THE *LIVEDOOR* SHOCK: SHOULD THE JAPANESE COURT CONSIDER U.S. PRECEDENT IN SECURITIES REGULATION?

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I. INTRODUCTION

On June 13, 2008, the Tokyo District Court handed down a decision ordering internet services company Livedoor Holdings Co. to pay a total of 9.54 billion yen (approximately $88.4 million, based on the June 13, 2008 exchange rate) in damages to six firms in connection with an accounting scandal.[1] This paper will explore the extent to which a similar case might have enjoyed a different outcome in the U.S., and whether U.S. precedent might have served as a useful reference when trying the case in Japan. The paper begins in Part II with a description of the events surrounding the litigation. Part III includes analysis of the relevant Japanese and U.S. laws, as well as discussion of their parallels and the ways in which U.S. precedent might serve as a useful reference for a Japanese judge trying such a case, and then posits that the outcome of this case makes sense in the context of Japanese jurisprudence, particularly as explicated in Frank Upham's book Law and Social Change in Postwar Japan.[2]

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1. Nippon Life Ins. Co. v. Livedoor Holdings Co., Tokyo Chiho Saibansho, (Dist. Ct., June 13, 2008). The court has not yet published the legal opinion. For summaries of the ruling, *see Court Orders Livedoor to Pay 9.5 Billion Yen in Compensation to 6 Firms*, JAPAN ECON. NEWSWIRE, June 13, 2008 [hereinafter *Nippon Life*]; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], MSN Sankei Nyusu [MSN INDUS. & ECON.NEWS], June 13, 2008, Nyusu Toppu, Jiken, Saiban, Kijishousai [at News Top, Occurrences, Judgments, Article Details], *available at* http://sankei.jp.msn.com/affairs/trial/080613/trl0806131535012-n1.htm.

2. FRANK K. UPHAM, LAW AND SOCIAL CHANGE IN POSTWAR JAPAN (Harvard, 1987).

II. BACKGROUND

Most readers of this article who have invested in U.S.-listed securities already know that the U.S. Securities and Exchange Commission ("SEC") encourages investors to obtain, first-hand, the most updated information about securities before investing.[3] The SEC provides such information on its free EDGAR website.[4] In June 2001, Japan's Financial Services Agency ("FSA") also commenced use of a free, online system analogous to EDGAR.[5] They call that system "EDINET" (Electronic Disclosure for Investors' NETwork).[6] Like the SEC, the FSA encourages investors and potential investors to use EDINET to get the most updated and accurate information about companies when making investment decisions.[7]

In its financial report for the year ending September 30, 2004, Livedoor Holdings "padded profits by over 5 billion yen."[8] Livedoor's subsequently filed January 1, 2005 securities report in-

3. *See* U.S. Securities and Exchange Commission, *SEC Filings and Forms (EDGAR)*, http://www.sec.gov/edgar.shtml (last visited Mar. 3, 2009).

4. *Id.*

5. *See* Financial Services Agency, Kin'yucho Shinsei Todokede tou tetsuduki no denshikasuishin akushon puran ni tsuite [Regarding the Financial Service Agency's Plan for Advancement of Electronification of Application, Notification, and Other Procedures] (June 13, 2001), http://www.fsa.go.jp/news/newsj/kinyu/f-20010711/f-20010711-2a.pdf; *see also* Financial Services Agency, February 2008 Working Group for the Improved Operations of EDINET, *Summary of Issues for the Improved Operations of EDINET* (Provisional Translation) (February 2008), http://www.fsa.go.jp/en/news/2008/20080416/02.pdf (last visited Mar. 3, 2009) (containing a brief history of EDINET from its inception through early 2008.); Electronic Disclosure for Investors' Network, http://info.edinet-fsa.go.jp/.

6. *See* Financial Services Agency, Kin'yucho Shinsei Todokede tou tetsuduki no denshikasuishin akushon puran ni tsuite [Regarding the Financial Service Agency's Plan for Advancement of Electronification of Application, Notification, and Other Procedures] (June 13, 2001), http://www.fsa.go.jp/news/newsj/kinyu/f-20010711/f-20010711-2a.pdf; *see also* Financial Services Agency, February 2008 Working Group for the Improved Operations of EDINET, *Summary of Issues for the Improved Operations of EDINET* (Provisional Translation) (February 2008), http://www.fsa.go.jp/en/news/2008/20080416/02.pdf (last visited Mar. 3, 2009); Electronic Disclosure for Investors' Network, http://info.edinet-fsa.go.jp/.

7. *See generally* Financial Services Agency, Homepage, http://www.fsa.go.jp/ (last visited May 19, 2009); *see also* Financial Services Agency Kin'yucho Shinsei Todokede tou tetsuduki no denshikasuishin akushon puran ni tsuite [Regarding the Financial Service Agency's Plan for Advancement of Electronification of Application, Notification; and Other Procedures] (June 13, 2001), http://www.fsa.go.jp/news/newsj/kinyu/f-20010711/f-20010711-2a.pdf; Financial Services Agency, February 2008 Working Group for the Improved Operations of EDINET, *Summary of Issues for the Improved Operations of EDINET* (Provisional Translation) (February 2008), http://www.fsa.go.jp/en/news/2008/20080416/02.pdf (last visited Mar. 3. 2009); Electronic Disclosure for Investors' Network, http://info.edinet-fsa.go.jp/.

8. *Livedoor Ordered to Pay 9.5 B. Yen in Damages*, JIJI PRESS TICKER SERVICE (Japan), June 13, 2008.

cluded the corrected information.[9] However, the company failed to issue additional filings to officially "correct" the report for the year ending September 30, 2004.[10] It also failed to otherwise explicitly notify the investing public of the mistake and correction thereof.[11]

Subsequent earnings reports did not include such "padding," but instead included the correct information.[12] Therefore, investors and potential investors searching EDINET for the most updated official information about the company after January 1, 2005 would have found and presumably relied on the corrected information. They would not have known that Livedoor's 2004 earnings report included incorrect information. Such investors also would have remained happily unaware that, although Livedoor corrected such a mistake, it failed to file the appropriate report notifying the investing public of the mistake and correction. Accordingly, in making their investment decisions relating to Livedoor Holdings, Inc., those investors might have, at worst, made a mistake with respect to the extent to which they could trust Livedoor to consistently report accurate financial information.[13] They would not, however, have made any mistake with respect to the financial information upon which they relied in making their investment decisions.[14]

More than one year later, on the evening of Thursday, January 12, 2006, "law-enforcement officers . . . raided Livedoor Co."[15] They did not immediately notify the press of their actions.[16] In fact, Livedoor-related news even through the mid-day of the following Monday, January 16, 2006, remained focused on such things as "Livedoor Co. President Takafumi Horie un-

9. *Nippon Life*, *supra* note 1. *See also Jim Fredrick, Living on the Edge,* TIME MAG., Jan. 23, 2006, available at http://www.time.com/time/asia/2006/livedoor/story.html.

10. *Id.*; *Livedoor Ordered to Pay 9.5 B. Yen in Damages*, *supra* note 8; *see also* Fredrick, *supra* note 9.

11. *Nippon Life*, *supra* note 1; *Livedoor Ordered to Pay 9.5 B. Yen in Damages*, *supra* note 8; *see also* Fredrick, *supra* note 9.

12. *Nippon Life*, *supra* note 1; *Livedoor Ordered to Pay 9.5 B. Yen in Damages*, *supra* note 8; *see also* Fredrick, *supra* note 9.

13. For a discussion of the importance of financial reporting in maintaining a reliable and stable securities market, *see* JAMES D. COX, SECURITIES REGULATION, CASES AND MATERIALS, 545 (Aspen Publishers 2006).

14. Although archived financial information remains available on EDINET, by default, EDINET first provides the most current information for companies. *See* Electronic Disclosure for Investors' Network, http://info.edinet-fsa.go.jp/.

15. *(Update) Livedoor, Horie's Home Raided over Suspected Securities Law Violation*, JIJI PRESS TICKER SERVICE (Japan), Jan. 16, 2006.

16. *See* Fredrick, *supra* note 9 (providing an overall good description of the events, but demonstrating that the U.S. press remained unaware of the June 13 raids even after the continuation on June 16.).

veil[ing] plans to enter the space tourism business."[17] Even after the press became fully aware of the raids, many reports ignored the initial January 12 raids, and continued to mark the evening of Monday, January 16 as the time and date of the first raids.[18] News of the raids "broke" on the evening of Monday, January 16, citing "suspected involvement in an affiliated firm's alleged illicit attempt to lift its own stock price."[19] The news also reported that the "Tokyo district Public Prosecutors Office and the Securities and Exchange Surveillance Commission also searched for evidence at the home of Livedoor president Takafumi Horie. . . as well as the affiliated company, Livedoor Marketing Co."[20] At that time, news reports focused primarily on two points.[21] First, Livedoor Marketing's stating in October 2004 that "it would make Tokyo-based publisher MoneyLife Inc. a fully owned subsidiary through a stock swap," when in fact "the Livedoor group had already acquired MoneyLife four months earlier."[22] Second, "Livedoor Marketing [was] suspected of overstating its sales, recurring profit and net profit for January-September 2004 to boost its stock price."[23] As noted, the press learned of (and began reporting) the investigation and quarantining of Livedoor's offices and financial records on Monday, January 16.[24] However, even as of January 17, the authorities refrained from telling the press the reason for their investigation.[25] Even as of January 17, the press mentioned only the "possibility" of securities fraud, based on a "tip" from the office of the Tokyo public prosecutor.[26] Nev-

17. *Livedoor Chief Aims at Low-Cost Space Tourism*, NIKKEI WKLY (Japan). Jan. 16, 2006.

18. *See, e.g.*, *Market Eyes Stock Players Expecting Livedoor Shock to Linger on Market*, JIJI PRESS TICKER SERVICE (Japan), Jan. 17, 2006; Fredrick, *supra* note 9.

19. *(Update) Livedoor, Horie's Home Raided over Suspected Securities Law Violation*, *supra* note 15.

