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**Problematic Supreme Court decision
in Murakami Fund case**

Japan's Supreme Court refused to hear Yoshiaki Murakami and his fund management company's appeal of their insider trading conviction, which was previously upheld by a lower appellate court. Given that Mr. Murakami unquestionably acted unfairly and illegally, the Court's dismissal of the appeal was the right decision but questions remain about the reasoning behind it.

On June 6, 2011, Japan's Supreme Court dismissed an appeal in the Murakami insider trading case. Yoshiaki Murakami, head of the Murakami Fund, and his fund management company had been convicted of illegal insider trading under the Securities and Exchange Act (SEA). The defendants had unsuccessfully appealed their conviction to a lower appellate court before appealing to the Supreme Court. The Supreme Court's dismissal of the appeal upheld the appellate court's guilty verdict, which imposed a three-year suspended sentence on Mr. Murakami in lieu of his initial sentence of two years imprisonment.

The SEA (which has since been amended and renamed the Financial Instruments and Exchange Act) prohibits corporate insiders (e.g., corporate officers, major shareholders) of an entity that conduct tender offers or otherwise seek to acquire material equity stakes in other companies, quasi-insiders (e.g., lawyers, accountants, and other parties with a contractual relationship with the would-be acquirer), and direct recipients of information from insiders and quasi-insiders from trading in the stock of the target company before the decision to conduct a tender offer or otherwise acquire a material equity stake has been publicly disclosed (Article 167). Mr. Murakami was charged with insider trading in connection with Livedoor's February 2005 purchase of a block of Nippon Broadcasting's stock. He had traded in Nippon Broadcasting's shares after being informed that Livedoor had decided to acquire a material equity stake in Nippon Broadcasting but before that decision had been publicly disclosed.

The case garnered widespread public attention because Mr. Murakami is famous in Japan, most notably for proposing an IPO of the Hanshin Tigers baseball team. Legally, however, the most contentious issue was the interpretation

of the term "decision" in insider trading regulations.

With respect to this issue, the Tokyo District Court, the original trial court, ruled that intent to actually acquire a material equity stake is required and also sufficient to determine that a "decision" to do so had been made, but an expectation that the acquisition would unflinchingly occur is not required. The court ruled that the intended acquisition's degree of feasibility is irrelevant to the issue of whether a "decision" had been made unless it is completely unfeasible. The court's decision was regarded as in adherence with the Supreme Court's decision in the 1999 *Nippon Orimono Kako* insider trading case (53 *Keishu* 5 at p.415, Sup. Ct., June 10, 1999)¹. The same time, it was criticized, mainly by legal practitioners, for construing that merely going through the motions of preparing to undertake an acquisition could constitute a "decision" even in the absence of a realistic probability of actually succeeding.

Incidentally, the Tokyo District Court's decision angered many market participants by commenting that, "[Mr. Murakami] claims that for a fund to buy low and sell high is business as usual but his extreme pursuit of profit above all else is appalling." However, this comment was emphasizing the treachery of Mr. Murakami's investment approach of profiting by betraying the trust of his personal contacts at companies such as Livedoor and Fuji Television. Accusations on the basis of this statement alone that the judge was opposed to money-making were somewhat of an overreaction.

In contrast the lower court's decision, the Tokyo High Court, the first appellate court, ruled that to determine whether a bona fide "decision" had been made in such cases, courts should comprehensively examine the facts at hand and specifically judge whether the decision could

significantly influence investors' investment decisions. It further ruled that an expectation that the planned acquisition be carried out with certainty is not required to determine that a "decision" had been made, but the decided-upon plan must be reasonably detailed, backed by serious intent to execute it and, therefore, reasonably feasible. Regarding this issue of feasibility, the court ruled that a "decision" must be deemed reasonably feasible both objectively and subjectively based on reasonable grounds. While the appellate court upheld the guilty verdict against Mr. Murakami, it ruled that a plan with negligible prospects of being realized does not constitute a "decision." One attorney praised this ruling as "a significant milestone that frees compliance practitioners from the shackles of the consensus interpretation of the [Supreme Court's] *Nippon Orimono Kako* decision."²⁾

