Corporate governance and directors' duties in Japan: overview

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CORPORATE GOVERNANCE TRENDS

1. What are the main recent corporate governance trends and reform proposals in your jurisdiction?

On 1 May 2015, the amendment to the Companies Act (Amendment) came into effect. A brief overview of the Amendment is provided below.

A new corporate governance model

Companies can now choose to become companies with a supervisory committee (*kansatouiinkai-secchi-kaisha*). Under this model, a company has a supervisory committee of directors (a majority of whom must be outside directors), instead of having non-director company auditors, which is the traditional model for a stock company (*kabushiki kaisha*) (KK)).

The members of the supervisory committee are elected by a resolution of the shareholders' meeting and separately from other directors. The members of the supervisory committee have broader audit and supervisory authority over the executive directors (members of the audit committee cannot be executive directors or employees of the company) compared to company auditors of traditional KKs.

Amendment to qualification for outside directors and outside company auditors

Directors, executive officers or employees (including managers) of the parent company or any of the parent company's subsidiaries and close relatives of directors and executives of the company are no longer eligible to be outside directors (*see Question 8*) and outside company auditors.

The Amendment does not mandate that listed companies have at least one outside director. However, it does order companies that must submit annual securities reports and that have no outside directors to explain why appointing an outside director on their board would be inappropriate (comply or explain rule). According to the Amendment, listed companies and companies that are required to submit annual securities reports must choose between either:

- Having at least one outside director.
- Having no outside directors on their board, but explaining why appointing an outside director would be inappropriate.

In addition, the Corporate Governance Code, which was established by the Tokyo Stock Exchange (TSE) based on a discussion by the Council managed jointly by the TSE and the Financial Services Agency (FSA) became effective on 1 June 2015. The Code adopts a principles-based approach so as to achieve effective corporate governance in each company's particular situation. Furthermore, the Code also adopts a "comply or explain" approach for implementation. Therefore, if, in its particular circumstances a company finds a certain principle inappropriate, such company does not need to comply with the principle, provided that the company fully explains the reason why it does not comply. For example, the Code provides that listed companies should appoint at least two independent directors.

CORPORATE ENTITIES

2. What are the main forms of corporate entity used in your jurisdiction?

Stock company (kabushiki kaisha) (KK)

A stock company (*kabushiki kaisha*) (KK) is the most common form of corporate entity in Japan. The answers below relate to KKs.

KKs are classified according to the transfer restrictions imposed on their shares. The classifications are as follows:

- **Close KKs.** These are KKs with provisions in their articles of incorporation (articles) that require the company's approval for any acquisition or transfer of the company's shares.
- **Open KKs.** These are KKs that are not close KKs. Generally, only securities issued by open KKs can be listed on a securities exchange in Japan.

LEGAL FRAMEWORK

3. Outline the main corporate governance legislation and authorities that enforce it. How influential are institutional investors and other shareholder groups in monitoring and enforcing good corporate governance? List any such groups with significant influence in this area.

Corporate governance and directors' duties are regulated by:

- The Companies Act.
- A company's articles.

Listed KKs are also regulated by:

- The Financial Instruments and Exchange Law.
- Securities Listing Regulations published by the securities exchanges (including the Corporate Governance Code). The Tokyo Stock Exchange (TSE) is the largest securities exchange in Japan.

The Ministry of Justice is the administrative authority in charge of the Companies Act (*www.moj.go.jp/ENGLISH/index.html*). The Legal Affairs Bureau is the authority responsible for company registration (*http://houmukyoku.moj.go.jp/homu/static*).

The Financial Services Agency (FSA) is the administrative authority in charge of the Financial Instruments and Exchange Law, and the regulation of listed KKs (*www.fsa.go.jp/en/index.html*). TSE is responsible for the regulation of listed KKs whose shares are listed on its exchange (*www.jpx.co.jp/english*).

The Pension Fund Association has been active in monitoring corporate governance matters. The Pension Fund Association publishes the principles of corporate governance and guidelines on the exercise of shareholder voting rights. Institutional Shareholder Services Inc. (ISS) and other proxy voting advisers also have influence in corporate governance matters.

4. Has your jurisdiction adopted a corporate governance code?

The Corporate Governance Code became effective on 1 June 2015 (*see Question 1*). The general principles that the code offers are:

- Securing the rights and equal treatment of shareholders.
- Appropriate co-operation with stakeholders other than shareholders.
- Ensuring appropriate information disclosure and transparency.
- Responsibilities of the board.
- Dialogue with shareholders for the purpose of achieving effective corporate governance.

