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Masayuki Tamaruya
The University of Tokyo, Graduate Schools for Law and Politics

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Masayuki Tamaruya (The University of Tokyo, Japan)

<Abstract>

In 2006, the Japanese law of nonprofits underwent a major reform. Notably, the reform involved a shift in the governance mechanism from external governmental oversight to a structure that emphasizes internal fiduciary governance. As the Japanese law in this area has historically been marked by various strands of fiduciary rules derived from different sources, the event presents a valuable case study on how the shift to fiduciary governance approach can impact the operation of those entities that are subject to the reform. This chapter will begin with a historical account of the evolution of Japanese nonprofit law that involves complex interactions among the indigenous nonprofit tradition, the civil law influence, American fiduciary principles, and the English-style charity commission. After discussing the major components of the 2006 reform against the backdrop of major events that created the reform momentum, this chapter will use available empirical evidence to critically examine the reform's achievements and consider any remaining issues that pose ongoing challenges.

Key words: nonprofit, fiduciary law, corporate governance, Japanese law, comparative law

Ensuring the proper governance of nonprofit organizations while simultaneously encouraging robust voluntary works has posed a perennial challenge for policy makers around the globe. In recent years, the Japanese law regarding nonprofits has undergone extensive changes. In 2006, legislation was introduced to replace the then-110-year-old Civil Code provisions for public-interest corporations. In fact, the 2006 legislative changes represent the culmination of a nonprofit law reform that has spanned nearly a quarter of a century. The process is not yet complete. The Legislative Council within the Japanese Ministry of Justice has recently published the General Outline for the reform of public-interest trust legislation.

This chapter will present the evolution of Japanese law regarding nonprofits from a comparative historical perspective and assess its achievements. Part I will provide a historical overview of Japanese law regarding nonprofits, beginning with the introduction of the Civil Code in 1896 and continuing until the 1980s. The evolution of Japanese nonprofit law is characterized by complex interactions among the indigenous nonprofit tradition and influences from both civil law and common law jurisdictions. The post-World War II expansion of administrative state amplified the role of the government in the governance of nonprofits. Beginning in 1970s, however, growing criticism of the mismanagement and corruption involving public-interest corporations and supervising government authorities created a momentum for reform.

The major theme of this chapter is the shift in the governance approach brought by the reform movement since the 1990s. As outlined in Part II, the overhaul of nonprofit legislation in 2006 represented a shift of emphasis from external governance through government regulation to internal governance that rely on fiduciary principles and transparency. The shift has not been without challenge. The fiduciary governance introduced in public-interest corporations though statute does not automatically apply to many other entity forms within the nonprofit sector. Even with regard to public-interest corporations, only a few cases have been decided to indicate how the new approach applies in practice. Part III will use the available statistics and empirical studies to critically examine the reform's achievements and consider any remaining issues.

A note on the terms "public interest (*koeki*)" and "charitable (*jizen*)" is warranted here. The term "public interest" has a broad meaning that includes "charitable" purposes. According to the version of the Civil Code introduced in 1896, a "public-interest corporation" was to serve the open-ended purposes of "worship, religion, *charity*, scholarship, art, or other public interests," subject to governmental permission and oversight.[1] By the end of the 20th century, the broad concept of public interest in the nonprofit context had attracted criticism in connection with concerns about the degree of government influence that could be exerted through its supervisory capacity. Following the 2006 reform, "public interest" has been understood more narrowly. Under the current statute, public-interest corporations must still serve "scholarship, art, charity, or other

[1] MINPŌ (CIVIL CODE), Law No. 89 of 1896 [hereinafter Civil Code], § 34 (repealed by the Law No. 50 of 2006) (emphasis added).

public interests" and benefit members of the general public, but a table appended to the statute specifies twenty-three categories of services to which public-interest corporations can direct their effort.[2] These statutory categories parallel the charitable purposes that are commonly listed in charity legislation in common law jurisdictions.[3] Today, many Japanese lawyers use the term "public-interest corporation" or "public-interest trust" in a way that is equivalent to the common law terms "charitable organization" and "charitable trust."

I. The Japanese Law of Nonprofits in Comparative Perspective

The Civil Code of 1896 introduced the modern law of nonprofits to Japan.[4] It was, however, not the only source, as common law trust was introduced in 1922, and both of these Western influences had to interact with local conditions, most notably the charitable enterprises indigenous to Japan, and growing administrative state after World War II.

A. The Civil Law Tradition

The Civil Code provided for two forms of public-interest corporations. One was an association, which was a membership-based corporation that could not distribute profits to its members but allowed them flexibility in designing their activities according to the collective will. The other was a foundation, an endowment-based entity without membership, which was typically established for enduring functions, such as educational or medical institutions. The Civil Code provided that "an association or foundation that concerns worship, religion, charity, scholarship, art, or other public interests, and whose purpose is not profit-making, may be incorporated by receiving permission (*kyoka*) from the competent governmental authority."[5] This contrasted with a for-profit corporation under the Commercial Code, which could be created automatically if certain statutory requirements were satisfied. According to Kenjiro Ume, a drafter of the Japanese Civil Code, the corporations involving public interests required special governmental regulation.[6]

In the nineteenth century, the law of nonprofit organizations was still evolving in Continental Europe. The Napoleonic Code of 1804 contained no provision for legal personality.[7]

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[2] Kōeki Shadan Hōjin oyobi Kōeki Zaidan Hōjin no Nintei tō ni kansuru Hōritsu [Public Interest Association Corporation and Public Interest Foundation Corporation Authorization Act] [hereinafter Public Interest Corporation Authorization Act], Law No. 49 of 2006 [hereinafter Public Interest Corporation Authorization Act], § 2(iv), Beppyō [Appended Table].

[3] *Compare* Appended Table to the Public Interest Corporation Authorization Act § 2 *with* Charities Act 2011 c 25, s 3(1) (U.K.); RESTATEMENT (THIRD) OF TRUSTS § 28 (2001); UNIFORM TRUST CODE § 405 (last revised 2010) (U.S.).

[4] Civil Code §§ 33-83.

[5] *Id.* § 34.

[6] KENJIRŌ UME, MINPŌ YŌGI I [LECTURE ON CIVIL CODE I], 68 (1896).

[7] French Civil Code did contain provisions on partnership (*société*), which has no legal personality. Voluntary association (*association*) was only made legal by statute in 1901. Edith

Anti-association attitudes prevailed in the subsequent French Republic, where the public interest was considered the exclusive prerogative of state bodies. The Japanese Government entrusted a French lawyer, Gustave Boissonade, with the task of drafting the Japanese Civil Code. As introduced in Parliament, the Boissonade Code only provided that "[a] legal person, whether public or private in nature, can only be created by virtue of statutory authorization; it can enjoy private right only in accordance with the statutory provisions."[8] Although it was passed by the Parliament in 1890, it never came into force for political reasons. The Japanese drafters of the Civil Code then looked to Germany, which was in the process of drafting its own civil code.[9] This second Civil Code, which came into effect in Japan in 1896, mirrors many aspects of the German Civil Code, which came into effect in 1900.[10]

Significant parallels between the German and Japanese Civil Codes can be observed in their distinction between membership-based associations and endowment-based foundations,[11] as well as their organizational structure. Both associations and foundations acted through directors, who represented the entity in all transactions relating to the corporation.[12] Although neither Code prescribed a director's specific duties, limitations were imposed on transactions that may represent a conflict of interest,[13] and directors were subject to rules applicable to agents acting under the contract of mandate.[14] In Japanese contexts, directors were regarded as owing "the duty

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Archambault, *France, in* DEFINING THE NONPROFIT SECTOR: A CROSS-NATIONAL ANALYSIS 103, 104-05 (Lester M. Salamon & Helmut K. Anheier, eds., 1997).

[8] MINPŌ JINJI-HEN [CIVIL CODE BOOK OF PERSON], Law No. 98 of 1880, § 5 (repealed by MINPŌ [CIVIL CODE], Law No. 89 of 1896).

[9] MASAAKI TOMII, MINPŌ GENRI DAI-IKKAN: SŌRON [THE PRINCIPLES OF CIVIL CODE I: GENERAL PRINCIPLES] 184-85 (1905).

[10] BÜRGERLICHES GESETZBUCH (CIVIL CODE) [hereinafter German Civil Code]. Following discussion relies on the English translation of the 1900 German Civil Code in CHUNG HUI WANG, THE GERMAN CIVIL CODE: TRANSLATED AND ANNOTATED WITH AN HISTORICAL INTRODUCTION AND APENDICES (1907). For Japanese studies comparing Japanese and German Civil Code provisions on associations and foundations, *see* MINORU TANAKA, KŌEKI HŌJIN TO KŌEKI SHINTAKU [PUBLIC INTEREST CORPORATIONS AND PUBLIC INTEREST TRUSTS] 7-8 (1980); TOSHIJI HAYASHI, [ZAIDAN, ZAIDAN HŌJIN NO KENKYŪ [STUDIES ON FOUNDATION AND INCORPORATED FOUNDATIONS] 377-402 (1983).

[11] Japanese Civil Code § 34. The German Civil Code has separate sets of provisions for associations (§§ 21-79) and foundations (§§ 80-88).

[12] Japanese Civil Code §§ 52, 53; German Civil Code §§ 26, 86.

[13] Japanese Civil Code § 57 (a conflicted director cannot represent the corporation); German Civil Code § 27(3), 86, 668 (the director as an agent must pay interest).

