex. Civ.

for the very purpose of escaping personal liability."<sup>70</sup>

In Japan, in the event of insolvency of a closely held corporation, personal liability of a director to contract creditors is relatively easily admitted.<sup>71</sup> On the other hand, in the U.S., most cases where directors' personal liability has been argued are cases of financial institutions<sup>72</sup> and courts will not hold a director or an officer liable to corporate creditors just because of bad business judgment but because of gross mismanagement amounting to fraud, particularly where there is some misappropriation.<sup>73</sup>

In addition, it is common practice in Japan that major creditors of a small corporation, such as a bank or a large supplier, can usually privately obtain the guarantee of the corporate president (that is, the controlling shareholders)<sup>74</sup> and obtain a mortgage on his private assets.<sup>75</sup> This practice is culturally accepted, and is quite widespread.

Therefore, the following comparisons between the modifications of the limited liability of shareholders in the two countries, may be made. In the U.S., the limited liability of the shareholder is sustained even in very small closely held corporations. Only in exceptional cases, is the principle modified by the doctrine of piercing the corporate veil. In Japan, the very nature of shareholders' limited liability has been changed as applied to small closely held corporations. Small closely held corporations have become closer to "incorporated limited partnerships" (*Gōshigaisha*).

The Tentative Draft takes its strongest stance in its effort to protect corporate creditors. Its attempt to do this may be divided into three parts: (1) it stresses the concept of stated capital and uses it in ways to protect corporate creditors; (2) it reforms disclosure policies and supervises corporate accounting; and (3) it allows the personal liability of directors and controlling shareholders in additional new circumstances.

On the use of stated capital to protect corporate creditors, the Tentative Draft has several provisions. First of all, the Tentative

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App. 1977); Douglas & Shanks, "Insulation from Liability through Subsidiary Corporation," 39 *Yale L.J.* 193, 210-11 (1929).

70. *Bartle v. Home Owners Co-operative, Inc.*, 309 N.Y. 103, 127 N.E.2d 832 (1955); *Brunswick Corp. v. Waxman*, 459 F. Supp. 1222 (E.D. N.Y. 1978).

71. *Nihon Jidōsha, K.K. v. Suzuki*, 20 *Minshū* 660 (Sup. Ct., P.B., Apr. 15, 1967); *Sato v. Beniyama*, 27 *Kōsai Minshū* 115 (Osaka High Ct., Apr. 17, 1974); *Miyako Kōsan, K.K. v. Usui*, 455 *Kinyū Shōji Hanrei* 11 (Tokyo Dist. Ct., May 8, 1975); *Nagakita Shōkai, K.K. v. Koyannagi*, 32 *Kakyū Minshū* 465 (Tokyo High Ct., Apr. 28, 1977). Cf. *Kitahara v. Ōhashi*, 909 *Hanrei Jihō* 95 (Tokyo Dist. Ct., Mar. 2, 1978).

72. *Frances T. v. Village Green Owners Ass'n*, 723 P.2d 573 (Cal. 1983); *Craig v. Stacy*, 330 Mo. 569, 50 S.W.2d 104 (1932).

73. *Devereaux v. Berger*, 264 Md. 20, 284 A.2d 605 (1971).

74. The same practice may also be common in the U.S.

75. This practice may be somewhat less common in the U.S.

Draft sets the minimum level for stated capital at 20 million yen (about \$133,000) for Kabushikigaisha (corporations) and 5 million yen (about \$33,000) for Yūgengaisha (G.m.b.H). It further requires Kabushikigaisha to have a "safe harbor" level of capitalization<sup>76</sup> at 50 million yen (about \$333,000—consisting of the stated capital, plus an additional amount of earned surplus to make the balance of 50 million yen). These minimum levels of capitalization may be construed as a prerequisite to limited liability.<sup>77</sup> Second, the draft tries to close existing loopholes in the minimum levels of stated capital by creating criminal sanctions for disguised investments,<sup>78</sup> and by prohibiting loans from corporations to their shareholders for a certain initial period after the creation of the corporation.<sup>79</sup> Thirdly, the Tentative Draft requires more of the corporate profit to be reserved to supplement the stated capital.<sup>80</sup>

On the second issue, that of the reformation of disclosure policies and the supervision of corporate accounting, the Tentative Draft places a heavy emphasis on making the process more feasible and requires truly effective financial disclosure and supervision. It recommends that disclosure should be made to a commercial register office and abandons the current requirement of public notice of accounting statements.<sup>81</sup> The current requirement is unnecessary for close corporations and they are unable to follow it.<sup>82</sup> Then, it tries to place closely held corporations under the scrutiny of accounting experts by allowing investigation<sup>83</sup> or instruction<sup>84</sup> by tax accountants, instead of C.P.A.'s.<sup>85</sup> Despite the efforts of legislators, the aims of these proposed reforms will be very difficult to realize. Small entrepreneurs who have actually dispensed with disclosure of this accounting statements are likely to resist, and the measure has

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76. Section III 14 and Section III 15 of the Tentative Draft could be interpreted to hold that the controlling shareholder will neither be liable for any labor or tort debt of the corporation nor be submitted to equitable subordination only if he/she keeps the level of capitalization over 50 million yen.

77. *Tentative Draft* § I 20.

78. *Id.* § I 11. Disguised investments are attempts to make an outlook of legal capitalization, in fact, without substance of money, usually by borrowing money from Bank A, then depositing it into Bank B which will issue the certificate of capital deposit, and soon after issuing the certificate, withdrawing money from Bank B and bringing it back to Bank A.

79. *Tentative Draft* § I 12.

80. *Id.* § IV 13.

81. *Commercial Code* § 283 III.

82. *Tentative Draft* § IV 2.

83. *Id.* § IV 4.

84. *Id.* § IV 5.

85. Now, in Japan, only large corporations (those with either stated capital at more than 500 million yen (about \$3.33 million) or debts on the balance sheets at more than 20 billion yen (about \$133 million)) must be investigated by C.P.A.s or accounting firms. There are many tax accountants but few C.P.A.s in Japan. Investigation of all corporations could not be handled only by C.P.A.s.

engendered disputes between C.P.A.'s and tax accountants over professional boundaries.

The provisions of the Tentative Draft on the third issue, the additional liability of directors and controlling shareholders in certain new circumstances are logically related to the provisions discussed above. The minimum stated capital and effective disclosure provisions act as prerequisites for the limited liability of shareholders, while the additional liability provision modifies the shareholders' limited liability principle itself, and applies when the prerequisites are not met. For example, when a corporation does not disclose its accounting statements or when it does not allow proper inspection by accounting experts, corporate creditors can sue the directors for their damages.<sup>86</sup> In the following circumstances, a controlling shareholder who would otherwise be protected from liability by the corporate form may be held personally liable: (1) When the stated capital of a corporation is below a certain amount,<sup>87</sup> the controlling shareholder will be liable for any labor or tort debts of the corporation;<sup>88</sup> (2) When the stated capital of a corporation is below a certain level,<sup>89</sup> a loan from the controlling shareholder to the corporation will be regarded as an investment by the shareholder;<sup>90</sup> (3) When a corporation becomes insolvent, the benefits<sup>91</sup> obtained by shareholders from the corporation must be reimbursed to the corporation by the shareholders.<sup>92</sup>

The degree to which the limited liability of shareholders is modified may be examined by looking at three aspects of such modification. The first way to view a modification is to look at the type of modification. A modification may be made by rescinding a fraudulent conveyance, subordinating the claims of shareholders who are also creditors of the corporation to the claims of all other creditors; or by making a shareholder directly liable to corporate creditors.<sup>93</sup> Another way to view a modification of the limited liability of shareholders is to look at the conditions of the modification. That is to say, whether the modification requires some evidence of fraud or is

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86. *Tentative Draft* § II 2.

87. Generally for Kabushikigaisha, the legal minimum amount for stated capital (20 million yen) plus an additional amount of earned surplus to equal a total of 50 million yen.

88. *Tentative Draft* § III 14. In the United States, New York has a statute which makes the ten largest shareholders of a closely held corporation personally liable for wages. *N.Y. Bus. Corp. Law* § 630.

89. See *supra* note 87.

90. *Tentative Draft* § III 15.

91. For example, unreasonable salaries which shareholders have obtained from the corporation as directors or as employees.

92. *Tentative Draft* § III 16.