20. *Id.*

21. *Id.*

22. *Id.* For more detailed commentary on the stock split issue, which falls outside the scope of this paper, *see also Horie's Business Strategy Called into Question*, DAILY YOMIURI, Jan. 16, 2006; Mayumi Negishi & Taiga Uranaka, *Stock Split Tactics Questioned: Livedoor Raid Stirs up Fear of Net Stocks*, JAPAN TIMES, Jan. 18, 2006.

23. *(Update) Livedoor, Horie's Home Raided over Suspected Securities Law Violation*, *supra* note 15. Notice that, although not irrelevant, the reports generally mentioned this as the second item in these early reports. Readers should remember this when considering how much it might have influenced the subsequent drop in Livedoor's stock price.

24. *See* Fredrick, *supra* note 9; *(Update) Livedoor, Horie's Home Raided over Suspected Securities Law Violation*, *supra* note 15.

25. *See* Fredrick, *supra* note 9.

26. *Id.*

ertheless, speculation began that Livedoor might have engaged in securities fraud.[27]

What did and would the raids mean to investors and law enforcement officials? "The news spurred aggressive selling of Livedoor shares on the Tokyo Stock Exchange's Mothers market for startup firms on Tuesday [January 17], sending the stock . . . down by a daily limit loss of 100 yen."[28] Even the earliest news reports recognized certain realities that might have influenced investigators', prosecutors', and judges' subsequent considerations and actions.[29] For example, one quoted "Masanobu Takahashi, chief strategist at Ichiyoshi Securities Co., [as] point[ing] to worries that the latest scandal may dampen foreign investor appetite for Japanese stocks."[30] "Over the last three to four years, foreign investors have grown extremely sensitive to corporate scandals as the U.S. stock market underwent a number of them."[31] "Some analysts note that the credibility of Japan's information disclosure system could come into question if the Livedoor affiliate is confirmed to have given false earnings statements."[32] Respectable sources cited the possibility of "Livedoor . . . drag[ging] down the TSE Mothers and other markets for startup firms," and even that Japan's markets might "stay in a correction phase for considerable time" in the aftermath.[33] Even as quickly as Tuesday, January 17, "[t]he Nikkei average of 225 major issues listed on the Tokyo Stock Exchange plunged [in] the biggest single-day loss since . . . 2004."[34] On Wednesday, January 18, it "lost more than [an additional] 400 points."[35] Foreign currencies also soared against the yen, as "[t]he Livedoor news fueled dollar [and Euro] buybacks."[36] "The Tokyo Stock Exchange on Wednesday [even had to] shut down trading 20 minutes earlier than the regular close, as a flurry of sell orders sparked by turmoil over . . . Livedoor Co. pushed the TSE's trading system near its capacity

27. *Id.*; *(Update) Livedoor, Horie's Home Raided over Suspected Securities Law Violation*, *supra* note 15.

28. *Market Eyes Stock Players Expecting Livedoor Shock to Linger on Market*, *supra* note 18.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.*

34. *Nikkei Tumbles 2.8 Pct. on Livedoor, Building Fraud Jitters*, JIJI PRESS TICKER SERVICE (Japan), Jan. 17, 2006.

35. *JSDA Chief Displeased at Livedoor Scandal*, JIJI PRESS TICKER SERVICE (Japan), Jan. 18, 2006.

36. *Dollar Gains Ground vs. Yen in Tokyo on Livedoor Debacle*, JIJI PRESS TICKER SERVICE (Japan), Jan. 17, 2006.

limit."[37] Those involved must have considered this a formidable problem requiring the sternest of punishment so as to rebuild the "credibility of Japan's information disclosure system" and the stability of its markets generally.[38]

By Wednesday, January 18, 2006, the press had already begun to question the credibility of Horie's character, citing "Horie-contrived treacherous alchemy" as the origin and cause of the alleged securities fraud.[39] On Monday, January 23, 2006, "[i]nvestigators from the Tokyo Public Prosecutors Office . . . ar-

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37. *Livedoor Scandal Forces TSE to Halt Trading*, JIJI PRESS TICKER SERVICE (Japan), Jan. 18, 2006. Even after that date, Livedoor's stock price continued to fall at its daily limit. *See Livedoor Goes Limit-Down for 5th Day on TSE*, JIJI PRESS TICKER SERVICE (Japan), Jan. 23, 2006 ("Livedoor ended the morning ask-only at 256 yen on the Tokyo Stock Exchange's Mothers market, posting the daily limit loss of 80 yen from Friday's closing.").

38. *See Japan FSA Questions Monex over Stock Market Fall*, JIJI PRESS TICKER SERVICE (Japan), Jan. 19, 2006 (stating that "[t]he FSA will ask the securities industry to reconsider before taking similar steps, in order to better protect investors."). *See, also*, Richard Katz, *Collateral Damage: Livedoor's Woes May Be a Setback for Corporate Reform*, TIME MAG., Jan. 23, 2006, *available at* http://www.time.com/time/magazine/article/0,9171,1151854,00.html ("Whatever the investigation uncovers, Japan's corporations still need a lot of reform."); *TSE Faces Imperative to Fix Structural Flaws*, NIKKEI WKLY (Japan)., Jan. 23, 2006; *Market Eyes Stock Players Expecting Livedoor Shock to Linger on Market*, *supra* note 18. Only a few days into the debacle, some reporters even wisely compared Livedoor to WorldCom, and recognized the need for serious action not unlike the U.S.' passage of the Sarbanes-Oxley Act:

> In Japan, the Securities Exchange Law, which was revised in 2005, restricts large stock splits and after-hours trading. Livedoor repeatedly split its shares at a ratio of 100 for one in order to increase the stock's liquidity.
>
> A company law, which will be enforced in May 2006, requires business operators to include the costs of stock option deals into their expenses. But measures in Japan seem to lag behind those of the United States.
>
> After a string of scandals, U.S. stock prices gradually recovered due to the Sarbanes-Oxley Act and other strict measures. An urgent response allowing the public to regain trust in the market as quickly as possible is necessary if stock prices are to recover their value.
>
> As the investigation into the Livedoor case progresses, it is thought that there will be increased calls for the implementation of measures to prevent window-dressing. Policies implemented by the U.S. authorities are helpful guidelines for the government to consider when debating what measures should be taken here. *WorldCom Scandal Acts as Livedoor Benchmark*, DAILY YOMIURI (Japan), Jan. 20, 2006.

In fact, since 2005, the Japanese government has already taken significant steps in strengthening its securities laws. For an excellent overview of such steps, *see* Walter Stuber et al., *International Securities and Capital Markets*, 41 INT'L LAW. 443 (2007). For more reading on the market impact of these events, *see Fallout Widens from Livedoor Scandal*, ASIA TIMES ONLINE, Jan. 20, 2006, http://www.atimes.com/atimes/Japan/HA20Dh02.html.

39. *See, e.g.*, *Dubious Deals Created Livedoor Monster*, DAILY YOMIURI, Jan. 18, 2006. *See, also Horie's Media Savvy Key to Success*, NIKKEI WKLY. (Japan), Jan. 23, 2006 ("Horie has put himself at the core of advertising, attracting individual in-

rested . . . Horie for his suspected role."[40] Horie, the charismatic CEO of Livedoor, had made himself and the company rich and famous throughout Japan because of his revolutionary management methods.[41] However, his fame had quickly turned to infamy.[42]

At the same time, the Japanese authorities also confirmed for the press that in their investigation they had also become aware of one case of possible securities fraud ("window-dressing") with respect to its September 30, 2004 earnings report.[43]

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vestors to drive up the share price. But while he has been pumping up his company on TV, management gears may have slipped into reverse.").

40. *(Update) Livedoor's Horie Arrested on Securities Fraud Charges*, JIJI PRESS TICKER SERVICE (Japan), Jan. 23, 2006.

41. *See, e.g.*, Kenichi Osugi, *What is Converging? Rules on Hostile Takeovers in Japan and the Convergence Debate*, 9 ASIAN-PAC. L. & POL'Y J. 143, 156 (2007) ("In 2005, Takafumi Horie, the CEO of Livedoor, was perceived by a wide range of citizens as a man of creative destruction. His actions were perceived as renewing Japan's economy and culture as well as enhancing the shareholders' interest.") However, the same article goes on to say: "In January 2006, he was arrested and indicted on allegations of accounting fraud and market manipulation. On March 16, 2007, the Tokyo District Court sentenced Horie to two and a half years imprisonment." *Id.* at 156-57. Other positive descriptions include: "Upstart tycoon Takafumi Horie, 33, who has risen to celebrity status . . .. Horie, who has gained further cache with his television appearances. . "*Livedoor Shock Halts TSE*, JAPAN TIMES, Jan. 19, 2006. However, after his arrest, the public's acclaim for Horie quickly turned to disdain. *See*, for example, John A. Tessensohn, *Publish and Not Perish: Japan's Universities Designated to Enjoy Patent Novelty Grace Period Amidst Promethean Changes in Biotechnology & University Patenting*, 8 ASIAN-PAC. L. & POL'Y J. 292 n.114 (2007), stating:

> Horie was lionized by the Japanese media and public as the poster boy of the new breed of young dynamic Japanese entrepreneur hero when he had taken on the flinty only Japanese business establishment on several high media profile business encounters which even included an unsuccessful run for political office.

42. *See* Tessensohn, *supra* note 41, at 369:

> This adulation abruptly ended when Horie was arrested and detained by Japanese prosecutors without bail, and indicted with a litany of Enronesque high corporate crimes including accounting fraud, stock market manipulation and money laundering in a corporate scandal that even forced the Tokyo Stock Exchange to suspend trading after a deluge of panicked sell orders of Livedoor shares occurred immediately after his arrest. (citing *Japan after Livedoor From Hero to Zero*, ECONOMIST, Feb. 4, 2006; *'Livedoor Shock' Brings TSE Trading to a Halt*, ASAHI SHIMBUN (Japan), Jan. 19, 2006).

