

# Comparison of Law, Legal Transplants and International “Legal Fashion“ in German and Japanese Corporate Law

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## I. COMPARISON OF LAW, LEGAL TRANSPLANTS AND “LEGAL FASHION”

### 1. *Comparison of Law*

Comparison of law has always shaped or at least influenced legislation to varying degrees either directly or indirectly, and it continues to do so all the more in today’s arena of globalization and universal availability of comparative legal information. Japan is long since a model for using a comparative basis to optimize its lawmaking.<sup>1</sup> Within the European Union, virtually all legislation is prepared on the foundation of comparative groundwork. The

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1 See H. BAUM, Comparison of Law, Transfer of Legal Concepts, and Creation of a Legal Design: The Case of Japan, in: Haley/Takenaka (eds.), *Legal Innovations in Asia. Judicial Lawmaking and the Influence of Comparative Law* (Cheltenham 2014) 60; for an overview of the development of modern Japanese law, see W. RÖHL (ed.), *A History of Law in Japan Since 1868* (Leiden 2005).

same is true for Germany when it comes to important legal reforms, to name but one of the EU Member States.<sup>2</sup> The motive of the lawmakers is, as a rule, to find the best possible regulatory solution for a specific social and economic issue. This includes, or should at least include, the challenging attempt to find a solution that actually fits in the specific path-dependent institutional setting of the receiving legal order.<sup>3</sup>

## 2. *Legal Transplants*

Where foreign concepts are integrated into national laws, one speaks of legal transplants, a phrase more or less simultaneously brought into use by the legal historian Alan Watson<sup>4</sup> and the comparatist Otto Kahn-Freund.<sup>5</sup> There is a heated discussion as to whether a reception of foreign legal institutions is actually feasible in a sensible way.<sup>6</sup> Some analysts, such as Alan Watson, regard “borrowing ... [as] the most fruitful source of legal

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2 A recent example is the German Mediation Act of 2012, which was prepared on the basis of a comprehensive comparative expert opinion of the Max Planck Institute for Comparative and International Private Law in Hamburg; an English version can be found in K. J. HOPT/F. STEFFEK (eds.), *Mediation – Principles and Regulation in Comparative Perspective* (Oxford 2013).

3 For a discussion of the importance of the given social and cultural context, see A. N. LICHT, *Culture and Law in Corporate Governance*, in: Gordon/Ringe (eds.), *The Oxford Handbook of Corporate Law and Governance* (Oxford 2018) 129; C. MILHAUPT/K. PISTOR, *Law and Capitalism* (Chicago 2008); for the Japanese context, A. A. ZIEGERT, *Path Dependence and the Differentiation of Law in East Asia and Europe – The Case of Japan*; Sydney Law School Research Paper No. 11/69; I. OZAKI, *Law, Culture and Society in Modernizing Japan*, in: Vanoverbeke/Maesschalck/D. Nelken (eds.), *The Changing Role of Law in Japan* (Cheltenham 2014) 50; for the concept of path-dependency see M. ROE, *Chaos and Evolution in Law and Economics*, *Harvard Law Review* 109 (1996) 641; L. BEBCHUK/M. ROE, *A Theory of Path Dependence in Corporate Governance and Ownership*, *Stanford Law Review* 52 (1999) 127; R. GILSON, *Corporate Governance and Economic Efficiency: When Do Institutions Matter?*, *Washington University Law Quarterly* 74 (1996) 327; R. MANN/C. MILHAUPT, *Path Dependence and Comparative Corporate Governance*, *Washington University Law Quarterly* 74 (1996) 317.

4 A. WATSON, *Legal Transplants. An Approach to Comparative Law* (Edinburgh 1974).

5 O. KAHN-FREUND, *On Uses and Misuses of Comparative Law*, *Modern Law Review* 37 (1974) 1.

6 An authoritative overview article on the discussion can be found in G. REHM, *Rechtstransplantate als Instrument der Rechtsreform und -transformation*, *The Rabel Journal of Comparative and International Law* 72 (2008) 1; see further M. GRAZIADEI, *Comparative Law as the Study of Transplants and Receptions*, in: Reimann/Zimmermann (eds.), *The Oxford Handbook of Comparative Law* (Oxford 2006) 441; R. COTTERRELL, *Comparative Law and Legal Culture*, in: *ibid.*, 709.

change”,<sup>7</sup> and some see legal borrowing as a movement toward efficiency in the context of legal competition.<sup>8</sup> But others are more skeptical. Pierre Legrand, for example, flatly rejects the possibility of any meaningful legal transfer.<sup>9</sup> In the view of cultural comparatists, law can only be understood within the culture it belongs to; any interpretation within a different cultural context leads automatically to a different meaning.<sup>10</sup> According to this viewpoint, a legal transplant is necessarily read in a different cultural environment, so it amounts to no more than a “meaningless form of words” because the actual meaning of the rules does not survive the journey to a different legal culture.<sup>11</sup> We cannot discuss – let alone solve – this complex issue here. But, for the purpose of this paper, let us assume that legal transplants have, at least in principle, the *potential* to improve regulation – if used in an appropriate manner.<sup>12</sup>

An indicator for a legal transplant or, more generally, a “non-native” regulatory concept is the continued use of the transplant’s original name in the receiving legal order even though it is a foreign loan word in that order’s language. A prominent example of interest here is the ubiquitous term “corporate governance” that has gained by now an almost universal acceptance and usage. It is as easily found as *terminus technicus* in, for example, standard German and Japanese legal texts.<sup>13</sup> In Germany’s legal

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7 A. WATSON, Aspects of Reception of Law, *American Journal of Comparative Law* 44 (1996) 335; see also *id.*, *supra* note 4, at 95; for a nuanced discussion of Watson’s views, see W. EWALD, *Comparative Jurisprudence (II): The Logic of Legal Transplants*, *American Journal of Comparative Law* 43 (1995) 489.

8 See U. MATTEI, Efficiency in Legal Transplants: An Essay in Comparative Law and Economics, *International Review of Law and Economics* 14 (1994) 3.

9 Cf. P. LEGRAND, What “Legal Transplants”?, in: Nelken/Feest (eds.), *Adapting Legal Cultures* (Oxford 2001) 55, 57; see also *id.*, *European Legal Systems Are Not Converging*, *International & Comparative Law Quarterly* 45 (1996) 52, 57.

10 See the analysis by COTTERRELL, *supra* note 6, at 712.

11 P. LEGRAND, The Impossibility of Legal Transplants, *Maastricht Journal of European and Comparative Law* 4 (1997) 111, 120; for problems related to the “indigenization” of transplants in the area of corporate governance, see C. JORDAN, The Conundrum of Corporate Governance, *Brooklyn Journal of International Law* 30 (2005) 983.

12 For a discussion about the risks and benefits of importing international *economic* theories into a given legislative environment, see K. LANGENBUCHER, *Economic Transplants. On Lawmaking for Corporations and Capital Markets* (Cambridge 2017).