93. R. Clark, *supra* note 13 at 40, 52, 71.

based only upon undercapitalization.<sup>94</sup> The third way to view a modification is to look at the maximum possible liability of a shareholder. For example, a shareholder may owe only up to the amount for which the corporation is undercapitalized, or he/she may have unlimited liability.<sup>95</sup> Here, we will apply the three aspects just mentioned both to the provisions of the Tentative Draft on the issue of increased liability of directors and shareholders, and to section 266-3 of the Commercial Code.

As to the type of modification, section III 16 on the reimbursement of benefits which shareholders have obtained from the corporation is not a true modification to the limited liability of shareholders but is rather a corollary to the rescission of fraudulent conveyances. This section, however, may play a role similar to such a modification because it shifts the burden of proving that the benefit received constituted reasonable remuneration. The burden shifts from the plaintiffs (corporate creditors) to the benefitting shareholders. Section III 15, which regards loans by a controlling shareholder as investments, uses the technique of subordination (placing loans to shareholders behind loans to general creditors), a technique which has never before been used in Japan. Section III 14 on the liability of controlling shareholders uses direct liability of shareholders, the method also used in section 266-3.

As to conditions for modification, section III 16, a corollary of the rescission of fraudulent conveyances, naturally requires some evidence of fraudulent acts. Section II 12 on the liability of directors where no disclosure of accounting statements has been made also targets cases of fraud. That provision makes it easier to prove a director's liability by shifting the burden of proof from the plaintiffs to the directors. Section III 14 on the liability of controlling shareholders and section III 15 on regarding loans by controlling shareholders as investments requires undercapitalization and sets a specific amount (50 million yen) to determine undercapitalization.<sup>96</sup> Section 266-3 originally required some fraudulence, but now some undercapitalization cases are also within its range.<sup>97</sup>

As to the maximum liability involved, section III 15 regards a loan by a shareholder to the corporation as an investment "up to the amount it is under fifty million yen (the legally required minimum

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94. *Id.* at 67, 74.

95. *Id.* at 81-82. K. Egashira, *supra* note 13 at 290.

96. In contrast, in the U.S., no such definite amount has been set, and undercapitalization is determined on a case-by-case basis.

97. *Kawakami v. Isono*, 9 Kakyū Minshū 2342 (Tokyo Dist. Ct., Nov. 28, 1958); *Japan v. Sakai*, 10 Kakyū Minshū 1293 (Fukushima Dist. Ct., Jun. 19, 1959); *Okubo v. Katsumata*, 783 Hanrei Jihō 125 (Sendai Dist. Ct., Sep. 30, 1974); *Shiozawa v. Tsujii*, 780 Hanrei Jihō 96 (Maebashi Dist. Ct., Takasaki Div., Dec. 26, 1974); K. Egashira, *supra* note 13 at 405.



for capital).” Therefore, it limits the direct liability to the amount to which a corporation was undercapitalized. Section III 14, which also requires undercapitalization as a condition, allows unlimited direct liability of shareholders for corporate obligation to workers and tort creditors. Section 266-3 also uses a scheme of unlimited direct liability.

To sum up, section III 16 treats cases of fraud, and leads to the same result as the rescission of a fraudulent conveyance in its method of accounting for the profit which shareholders have obtained from a corporation. Section III 15 deals with undercapitalization cases and makes claims by controlling shareholders subordinate to those of other creditors to the extent of undercapitalization. These two sections are logically consistent. On the other hand, section III 14 on undercapitalization makes controlling shareholders directly liable without limit (but only tort and labor claims may be brought). This section is an unusual form of modifying shareholders’ limited liability because it allows unlimited liability for undercapitalization. This section is strict for controlling shareholders (or parent companies) of small corporations, since their tort liability may become quite large, paralleling product liability.<sup>98</sup>

Several unsettled questions regarding the scheme of the Tentative Draft on the protection of corporate creditors may be posed. Firstly, how will the interests of the different kinds of creditors be balanced under section III 14 (which makes a controlling shareholder owe direct and unlimited liability to labor creditors and tort creditors)? In particular, what will the interest of creditors of the controlling shareholders be? It is clear that any modification of shareholders’ limited liability may bring harm to the shareholders’ creditors. However, it is important not to harm them too much or credit will become difficult for small corporations to obtain.

In Japan, it is an unwritten custom for major corporate creditors of small corporation to obtain a personal guarantee of payment from the president as well as a mortgage on the president’s private properties.<sup>99</sup> Will the labor and tort claims which are protected by the section III 14 rank above or below such mortgaged claims? If the tort and labor claims rank with the general claims, below the mortgages, the protection of section III 14 would not work very well because major corporate creditors, like banks, would take the private properties of controlling shareholders first. If labor claims or tort claims are ranked before mortgaged claims, a small corporation may be unable to obtain loans.

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98. Compared to the United States, product liability suits are still much rare and the amount of damages admitted by the courts usually is much smaller in Japan.

99. See *supra* notes 74-75 and accompanying text.

A second question is whether section 266-3 will continue its role as an alternative to piercing the corporate veil after the adoption of sections III 14, III 15, and III 16, which allow for personal liability of controlling shareholders under certain circumstances. Perhaps so, but with modifications. Section 266-3 has not been able to sufficiently cover the "pure" undercapitalization cases<sup>100</sup> or the cases where controlling shareholders are not directors. Also it has been very difficult for plaintiffs to prove that the compensation given to directors is unreasonably high. The three sections of the Tentative Draft should be considered as supplementary legislation to the case law regarding section 266-3.

Thirdly, whether the 'safe harbor' figure of 50 million yen<sup>101</sup> will shield directors and shareholders for undercapitalization liability under section 266-3 is an important question. Also, it is not clear whether a controlling shareholder or director will be shielded for liability even where the business is so large as to make the 50 million level an extremely small level of capitalization. How section 266-3 will be interpreted to take account of this problem remains to be seen.

### 3. Modification of Internal Relationships by Shareholder Agreements

Professor Eisenberg has pointed out that the actual structure of governance for most corporations deviates greatly from the formal legal structures.<sup>102</sup> This is true even for publicly held corporations, for whom the formal legal structure was designed.<sup>103</sup> For closely held corporations, the deviation is even greater.

Because of this, entrepreneurs who are planning to create a closely held corporation must first construct internal relationships which are suitable for their size and their members' expectations. Basically, they must refashion the readymade form created by the state corporate statute or the Commercial Code into a custom tailored form which will fit the needs of the particular closely held corporation.

The responses to the pressure to modify the legal model have differed in the U.S. and Japan. American law permits the modification of internal relationships by shareholder agreement, thus providing for "custom-made" structures.<sup>104</sup> In contrast, the Japanese tend

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100. Although most cases involve undercapitalization and fraud, I have used the term "pure" capitalization to refer to cases without fraud. Cases involving fraud would be fully covered by Section 266-3.

101. *Tentative Draft* §§ IV 13, III 14, III 15. See *supra* note 76.

102. M. Eisenberg, *supra* note 6 at 1-6.

103. *Id.* at 37-68.

104. In the U.S., also, early decisions were generally hostile toward private order-

to provide several legal alternatives among which a corporation must choose, resulting in greater restrictions on the modification of internal relationships by shareholder agreement.

There are two basic pressures to modify the corporate legal model for closely held corporations: modification of the free transferability of stock and modification of the principle of majority control.

The reason for the pressure to modify the free transferability of stock is the same in Japan and the U.S. In publicly held corporations, the free transferability of stock is indispensable for gathering large amounts of capital from numerous investors who are strangers to each other.<sup>105</sup> Also, the free transferability of stock is no threat to the management of a corporation as long as they can control the majority of stock because the management is independent of such anonymous investors (ownership and management are separate).<sup>106</sup>

In closely held corporations, however, all shareholders know each other, and most of them participate in managing the corporation in some way (ownership and management are not separate). It is natural that these shareholders want to keep out outsiders.<sup>107</sup> Although stock is usually not actually freely transferred in closely held corporations, the shareholders may want to place legal restrictions on transfer in order to avoid possible disputes. To legally restrict the transferability of stock, however, it is necessary to guarantee some means for the recoupment of the investments made by minority shareholders.