[14] German Civil Code § 27(3), 668 (application *mutatis mutandis* of the Code §§ 664-670 on the contract of mandate). Japanese law reached the same conclusion through statutory interpretation. SAKAE WAGATSUMA, ET AL., [WAGATSUMA, ARIIZUMI KONMENTĀRU MINPŌ, SŌSOKU, BUKKEN, SAIKEN [WAGATSUMA AND ARIIZUMI'S COMMENTARY ON CIVIL CODE: GENERAL PRINCIPLES, PROPERTY, AND OBLIGATION] 131 (4th ed. 2016). Mandates, understood as a species of contracts in civil law jurisdictions, are modern descendants of Roman law that are analogous to the agency relationship in common law. Martin Gelter & Geneviève Helleringer, *Fiduciary Principles in European Civil Law Systems, in* OXFORD HANDBOOK OF FIDUCIARY LAW 581, 588-90 (Evan Criddle, Paul Miller and Robert Sitkoff

of care of faithful managers,"[15] a term of art found in Japanese Civil Code that encompasses duties of care and loyalty in common law formulations.[16] For associations, the general assembly of the members had the power to appoint directors[17] and make decisions on corporate matters,[18] while foundations were not member-based and had no general assembly to convene. In Japan, an auditor could be appointed and was tasked with auditing the corporate books and assets, as well as supervising directors' role in running a given entity.[19] Nevertheless, it was still possible for the auditor to fail to provide sufficient oversight or even collude with the directors in their pursuit of illicit objectives. Thus, as stated by a drafter of the Civil Code, Masaaki Tomii, the government was expected to provide "supreme supervision" over public-interest corporations.[20]

In broad terms, the Japanese Code provisions echoed the stable pattern of cooperation between the state and the nonprofit sector, which paralleled that of nineteenth-century Germany.[21] At the same time, Japanese approach to the supervision of the nonprofits tended to be more centralized. Under the German federal system the supervision of nonprofit entities was delegated to each state, which seemingly exercised broad discretion.[22] In comparison, Japanese public-interest corporations were subject to discretionary supervision that applied nationally.[23] Eiichi Hoshino, an eminent scholar on the Civil Code in Japan, remarked that the idea that the determination of the public interest belongs exclusively to the government held sway well into the latter half of the twentieth century.[24] Until the 2006 reform, the governance of public interest corporations, beginning from their creation and continuing through the ongoing management to dissolution, were largely entrusted to the discretionary oversight by the government.

Another departure from the German Civil Code was the Japanese Code's focus on "the public interest." As already discussed,[25] the scope of operation the Japanese Civil Code allowed for public-interest corporations—service to "worship, religion, charity, academic activities, art, or other public interests"[26]—was open-ended compared to that of common law

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eds., 2019).

15 Japanese Civil Code § 644 (the duty of care of a faithful manager).

16 J. Mark Ramseyer & Masayuki Tamaruya, *Fiduciary Principles in Japanese Law, in* OXFORD HANDBOOK OF FIDUCIARY LAW 643, 643 (Evan Criddle, Paul Miller and Robert Sitkoff eds., 2019).

17 Japanese Civil Code § 6; German Civil Code § 27.

18 Japanese Civil Code § 63; German Civil Code § 32.

19 Japanese Civil Code §§ 58, 59.

20 TOMII, *supra* note 9, at 234.

21 Helmut K. Anheier & Wolfgang Seibel, *Germany, in* DEFINING THE NONPROFIT SECTOR: A CROSS-NATIONAL ANALYSIS 131 (Lester M. Salamon & Helmut K. Anheier, eds., 1997).

22 German Civil Code § 43, 44. *See* TANAKA, *supra* note 10, at 7; HAYASHI, *supra* note 10, at 381-82.

23 Japanese Civil Code § 67.

24 EIICHI HOSHINO, MINPŌ NO SUSUME [LEARNING THE CIVIL CODE] 96 (1998).

25 *See supra* notes 1-3, and accompanying text.

26 Japanese Civil Code § 34.

charity regulation.[27] Nevertheless, when compared to the German Code, which distinguished between for-profit and nonprofit entities but did not create a category for charitable or public-interest purposes,[28] the Japanese focus was narrow. Because the 1896 Civil Code disallowed the incorporation of an organization unless sanctioned by the Code or other specific legislation, those organizations that pursued mutual benefit or undefined nonprofit purposes had to either operate as unincorporated organizations or seek specialized legislation to incorporate themselves.[29]

The Civil Code provisions for public-interest corporations remained unchanged for over a century. World War II, however, had a deep impact on the operation of Japanese public-interest corporations. During the war, practically all public-interest corporations were required to align themselves with the government's war efforts. After World War II, constitutional constraints were imposed on the government to prohibit the use of public funds for religion and education.[30] In response, special legislation was introduced to create different types of legal personalities for religious[31] and school corporations.[32] The destruction and subsequent hyper-inflation caused by the war also posed a challenge for many public-interest organizations. One major avenue for survival was an organization's option to convert itself into a newly created entity as a social welfare[33] or medical corporation,[34] which was then placed under the auspices of the Ministry of Health and played an integral role in providing national social and medical services. These major nonprofit sectors were thus carved out of the public-interest corporation sector, and an idiosyncratic management and governance regime developed within each sector.[35]

This brief overview of the comparative and historical context reveals notable features of Japanese nonprofit legislation. While the oversight of nonprofit management was delegated to separate governmental departments with discretionary authority, the rules of internal fiduciary governance remained unarticulated for an extended period. While numerous forms of government-sponsored entities were introduced to partition the Japanese nonprofit sector, no legal mechanism existed through which a grassroots nonprofit organization could be incorporated. These features would become the major foci of reform in the late twentieth century.

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[27] *See* Charitable Uses Act 1601; *Income Tax Special Purposes Commissioners v Pemsel* [1891] All ER Rep 28 (Lord McNaughten); Charities Act 1960 (U.K.).

[28] German Civil Code § 21.

[29] Japanese Civil Code § 6.

[30] NIHONKOKU KENPŌ [KENPŌ] [CONSTITUTION] §20 (freedom of religion and separation of religion and state), § 89 (restriction on public spending on any religious or educational institutions).

[31] Shūkyō Hōjin Hō [Religious Corporations Act], Law No. 125 of 1951.

[32] Shiritsu Gakkō Hō [Private Schools Act], Law 270 of 1949, §§ 25-58.

[33] Shakai Fukushi Jigyō Hō [Social Welfare Services Act], Law No. 45 of 1951, renamed as Shakai Fukushi Hō [Social Welfare Act] by Law No. 111 of 2000.

[34] Iryō Hō [Medical Care Act], Law No. 205 of 1948.

[35] Masayuki Deguchi, *Globalization, glocalization, and Galapagos syndrome: Public interest corporations in Japan,* 18 INTERNATIONAL JOURNAL OF NOT-FOR-PROFIT LAW 5, 6 (2016).

B. Indigenous Nonprofits

Before the introduction of the modern Civil Code, Japan had its own tradition for nonprofit or charitable enterprises. Since the 7th and 8th centuries, large Buddhist temples have established hospitals and charities to provide food for the poor.[36] Buddhist temples were not necessarily independent institutions, but were established to further the interests of the state or powerful clans. More recently, in the 18th or 19th century, thousands of village institutions known as *Terakoya* (temple schools) were in operation, thus contributing to a high rate of literacy that resulted in the country's modernization, which began in the late 19th century.[37]

Nevertheless, the transition from indigenous charities to modern public-interest corporations was not easy. This is illustrated by the history of a secular nonprofit called *Kan'on-kō* (Society of Gratitude) founded in 1829 in Akita, a northeastern region of Japan.[38] A wealthy merchant named Sukenari Naba and his followers donated 2,000 *ryō* (equivalent to ¥260 million or $2.5 million today) to the domain government (*han*), which purchased farmland so feudal revenue could alleviate the region's poverty and prepare for possible famines.[39] Although Naba intended to donate the funds to the domain government, the government delegated its practical management to him and his fellow managers. They later agreed, with the approval of the authority, that the fund belonged to neither the authority nor to its subjects.[40]

In 1871, *Kan'on-kō* faced a major challenge soon after the Meiji restoration, when the newly established government confiscated the endowment as part of the centralization of the government structure and the modernization of the property system. Following repeated petitions, the government returned 6,000 yen in 1874 and 53,350 yen in 1881 (the total amount is equivalent to ¥1.18 billion and $10.8 million today).[41] Another crisis struck *Kan'on-kō* shortly thereafter, when donors sued its managers (*nenban*) based on their assertion of partial ownership of the fund and the right to be informed of its management.[42] The case was eventually brought to the Supreme Court (*Taishin'in*), which ruled in favor of *Kan'on-kō*'s managers in 1890.[43] The Court held that *Kan'on-kō* can be understood as a foundation without an owner, and upheld the lower

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[36] Takayoshi Amenomori, *Japan*, *in* DEFINING THE NONPROFIT SECTOR: A CROSS-NATIONAL ANALYSIS 188, 190-91 (Lester M. Salamon & Helmut K. Anheier, eds., 1997).

[37] *Id. See also* Wataru Fujiwara, *Nihon no Minkan Hieiri Soshiki no Genryū [The Sources of Private Nonprofit Organizations in Japan], in* NIHON NO NPO-SHI: NPO NO REKISHI WO YOMU, GENZAI, KAKO, MIRAI [THE HISTORY OF JAPANESE NPO: READING THE HISTORY OF NPO, PRESENT, PAST AND FUTURE] 1, 13-14 (Makoto Imada ed., 2006).