43. *See Livedoor Books Reportedly Cooked*, DAILY YOMIURI, Jan. 23, 2006 ("Livedoor reportedly window-dressed its accounts for the period [ending September 30, 2004] by taking about 2.4 billion yen from related companies . . . to cover its 1 billion yen deficit. As a result, it reported a 1.4 billion yen surplus for the business term."). *See also, (Update) Livedoor Alleged to Have Cooked Earnings*, JIJI PRESS TICKER SERVICE (Japan), Jan. 18, 2006; *'Livedoor Shock' Shakes Markets, Industry, Society*, NIKKEI WKLY. (Japan), Jan. 23, 2006. Readers can find early academic explanations of Livedoor's takeover strategies in Douglas G. Gruener, *Chilled to the Pill: The Japanese Judiciary's Cool Reception of the Poison Pill and Potential Repercussions*, 67 U. PITT. L. REV. 871, 878-80, 891, 896 (2006); Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79

Livedoor does not deny the securities fraud.[44] However, after the initial shock and confusion of the raids subsided, the media focused almost entirely on the more shocking topic of Horie's arrest, the potential charges against him, and the impact of Horie's misdeeds on the company, its shareholders, and others.[45] More than two years later, on July 21, 2008, the "Tokyo High Court . . . upheld a lower court ruling that sentenced . . . Horie to 30 months in prison for . . . conspiring with other former Livedoor executives to submit a false financial statement for the year that ended in September 2004 and to spread false information in order to boost the share price of a group firm."[46] Again, after this verdict, reporters, scholars, and respected legal professionals recognized the extent to which Horie's personal actions (as opposed to merely the actions of the company as a legal entity) damaged investors.[47] Livedoor itself also con-

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S. CAL. L. REV. 811, 841-42 (2006); Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171, 2178-80 (2005).

44. *See Nippon Life*, *supra* note 1; *Court Orders Livedoor to Pay 9.5 Billion Yen in Compensation to 6 Firms*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1.

45. *See, e.g.*, *A New Empire is Shaken*, JAPAN TIMES, Jan. 21, 2006:

> If a lesson can be drawn from the Livedoor incident at this time, it is that money games removed from true toil and labor . . . are likely to bring unexpected damage not only to the people playing such games, but also to ordinary citizens who are shaken by the economic reverberations.

46. *Prison Term Upheld for Japan Internet Tycoon Horie*, JIJI PRESS TICKER SERVICE (Japan), July 25, 2008.

47. *See, e.g.*, Colin P.A. Jones, *Book Review Essay: How Compliance is Ruining Japan*, 23 CONN. J. INT'L L 197, 200 (2007) (reviewing Nobuo Gohara, "HOREI JUNSHU" GA NIHON WO HOROBOSU [LEGAL COMPLIANCE WILL DESTROY JAPAN], ("[T]he sudden and dramatic raid orchestrated by the prosecutors in bringing [Horie] to justice . . . may have caused more harm to Livedoor investors . . . since it resulted in the share price collapsing."); *see also*, Minoru Matsutani & Takahiro Fukada, *High Court Zero-Tolerance Signal for Stock Scams Said No Surprise*, JAPAN TIMES, July 26, 2008, *available at* http://search.japantimes.co.jp/cgi-bin/nn20080726a4.html. The authors stated:

> Friday's high court ruling to uphold Livedoor Co. founder Takafumi Horie's prison term is significant because the judiciary has restated its zero tolerance of activities that undermine fair stock market trading, experts said.
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> "The ruling was no surprise, considering the scale of losses by investors and the viciousness of the defendant's acts," said Shin Ushijima of law firm Ushijima & Partners. "The high court sent a warning to authorities watching securities laws to get a grip."
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> The punishment seems severe because white-collar crimes normally result in suspended sentences. However, some experts say the verdict was necessary to send a message that those who violate stock market rules will be punished to protect individual investors from being victimized and keep foreign investors from taking their money out of Japan.

tinues to pursue Horie (as well as other executives) on civil charges.[48]

Among the many lawsuits stemming from this series of events, Horie's criminal charges have probably attracted the most media attention.[49] Civil suits filed by investors against Livedoor for securities fraud probably constitute the next most widely-covered suits; perhaps due to the large sums of money involved and the direct impact of such suits on the financial viability of the company and the value of Livedoor shareholders' investments.[50] In these securities fraud cases, past and present investors have sued Livedoor for securities fraud based on the misstatement and failure to correct.[51] In these suits, the plaintiffs have generally claimed damages equal to the full extent to which the price fell (i.e., not just an amount actually attributable to the

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Yo Ota, a lawyer at Nishimura & Asahi, pointed out that Horie's sentence was lighter than it would have been for a similar crime in the United States and many other countries.

Id.

48. *See Livedoor Founder Horie, Others Face Damages Suit*, JIJI PRESS TICKER SERVICE (Japan), Aug. 11, 2008. Some of the others' lawsuits have already resulted in convictions. *See High Court Reduces Jail Term of Ex-Livedoor Exec.*, JIJI PRESS TICKER SERVICE (Japan), Sept. 12, 2008 ("Tokyo High Court on Friday found former Livedoor Co. board director Ryoji Miyauchi guilty of window-dressing, but handed down a reduced prison sentence."). *See also Former IT Darling 'Lacks Grace': High Court Judge Condemns Absent Horie over 'Livedoor Tactics,'* DAILY YOMIURI (Japan), July 26, 2008.

49. *See, e.g.*, *Dubious Deals Created Livedoor Monster*, *supra* note 39. *See also*, *Horie's Media Savvy Key to Success*, *supra* note 39; *(Update) Livedoor's Horie Arrested on Securities Fraud Charges*, *supra* note 40; Osugi, *supra* note 41; Tessensohn, *supra* note 41; *Japan After Livedoor-From Hero to Zero*, ECONOMIST, Feb. 4, 2006; *'Livedoor Shock' Brings TSE Trading to a Halt*, *supra* note 42.

50. Japan's Securities Commission filed criminal complaints against the founder and six former executives of Livedoor, and the company was delisted from the Tokyo Stock Exchange. All of the individuals were found guilty of securities laws violations and sentenced to prison. Additionally, Fuji Television filed a $292 million lawsuit against Livedoor seeking compensation for stock valuation losses involving 134 million shares. The Tokyo District Court fined Livedoor $2.4 million (280 million yen), which is the largest fine ever imposed in Japanese corporate history for violating securities laws. Gary L. Gussman & Perry S. Granof, *Global Issues Affecting Securities Claims at the Beginning of the Twenty-first Century*, 43 TORT TRIAL & INS. PRAC. L.J. 81, 106-07 (2007) (citing Fredrick, *supra* note 9; *Fuji TV Sues Livedoor for $292m*, TELECOMS ASIA, Mar. 27, 2007, www.telecomasia.net/article.php?type=article&id_article=4144; Odell Guyton & Roy Snell, *Authorities Raid Offices and Home of Japanese Businessman*, SOC'Y OF CORP. COMPLIANCE & ETHICS, E-CORPORATE COMPLIANCE NEWS, Jan. 19, 2006, www.corporatecompliance.org/CCN/ccn_vIII3.htm.; Norimitsu Onishi, *Livedoor Founder Gets Prison Sentence*, INT'L HERALD TRIB., Mar. 16, 2007; *Fallout Widens from Livedoor Scandal*, *supra* note 38 *Panic Selling Shuts Tokyo Exchange Early*, CNN, Jan. 18, 2006, http://business.timesonline.co.uk/tol/business/markets/japan/article792615.ece; Katz, *supra* note 38).

51. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1.

incorrect information appearing in the securities report).[52] As one author wrote: "[T]he sudden and dramatic raid orchestrated by the prosecutors in bringing [Horie] to justice . . . may have caused more harm to Livedoor investors . . . since it resulted in the share price collapsing."[53]

In the first significant verdict among many similar cases by more than 3,300 plaintiffs, the Tokyo district court ruled in favor of six large plaintiffs.[54] As noted above, Livedoor does not dispute that it engaged in securities fraud.[55] Further, it does not dispute that such securities fraud might have resulted in some losses to some stockholders.[56] However, during the trying of that case, and in its pending appeal, Livedoor did and does dispute the extent to which the securities fraud caused its share price to fall.[57]

In the June 13, 2008 ruling, the judge explicitly refrained from considering the precise extent to which individual plaintiffs could actually attribute losses to the securities fraud.[58] Instead, the court applied a presumptive rule pursuant to which it attributed 70% of the losses to the securities fraud perpetrated by

52. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1.

53. Jones, *supra* note 47, at 200.

54. *See* Nippon *Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1; *Livedoor Ordered to Pay 9.5 B Yen in Damages*, *supra* note 8.

55. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1.

56. Specifically, it might have resulted in losses only for investors who invested in Livedoor stock based on the erroneous September 2004 securities report, and then sold the securities after the announcement that such securities report included incorrect data. Although Livedoor corrected this data in its subsequent annual securities report, Livedoor failed to file the relevant document notifying the investing public of the correction of the incorrect information that appeared in that report. However, as explained below, the court could have reasonably limited the damages to those amounts only. *See Court Orders Livedoor to Pay 9.5 Billion Yen in Compensation to 6 Firms, supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1; *Livedoor Ordered to Pay 9.5 B Yen in Damages*, *supra* note 8.

57. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1; *Livedoor Ordered to Pay 9.5 B Yen in Damages*, *supra* note 8.

58. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1; *Livedoor Ordered to Pay 9.5 B Yen in Damages*, *supra* note 8.

Livedoor, and 30% to Horie's arrest.[59] The court rationalized this calculation method by stating that it should reduce the burden of proof where the aggregate of all plaintiffs suing Livedoor for securities fraud would exceed 3300.[60]

It seems Livedoor could make a reasonable argument that the court should not oversimplify its calculations as such. The court could instead consider many mitigating factors pursuant to which the court might reduce the amount with respect to individual plaintiffs. The following brief comparative analysis of the relevant U.S. and Japanese law shows that one can reasonably analogize the applicable Japanese law to certain U.S. laws. It follows from this conclusion that U.S. law and precedent therefore constitutes a useful reference. The Livedoor defense team might put forth many convincing but complex theories and calculations regarding burden of proof, materiality, loss causation, and so forth.