This background situation is common to both countries, but the ways of restricting transferability of stock differ slightly. There are many kinds of restrictions in the U.S. because shareholders can restrain transferability of stock by shareholder agreement. Some examples of restrictions used are: first refusal,<sup>108</sup> first option,<sup>109</sup>

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ings. See *McQuade v. Stoneham*, 263 N.Y. 323, 189 N.E. 234 (1934). Today, however, courts enforce all kinds of shareholder agreements in closely held corporations. See, *Clark v. Dodge*, 269 N.Y. 410, 199 N.E. 641 (1936); *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964); *Lehrman v. Cohen*, 43 Del. Ch. 222, 222 A.2d 800 (1966); *In re Vogel*, 25 A.2d 212, 268 N.Y.S.2d 237 (1966), *aff'd mem.*, 19 N.Y.2d 589, 224 N.E.2d 738, 278 N.Y.S.2d 236 (1967); *Colbert v. Hennessey*, 351 Mass. 131, 217 N.E.2d 914 (1966); *Allen v. Biltmore Tissue Corp.*, 2 N.Y.2d 534, 141 N.E.2d 812, 161 N.Y.S.2d 418 (1957); see also *Model Statutory Close Corporation Supp.* § 20(a)-(b); *Del. Gen. Corp. Law* § 350; *Easterbrook & Fischel*, "Close Corporations and Agency Costs," 38 *Stan. L. Rev.* 271, 280-83 (1986).

105. R. Clark, *supra* note 13 at 14.

106. See Generally, A. Berle & G. Means, *The Modern Corporation and Private Property* (1932).

107. See W. Cary & M. Eisenberg, *supra* note 13 at 93.

108. First refusals prohibit a shareholder from selling his/her stock to a third party unless he/she offers it to the corporation or the other shareholders at the same price which is offered by the third party. W. Cary & M. Eisenberg, *supra* note 13 at 421; R. Clark, *supra* note 13 at 765. This method is considered the least restrictive

consent restraints,<sup>110</sup> buyback rights,<sup>111</sup> and buy-sell arrangements.<sup>112</sup> Statutes and cases have recognized the effectiveness of such shareholder agreements on restricting stock transferability,<sup>113</sup> but still require reasonableness of the restraints and notice to shareholders who subject to them.<sup>114</sup>

In Japan, in contrast, there is basically only one way to restrict stock transferability, provided for in Commercial Code section 204-2 and the sections following. Under those provisions, a corporation may adopt a bylaw which restricts the transfer of stock.<sup>115</sup> Under such a bylaw, if the Board of Directors rejects a potential buyer of a shareholder's stock, the Board must appoint its own buyer to negotiate with the seller shareholder.<sup>116</sup> If negotiations fail, the shareholder may request judicial assistance in valuing the stock.<sup>117</sup> Although it is also possible for some shareholders to force other shareholders to contractually agree to restrict stock transferability,<sup>118</sup> the penalty for violation of such a contract is only compensa-

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and such provisions are widely upheld. W. Cary & M. Eisenberg, *supra* note 13 at 422.

109. First options are almost the same as first refusals, except that the price of stock is not the offered price of the third party but is determined by the agreement creating the option. W. Cary & M. Eisenberg, *supra* note 13 at 421; R. Clark, *supra* note 13 at 765. The issue is the divergence between the option price and a fair price. W. Cary & M. Eisenberg, *supra* note 13 at 422.

110. Consent restraints prohibit a shareholder from selling his/her stock to a third party unless he/she obtained the consent of the board or the other shareholders. W. Cary & M. Eisenberg, *supra* note 13 at 421; R. Clark, *supra* note 13 at 765. This method is considered to be the most restrictive. Although some statutes and some cases are more tolerant against consent restraints, their validity remains uncertain. W. Cary & M. Eisenberg, *supra* note 13 at 422.

111. Particularly with employee-shareholders, corporations often retain the option to repurchase their stock when the employment relationship is terminated, even if the shareholder does not want to sell. W. Cary & M. Eisenberg, *supra* note 13 at 423; R. Clark, *supra* note 13 at 765.

112. Buy-sell agreements create both the obligation of a shareholder to sell his/her stock and the obligation of the corporation or the other shareholders to buy them in the case of death or retirement of a shareholder. W. Cary & M. Eisenberg, *supra* note 13 at 423; R. Clark, *supra* note 13 at 765.

113. *Del. Gen. Corp. Law* §§ 202, 349; *Cal. Gen. Corp. Law* §§ 204(b), 408(1); *Rev. Model Bus. Corp. Act* § 6.27; *Model Stat. Close Corp. Supp.* § 10-17. On first refusals: *Groves v. Prickett*, 420 F.2d 1119 (9th Cir. 1967); *Tu-Vu Drive-In Corp. v. Ashkins*, 61 Cal. 2d 283, 391 P.2d 828, 38 Cal. Rptr. 348 (1964). On first options: *Lawson v. Household Finance Corp.*, 17 Del. Ch. 343, 152 A. 723 (1930); *In re Mather's Estate*, 410 Pa. 361, 189 A.2d 586 (1963). On consent restraints: *Colbert v. Hennessey*, 351 Mass. 131, 217 N.E.2d 914 (1966).

114. R. Clark, *supra* note 13, at 767. Although reasonableness could be required on methods for recouping investments, the degree of the requirement is not very strong. For example, there are many cases which held first options valid, even though the option price was far less than the fair value. *In re Mather's Estate*, 410 Pa. 361, 189 A.2d 586 (1963).

115. *Commercial Code* § 204 I.

116. *Id.* § 204-2.

117. *Id.* § 204-4.

118. Recently, Japanese commentators have more and more liberal views on ad-

tory damages from the contracting party. The stock transfer will probably not be rescinded.<sup>119</sup>

Thus, as to restrictions on the transferability of stock, the differences between the policies of the two countries are minor. Except for the number of methods of restriction, the policies are similar since restrictions are allowed and some means for recoupment of investments must be available.

As to modification of the principle of majority control of stock, there are substantial differences between the two countries. In the U.S., it is clearly possible to modify majority control by shareholder agreements,<sup>120</sup> but in Japan, it is difficult to do so.<sup>121</sup>

In corporations, it is a basic principle that a person who owns a majority of stock or a person who can control a majority of stock by means of proxies can elect all the board members and can manage the corporation, limited only by the business judgment rule.<sup>122</sup>

At one time, in both countries, there was an attempt to let minority shareholders send their representatives to the board by using a cumulative voting system.<sup>123</sup> However, this policy could be evaded by use of a staggered system, in which the terms for directors were begun at different times.<sup>124</sup> Although in the U.S. it is still arguable whether cumulative voting is a good idea or not,<sup>125</sup> in Japan, it is almost uniform knowledge that allowing minority representatives to the board of directors is inefficient, and the cumulative voting system is of no substantial significance.

In publicly held corporations, minority shareholders can sell their stock in stock markets any time they are not satisfied with management. The centralized management system which is sup-

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mitting contractual restraints on stock transferability. See Maeda, "Keiyaku ni yoru Kabushiki no Jōdoseigen [Restrictions of Stock Transfer by Contracts]" 121 *Hōgaku Ronsō* 36 (1987); Ueyanagi, Kabushiki no Jōdoseigen—Teikan ni yoru Seigen to Keiyaku ni yoru Seigen [Restrictions of Stock Transfer—Restrictions by Bylaws and Restrictions by Contracts], 15 *Osaka Gakuin Daigaku Hōgaku Kenkyū* 1 (1989).

119. 3 *Shin Chūshaku Kaishahō* (Corporate Law Annotated, new ed.) 71 (Ueyanagi) (1986); Maeda, *supra* note 118, at 36; Swisher, "Use of Shareholder Agreements and Other Control Techniques in Japanese Joint Venture Corporations and Their Validity under Japanese Corporate Law," 9 *Int'l Law.* 159, 172-73, 179-80 (1975).

120. Many early decisions, however, were hostile toward private agreements. Easterbrook & Fischel, *supra* note 104 at 280.

121. See Swisher, *supra* note 119, at 181.

122. F. O'Neal & R. Thompson, *supra* note 14 § 1.02.

123. In the United States, some states have statutes mandating cumulative voting. *Cal. Gen. Corp. Law* § 708. Most states, however, leave it optional with the corporation. *Rev. Model Bus. Corp. Act* § 7.28(b); *N.Y. Bus. Corp. Law* § 618. In Japan, basically any shareholder could request cumulative voting if there is no bylaw against it (*Commercial Code* § 256-3). In practice, however, most corporations waive cumulative voting by bylaws.