[38] KAN'ON-KŌ, KAN'ON-KŌ SHI [KAN'ON-KŌ JOURNAL] (1921); TANAKA, *supra* note 10, at 27-56.

[39] The legal history of *Kan'on-kō* is narrated in Zennosuke Nakagawa, *Kan'on-kō Hōritsushi: Nihon Hōjinshi no Ichi Shiryō [The Legal History of Kan'on-kō: A Material for the History of Organizational Law in Japan],* 49 HŌGAKU-KYŌKAI ZASSHI [J. JURIS. ASS'N] 80 (1931).

[40] KAN'ON-KŌ, *supra* note 38, at 5.

[41] *Id.* at 15, 21.

[42] Nakagawa, *supra* note 39, at 109-10.

[43] Taishin'in Judgment of July 9, 1890, as quoted by Nakagawa, *supra* note 39, at 110-11.

court judgment, which characterized *Kan'on-kō* as a moral person for charitable purposes. The Supreme Court also held that the donor relinquished ownership to the property in the form of a gift to the *Kan'on-kō,* and therefore had no entitlement to its funds.

These legal challenges prompted *Kan'on-kō* to codify its governing rules. After excavating old documents and practices and seeking legal advice, a constitutional document (*kanrei*) was drawn up in 1892.[44] The drafting process attracted the attention of Boissonade, who was finishing the draft of the initial Civil Code. Boissonade provided several rounds of editing support, and personally contributed fifty yen (¥1 million or $9,100 today) to the fund. When the new Civil Code was introduced to replace the Boissonade Code, *Kan'on-kō* was duly registered as a foundation in 1898.

During the World War II, the organization suffered a more serious blow. After the war, the Supreme Commander for the Allied Powers issued a series of orders intended to democratize Japan. As part of the farmland reform, large landholdings were repossessed by the government and redistributed to numerous tenant farmers. *Kan'on-kō's* land was also subject to repossession, thereby depriving it of the property basis for its poverty relief works.[45] Work could only be continued via reliance on a government subsidy provided by the Social Welfare Services Act of 1948. In 1951, *Kan'on-kō* converted itself to a social welfare corporation, and has since served the community by running an orphanage.

In Akita alone, at least 18 *Kan'on-kō*s followed Naba's example, and numerous *ko*s were scattered throughout pre-modern Japan. Their purposes and structures varied.[46] The introduction of uniform rules applicable to charitable institutions did not occur until the Meiji restoration. Yet the same government was hostile to such local charitable initiatives, and the modernization of the landholding system through the abolition of feudal incidents was irreconcilable with the basic structure of such indigenous endeavors.[47] The same may be said of the democratization of landholdings after World War II, and the subsequent growth of the welfare state. Very few *ko*s and other indigenous charitable arrangements survive today as legally

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[44] KAN'ON-KŌ, KAN'ON-KŌ KANREI GIKAI [KAN'ON-KŌ CUSTOMARY RULES EXPLAINED] (1893).

[45] MICHIO AOKI & SHOJI TAKUYA, KINSEI SHAKAI FUKUSHI SHIRYŌ: AKITA KAN'ON KŌ BUNSHO [HISTORICAL MATERIAL ON MODERN SOCIAL WELFARE: AKITA KAN'ON-KŌ DOCUMENTS] 14 (2000).

[46] Masayuki Deguchi, *Nihon ni okeru Minpō Sekō Mae no Kō to Gendai Hieiri Soshiki to no Tokusei no Kyōtsuusei [Similarities between the "Kō" of the Pre-Civil Code era and present-day Nonprofit Organizations (NPOs) in Japan]*, 38 KOKURITSU MINZOKUGAKU HAKUBUTSUKAN KENKYŪ HŌKOKU [NATIONAL MUSEUM OF ETHNOLOGY STUDIES REPORT] 299, 305-08 (2014).

[47] Takuya Shoji, *Meiji Zenkin ni okeru Chiiki teki Kyūsai Soshiki no Sonzoku Katei: Kan'on-kō no Hōjinka wo Megutte [The Survival of Local Poverty Relief Arrangements in Early Meiji: Kan'on-kō's Transition to a Legal Entity],* 33 SENSHŪ SHIGAKU [SENSHŪ HISTORY REVIEW] 67, 82 (2002).

recognized entities.[48]

C. Governance in the Nonprofit Sector

By the end of World War II, each public-interest corporation was subject to supervision by either one of the national governmental departments possessing jurisdiction over its activities or the governor of the prefecture within which it operated. The supervision was highly discretionary as the Japanese Civil Code did not contain specific standards to be applied by the government in reviewing application to the creation of public-interest corporation or by way of ongoing supervision.[49] By the early 1970s, it was a standard practice for those who wish to create a public-interest corporation to consult with government officials in advance of application and to adhere to any administrative guidance that was given.[50]

The Japanese court shied away from scrutinizing the government's determination of public-interest corporation status. In Adachi River-North Medical Association v. Governor of Tokyo (1988),[51] the Tokyo Metropolitan Government denied a petition submitted by a group of physicians to form a new local medical association as a public-interest foundation following their separation from the local Adachi Medical Association due to internal conflict. The lower court sided with the petitioners, asserting that the denial constituted an unlawful abuse of discretion, because no factual basis existed for the government's assumption that the establishment of rival medical associations could confuse and disrupt the provision of public health services. However, the Supreme Court reversed this judgment. Citing past instances in which the local government struggled to reconcile the feuding members of the Adachi Medical Association, the Court held that when a governmental decision has a certain factual foundation and is *prima facie* rational, absent exceptional circumstances, the decision does not constitute illegal excess or abuse of administrative discretion.

The supervising departments occasionally made genuine efforts towards enhancing internal governance when issuing permission for a new public-interest corporation. One such method was requiring the bifurcation of the board of directors to create a supervisory council called *hyogi-kai*.[52] Creation of this council was useful for foundations because they had no separate general meeting to which the final authority to monitor directors could be assigned. Such

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[48] Deguchi, *supra* note 46, at 310.

[49] Japanese Civil Code § 34 (repealed).

[50] NIHON KŌEKI HŌJIN KYŌKAI [JAPAN ASSOCIATION OF CHARITABLE ORGANIZATIONS] (JACO), KŌEKI HŌJIN NO SETSURITSU, UN'EI, KANTOKU NO TEBIKI [A HANDBOOK FOR THE ESTABLISHMENT, MANAGEMENT, AND SUPERVISION OF PUBLIC INTEREST CORPORATIONS] 12-13 (editorial support by Sōmushō Daijin Kanbō Kanri Shitsu [Internal Affairs Minister's Secretarial Management Office], 6th ed. 2003).

[51] 1297 Hanji 29 (Supreme Court, July 14, 1988).

[52] TANAKA, *supra* note 10, at 16-18. This is similar to the German style of corporate governance. James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform,* 34 EMORY L.J. 617, 679-83 (1985).

a separate board was created by the founding document, and was typically given the power to nominate directors and approve fundamental changes to the foundation. The membership-based association did have a general meeting for members, which had the power to determine matters not exempted by the constitutional document, and to dissolve the association by a three-quarters majority.[53] Nonetheless, members had diverse and sometimes contradictory interests that were not always consistent with those of the general public. The disjunction between members' interest and that of the public remained unarticulated well into the 1990s, even in academic writings.[54]

In the 1960s and 1970s, a series of publicized scandals occurred that questioned the effectiveness of governmental supervision over public-interest corporations. One such instance involved the Postal and Transportation Association, a foundation created in 1955 with the Ministry of Posts and Telecommunication's permission.[55] Although its board was filled with prominent figures in politics and industry, including then Prime Minister Eisaku Sato, the foundation had long remained dormant. In 1967, Tokuji Kojima, its newly appointed director, proceeded to collect 450 million yen ($1.3 million) from small business owners as advance payment for using the welfare facilities center he promised would be built by the Central Tourism Corporation, a for-profit corporation he led.[56] While Kojima took advantage of the trust that the name of the public foundation generated, his fellow directors and the regulator, the Ministry of Posts and Telecommunication, were apparently unaware of his general operations.[57] After Central Tourism went bankrupt in 1967, the Postal and Transportation Association's permission to operate was revoked, and Kojima and a fellow director were investigated for the criminal forgery of private and public documents.[58]

Kojima was then involved in another publicized scandal implicating the National Association for the Traffic Safety of Children. This foundation was established in 1966 with the permission of the Prime Minister's Office and was supervised by the then ruling Liberal Democratic Party (LDP)'s vice secretary-general, Yuzo Matsuzawa. After becoming the foundation's Vice President, Kojima embezzled five million yen ($13,900) using various tactics, including charging a donor for the cost of printing 100,000 copies of "Safety Booklet for Good

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[53] Civil Code §§ 63, 69 (repealed).

[54] Nobuko Kawashima, *Governance of Nonprofit Organizations: Missing Chain of Accountability in Nonprofit Corporation Law in Japan and Arguments for Reform in the U.S.,* 24 UCLA PAC. BASIN L.J. 81, 103-105 (2006).

[55] *Chūō Kankō Aratana Kuroi Kiri [Central Tourism and New Dark Fog],* YOMIURI SHIMBUN (August 10, 1967).

