Japan

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CORPORATE ENTITIES

The joint stock company (*kabushiki kaisha*) (KK) is the vehicle most commonly used for business enterprises in Japan.

KKs are classified according to the stated capital of the company and the liability section of their latest balance sheet into:

- **Large companies.** These must be audited by accounting auditors (*see Question 27*). Large companies are KKs with either:
  - a stated capital of JPY500 million (about US$5.56 million) or more;
  - a total of JPY20 billion (about US$222 million) or more stated in the liability section of their latest balance sheet.
- **Small companies.** These are KKs that are not large companies.

KKs are also classified according to restrictions on transferring shares:

- **Close companies.** These are KKs with articles of incorporation (articles) that require the company's consent for all share transfers. A close company can omit a board of directors (board) (*see Question 2*).
- **Open companies.** These are KKs that are not close companies. An open Company must have a board, because its ownership and management are considered to be highly separate.

  Certain open companies can be listed on the Tokyo Stock Exchange (TSE) and other stock exchanges (listed companies).

Consequently, KKs are classified into four types:

- Large open companies.
- Large close companies.
- Small open companies.
- Small close companies.

The second common corporate entity is the limited company (*Yugen Kaisha*) which was established under The Limited Company Law, which was abolished on 1 May 2006. Such companies formed before 1 May 2006 are called special liability companies (*Tokurei Yugen Kaisha*) and are regulated as a type of KK. This type of company cannot be newly established after 1 May 2006.

In addition, there are:

- General partnership companies (*Gomei Kaisha*).
- Limited partnership companies (*Goshi Kaisha*).
- Limited liability companies (*Godo Kaisha*).

LEGAL FRAMEWORK

1. What is the regulatory framework for corporate governance and directors' duties?

Corporate governance and directors duties are generally regulated by:

- The Corporation Law 2005.
- The Enforcement Regulations for the Corporation Law 2006.
- The Accounting Regulations for the Corporation Law 2006.

Listed Companies are also regulated by:

- The Financial Instruments and Exchange Law 1948. Revisions to this law came into effect on 30 September 2007 and established new regulations, including the requirement for an internal control report for listed companies.
- The Listing Regulations and Disclosure Regulations published by the TSE and other stock exchanges.

All companies must establish their articles which regulate their corporate governance.

BOARD COMPOSITION AND REMUNERATION OF DIRECTORS

2. What is the management/board structure of a company? In particular:

- **Is there a unitary or two-tiered board structure?**
- **Who manages a company and what name is given to these managers?**
- **Who sits on the board(s)?**
- **Do employees have a right to board representation?**
- **Is there a minimum or maximum number of directors or members of the managerial and supervisory bodies?**

Structure and management

In principle, KKs must have a unitary board. A KK can be organised with or without committees. Close companies can be organised without a board.

Companies with a board can be divided into either of the following:

- **Companies without committees.** Directors are appointed at a general meeting of shareholders (general meeting) to make decisions as a board on corporate affairs. The board must appoint one or more representative directors who are responsible for executing the business of the company. This is the most common KK structure.
- **Companies with committees (*Iinkaisetchi-kaisha*).** These must have a nominating committee, an audit committee and a compensation committee. In a company with committees, directors are appointed at a general meeting to make decisions on corporate affairs as a board but may not directly execute the business of the company and instead must appoint one or more executive officers (*shikko-yaku*) to do so. Directors can concurrently serve as executive officers of the company. This structure was introduced on 1 April 2003. KKs with committees are rare. According to a survey of the Japan Corporate Auditors Association, there are only 72 companies with committees listed as of 8 July 2008, out of almost 4,000 companies that are listed in Japan.

With companies without a board, directors are appointed at a general meeting to make decisions. If a company has two or more directors, unless otherwise provided in the articles, a majority of directors make decisions on corporate affairs, which needs no formality as a board. Every director is responsible for executing the business of the company. This structure was introduced as of 1 May 2006.