124. *Bohanon v. Corporation Commission*, 313 P.2d 379 (Ariz. 1957).

125. R. Clark, *supra* note 13 at 363-64.

ported by the principle of majority stockholder control is reasonable. In closely held corporations, however, some unreasonable situations may arise if the principle of majority shareholder control is strictly applied. Because a shareholder in a closely held corporation, even if he/she is a minority shareholder usually invests in the corporation in order to participate in management, (in contrast to most shareholders in a publicly held corporation who have no intent to participate), a minority shareholder in a closely held corporation has an interest in maintaining some voice or some control in managing the corporation.<sup>126</sup> At least, initially there is usually a "gentlemen's agreement" on these issues. Once a dispute among shareholders occurs, however, such a gentlemen's agreement is not legally enforceable.

The struggle for control in a closely held corporation may be construed as a dispute between majority shareholders and minority shareholders over the modification of the principle of majority shareholder control or an argument over institution of "proportional representation." In a joint venture, which is a closely held corporation among enterprises, this problem is almost always a major issue.<sup>127</sup> Although in family owned closely held corporations, there are probably fewer cases where the modification of the principle of majority shareholder control is disputed than in joint ventures, shareholder agreements which modify majority control are already popular in the U.S.<sup>128</sup>

A typical joint venture agreement includes several types of "proportional representation." First, the allotment of directors in proportion to the shares held by each partner is discussed. For example, in a joint venture with a 51% and a 49% partner, in the absence of a contractual agreement, the principle of majority control would apply and the 51% partner could appoint all the board of directors. In such a case, however, each partner would usually arrange by contract to retain the power to elect half the directors.<sup>129</sup>

Second, veto powers on important decisions is agreed upon. If there were no contractual agreement, a majority partner could de-

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126. No reasonable person would voluntarily invest in a closely held corporation, from the beginning, as a minority shareholder, who has neither voice nor control in managing the corporation.

127. United Nations Industrial Development Organization (U.N.I.D.O.), *Manual on the Establishment of Industrial Joint-Venture Agreements in Developing Countries*, Ch. 3 § 1(4) (1971) [hereinafter U.N.I.D.O.]. Swisher, *supra* note 119 at 163-71, 173.

128. F. O'Neal & R. Thompson, *supra* note 14 § 1.02. In Japan, there are still very few cases where the modification of the principle of majority control is done by shareholder agreements in family-owned closely held corporations.

129. U.N.I.D.O., *supra* note 127, at ch. 3 § 1(4); Shishido, "Conflicts of Interest and Fiduciary Duties in the Operation of a Joint Venture," 39 *Hastings L.J.* 63, 69 (1987).

cide almost everything<sup>130</sup> and a minority partner would have no voice. In most joint venture agreements, minority partners establish their veto powers not only over fundamental changes, but also over other important business decisions such as the issuance of new shares, large loans or entry into new markets.<sup>131</sup>

Third, how minority partners will specifically be involved in management is always an important problem in making joint venture contracts. In particular, which management positions a minority partner is eligible to fill, executive vice president, treasurer, or so on, is a point for major negotiation.<sup>132</sup>

The background situations for modification of the principle of majority control are thus similar in both countries. The situations in the two countries are different, however, in the following ways. There is the differing recognition of the necessity for modification of the principle of majority control by contractual agreement. In the U.S., not only in joint ventures, which are created among enterprises, but also in family-owned closely held corporations, shareholder agreements which include modification of majority control are popular.<sup>133</sup> In Japan, although managers of big corporations have recognized the necessity for modification (because of their international joint ventures with foreign corporations), shareholders in family-owned closely held corporations do not yet sense any necessity for change.

The enforcement of a shareholder agreement which modifies majority control may be different. In the U.S., one is basically free to modify the statutory corporate governance model by shareholder agreement,<sup>134</sup> and there are several legally enforceable forms (e.g. voting trusts<sup>135</sup> or use of different classes of stock<sup>136</sup>). In Japan, there is no guarantee of legal enforcement of agreements which

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130. In Japan, the Commercial Code requires a special majority vote (two third of shares present at the meeting) on some important decisions like mergers or amending bylaws. In the U.S., most state statutes only require a simple majority.

131. U.N.I.D.O., *supra* note 127 at ch. 3 § 1(7); Shishido, *supra* note 129 at 70.

132. F. O'Neal & R. Thompson, *supra* note 14, § 9.01; Swisher, *supra* note 119, at 173.

133. See *supra* note 128.

134. In closely held corporations, a bargain should normally be enforced according to its terms, without regard to whether it is reasonable or fair. However, an execution of a contractual right leading to an opportunistic exploitation of bargained-out structural and distributional rules may be denied by the court through the fiduciary duty theory. *Smith v. Atlantic Properties, Inc.*, 12 Mass. App. 201, 422 N.E.2d 798 (1981); Eisenberg, "The Structure of Corporation Law," 89 *Colum. L. Rev.* 1461 at 1463, 65 (1989).

135. *Del. Gen. Corp. Law* § 218(a); *Cal. Gen. Corp. Law* § 706(b); *Rev. Model Bus. Corp. Act* § 7.30; *Mass v. Stone*, 346 Mass. 67, 190 N.E.2d 217 (1963); *Carnegie Trust Co. v. Security Life Ins. Co.*, 111 Va. 1, 68 S.E. 412 (1910).

136. *N.Y. Bus. Corp. Law* §§ 703, 704; *Del. Gen. Corp. Law* § 151(a); *Lehrman v. Cohen*, 43 Del. Ch. 222, 222 A.2d 800 (1966).

modify the corporate governance model of the Commercial Code.<sup>137</sup> This may create large problems for foreign corporations desiring to create joint ventures in Japan.

The Tentative Draft does not consider the necessity of modification of corporate governance by shareholder agreement, but it includes two important provisions which will affect the structure of control of closely held corporations. The first one is the restriction on the inheritability of stock. This section allows a corporation to have a bylaw which provides that the right to buy stocks transferred by inheritance may be given to a person elected at a shareholder meeting.<sup>138</sup> The legislators may have considered the fact that inheritance tends to lead to disputes among shareholders and intended to prevent these useless disputes by allowing buyout by a person elected by the shareholders.<sup>139</sup> This section will be a very important modification on the free transferability of stock, and also may strengthen the principle of majority control.<sup>140</sup>

The second provision is a section which gives preemptive rights to each shareholder of a corporation with bylaws restricting the transferability of stock.<sup>141</sup> A preemptive right is the right of every shareholder to maintain his/her percentage of outstanding stock upon issuance of new shares.<sup>142</sup> In both the U.S. and Japan, a board of directors has discretion over the issuance of new stock for flexible financing: when to issue, how much to issue, and to whom.<sup>143</sup> Although this scheme is reasonable in publicly held corporations,<sup>144</sup> there is a large possibility for management people in closely held corporations to abuse their discretion in order to increase their own power.<sup>145</sup> In the U.S., most joint ventures and some closely held corporations guarantee preemptive rights or vetoes on issuing new

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137. Swisher, *supra* note 119 at 178-81.

138. *Tentative Draft* § III 3.

139. Due to a lack of adequate estate planning, inheritances are always triggers of internal disputes in family owned closely held corporations in Japan. Shishido, *supra* note 16 at 101.

140. This buyout right will avoid creating minority shareholders who tend to create disputes among shareholders. As a consequence, it will support the management power of a majority shareholder.

141. *Tentative Draft* § III 4.

142. W. Cary & M. Eisenberg, *supra* note 13 at 1495; R. Clark, *supra* note 13 at 719.

143. *Del. Gen. Corp. Law* §§ 102(b)(3), 154; *Rev. Model Bus. Corp. Act* §§ 6.21, 6.30; R. Clark, *supra* note 13 at 719. In Japan, a board of directors has discretion to issue new shares, which could be up to three-fourths of all the shares the corporation can issue (at least one-fourth of them have to be issued at the incorporation). *Commercial Code* §§ 166 III, 180-2.