CORPORATE SOCIAL RESPONSIBILITY AND REPORTING

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

There are no legally binding requirements relating to corporate social responsibility, although the Corporate Governance Code provides that companies should take appropriate measures to address social and environmental issues. Some listed companies voluntarily report social, environmental and ethical issues in securities reports or corporate governance reports.

BOARD COMPOSITION AND RESTRICTIONS

6. What is the management/board structure of a company?

Structure

Open KKs must have a board of directors (board), while close KKs can establish a board, if provided by its articles, but are not required to. A KK with a board can establish three committees, or a supervisory committee, if provided by its articles. Management structure varies accordingly.

KKs with board. The board must be unitary and has decision-making authority over the management of the company.

KKs with board and three committees. A KK with a board can establish three committees, which must consist of:

- A nominating committee.
- An audit committee.
- Compensation committee.

While both close KKs and open KKs can choose to have three committees, this is not common and, as of 1 August 2016, only 71 of the approximately 3,500 listed companies had three committees.

KKs with board and supervisory committee. A KK with a board can establish a supervisory committee. KKs with a supervisory committee have been widely adopted. Approximately 690 listed companies have chosen to become KKs with board and supervisory committee as of 1 August 2016.

Close KKs without board. Close KKs can choose not to have a board. If so, a majority of the directors has decision-making authority over the management of the company.

Management

KKs with board. The board must appoint one or more representative directors from among its directors to have authority to represent the company. Representative directors and other directors appointed by board resolution are responsible for carrying out the decisions made by the board and have the authority to represent the company.

KKs with board and three committees. The board must appoint one or more executive officers (*shikko-yaku*) and must appoint one or more representative executive officers from among the executive officers. These representative executive officers are responsible for carrying out the decisions made by the board or the executive officers and have authority to represent the company. The board can delegate to executive officers substantial decision-making authority over the management of the company. Directors can serve concurrently as executive officers.

KKs with board and supervisory committee. The board must appoint one or more representative directors from among its directors to have authority to represent the company. Representative directors and other executive directors appointed by board resolution are responsible for carrying out the decisions made by the board and have the authority to represent the company. The board can delegate to representative directors and other executive directors substantial decision-making authority over the management of the company, as long as the articles allow for such delegation, or the majority of directors are outside directors.

Close KKs without board. Each director of a close KK without a board is responsible for carrying out the decisions made by the majority of the directors, and has authority to represent the company unless a representative director is elected.

Board members

KKs with board/KKs with board and supervisory committee. All board members (including members of the supervisory committee) must be directors of the company. For KKs with a company auditor, company auditors must attend board meetings and must state their opinions where necessary.

KKs with board and three committees. All board members must be directors of the company. Executive officers must attend board meetings when requested by the board and provide explanations on matters requested by the board.

7. Are there any general restrictions or requirements on the identity of directors?

Age and gender restrictions

There are no age or gender restrictions on serving as a director.

Nationality restrictions

There are no nationality restrictions on serving as a director. Only a natural person can serve as a director.

8. Are non-executive, supervisory or independent directors recognised or required?

Recognition

Outside directors. Outside directors are directors who are not executive directors (*gyomushikko-torishimariyaku*), executive officers or employees (including managers) of the company, any of its subsidiaries, and the parent company or any of the parent company's subsidiaries, and who have never occupied any of these positions in the company or any of its subsidiaries in the past ten years.

Executive directors are representative directors, directors other than representative directors who are appointed by board resolution to execute the company's operations, and directors other than these two types of director who have executed the company's operations.

Independent officers. Independent officers are outside directors or outside auditors who are not likely to have a conflict of interest with the company's shareholders (*TSE Securities Listing Regulations*).

Outside auditors are company auditors who:

- Are not directors, accounting advisers, executive officers or employees of the company, or any of its subsidiaries.
- Are not directors, executive officers, company auditors or employees of the parent company.
- Are not executive directors (*gyomushikko-torishimariyaku*), executive officers or employees of any of the parent company's subsidiaries.
- Have never occupied the position of director, accounting adviser, executive officer or employee in the company or any of its subsidiaries in the past ten years.

Non-executive directors and supervisory directors. Non-executive directors are directors who are not executive directors. Supervisory directors are not recognised.

Board composition

KKs with board and three committees/supervisory committee. A majority of the members of each committee must be outside directors.

Listed KKs. Listed KKs must have one or more independent officers.

Independence

Outside directors. Directors, executive officers or employees (including managers) of the parent company or any of the parent company's subsidiaries, and close relatives of directors and executives of the company, are no longer eligible to be outside directors. However, in practice, directors of companies with a business relationship often serve as outside directors of a company.