Board members

This depends on the board structure (in both the following directors are board members):

- **Companies without committees.** Representative directors are responsible for executing the business of the company as well as serving in their capacity as directors. Corporate auditors with legal audit authority must attend all board meetings but are not members of the board (*see Question 27*).
- **Companies with committees.** Executive officers must attend board meetings when requested to do so, but are not members of the board.

Employees' representation

Employees are not entitled to board representation.

Number of directors or members

The statutory minimum number of directors varies:

- **Companies with a board.** Three directors are required.
- **Companies without a board.** Only one director is required.
- **Companies with committees.** The nominating committee, audit committee and compensation committee must each have three or more directors. A director can belong to multiple committees at one time.

There is no legal maximum number of directors. Generally, a company's articles specify the minimum and/or maximum number of directors a company can have.

3. Are there any age or nationality restrictions on the identity of directors?

Age restrictions

There is no age restriction on who can serve as a director. However, a person under the age of 20 must have his parents' consent before assuming office.

Nationality restrictions

There is no nationality restriction on who can serve as a director. The Legal Affairs Bureau requires that at least one representative director or executive officer of a KK be a resident of Japan. Only a natural person can serve as a director.

4. In relation to non-executive, supervisory or independent directors:

- **Are they recognised?**
- **Does a part of the board have to consist of them? If so, what proportion?**
- **Do non-executive or supervisory directors have to be independent of the company? If so, what is the test for independence or what makes a director not independent?**
- **What is the scope of their duties and potential liability to the company, shareholders and third parties?**

- **Recognition.** Non-executive directors, supervisory directors and independent directors are not legally recognised. However, an outside director is legally recognised. An outside director is a director who does not, and never has, managed the corporate affairs of the company or one of its subsidiaries as a director, executive officer, manager, or other employee and who is not currently an employee of the company or any of its subsidiaries.

- **Board composition.** This depends on the board structure:
  - companies without committees are not required to have any outside directors;
  - companies with committees must appoint outside directors to half of the seats of each of its nominating committee, audit committee and compensation committee.
- **Independence.** Outside directors need not be independent of the company. In practice, many companies appoint directors of their parent companies or with a business connection to these positions. There are no specific regulations for outside directors in listed companies. However, a listed company must disclose, in a corporate governance report, any relationships that it has with its outside directors as well as the reason why they are appointed as outside directors.
- **Duties and liabilities.** The scope of outside directors' duties and potential liability are generally equivalent to those of executive directors. If provided for in the company's articles, an outside director's liability to the company can be capped by agreement between the company and the outside director (*see Question 15*).

5. Are the roles of individual board members restricted? For example, can one person be the chairman and chief executive?

There are no legal restrictions on concurrent roles. The most senior representative director or executive officer is generally called president or chief executive officer (CEO). In practice, many presidents and CEOs are concurrently chairmen of the board, although some companies do separate these roles.

6. How are directors appointed and removed? Is shareholder approval required?

Appointment of directors

Companies without committees. Directors are appointed at a general meeting. Generally, the board decides who to nominate.

Companies with committees. Directors are appointed at a general meeting. The nominating committee decides who to nominate.

Removal of directors

A director can be dismissed at any time in a general meeting. In certain situations, shareholders can apply to the court for the dismissal of a director (*see Question 24*).

However, where the directors' terms of office are set out in the articles or appointment resolution, if a director is dismissed without justifiable reason before the expiration of his term, he can demand compensation from the company for consequential damages.

Shareholder approval

Unless otherwise provided for in the articles, an ordinary resolution is needed to appoint or remove directors. Unless otherwise provided in the articles, an ordinary resolution of a general meeting requires a majority vote, at which shareholders having a majority of the total voting rights (or other quorum as provided in the articles) are present.

The quorum for a resolution for appointing or dismissing directors cannot be reduced to shareholders representing less than one-third of the voting rights represented by all shareholders.