13 For a general analysis of the influence US company law in Germany and Japan, see J. VON HEIN, *Die Rezeption US-amerikanischen Gesellschaftsrechts in Deutschland* (Tübingen 2008) and H. KANDA/C. MILHAUPT, Re-examining Legal Transplants: The Director’s Fiduciary Duty in Japanese Corporate Law, *American Journal of Comparative Law* 51 (2003) 887; K. EGASHIRA, The Influence of American Law in the Field of Commercial Law in the Post-World War II Era, *Law in Japan* 26 (2000)

parlance it became “Corporate Governance”, with the only change being the capitalization of the words. In Japanese parlance the term morphed into “kōporēto gabanansu” and – written in *katakana*<sup>14</sup> – it can easily be identified as an English loan word.<sup>15</sup> The corporate governance codes of both countries are accordingly, and respectively, titled “Deutscher Corporate Governance Kodex” and “Kōporēto gabanansu kōdo”.<sup>16</sup>

### 3. “Legal Fashion“

The fact that an imported term has become part of the standard legal language of the country receiving the transplant seems to indicate, at first glance at least, that there was *no* corresponding national regulatory concept before the transplantation. Things are not as straight forward as such, however, if the transplant in question is a general regulatory concept like “corporate governance”. The term broadly means “the system by which companies are directed and controlled”.<sup>17</sup> If we take the German stock corporation as an example, it goes without saying that from its very beginning in the 19<sup>th</sup> century the pertinent corporate law had detailed regulations on organizing, directing, and controlling companies. The German Stock Corporation Act (the *Aktiengesetz*) even provides for a two-tier board structure with a specific corporate organ, the supervisory board, exclusively responsible for supervising the management board. Nevertheless, as will be discussed later in greater detail, Germany felt the need to establish its own corporate governance code in 2002.<sup>18</sup> Yet if corporate control already enjoyed such a massive statutory back-up in the Stock Corporation Act, the question arises as to what exactly should be gained by adopting a corporate governance code that deals, by and large, with many of the same issues.

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50, respectively. For the relationship between Germany’s and Japan’s company law, see E. TAKAHASHI, ‘Reception’ and ‘Convergence’ of Japanese and German Corporate Law, *ZJapanR/J.Japan.L.* 38 (2014) 109.

14 The Japanese syllabary which is regularly used for the transcription of foreign words and names in modern Japanese.

15 A glance at recent publications dealing with corporate governance issues in both countries demonstrates this: see for Germany, e.g., T. KREMER *et al.* (eds.), *Deutscher Corporate Governance Kodex* (Munich 2016); P. HOMMELHOFF ET AL. (eds.), *Corporate Governance im grenzüberschreitenden Konzern* (Berlin 2017); and for Japan, see e.g., T. FUJIWARA, *コーポレート・ガバナンス [Kōporēto gabanansu]* (Tōkyō 2013); K. KARATSU, *日本再興のためのコーポレートガバナンス改革 [Nihon saikō no tame no kōporēto gabanansu kaikaku]* (Tōkyō 2014).

16 See [www.dcgk.de](http://www.dcgk.de) and [www.jpx.co.jp](http://www.jpx.co.jp), respectively; English translations of both codes are provided.

17 This is the classic definition in the so-called “Cadbury Report”, see *infra* at III.1.

18 See *infra*, at III.2.

This casts doubts on the assumption that the lawmaker's efforts were primarily aimed at finding the best solution for an unsolved *national* legal problem. The regulatory agenda seems rather to be directed towards the *international* arena. And indeed, as will be discussed later, the German Corporate Governance Code expressly intends this kind of signaling.<sup>19</sup> In the context of legal competition, the regulatory setting is obviously designed to meet what is perceived as the expectations of "good corporate governance" by international institutional investors and their advisers, such as the proxy advisory firms. And, in the international arena, corporate governance codes are indeed regarded as the embodiment of quality corporate governance, and to have one is today "de rigueur". In other words, the codes have evolved into an international "legal fashion".

The same observation can be made for a central feature of almost all corporate governance codes: the concept of the monitoring board of stock corporations staffed with "independent directors".<sup>20</sup> The concept has become the latest international "legal fad" in corporate law and a "must have" corporate governance tool regardless of whether it actually improves a country's given corporate system. As will be discussed later, it appears to be highly questionable how such an outsider-oriented corporate governance device can be successfully integrated in an insider-oriented corporate governance system like Japan's. Also, it remains an open question why Germany, with its traditional distinction between a managing and a supervisory board staffed with outside directors, some of whom represent controlling and thus supervising shareholders, needs independent directors.<sup>21</sup>

#### 4. *No Free Lunches*

The question whether a legal transplant makes up for a normative void in a country's regulatory setting or whether it only follows a present "legal fashion" for better or worse is *not* trivial because all regulation comes with an often heavy price tag for those that have to observe it. Also, there is the danger that alternative and potentially more promising regulatory venues will not receive the appropriate attention by lawmakers focused on internationally standardized solutions. There are, in other words, no free regulatory lunches. These aspects of transplanting fashionable legal concepts often do not gain sufficient attention.

The rest of the paper is organized as follows: Part II explores the shift of emphasis from corporate law to corporate governance; Part III deals with the worldwide spread of corporate governance codes since the 1990s and

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19 See *infra*, III.2.

20 See *infra*, at IV.

21 See *infra*, at IV.4.b) and IV.4.a) respectively.

discusses the outcome for Germany and Japan; Part IV narrows the focus on independent directors as today's state of the art corporate governance device or, depending on the observer's point of view, as the latest fad in corporate law, and it discusses the outcome for Germany and Japan; and Part V concludes.

## II. FROM CORPORATE LAW TO CORPORATE GOVERNANCE

Some 40 years ago, as in the previous 150 years, corporate problems were "still" mainly addressed by corporate law and the academic discussion was focused on the improvement of company laws. The term and concept of "corporate governance" as such was virtually unknown until the mid-1970s.<sup>22</sup> The underlying problems were, of course, known as long as corporations exist. The discussion started in the US in the wake of corporate scandals when the nation's supervisory agency, the SEC, tried to improve corporate control in the second half of the 1970s.<sup>23</sup> Today, in all modern industrialized states the academic and policy discussions focus on corporate governance as a key regulatory concept.<sup>24</sup> International organizations, like the OECD, are ardent promoters of good corporate governance.<sup>25</sup> In the early 2000s the literature on corporate governance exploded.<sup>26</sup> Improving corporate governance is regarded as *the* solution to almost all kinds of corporate and economic ills. Some talk of an outright "corporate governance obsession".<sup>27</sup>

A recent study, intriguingly titled "From Corporate Law to Corporate Governance", claims that corporate law has become more or less "trivial"

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22 See B. R. CHEFFINS, *The History of Corporate Governance*, available as ECGI – Law Working Paper No. 184/2012 at SSRN: <https://ssrn.com/abstract=1975404>.

23 *Ibid.*, at 2 ff.

24 K. J. HOPT, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 *Am. J. Com. L.*, 1, 3 (2011). One of the first comparative studies was K. J. HOPT/H. KANDA/M. ROE/E. WYMEERSCH/S. PRIGGE (eds.), *Comparative Corporate Governance: The State of the Art and Emerging Research* (Oxford 1998); follow-up studies include K. J. HOPT/E. WYMEERSCH/H. KANDA/H. BAUM (eds.), *Corporate Governance in Context: Corporations, State, and Markets in Europe, Japan, and the US* (Oxford 2005); A. M. FLECKNER/K. J. HOPT (eds.), *Comparative Corporate Governance* (Cambridge 2013).

25 The OECD first published its *Principles on Corporate Governance* in 1999; for the present version see *infra* note 72.

26 The number of papers on the SSRN website that deal explicitly with corporate governance issues nearly tripled within the last ten years from some 3,500 papers in 2006 to more than 11,000 papers by 2015; see M. PARGENDLER, *The Corporate Governance Obsession*, *Journal of Corporation Law* 42 (2016) at 361 with further references; available at SSRN: <https://ssrn.com/abstract=2491088>.