The remainder of this paper sets forth only an analysis and comparison of the laws relevant to mitigation pursuant to defenses against the "fraud-on-the-market theory".[61] It arrives at the conclusion that U.S. law and precedent constitutes a useful reference, or at least that this ongoing litigation presents an opportunity for lawyers, economists, judges and academics to consider (particularly in this time of international economic instability) whether U.S. jurisprudence so constitutes. After introductory explanation of this theory, it will examine various defenses to the fraud on the market theory (under U.S. law), and speculate on such defenses' potential applicability to the claims against Livedoor. As noted above, the *Livedoor* judge expressly declined to apply such theories due to the large number of plaintiffs and the financial complexity of the facts.[62] In response, this paper will also offer some brief commentary about the judge's approach. Readers might also consider the wisdom of the court's July 13, 2008 ruling in this kind of case.

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59. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1; *Livedoor Ordered to Pay 9.5 B Yen in Damages*, *supra* note 8.

60. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1; *Livedoor Ordered to Pay 9.5 B Yen in Damages*, *supra* note 8.

61. Basic Inc. v. Levinson, 485 U.S. 224, 229 (1988).

62. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1; *Livedoor Ordered to Pay 9.5 B Yen in Damages*, *supra* note 8.

III. ANALYSIS AND DISCUSSION

A. U.S. LAW AS A USEFUL REFERENCE FOR JAPANESE JUDGES IN THIS AND SIMILAR CASES:

U.S. law and precedent constitutes a useful reference for Japanese judges in this case and cases like it. The securities laws of both Japan and the U.S. require securities issuers to issue periodic disclosures to the Financial Services Agency ("FSA") and the Securities and Exchange Commission ("SEC"), respectively.[63] Both the FSA and the SEC encourage securities issuers to make such disclosures via their free, electronic filing systems online.[64] Under the laws of both Japan and the United States, issuers that include material false statements in such disclosures can bear liability to the extent that such false statements cause actual, realized losses to the value of such securities.[65] Importantly, both Japanese and U.S. law provide an affirmative defense for such liability to the extent that the issuers can prove such losses resulted from anything other than the false statement(s) in the securities report(s).[66] The relevant similarities

63. The codified U.S. reporting requirements appear under section 11 of the Securities Act of 1933, 15 U.S.C. § 77a, et seq. (hereinafter '33 Act) and section 13 of the Securities and Exchange Act of 1934, 15 U.S.C. § 78a et seq. (hereinafter'34 Act). Most of the relevant rules under the '33 Act and '34 Act remain primarily parallel to one another. Accordingly, for simplicity's sake, where the rules remain parallel, this paper will refer primarily only to the '33 Act. In Japan, a civil law country, the rules appear under the Kin'yu shouhin torihiki hou [Financial Instruments and Exchange Act] [Act No. 25 of 1948] (hereinafter FIEA, FIEL, or SEL). Importantly, prior to amendment in 2006, Act No. 25 of 1948 was known as the Securities Exchange Law (hereinafter SEL). In connection with amendments in 2006, 2007 and 2008, the name has changed from the SEL to the FIEA/FIEL. However, all article and paragraph numbers referenced in this paper remain the same after as before the amendments. Other relevant scholarship refers to the FIEA or FIEL. This paper will refer primarily to the SEL. However, this paper will sometimes use SEL, FIEA, and FIEL interchangeably. Readers can conveniently download a bilingual version of the updated FIEA at http://www.fsa.go.jp/common/law/fie02.pdf.

64. *See generally,* Financial Services Agency Homepage, http://www.fsa.go.jp/; *see also* Financial Services Agency, Kin'yucho Shinsei Todokede tou tetsuduki no denshikasuishin akushon puran ni tsuite [Regarding the Financial Service Agency's Plan for Advancement of Electronification of Application, Notification, and Other Procedures] (June 13, 2001), http://www.fsa.go.jp/news/newsj/kinyu/f-20010711/f-20010711-2a.pdf; Financial Services Agency, February 2008 Working Group for the Improved Operations of EDINET, *Summary of Issues for the Improved Operations of EDINET* (Provisional Translation) (February 2008), http://www.fsa.go.jp/en/news/2008/20080416/02.pdf (last visited Mar. 3, 2009); Electronic Disclosure for Investors' Network, http://info.edinet-fsa.go.jp/. *See* U.S. Securities and Exchange Commission, *supra* note 3.

65. Section 11 of the '33 Act and section 21D of the '34 Act set forth the rules for private securities litigation, including limitations on damages. SEL articles 18(1), 19(1), and 11 provide for damages, set forth the calculations for damages, and set forth the limitations on damages for similar violations in Japan.

66. '33 Act, § 11(e); SEL, art. 11.

suggest that damage calculation methods used in the many complex U.S. cases regarding misstatements in periodic disclosure documents should serve as useful guides in applying the (essentially identical) Japanese laws in the *Livedoor* case.

1. Periodic Disclosure Requirements:

a. Japan:

Article 5 of Japan's SEL[67] requires that issuers of securities issue annual securities reports and quarterly securities reports.[68] Such reports should provide to the Prime Minister (and to the general public) all "information that will have material influence on investors' Investment Decisions."[69] SEL articles 24-4-7 and 24 impose additional requirements for most companies to submit quarterly and semiannual securities reports.[70] In the SEL and for the purpose of this paper, such quarterly and semiannual securities reports, as well as any amendments thereto, also constitute "Securities Registration Statements."[71]

b. United States:

The Securities Exchange Act of 1934 section 13(a) sets forth the periodic reporting requirements for U.S. issuers.[72] To the extent relevant to this discussion of the *Livedoor* case, the rules do not differ from the Japanese rules.

2. Free, Online Filing Systems:

a. Japan:

As noted above, at all times relevant to the *Livedoor* litigation, Japan had already established its EDINET system, and Livedoor filed regular periodic securities reports using EDINET.[73]

b. United States:

As explained above, the SEC also uses a similar system, called EDGAR.[74]

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67. *See infra* note 63 for the definition of "SEL"
68. SEL, art. 5.1.
69. *Id.*
70. SEL art. 24-4-7(1), 24(5).
71. This results from application of the definition of "Securities Registration Statement" in SEL art. 2(7) to the text of sections 5(1), 5(5), 5(6), 7, 9, and 10(1).
72. '34 Act § 13(a).
73. Electronic Disclosure for Investors' Network, http://info.edinet-fsa.go.jp/.
74. U.S. Securities and Exchange Commission, *supra* note 3.

3. Liability for False Statements in Securities Statements:

a. Japan:

Article 18(1) of Japan's SEL provides that "if a Securities Registration Statement contains any fake statement on important matters or lacks a statement on important matters that should be stated or is on a material fact that [sic] necessary for avoiding misunderstanding," the issuer shall generally "compensate damage sustained by a person who acquires the Securities."[75] For ease of comparison, this paper will also collectively refer to all analogous U.S. documents as "Securities Registration Statements."

b. United States:

Although the liability stems from a much more complex set of statutes and case law, the U.S. similarly imposes liability for making untrue statements in Securities Registration Statements.[76] '33 Act section 11 and '34 Act section 21D provide a right to sue for false statements in securities registration statements, and periodic securities reports, respectively.[77] However, unique from Japanese law, the basis for such rights of action to sue for securities fraud in the U.S. arises from Rule 10b-5.[78] Specifically, rule 10b-5 provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[79]

This provision proscribes fraud that touches on the purchase or sale of a security.[80] It gives rise to causes of legal action both

75. SEL art. 18(1).

76. *See* Rule 10b-5, '33 Act sect. 11, and '34 Act sect. 21D.

77. '33 Act, sect.§ 11, and ;'34 Act, sect.§ 21D.

78. Also referenced as 17 CFR.F.R. section 240.10b-5 (year), Rule 10b-5 also appears under the '34 Act, also at 15 U.S.C. § 78a et seq. Congressional authority to pass Rule 10b-5 stems from section 10; 48 Stat. 891 (year); 15 USC § 78 (year).

79. *Id.*

80. *Id.*

public and private.[81] This paper will not discuss criminal sanctions for securities fraud. Private rights of action exist for any party acquiring a security when "any part of [the Securities Registration Statement], when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading."[82]

c. Comment:

Importantly, both Japan and the U.S. essentially prohibit the inclusion in any Securities Registration Statement of any untrue "material fact."[83] This paper will not discuss scienter requirements to find liability in Japanese and U.S. securities fraud cases, as scienter remains irrelevant to the intended focus on the fraud on the market theory.

4. Calculation of Damages:

a. Japan:

Article 19(1) of Japan's SEL provides for calculation of damages in such cases as follows:

> The amount of damages to be paid . . . shall be the amount calculated by deducting the amount specified by either of the following items from the amount paid for acquisition of the Securities by the person who is entitled to claim damages:
>
> (i) market value of the securities at the time when claiming damages [with respect to securities not sold before the false statement became publicly known] (or, where no market value exists, their estimated disposal value); or
>
> (ii) disposal value of the Securities, if the Securities were disposed of before the time referred to in the previous item.[84]

b. United States:

Section 11 provides for calculation of damages in such cases as follows:

> [T]he difference between the amount paid for the security . . . and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before the suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the

81. *See* Herman v. Huddleston, 459 U.S. 375, 380 (1983).
82. '33 Act, sect. 11(a).
83. SEL, art. 18(1) and '33 Act, sect. 11(a).
84. SEL, art. 19(1).

security . . . and the value thereof as of the time such suit was brought.[85]

A complex body of law and precedent has developed with respect to liability for false statements in securities statements in the United States.[86] However, the resulting rules relevant to this discussion remain essentially the same as those in Japan.

c. Comment:

Notice that, to (perhaps over-)simplify, both Japan and the United States calculate damages based on the amount by which the relevant held security actually lost value on the market.