7. Are there any restrictions on a director's term of appointment?

Companies without committees

A director's term expires at the conclusion of the annual general meeting (AGM) for the latest accounting period ending within two years from his assumption of office. Directors' terms in open companies cannot be extended. In contrast, the articles of a close company may extend its directors' terms until the conclusion of the AGM for the latest accounting period ending within ten years from their assumption of office.

Companies with committees

A director's term expires at the conclusion of the AGM for the latest accounting period ending within one year from their assumption of office. It may not be extended in either open or close companies.

8. Do directors have to be employees of the company? Can shareholders inspect directors' service contracts?

Directors employed by the company

Companies without committees. Although it is not necessary, in practice, directors often concurrently serve as employees, except representative directors who cannot serve as employees.

Companies with committees. Employees cannot serve as directors of a company with committees but can serve as executive officers.

Shareholders' inspection

Shareholders are not entitled to inspect directors' service contracts.

9. Are directors allowed or required to own shares in the company?

Directors are permitted, but not required, to own shares in the company. An open company cannot require that a director be a shareholder.

10. How is directors' remuneration determined? Is its disclosure necessary? Is shareholder approval required?

Determination of directors' remuneration

Companies without committees. The articles, or a shareholders' resolution, determine directors' remuneration. Unless otherwise provided in the articles, an ordinary resolution is needed to determine directors' remuneration (*see Question 6, Shareholder approval*). The board usually decides on remuneration proposals. Generally, only the total amount of remuneration is decided at a general meeting; the board then determines the distribution of their remuneration (or delegates this task to the president).

Companies with committees. The compensation committee determines the amount of remuneration to be received by each director and executive officer. Shareholder approval is not required.

Disclosure

Open companies are required to disclose to shareholders the total amount of directors' remuneration in the business report. An open company with outside directors is required to disclose to shareholders the total amount of the outside directors' remuneration in the business report.

Shareholder approval

Any stock options to directors of a close company must be ratified by an extraordinary resolution, whether it is with or without committees. An extraordinary resolution requires a two-thirds majority vote at a general meeting at which shareholders having a majority of the total voting rights (or other quorum as provided in the articles) are present.

MANAGEMENT RULES AND AUTHORITY

11. How is a company's internal management regulated? For example, what is the length of notice and quorum for board meetings, and the voting requirements to pass resolutions at them?

Unless otherwise provided in the articles, the convocation must be done no later than a week before the date of the board meeting and the resolution requires a majority vote, at which a majority of the directors attend. A company's internal management is also regulated by the articles or other internal regulations (for example, the board's regulations). Generally, the board establishes important internal regulations. If not regulated by the articles, internal management is regulated by the board.

12. Can directors exercise all the powers of the company or are some powers reserved to the supervisory board (if any) or a general meeting? Can the powers of directors be restricted and are such restrictions enforceable against third parties?

Directors' powers

The approval of a general meeting is required and cannot be delegated to a board decision for certain matters, including:

- Amendments to the articles.
- Mergers, company splits, share exchanges, share transfers and transfers of business.
- Reduction of stated capital.
- Issuing new shares in a close company.
- Surplus dividends.

Surplus dividends can be delegated to the board in companies with a board of corporate auditors and accounting auditors or companies with committees and accounting auditors in which directors' terms are limited to one year by the articles.

See also *Question 2, Management*.

Restrictions

Representative directors or executive officers have power and authority to execute the business of the company, although, if required by the articles, the approval of a general meeting must be obtained for certain matters. However, these restrictions are not enforceable against a third party, unless the third party knew, or should have known of such restrictions.

13. Can the board delegate responsibility for specific issues to individual directors or a committee of directors? Is the board required to delegate some responsibilities, for example for audit, appointment or directors' remuneration?