144. H. Ballantine & G. Sterling, *California Corporation Laws* 142 (1949).

145. See *Ross Transport, Inc. v. Crothers*, 185 Md. 573, 45 A.2d 267 (1946); *Schwartz v. Marien*, 37 N.Y.2d 487, 373 N.Y.S.2d 122, 335 N.E.2d 334 (1975). See also *In re Zunō Kōgaku Kōgyō, Inc.*, 15 Minshū 645 (Sup. Ct. Mar. 31, 1961); *In re Ebisu Orimono, Inc.*, 731 Hanrei Jihō 85 (Osaka Dist. Ct. Sakai Div., Nov. 29, 1973); *In re*



shares<sup>146</sup> to shareholders by corporate agreement.<sup>147</sup> In Japan, because such shareholder agreements are unlikely to take place, the legislators legally require preemptive rights for shareholders in the new Tentative Draft. This requirement will exist unless overruled by special shareholder vote (two thirds of shares present at a meeting).<sup>148</sup>

#### 4. The Protection of Minority Shareholders and Ways to Liquidate Investments

In a corporation, the principle of majority control generally holds true unless changed by shareholder agreement. This means that a person able to control (by ownership or proxy) a majority of shares can control most management decisions.<sup>149</sup> However, any stock issued within a given class must be treated equally, that is, the economic interest of each stock must be afforded the same treatment no matter who owns it, majority or minority shareholder. This is the principle of economic fairness among shareholders.<sup>150</sup>

In a publicly held corporation, this kind of economic fairness is generally guaranteed by the stock markets, since minority shareholders of a publicly held corporation may usually sell their stock at virtually the same price as the stock of majority shareholder.<sup>151</sup> In closely held corporations, however, economic fairness will not be obtained since there is no market (such as a stock market) for the sale of the shares.<sup>152</sup>

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*Yae Kōgyo, Inc.*, 533 Kinyū Shōji Hanrei 22 (Tokyo Dist. Ct., Aug. 30, 1977); *In re Higashi Nihon Fudōsan, Inc.*, 1208 Hanrei Jihō 123 (Tokyo High Ct. Aug. 21, 1986).

146. Preemptive rights are not enough to maintain the balance of power because a managing shareholder may issue new shares knowing that a non-managing shareholder has no money to execute his/her preemptive right.

147. H. O'Neal & R. Thompson, *supra* note 14 § 9.16, U.N.I.D.O., *supra* note 127 at ch. 3 § 1(7).

148. *Tentative Draft* § III 4.

149. See note 122 and accompanying text.

150. *Hiscock v. Lacy*, 9 Misc. 578, 30 N.Y.S. 860 (1894); *Carr v. Kimball*, 153 A.D. 823, 139 N.Y.S. 253 (1st Dep't 1912), *aff'd mem.*, 215 N.Y. 634, 109 N.E. 1068 (1915); *Barrett v. Smith*, 185 Minn. 596, 242 N.W. 392 (1932); *Baker v. Cohn*, 42 N.Y.S.2d 159 (Sup. Ct. 1942), *mod. and aff'd*, 266 A.D. 715, 40 N.Y.S.2d 623 (1st Dep't 1943), *aff'd as modified*, 292 N.Y. 570, 54 N.E.2d 689 (1944); *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 367 Mass. 578, 328 N.E.2d 505 (1975); *Erdman v. Yolles*, 62 Mich. App. 594, 233 N.W.2d 667 (1975); *Stumpf v. C.E. Stumpf & Sons, Inc.*, 47 Cal. App. 3d 230, 120 Cal. Rptr. 671 (Ct. App. 1975); *Jones v. H.F. Ahmanson & Co.*, 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rep. 592 (1969). But see *Easterbrook & Fischel*, *supra* note 104, at 295.

151. It may be noted that in the case of merger or acquisition, the sale of majority control may bring a higher price. That point will not be discussed here.

152. "[T]he problem of exploitation is uniquely related to illiquidity . . ." Hetherington & Dooley, "Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem," 62 *Va. L. Rev.* 1 at 6 (1979). See also, R. Clark, *supra* note 13 at 785.

Easterbrook & Fischel strongly argue against this point. They say "there is no

The typical pattern of squeeze-outs in closely held corporations is almost identical in the U.S. and Japan. Once disputes occur, a majority will first shut the minority shareholders out of management positions. Thus, minority shareholders are edged out from the most profitable aspect of closely held corporations: officers' compensation. The majority may monopolize all the compensation for persons of its own choosing, typically, its own family. Then, the majority will fail to issue dividends, which is the only other way that minority shareholders could share in corporate profit. Of course, when this is done, majority shareholders also cannot obtain dividends, but this will not matter because they can get at the profits through officers' compensation and other fringe benefits. Minority shareholders of a closely held corporation have no way to sell their stock in stock markets, as shareholders of publicly held corporations could. The final result will be that the majority shareholders may buy the stock of the minority shareholders for nominal amounts, and thus the majority can wipe out their "enemies" entirely.<sup>153</sup>

Economic fairness is the sharing of economic interests by each shareholder in proportion to the stock he/she owns.<sup>154</sup> Although this principle seems straightforward, it is actually very difficult to realize in a closely held corporation. The basic reason that economic unfairness often occurs in closely held corporations is the lack of methods for minority shareholders to recoup their investments.<sup>155</sup> Therefore, in closely held corporations, it is necessary that the law intervene in order to provide a legal means for minority sharehold-

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reason to believe that shareholders of either closely or publicly held corporations will be more or less 'exploited' " because "[a] closely held firm that insists on joint management and investment must offer a better deal to attract capital" and "[i]lliquidity is not the problem." Easterbrook & Fischel, *supra* note 104 at 272-75.

However, they seem to focus too much on *ex ante* argument and ignore the fact that most minority shareholders of closely held corporations were not in the minority positions from the beginning. No reasonable person would invest in a closely held corporation as a minority shareholder. He/she had no incentive to deal with a majority shareholder because he/she was a member of the majority group at that stage.

153. H. O'Neal & R. Thompson, *supra* note 14, §§ 3.01-3.02; R. Clark, *supra* note 13 at 792.

154. See, *supra* note 150 and accompanying text.

155. See, *supra* note 152 and accompanying text. Professor Karjala pointed out that Japanese law is "surprisingly liberal" on voluntary dissolutions because it provides that a corporation is dissolved upon the occurrence of any reason specified in the article of incorporation, as well as by resolution of the general meeting. *Commercial Code* §§ 94, 404; G.m.b.H. act § 69I. He suggests that, through advance planning, minority shareholders can use these provisions to protect their interests. Although there may be a problem with specific enforcement of such agreements, he argues, a damages remedy will often provide effective protection. Karjala, "The Closely Held Enterprise Under Japanese Law," 7 *Boston Univ. Int'l. L.J.* 229, 245-46 (1989). Japanese courts are, however, often reluctant to use dissolution to protect minority shareholders. See *infra* text accompanying note 181.

ers to recoup their investments and prevent economic unfairness.<sup>156</sup> However, judicial or legislative intervention to provide such recoupment of investments interferes with another important principle of the corporate model: the independent legal personality of a corporation and its corollary, corporate perpetuity.<sup>157</sup>

Providing a legal means for recoupment of investments to minority shareholders of closely held corporations is equal to giving minority shareholders the right to sell their stocks to the corporation or the majority shareholders. Where buying out the minority shares is financially impossible, minority shareholders may be given the right to dissolve the corporation.<sup>158</sup>

Forcing a corporation to buy minority stock clearly modifies the principle of the independent legal personality of a corporation, that is, the principle that the powers, life span and purpose of the corporation are independent from the shareholders, similarly giving minority shareholders the right to dissolve the corporation is a modification of the principle of corporate perpetuity, the principle that the life span of the corporation is independent of the will of the individual shareholders.<sup>159</sup>

Although forcing majority shareholders to buy minority stocks appears simpler, there is virtually no difference between making a majority shareholder buy minority stocks and making the closely held corporation buy them, since a majority shareholder is likely to borrow money for the purchase from the corporation. Even if a majority shareholder has enough money to buy minority stock, it will affect both the corporation and the majority shareholder, because that money might have been used for the future development of the

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156. *Rev. Model Bus. Corp. Act* § 14.30(2); *N.Y. Bus. Corp. Law* §§ 1104, 1104-a; *Cal. Gen. Corp. Law* § 1800(b); *Mich. Bus. Corp. Act* § 21.200(825); *Minn. Bus. Corp. Act* § 302A.751; Hetherington & Dooley, *supra* note 152 at 6; R. Clark, *supra* note 13 at 786; W. Cary & M. Eisenberg, *supra* note 13 at 462.