5. Limitations on Liability:

a. Japan:

Section 18 of the SEL "shall not apply to cases where the person who acquired the Securities knew of the existence of such fake statement or lack of such statement at the time of making an offer to acquire the Securities."[87] Furthermore:

> The person liable for damages. . ., when she proves that all or part of the damage sustained by the person who [sic] entitled to claim damages was caused by any reason other than decline in value of the Securities that should arise [sic] the fact that the Securities Registration Statement or the Prospectus contains any fake statement on important matters or lacks a statement on important matters that should be stated or on a material fact that is necessary for avoiding misunderstanding, shall not be liable for that all [sic] or part of the damages.[88]

b. United States:

Like in Japan, in the U.S.:

> [I]f the defendant proves that any portion or all such damages represents other than the depreciation in value of such security resulting from such part of the registration statement with respect to which his liability is asserted, not being true or omitting a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable.[89]

c. Comment:

Again, like in the U.S., Japanese law does not allow a plaintiff to collect for damages "caused by any reason other than de-

85. '33 Act, § 11(e).
86. *See* Cox, *supra* note 13, at 481.
87. SEL, art. 18(1).
88. SEL, art. 19(2).
89. '33 Act, § 11(e).

cline in value of the securities that should arise" as a result of the "fake statement."[90]

6. *U.S. law can serve as a useful reference for the Livedoor case.*

The legal points listed above constitute the most relevant rules necessary for the Japanese court to rule on the *Livedoor* cases, and for U.S. judges to rule on analogous U.S. cases. The Japanese judge did not note any facts in the *Livedoor* case that would take it out of the framework of the above rules. As noted above, the judge based his decision to apply the "70% rule," thereby refraining from thoroughly considering proof:

> that all or part of the damage sustained by the [plaintiffs] . . . was caused by any reason other than decline in value of the Securities that should arise [sic] the fact that the Securities Registration Statement . . . contains any fake statement on important matters or lacks a statement on important matters that should be stated or on a material fact that is necessary for avoiding misunderstanding.[91]

The author of this paper would not purport to know better than an esteemed Japanese Presiding Judge June Abe how to apply Japanese law in a Japanese securities fraud case. Nevertheless, even Judge Abe claimed that the *Livedoor* case does not fall neatly into any category covered under Japanese legislation.[92] Accordingly, one might consider whether precedent in the plethora of adjudicated U.S. securities fraud cases might offer useful perspectives when considering whether more detailed consideration of such proof might yield useful information about potentially mitigating factors in such cases.

B. FRAUD ON THE MARKET THEORY:

1. *Fraud on the Market Theory's Creation of a Rebuttable Presumption*

Before considering specific factors that might reduce the appropriate liability of a company issuing a securities statement that included false information, readers should first understand the "fraud-on-the-market theory."[93]

> The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material in-

90. SEL, art. 19(2).
91. SEL, art. 19(2).
92. *Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1.
93. Basic, *supra* note 61.

> formation regarding the company and its business. . .. Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . .. The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.[94]

In *Basic*, The court approved of the lower court's "accepting the 'fraud-on-the-market' theory to create a rebuttable presumption that respondents relied on petitioners' material misrepresentations, noting that without the presumption it would be impractical to certify a class under Fed. Rule Civ. Proc. 23(b)(3)."[95] With respect to this question, the *Basic* court ruled that "[i]t is not inappropriate to apply a presumption of reliance supported by the fraud-on-the-market theory."[96] The court qualified this statement by saying "the presumption, however, is rebuttable."[97] They therefore concluded that "[t]he District Court's certification of the class here was appropriate when made but is subject on remand to such adjustment, if any, as developing circumstances demand."[98]

The *Basic* court's conclusion about the rebuttable presumption stands as the very foundation for "certification of the class" in the *Basic* case.[99] Indeed, one might expect that, if the court could not require opportunity for defendants to rebut this presumption, they would refrain from certifying classes in cases such as this. The Tokyo District Court, on the other hand, (which has encouraged plaintiffs to join together in their suits), uses the large number of plaintiffs as their rationale for applying the 70% rule and *not* permitting the defendant to rebut with respect to

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94. *Id.* at 241-42 (citing Peil v. Speiser, 806 F.2d 1154, 1160-61 (CA3 1986). Referencing the code's allowance for this concept might also help some readers understand the concept.

> If such person acquired the security after the issuer has made generally available to its security holders an earnings statement ., then the right of recovery under this subsection shall be conditioned on proof that such person acquired the securities relying on such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person. ('33 Act, sect. 11(a).)

95. *Id.* at 229-30.

96. *Id.* at 250.

97. *Id.*

98. *Id.*

99. *Id.* One might also note that even the dissent in this case only dissented with respect to whether "the 'fraud-on-the-market' theory" should apply in this particular case. *Id.* (White, J., dissenting). They did not dispute the need for rebutability when applying the theory. *Id.*

any specific amounts claimed by any plaintiff or group of plaintiffs.[100]

Restating the *Basic* Court's opinion, we find the Court outlining the theory in three steps.[101] The Court first rules that "in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business.[102] This becomes apparent when one considers that. Since the market price constantly changes in accordance with what others have paid for the stock.[103] Each investor enters each of their transactions with certain information in mind.[104] That information impacts their decision as to whether they wish to buy, sell, or hold a security at any given price.[105] The aggregate of all such decisions (based, of course, on the aggregate of all information in the market) create a market price that includes consideration of all available information at any given time.[106]

Second, the Court states "[m]isleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements."[107] After carefully considering the court's first point, this also becomes obvious. To the extent that "misleading statements" have caused even one person to buy, sell, or hold at a given price, such "misstatements" have influenced the overall price of the stock.[108] For example, if one person believes a "misstatement" that a company has won a major lawsuit, when the company has actually lost the suit, that person will overvalue the stock.[109] Such overvaluation will manifest itself in investor willingness to buy or hold the stock at a price higher than the price at which they would buy or hold it if they did not believe such "misstatement."[110] Consequently, other people who wish to buy the stock will need to offer a higher price to purchase.[111] Many purchasers might not have heard the "misstatement." In fact, many of them might make their purchases "not knowing" about the lawsuit (or other subject of fraud).[112]

100. *See* Nippon *Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1.
101. *Basic*, 485 U.S. 224.
102. *Id.*
103. *Id.* at 241-42 (citing Peil v. Speiser, 806 F.2d 1154, 1160-61 (3d Cir. 1986)).
104. *Id.*
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.*
111. *Id.*
112. *Id.*

Nevertheless, they do not need to know about the "misstatement," or even the lawsuit, in order to discover that at least one other investor has decided to buy or hold the stock at a given price.[113] In this way, that decision to buy or hold the stock at that price will influence the overall price of the stock.[114] Thus, the "misinformation" will have influenced the price of the stock.[115]

Finally, the *Basic* Court says "[t]he causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations."[116] Most investors do not perform detailed analysis of stock prices before deciding to buy, sell, or hold the stock.[117] Instead, they look to market trends, the recent trading history of that particular stock, perhaps some analysts' comments, and their own feelings about the likelihood of the recent pricing trend of that stock continuing or changing.[118] Misinformation in the market will affect each of those factors.[119] Therefore, as soon as misinformation has entered the market, it becomes at least as significant as if the company had communicated it to all investors and potential investors, even if they have not in fact heard the misinformation.[120]

2. *Claims Based on the Fraud-on-the-Market Theory: Four Elements:*

With an understanding of the "'fraud-on-the-market' theory," the reader might turn to the elements of establishing a "fraud-on-the-market" claim. Once again, the *Basic* case pro-

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113. Basic Inc. v. Levinson, 485 U.S. 224, 229 (1988).
114. *Id.*
115. *Id.* at 241-42 (citing Peil v. Speiser, 806 F.2d 1154, 1160-61 (3d Cir. 1986)).
116. *Id. at* 242.
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.* As a side note, readers might also note that the '34 Act provides the following limitation on damages:

> Except as provided in paragraph (2), in any private action arising under this title in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of the security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market. '34 Act, § 21D(e)(1).

The analogous provision under Japanese law remains at "one month." SEL, art. 21-2(2). To the extent that the effect of a shock to a stock market eventually subsides to some extent at a point more than one month, but less than three months, after the initial shock, this could result in greater damages in Japan than in the U.S.

vides guidance in this respect. Although the *Basic* Court did not do so explicitly, one might summarize the criteria for invoking the "fraud-on-the-market" theory in four parts.[121] First, "in order to invoke the presumption, a plaintiff must allege and prove . . . that the defendant made public misrepresentations."[122] Many statements can constitute "public statements," including anything printed in a public SEC filing, and official statements made on behalf of the company.[123] Second, "that the misrepresentations were material [and] would [therefore] induce a reasonable, relying investor to misjudge the value of the shares."[124] "[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information."[125] Courts have generally presumed that false statements about financial information made in securities reports constitute "material" misstatements.[126] However, "to fulfill the materiality requirement, 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'"[127] The Court named a third criterion; "that the shares were traded on an efficient market."[128] With respect to this criterion, the court stated:

> We note there may be a certain incongruity between the assumption that Basic shares are traded on a well-developed, efficient, and information-hungry market, and the allegation that such a market could remain misinformed, and its valuation of Basic shares depressed, for 14 months, on the basis of the three public statements. Proof of that sort is a matter for trial, throughout which the District Court retains the authority to amend the certification order as may be appropriate. *See* Fed. Rule Civ. Proc. 23(c)(1) and (c)(4). See 7B C. Wright, A. Miller & M. Kane, Federal Practice and Procedure 128-132 (1986) Thus, we see no need to engage in the kind of factual analysis the dissent suggests that manifests the "oddities" of

121. *Id.*

122. *Id.* at 248 n. 27.

123. *Id.*

124. *Id.* at 248 n. 27.