Companies with a board

Companies without committees. The board often delegates responsibility for specific issues to the president, managing directors and operating officers (*shikko-yakuin*) who are employees of the company. However, the board cannot delegate decision-making powers for certain matters, including the following:

- Disposition or acceptance of a transfer of any important asset.
- Borrowing a significant amount of money.
- Appointment or dismissal of a manager or other important employee.
- Establishment, modification, or abolition of a branch office or other important organisational body.
- Issuing of bonds.
- Calling a general meeting.
- Establishment of the internal control system.
- Important corporate affairs.

Companies with committees. The board cannot delegate decision-making powers for certain matters including:

- Deciding on management's basic policies.

- Allocating executive officers' duties.
- Calling a general meeting.
- Establishment of internal control systems.

The nominating committee, audit committee and compensation committee each have their own authority and cannot further delegate their responsibilities.

Companies without a board

Directors cannot delegate decision-making powers for certain matters, including:

- Appointment or dismissal of a manager or other important employee.
- Establishment, modification, or abolition of a branch office or other important organisational body.
- Calling a general meeting.
- Establishment of the internal control system.

DUTIES AND LIABILITIES OF DIRECTORS

14. What is the scope of a director's duties and personal liability to the company, shareholders and third parties? Please distinguish between civil and criminal liability under each of the following (if relevant):

- **General duties.**
- **Theft and fraud.**
- **Securities law.**
- **Insolvency law.**
- **Health and safety.**
- **Environment.**
- **Anti-trust.**
- **Other.**

- **General duties.** A director must obey all laws and regulations, the articles and all resolutions adopted at a general meeting, and perform his duties faithfully. Directors are jointly and severally liable to the company for:
  - surplus dividends in violation of the legal limit. Liability is equal to the amount of unlawfully distributed dividends or cash;
  - giving shareholders any property interest which has been given to any person in connection with the exercise of shareholders' rights. Liability is equal to the value of the interest given;
  - performing any act in violation of any law or regulation, or of the articles.

  Liability is equal to the damage suffered by the company. A director who performs his duties in bad faith or with gross negligence and consequently causes damage to third parties is liable to those third parties.

- **Theft and fraud.** Any director, corporate auditor or executive officer who acts in breach of his duties for his own benefit or that of any third party, or to cause damage to the company, and actually causes damage to the company, is punishable by imprisonment with labour for a period of up to ten years or a fine of up to JPY10 million (about US$111,256).
- **Securities law.** Any director, corporate auditor or executive officer of a listed company who files a securities report that includes a materially false statement, is both civilly and criminally liable.
- **Insolvency law.** A director who performs his duties in bad faith or with gross negligence and consequently causes damage to the company can be personally liable under the Bankruptcy Law, the Civil Rehabilitation Law and the Corporate Reorganisation Law. A bankruptcy administrator, reorganisation trustee and creditors in civil rehabilitation proceedings can file an assessment of the director's liability to the court.
- **Health and safety.** Any director, corporate auditor or executive officer who violates certain health and safety laws is criminally liable.
- **Environment.** Any director, corporate auditor or executive officer who violates certain environmental laws is criminally liable.
- **Anti-trust.** Any director, corporate auditor or executive officer who violates certain provisions of the Anti-trust Law is criminally liable.

15. Can a director's liability be restricted or limited? Is it possible for the company to indemnify a director against liabilities?

There are several ways of restricting or limiting liability:

- A director can be exempted from liability with the unanimous consent of all shareholders.
- If a director has performed his duties in good faith and without gross negligence, the director can, by an extraordinary resolution (*see Question 10, Shareholder approval*), be partially exempted from liability for illegal acts or acts contrary to the articles, so that the director is not liable for damages in excess of:
  - in the case of a representative director, six times his annual remuneration;
  - in the case of an outside director, double his annual remuneration; and

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- in the case of other directors, four times his annual remuneration.

- In companies with corporate auditors or companies with committees, these resolutions can be delegated to the board in the articles.

- A company's articles can allow a company to contract that an outside director has limited liability if the director performs his duties in good faith and without gross negligence. This liability is limited to the larger of an amount:
  - determined in advance, within the range provided in the articles; or
  - equal to double his annual remuneration.