157. R. Clark, *supra* note 13 at 15-21, 762-63.

158. The most extreme proposal is to give every minority shareholder in a closely held corporation an unconditional right to sell out their stocks to the corporation or the majority shareholders. If they refused to purchase at the fair price, the corporation would be dissolved. Hetherington & Dooley, *supra* note 152 at 1-3, 6.

159. A partnership could be dissolved on the will of the individual partner. *Uniform Partnership Act* § 29.

Hillman, however, pointed out that the single contrast of corporate perpetuity and partnership free dissolvability is misleading. Hillman, "The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations," 67 *Minn. L. Rev.* 1 (1982). Easterbrook and Fischel also criticize the partnership analogy on the involuntary dissolution. They say "The right inquiry is always what the parties would have contracted for had transaction costs been zero, not whether closely held corporations are more similar to partnerships than to publicly held corporations." Their next inquiry is then "why people formed the corporation and why, having done so, they did not adopt partnership-like rules by contract." Easterbrook & Fischel, *supra* note 104 at 298-99.

corporation.<sup>160</sup> Where the majority shareholder cannot buy the stocks, the corporation must be dissolved. Therefore, forcing a majority shareholder to buy is also a modification of the independent legal personality of the corporation and the principle of corporate perpetuity.

An arguable issue on the legal modification of these principles is how far the law should go. Two aspects concerning the degree of intervention are these: 1) what conditions should be present for minority shareholders to have the right to sell their stock, or the right to dissolve the corporation; and 2) what price should majority shareholders or the corporation pay for minority stock. Thus far in Japan, the law has rarely intervened in economic conflicts among shareholders.<sup>161</sup> The Tentative Draft, as will be discussed later, has recognized the necessity of legal intervention.<sup>162</sup> In the U.S., there are many cases and statutes on this issue.<sup>163</sup>

On the first point, the conditions necessary for the minority shareholders rights to be present, there are two extreme positions. One is to require either deadlock among the shareholders or directors or maladministration and waste.<sup>164</sup> The other is to require nothing—no conditions whatsoever.<sup>165</sup> Intermediate positions also exist.

Most American cases require "oppression" of minority shareholders by a majority before the minority shareholders can force the purchase of their stock or dissolve the corporation.<sup>166</sup> In other words, "bad faith" on the part of the majority is required.<sup>167</sup> More

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160. Hillman, *supra* note 159 at 70.

161. In Japan, virtually the only opportunities for minority shareholders of closely held corporations to obtain judicial intervention for recouping their investment are, in practice, either executing the appraisal right in case of incorporating stock transfer restriction clause in by-laws (*Commercial Code* §§ 204, 348), or requesting the nomination of an alternative buyer of their stocks, when the corporation has a by-law restricting stock transfer (*Commercial Code* §§ 204-2, 204-3, 204-4). See *supra* notes 115-17 and accompanying text.

162. *Tentative Draft* §§ III 8, VI 2.

163. *Rev. Model Bus. Corp. Act* § 14.30(2); *Model Stat. Close Corp. Supp.* §§ 40-43; *N.Y. Bus. Corp. Law* §§ 1104, 1104-a; *Cal. Gen. Corp. Law* § 1800(b); *Mich. Bus. Corp. Act* § 21.200(825); *Minn. Bus. Corp. Act* § 302A.751; *Matter of Kempt & Beatley, Inc.*, 64 N.Y.2d 63, 484 N.Y.S.2d 799, 473 N.E.2d 1173 (1984); *Baker v. Commercial Body Builders, Inc.*, 264 Or. 614, 507 P.2d 387 (1973); *Stumpf v. Stumpf & Sons, Inc.*, 47 Cal. App. 3d 230, 120 Cal. Rptr. 671 (1975).

164. *Johnston v. Livingston Nursing Home, Inc.*, 211 So. 2d 151 (Ala. 1968).

165. *Hetherington & Dooley*, *supra* note 152 at 1-3.

166. The traditional cases have adopted a restrictive view requiring severe misconduct as evidence of oppression and have been reluctant to order involuntary dissolution: *Baker v. Commercial Body Builders, Inc.*, 264 Or. 614, 507 P.2d 387 (1973); *Polikoff v. Dole & Clark Bldg. Corp.*, 37 Ill. App. 2d 29, 184 N.E.2d 792 (1962). There are some cases, however, which take a more liberal view as to what is oppressive: *White v. Perkins*, 189 S.E.2d 315 (Va. 1972); *Gidwitz v. Lanzit Corrugated Box Co.*, 170 N.E.2d 131 (Ill. 1960).

167. "Oppression" does not require fraud or illegality but a departure from fair

recently, however, a more relaxed position is gaining strength in case law and among commentators. This position allows the selling of stock or dissolution where "reasonable expectation" of a minority shareholder have been frustrated<sup>168</sup> or where economic unfairness exists between the majority and minority shareholders<sup>169</sup> even if there is no bad faith of the majority.<sup>170</sup>

The second issue, the valuation of the stock, is closely related to the first issue, the necessary conditions for selling out. No matter how relaxed the conditions for forced purchase by the majority or the corporation, such protection for the minority shareholder is worthless if the stock is valued too cheaply. Conversely, if the conditions are impossible for the minority shareholders to meet, high valuation of the stock is useless to the minority shareholder.

Japan and the U.S. has no statutory provision which provides specific guidelines as to the valuation of the stock.<sup>171</sup> There are many cases on the valuation of stock, however, in both countries:

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dealing. *White v. Perkins*, 189 S.E.2d 315, 319-20. Clark says that "oppression" should be interpreted as a breach of the majority shareholders' fiduciary duty of loyalty to the minority, which includes two main categories of behavior patterns: self-dealing and squeeze-out moves. *R. Clark*, *supra* note 13 at 792.

168. *Topper v. Park Sheraton Pharmacy, Inc.*, 107 Misc. 2d 25, 433 N.Y.S.2d 359 (Sup. Ct. 1980); *Hillman*, *supra* note 159 at 75-87.

169. *Stumpf v. Stumpf & Sons, Inc.*, 120 Cal. Rptr. 671 (Cal. App. 1975).

170. On the other hand, there is an argument which criticizes the effort to ease dissolution. "If it is easy to dissolve a firm, there will be more deadlocks, more claims of oppression. The threat to create a deadlock (or claim oppression) may be used to induce the other party to hand over more of the firm's profits. The anticipation of opportunistic behavior of this sort will make the entire business transaction less attractive as an initial matter." *Easterbrook & Fischel*, *supra* note 104 at 287.

171. The Model Act defines "fair value" very generally as "the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable." *Rev. Model Bus. Corp. Act* § 13.01(3). And Comment 3 explains: "the definition . . . leaves to the party (and ultimately the courts) the details by which 'fair value' is to be determined within the broad outlines of the definition. This definition leaves untouched the accumulated case law about market value, value based on prior sales, capitalized earnings value and asset value." The Delaware Statute says ". . . the Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation . . . . In determining such fair value, the Court shall take into account all relevant factors." *Del. Gen. Corp. Law* § 262(h). The New York Statute instructs: "In fixing the fair value of the shares, the court shall consider the nature of the transaction giving rise to the shareholder's right to receive payment for shares and its effects on the corporation and its shareholders, the concept and methods then customary in the relevant securities and financial markets for determining fair value of shares of a corporation engaging in a similar transaction under comparable circumstances and all other relevant factors." *N.Y. Bus. Corp. Law* § 623(4). In case of appraisal, the California Statute just instructs appraisers to determine "the fair market value." *Cal. Gen. Corp. Law* § 1305(a). On the other hand, when avoiding dissolution it admits "fair value" to "moving parties" and shows some specified criteria: "The fair value shall be determined on the basis of the liquidation value as of the valuation date but taking into account the possibil-

particularly on appraisal rights in the U.S.,<sup>172</sup> and on the sale price of transfer restricted stock in Japan (§ 204-2).<sup>173</sup> There are no basic differences in the methods for the valuation of stock in the two countries. All of the methods can be construed as ways to combine the following three factors: net asset value,<sup>174</sup> investment value,<sup>175</sup> and market value.<sup>176</sup>

There are two special characteristics of Japanese case law on the valuation of stock. Although in the U.S. methods for valuing of stock take it for granted that the investment value (particularly, earnings value) is higher than the net asset value (particularly, liqui-

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ity, if any, of sale of the entire business as a going concern in a liquidation." *Cal. Gen. Corp. Law* § 2000(a).