125. *Id.* at 240 (citing Pavlidis v. New England Patriots Football Club, Inc., 737 F.2d 1227, 1231 (1st Cir. 1984) ("A fact does not become more material to the shareholder's decision because it is withheld by an insider, or because the insider might profit by withholding it") and Aaron v. SEC, 446 U. S. 680, 691 (1980) ("scienter is an element of a violation of § 10(b) and Rule 10b-5, regardless of the identity of the plaintiff or the nature of the relief sought.")).

126. '33 Act, § 11(a).

127. *Basic*, 485 U.S. at 231 (citing TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

128. *Id.* at 248 n.27.

applying a rebuttable presumption of reliance in this case. *See post*, at 259-263.[129]

Fourth and finally, the *Basic* Court stated "that the plaintiff [must have] traded the shares between the time the misrepresentations were made and the time the truth was revealed.[130]

3. *Defenses Against the Fraud-on-the-Market Theory Claims, and Why Some Would Probably Apply to Certain Livedoor Plaintiffs Re Matters Other Than and in Addition to Horie's Arrest:*

In the United States, a defendant in a securities fraud lawsuit under section 11 may employ any of several primary defense strategies. First, they may rebut any of the elements giving rise to the presumption.[131] Second, they may show that, notwithstanding the materiality of the misstatement, the misstatement did not lead to a distortion in the market price of the security.[132] Third, they may prove that the plaintiff traded or would have traded the security, despite awareness of the misstatement and its untruth.[133] Finally, they may show that any given plaintiff failed to exercise reasonableness in relying on any information on which they relied in purchasing the security.[134] If given the opportunity to do so, it seems likely that Livedoor could have successfully employed one or more of these defenses with respect to many of the claims against it.

a. Rebutting the Elements Giving Rise to the Presumption:

i. Defendant Made Public Misrepresentations:

In fact, the Livedoor defense did include contentions that the false information that appeared in the securities report did not constitute a "public misrepresentation."[135] However, this contention depends on an aspect of Japanese law not analogous to the U.S. law outlined above. Therefore, this paper will not discuss this argument.

ii. Materiality

As noted above, the false information appeared in Livedoor's September 30, 2004 securities report.[136] The subse-

129. *Id.* at 249 n.29.
130. *Id.*, at 250.
131. *Id.* at 250
132. *Id.* at 248.
133. *Id.*
134. *Id.*
135. *Nippon Life*, *supra* note 1.
136. *See id.*, *Livedoor Ordered to Pay 9.5 B Yen in Damages*, *supra* note 8.

quent report, filed only three months later, included the corrected information.[137] Those plaintiffs claim the court should assume they relied on the information that appeared in the outdated report from the previous year, instead of on the correct reports of the year in which they traded.[138] They base this claim on the fact that, although the latest statements contained the correct information, Livedoor failed to make an official announcement that the September 2004 report included false information, and they therefore relied on (or perhaps *could have reasonably* relied on?) such incorrect information.[139] In fact, neither the U.S. code nor the "fraud-on-the-market" theory supports this argument.[140] Those false statements constituted material misinformation in the marketplace. Accordingly, the misinformation probably affected the market price at some time.[141] However, query whether the information still constituted "material information" after the correct information appeared in the latest financial statements, which the FSA made available online for free via EDGAR.[142] The statement in the outdated quarterly securities report arguably did not constitute "material" statements for investors "in the total mix" of all information in the marketplace after issuance of the updated annual report only three months after issuance of the erroneous quarterly securities report.[143]

The concept of "relevance" probably puts this argument into context best. Even if a particular fact did at one time constitute "material information," after a significant amount of time has passed, it becomes necessary to carefully examine whether it remains "logical" for individuals to continue relying on it.[144] Eventually any given fact will become outdated and no longer relevant.[145] At that point, it becomes illogical to consider it "material" in the "total mix" of information available in the market.[146]

iii. Efficient Market:

The *Cammer* court also expanded on the *Basic* Court's discussion of how to determine whether an "efficient market" existed for the trading of a particular security. The *Cammer* court

137. *Nippon Life*, *supra* note 1; *Livedoor Ordered to Pay 9.5 B. Yen in Damages*, *supra* note 8.
138. *Nippon Life*, *supra* note 1.
139. *Nippon Life*, *supra* note 1.
140. *See* '33 Act, §11(a); Basic Inc. v. Levinson, 485 U.S. 224, 241-42 (1988).
141. *See*, Basic, supra note 61.
142. *Id.* at 231-32.
143. *Id.* at 232.
144. Cammer v. Bloom, 711 F. Supp. 1264, 1287 (1989).
145. *Id.*
146. *Basic*, 485 U.S. at 231-32.

set forth a five-factor test including (1) "extent of weekly trading volume," (2) "number of securities analysts . . . follow[ing] and report[ing] on a company's stock during the class period," (3) existence and "number of market maters and arbitrageurs," (4) size and type of securities issuer, and (5) "cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock price."[147] In the case of Livedoor, analysis of these factors clearly suggests an efficient market. However, the judge's failure to perform any such analysis in the *Livedoor* case might provide a somewhat 'dangerous' reference for future cases.[148]

iv. Plaintiff Traded Between Time of Misrepresentations and Time Truth Was Revealed:

Section III.B.3.a.ii, para. 2 above discusses the concept of "relevance." With respect to many securities traders, an alternative temporal argument also exists. Often, securities traders enter into long-term contracts with their brokers for periodic purchases or sales of securities. Similarly, sometimes investors give instructions such as "please buy X number of shares of Y stock at market price after January 1," or "please buy X number of shares of Y stock at any price less than Z dollars (or yen) on A date," or other such complex instructions. Trades based on such contracts or instructions made prior to the existence of the false statement in Livedoor's securities report of course could not have relied on the information in the securities report. Query whether it seems fair for the Japanese court to refrain from considering such exclusions.

b. Show the Misrepresentation Did Not in Fact Lead to a Distortion (Or as Much of a Distortion as Plaintiffs Claim) in Price:

This defense attempts to dispute the plaintiffs' reliance on the false information. As stated by the *Basic* Court:

> Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair price, will be sufficient to rebut the presumption of reliance. For example, if petitioners could show that the 'market makers' were privy to

147. *Cammer*, 711 F.Supp at 1286-87.

148. As a civil law country, the concept of precedent and stare decisis does not apply in Japan. However, the judge in the Livedoor case specifically stated that no applicable statute exists for calculation of damages in such a case. Accordingly, until the legislature passes such a statute, judges trying cases like the Livedoor case might still look to the Livedoor for guidance on deciding their own cases. In this way, it might become 'dangerous."

> the truth about the [subject matter of the false statements], and thus that the market price would not have been affected by their misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone.[149]

With respect to Livedoor, one might ask whether, for example, large, institutional investors could directly access Livedoor's financial records. In fact, any investor holding more than 3% of the issued and outstanding shares of a Japanese listed company enjoys certain inspection rights under Japanese law.[150] Investors with special financial record inspection rights (whether by law or due to special relationships with the company) would have presumably inspected those records before making their investment decisions, rather than relying on the publicly available securities reports. With the "reliance" thus disproved, one would think their right to damages would decrease or disappear.[151]

A similar phenomenon could have occurred "if, despite [Livedoor's] allegedly fraudulent attempt to [inflate the price of its stock by including false statements in its securities report], news of the [correct financial information] credibly entered the market and dissipated the effects of the misstatements."[152] In that case, "those who traded. . . shares after the [news of the securities fraud became public] would have no direct or indirect connection with the fraud."[153]

c. Show That Individual Plaintiffs Traded (Or Would Have Traded) Despite Knowing the Falsity of the Statement:

Although similar to the footnoted argument in item b. above, this deserves separate attention as well. If an individual traded, or would have traded, despite knowing the falsity of the statements in the securities reports, they might have forfeited their right to claim due, again, to lack of "direct or indirect connection with the fraud."[154] In other words, the investors might

149. *Basic*, 485 U.S. at 248.

150. *See* Kaishahou [Company Law], Law No. 66 of 2006, art. 433, no 1, 2.

151. *Basic*, 484 U.S. at 248. If it remains unclear why the fraud-on-the-market theory would not fully apply in such case, consider this: The general market price might have increased as a result of the overly optimistic statements in the financial reports. However, investors with access to the correct financial records could perform independent evaluations and determine whether they wanted to buy or sell the securities. If overpriced, they would sell, and do so at a (correctly) perceived excessively high price! In that way, not only would the false statements *not hurt* them; they could in fact gain profit, at the expense of other shareholders, based on their knowledge of the falsity of the public information.

152. *Id.* at 248-49.

153. *Id.*

154. *Id.*

have made their investment decisions "without relying on the integrity of the market" at all.[155] "For example, a plaintiff who believed that [Livedoor]'s statements were false . . . and who consequently believed that [Livedoor] stock was artificially inflated, but [performed the same trades they would otherwise have performed] because of unrelated [reasons] could not be said to have relied on the integrity of a price he knew had been manipulated."[156] Returning to the fact that Livedoor indicated the correct financial information in its January 1, 2005 securities report, this argument might apply to many plaintiffs in the *Livedoor* cases.

d. Show That Any Given Plaintiff Failed to Exercise Reasonableness:

Finally, one could argue that any given plaintiff failed to exercise reasonableness in relying on any information on which they relied in deciding to purchase, hold, or sell Livedoor stock. "In [U.S.] fraud on the market cases, an inflated purchase price will not itself constitute or proximately cause the relevant economic loss."[157] In fact, rule 10b-5 liability essentially only arises with respect to a wrong resulting from an "intent to deceive."[158] Therefore, a U.S. plaintiff can only assert the lack of due care defense in cases where the plaintiff acted at least "recklessly" in allowing the harm to occur.[159] The "failure to exercise reasonableness" doctrine finds its basis in this fact.[160]

Importantly, recall that article 18(1) of Japan's SEL does *not* limit liability to intentional wrongs.[161] Thus, the reasonability of plaintiffs' "reliance" on such statements would seem irrelevant under current Japanese law.[162] Accordingly, this final argument remains somewhat academic at this time. Nevertheless, readers might consider whether the U.S. or Japanese system best accomplishes the goals they think securities regulation should embody.