Independent officers. A listed company must disclose its independent officers' details in its corporate governance reports. If an independent officer has certain relationships with the company (for example, is a main business partner, consultant or a major shareholder), this relationship must be disclosed for the designation of the individual as an independent officer. In addition, the Corporate Governance Code provides that the board of a listed company should establish and disclose its standards of independence for independent directors.

9. Are the roles of individual board members restricted?

There are no legal restrictions on the roles of individual board members.

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

Appointment of directors

Directors are elected by an ordinary resolution (*see Question 34*) at a shareholders' meeting. Generally, the board nominates directors or, in companies with three committees, this must be done by the nominating committee.

Removal of directors

Directors (other than directors who are supervisory committee members) can be dismissed at any time by an ordinary resolution of the shareholders' meeting. Directors who are supervisory committee members can be dismissed by an extraordinary resolution of the shareholders' meeting. Directors can seek damages for dismissal from the company if they are dismissed without justifiable grounds.

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

KKs without committees

A director's term of office continues until the end of the annual shareholders' meeting for the last fiscal year ending within two years after the director's election (in close KKs, this period can be extended to ten years).

KKs with three committees

A director's term of office continues until the end of the annual shareholders' meeting for the last fiscal year ending within one year after the director's election.

KKs with supervisory committee

The term of office of a director (other than a director who is a supervisory committee member) continues until the end of the annual shareholders' meeting for the last fiscal year ending within one year after the director's election. The term of a director who is a supervisory committee member continues until the end of the annual shareholders' meeting for the last fiscal year ending within two years after the director's election (this supervisory committee member's term cannot be reduced).

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

Directors employed by the company

KKs without committees. Although it is not necessary, in practice, directors often serve concurrently as employees of the company. This does not apply to representative directors, who cannot serve as employees.

KKs with three committees/KKs with supervisory committee. Directors who are members of three committees or a supervisory committee cannot serve concurrently as employees, including as managers of the company.

Shareholders' inspection

Shareholders do not have statutory rights to inspect directors' service contracts.

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

Directors are permitted, but not required, to own shares in the company. The articles of an open KK cannot stipulate that a director must be a shareholder.

DIRECTORS' REMUNERATION

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

Determination of directors' remuneration

KKs without committees. Directors' remuneration is determined by an ordinary resolution (*see Question 34*) at a shareholders' meeting. In practice, only the maximum aggregate remuneration for all of the directors is determined by a shareholders' resolution, and the board determines the distribution of the remuneration among the directors (or the board delegates these responsibilities to the representative director).

KKs with three committees. The remuneration for each director and executive officer is determined by the compensation committee in accordance with the remuneration policy prescribed by the committee. Shareholder approval is not required.

KKs with supervisory committee. The remuneration for directors who are members of a supervisory committee must be determined separately from that of other directors at a shareholders' meeting. In practice, the members of the supervisory committee determine the distribution of remuneration among the members of the supervisory committee and the board determines the distribution of remuneration among other directors (or the board delegates these responsibilities to the representative director).

Disclosure

An open KK must disclose the aggregate remuneration of all of its directors (in KKs with a supervisory committee this includes directors who are members of the supervisory committee and other directors) or the respective remuneration of each director to its shareholders in its business report. If directors are given stock options, the company must disclose an outline of the terms and conditions of the stock options granted and the number of directors who have the stock options. In its business report, a company with outside directors must make separate disclosures for outside directors and directors who are not outside directors.

In addition, a listed KK must disclose the following information in the securities report under the Financial Instruments and Exchange Law:

- The amount of remuneration and a breakdown by the type of payments (for example, salary, bonus, stock option or retirement payment) for each director, if his remuneration for the relevant fiscal year is JPY100 million or more.
- The total amounts of remuneration for directors and outside directors and a breakdown by the type of payments.

Shareholder approval

An extraordinary resolution at a shareholders' meeting (*see Question 34*) is required to grant stock options to directors of a close KK.

As a general rule, board approval must be obtained to grant stock options to directors of an open KK. However, an extraordinary resolution at a shareholders' meeting is required if:

- A payment is not received in exchange for the stock options and this lack of payment is particularly favourable to the directors.
- The amount to be paid for the stock options is particularly favourable to the directors.

General issues and trends

In Japan, directors' remuneration consists mainly of fixed cash compensation. Performance-based remuneration accounts for a relatively small portion of total remuneration and equity-based incentives such as stock options remain unpopular. The Corporate Governance Code provides that the remuneration should include incentives such that it reflects mid-to long-term business results and potential risk, as well as promote healthy entrepreneurship.