16. Can a director obtain insurance against personal liability? If so, can the company pay the insurance premium?

Directors can obtain directors' and officers' (D&O) liability insurance for personal liability, which indemnifies against the legal costs of a lawsuit and personal liability to a third party. Directors of listed companies generally have this insurance.

The portion of D&O liability insurance that can be paid by the company does not indemnify a director against personal liability, but a director can purchase additional insurance for this purpose and must pay the insurance premium himself.

17. Can a third party (such as a parent company or controlling shareholder) be liable as a de facto director (even though such person has not been formally appointed as a director)?

It is possible that a person who has not been formally appointed as a director but in reality manages the corporate affairs of the company can be found by the courts to be liable to a third party as a de facto director.

Where a corporate entity is abused or becomes a mere facade, it is possible to pierce the corporate veil so that a parent company or controlling shareholder can be liable to a third party. If a company is dominated as a tool by shareholders who have an illegal or unjust purpose, it may be identified as an abuse. If a company exists only in name and it is substantially the shareholders' personal business or one section of a parent company, it may be identified as a mere facade.

TRANSACTIONS WITH DIRECTORS AND CONFLICTS

18. Are there general rules relating to conflicts of interest between a director and the company?

In a company with a board, with or without committees, a director must obtain the prior approval of the board if he wishes to carry out a transaction causing a conflict of interest. A director may not participate in a resolution of the board in which he has a conflict of interest. A director having executed any transaction causing a conflict of interest must report the material facts of the transaction to the board without delay.

In a company without a board, a director must obtain prior approval of the general meeting if he wishes to carry out a transaction causing a conflict of interest.

19. Are there restrictions on particular transactions between a company and its directors?

The Corporation Law restricts transactions where directors (on behalf of themselves or a third party) directly compete with the company's business, or enter into contracts with the company. A director must obey the general rules relating to conflicts of interest if he wishes to carry out such transactions (*see Question 18*).

20. Are there restrictions on the purchase or sale by a director of the shares and other securities of the company he is a director of?

The Corporation Law does not restrict the purchase or sale of a company's shares and other securities by its directors. But a director who has important inside information about a listed company cannot purchase or sell the company's shares or other securities if this would constitute insider trading (*The Financial Instruments and Exchange Law*).

A director of a listed company who purchases or sells shares or other securities issued by the company must file a report with the Securities and Exchange Surveillance Commission. A director of a listed company who sells securities issued by the company within six months of acquiring them or purchases securities issued by the company within six months of selling them, is liable to pay any short-swing profits (that is, profits earned within six months of a trade) to the company.

DISCLOSURE OF INFORMATION

21. Do directors have to disclose information about the company to shareholders, the public or regulatory bodies?

The Corporation Law

All companies must maintain the following in their head office for five years and keep a copy of them in their branch offices for three years:

- Their balance sheet.
- Profit and loss statement.
- Shareholders' equity statement.
- Specific explanatory notes.

- Business report.
- Accounting report of the corporate auditors (if they exist).
- Accounting report of the audit committees (if they exist).
- Accounting report of the accounting auditor (if it exists).

Shareholders and creditors of the company can inspect or copy these documents.

In a company with a board, whether it is with or without committees, these documents are sent to shareholders when the AGM is convened.

The directors must explain any matter to shareholders that they are requested to at a general meeting unless there is a justifiable reason not to do so. The Corporation Law allows the directors wide discretion to determine, and does not limit, what constitutes a justifiable reason to refuse explanation, and it specifically states that justifiable reasons include:

- That the matter does not relate to the agenda of the meeting.
- The explanation would significantly impair the common interests of the shareholders.
- The explanation would infringe on the rights of the company or other people.
- The explanation requires an investigation.

Each small company must give public notice of their balance sheet or a summary of it. Each large company must give public notice of their balance sheet and their profit and loss statement. In both cases, the required information can, by a board resolution, be disclosed on the internet.