27 *Ibid.*, at 359.

as a result of an analytical "reframing of corporate law into something far broader".<sup>28</sup> The shift from corporate law to corporate governance is analyzed as a shift from "a largely legal focus to one that focuses on the corporation's inputs, outputs and how they are managed and, ultimately, the manner in which governance interfaces with other institutional elements that make up the capitalist system".<sup>29</sup> In other words, we see a move from a rather simple and static legal view of the corporation to a far more complex and dynamic one.<sup>30</sup> In a broad understanding, corporate governance is concerned with all different types of principal-agent conflicts that bedevil corporations, the one between managers and shareholders, between minority shareholders and controlling block-holders, and between shareholders as a group and non-shareholders (other stakeholders).<sup>31</sup>

Being a "midway solution between markets and governments" made corporate governance attractive to all sorts of regulators, yet whether the emphasis on this concept is "worth the candle" is regarded by some as an open question.<sup>32</sup> To answer that question one has to take into consideration costs that arise in the form of policy approaches that are crowded out by the focus on corporate governance.<sup>33</sup> Others criticize that corporate governance policies may be symbolic, serving a "mythological or ritual" function rather than dealing with real world problems.<sup>34</sup> In this vein, it is also critically noted that international corporate governance rankings are a big business for some but that it remains unclear what exactly is being measured and what these rankings may tell investors about the company's future economic success.<sup>35</sup> In general, skepticism is growing whether the internationally promoted "global" corporate governance standards are really universally

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28 R. J. GILSON, From Corporate Law to Corporate Governance, ECGI Law Working Paper No. 324/2016. Available at SSRN: [http://ssrn.com/abstract\\_id=2819128](http://ssrn.com/abstract_id=2819128) at 10.

29 *Ibid.*, at 7.

30 *Ibid.*, at 43.

31 HOPT, *supra* note 24, at 5 f. For a general discussion of the agency conflicts, see R. KRAAKMAN/J. ARMOUR/P. DAVIES/L. ENRIQUES/H. HANSMANN/G. HERTIG/K. HOPT/H. KANDA/M. PARGENDLER/W.-G. RINGE/E. ROCK, *The Anatomy of Corporate Law. A Comparative and Functional Approach* (3<sup>rd</sup> ed., Oxford 2017) 29.

32 PARGENDLER, *supra* note 26, at 361.

33 *Ibid.*

34 M. KAHAN/E. B. ROCK, *Symbolic Corporate Governance Politics*, Boston University Law Review 94 (2014) 1997.

35 B. C. TINGLE, *What is Corporate Governance? Can We Measure it? Can Investment Fiduciaries Rely on it?*, Queen's Law Journal 43 (2) (2018) 1 (with detailed empirical data); skeptical also I. LOVE, *Corporate Governance and Performance around the World: What We Know and What We Don't*, World Bank Research Observer 26 (1) (2011) 42.

adaptable without giving ample consideration to the local institutional frame in a given national economy.<sup>36</sup>

We do not need to delve deeper into the questions about the merits and demerits of the corporate governance movement. For our purpose it is sufficient to state that international observers obviously expect any sophisticated corporate regulation to deal with corporate governance issues in one way or another. As has been aptly stated: “[W]ith the rise of the corporate governance movement, an international bandwagon that started in the United States and the United Kingdom, swooped over to Continental Europe and Japan, and has since permeated all industrialized countries.”<sup>37</sup> We now turn to the question of how the narrative that good corporate governance has to be embodied in corporate governance *codes* has become an international legal conviction.

### III. CORPORATE GOVERNANCE CODES AS A “MUST HAVE” REGULATORY TOOLS

#### 1. *Origins and International Dissemination*

The European Corporate Governance Institute in Brussels lists more than one hundred corporate governance codes of countries and international organizations on its website “Index of Codes”, starting in Albania and ending in Yemen.<sup>38</sup> After the US had set the frame for the corporate governance movement in the late 1970s, the UK somewhat unexpectedly initiated the corporate governance *code* movement in the 1990s. The starting point was the so-called “Cadbury Code of Best Practices”. After a series of scandals involving serious corporate fraud had become public, in 1991 the U.K. government together with London Stock Exchange and the Financial Reporting Council commissioned a committee chaired by Sir Adrian Cadbury to propose a way to improve the direction and control of public companies, the core issues of corporate governance.<sup>39</sup> In 1992 the Committee published its path-breaking

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36 Cf. e.g., M. HOHMANEN/H. LIANG, Universal Corporate Governance, ECGI Working Paper in Finance Nr. 585/2018 with further references.

37 K. J. HOPT, Comparative Company Law 2018, ECGI Working Paper No. 460/2019, at 2.

38 Available at: [http://www.ecgi.org/codes/all\\_codes.php](http://www.ecgi.org/codes/all_codes.php). For a brief comparative analysis, see A.F.M. DORRESTEIJN/C. DE GROOT, Corporate Governance Codes: Origins and Perspectives, European Company Law (2/2014) 5.

39 For a detailed historical analysis, see B. R. CHEFFINS, The Rise of Corporate Governance in the UK: When and Why, University of Cambridge Faculty of Law Research Paper No. 18/2015; available at SSRN: <https://ssrn.com/abstract=2598179>.

report, the so-called "Cadbury Report".<sup>40</sup> Out of the Report grew the "Code of Best Practices". It was the beginning of the British corporate governance movement.<sup>41</sup> The brief Code introduced, for the first time, the idea that listed companies should publish a statement of compliance with the Code as a continuing listing obligation.<sup>42</sup> This was the birth of the famous "comply-or-explain" principle. In various stages the Code of Best Practices was transformed into the present UK Corporate Governance Code.<sup>43</sup>

The Report soon attracted international attention and became an unlikely but highly influential bestseller.<sup>44</sup> Various reasons contributed to the Code's worldwide success. It helped that the Report and ensuing Code were initiated by the London Stock Exchange, at that time the most international of all exchanges.<sup>45</sup> Furthermore, liberalized access to capital made corporations from a wide range of jurisdictions responsive to the demands of international institutional investors, often from the US, who viewed a corporate governance code as a benchmark for good corporate governance.<sup>46</sup> This trend was substantially promoted by an OECD report in 1998 and its Principles on Corporate Governance of 1999 which were strongly influenced by representatives from the UK and the US, among others from Cadbury himself.<sup>47</sup> Later on, international institutions like the World Bank and International Monetary Fund engaged in convincing developing countries to adopt the OECD Principles as a component of their assistance in the wake of the Asian financial crisis and others.<sup>48</sup>

A strong additional accelerant was the so-called "legal origins" theory which appeared at that time. The misguided theory was highly influential because the World Bank and the IMF used it as guideline for their counseling

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40 See A. CADBURY, Report of the Committee on the Financial Aspects of Corporate Governance (London 1992); available at: <http://www.ecgi.org/codes/documents/cadbury.pdf>.

41 P. L. DAVIES/S. WORTHINGTON, Gower and Davies' Principles of Modern Company Law (9<sup>th</sup> ed., London 2012) 424.

42 CHEFFINS, *supra* note 39, at 24.

43 Financial Reporting Council, The UK Corporate Governance Code (2018); available at [www.frc.org.uk](http://www.frc.org.uk).

44 See C. JORDAN, Cadbury Twenty Years on, Villanova Law Review 58 (2013) 1; for a critical analysis of the Code's development, see D. NORDBERG, Cadbury and a Road Not Taken: Contestation Over Board Design and Development of UK Corporate Governance (23 May 2017); available at: <https://ssrn.com/abstract=2972545>.

45 *Ibid.*, at 5.

46 CHEFFINS, *supra* note 39, at 52.

47 JORDAN, *supra* note 44, at 6 f. with further references. For the present version of the OECD Principles see *infra* note 62.

48 JORDAN, *supra* note 44, at 7.

on corporate governance.<sup>49</sup> In a nutshell and somewhat crudely put, the theorem meant that legal origins mattered and that the Anglo-American legal (common law) institutions were “superior” to civil law institutions in promoting the growth of financial markets.<sup>50</sup> In this way the theory justified the worldwide imposition of Anglo-American legal concepts of corporate governance and their embodiment in corporate governance codes irrespective of their appropriateness in the given jurisdiction’s institutional context.<sup>51</sup> If nothing else, one may call this a pervasive international legal fashion.