MANAGEMENT RULES AND AUTHORITY

15. 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?

A KK's internal management is regulated by the Companies Act, the articles, other internal regulations (for example, board regulations) or resolutions of the board.

Notice of a board meeting must be provided to each director (for KKs with company auditor, to each director and each company auditor) no later than one week before the day of the board meeting.

Resolutions at board meetings are approved by an affirmative vote of a majority of the directors present, where the majority of the directors entitled to participate in the vote are present. Directors with a conflict of interest cannot participate in the vote.

16. 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

Shareholders' approval is required for certain matters, including the following:

- Amending the articles.
- Mergers, company splits, share exchanges, share transfers, assignment of business and reduction of stated capital.
- Election or dismissal of directors and company auditors.
- Issuing new shares in a close KK.
- Dividends of surplus. However, KKs with board can provide in the articles that it can distribute a one-time interim cash dividend of surplus by board approval. In addition, in a company with an accounting auditor that has a board of company auditors, three committees or a supervisory committee, and the term of its directors is no more than a year, the responsibility to determine the distribution of dividends of surplus can be delegated to the board by the articles.

Restrictions

Close KKs without board. Shareholders' meetings can resolve any and all other matters regarding the company, and the directors must comply with the shareholders' resolutions.

KKs with board. Shareholders' meetings can resolve only the matters provided for in the company's articles and the Companies Act. A company's articles may require shareholders' approval and restrict the board's powers in relation to certain matters. However, these restrictions are not enforceable against third parties, unless the third parties knew or should have known of the restrictions. If the company issues class shares with veto rights, the board's powers may be restricted in relation to matters where the class shares have veto rights.

17. 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?

KKs with board

A board often delegates decisions on certain matters regarding the day-to-day operations to individual directors, such as representative directors or other executive directors. However, the board cannot delegate certain important company matters to individual directors, including:

- Disposing of or acquiring important assets.
- Incurring significant debt.
- Electing or dismissing important employees, including managers.
- Establishing, changing or abolishing important organisational bodies, including branch offices.
- Developing internal control systems.

KKs with board and three committees

The board has decision-making authority over the management of the company, including matters that cannot be delegated to individual directors, such as basic management policy and development of internal control systems.

A board may delegate decision-making authority over the management of the company to the executive officers (in KKs with three committees) or representative directors and other executive directors (in KKs with a supervisory committee whose articles allow for such delegation, or who have a majority of directors who are outside directors). However, the board cannot delegate certain important matters (in addition to the matters mentioned above) including:

- Approval of a share transfer in close KKs.
- Contents of agreement or plan for mergers, company splits, share exchanges or share transfers.

DIRECTORS' DUTIES AND LIABILITIES

18. What is the scope of a director's general duties and liability to the company, shareholders and third parties?

Directors must perform their duties (*Companies Act*):

- With the care of a prudent manager.
- In compliance with all laws and regulations, the articles and resolutions of shareholders' meetings.
- In a loyal manner.

Directors who neglect their duties are liable to the company for resulting damages. Where directors are grossly negligent or knowingly fail in performing their duties, such directors are also liable to third parties or shareholders for resulting damages.

Directors are also liable to the company for the following:

- Distributions of surplus dividends or repurchase of shares that exceed the distributable amount under the Companies Act at the time of that distribution or repurchase of shares.
- The occurrence of a shortfall of the distributable amount under the Companies Act after the distributions of surplus dividends or repurchase of shares, at the end of the fiscal year when those distributions or repurchase took place.
- Giving property benefits to any person for the exercise of shareholders' rights.

However, if directors can demonstrate that they did not fail to exercise their duty of care in the performance of their duties, they will not be held liable. If there are two or more directors who are liable, they are jointly and severally liable to the company.

19. Briefly outline the regulatory framework for theft, fraud, and bribery that can apply to directors.

A director can be criminally liable for aggravated breach of trust if he both:

- Acts in breach of his duties for the purpose of promoting his own interests or the interests of a third party, or inflicting damage on the company.
- Causes actual financial damages to the company.

20. Briefly outline the potential liability for directors under securities laws.

Any director of a company that submits a securities report (*see Question 31*) containing misstatements of any important matter or engages in illegal insider trading may be subject to both civil and criminal liabilities.

21. What is the scope of a director's duties and liability under insolvency laws?

There is no specific liability owed by a director under the insolvency laws (for example, the Civil Rehabilitation Law, the Bankruptcy Law and the Corporate Reorganisation Law). However, a rehabilitation debtor, a bankruptcy administrator or an administrator can petition the court to assess a claim for damages, based on a director's liability under his general duties.