The Japanese Commercial Code shows much more general guidance. In case of appraisal, it only says "fair value which should have been if there were no resolution [of the transaction]." *Commercial Code* § 245-2. In case of judicial valuation of transfer restricted stock (see notes 107-09 and accompanying text), the Code vaguely instructs: "the Court must consider assets of the corporation and all other factors." *Commercial Code* § 204-4 II.

172. *Bell v. Kirby Lumber Corp.*, 413 A.2d 137 (Del. 1980); *Flarsheim v. Twenty Five Thirty Two Broadway Corp.*, 432 S.W.2d 245 (Mo. 1968); *Brown v. Hedahl's-QB&R, Inc.*, 185 N.W.2d 249 (N.D. 1971); *In re Endicott Johnson Corp. v. Bade*, 37 N.Y.2d 585, 376 N.Y.S.2d 103, 338 N.E.2d 614 (1975).

173. *In re Shizuoka Mazuda, Inc.*, 22 Kaminshū 9 (Tokyo High Ct., Jan. 19, 1971); *In re Kōwa Kōgyō, Inc.*, 846 Hanrei Jihō 105 (Tokyo High Ct., Dec. 24, 1976); *In re Nagoya Geigi, Inc.*, 947 Hanrei Jihō 121 (Nagoya High Ct., Oct. 4, 1979); *In re Nakano Seiyaku, Inc.*, 685 Kinyū Shōji Hanrei 16 (Osaka High Ct., Jan. 28, 1983); *In re Fukuoka Uo Ichiba, Inc.*, 788 Kinyū Shōji Hanrei 13 (Fukuoka High Ct., Jan. 21, 1988).

174. Net asset value is what we value the corporation on a stock basis. There are three kinds of net asset value: book value, going concern value, and liquidation value. The book value is easy to calculate but only as historical data regarding corporate assets. The going concern value hypothesizes the sale of the corporation as a whole and, therefore, includes the value of goodwill. In other words, the going concern value should be equal to the earnings value in most cases. The liquidation value hypothesizes dissolution and distribution of the corporate assets. The meaningful net asset value is the liquidation value.

175. Investment value is what we value the corporation on a cash flow basis. It capitalizes annual earnings (earnings value) or dividends (dividends value) by interest rate (opportunity costs) and some discount for risks. Theoretically, future prospective earnings should be taken as annual earnings. In American case law, however, courts always take the average annual earnings figure, based on the corporation's recent earnings history. E.g., *In re Valuation of Common Stock of Libby, McNeil & Libby* 406 A.2d 54 (Sup. Jud. Ct. Me. 1976). Both in the U.S. and in Japan, earnings value is considered to be the most important factor in valuation of a corporation.

176. Market value is the price at which the stock is selling on the market. The problem is that there is no reliable market for closely held stocks. Therefore, when we say "market value" in a closely held corporation context, it is not a real market value, but a reconstructed or hypothetical market value. A reconstructed market value can be calculated based on limited transactions that have previously occurred. E.g., *Application of Delaware Racing Ass'n*, 42 Del. Ch. 477, 213 A.2d 203 (1965). Particularly in Japan, the method of calculating the reconstructed market value of a closely held stock by comparing the book value, earnings value and dividend value of the closely held corporation with those of some publicly held corporations in the same industry is quite influential.

dation value), because of goodwill,<sup>177</sup> in Japan, the reverse is true. In most Japanese court cases the liquidation value is higher than the investment value, because of the high price of land.<sup>178</sup> Current land prices are so high that a corporation would have to be dissolved if net asset valuation is used. It is no exaggeration that this is the hottest issue in Japan: how to decrease the court-assessed price of the stock by using formulas that include the investment value and the reconstructed market value, thus watering down the total value of the stock.

Secondly, in Japan, there is a strong emphasis on the rights of employees, and this emphasis is reflected in Japanese case law.<sup>179</sup> Indeed, it is widely accepted in society that the welfare of the employee is the most important goal of a corporation.<sup>180</sup> Therefore, courts are very reluctant to value stock in a way that would reflect full appreciation of the asset value (e.g. the land), because such a valuation might lead to dissolution of the corporation (if there are insufficient funds to pay for the minority shareholder's stock) and would deprive the employees of their jobs.<sup>181</sup> Thus, even where from a purely economic point of view a corporation should be dissolved, the courts will be highly reluctant to do so.

Up to this time, minority shareholders of closely held corporations have had no legal means to recoup their investments and they have been forced to utilize self help methods, such as setting aside resolutions at shareholder meetings (Commercial Code §§ 247-252)<sup>182</sup> or exercising the right of requiring the corporation to elect a transferee where transfer-restricted stock is involved (Commercial Code § 204-2 and the sections following).<sup>183</sup>

The Tentative Draft has several important provisions allowing a legal means for recoupment of investments for minority shareholders. In a *Kabushikigaisha* which has restrictions on stock transfer,

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177. Hillman, *supra* note 158, n.147. Note, however, even in the U.S., cases in which net asset value estimated to be greater than earnings value are not rare. See *Bell v. Kirby Lumber Corp.*, 413 A.2d 137 (Del. 1980), *Lynch v. Vickers Energy Corp.*, 429 A.2d 497 (Del. 1981), *modifying* 402 A.2d 5 (Del. Ch. 1979); Note, "Valuation of Dissenters' Stock under Appraisal Statute," 79 *Harv. L. Rev.* 1453, AT 1469 (1966); Schaefer, "The Fallacy of Weighting Asset Value and Earnings Value in the Appraisal of Corporate Stock," 55 *S. Cal. L. Rev.* 1031 at 1054 (1982).

178. In re *Shizuoka Mazda, Inc.*, 22 Kaminshū 9 (Tokyo High Ct. Jan. 19, 1971); In re *Kōwa Kōgyō, Inc.*, 846 Hanrei Jihō 105 (Tokyo High Ct., Dec. 24, 1976).

179. For example, employees have great influence over corporate decisionmaking. Employees may even regard the corporation at which they work as their own, regardless of the legal reality of shareholder ownership.

180. See H. Itami, *Jinponshugi Kigyō [Humanistic Corporations]* (1988).

181. Interviews with judges of the Tokyo & Osaka District Courts, who have handled many corporation cases (Oct. 13, 1981, Mar. 18, 1983). Shishido, *supra* note 14 at 545-46.

182. See, *supra* text accompanying notes 39-41.

183. See, *supra* text accompanying notes 115-17.

and in a Yūgengaisha, the Tentative Draft allows shareholders to require the corporation to elect a transferee of their stocks "when there has been extremely unfair treatment of some of the shareholders."<sup>184</sup> In a Kabushikigaisha with less than fifty shareholders or one with restrictions on stock transfers, and in a Yūgengaisha, the Tentative Draft allows each shareholder the right to request a judicial order of dissolution.<sup>185</sup> This right presently belongs only to shareholders with at least 10% of the stock of the corporation.<sup>186</sup> The Tentative Draft also adds a general clause to the acceptable reasons for involuntary dissolution, "other reasons which make dissolution indispensable."<sup>187</sup> Finally, the Tentative Draft has a provision that benefits majority shareholders, by allowing the shareholders opposing dissolution to prevent dissolution by buying the dissenter's stock.<sup>188</sup>

In three major ways, the Tentative Draft is of great significance in changing the present law. Firstly, the proposed legislation would provide increased protection for minority shareholders of closely held corporations.<sup>189</sup> Secondly, it would provide deterrents to the oppression of minority shareholders by majority shareholders. Thirdly, the courts would have the chance to balance the economic interests of majority and minority shareholders.<sup>190</sup>

As discussed earlier, a large disparity between actual disputes and the legal disputes around which litigation is structured is highly characteristic of suits involving Japanese closely held corporations.<sup>191</sup> The new laws would hopefully reduce the disparity to some degree, because the dissatisfaction of the minority shareholders could be expressed in ways more relevant to the actual disputes, namely, through lawsuits on stock sales or on dissolution. Further, courts could more effectively balance the interests of majority and minority shareholders through two judicial means: judicial decisions on the conditions for stock sales, and decisions on the valuation of stock. In particular, in valuing stock, courts would not be bound by plaintiff requests for relief, but could balance the conflicting interests of the parties (as with the Anglo-American principle of eq-

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184. *Tentative Draft* § III 8.