## 2. *Germany as an Early Convert*

Not only developing but also developed countries submitted to that legal fashion. Germany, a country with no roots in common law, nevertheless adopted the Anglo-American legal concept of corporate governance and established its Corporate Governance Code in 2002.<sup>52</sup> In spite of having a detailed statutory regulatory regime dealing with more or less all core issues of good corporate governance in a total of 40 provisions in the Stock Corporation Act (Articles 76–116), which have been almost annually updated over the last two decades, the initial and subsequent versions of the Code merely replicated a substantial portion of these provisions, albeit in a simplified and thus not coherent language.<sup>53</sup> This caused problems for the companies because it was not clear which statutory text was the decisive one.<sup>54</sup> Continuing criticism has led to abolition of most of these passages in the 2019/20 revision of the Code.<sup>55</sup>

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49 *Ibid.*, at 8 f.

50 Cf. for example R. LA PORTA/F. LOPEZ-DE-SILANES/A. SHLEIFER/R. VISHNY, *Law and Finance*, *Journal of Political Economy*, 106 (1998) 1113. For a highly critical assessment see D. CABRELLI/M. SIEMS, *A Case-Based Approach to Comparative Law*, in: *id.* (eds.), *Comparative Company Law* (Oxford 2013) at 7 ff. with further references; see also S. DEAKIN/P. SARKAR/M. SIEMS, *Is There a Relationship between Shareholder Protection and Stock Market Development?*, University of Cambridge Faculty of Law Research Paper No. 9/2018; available at: <https://ssrn.com/abstract=3105234>.

51 JORDAN, *supra* note 44, at 9.

52 GOVERNMENT COMMISSION FOR THE GERMAN CORPORATE GOVERNANCE CODE, *German Corporate Governance Code* (as of March 2020); available at: <http://www.dcgk.de>; for a detailed analysis of the 2019/20 revision, see K. J. HOPT/P. LEYENS, *Der deutsche Corporate Governance Kodex 2020 – Grundsatz- und Praxisprobleme*, *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 2019, 929.

53 M. LUTTER, *Deutscher Corporate Governance Kodex*, in: Hommelhoff/Hopt/v. Werder (eds.), *Handbuch Corporate Governance* (2<sup>nd</sup> ed., Stuttgart 2009) at 123, 127.

54 Critical, ARBEITSKREIS EXTERNE UND INTERNE ÜBERWACHUNG DER UNTERNEHMEN, *Die Zukunft des Deutschen Corporate Governance Kodex*, *Der Betrieb* 2016, 395.

The intended advantages were that there should be an official English version of the Code which is easy to access and to understand, as the Code, somewhat different from the Stock Exchange Act, uses internationally familiar terms of corporate governance. The aim of attracting foreign investors is a reaction to changes in the financing of German companies, whereby there has been a shift from a national bank-based system to international capital markets as a source of external finance.<sup>56</sup> This regulatory aim is directly addressed in the foreword of the initial version of the Code:

“[T]he Code aims to make the German Corporate Governance system transparent and understandable. Its purpose is to promote the trust of *international* and national investors, customers, employees and the general public in the management and supervision of listed German stock corporations.”<sup>57</sup>

The Code is based in principle on the British “comply-or-explain” approach, a legal transplant in Germany’s law based on a different tradition. The difference is exemplified by the way the principle is given legal force. This is achieved by the Stock Corporation Act and not, as in the UK, by listing rules. Listed companies in Germany have the *statutory* duty to publish annually a declaration of compliance with the Code, where they have to disclose whether they comply or, if not, explain to what extent they are not complying with the Code.<sup>58</sup> Unlike the British model, however, German companies have not only to “explain” that they are not following a recommendation of the Code but, since 2009, have *additionally* to state the reasoning for their decision to abstain. This transparency duty is increasingly (mis)used by shareholders to contest decisions of the general meeting via the courts and to block corporate decisions by claiming that the reasons stated for abstaining were not correct.<sup>59</sup> To avoid these pitfalls the compliance rate is so high that the German Corporate Governance Commission encourages companies *not* to comply. This example demonstrates that the legal transplant is obviously at least partly dysfunctional.

A further difficulty is posed by the misguided understanding of the comply-or-explain principle held by the legislature, which (generally) expects companies to comply as relates to major issues. Female representation in the supervisory board is but one example. As too many companies had

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55 HOPT/LEYENS, *supra* note 52, at 933.

56 LUTTER, *supra* note 53, at 125, 127; E. MICHELER, *Transplanting Corporate Governance Codes – The Role of Legal Doctrine*, Working Paper 2012. Available at: <https://ssrn.com/abstract=2087620>, at 7.

57 Emphasis added. The 2020 version does not directly address “international investors” any longer; available at <http://www.dcgk.de/en/code//foreword.html>.

58 Section 161 Stock Corporation Act.

59 For a critical analysis, see ARBEITSKREIS, *supra* note 54, at 398 f.

offered an explanation but not complied with the pertinent recommendation in the Code, the legislator in 2016 introduced a binding statutory obligation for large listed companies to introduce a 30% minimum of female supervisory board members – a laudable legislative undertaking though perhaps not exactly in the legal transplant’s “comply *or* explain” spirit.<sup>60</sup>

Another problem was a threefold obligation to report on the company’s corporate governance policy. First, if the company does not comply with a recommendation of the Code, it has to explain this fact in accordance with Article 161 Stock Corporation Act. Second, according to Section 3.10 of the earlier versions of the Code, the Management Board and Supervisory Board had to compile each year a so-called Corporate Governance Report and publish this report in connection with the Statement on Corporate Governance required by Article 161. This reporting duty was abolished in the 2019/20 reform and merged with the report described in the next two sentences.<sup>61</sup> (Originally) Third, since 2009, companies have been obliged to file an annual report with key figures about the company’s corporate governance policy. This report is based on Article 289a of the Commercial Code. These three reports were only partly aligned in terms of aim and content.<sup>62</sup>

### 3. *Japan as a Late Convert*

Like Germany, Japan is a country with no original roots in common law though, for historical reasons, it adopted elements of the US’s economic regulation after 1945. In 2015, more than a decade after Germany had created its Code and notwithstanding its highly ambivalent experiences with that Code, Japan succumbed to the international trend and established its own corporate governance code, the “Kōporēto gabenansu kōdo”.<sup>63</sup> A year earlier it had already adopted a stewardship code for listed companies.<sup>64</sup>

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60 For the background to this legislation, see U. SEIBERT, *Frauenförderung durch Gesellschaftsrecht – Die Entstehung des Frauenfördergesetzes*, *Neue Zeitschrift für Gesellschaftsrecht* 1 (2016).

61 HOPT/LEYENS, *supra* note 52, at 990 f.

62 Critical, ARBEITSKREIS, *supra* note 54, at 400.

63 An English translation of the amended 2018 version of the Code can be found at: [www.jpx.co.jp/english/equities/listing/cg/](http://www.jpx.co.jp/english/equities/listing/cg/); for a critical assessment, see J. BUCHANAN/D. H. CHAI/S. DEAKIN, *Taking a Horse to Water? Prospects for the Japanese Corporate Governance Code*, *ZJapanR/JJapan.L.* 47 (2019) 69.