Returning to the U.S. case of *Citizens Bank v. Wright*, we find the court's discussion of what a court should consider to determine whether an investor "justifiably relied" on fraudulent information relating to a security.[163] The court listed many factors.

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155. *Id.*
156. *Id.*
157. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 342 (2005).
158. Citizens Bank of Wash County v. Wright, 299 B.R. 648, 657 (Bankr. M.D. Ga. 2003).
159. *Id.* at 661.
160. *Id.*
161. SEL, art. 18(1).
162. *Citizens Bank*, 299 B.R. at 657.
163. *Id.*

For example, "the sophistication and expertise of the plaintiff in financial and securities matters."[164] This seems particularly important with respect to Livedoor, in which plaintiffs essentially seem to claim they continued to rely on information in an expired securities report even after the correct financial information appeared in the latest reports. As a second factor, the court cites "the existence of long-standing business or personal relationships," and whether the court "had access to the relevant information" and, if so, whether they "should have accessed" such information.[165] Related to these, courts should also consider "the existence of a fiduciary relationship" (which again might merit direct access to internal financial records). These provide an additional defense against those plaintiffs, discussed in III.B.3.a.ii, para. 2 above, with direct access to Livedoor's financial statements. Courts should also consider "concealment of the fraud."[166] One might argue that Livedoor's failure to report its mistake constitutes an attempt to "conceal the fraud."[167] However, their publication of the corrected information in the subsequent report would seem to indicate otherwise. In the U.S., the liability (and difficulty in proving it) would decrease significantly if the court did not believe they intended to "conceal the fraud."[168] The court will also look at "whether the plaintiff initiated the [securities] transaction or sought to expedite the transaction."[169] If so, it might give rise to speculation as to whether, as discussed in the note in section III.B.3.a.ii, para. 2 above, the plaintiff might in fact have profited, or intended to profit, from trading based on what they knew to constitute false information. In the U.S., their failure to actually profit from known false information in the market would remain irrelevant.[170] Although not under Japan's SEL article 18(1), this would increase the likelihood of liability under 10b-5 and *Citizens Bank* in the U.S. Finally, the court would consider "the generality or specificity of the misrepresentations."[171] One might think the specificity of Livedoor's misstatement would weigh against it in this context. However, a perhaps even more persuasive argument says that serious investors can easily do a few simple calculations to verify specific misrepresentations. If so, their reliance might not seem reasonable at all.[172]

164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.*
171. *Id.*
172. *Id.*

IV. CONCLUSIONS AND BRIEF COMMENTARY

Regardless whether it agrees with U.S. legislation and precedent, Judge Abe's decision in the *Livedoor* case seems consistent with – one might even say predictable based on – a great deal of existing western scholarship about Japanese law and society. Many scholars refer to Frank Upham's book on Law and Social Change in Postwar Japan probably as the most comprehensive continuous text by one author on the topic.[173] Judge Abe's decision in the *Livedoor* case seems consistent with many of the ideas Upham presents in that book. In fact, a discussion of the Livedoor case might even fit nicely as the focus of a chapter in an updated version of the book.

A. ENVIRONMENTAL TRAGEDY AND RESPONSE: THE "COMMON PATTERN" IN JAPAN:

Upham tells us, at least with respect to environmental tragedy, "the common pattern of conflict [in Japan] may be described as consisting of appeals to government benevolence followed by collective, often violent, protest, and eventually resulting in effective government action."[174] It makes sense that we would not have seen quiet "appeals to government benevolence" with respect to Livedoor before the government took formal action against Horie and Livedoor.[175] Who would make such "appeals?"[176] Large financial institutions have lost more money by investing in Livedoor than private individuals have. However, one might find it difficult to imagine representatives of large corporations making "appeals to government benevolence."[177] Similarly, who would engage in "collective . . . protest?"[178] If many Japanese companies began adopting Horie-style management techniques *and* their doing so began to clearly *cause* widespread economic problems for the general populace, we might begin to see representatives of other companies or interest groups do so. However, absent such a situation, who other than the government (e.g., the FSA, whose job includes maintaining stability of the securities markets) would take action? How? We see the answer in the *Livedoor* case. A few injured institutional investors decided to file suit against Livedoor.[179] After doing so, they

173. UPHAM, *supra* note 2.
174. *Id.* at 72.
175. *Id.*
176. *Id.*
177. Id. at 72.
178. Id. at 72.
179. *See Livedoor Founder Horie, Others Face Damages Suit*, *supra* note 49. Some of the others' lawsuits have already resulted in convictions; *Nippon Life*, *supra*

actively brought more than 3000 others into the suit.[180] Both the court and the FSA responded as expected.[181] The FSA responded with legislation restricting the activities that caused the economic harms.[182] The court handed down a firm sentence.[183] The court handed down a decision arguably different from what a U.S. court would have ruled. However, perhaps Judge Abe handed down the decision they felt would best achieve "[t]he elevation of natural over positive law, of fairness over legal rules, and of moral over legal justice in effecting the outcome of [this] dispute."[184] Furthermore, when the media saw the Tokyo public prosecutor's call to action, they immediately responded by criticizing Horie, whom they had until then lauded as a corporate genius.[185] This change in the media's attitude has of course already changed the minds of many Japanese. As Upham said, "the public statement and restatement of the arguments and the reasoned justifications for particular outcomes universalize the issues in ways that profoundly influence the public's perception of the justice of different possible outcomes under similar or analogous circumstances."[186] In this way, the press has already played a significant role, even (or perhaps "especially") if Japanese law would have permitted U.S. style analysis resulting in lesser damages for Livedoor.

B. *BURAKUMIN*[187] WHY NOT DENUNCIATION?

Denunciation has seemed to prove moderately successful with respect to the *burakumin* issue in Japan. In fact, although "in those few cases where individual *Burakumin* have sued civilly, they have won," the method of choice for dealing with *burakumin* problems remains denunciation.[188] Why might or

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note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1.

180. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1.

181. *See, e.g.*, Stuber et al., *supra* note 38.

182. *Id.*

183. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1.

184. UPHAM, *supra* note 2, at 74.

185. *See, e.g.*, Tessensohn, *supra* note 41.

186. UPHAM, *supra* note 2, at 76.

187. "*Burakumin*" refers to a Japanese minority social group considered tainted by virtue of employment relating to death or ritual impurity, such as butchers, tanners, and anyone working with blood or funerary matters. Although technically liberated in 1871, they continue to struggle against discrimination within Japan. One method Upham describes as possibly successful to at least some extent is "denunciation."

188. *Id.* at 111.

might not denunciation have worked with respect to Horie's "dynamic . . . entrepreneur[ial]" corporate management style?[189] One must first ask; who would denounce him? Perhaps other corporate leaders who felt his management style might corrupt the Japanese system and put their own jobs (or companies) at risk? One might think so. However, Horie aggressively captured the media early in his career.[190] Upham recognized the importance of media in an area where the proponents wish to use denunciation tactics.[191] Horie made it impossible for opposition to capture the media in opposition to him. In a time of economic uncertainty, he portrayed himself as a man of change; a man of hope for Japan's economy.[192] The media would need a significant reason to say anything but good things about him. The raiding of Livedoor's offices and Horie's home created precisely the reason they needed. Furthermore, the existence of that reason created a contrapositive situation in which the same principles that govern results of the *burakumin* denunciation would work in favor of reforming Japan's corporate governance systems.[193]

Upham gives us two reasons why the *buraku* conflicts have seldom entered the courts.

> The most important reason may be the relative effectiveness of denunciation and litigation in influencing the social agenda and determining whether individual disputes become issues in the general political debate. By keeping these controversies out of the courts, the government can prevent the crystallization of the BLL's grievances into questions of equality, discrimination, and social structure that have universal normative appeal. As long as the issues are particularized to those involved in specific disputes, the BLL's actions and demands seem so idiosyncratic that the fundamental issue of equal treatment is obscured and substantial political appeal lost.[194]

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189. Tessensohn, *supra* note 41.

190. *Horie's Media Savvy Key to Success*, *supra* note 39 ("Horie has put himself at the core of advertising, attracting individual investors to drive up the share price").

191. "Media campaign . . . has been successful in allowing the [Burakumin Liberation League (BLL)] to dominate the rhetoric of the Buraku question just as conclusively as denunciation has contributed to the BLL's success in other fields." UPHAM, *supra* note 2 at 114.

192. *See* Tessensohn, *supra* note 41; *Horie's Media Savvy Key to Success*, *supra* note 39.

193. For discussion of Japan's accounting standards and their reformation (largely as a result of the events connected with Horie and Livedoor), *see* Yuka Hayashi & Andrews Morse, *Livedoor Probe Sparks Scrutiny of Japan's Accounting Standards*, WALL ST.J. ASIA, Jan. 26, 2006, at 1; Christopher T. Hines et al., *Doing Deals in Japan: An Analysis of Recent Trends and Developments for the U.S. Practitioner*, 2006 COLUM. BUS. L. REV. 355 (2006).

194. UPHAM, *supra* note 2, at 121.

In the case of Livedoor, the government *wants* political appeal.[195] They *want* economic reform, in hopes that Japan can avoid the kinds of economic struggles the U.S. faces today.[196] Accordingly, it appears the same system and conditions that keep the *burakumin* movement content but somewhat quashed have served well to bring the corporate governance issue to the forefront, precisely at the time when the government needed to do so.[197]

"A second limitation on the political effect of denunciation is its eventual dependence on governmental action."[198] One might fear that awarding significant damages in a private securities fraud case might result in large numbers of additional plaintiffs filing civil securities fraud cases in Japan.[199] However, in this respect as well, the *Livedoor* court seems to have done quite well. Viewing the situation from this perspective, we can now see the value in refraining from allowing defendants to rebut claims of every individual plaintiff (which would of course require the court to examine all such rebuttals.[200]

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195. *See* Katz, *supra* note 38 (stating "[w]hatever the investigation uncovers, Japan's corporations still need a lot of reform."). *See also Japan FSA Questions Money over Stock Market Fall*, *supra* note 38; *Market Eyes Stock Players Expecting Livedoor Shock to Linger on Market*, *supra* note 18; *TSE Faces Imperative to Fix Structural Flaws*, *supra* note 38; *WorldCom Scandal Acts as Livedoor Benchmark*, *supra* note 38.