185. *Id.* § VI 2a.

186. *Commercial Code* § 406-2; *G.m.b.H. Act* § 71-2.

187. *Tentative Draft* § VI 2b.

188. *Id.* § VI 2c.

189. Note, however, how much the proposed legislation might increase the protection for minority shareholders will depend on the case law. If courts take too restrictive a view on the condition of buyout or dissolution, or value minority shares only a nominal amount, the situation would not change.

190. See, *supra* text accompanying notes 53-54.

191. See, *supra* text accompanying notes 20-23.



uity).<sup>192</sup> This is so because in Japan, hearings on valuation of stock issues are less formal and the judge always has greater discretion.<sup>193</sup>

Several questions may be posed regarding the Tentative Draft's provisions on buyout and dissolution. Firstly, the specific conditions for buyout are not clear. What precisely is "extremely unfair treatment?"<sup>194</sup> It may be the equal of "oppression" as defined in American case law.<sup>195</sup> Officers of the Department of Justice have proposed several examples: "[1] no shareholder meeting has been held and no information on the current state of the corporation is available to shareholders; [2] although a corporation has made a substantial profit, it has not paid out dividends and given no persuasive reasons for its failure to do so; [3] an unreasonably high compensation has been paid to management that prevents the corporation from realizing its profits and majority shareholders will not correct the situation."<sup>196</sup> Because these examples are typical squeeze-out cases,<sup>197</sup> it is probable that the conditions for buyout are present when there has been "oppression."

The Judicial Officers have gone on to explain, "Although the condition [of 'extremely unfair treatment'] is not necessarily satisfied where a shareholder is simply not allowed to be a director, it might be satisfied where a shareholder is removed from that position without any evidence of negligence on his/her part."<sup>198</sup> This explanation seems to require less than the American traditional definition of oppression<sup>199</sup> but more than surely situational economic unfairness<sup>200</sup> that is, some omission (e.g. negligence) or some act by the majority must be present. The legislators seem to have used the current standards of American case law as a model, but the precise parameters of the condition are still ambiguous. Much more discussion of this issue is necessary, particularly on the importance of balancing the interests of minority and majority shareholders.

The second problem is the valuation of stock. It is the most im-

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192. *Hishō Jiken Tetsuzuku Hō* [Non-Contentious Cases Procedure Law] §§ 10, 31. See, T. Hattori & D. Henderson, *supra* note 20 § 9.09.

193. In Japan, there are two separate types of judicial proceedings: the formal process [*Soshō Tetsuzuki*] where a judge has little discretion and is bound by the requests of the plaintiff; and the less formal proceedings [*Hishō Tetsuzuki*] where a judge may balance the interests of the parties. The latter includes stock valuation hearings, divorce, and probate issues. Tentative Draft § III 8 appropriates Commercial Code § 204-4 and the sections following which adopt *hishō tetsuzuki*.

194. *Tentative Draft* § III 8.

195. See, *supra* notes 166-67 and accompanying text.

196. Inaba & Otani, "Shōhō Yūgengaisha Hō Kaisetsu [Comments on the Tentative Draft of Revised Commercial Code and G.m.b.H. Act]," 89 *Bessatsu Shōji Hōmu* 64 (1986).

197. See, *supra* text accompanying notes 153.

198. Inaba & Otani, *supra* note 196 at 64.

199. See, *supra* notes 166-67 and accompanying text.

200. See, *supra* notes 168-70 and accompanying text.

portant part of the legal process for the recovery of investments. Clearly, it is important to minority shareholders whether anyone (a majority shareholder or the corporation) will buy the stock. The real concern, however, is how much money will be obtained. The Tentative Draft leaves such matters to case.<sup>201</sup> Much more discussion of this issue is necessary in order for courts to effectively balance the conflicting interests of the majority and minority shareholders.<sup>202</sup>

A third problem is the relationship between buyout rights and the right to require dissolution. In the U.S., these two rights are logically related. When a minority shareholder can demand dissolution, majority shareholders may prevent such dissolution by purchasing his/her stock.<sup>203</sup> Conversely when a minority shareholder cannot obtain enough of a remedy through his/her buyout rights, he/she can require corporate dissolution.<sup>204</sup> In the Tentative Draft, the relationship of these two rights is ambiguous.<sup>205</sup> From both a logical and a practical perspective, these two legal rights should be related to each other.

### CONCLUSION

The common problems of Japanese and American closely held corporations are the following:

- 1) Economic unfairness to corporate creditors may frequently occur. In particular, the problems of fraudulent conveyances and undercapitalization must be handled.<sup>206</sup>

- 2) Economic unfairness among shareholders may also frequently occur. In particular, the problems of squeeze-out and of "locked-in" shareholders who are unable to recoup their investments should be solved.<sup>207</sup>

- 3) There is an intrinsic demand to maintain the closed nature of the corporation. Specifically, shareholders may wish to restrict the transferability and the inheritability of stock.<sup>208</sup>

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201. The Tentative Draft § III 8 appropriates Commercial Code § 204-4 and the sections following on valuation.

202. Although not a few arguments have been done on the issue of valuation of the stock of closely held corporations in Japan, no specific theory has yet dominated. See T. Seki, *Kabushiki Hyōka Ron* [On Valuation of Stock] (1983); Egashira, *Torihikisōba no nai Kabushiki no Hyōka* [The Valuation of the Stock without Market Value] 3 *Hōgaku Kyōkai Hyakushūnen Kinen Ronbunshū* (Essays in Celebration of the 100th Anniversary of the Founding of Jurisprudence Association of the University of Tokyo) 445 (1983).

203. *Cal. Gen. Corp. Law* § 2000; *N.Y. Bus. Corp. Law* § 1118.

204. *Minn. Bus. Corp. Act* § 302A.751.

205. *Tentative Draft* §§ III 8, VI 2.

206. See, *supra* text accompanying notes 56-58.

207. See, *supra* text accompanying notes 149-157.

208. See, *supra* text accompanying notes 105-107.

4) There is an intrinsic demand to modify the principle of control by the majority shareholders. Minority shareholders who intend to participate in management are greatly interested in obtaining directorships and the power to veto important decisions.<sup>209</sup>

The background for Japanese closely held corporations is very different from that of American closely held corporations in the following ways:

a) The actual underlying disputes among shareholders are not necessarily apparent in Japanese litigation because of the rigidity of the legal process.<sup>210</sup>

b) As to the protection of corporate creditors, Japan's Commercial Code § 266-3 on the liability of the director to third parties plays a role similar to the American concept of piercing the corporate veil. This phenomenon, along with the widely accepted Japanese custom of obtaining the corporate president's personal guarantee for corporate debt, may have the practical effect of unlimited liability for small entrepreneurs in Japan.<sup>211</sup>

c) It is difficult to modify the structure of the corporation provided for in the Commercial Code and there is no guarantee that minority shareholders may obtain directorships or veto powers.<sup>212</sup>

d) Finally, in providing a legal means for the recovery of investments by minority shareholders, the following points should be noted: a) astronomical land prices will affect the valuation of stock; and b) it is very difficult to recoup investments by means of dissolution or sale of a corporation because employees have great power.<sup>213</sup>

It should be noted that these differences are all differences of background only, and are not intrinsic to the closely held corporation. The intrinsic problems of a closely held corporation are very similar in the U.S. and Japan, and certain features of normative model can be drawn.

a) When assessing the protection of creditors, it is very important to find a proper balance of the stimulation of entrepreneurial spirit (i.e. limit liability where possible) and the protection of creditors (i.e. discourage fraud and undercapitalization).

b) The internal structure of a corporation should be flexible. Shareholders should be able to choose a structure which best fits the size of the corporation and the needs of the shareholders.

c) For the protection of minority shareholders, it is necessary to provide "locked-in shareholders" an "exit," i.e., buyout rights. In

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209. See, *supra* text accompanying notes 126-127.

210. See, *supra* text accompanying notes 20-24, 34-41.

211. See, *supra* text accompanying notes 67-75.

212. See, *supra* text accompanying notes 137.

213. See, *supra* text accompanying notes 178-181.

considering the conditions for buyout rights and the valuation of stock, the most important issue is to balance the interests of majority shareholders and those of minority shareholders.

Although some problems remain to be worked out, the Tentative Draft for small corporations in Japan is a significant step toward a more effective and efficient legal model for closely held corporations.