[56] *Id.*

[57] *Kōeki Hōjin wo Arai Naose: Ninka Torikeshi Shobun mo [Thorough Investigation Needed for Public Interest Corporation: Possible Revocation of Permissions],* YOMIURI SHIMBUN (August 10, 1967).

[58] *Shushōin nado Gizō Mitomeru: Teishin Un'yu Kyōkai no Moto Riji [Forgery of Prime Minister's Seal Admitted: Former Director of Postal and Transportation Association],* YOMIURI SHIMBUN (September 27, 1967).

Children" while only printing 30,000.[59] Kojima concealed this and other misconduct through off-book transactions.[60]

These revelations were just the tip of the iceberg. In 1971, the Government conducted an inquiry into public-interest corporations, and found evidence of inappropriate management in 40% of the 106 entities randomly selected from 4,407 public-interest corporations.[61] Issues included the absence of operational records, excessive profit-making, the use of accumulated assets for staff and related persons' benefit, and offering directorships to supervising department officials.

Faced with criticism, governmental departments with jurisdiction over public-interest corporations created a standing committee in 1971 to coordinate their guidance and supervisory work.[62] The Civil Code was amended in 1979 to explicitly provide the supervising department with the power to issue supervisory orders and revoke permission upon a public-interest corporation's failure to comply.[63] In July 1986, the standing committee published a standard for the guidance and supervision of the administration of public-interest corporations.[64] These informal standards were updated in the 1980s and 1990s, and were formalized through the Cabinet Resolution in September 1996.[65] This guidance required organizations to adopt a more rigid organizational structure and accounting procedures. All public-interest corporations were asked to disclose their constitutional and financial documents via the internet, and those entities that provided services under government contract were required to disclose more extensive information on the government department's website.[66] The Cabinet Resolution exhorted public-interest corporations to actively pursue the benefit of numerous unascertained individuals, and demonstrated the intention of eliminating entities that only pursue mutual benefit or provide welfare services for members of a certain group, such as industry associations.[67] Public-interest

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[59] *Jidō Kōtsū Kyōryoku Kai: Kojima Fukukaichō wo Taiho [Children Traffic Safety Association: Vice President Kojima Arrested],* YOMIURI SHIMBUN (June 2, 1971).

[60] *Id.*

[61] Administrative Management Agency's report submitted to the Cabinet Meeting on December 21, 1971, as reported in *Daidassen no Kōeki Hōjin: Datsu Mokuteki, Kane Mōke, Zentai no 40% mo to Gyōkan Happyō [Public Interest Corporation in Disarray: Lost Purposes and Money Making in over 40% of the PICs, Administrative Management Agency Says]*, YOMIURI SHIMBUN (December 21, 1971).

[62] Standing Committee the Supervision of Public Interest Corporations, *Agreement on Standards of Permission for Creation of Public Interest Corporations* (March 1972); *see* JACO, *supra* note 50, at 8.

[63] Civil Code §§ 67(2), 71 (as amended by the Law No. 68 of 1979).

[64] Standing Committee for the Guidance and Supervision of Public Interest Corporations, *Standards of Guidance and Supervision for Public Interest Corporations* (1979).

[65] Cabinet Resolution, *Standards of Permission for Creation and Guidance and Supervision of Public Interest Corporations* (September 1996).

[66] Agreement among Cabinet Ministers Responsible for Guidance and Supervision of Public Interest Corporations, *Disclosure of Public Interest Corporation through the Internet* (August 2001).

[67] Cabinet Resolution, *supra* note 65, at para.1.

corporations whose services overlapped and competed with those of for-profit corporations were required to broaden their scope of services or add new ones in the public interest; otherwise their permission to operate was revoked.[68] However, these tightened regulations ironically made it more difficult for newly formed nonprofits to receive permission for incorporation.

Despite these measures, issues persisted. A government inquiry in 1992 found that nearly 20% of a sample comprising 923 public-interest corporations showed evidence of improper administration of charity affairs or weakness in their governance structure.[69] For instance, one unnamed foundation made a profit of 583 million yen ($3.9 million) in 1989 and accumulated almost 2 billion yen ($13.3 million), but showed minimal expenditure towards any public interest.[70] Another foundation, whose ten directors and three auditors were also officials for-profit corporation, invested 43% of the foundation's endowment into the for-profit and its affiliates.[71] The report meticulously described and categorized the instances of abuse and mismanagement, while avoiding the identification of any entity or person by anonymizing their names. Nevertheless, these instances of underperformance and corruption fueled the momentum for reform.[72]

D. The Evolution of Public-Interest Trusts

The controversy over public-interest corporations led the philanthropists to seek an alternative model of charitable giving: public-interest trusts. Although the Trust Act of 1922 contained eight sections on public-interest trusts, trusts were used exclusively in commercial contexts, and no public-interest trusts had been created for over half a century.[73] In 1976, the government commissioned a comprehensive study of public-interest trusts. The Japan Association of Charitable Organization (JACO) submitted a report, which supported the Japan Business Federation (*Keidanren*) in advocating the use of trusts for philanthropic activities.[74] The first two public-interest trusts in modern Japanese history were created in 1977.

As the 1922 Trust Act was silent on regulatory matters, public-interest trusts were assigned to individual governmental departments for oversight. Of the first two public-interest trusts created in 1977, one was assigned to the Ministry of Foreign Affairs and the other to the Ministry of Infrastructure (now the Ministry of Land, Infrastructure, Transport, and Tourism).

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[68] *Id.* at para. 2(2).
[69] Ministry of Internal Affairs Administrative Inspection Bureau, *The Present Status and Issues of Public Interest Corporations: Observation from Ministry of Internal Affairs' Audit Result,* 13 (1992).
[70] *Id.* at 15.
[71] *Id.* at 35.
[72] Hiroyasu Nakata, *Kōeki Hōjin, Chōkan Hōjin, NGO [Public Interest Corporations, Intermediate Corporations, and NGOs],* 1126 JURIST 53, 56 (1998).
[73] Shintaku Hō [Trust Act], Law No. 62 of 1922, §§ 66-73.
[74] Tatsuo Ohta, *Charitable Trust in Japan: An Article submitted to "Charitable Trust Session" at China Charity Fair in Shenzhen, China,* 3-4 (September 19, 2015).

Guidance similar to that provided for public-interest corporations was published in 1994, which in practice limited the scope of public-interest trusts to grant-making and providing scholarships.[75] Trusteeship for virtually all public-interest trusts was undertaken by trust banks.

Since 1977, the number of public-interest trusts has steadily increased. By 1990, 304 public-interest trusts were created to hold 20.9 billion yen ($140 million), and the total assets peaked in 2001 at 73.7 billion yen ($615 million), held by 566 public-interest trusts.[76] While the scale of trust assets pales when compared with the 13.6 trillion yen ($124 billion) held by 9,371 public-interest corporations, it is noteworthy that no alleged or proven case of misused public-interest trust has emerged even in the 1980s and 1990s, when public-interest corporations were under incessant criticism and scrutiny. Unlike managers of public interest corporations, the trust banks are under the regulatory oversight by the financial authorities. The limited purposes served by the public-interest trusts also made it relatively easy to maintain transparency in operation and management of the funds.

II. Reform Movements in 2000s and 2010s

Toward the end of twentieth century, criticism against mismanagement of the public-interest corporation and overbearing government oversight led to a series of reform in nonprofit law. A legislation was introduced in 1998 to allow a new form of nonprofit organization; the Civil Code provisions governing public-interest corporation were replaced by a new set of legislation in 2006; and as of 2020, a new public interest trust legislation is being proposed. These changes represent a major shift of emphasis from external governance through government regulation to internal governance that rely on fiduciary principles and transparency.

A. Background Shifts

In 1990, the Japanese economic bubble burst. Political instability came alongside the economic downturn as the LDP lost its almost 40-year-long parliamentary majority in 1993. In 1994, Tomiichi Murayama became the first Socialist Prime Minister in 47 years, but his was just the first of several short-lived coalition governments that jostled for control for the remainder of the century. However, the last decade of the 1990s was a springboard for the comprehensive reform of the Japanese charity sector.[77] In 1995, a disastrous earthquake hit the Hanshin-Awaji

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[75] Standing Committee on Guidance and Supervision of Public Interest Corporations, *Standard for Permission to Undertake Public Interest Trusts* (September 1994).

[76] Shintaku Kyōkai [Trust Companies Association of Japan], *Kōeki Shintaku no Jutaku Jōkyō 2019 Nen 3 Gatsu Genzai [The Status of Charitable Trust Business as of March, 2019]*, 279 SHINTAKU [TRUSTS] 88, 89(2019).

[77] Masayuki Deguchi, *The Distinction between Institutionalized and Noninstitutionalized NPOs: New Policy Initiatives and Nonprofit Organizations in Japan, in* THIRD SECTOR POLICY AT THE CROSSROADS: AN INTERNATIONAL NON-PROFIT ANALYSIS 153, 158-63 (Helmut K. Anheier & Jeremy Kendall eds., 2001).

area. The earthquake triggered broad civic participation in volunteer works and charitable activities. Various grass-root organizations emerged and demanded the recognition of their status as legal entities to facilitate volunteer works. The non-LDP administration was more receptive to the public demand for the reform of public-interest corporations.