22. Briefly outline the potential liability for directors under environment and health and safety laws.

There are various environmental laws that regulate the actions of the company such as the Soil Contamination Countermeasures Act. Directors who violate environmental and health and safety laws can be subject to both civil and criminal liabilities.

23. Briefly outline the potential liability for directors under anti-trust laws.

Directors who violate anti-trust laws (for example, cartel activities and bid rigging) can be subject to both civil and criminal liabilities.

24. Briefly outline any other liability that directors can incur under other specific laws.

Directors who violate applicable laws such as tax laws, employment laws (for example, permission of illegal overtime work, unpaid work, sexual and other harassment, such as bullying or demeaning treatment in the workplace), and the Act on the Protection of Personal Information can be subject to both civil and criminal liabilities.

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

A director's liability to the company under the Companies Act can be restricted or limited as follows:

- A director can be exempted from liability with the unanimous consent of all shareholders.
- Directors that are both unaware of the wrongdoing and not grossly negligent in performing their duties, can be partially exempted from liability by an extraordinary resolution of shareholders' meeting (*see Question 34*), for damages in excess of the minimum liability limits, which are:
  - for representative directors, six times their annual remuneration;
  - for executive directors, four times their annual remuneration;
  - for other directors, double their annual remuneration.
- For KKs with company auditor that have more than two directors, or KKs with committee, decisions on a partial exemption of a director's liability can be delegated to directors (or to the board where there is one) by the articles.
- If the articles so allow, a company can contractually limit the liability of its directors (excluding executive directors) who are both unaware of the wrongdoing and not grossly negligent in performing their duties (*see Question 8*). Liability is limited to the larger of:
  - an amount determined in advance, within the range provided in the articles;
  - an amount equal to double the director's annual remuneration.

26. 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 that indemnifies them against the legal costs of a lawsuit, and personal liability to a third party and the company. The tax authority in Japan recently announced and clarified that the company can pay and bear the cost for the insurance premiums, if:

- These insurance premiums have been approved by a board of directors' meeting.
- There is approval by either:
  - a voluntary committee, the majority of which are outside directors; or
  - all of the outside directors.

27. 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)?

A person who has not been formally appointed as a director but who manages the company, may be found liable to a third party as a de facto director. For example, a person who is complicit in misrepresenting himself as a director on the corporate registry, or a person who mainly carries out management decisions with respect to the operations of the company, may be found liable to the company or a third party as a de facto director.

TRANSACTIONS WITH DIRECTORS AND CONFLICTS

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

Close KKs without board

If a director intends to carry out any transaction between the company and himself (for himself or a person other than himself) that results in a conflict of interest, an approval must be obtained at a shareholders' meeting. The director must disclose material facts about the transaction at a shareholders' meeting.

KKs with board

If a director intends to carry out any conflicting interest transactions, an approval must be obtained at a board meeting. A director with a conflict of interest cannot participate in the board meeting. A director must disclose material facts about the transaction at the board meeting. After the transaction, the director must also report material facts about the transaction to the board without delay.

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

Close KKs without board

An approval at a shareholders' meeting must be obtained if a director intends to carry out transactions that:

- Compete with the company (for himself or a person other than himself).
- Benefit himself or any third party.
- Involve any conflicting interest (including a guarantee given by the company for the benefit of a director) (*see Question 28*).

The director must disclose material facts on the transaction at a shareholders' meeting.

KKs with board

An approval at a board meeting must be obtained if a director intends to carry out transactions that:

- Compete with the company (for himself or a person other than himself).
- Benefit himself or any third party.
- Involve any conflicting interest (including a guarantee given by the company for the benefit of a director) (*see Question 28*).

The director cannot participate in the vote as he has a conflict of interest (*see Question 28*).

30. 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 Companies Act does not restrict the purchase or sale by a director of company's shares and other securities. However, some restrictions are imposed on a director of a listed company under the Financial Instruments and Exchange Law.

Under the insider trading rules, a director of a listed KK who has come to know material, non-public information on a company cannot purchase or sell the company's shares and other securities.

A director of a listed KK who purchases or sells shares or other securities issued by that company must submit a report to the authorities. A listed KK can require a director to return to the company short-swing profits, from certain transactions within six months.

DISCLOSURE OF INFORMATION

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

Companies Act

Under the Companies Act, a KK must keep the following documents at the head and/or branch offices:

- The articles.
- Shareholder registry.
- Minutes of shareholders' meetings:
- Minutes of board meetings (and committee meetings).
- Financial statements and business reports for each fiscal year, with supplementary schedules:

KKs with board must provide shareholders with financial statements and business reports approved by the board when giving a notice of an annual shareholders' meeting.