64 *Suchuwādoshippu Kōdo*, an Engl. translation of the present version amended in 2017 is available at: [www.fsa.go.jp/en/refer/councils/stewardship/20170529.html](http://www.fsa.go.jp/en/refer/councils/stewardship/20170529.html); an analysis of the code and its history can be found in H. KANSAKU, *Genuine Self-regulation in Japanese Capital Markets: The Stewardship Code*, in: Baum/Bälz/Dernaier (eds.), *Self-regulation in Private Law in Japan and Germany* (2018) 61;

This second layer of regulation was introduced independent of the fact that the country had only shortly before fundamentally reformed its company law with the creation of the comprehensive Companies Act of 2005.<sup>65</sup> The respective reforms of 2015 and 2014, with their embrace of the underlying British concept of corporate governance, can be understood as an attempt to align the country’s corporate governance structure with the international standards.<sup>66</sup> This trend has been met with skepticism.<sup>67</sup>

The Code mostly follows the recommendations of the OECD. It is characterized by an adoption of the British “comply-or-explain” approach, which was novel for Japan and is a legal transplant without historical precedents there.<sup>68</sup> Like in the UK, the Japanese Code is part of the listing rules, here those of the Tōkyō Stock Exchange, and, different from Germany, its “comply-or-explain” principle is not given legal force by a statutory act. Japan thus follows the UK’s example and is spared the difficulties described above that arise in Germany in the context of Article 161 Stock Corporation Act.

Like in Germany, the rate of compliance is very high. In 2017, only two years after its establishment, 88.9% of the companies listed at the TSE complied with at least 90% of the Code’s recommendations.<sup>69</sup> In both jurisdictions, the recommendations are obviously regarded as quasi-statutory

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critical, G. GOTO, *The Logic and Limits of Stewardship Codes: The Case of Japan*, The University of Tokyo Business Law Working Paper Series, No. 2018-E-01.

65 *Kaisha-hō*, Law No. 86/2005.

66 For an analysis of the policy background of the reforms, see S. KOZUKA, *Reform After a Decade of the Companies Act: Why, How, and to Where?*, *ZJapanR/J.Japan.L.* 37 (2014) 39; H. MORITA, *Reforms of Japanese Corporate Law and Political Environment*, *ZJapanR/J.Japan.L.* 37 (2014) 25; E. TAKAHASHI, *Entwicklung und Hintergründe der Regelungen zur Corporate Governance in Japan mit einem Schwerpunkt auf der Reformdiskussion von 2013*, *ZJapanR/J.Japan.L.* 35 (2013) 63.

67 See S. K. VOGEL, *Japan’s Ambivalent Pursuit of Shareholder Capitalism*, *Politics & Society* 47(1) (2019) 117; A. TOKUTSU, *Do Corporate Law Reforms Increase Profitability? The Japanese Context*, *ZJapanR/J.Japan.L.* 48 (2019) 111; for a general comparative analysis of Japan’s corporate governance system, see L. NOTTAGE, *Perspectives and Approaches: A Framework for Comparing Japanese Corporate Governance*, in: Nottage/Wolff/Anderson (eds.), *Corporate Governance in the 21<sup>st</sup> Century: Japan’s Gradual Transformation* (2008) 21; C. PEJOVIĆ, *Reforms of Japanese Corporate Governance: Convergence in the Eye of the Beholder*, *ZJapanR/J.Japan.L.* 35 (2013) 107.

68 For the discussion about the introduction of this principle and the practice of compliance in Japan, see BUCHANAN/CHAI/DEAKIN, *supra* note 63, at 87 ff.

69 T. SPIEGEL, *Independent Directors in Japan: Changing Corporate Governance?*, *ZJapanR/J.Japan.L.* 46 (2018) 85, 116 with further references.

law which is best complied with, even if this may actually be no more than a purely formal compliance. The cumulation of (i) different “General Principles”, (ii) various “Principles”, and (iii) numerous “Supplementary Principles” makes the Code very comprehensive, and true compliance with it is costly and complicated. Many smaller listed companies – in 2019 more than 3,700 companies were listed at the TSE – may simply do not have the means to comply properly.<sup>70</sup>

Whether the merits of following the international fashion of adopting a corporate governance code outweigh the costs of complying with that code is anyone’s guess – for Germany as for Japan.

#### IV. INDEPENDENT DIRECTORS AS A STATE-OF-THE-ART CORPORATE GOVERNANCE DEVICE

We now turn to the “independent director” as a state-of-the-art corporate governance device, this being one of the central features of almost all corporate governance codes. Both in Japan and Germany, the institution of the independent director was accordingly introduced alongside the respective corporate governance codes.

##### 1. *The Ubiquity of Independent Directors*

Today, any sophisticated jurisdiction must deal with independent directors in one way or another to be considered credible. Accordingly, the US, the Member States of the European Union, and virtually all major Asian jurisdictions have by now rules for appointing at least some independent directors to the boards of their publicly listed companies.<sup>71</sup> On the supra-national level, the OECD recommends in its Principles of Corporate Governance of 2015 that important tasks should be assigned to independent board members who “can contribute significantly to the decision-making of the board”.<sup>72</sup> The European Model Company Act of 2015 recommends an “appropriate balance of independent non-executive directors”.<sup>73</sup> Independent directors have obviously become global players, and, at least until very recently, independent directors seemed to be regarded as some kind of

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70 Cf. BUCHANAN/CHAI/DEAKIN, *supra* note 63, at 104 f.

71 For detailed analyses, see the various contributions in: PUCHNIAK/BAUM/NOTTAGE (eds.), *Independent Directors in Asia: A Historical, Contextual and Comparative Approach* (Cambridge 2017).

72 The G20/OECD Principles of Corporate Governance (OECD Publishing 2015); available at <http://dx.doi.org/10.1787/9789264236882-en>.

73 Sec. 5 of the final draft in 2015 European Model Company Act, available at <http://law.au.dk>.

largely unquestioned prescription for a panoply of corporate governance problems.<sup>74</sup> In the US, over the last decades, the primary legislative and judicial response to almost every major corporate scandal has been to increase reliance on independent directors.<sup>75</sup>

This is somewhat surprising given the fact that there is only shaky empirical support for staffing boards with independent directors.<sup>76</sup> It does seem that the empirical evidence leans towards indicating that there is no obvious benefit to including independent directors on boards. It also suggests that too much independence may be a bad thing. Nevertheless, in 2013, in US public companies, 85% of directors were independent and 60% of boards had only one non-independent director – the Chief Executive Officer (CEO).<sup>77</sup> In this way the fundamental, although often ignored, paradox arises that 'independence actually creates dependence', as the independent director has to rely on company insiders, namely the CEO, for his or her information.<sup>78</sup>

In the wake of the global financial crisis of 2008 the concept of the independent director came under closer and critical scrutiny as it became clear that independence could not substitute for experience.<sup>79</sup> This has somewhat weakened the faith in the concept, but independent directors still remain an

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74 For an overview see H. BAUM, The Rise of the Independent Director in the West: Understanding the Origins of Asia's Legal Transplants, in: Puchniak/Baum/Nottage (eds.), *supra* note 71, at 21; also available as "The Rise of the Independent Director: A Historical and Comparative Perspective", Max Planck Institute for Comparative and International Private Law Research Paper Series, No. 16/20, at <http://ssrn.com/abstract=2814978>.

75 This appears somewhat paradoxically to be a reaction to the collapse of Enron in 2001, one of the major corporate scandals in the US in recent years. Enron's board was composed mostly of independent directors, and the head of Enron's audit committee was a professor of accounting at Stanford University, whom one might regard as highly qualified for the job. Nevertheless, the Sarbanes-Oxley Act of 2002 – aimed at improving corporate governance in effect – codified the monitoring model that had not worked at Enron.

76 For details See W.-G. RINGE, Independent Directors: A Theoretical Framework, in: Puchniak/Baum/Nottage (eds.), *supra* note 71, at 58. Two much-cited critical empirical meta-studies are S. BHAGAT/B. BLACK, The Uncertain Relationship Between Board Composition and Firm Performance, *Bus. Law.* 54 (1999) 921, and S. BHAGAT/B. BLACK, The Non-Correlation Between Board Independence and Long-Term Firm Performance, *Journal of Corporation Law* 27 (2002) 231.