In 2000, a scandal erupted at a public-interest corporation called KSD, which was founded by a former Labor Ministry bureaucrat, Tadao Koseki, with the permission of the Tokyo Metropolitan Government to provide mutual insurance and welfare services for small businesses. In actuality, he hired other retired bureaucrats from the Labor Ministry, paid politicians lavishly for political and bureaucratic advantage, and embezzled massive amounts of money for himself. The courts eventually convicted him and other involved parties on criminal charges.[78] By the 2000s, the administrative reform had attracted national attention calling for a reorganization of the manner in which government works were delegated and subsidies were distributed through non-governmental organizations. The revision of Civil Code provisions on public-interest corporations thus became a major reform agenda.[79]

The criticism of the governmental supervision of public-interest corporations was complex. On the one hand, regulators were criticized for being too lax. Once public-interest corporations were recognized as such via government permission, many perpetuated abuse and mismanagement beneath the supervisory radar. Government officials operated under conflicts of interest, because upon retirement they were often offered director seats from the public-interest corporations they regulated and received hefty compensation in return. On the other hand, regulators were criticized for being overly restrictive. Faced with mounting criticism, regulators allowed incorporation only when a proposed entity possessed sufficient funds and had a managerial structure in place. Meanwhile, the Civil Code granted no entity status for organizations that operated as nonprofits but were non-charitable in nature. This prevented start-up or grassroots voluntary organizations from incorporating themselves.[80]

In 1996, the Civic Activities Promotion Bill was introduced in the legislature as a Parliamentary member's bill (*giin rippo*), in a rare deviation from the standard practice where the government introduces a bill.[81] In 1998, it ultimately became law as the Specified Nonprofit Activities Promotion Act.[82] The law is intended to enable citizens' groups to

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[78] 1832 HANREI JIHŌ 39 (Tokyo D.Ct. May 20, 2003), *aff'd,* 62 SAIHAN KEISHŪ 507 (Tokyo High Ct. Dec. 19, 2005), *aff'd,* 1457 HANREI JIHŌ 6 (S. Ct. Mar. 27, 2008).

[79] Cabinet Resolution, *The Comprehensive Reform of Public Interest Corporation Legislation* (March 2002); Cabinet Resolution, *The Principles of Administrative Reform* (December 2004).

[80] Hiroyasu Nakata, *Outline of the General Association and Foundation Corporation Legislation,* 1328 JURIST 2 (2007); AKIRA MORIIZUMI, STUDIES IN PUBLIC INTEREST CORPORATION 6-8 (1977).

[81] Deguchi, *supra* note 77, at 162-63.

[82] Tokutei Hieiri Katsudō Sokushin Hō [Specified Nonprofit Activities Promotion Act], Law No. 7 of 1998 [hereinafter NPO Corporation Act].

obtain a legal personality without discretionary intervention from the government. Thus, a specified nonprofit corporation, commonly known as an *NPO Hōjin* (NPO [nonprofit organization] corporation), can be established by filing the requisite papers with the relevant government office,[83] and the government must approve the application if the papers satisfy the prescribed requirements.[84] Although the 1998 Act contained very limited provisions on directors' fiduciary duties, tax legislation was introduced in 2001 that allowed tax-deductible donations to a NPO corporation that maintains proper governance and contributes to the public interest.[85] Mirroring the American test of public support, such corporations must have a geographically broad funding base or service area, cannot provide more than half of their services to members or other specified groups, and must receive at least one-third of their revenue through donations.[86]

B. The Nonprofit Reform in 2006

In 2006, the reform momentum of the 1990s culminated in a comprehensive overhaul of public-interest corporation law when three sets of legislation were passed to replace the previous Civil Code provisions.[87] The statute divides nonprofit corporations into two categories: general and public-interest corporations. General corporations can be created simply by filing with the local registration office without government permission.[88] If the general corporation pursues one or more of the statutorily enumerated public interests and receives authorization from the newly created Public-Interest Commission (*Koueki Nintei-tō Iinkai*), it becomes a public-interest corporation and enjoys certain tax benefits.[89] Modeled after the Charity Commission in England and Wales,[90] the Commission comprises seven commissioners from outside of the government with the mandate to act independently from the administrative body. The Commission administers the standard for permission and operational requirements that were

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[83] NPO Corporation Act § 10.

[84] *Id.* § 12.

[85] NPO Corporation Act § 44; Sozei Tokubetsu Sochi Hō [Tax Special Measures Act], Law No. 26 of 1957, § 41-18-2 (as inserted by Law No. 7 of 2001). The requirement for tax privileges was relaxed through successive amendment to tax legislation in 2003, 2005, 2006, 2008, and 2011.

[86] NPO Corporation Act § 45(i).

[87] Ippan Shadan Hōjin oyobi Ippan Zaidan Hōjin ni Kansuru Hōritsu [General Association and General Foundation Act], Law No. 48 of 2006 [hereinafter, General Corporation Act; Public Interest Corporation Authorization Act; Ippan Shadan Hōjin oyobi Ippan Zaidan Hōjin ni Kansuru Hōritsu oyobi Kōekishadan Hōjin oyobi Kōeki Zaidan Hōjin no Nintei tō ni Kansuru Hōritsuno Sekō ni Tomonau Kankei Hōritsu no Seibini Kansuru Hōritsu [General Corporation Act and Authorization Act Implementation Act], Law No. 50 of 2006 (hereinafter Implementation Act).

[88] General Corporation Act § 22.

[89] Public Interest Corporation Authorization Act §§ 4-10.

[90] In England, the Charity Commission was established in 1853. Charitable Trust Act 1853, 16 & 17 Vict. c. 137.

reformulated and incorporated in the 2006 Public Interest Corporation Authorization Act.[91]

A general corporation can take the form of either an association or a foundation. Although general corporations cannot distribute profits, the range of activities in which they may engage is unlimited. This created the possibility for the incorporation of business interest organizations and mutual benefit groups. A set of governance mechanisms parallel to those used by for-profit corporations was introduced for both general and public-interest corporations. For associations, the general meeting of the members ultimately has the power to determine all matters relating to the corporation,[92] and appoints directors and auditors who it can remove through a resolution.[93] Foundations must have at least three councilors, who collectively have the power to select and dismiss directors and auditors, approve accounting documents, and determine other organizational matters.[94] This board of councilors is now required by statute, and is no longer an informal practice encouraged by administrative guidance. The directors' duties entailing loyalty and non-competition are now also prescribed in the statute.[95] The statute further clarifies that directors, auditors, and foundation councilors are agents of the corporation, which means that they each owe to the corporation the duty of care of faithful managers.[96]

A general corporation can apply to become a public-interest corporation if it engages in activities relating to scholarship, art, charity, or other public interests for the benefit of unascertainable beneficiaries.[97] The corporation must also demonstrate that it possesses the requisite accounting base and technical capability; does not provide special interests to its members, officials, or employees and their related persons; and no single director and his spouse or relatives comprise more than a third of the board.[98] Three financial constraints are imposed. First, if a corporation raises revenue from public-interest activities, the revenue cannot exceed the expenses covering the proper costs for such services.[99] Second, the expenditure for public-

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[91] Public Interest Corporation Authorization Act §§ 4-26. The Public Interest Commission has also published a detailed guidance and associated Q&As. Koueki Nintei-tō Iinkai [Public Interest Commission], *Koueki Nintei-tō ni Kansuru Un'yō ni Tsuite (Koueki Nintei-tō Gaidorain) [On the Application of Public Interest Standard etc. (Public Interest Standard etc. Guideline)]* (April 2008, last updated March 2019); Koueki Nintei-tō Iinkai [Public Interest Commission], *Koueki Nintei Hōjin Seido-tō ni Kansuru Yoku Aru Shitsumon (FAQ) [Frequent Questions and Answers (FAW) on the Public Interest Corporation System]* (March 2020).

[92] General Corporation Act § 35.

[93] *Id.* §§ 63, 70.

[94] *Id.* §§ 173, 176, 177.

[95] General Corporation Act §§ 83, 84, 197.

[96] *Id.* §§ 64, 172, applying *mutatis mutandis* the Civil Code provisions on mandate contracts. For discussion of civil law mandates and their implication on Japanese law, *see supra* notes 14-16 and accompanying text, as well as references cited therein.

[97] Public Interest Corporation Authorization Act §§ 2(iv), 5(i). The appendix to the Act lists 23 activities that are deemed to contribute to the public interests.

[98] These requirements are listed at Public Interest Corporation Authorization Act § 5 (ii)-(xviii).