After the annual shareholders' meeting, a company must give public notice of the information of its balance sheet (for large companies (*see Question 37*), the balance sheet, and profit and loss statement) without delay.

Shareholders can inspect or copy these documents, but for KKs with company auditor or KKs with board and committee(s), court permission is required for minutes of board meetings or committee meetings.

Shareholders with 3% or more of the voting shares or issued shares can inspect and copy relevant accounts or materials.

Financial Instruments and Exchange Law

Listed companies have periodic reporting requirements and must submit annual and quarterly securities reports to the authorities. Certain unlisted companies (such as companies with 1,000 or more shareholders on the last day of the fiscal year) must submit annual and bi-annual securities reports to the authorities.

These companies must file, without delay, extraordinary reports on the occurrence of certain actions or events.

Listing regulations

Listed companies must promptly disclose certain material events, and must disclose summary reports on financial results on a quarterly basis (*TSE Securities Listing Regulations*).

SHAREHOLDER RIGHTS

Company meetings

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

Annual shareholders' meeting

A KK must hold an annual shareholders' meeting within three months of the end of each fiscal year.

Financial statements must be provided and approved at the annual shareholders' meeting. However, for companies with an accounting auditor (*see Question 40*) the contents of the financial statements need only be reported at the annual shareholders' meeting, and an approval of the financial statements by the shareholders is not necessary where all of the following requirements are satisfied:

- The accounting auditor's audit report states that financial statements correctly represent the status of the company's assets and profits or losses, in accordance with generally accepted accounting principles.
- The company auditors, the board of company auditors, the audit committee or the supervisory committee accepts the accounting auditor's audit.
- The company has a board.

The business report must be provided at the annual shareholders' meeting, and the directors must report its contents at the annual shareholders' meeting.

Any other issue provided by the Companies Act or the articles as matters that may be resolved by the shareholders' meetings (*see Question 16*) may also be discussed and approved at the annual shareholders' meeting.

33. What are the notice, quorum and voting requirements for holding meetings and passing resolutions?

Directors that are specified in the articles can convene board meetings by giving one week's notice to all directors (and company auditors in the case of KKs with a company auditor), but other directors can also demand that a board meeting be held when necessary by following certain steps. If the articles do not specify directors who can convene board meetings, any director can convene the meetings. Board meetings can be held as a teleconference, where each director can interactively communicate with each other.

Resolutions are passed with a simple majority of directors present at the meeting, and a quorum is represented by a majority of all directors with voting rights. A director who has a conflict of interest in a resolution cannot participate in that vote. A resolution can be passed by obtaining the written or electromagnetic consent of all directors (and company auditors) if provided in the articles.

34. Are specific voting majorities required by statute for certain corporate actions?

Most items can be resolved at a shareholders' meeting by a majority of the votes casts, where the majority of the shareholders entitled to vote are present (ordinary resolution). However, some material issues require a two-thirds supermajority of the votes cast, where a majority of the shareholders entitled to vote are present (extraordinary resolution). The material issues include:

- Amending the company's articles.

- Company mergers.
- Company demergers.
- Stock-for-stock exchanges.
- Stock transfers.
- Business transfers.
- Reduction of stated capital.
- Issuing new shares in a close KK.
- Issuing new shares at an especially favourable price.

In addition, an amendment of the articles that would cause an open KK to become a close KK, requires a majority of all shareholders entitled to vote and a two-thirds supermajority of the total voting rights.

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

Shareholders can require the directors to call a shareholders' meeting if they have held shares consecutively for the preceding six months or more that give them no less than 3% of the votes of all the shareholders.

In close KKs, shareholders can do this without having held the required shares consecutively for the preceding six months.

Certain shareholders can demand that the directors include an agenda at the shareholders' meeting. The level of shareholding required for this right varies according to the board structure:

- **Close KKs without board.** Any shareholder can demand that the directors include an agenda at a meeting.
- **KKs with board.** Shareholders can demand that the directors include an agenda at a meeting if they have held shares consecutively for the preceding six months or more that give them no less than either 1% of the votes of all the shareholders or 300 votes. In close KKs, shareholders can demand that the directors include an agenda at a meeting without having held the required shares consecutively for the preceding six months. The demand must be submitted no later than eight weeks before the shareholders' meeting.

Minority shareholder action

36. 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?