The Supreme Court, however, disagreed on this point. Insider trading regulations specifically and objectively stipulate the scope of prohibited acts and do not require that a "decision" influence investors' investment decisions. From the standpoint of increasing predictability by clearly defining insider trading regulations' scope, the Supreme Court construed that the degree of influence on others' investment decisions is rendered irrelevant by limitation of the regulations' scope to acts done in recognition that, if a "decision" has occurred, the "decision" alone ordinarily could influence investors' investment decisions. The court acknowledged that a plan to acquire a material equity stake could conceivably fail to substantively constitute a "decision" because the plan is completely or practically unfeasible and therefore presumed to not influence ordinary investors' investment decisions. Aside from such cases, the court ruled that if a company's management decision-making body decides to initiate preparations to acquire a material equity stake in another company as a matter of company business, it is reasonable to construe such a decision to be sufficient without requiring that the planned acquisition be specifically deemed feasible. In terms of the facts of the Murakami case, the Supreme Court ruled that Livedoor's plan to acquire shares in Nippon Broadcasting was clearly not completely or practically unfeasible and therefore constituted a "decision."

Based on such reasoning, the Supreme Court upheld the Tokyo High Court's conclusion that a "decision" had

been made in the Murakami case but ruled that the Tokyo High Court had erred in imposing a requirement that the "decision" be objectively and subjectively feasible based on reasonable grounds.

That is, the Supreme Court ruled that whether an event constitutes a material fact subject to insider trading regulations is not contingent upon whether or not it would specifically influence investment decisions. In doing so, the Supreme Court clearly adopted a formalistic standard of judgment like in the original trial court's decision, which was criticized by legal practitioners. According to the Supreme Court, it adopted this standard to increase predictability by clearly defining the scope of insider trading regulations.

However, if statutorily prescribed detailed technical requirements are applied formalistically and even trades by parties in possession of nonpublic information that would not materially influence investors' investment decisions are treated as illegal insider trading, such an outcome would unjustifiably expand the scope of insider trading regulations and unduly constrain the investment behavior of certain parties, including listed-company insiders. Moreover, corporate compliance departments that deal with securities trading by listed companies and their personnel in fact routinely impose excessive restrictions on trading by slavishly adhering to formal requirements to avoid "inadvertent insider trading."

Japan's insider trading regulations apply only to primary information recipients that have received information directly from insiders. As such, they have been criticized for being unreasonably narrow in scope and permissive of substantively unfair trading in comparison to other countries' corresponding laws. This point sparked controversy when suspicions of insider trading in connection with several large follow-on equity offerings were reported last year. This limitation of insider trading regulations' applicability to primary information recipients reflects a legislative intent to increase predictability by clearly defining the regulations' scope.

Establishing such a formalistic scope of regulation is highly problematic if it leads to excessive constraint of trading while also inviting the criticism of being laden with

loopholes. Japan should rethink its regulatory framework in the aim of returning to insider trading regulations' true intent of preventing misuse of nonpublic information that would materially influence investors' investment decisions.

Note

1) In the *Nippon Orimono Kako* case, a listed company in financial difficulty decided to issue additional shares and entered into an agreement with another company to engage in a private-placement equity offering and M&A deal. The counterparty company's auditor (and also legal advisor), who had learned of the pending equity offering and M&A deal before they were publicly disclosed, was charged with illegal insider trading. In its decision in this case, the Supreme Court ruled that in the Securities and Exchange Act company decision-making "bodies" means not only bodies vested with decision-making authority pursuant to the Commercial Code but also any other body deemed to have substantively equivalent decision-making authority. Regarding such bodies' decisions, the Supreme Court ruled that "decision" means a decision to issue shares or take preparatory action to do so as a matter of company business and requires intent to actually issue shares but does not require an expectation that the share issuance will unfailingly occur.

2) Hiroshi Kameda and Masayuki Yamada, "Murakami fando jiken kousoshin hanketu no kento" (Analysis of the Appeal Court judgement on Murakami Fund Case) *Shojihoumu* No.1864 (2009) p.4.

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