[99] *Id.* § 14.

interest services must comprise at least 50% of the total.[100] Third, the value of unused assets cannot exceed the projected expenditure for the public-interest activities for the following year.[101] These statutory requirements are intended as a departure from the discretionary supervision of governmental departments, although the Authorization Act delegated the definition of many key concepts and procedural requirements to the administrative regulation issued by the Cabinet Office.[102]

C. The Reform of Public-Interest Trusts

As of 2020, the reform of the public-interest trust was underway.[103] In 2018, the Legislative Council published a General Outline for the proposed reform, laying the groundwork for the bill's presentation to Parliament.[104]

The General Outline proposes the broadening of trustee bases by enabling ordinary individuals or corporations to serve as trustees.[105] This was controversial, as it signaled a shift from the previous practice where the trusteeship was almost invariably undertaken by trust banks. The debate also reflected a lingering concern regarding the abuse of public-interest entities. This concern has been further augmented because the General Outline proposes using public-interest trusts for more extensive works compared to the prior parameters for use, which were limited to the distribution of grants or scholarships.[106]

The General Outline makes various proposals towards enhancing accountability in trust management.[107] One such proposal consists of the introduction of a trust supervisor (*shintaku-kanrinin*) as a mandatory oversight mechanism.[108] To ensure independence, the supervisor cannot be related to the trustees, the settlors, or their family or employees.[109]

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[100] *Id.* § 15.
[101] *Id.* § 16.
[102] *Kōeki Shadan Hōjin oyobi Kōeki Zaidan Hōjin no Nintei-tō ni Kansuru Hōritsu Sekou Kisoku [Order Implementing the Public Interest Corporation Authorization Act],* Cabinet Office Order No. 68 of 2007.
[103] Yuichiro Nakatsuji, *Kōeki Shintaku Hō no Minaoshi ni Kansuru Chūkan Shian no Gaiyō [Outline of the Interim Proposal on the Revision of the Charitable Trust Act]*, 273 SHINTAKU [TRUST] 152 (2018).
[104] HŌMUSHŌ HOUSEI SHINSAKAI [MINISTRY OF JUSTICE LEGISLATIVE COUNCIL], KŌEKI SHINTAKU HŌ NO MINAOSHI NI KANSURU CHŪKAN SHIAN [GENERAL OUTLINE FOR THE REVISION OF PUBLIC INTEREST TRUST ACT] (December 18, 2018) [hereinafter GENERAL OUTLINE].
[105] GENERAL OUTLINE § 4, at 3-4.
[106] *Id.* at § 9.
[107] *Id.* at § 5 (trust supervisor), §§ 7, 8 (administrative authorization), § 11 (disclosure).
[108] GENERAL OUTLINE § 5, at 5-6. The enforcer had been introduced for private trusts in 2006. Trust Act §§ 258(4); 123-130.
[109] *Id.* § 5-2(2).

III. Assessing Nonprofit Reform in Japan

The reform of nonprofit law put greater emphasis on internal governance through fiduciary principles and transparency. The reform was not without challenge and this section will use available empirical evidence to assess the reform's achievements and consider any remaining issues that pose ongoing challenges.

A. Transition to the New Public-Interest Regime

After the 2006 reform was implemented in 2008, public-interest corporations formed under the former Civil Code provisions were given five years to either register as general corporations or apply for re-authorization as public-interest corporations. Of the 24,317 public-interest corporations at the beginning of the transition period, nearly half (11,679) opted for a status as a general corporation, and little more than a third (9,050) completed the transition to new public-interest corporations.[110] Of the remaining entities, 3,588 dissolved themselves or merged with other entities, and 426 simply disappeared, along with assets worth at least 9.92 billion yen ($90 million).[111]

As of December 2018, 9,561 public-interest corporations existed in Japan, with assets totaling 14.9 trillion yen ($135 billion).[112] During 2018, they received 281 billion yen ($2.6 billion) in donations, raised 3.3 trillion yen ($30.0 billion) from service provision, and spent 4.7 trillion yen ($42.7 billion) for public-interest services.[113]

According to an international survey published in 2016, the total amount of individual charitable giving in Japan was estimated at 7.0 billion dollars, compared to 258.5 billion dollars in the U.S., 17.4 billion dollars in the U.K., and 6.9 billion dollars in South Korea.[114] When compared to the GDP, the Japanese figure is 0.12%, which is much lower than those of the U.S. (1.44%), the U.K. (0.54%), and South Korea (0.50%). However, it should be noted that the Continental European jurisdictions tend to have lower figures, as demonstrated by Germany (0.17%) and France (0.11%).[115]

Against these figures, the reform of nonprofit legislation can be assessed.

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[110] Takako Amamiya, *Kōeki Hōjin Seido Kaikaku no Genjō to Kongo no Kadai [The Present State and Future Prospects of the Public Interest Corporation Reform], in* SHIMIN SHAKAI SEKUTĀ NO KANŌSEI: 110 NENBURI NO DAIKAIKAKU NO SEIKA TO KADAI [THE POTENTIALS OF THE CIVIL SOCIETY SECTOR: ACHIEVEMENTS AND REMAINING ISSUES OF THE MAJOR REFORM IN 110 YEARS] 17, 22 (Masahiro Okamoto ed., 2015).

[111] NHK KURŌZU APPU GENDAI SHUZAI HAN [NHK CLOSE-UP MODERN TIMES INVESTIGATIVE TEAM], KŌEKI HŌJIN KAIKAKU NO FUKAI YAMI [THE DEEP DARKNESS OF THE PUBLIC INTEREST CORPORATION REFORM] 38 (2014).

[112] Naikakufu [Cabinet Office], *Heisei 30 Nen Kōeki Hōjin no Gaikyō oyobi Kōeki Nintei tō Iinkai no Katsudō Hōkoku [The Overview of Public Interest Corporations and the Annual Report of the Public Interest Commission for the Fiscal Year 2018],* 3, 24 (December, 2019).

[113] *Id.* at 27, 29.

[114] CHARITIES AID FOUNDATION, GROSS DOMESTIC PHILANTHROPY 12 (January 2016).

[115] *Id.*

B. The Public-Interest Commission

The Public-Interest Commission has been positively received by the general public as the overseer of public-interest corporations. The Commission administers the statutory standard for authorizing public-interest corporations, thereby replacing the prior administrative guidance. The publication of their decisions and the underlying reasoning contributes to the regulatory process's transparency.[116] This English Charity Commission model of supervision will likely be extended to public-interest trusts.[117]

While the Commission reports to the Cabinet Office, the seven commissioners are selected from outside of the government ministries and are appointed by the Prime Minister with the approval of both Houses of Parliament.[118] Each commissioner is guaranteed a three-year term, and is under the statutory obligation to exercise his or her duty independently.[119] Nevertheless, some critics have voiced concern.[120] The administrative staff serving the Commission are officials of the Cabinet Office, who came from various governmental departments that formerly exercised broad discretion in supervising public-interest corporations. Tsutomu Hotta, a prominent advocate for nonprofit reform, charged that the officials of the Cabinet Office

> failed to understand the Authorization Act's purposes or appreciate the significance of the new public-interest corporation regime. They continued to follow their past experience characterized by absolute discretion, posing questions to applicants that do more harm than good. They wasted a significant amount of applicants' energy by requesting useless documentation, and disincentivized their application by providing an incorrect interpretation of the law.[121]

To the credit of the officials, Hotta notes that the situation improved beginning in the second year, when new personnel arrived and the full-time staff began handling the applications in earlier stages of the authorization process.[122]

Given the scarcity of cases, it is premature to identify a shift in the Court's deferential

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[116] Masahiro Okamoto, *Kōeki Hōjin Seido Kaikaku no Bunmyaku to Igi [The Context and Implication of Public Interest Corporation Legislation Reform], in* SHIMIN SHAKAI SEKUTĀ NO KANŌSEI: 110 NENBURI NO DAIKAIKAKU NO SEIKA TO KADAI [THE POTENTIALS OF THE CIVIL SOCIETY SECTOR: ACHIEVEMENTS AND REMAINING ISSUES OF THE MAJOR REFORM IN 110 YEARS] 13, 16 (Masahiro Okamoto ed., 2015).

[117] GENERAL OUTLINE §§ 7, 8.

[118] Public Interest Corporation Authorization Act §§ 32, 34, 35.

[119] *Id.* §§ 36, 37, 38.

[120] Okamoto, *supra* note 116, at 15-16.

[121] Tsutomu Hotta, *Seido Sekkei no Yugami ga Okosu Mondaiten [Problems that Have Arisen from the Skewed System Design],* 1421 JURIST 32, 36-37 (2011).

[122] *Id.* at 37.

attitude to the administrative authorization of public-interest company status. Nonetheless, in the *Japan Society for Dying with Dignity v. Japan*,[123] the Tokyo District Court reversed the Public-Interest Commission's denial of authorization. One of the main works of the Japan Society for Dying with Dignity was to run an unofficial registration service for living wills, and the Commission denied the application because such service cannot be regarded as a public-interest activity. It ruled that conferring the status of public-interest corporation would give the public undue impression that the government gave official approval to the registration of living wills, which could exert undue pressure upon the physicians who provide necessary medical services in terminal care. The Court, however, held that such findings were based on incorrect premises, given that various guidelines published by public bodies, including the Ministry of Health and Labor and the Japan Medical Association, recognize the primacy of patient autonomy, and physicians could continue following these guidelines to provide proper care.

C. Fiduciary Governance and Internal Checks and Balances

As discussed earlier, the 2006 legislation introduced an elaborate set of rules on fiduciary governance, including the codified duty of loyalty owed by the directors of general and public-interest corporations.[124] However, the significance of the formal changes should not be overstated. Even before the reform, these officials were considered as acting under the Civil Code provisions applicable to agency relationships,[125] and the Civil Code provided that self-dealing transactions were void.[126]

The Japanese courts' approach can be illustrated by *Japan Kanji Aptitude Testing Foundation v. Okubo*,[127] involving extensive self-dealing and asset diversion within a public-interest corporation before the transition to the new statutory regime. The Court ordered a remedy without relying on the duty of loyalty provision. The Japan Kanji Aptitude Testing Foundation (*Nihon Kanji Noryoku Kentei Kyokai*) was approved in 1992 and offered ten different levels of Chinese character writing tests, attracting 2.7 million examinees in 2007. The chairman and his son, who was also the vice-chairman of the foundation, had authorized a series of unnecessary transactions between the foundation and their four family companies that constituted conflicts of interest.[128] The Kyoto District Court ordered them to pay 2.4 billion yen ($21.8 million) for failure to exercise the due care of faithful managers, and four of their family companies were required to divulge their unjust enrichment. In separate criminal proceedings, the two directors

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123 2019 WLJPCA 01186004 (Tokyo Dist. Ct., January 18, 2019).
124 General Corporation Act §§ 83, 84, 197.
125 Ramseyer & Tamaruya, *supra* note 16, at 663.
126 Civil Code § 57 (repealed).
127 Kyoto District Court Judgment of Jan. 12, 2015, LLI/DB and LEX/DB.
128 *Monka-shō Kanken ni Torihiki Kaishō Shidō: Rijichō Kanren Ni-sha to [Guidance by the Ministry of Education: The Kanji Testing Foundation to dissolve transaction with two Chairman-related companies],* YOMIURI SHIMBUN (March 11, 2009).

were convicted for criminal breach of trust and sentenced to two and a half years in prison.[129] The foundation's public-interest corporation status was revoked, and it received re-authorization in 2013 only after the board reorganized and implemented a series of reforms.