Minority shareholders who believe that the company is being mismanaged can:

- Demand the dismissal of officers by filing a court action, if:
  - they have held consecutively for the preceding six months or more no less than 3% of the total voting rights or of the issued shares;
  - there is misconduct or material violation of laws and regulations, or the articles in connection with the execution of officers' duties; and
  - the agenda containing the proposal for dismissal of these officers was refused by the shareholders' meeting.
- Demand that a director ceases an activity, if:
  - they have held one or more shares consecutively for the preceding six months or more; and
  - the director is, or is likely to be, acting in violation of laws and regulations or the articles, and is likely to cause irreparable damage to the company.
- Demand that the company files an action to pursue officers for their liabilities to the company if the shareholders have held one or more shares consecutively for the preceding six months or more. If the company does not file an action within 60 days, the shareholders can file an action on behalf of the company.
- File a petition for the election of a court inspector to investigate the status of the company's operations and/or finances, if:
  - the shareholders hold no less than 3% of the total voting rights or of the issued shares; and
  - there are sufficient grounds to suspect misconduct or violations of laws and regulations, or the articles in connection with the management of the company.

In close KKs, shareholders need not have held shares consecutively for the preceding six months or more in the first three actions above.

INTERNAL CONTROLS, ACCOUNTS AND AUDIT

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

KKs without committees

The requirements relating to internal control systems under the Companies Act vary depending on whether companies are large or small companies. Large companies are companies with either:

- Stated capital in the balance sheet at the end of the most recent fiscal year of JPY500 million or more.
- Total liabilities as of the end of its most recent fiscal year of JPY20 billion or more.

Companies not falling within the definition of a large company are small companies.

Boards of large companies must develop internal control systems that ensure compliance with laws and the articles by directors and company operations (*Companies Act*).

There is no formal requirement for internal control systems for small companies. However, some courts have found that directors must establish appropriate internal control systems in some circumstances. If a small company voluntarily develops such an internal control system, board approval is required.

KKs with three committees/supervisory committee

Regardless of size, boards must develop internal control systems that ensure compliance with laws and the articles by executive officers and company operations (*Companies Act*).

Listed KKs

Listed KKs must submit an internal control report that describes the systems in place to ensure the accuracy of financial accounting information and the financial report. In addition, listed KKs must disclose the status of its corporate governance (including organisation, related persons and process) in its securities report (*Financial Instruments and Exchange Law*).

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

Companies Act

If directors breach laws and regulations in relation to the company's accounts, such as accounting fraud, such acts will be a breach of a director's general duties (*see Question 18, General duties*) and result in the directors being liable to the company, third parties and shareholders for damages arising as a result.

If directors make false statements about important matters in financial statements and business reports, and their supplementary schedules, they can be liable to third parties or shareholders for damages arising as a result, unless they prove that they did not fail to exercise due care in the performance of their duties.

Financial Instruments and Exchange Law

If directors submit securities reports containing misstatements of any important matters, the directors can be both civilly and criminally liable for the misstatements (*see Question 18, Securities law*).

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

A company's accounts must be audited, unless the company chooses not to have a company auditor (*see Question 40*), where it is either:

- A small and close KK with a board (excluding KKs with committees) that does not have a company auditor, in which case it must have accounting advisers (*kaikei-sanyo*) to prepare its financial statements with directors.
- A small and close KK without a board.

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

Company auditors

Company auditors audit the execution of directors' duties including financial statements and are elected by resolutions at shareholders' meetings. Directors must obtain the consent of the company auditors to submit a proposal for the election of a company auditor.

Company auditors' terms of office continue until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within four years from the time of their election. Close KKs can extend the terms of office of company auditors until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within ten years from the time of their election.

While company auditors generally have authority to audit directors' execution of their duties, the articles of close KKs (excluding KKs with board of company auditors and KKs with accounting auditor) can limit the authority of company auditors to only accounting audits.

Audit committee

KKs with three committees do not have company auditors. Instead, the audit committee audits the execution of directors' duties including financial statements, while the accounting auditor audits the financial statements. Members of audit committees are appointed from among the directors by resolution at board meetings.

In KKs with three committees, the directors' terms of office continue until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within one year from the time of their election.

Supervisory committee

KKs with a supervisory committee do not have company auditors. Instead, the supervisory committee supervises and audits the execution of directors' duties including financial statements, while the accounting auditor audits the financial statements. Members of a supervisory committee are elected by a resolution at a shareholders' meeting, separately from other directors. In KKs with a supervisory committee, the terms of office of directors who are supervisory committee members continue until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within two years from the time of their election.

