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# Taking a Fresh Look at the Ghosn Case

Much of the commentary compares the wrong things. Here is what we should be looking at.

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The Shakespearean downfall of Carlos Ghosn, one of the world's best-known business executives, has focused unprecedented international attention on two aspects of Japan's legal system that are poorly understood abroad: corporate governance and criminal justice. Up to now, this "teachable moment" has been largely wasted: much of what has been written in English-language media has repeated a simplistic narrative. From the outset, while the Japanese press portrayed Ghosn as a greedy autocrat, the Western media saw him as the victim of a coup inside Nissan (aided by the Japanese government) to avoid a merger with Renault. Now, some ten months after Ghosn's dramatic flight to Lebanon, the criminal trial in Japan of Ghosn's former aide, Greg Kelly, may provide additional evidence to determine whether the case represents a failure of corporate governance, a failure of criminal justice, both, or neither.

But first one must avoid several common traps in comparing legal systems. The first is comparing "my theory with your practice" – that is, comparing an idealized version of one's own legal system with the nitty-gritty reality of another. The second is the tendency to resort to broad cultural generalizations and stereotypes about the other system, in this case Japan. The third is to assume that all societies share a common standard for what it means to have "good corporate governance" or "fair criminal justice" and use similar measures to achieve them.

Let's take the corporate governance and criminal justice debates in turn.

A Wall Street Journal editorial on the Ghosn case criticized Japan's corporate governance law as a "weapon" the Japanese used to "get rid of" Ghosn, adding that everyone knows Japan's corporate governance law "is defined by its opacity." In fact, the two major factors contributing to corporate governance weaknesses at Nissan were the presence of a controlling shareholder, Renault, and the long period – nearly 20 years – of executive control exercised by Ghosn. Neither of these factors is common, either in Japan or the U.S. Rather than revealing any systemic weaknesses in Japan's corporate governance system, the Ghosn case illustrates the risks of this specific structure at Renault-Nissan.

Renault seemed quite content to let Ghosn exercise unusual formal authority, such as deciding the nomination and compensation of directors. Ghosn's power became

increasingly entrenched over his time as Nissan's leader. He reportedly dominated the board of directors, with little open discussion. Ghosn's aide, Kelly, also reportedly exercised extraordinary powers on Ghosn's behalf, and dismissed internal questions concerning Ghosn's activities as interfering with "CEO matters."

From a corporate governance perspective, there is a good reason why CEOs generally do not serve for as long as 20 years. As illustrated by a famous case in the United States in the 1990s, where long-serving Disney CEO Michael Eisner allegedly made excessive payments to a short-lived Disney executive, a CEO who starts out being an effective company leader may, over time, end up being surrounded by yes-men and treating company assets as his own.

*The Ghosn case had its roots in a reform to increase transparency about executive compensation*

To illustrate a significant difference in corporate governance standards, we can look at the debate over Ghosn's executive compensation. Japan and the U.S. represent two extremes among advanced countries, with well-compensated CEOs in the US earning 10 times the compensation of their counterparts in Japan. In the Japanese system, a company president is typically a salaryman who rose through the ranks, and his compensation is calculated similarly to that of other executives. In the U.S., the CEO is often regarded as a "superstar" apart from other company personnel, and much of his

generous compensation is paid through stock options that reward providing a high return to shareholders as measured by an increase in stock price.

Nissan tried to essentially "split the difference" between Japanese and U.S. compensation standards, but ultimately did not satisfy anyone: Nissan feared criticism in Japan for Ghosn's high compensation, while Ghosn thought he was substantially underpaid compared to global peers such as the CEO of General Motors. When a new Japanese legal requirement in 2010 called for the disclosure of individual compensation for executives earning roughly one million dollars, Ghosn's disclosed compensation was cut in half compared to the prior year. Even so, he was still the highest paid executive in Japan. Thus, the Ghosn case had its roots not in any "opacity" of Japanese corporate governance rules, but in a reform to increase transparency about executive compensation.

Ghosn and Kelly claim that Ghosn's compensation disclosure was accurate since Nissan had no legal obligation to pay Ghosn the "other half" of his original compensation. However, both Nissan and Ghosn carefully tracked this "deferred compensation." Ghosn is also alleged to have diverted Nissan funds for personal purposes without following proper internal procedures and disclosure. Ghosn was ultimately indicted in Japan on four counts—two counts of false information disclosure concerning his compensation (for which Nissan and Kelly were also indicted) and two

counts of personal misuse of company funds, a more serious crime. For the two securities disclosure violations, the SEC in the U.S. also brought civil cases against Nissan, Ghosn and Kelly; Ghosn settled for a \$1 million fine without admitting wrongdoing.

Japan's criminal justice system has been even more strongly criticized in the Ghosn case than its corporate governance practices. Despite agreement by the Japanese and U.S. governments that Ghosn's compensation disclosures violated the law, Ghosn (and his lawyers) succeeded in focusing international attention on systemic weaknesses in Japan's criminal justice system, specifically its practice of detaining suspects for extended periods of time and not permitting attorneys to attend interrogations (a practice derided as "hostage justice"). This media strategy succeeded, in part, because the accusations contained an element of truth. The greatest weakness in Japanese criminal justice is its emphasis on extracting confessions through extended detention of suspects. However, the U.S. has a corresponding flaw: its reliance on plea bargaining. Defendants know that if they spurn the prosecutor's offer of a plea bargain and subsequently are convicted at trial, they will generally receive a significantly higher sentence – dubbed the "trial penalty." Thus, both systems have institutionalized forms of coercion in order to clear the bulk of criminal cases.

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Much of the commentary in the Ghosn case has highlighted a single statistic: Japan's purported conviction rate of 99%. However, this unfairly singles out Japan. This statistic is computed in Japan based on all prosecuted cases, including those with guilty pleas as well as contested cases. This is because all cases in Japan receive a full trial, even when the defendant pleads guilty. In the United States, where nearly 97% of federal criminal prosecutions are not tried because they end in plea bargains, the federal conviction rate would also exceed 99% percent if plea bargains were counted.

There are always significant gaps between the high ideals that underpin criminal justice systems in democratic societies and the messy reality of criminal procedure in practice. Systems in the U.S. and Japan have different strengths and weaknesses. It is hard to call Japan's system a "failure" when it has among the lowest rates of crime and incarceration in the world.

In Western media commentary about the Ghosn case, references to the U.S. were often idealized. Perhaps following the recent emphasis on stakeholder capitalism by CEOs of large U.S. corporations and protests related to the Black Lives Matter movement, we can utilize better-informed comparisons to have a more constructive public discussion. Kelly's trial in Tokyo allows us to revisit the issues of the Ghosn case and may provide us with a second chance to learn about another legal system and reflect on our own. I hope we take better advantage of the opportunity this time.

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