Public-interest corporations are subject to additional governance requirements. Public-interest authorization is not available if over one-third of the applying general corporation's board comprises the spouse or other relatives within three degrees of any single director.[130] The directors and employees of an outside corporation cannot comprise more than one-third of the corporation's board.[131] The public-interest corporation cannot provide special benefits to any member, official, or employee,[132] and when paying remuneration to officers, it must follow a disclosed standard from within the range specified by the Cabinet Order.[133]

For foundations, a board of councilors that oversees the board of directors is now mandatory.[134] The board of councilors is expected to serve as an autonomous body to monitor the board of directors.[135] In practice, it is unclear whether the board of councilors constitutes a truly informed and independent body that can provide checks. At present, the checks and balances between the separate boards are expected to be self-executing, and no case regarding councilors' responsibility and liability has been reported. The same applies to the trust supervisor, which is expected to serve as a similar check and balance mechanism for the proposed public-interest trusts.[136]

D. Preventing Abuse

The abuse in the Kanji Aptitude Testing Foundation was revealed before the 2006 reform through an inspection by the Ministry of Education, which had supervisory authority over the education-related public-interest corporation at the time. Nevertheless, the Ministry of Education was also criticized for its failure to ensure compliance and detect more serious violations.[137] Prior to the revelation of the large-scale asset diversion, the Ministry had merely faulted the foundation for making excessive profit. It had issued guidance to reduce the testing fee, but the foundation failed to comply.

Some commentators feared the emergence of another organization like the Kanji Testing

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[129] Kyoto District Court Judgment of February 29, 2012, LLI/DB and LEX/DB, *affirmed by* Osaka High Court Judgment of March 26, 2013, and Supreme Court Judgment of December 9, 2014.
[130] Public Interest Corporation Authorization Act § 5(x).
[131] *Id.* § 5(xi).
[132] *Id.* § 5(iv).
[133] *Id.* §§ 5(xiii), 20; Cabinet Order § 3.
[134] General Corporation Act §§ 170, 172-196.
[135] Fishman, *supra* note 52, at 679-80.
[136] GENERAL OUTLINE § 5, at 5-6.
[137] *Kyōkai to Monkashō no Mitsugetsu: Shōeki Yūsen Kumotta Shidōryoku [Honeymoon of the Foundation and the Ministry of Education: Ministry Interest Advanced and Ability to Guide Reduced],* YOMIURI SHIMBUN (May 22, 2009).

Foundation. However, since its establishment in 2007, the Public-Interest Commission has observed no case similar in scale. The Commission has the power to require reports from a public-interest corporation, enter its office, and inspect the organizational operation, the books, and other documents.[138] During fiscal year 2017, the Commission entered the offices of 2915 public-interest corporations. This frequency is intended to subject each corporation to entry by the Commission once every three years.[139]

Until 2018, only three public-interest corporations had been deauthorized by the Commission.[140] In one such case, the Japan Life Foundation (*Nihon Raifu Kyokai*) had guaranteed the payment of medical and service fees to hospitals and care houses on behalf of elderly people who had no relatives or friends to sign a guarantee contract for them. The foundation diverted 270 million yen ($2.5 million) from funds deposited by service recipients and underwent voluntary reorganization. In 2016, the Commission moved to revoke its authorization on grounds that it had failed to secure sufficient financial resources for the provision of public-interest services.[141] Three directors were later arrested for violation of money lending regulations and the foundation was declared bankrupt.

Given the reduced transparency of general corporations, they are more susceptible to abuse than public-interest corporations. For instance, a tax evasion scheme was quickly devised to exploit the general corporation.[142] One must merely create a general corporation and fund it with family assets, such that family members continue to run the corporation as their own upon his or her death, without paying inheritance tax. This loophole was plugged by the 2018 tax reform.[143] Further, the name of an association or foundation generates a sense of trustworthiness among the general public, which is also problematic. Some general corporations have reportedly taken advantage of such trust and collected money that was ultimately exhausted for illegitimate purposes.

Other nonprofits have also made headlines for abusive practices. In 2014, it was reported that a social welfare corporation was being sold at a high price.[144] Although the social welfare corporation had no share to trade as a nonprofit foundation, the steady flow of government subsidy for social welfare services and the sense of entitlement from endowing the foundation made the chairmanship a lucrative commodity. According to a newspaper article by Asahi Shinbun, the

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138 Public Interest Corporation Authorization Act §§ 27, 59.
139 Cabinet Office, *supra* note 112*,* at 70.
140 *Id.* at 78.
141 Naikakufu [Cabinet Office], *Heisei 28 Nen Kōeki Hōjin no Gaikyō oyobi Kōeki Nintei tō Iinkai no Katsudō Hōkoku [The Overview of Public Interest Corporations and the Annual Report of the Public Interest Commission for the Fiscal Year 2016],* 73-74 (September 2017).
142 Shin'ya Oshino, *Ippan Shadan: Sōzoku ni Kazei [General Corporation: Taxation on Inheritance],* NIKKEI SHIMBUN (March 26, 2018).
143 Inheritance Tax Act, Law No. 73 of 1950, § 66-2, as inserted by Law No. 7, 2018.
144 *Shafuku Riken, Tobikau Kane: Enchō no Za Kōnyū [Concessions over Social Welfare, Money Flying Around: Chairman's Seat on Sale],* ASAHI SHIMBUN (May 19, 2014).

chairman of the board of directors for the Sakuragaoka Welfare Association received 125 million yen ($1.1 million) for ceding his position. In a related article, the same paper asserted that some social welfare corporations were run by the chief director for his own interest and the boards of directors and councilors often failed to provide effective checks. Among the various social welfare corporations mentioned, the chief director of the Sunflower Society (*Himawari-no-kai*) was named as having sold donated property, thereby increasing his salary without the board's authorization.[145] However, the corporation successfully sued the newspaper, which agreed to publish an article apologizing for the inadequate verification of facts and inaccurate statements.[146]

E. Encouraging Voluntary Works

While the prevention of abuse is an important policy objective, it should not defeat the original purpose of facilitating works for the public interest. Gift giving is increasing. The Japan Fundraising Association estimates that 45.7 million individuals donated 775.6 billion yen ($7.1 billion) in 2016 after a steady increase from 545.5 billion yen ($5.0 billion) in 2009.[147] The year 2011 was an exception year, when the Great Tohoku earthquake and tsunami disaster generated donations over 1 trillion yen ($9.3 billion). Corporate donations have increased from 477 billion yen ($4.3 billion) in 1994 to 790.9 billion yen ($7.2 billion) in 2015.[148]

Generally, tax incentives for donations increase people's willingness to donate to charities. In Japan, however, that is not necessarily the case. Of all nonprofit donors in 1994, only 14.3% claimed their donations on their tax returns (although over 40% of those donating over ten thousand yen did claim the donation).[149] A further shift in the volunteer and donation culture in Japan may be required before tax benefits create significant incentives to donate.

More relevant to fiduciary governance, a recent study suggests that people tend to donate to entities that have stronger governance, and derive more revenue from the government and other independent sources. Entities that publish their accounting documents on their websites receive 370 thousand more yen ($3,360) than those that do not, on average.[150] Research also shows that donors are interested in financial information regarding efficiency in the management of expenses, the extent of revenue-raising activities, and the donation balance.[151]

Critics, however, argue that public-interest corporations are overburdened by a rigid

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[145] *Shafuku Hōjin no Shibutsu-ka: Wanman Rijichō "Bōsō" [Social Welfare Corporation Made Personal Possession: One-man Chief Director Running out of Control],* ASAHI SHIMBUN (May 26, 2014).

[146] *Shakai Fukushi Hōjin "Himawari-no Kai" no Kiji wo Teisei-shi, Owabi Shimasu: Asahi Shimbunsha [Asahi Shimbun Correct the Errors in an Article on Social Welfare Corporation Himawari-no-kai and Make an Apology],* ASAHI SHIMBUN (April 17, 2015).

[147] Japan Fundraising Association, *supra* note 164, at 26-27.

[148] *Id.* at 48-49.

[149] *Id.* at 80.

[150] *Id.* at 76-77.

[151] *Id.* at 78.

set of financial requirements.[152] The provision mentioned most frequently in this context is the requirement that the income from revenue generating activities must not exceed the expenditures required to provide services for public benefit.[153] The restriction made sense in the 1990s, when the government was endeavoring to stop inactive or old public-interest corporations from accumulating unnecessary cash or assets. Nonetheless, the requirement that corporate books be kept in the red contradicts sensible directors' notions of healthy fiscal management.[154] It also prevents a corporation from preparing for contingencies and deploying its assets strategically.