196. *See TSE Faces Imperative to Fix Structural Flaws*, *supra* note 38; *Market Eyes Stock Players Expecting Livedoor Shock to Linger on Market*, *supra* note 18 ; Katz, *supra* note 38.

197. Hayashi & Morse, *supra* note 191; Hines et al., *supra* note 191. One might also consider the long-standing debate about the independence of the Japanese judiciary. Regardless which side of that debate one prefers, it seems clear that this case presented yet another case for the Japanese judiciary to act in a way consistent with the objectives of the current administration. For discussion about the independence of the Japanese judiciary, *see* Frank K. Upham, *Political Lackeys or Faithful Public Servants? Two views of the Japanese Judiciary*, 30 LAW & SOC. INQUIRY 421, 421-55 (2005) (review essay).

198. UPHAM, *supra* note 2, at 122.

199. In addition to the mere concern regarding the number of cases filed, readers should also remember that:

> the statutes make these . . . actions available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause. Dura Pharms, Inc. v. Broudo, 544 U.S. 336, 342 (2005). *Cf.* Basic Inc. v. Levinson, 485 U.S. 224, 252(White, J. and O'Connor, J., concurring in part and dissenting in part) ("[A]llowing recovery in the face of affirmative evidence of nonreliance-would effectively convert Rule 10b-5 into a scheme of investor's insurance. There is no support in the Securities Exchange Act, the Rule, or our cases for such a result." (internal quotation marks and citations omitted)).

200. *See Nippon Life*, *supra* note 1; Raibudoa gawa ni 95 okuen no baisho meijiru, Tokyo Chi-Sai [*Livedoor Ordered to Pay 9.5 Billion Yen in Compensation: Tokyo District Court*], *supra* note 1; *Livedoor Ordered to Pay 9.5 B Yen in Damages*, *supra* note 8.

1. *Women, civil rights, and the limitations of litigation:*

Upham tells us "[i]t would be extremely difficult to argue that Japanese attitudes towards women's roles in society have liberalized greatly in the last two decades. On the contrary, many Japanese women feel that popular attitudes have become more 'traditional.'"[201] He seems equally pessimistic about the litigation as used in the *burakumin* movement.[202] Will the movement to stop Horie-style corporate governance befall the same fate? No.

The securities fraud litigation differs from the women's rights movement litigation. Litigation alone might fail to change perspectives. However, when coupled with outright bans on certain corporate activities and methods, it should work quite well. Additionally, the press has taken an active stance in criticizing Horie for his actions.[203] As for the possibility of large corporations keeping this movement suppressed with "socially marginal activities and programs," this will not happen either.[204] We know this because we have already seen significant change.[205] We could have anticipated it because the company targeted in this course of events had set itself apart as an independent "dynamic . . . entrepreneur[ial]" Horie.[206] Livedoor never attempted or pretended to subject itself to Japan's *keiretsu*, "main bank," or any other such system.[207]

Unlike some American activist lawyers, the Japanese lawyers lack a devotion to the 'rule of law' as a descriptive of an ideal legal system. The latter are much more political in the sense that they view these cases as contributing to social change rather than as correcting flaws in the legal order.

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201. UPHAM, *supra* note 2, at 144.

202. [T]he Japanese government and large corporations have crafted the ideal situation: the moral issue of discrimination can be dealt with by pointing to the substantial affirmative action programs while the underlying social and economic structure is left unaffected. The BLL is kept, if not happy, at least preoccupied with socially marginal activities and programs. (UPHAM, *supra* note 2, at 161.)

203. *See, e.g.*, Tessensohn, supra note 41.

204. UPHAM, *supra* note 2, at 161.

205. Hayashi & Morse, *supra* note 192; Hines, et al., *supra* note 191.

206. Tessensohn, supra note 41.

207. This paper will not attempt to contribute to the long-standing debate on corporate governance among such scholars as Miwa, Ramseyer, and Milhaupt. Interested parties may find some of their discussions at Yoshiro Miwa and J. Mark Ramseyer, *The Myth of the Main Bank: Japan and Comparative Corporate Governance*, 27 LAW & SOC. INQUIRY 401, 403-21 (2002); Curtis J. Milhaupt, *On the (Fleeting) Existence of the Main Bank System and Other Japanese Economic Institutions* 27 LAW & SOC. INQUIRY 425, 425-35 (2002), Curtis J. Milhaupt, *Symposium Norms & Corporate Law: Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance*, 149 U. PA. L. REV. 2083, 2083-85 (2001).

The Livedoor case has certainly succeeded in this respect. As soon as the Japanese government mobilized its prosecutorial forces the media began to question the character of Horie and his kind.[208] By now, most Japanese have already internalized a dislike for what they previously viewed as a "young dynamic Japanese entrepreneur hero," but now view as excessively aggressive corporate governance.[209]

C. Industrial Policy and the Implication of Informality

> [An] implication of informality in industrial policy is its effect on the government-business relationship and on the tendency of private companies to comply voluntarily with [the Ministry of International Trade and Industry's ("MITI's")] informal guidance. MITI and business have worked to create a relationship of mutual trust and interdependence by institutionalizing the constant contact between industry representatives and MITI officials at all levels, as was apparent in the three industrial policy case studies [in Upham's book].[210]

As noted above, whether one prefers to discuss *keiretsu*, "main banks," or other constructs, "the crucial part played by the government was bureaucratic, implicit, and private. Its readiness to stand behind leading financial institutions was the ultimate strength of the safety net lying below the company."[211]

> Intervention by the main bank in such cases is often subtle in nature in that the bank will require a recovery plan to be devised and submitted to it for approval and in the course of agreeing to this plan the bank will typically require measures such as labor-force reductions and asset disposals to be implemented.[212]

Horie and Livedoor managed to largely escape this entire system. However, by doing so they made themselves more vulnerable to certain methods of attack than if they had functioned like other CEOs and companies. Much of Upham's chapter on legal informality focuses on MITI's power to favor or disfavor industry, and drive industries and companies to rise or fall by using bank financing, placement of corporate officials by *amakudari*, and so forth.[213] Livedoor escaped the influence of

208. *See, e.g.*, *Dubious Deals Created Livedoor Monster*, The Daily Yomiyuri, Jan. 18, 2006. *See, also*, *Horie's Media Savvy Key to Success*, The Nikkei Weekly, Jan. 23, 2006.

209. Tessensohn, supra note 41.

210. Upham, *supra* note 2, at 202.

211. Richard Pascale and Thomas P. Rohlen, *The Mazda Turnaround*, 9 J. Japanese Stud. 219, 233 (1983).

212. Paul Sheard, *The Main Bank System and Corporate Monitoring and Control in Japan*, 11 J. Econ. Behav. & Org. 399, 408 (1989).

213. Upham, *supra* note 2, at 166-204.

MITI by obtaining financing from foreign banks, "inventing" structures that enabled them to engage in financial activities with less capital, and hiring young, aggressive candidates (instead of retired government officials) into management positions.[214] With no members on the board, and no ability to control their financing, MITI's immunity from legislation (i.e., the administrative review process, by which MITI exerts a great deal of pressure on most Japanese companies) did not help MITI or any other government entity control Livedoor.[215] Horie having divorced himself and Livedoor from all governmental interests, though, perhaps the judiciary feels less hesitation to hand down rather harsh judgments against them.[216] [217]

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214. *See* Richard Schwindt and Devin McDaniels, *Competition Policy, Capacity Building, and Selective Adaptation: Lessons from Japanese Experience*, 7 WASH. U. GLOBAL STUD. L. REV. 35, 83 (2008); Sanford M. Jacoby, *Convergence by Design: The Case of Calpers in Japan*, 55 AM. J. COMP. L. 239, 284 (Spring 2007); Gruener, *supra* note 43, at 891.

215. UPHAM, *supra* note 2, at 166-204.

216. Notice, though, this does not mean Japan has begun leaning towards the kind of "adversarial legalism" for which Kagan criticizes the United States. Robert Kagan, *Adversarial Legalism and American Government*, 10 J. POL'Y ANALYSIS & MGMT. 369, 369-406 (1991). Quite to the contrary, although this might at first look like U.S. style litigation, it still bears features of Japanese policymaking and jurisprudence that differ from those of the U.S., as explained throughout in this paper. In this way, it becomes the perfect tool to suppress a western style "young dynamic Japanese entrepreneur hero" CEO like Horie and his company in Japan. Tessensohn, *supra* note 41.

217. Some scholars have in fact noted that the government and judiciary have responded to Horie and Livedoor with unusual harshness:

> [T]here was media criticism of the comparatively harsh punishment meted out to Horie when during the same period it was revealed that Nikko Cordial, Japan's third largest securities firm, had inflated profits for two business years in amounts far larger than those involved in the Livedoor case. Although Nikko Cordial had committed the same type of offenses as Livedoor, no executives at the firm were charged with any crimes and its shares were not delisted. The firm paid a $500 million fine. Jones, *supra* note 48, at 200 n.12 (citing Yuri Kageyama, *After Horie's Fall, Nikko Case Seen Smacking of Favoritism*, JAPAN TIMES, Mar. 22, 2007, *available at* http://search.japantimes.co.jp/cgi-bin/nn20070322f3.html.).

However, readers will again note that such criticisms have not received widespread support in Japan. The government, judiciary, and media all support the idea that Horie and Livedoor should receive harsh punishments. In this way, the government and judiciary have "universalize[d]" the disdain for Horie's and Livedoor's once-lauded (now considered reckless) management and corporate governance techniques "in ways that profoundly influence the public's perception of the justice of" the outcomes of those cases. UPHAM, *supra* note 2, at 76.