77 U. VELIKONJA, The Political Economy of Board Independence, *North Carolina Law Review* 92 (2014) 855, 857 f. with further references.

78 J. N. DRUEY, Unabhängigkeit als Gebot des allgemeinen Unternehmensrechts, in: Kalss/Nowotny/Schauer (eds.), *Festschrift Peter Doralt* (Vienna 2004) 151 ff.

79 See RINGE, *supra* note 76, at 77 f.; BAUM, *supra* note 74, at 54, with further references.

entrenched feature on boards of public companies. We see, in other words, another lasting and truly international “legal fashion”.

## 2. *The Function of the Independent Director*

The term “independent director” is indiscriminately used in the international discussion about corporate governance, but there is no universal definition and the context in which independent directors operate in each jurisdiction is highly path-dependent. If the main task assigned to the independent directors is to monitor management as a means to solve the classic agency conflict between managers and dispersed shareholders as owners of the firm, independence from the entrenched CEO of the stereotypical US Berle-Means corporation seems to be the most important criterion. If, on the other hand, the directors’ task is defined predominantly as protecting minority shareholders against a controlling block holder in an archetypical Continental European company or in many Asian companies, independence from the latter will be the decisive characteristic.

The question is thus whether the concept of the independent director was designed to solve the classical agency conflict between managers and dispersed shareholders or the agency conflict is between controlling and non-controlling shareholders or both.<sup>80</sup> At least historically, the concept was designed to address the first agency conflict only.

## 3. *The Origin of the Independent Director*

The US and the UK are commonly credited with creating the concept of the “independent director” and the related model of a “monitoring board of directors” and with exporting it around the world.<sup>81</sup> We first look at the US and thereafter the UK.

The concept originated in the US in the 1970s in reaction to corporate scandals and became firmly entrenched in the American corporate world over the next four decades as a remedy against all kinds of corporate governance ills.<sup>82</sup> The US lawmaker’s answer to corporate problems was regularly to increase the level of independence within company boards. In the 1970s, the US stock market was characterized by widely dispersed individ-

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80 For a general discussion of the agency conflicts, see KRAAKMAN *et al.*, *supra* note 31, at 29.

81 For a comparative overview, see BAUM, *supra* note 74, at 33; a comprehensive analysis can be found in Y. ZHAO, *Corporate Governance and Directors’ Independence* (Alphen aan den Rijn 2011).

82 For a detailed historical analysis, see J. N. GORDON, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, *Stanford Law Review* 59 (2007) 1465.

ual (household) ownership. This shareholder structure was associated with passivity, the “rational apathy” of individual minority shareholders. Today we still see a dispersed ownership but now made up by institutional shareholders. What has not changed, however, is the passivity of these owners with respect to corporate governance, what has been labeled as a kind of “rational reticence”.<sup>83</sup>

The above structure can be easily distinguished from active institutional, family or state block holdings by substantial shareholders as observed in Continental Europe and much of Asia. Not surprisingly, the rules on board composition in the US are applicable to diffusely held public companies *only*, but *not* to controlled companies where a shareholder (or a coordinated group of shareholders) holds more than 50% of the voting rights.<sup>84</sup> In this sense, the US has clearly made the decision that the primary function of independent directors is to monitor management on behalf of dispersed shareholders who are – unlike a controlling shareholder – prevented from doing so themselves as a result of their own collective action problems. Obviously, the US has envisaged independent directors to be of limited or no value when there are controlling shareholders as a controlling shareholder can monitor and, if need be, replace management or manage the company themselves. This has not, however, prevented countries where block holdings by substantial shareholders are the rule to nevertheless adopt the concept in order to obtain good international corporate governance rankings.<sup>85</sup>

We now turn to the UK. There, the adoption of the monitoring board model is fairly recent.<sup>86</sup> But it has been highly influential in spreading the model and with it the independent director around the world. Similar to the ownership structure of US public corporations, shareholdings in UK listed companies were and are normally not concentrated and blockholdings play no important role.<sup>87</sup> In 1992, the Cadbury Report mentioned previously

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83 R. J. GILSON/J. N. GORDON, Agency Capitalism: Further Implications of Equity Intermediation, ECGI, Law Working Paper N° 239/2014; available at: <http://ssrn.com/abstract=2359690>.

84 Section 303 A, NYSE Listed Company Manual 2016; available at <http://nysemanual.nyse.com/lcm>.

85 A prominent example is Singapore. In 2001, in reaction to the Asian financial crisis of the late 1990s, Singapore adopted the US-style independent director model to make its corporate governance state of the art and, indeed, acquire the best ranking for this; see D. W. PUCHNIAK/L. L. LAN, Independent Directors in Singapore: A Corporate Governance Outlier?, in: Puchniak/Baum/Nottage (eds.), *supra* note 71, at 311.

86 For a detailed historical analysis, see CHEFFINS, *supra* note 39; for a brief overview see BAUM, *supra* note 74, at 43 ff.

87 See P. L. DAVIES, Shareholders in the United Kingdom, ECGI Working Paper No. 280/2015, with further references.

identified the domination of many companies by a single highly powerful CEO as a central governance problem.<sup>88</sup> Accordingly, the Cadbury Code of Best Practices – and today the Corporate Governance Code<sup>89</sup> – proposed a board staffed with a sufficient number of non-executive directors. A majority of these were suggested to be independent.<sup>90</sup> In the early 2000s the number of independent directors on the boards of companies listed in the UK oscillated around the high benchmark of 90%.<sup>91</sup> After the global financial crisis, however, a stronger emphasis on experience emerged and the number of independent directors on the boards of companies listed in the UK started to sink, but still they make up the majority of board members today.

Though the UK was late to embrace the independent monitoring model pioneered by the US, it was able to make considerable refinements to the model by making it a fundamental corporate governance principle enshrined in a corporate governance code with its “comply-or-explain” principle as described above.<sup>92</sup> From the UK, the concept of the independent monitoring model started to conquer the European Union and, also, the developments in the UK helped to spread the concept to the major Asian economies.<sup>93</sup>

#### 4. *The Anglo-American Independent Director as a Transplanted Legal Fashion*

We now turn to the German and Japanese experiences to see how the Anglo-American independent director has worked as a transplanted legal fashion in totally different corporate governance environments.

##### a) *Germany: Outside or Independent Directors?*

Germany was probably the first jurisdiction to establish a formalized separation between management and supervision, this occurring as early as 1861. Since then, the German corporate governance system has been characterized by a two-tier board structure.<sup>94</sup> Members of the management

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88 P. L. DAVIES/S. WORTHINGTON, *Gower and Davies' Principles of Modern Company Law* (9<sup>th</sup> ed., London 2012) 424 f.

89 *See supra* note 43.

90 P. L. DAVIES, *Corporate Boards in the United Kingdom*, in: Davies/Hopt/Nowak/van Solinge (eds.), *Boards in Law and Practice* (Oxford 2013) 713, 738.

91 M. ROTH, *Unabhängige Aufsichtsratsmitglieder*, *Zeitschrift für das gesamte Handels- und Wirtschaftsrecht* 175 (2011) 605, 616 with further references.

92 *Supra*, at III.1.

93 *See* D. W. PUCHNIAK/K. KIM, *The Independent Director in Asia: A Taxonomy*, in: Puchniak/Baum/Nottage (eds.), *supra* note 71, at 89 ff.