The Financial Instruments and Exchange Law

Listed companies must file two reports:

- Securities report.
- Quarterly report four times a year.

Certain companies that offer securities to the public must file the following two reports:

- Securities report.
- Semi-annual report.

These companies must also file an extraordinary report soon after the occurrence of certain actions or events specified by law.

The Disclosure Regulations published by the TSE or other stock exchanges

Listed companies must make quarterly disclosure and timely disclosure.

COMPANY MEETINGS

22. Does a company have to hold an annual shareholders' meeting? If so, when? What issues must be discussed and approved?

A company must generally hold an AGM within three months after the end of the accounting period. Financial documents in a company without accounting auditors are approved of in a different way to those of a company with accounting auditors (*see Question 27*).

Company without accounting auditors

The balance sheet, profit and loss statement, shareholders' equity statement, business report, and specific explanatory notes must be presented, and approved, at the AGM.

Company with accounting auditors

The balance sheet, profit and loss statement, shareholders' equity statement, business report, and specific explanatory notes are only reported to the company's AGM if both:

- The audit report of the accounting auditor states that the balance sheet and the profit and loss statement correctly represent the status of the assets and the profits or losses of the company in accordance with the law, regulations and the articles.
- The board of corporate auditors or audit committees accept the audit report of the accounting auditor.

Any other issue (for example, the appointment of directors, a proposal relating to the appropriation of profits or the disposition of losses) can also be discussed and approved at the AGM.

23. Can shareholders call a meeting or propose a specific resolution for a meeting? If so, what level of shareholding is required to do this?

Companies with a board

Shareholders that have 3% or more of the total voting rights continuously (it is not necessary to hold shares continuously for close companies) for at least the preceding six months, can demand a general meeting by submitting an agenda for the meeting and the reasons for holding one, to the directors. If the procedures for holding a meeting are delayed, the shareholders who made the demand can convene a general meeting with the permission of the court.

Shareholders that have 1% or more of the total voting rights, or 300 or more voting rights, continuously (it is not necessary to hold shares continuously for close companies) for at least the preceding six months, can demand that a certain matter be included in the agenda for a general meeting. This must be done no later than eight weeks before the date of the meeting.

Companies without a board

For companies without a board, all shareholders can demand that a general meeting be held and that a given matter be included in the agenda of the general meeting.

MINORITY SHAREHOLDER ACTION

24. What action, if any, can a minority shareholder take if it believes the company is being mismanaged and what level of shareholding is required to do this?

There are four main courses of action for a minority shareholder who believes that the company is being mismanaged:

- Shareholders can apply to the court for the dismissal of a director if all of the following apply:
  - there has been misconduct or a material act that is illegal or contrary to the articles in a director's performance of his duties;
  - the dismissal of the director is rejected at a general meeting;
  - the shareholders hold 3% or more of the total voting rights of all shareholders continuously for at least the preceding six months (it is not necessary to hold shares continuously in close companies); and
  - the application is filed within 30 days of the general meeting.
- Shareholders can demand that directors cease an act if all of the following apply:
  - any director performs (or is about to perform) an act that is outside the scope of the purposes of the company, or is illegal or contrary to the articles;
  - the act is likely to result in irreparable damage (or significant damage, where no corporate auditor with legal audit authority is appointed) to the company; and
  - the shareholders have held a share continuously for at least the preceding six months (it is not necessary to hold shares continuously at close companies).
- Any shareholder having held shares continuously for at least the preceding six months can make a written demand to the company to file a lawsuit to pursue the liability of company directors (it is not necessary to hold shares continuously at close companies). The shareholder can file the lawsuit on behalf of the company if the company either:
  - has not filed the lawsuit within 60 days of the demand; or
  - is likely to suffer irreparable damage due to the expiry of the period.
- If necessary for the exercise of his rights, a shareholder can demand to inspect or copy both the:
  - minutes of a board meeting by obtaining the permission of the court; and
  - accounting books of the company and related materials, if he has 3% or more of the total voting rights of all shareholders.