More generally, many regulations and restrictions apply to all public-interest and general corporations of all types. Smaller start-up organizations have found it too cumbersome to engage a certified accountant and, in the case of foundations, a separate board of councilors. Although JACO has proposed the need for a more simplified organizational structure for small nonprofits, no legislative response has been delivered thus far.[155] The ongoing reform of public-interest trusts is premised on the assumption that they are "lightweight and lightly equipped" compared to public-interest corporations.[156] Even so, some commentators call for governance mechanisms more stringent than proposed to allay the fear of abuse.[157]

F. Transparency

The 2006 legislation expanded the disclosure obligations of public-interest corporations. Public corporations must now prepare a yearly project plan, budget, list of assets, list of officials, and compensation payment standards, which must be submitted to the Public-Interest Commission and made accessible to the general public.[158] Public corporations and large-scale general corporations with debt that exceeds 20 billion yen ($182 million) are generally required to undergo a third-party audit by professional accountants.[159]

The volume of information available to the public has increased.[160] Although disclosure

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[152] Hotta, *supra* note 121, at 32-34.
[153] Authorization Act § 14.
[154] KŌEKI HŌJIN KYŌKAI [JACO], KŌEKI HŌJIN NO UN'EI OYOBI KIFU TŌ NI KANSURU ANKĒTO CHŌSA KEKKA [QUESTIONNAIRE RESEARCH ON THE ADMINISTRATION OF AND GIFT GIVING TO PUBLIC INTEREST CORPORATION AND GENERAL CORPORATION] 46-66 (August 2019).
[155] KŌEKI HŌJIN KYŌKAI [JACO], KŌEKI HŌJIN SEIDO KAIKAKU YŌBŌ NI KANSURU HŌKOKUSHO [THE REPORT ON PUBLIC INTEREST CORPORATION REFORM PROPOSAL] 18-19 (June 2012).
[156] HŌMUSHŌ [MINISTRY OF JUSTICE], KŌEKI SHINTAKU HŌ NO MINAOSHI NI KANSURU CHŪKAN SHIAN NO HOSOKU SETUMEI [SUPPLEMENTARY EXPLANATION FOR THE INTERIM PROPOSAL FOR THE REVISION OF PUBLIC INTEREST TRUST LEGISLATION] 79 (2017); Nakatsuji, *supra* note 107, at 153 n.6.
[157] Takeshi Sakuma, *Kōeki Shintaku Hō Kaisei no Ronten [Issues Relating to the Revisions of Public Interest Trust Legislation],* 271 SHINTAKU [TRUST] 4, 8-10 (2017).
[158] Authorization Act §§ 21, 22.
[159] General Corporation Act §§ 62, 171; Authorization Act § 5(xii).
[160] Tadashi Sato, *Kōzō Kaikaku-kii to Hanshin Awaji Dai-Shinsai [The Structural Reform*

via the internet is not required, 86% of public-interest corporations publish information through their websites.[161] The Cabinet Office publishes information and statistics on public-interest corporations online on behalf of the Public-Interest Commission, as required by statute.[162] Many non-governmental organizations were established to provide logistical and other support for individual nonprofits. For instance, the Japan NPO Center was established in 1995 to serve as an information center for NPO corporations and other volunteer organizations.[163] The Japan Fundraising Association, which was created in 2009, began publishing statistical analyses and reports in 2010.[164]

However, it is noteworthy that most former public-interest corporations opted to continue as general corporations. They can be readily created and have no duty to disclose beyond publishing their balance sheet and retaining their financial statements for inspection by members and creditors.[165] Online disclosure is voluntary, and only 62.2% of general corporations publish information online.[166] The reduced transparency of these organizations means that the public (and the media) can no longer access their lists of directors (possibly former bureaucrats), cash flow statements (possibly government subsidies) or project plans (how the money is spent).[167]

G. Integration of the Nonprofit Sector

The Japanese nonprofit sector remains fragmented. Although the authorization and oversight procedure for public-interest corporations was consolidated under the Public-Interest Commission, school, religious, social welfare, and medical corporations remain outside of its jurisdiction.[168] Furthermore, the NPO corporations were introduced by 1998 statute and before the 2006 reform, they formed a nonprofit sector that is distinct from public-interest corporations.[169] In fact, when the government declared its intention to undertake the comprehensive reform of nonprofit legislation in 2002, the representatives of NPO corporations

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Period and Hanshin-Awaji Earthquake], in NIHON NO NPO-SHI: NPO NO REKISHI WO YOMU, GENZAI, KAKO, MIRAI [THE HISTORY OF JAPANESE NPO: READING THE HISTORY OF NPO, PRESENT, PAST AND FUTURE] 217 (Makoto Imada ed., 2006).

161 KŌEKI HŌJIN KYŌKAI & NIHON NPO SENTĀ [JACO & NPO Center], *Hi-Eiri Hōjinkaku Sentaku ni Kansuru Jittai Chōsa [Survey Report on the Selection of Nonprofit Entity Form],* 36 (February 2017).

162 Public Interest Corporation Authorization Act, § 57.

163 Sato, *supra* note 160, at 236.

164 Nihon Fando Reijing Kyōkai [JAPAN FUNDRAISING ASSOCIATION], KIFU HAKUSHO 2017 [GIVING JAPAN 2017] (2017).

165 General Corporation Act §§ 128, 129, 199.

166 JACO, *supra* note 154, at 34.

167 NHK CLOSE-UP MODERN TIMES INVESTIGATIVE TEAM, *supra* note 111, at 144-48.

168 For historical background, *see* nn. 31-35, and accompanying text.

169 Nobuko Matsumoto, *Recent Changes in Laws Regarding Nonprofit Corporations and Charitable Trusts in Japan,* 45 ZEITSCHRIFT FÜR JAPANISCHES RECHT /J. OF JAPANESE L. 129, 135 (2018).

lobbied extensively to remove them from the reform's scope.[170]

Nonetheless, there are signs that policy makers are beginning to view the nonprofit sector from a more comprehensive perspective.[171] When the governance mechanism for medical corporations was reformed in 2006, and that of social welfare corporations in 2016, a number of provisions were introduced that parallel the general corporation legislation. The directors of these corporations now owe statutory fiduciary duties,[172] and they and their board are accountable to the general meeting (if acting as an association) or separate board of councilors (if acting as a foundation).[173] Although school corporations have not undergone such thorough reform, as of 2014, their directors were assigned the statutory duty of loyalty to their corporation;[174] meanwhile, the same reform gave the Ministry of Education additional powers to monitor and intervene in schools found to be in breach of legal or government orders or improperly managed.[175] Furthermore, accounting standards, which were previously idiosyncratic in each corporate category, are now gradually harmonizing.[176]

Conclusion

A nation's charity sector cannot be reformed in one day. The twisted history of Japanese public-interest corporation legislation has meant that its nonprofit sector has long been divided into complex subsectors and governed by a kaleidoscope of legal norms derived from various civil and common law jurisdictions. Such an amalgam of legislation, which has been in conflict with indigenous charitable works from its inception, has undergone significant transformation over the years, while the government's supervisory role has shifted from direct control to a more detached approach towards ensuring sound fiduciary governance.

This chapter looked at Japan's continuous attempt toward a conceptual and comparative synthesis of fiduciary principles and the integration of the nonprofit sector. The assessment has revealed reasons to be both optimistic and cautious. While the greater emphasis on internal governance has generally been accepted, the limited number of court cases has made it difficult to assess how fiduciary principles are to be implement on the ground. The greater

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[170] Masayuki Deguchi, *Seido Tōgō no Kanōsei to Mondai: Garapagosuka to Gurobaruka [The Potential and Concerns with Systemic Integration: Galapagos and Globalization], in* SHIMIN SHAKAI SEKUTĀ NO KANŌSEI: 110 NENBURI NO DAIKAIKAKU NO SEIKA TO KADAI [THE POTENTIALS OF THE CIVIL SOCIETY SECTOR: ACHIEVEMENTS AND REMAINING ISSUES OF THE MAJOR REFORM IN 110 YEARS] 157, 160-63 (Masahiro Okamoto ed., 2015).

[171] Aya Okada, et al., *The State of Nonprofit Sector Research in Japan: A Literature Review,* 2 VOLUNTARISTICS REVIEW 1, 7-8 (2017).

[172] Social Welfare Act §§ 45-13, 45-16, 45-20, 64, 172; Medical Care Act §§ 46-6 through 46-6-4, 46-4(2), 46-5(3), 47-49-3.

[173] Social Welfare Act § 45-8 through 45-15, and Medical Care Act §§ 46-7, 46-8, 46-3 through 46-3-6; 45-8; 46-4-46-4-7.

[174] Private Schools Act § 40-2.

[175] *Id.* §§ 60, 63.

[176] Deguchi, *supra* note 35, at 9-10.

emphasis on transparency and newly created Public Interest Commission has also been received positively. While no new case of blatant abuse or corruption has surfaced under the new regime under 2006 legislation, and the Commission's periodic entries may have prevented potential abuse, the limited number of enforcement action makes it difficult to see the hidden abuse. While one can observe a steady effort to integrate the nonprofit sector and encourage healthy public-interest works, the sector has yet to overcome its excessive fetishism of entity forms.