94 For a comparative discussion in English, *see* M. ROTH, *Corporate Boards in Germany*, in: Davies *et al.*, *supra* note 90, at 253 ff.

board were not—and still are not— allowed to simultaneously act as members of the supervisory board. The management board is exclusively staffed with executive directors. It has direct responsibility for the management of the company. The law requires the supervisory board, by contrast, to be composed exclusively of outside non-executive directors.<sup>95</sup> The tasks of the supervisory board are usually regarded as twofold: *ex post* monitoring of the management board and *ex ante* advising on business strategy. Arguably, the latter is in substance a form of proactive or preventative monitoring.

Being an outside director does not, of course, mean the same thing as being an independent director. Rather, the non-executive directors staffing the supervisory board were – and to some extent still are – typically either affiliated with the company and its management or were constituency directors representing major shareholders. Accordingly, the traditional structure has been aptly described as an ‘insider system’ of corporate governance.<sup>96</sup> This pattern corresponded with the traditional widespread block-holding structure. Until today, we see a prevailing strong presence of group affiliation and block-holding families among listed companies.

The German Stock Corporation Act still has no general provision on independence, but it provides only a few mandatory requirements for supervisory directors. Instead, independence is predominantly dealt with in the German Corporate Governance Code.<sup>97</sup>

According to the Code, supervisory board members are to be considered independent from the company and its management board if they have no personal or business relationship with either of these that may cause a substantial and not merely temporary conflict of interest.<sup>98</sup> Initially, independence required this absence of potentially conflicting personal or business relations only with the company or its executive bodies but *not* from a controlling shareholder. In this way, the “wrong” agency conflict, i.e. the conflict between managers and dispersed shareholders, but not the for-Germany-more-important conflict between minority shareholders and a controlling block-holder, was addressed. Given the Code’s aim of signaling good corporate governance in Germany it was, however, sufficient to be

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95 The regulation is presently found in Section 105, Stock Corporation Act of 1965. For an assessment K. J. HOPT, The German Law of and Experience with the Supervisory Board, ECGI Working Paper No. 305/2016; available at <http://ssrn.com/abstract=272270>.

96 K. J. HOPT, Law and Corporate Governance: Germany within Europe, *Journal of Applied Finance* 27 (2015) 8.

97 Section C.II., German Corporate Governance Code 2020; references of the Code *supra*, at note 52.

98 Recommendation C.7., German Corporate Governance Code 2020; for a detailed discussion, see HOPT/LEYENS, *supra* note 52, at 956 ff.

consistent with the US and the UK model of the independent monitoring board of that time – whether or not that was well suited for the German corporate structure.

This changed only in 2012 when after a heated discussion the list of criteria for independence was extended to include a relationship with a controlling shareholder (or an enterprise associated with him or her) as excluding independence.<sup>99</sup> Since then, depending on the size of the company, with smaller companies at least one shareholder representative – and with bigger companies at least two – are to be independent from the controlling shareholder.<sup>100</sup> Given that the historical legislator of the Stock Corporation Act conceived the Supervisory Board as a representative organ of the *shareholders* – to compensate them for a loss of direct influence on the management – it may indeed appear to be irritating that, today, being a shareholder or having a relationship with a shareholder potentially disqualifies an individual from serving as a member of that Board or a committee thereunder.<sup>101</sup> Critics have emphasized that representatives of controlling shareholders have the incentives and probably the expertise to monitor the management board efficiently.<sup>102</sup> Thus it comes as no surprise that the idea of independent monitoring by outsiders still meets with considerable skepticism, such skepticism being rooted in the persistently strong presence of family-controlled and dependent companies.<sup>103</sup>

Furthermore, there was also no substantial need in Germany to address the problem of minority protection in the Corporate Governance Code because the extensive mandatory regulation found in the Stock Corporation Act and elsewhere provided sufficient protection in any event. One thus suspects that the likely aim was rather to adhere to the international legal fashion. Once more we see a legal transplant that does not actually fit in the

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99 An overview over the discussion can be found in T. FLORSTEDT, Die Unabhängigkeit des Aufsichtsratsmitglieds vom kontrollierenden Aktionär, *Zeitschrift für Wirtschaftsrecht* 2013, 337.

100 Recommendation C.9., German Corporate Governance Code 2020.

101 M. HOFFMANN-BECKING, Unabhängigkeit im Aufsichtsrat', *Neue Zeitschrift für Gesellschaftsrecht* 2014, 801, 806. By contrast, the Swedish Corporate Governance Code takes a positive view toward the role the company's major shareholder can play in corporate governance, see J. L. HANSEN, Active Owners and Accountable Directors, in: Birkmose/Neville/Sørensen (eds.), *Boards of Directors in European Companies* (Alphen aan den Rijn 2013) 241, 260 with further references.

102 N. PASCHOS/S. GOSLAR, Unabhängigkeit von Aufsichtsratsmitgliedern nach den neuesten Änderungen des Deutschen Corporate Governance Kodex, *Neue Zeitschrift für Gesellschaftsrecht* 2012, 1361 f.; HOFFMANN-BECKING, *supra* note 101, at 807; HANSEN, *supra* note 101, at 250 ff.

103 HOPT, *supra* note 96, at 10.

specific path-dependent institutional setting of the receiving legal order. It is a small wonder that Germany still has one of the lowest proportions of independent (supervisory) directors in Europe.

*b) Japan: Independent Directors in an Insider-Oriented Corporate Governance Model*

Even more than Germany, Japan is famous for its insider-oriented corporate governance model. Thus, the decision to opt for the outsider-oriented governance concept of the independent director came only after a lengthy discussion and against much resistance from the industry. The introduction was made gradually and in homeopathic doses, starting first with the "outside director" (*shagai torishimari-yaku*) and followed later on in 2009 by the "independent director" (*dokuritsu torishimari-yaku*).<sup>104</sup>

The organizational structure of the Japanese stock corporation traditionally follows a hybrid monistic model.<sup>105</sup> But today the picture is more complex as three optional organizational forms are available.<sup>106</sup> In the traditional model with a managing board and a statutory board of auditors (*kansa yak-kai*), half of the latter must be staffed with outside auditors since 2001. The attempt to introduce a mandatory rule to appoint in addition to outside auditors also one outside *director* failed in the company law reform of 2014.<sup>107</sup> In the company with three committees (nomination, audit and remuneration), introduced in 2002, the majority of the committees' members must be outside directors. The same is true for the third available option, the company with a supervisory committee, introduced in 2014, where the majority of the committee's members must be outside directors. Outside (*shagai*) means auditors or directors may not have been employed by the company, its subsidiary or by a parent or sister company during the last 10 years.<sup>108</sup>

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104 A comprehensive analysis of these developments can be found in G. GOTO/M. MATSUNAKA/S. KOZUKA, Japan's Gradual Reception of Independent Directors: An Empirical and Political-Economic Analysis, in: Puchniak/Baum/Nottage (eds.), *supra* note 71, at 135, 137 ff., 160 ff.; see also G. GOTO, Recent Boardroom Reforms in Japan and the Roles of Outside/Independent Directors, in: Oda (ed.), *Comparative Corporate Governance. The Case of Japan* (Cologne 2018) 33; an in-depth analysis in German is provided by T. SPIEGEL, *Independent Directors in Japan. Die japanische Corporate Governance und effektives Monitoring aus rechtsvergleichender Sicht* (Tübingen 2017) 75 ff., 103 ff., 197 ff.

105 See H. TAKADA/M. YAMAMOTO, The „Roesler Model“ Corporation, *ZJapanR/J.Japan.L.* 45 (2018) 45.

106 An overview can be found in SPIEGEL, *supra* note 104, at 103 ff.

107 For details see GOTO/MATSUNAKA/KOZUKA, *supra* note 104, at 166 ff.

108 Art. 2 no. 15 Companies Act.

The obligation to appoint at least one *independent* auditor or director was first introduced in the Listing Rules of the TSE in 2009. This obligation is mandatory for listed companies in Japan and was supplemented in 2012 by a recommendation that these companies should at least *try* to appoint one additional independent director. On top of this, the Corporate Governance Code of 2015 stipulates the duty for all listed companies regardless of their organizational structure to appoint at least two independent directors.<sup>109</sup> But this duty is only on a comply or explain basis and thus not mandatory. A director is independent (*dokuritsu*) if he or she meets the criteria for an outside director, and in addition it is required that the person in question is unlikely to have conflicts of interest with the general shareholders.<sup>110</sup> A major shareholder and his or her representative are accordingly not regarded as independent, but they may act as an outside director.