INTERNAL CONTROLS, ACCOUNTS AND AUDIT

25. Are there any formal requirements or guidelines relating to the internal control of business risks?

Small company without committees

There is no formal requirement for the internal control of business risks. However, it is the legal interpretation of some courts that directors must establish appropriate risk control systems.

Large company or company with committees

The board must, by resolution, establish the internal control system including business risk management.

Listed company

Listed companies must file an internal control report for business years starting on and after 1 April 2008. An internal control report includes a basic framework of internal control regarding financial reporting.

26. What are the responsibilities and potential liabilities of directors in relation to the company's accounts?

A director who commits accounting fraud can be civilly and criminally liable for breaching his general duties (*see Question 14*).

27. Do a company's accounts have to be audited?

KKs' accounts must be audited by the corporate auditors (*kansayaku*), audit committees (*kansa-iinkai*) and/or accounting auditors (*kaikei-kansanin*) as the case may be.

Corporate auditors

In companies with corporate auditors, accounts are audited by the corporate auditors, who are not required to have any accounting qualifications. Corporate auditors have authority to audit directors' execution. In principle, they have both legal and accounting authority. In small close companies, the authority of the corporate auditors can be restricted by the articles to accounting audit authority only. Companies with committees cannot have corporate auditors.

Companies with a board. In principle these companies must have one or more corporate auditor. Only a close company with an accounting counsellor can omit corporate auditors even if it is a company with a board. In addition, a large open company with a board must have a board of corporate auditors with at least three auditors.

Companies without a board. A large company without a board must have one or more corporate auditors. Small companies without a board need not have any corporate auditors.

Audit committees

In companies with committees, accounts are audited by the audit committee (directors of the committee are not required to have any accounting qualifications). The audit committee has authority to audit directors' and executive officers' execution. They have both legal and accounting authority.

Accounting auditors

In companies with accounting auditors, accounts are also audited by their accounting auditors who are either certified public accountants or an incorporated accounting firm. Large companies without committees or all companies with committees must have accounting auditors.

28. How are the company's auditors appointed? Is there a limit on the length of their appointment?

Corporate auditors

Corporate auditors are appointed at a general meeting to audit the accounting practices of the company and the legality of directors' actions. A corporate auditor cannot concurrently serve as a director, manager, executive officer or other employee of the company or any subsidiary of the company. The role of the corporate auditor is separate from the accounting auditor's role.

A corporate auditor's term expires at the conclusion of the AGM for the last accounting period ending within four years from their assumption of office. In order to secure the corporate auditors' authority and independence, their terms cannot be reduced.

Audit committees

Directors of the audit committee are appointed by the general meeting (*see Question 6 and 7*).

Accounting auditors

An accounting auditor is appointed at a general meeting to audit the accounting practices of the company.

The term of office of an accounting auditor expires at the conclusion of the AGM for the latest accounting period ending within one year from his assumption of office. Accounting auditors are, unless otherwise resolved at the AGM, deemed to have been reappointed at the AGM.

29. Are there restrictions on who can be the company's auditors?

Corporate auditors

A corporate auditor must be a natural person, but no age, nationality or residency restrictions apply. A corporate auditor is not required to have any accounting qualifications. For a company with a board of corporate auditors, at least half of the corporate auditors must be outside auditors, whose qualifications are similar to outside directors (*see Question 4*).

Audit committees

Directors of the audit committee are not required to have any accounting qualifications. At least half of the directors of the audit committee must be outside directors (*see Question 4*).

Accounting auditors

An accounting auditor is either a certified public accountant or an incorporated accounting firm. A certified public accountant who has a significant interest in the company or who has been a director or employee of the company during the preceding year cannot be appointed accounting auditor.