Accounting auditor

An accounting auditor audits the company's financial statements and is appointed at a general meeting of shareholders. Companies with three committees or a supervisory committee must have an accounting auditor and large companies (*see Question 37*) must have an accounting auditor in addition to company auditors. The company auditors, audit committee or supervisory committee propose candidates for the election of an accounting auditor.

Accounting auditor's terms of office continue until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within one year from the time of their election. An accounting auditor is deemed to have been re-elected at the annual shareholders' meeting, unless otherwise resolved at the annual shareholders' meeting.

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

Company auditors

A company auditor cannot concurrently serve as a director, employee (including manager), accounting adviser or executive officer of the company or of any of its subsidiaries.

For a company with a board of company auditors, there must be three or more company auditors and at least half of the company auditors must be outside company auditors, whose qualifications are similar to outside directors (*see Question 8*).

Audit committee/supervisory committee

Audit committee and supervisory committee must have three or more members, and the majority of members must be outside directors (*see Question 8*). A member of the audit committee or the supervisory committee who is not an outside director cannot concurrently serve as an:

- Executive officer or executive director of a company with committee or of its subsidiaries.
- Accounting adviser or employee (including manager) of a subsidiary of a company.

Accounting auditor

An accounting auditor must be a certified public accountant or an audit firm. A certified public accountant cannot serve as an accounting auditor if he has:

- A significant interest in the company.
- Been an officer or employee of the company during the preceding fiscal year.
- Provided certain non-audit work (such as management consultancy) to the company.
- Certain other relationships with the company.

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

Company auditors

A company auditor cannot do non-audit work that would violate the restrictions set out above.

Accounting auditor

A certified public accountant who serves as an accounting auditor cannot do certain non-audit work (such as management consultancy) for the company.

43. 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?

A company auditor or an accounting auditor who neglects his or her duties, such as through accounting fraud, is liable to the company for resulting damages. If the breach of duty is with the auditors' knowledge or gross negligence, he or she is liable to third parties or shareholders for damages arising as a result.

A company auditor or an accounting auditor who make false statements about important matters in audit reports is liable to third parties and shareholders for resulting damages, unless he or she can prove that he or she did not fail to exercise due care in the performance of their duties.

If an accounting auditor wrongly certifies that there are no misstatements in securities reports that are then submitted, the accounting auditor is subject to both civil and criminal liability (*Financial Instruments and Exchange Law*).

There are several ways of restricting or limiting liability under the Companies Act:

- A company auditor and/or accounting auditor can be exempted from liability with the unanimous consent of all shareholders.
- If a company auditor and/or accounting auditor is unaware of the breach and is not grossly negligent in performing his duties, the company auditor and/or accounting auditor can, by an extraordinary resolution of a shareholders' meeting (*see Question 34*), be partially exempted from liability for neglecting his duties, for amounts in excess of the minimum liability limit, which is double his annual remuneration. In KKs with company auditors that have more than two directors or companies with committees, decisions on partial exemption of a company auditor's and/or accounting auditor's liability may be delegated to directors (to the board where there is one) by the articles.
- If the articles so provide, a company can, through contracts with the company auditor and/or accounting auditor, limit their liability to the extent they are unaware of breaches and are not grossly negligent in performing their duties. Liability is limited to the larger of:
  - an amount determined in advance, within the range provided in the articles; and
  - an amount equal to double the annual remuneration.

44. What is the role of the company secretary (or equivalent) in corporate governance?

No legal position exists in a Japanese company corresponding to that of a company secretary, although the function of the head of the general affairs department (*soumu-bucho*) is similar. The position is generally held by an executive employee who sometimes concurrently serves as a director. The general affairs department handles shareholder matters and internal concerns of the company, including organising annual shareholders' meetings and board meetings, and preparing minutes of the meetings.

ONLINE RESOURCES

Japanese Ministry of Internal Affairs and Communications

W http://law.e-gov.go.jp/cgi-bin/idxsearch.cgi

Description. The official website maintained by the Ministry of Internal Affairs and Communications, which provides up-to-date information on Japanese laws and ordinances (including the Companies Act, the Financial Instruments and Exchange Law, and orders and ordinances related to them).

Japanese Law Translation, Ministry of Justice

W www.japaneselawtranslation.go.jp/?re=02

Description. The official website maintained by the Ministry of Justice, which provides up-to-date information on English translations of certain Japanese laws and ordinances (including the Companies Act, the Financial Instruments and Exchange Law, and orders and ordinances related to them).

Tokyo Stock Exchange

W www.jpx.co.jp/english

Description. The official website of the Tokyo Stock Exchange, which provides up-to-date information on its Securities Listing Regulations and their English translations.

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