The concept of the independent director is thus realized in Japan by the interplay of three different regulatory levels. This regulatory complexity seems to reflect the intense political struggle over the concept's introduction. Nevertheless, only two years after the enactment of the Code, in 2017 almost 85% of the listed companies had appointed the two independent directors recommended by the Code.<sup>111</sup>

The government's promotion of the adoption of the independent director met with fierce resistance from the industry because the Anglo-American concept is diametrically opposed to Japan's traditional insider-oriented corporate governance system. This can be characterized – albeit in a stark simplification – as follows: At least until very recently, a company was generally perceived as a socially integrated community with a quasi-family character (*uchi no kaisha*) in which there was no room for outsiders.<sup>112</sup> Key concepts were – and to some extent still are – lifelong employment in large companies for the core of the workforce, professional careers within the company, board members chosen from the company's senior employees, payment at least predominantly linked to seniority, comparatively low income differences within the company (especially when compared to the

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109 Principle 4.8. *Kōporēto gabenansu kōdo*.

110 Rule 436-2 TSE Listing Rules; for details of the complex definition, see SPIEGEL, *supra* note 104, at 218 ff., 223 ff.

111 See SPIEGEL, *supra* note 69, at 116 with further references.

112 Some speak of the “community firm”, see J. BUCHANAN/D. H. CHAI /S. DEAKIN (eds.), *Hedge Fund Activism in Japan: The Limits of Shareholder Primacy* (Cambridge 2012) 297 ff.; others call it an “insiders’ community”, see S. KOZUKA, *Diversity in Japanese Companies’ Boardroom: Sign of Shifts in the Japanese Model or Corporate Reform as Fashion?*, *European Business Law Review* 30(2) (2019) 223, discussing whether increasing female participation in the boards might be an additional driver for breaking the traditional mold.

US), and company unions (as opposed to European-style industry unions).<sup>113</sup> Accordingly, internal corporate governance is oriented in a mostly “firm-centric” manner, targeting the interests of the company in its entity and only to a lesser degree an increase in shareholder value.<sup>114</sup>

This picture corresponds with the ownership structure of Japanese companies, its being characterized by significant participation of so-called “stable shareholders” (*antei kabunushi*) often in the form of cross-shareholdings. These are firms that have a lasting financial or other business relationship with the company. Cross-held shares are held predominantly to secure the commercial relationship and to protect the involved companies’ management against external interference, namely in the form of hostile acquisitions of substantial blocks of shares or outright hostile takeovers.<sup>115</sup> Furthermore, the managers and directors of the involved companies often exchange blank voting proxies amongst one another, with the result that there is factually no proper control of management by the shareholders as owners of the companies. This again corresponds with the secondary role shareholders play in the traditional understanding of the company. In 1990, stable shareholdings made up two-thirds of the outstanding shares, and in 2012 these still amounted to about one-third.<sup>116</sup>

It was these stable shareholders who successfully thwarted the manifold attempts of (mostly) foreign activist shareholders, namely hedge funds, to acquire undervalued Japanese companies in the mid-2000s. Since 1945 no genuine hostile takeover has been successful.<sup>117</sup> Nor did hostile acquisitions of substantial shareholdings – done in order to enforce policy changes in the management of undervalued companies – prove a lasting success. Most foreign hedge funds have quietly exited the Japanese market.<sup>118</sup> For the foreseeable future the “market for corporate control” will play no important role as a means of external corporate governance; rather, insider governance seems to prevail.

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113 See e.g. H. BAUM, *Marktzugang und Unternehmenserwerb in Japan* (Heidelberg 1995) 81 ff.; PEJOVIĆ, *supra* note 67, at 114 ff., 132 ff.

114 BUCHANAN/CHAI/DEAKIN, *supra* note 112, at 298.

115 For details see H. BAUM/M. SAITO, *Übernahmerecht*, in: Baum/Bälz/Dernauer/Koziol (eds.), *Handbuch Japanisches Handels- und Wirtschaftsrecht*, (2<sup>nd</sup> ed., forthcoming 2021), Chap. 6, Marginal Notes 3 ff.

116 GOTO/MATSUNAKA/KOZUKA, *supra* note 104, at 149.

117 See D. PUCHNIAK/M. NAKAHIGASHI, *The Enigma of Hostile Takeovers in Japan: Bidder Beware*, *Berkeley Business Law Journal* 15/1 (2018) 4, 14 f.

118 For details see J. BUCHANAN/D. H. CHAI/S. DEAKIN, *Unexpected Corporate Outcomes from Hedge Fund Activism in Japan*, Centre for Business Research, University of Cambridge, Working Paper No. 494, March 2018.

It is an open question how independent directors as outsiders can be sensibly integrated in this insider-oriented corporate governance model. So far, it has been not sufficiently clarified what the exact function of an outside director should be in such a surrounding.<sup>119</sup> Gradual changes in the employment system over the last 20 years and a substantial increase in foreign (non-activist) shareholdings have, so far at least, not prompted a change towards a “shareholder centric” governance model or an embrace of the underlying shareholder value concept for which the independent director stands. Rather, Japanese managers continue to see themselves as guardians of the company in its totality, including all of its stakeholders.<sup>120</sup> Indeed, the Japanese “community firm” seems to be experiencing a longer life than foreign observers expected – even without boards staffed with a majority of independent directors.<sup>121</sup> If the number of listed companies is a measure, it even seems to be a remarkably successful model. Whereas the number of listed companies has constantly decreased in the US and the UK since the start of the millennium, it has steadily grown in Japan during that period.<sup>122</sup>

## V. OUTLOOK

Today’s national regulators seem obliged to navigate a kind of regulatory Scylla and Charybdis – like the Greek hero Ulysses who had to master the historical challenge. On the one hand, they have to conform to the expectations of the global investment community (as to what constitute internationally perceived “good” corporate governance standards along the lines of Anglo-American practices) if they want to attract capital in the international financial markets. At the same time, they face the task of designing an optimal regulatory architecture suited for their national markets with their path-dependent institutional frameworks. This dual obligation may cause frictions if the global standards and the given institutional set-up derive from different regulatory and organizational traditions. In such a case it is far from certain whether conforming to the international expectations actually improves corporate governance in the given jurisdiction. Rather, the regulator may feel forced to adopt regulatory standards which are unnecessary or even unsuitable when viewed from the national perspective. As all

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119 SPIEGEL, *supra* note 104, at 276 f.

120 BUCHANAN/CHAI/DEAKIN, *supra* note 63, at 77.

121 BUCHANAN/CHAI/DEAKIN, *supra* note 112, at 311.

122 See J. FRANKS/C. MAYER, *Evolution of Ownership and Control Around the World: The Changing Face of Capitalism*. European Corporate Governance Institute (ECGI) Finance Working Paper No. 503/2017, at 28 f.

regulation comes with a price tag of compliance costs and an out-crowding of potentially better alternative solutions, the outcome may be suboptimal.

The examples discussed here may well fall into this category. Nonetheless, it seems as if doubts are growing about the suitability of uniform, globally standardized solutions. Accordingly, the national institutional contexts may (again) receive increasing attention, and international legal fashion in corporate law may correspondingly become perhaps less pervasive in the future.