30. Are there restrictions on non-audit work that auditors can do for the company that they audit accounts for?

Corporate auditors

A corporate auditor can also provide non-audit work for the company they audit.

Accounting auditors

A certified public accountant who provides certain non-audit work (for example, management consultancy) to a company cannot be appointed as an accounting auditor.

31. What is the potential liability of auditors to the company, its shareholders and third parties if the audited accounts are inaccurate? Can their liability be limited or excluded?

Corporate auditors or accounting auditors who neglect their duties and cause damage to the company are jointly and severally liable for such damage.

There are several ways of restricting or limiting liability:

- If a corporate auditor or an accounting auditor has performed his duties in good faith and without gross negligence, he can, by an extraordinary resolution, be partially exempted from liability for illegal acts or acts contrary to the articles, such that he is not liable for damages in excess of double his annual remuneration. In companies with corporate auditors or companies with committees, these resolutions can be delegated to the board by the articles.
- A company's articles can allow a company to enter into a contract under which a corporate auditor or an accounting auditor has limited liability if he performs his duties in good faith and without gross negligence. Liability is limited to the larger of:
  - an amount determined in advance, within the range provided in the articles; or
  - an amount equal to double his annual remuneration.

Corporate auditors or accounting auditors who cause damage to a third party due to a false statement with respect to any material matter in their audit report are jointly and severally liable for damages to the third party. This does not apply to an accounting auditor who proves that he did not fail to exercise due care in the performance of his duties.

CORPORATE SOCIAL RESPONSIBILITY

32. Is it common for companies to report on social, environmental and ethical issues? Please highlight, where relevant, any legal requirements or non-binding guidance/best practice on corporate social responsibility.

There are no legal requirements on corporate social responsibility. However, some companies voluntarily report social, environmental and ethical issues.

ROLE OF COMPANY SECRETARY

33. What is the role of the company secretary in corporate governance?

There is no legal status corresponding to that of company secretary. It is generally considered that the function of the head of the general affairs department (*soumu-bucho*) is similar to a corporate secretary. He is generally an executive employee and sometimes serves as a director concurrently. Usually, the general affairs department deals with the shareholders of the company and internal concerns, including:

- Organising general meetings.
- Organising the board.
- Administering internal documents of the company.
- Administering the company's seal.

ROLE OF INSTITUTIONAL INVESTORS AND SHAREHOLDER GROUPS

34. How influential are institutional investors and other shareholder groups in monitoring and enforcing good corporate governance? Please list any such groups with significant influence in this area.

The Pension Fund Association has recently been active in monitoring corporate governance matters. The Pension Fund Association publishes the principles of corporate governance and the guidelines for the exercise of shareholder voting rights. Institutional Shareholder Services and other proxy voting advisories also have influence in corporate governance matters.

WHISTLEBLOWING

35. Is there statutory protection for whistleblowers (persons who disclose criminal activity or other serious malpractice within a company)?

The Whistleblower Protection Law protects whistleblowers. The guidelines for whistleblower protection were established by the Cabinet Office in July 2005.

REFORM

36. Please summarise any impending developments or proposals for reform.

After the Corporation Law completely came into effect on 1 May 2007, reform of corporation law has settled. There are no plans to drastically reform corporation law relating to corporate governance.

The Securities and Exchange Law was revised and became the Financial Instruments and Exchange Law. This revised law came into effect on 30 September 2007. The Financial Instruments and Exchange Law established new regulations, including the requirement for an internal control report for listed companies.

The internal control report system, which is applied from business years starting on and after 1 April 2008, is sometimes called J-SOX, because it was introduced with reference to the US Sarbanes-Oxley Act. The Financial Services Agency published the "Q&A about the Internal Control Report System" on 1 October 2007 and revised it on 24 June 2008. The Financial Services Agency also published on 11 March 2008 the "Eleven Misunderstandings about the Internal Control Report System" to defend this system against the suggestion that excessively conservative attitudes are apparent in it.

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