

## 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?

##### Recent amendment and reform proposals

On 1 May 2015, the amendment to the Companies Act (Amendment) came into effect and introduced several reforms in terms of corporate governance. Further amendments to the Companies Act have been discussed currently and will likely include changes to the rules governing shareholder's proposal of agenda items for shareholders' meetings, directors' incentives.

In addition, the Corporate Governance Code (Code), which became effective on 1 June 2015 was amended on 1 June 2018 by the Tokyo Stock Exchange (TSE). The Code adopts a principles-based approach to achieving effective corporate governance for each company's unique situation. The Code adopts a "comply or explain" approach to implementation. Therefore, if a company finds a certain principle inappropriate to its particular circumstances, the company does not need to comply with the principle, provided that the company fully explains the reasons for noncompliance. The recent amendment to the Code establishes new principles, including principles designed to ensure objectivity and transparency in the appointment, dismissal and remuneration of directors.

##### Corporate governance models

The Amendment introduced a company with a supervisory committee (*kansatouinkai-secchi-kaisha*) in addition to the traditional company models: companies with corporate auditors and companies with committees. Companies organised under this new model have a supervisory committee of directors (a majority of whom must be outside directors), instead of 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 elected 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 with the company auditors of traditional Kks.

##### Rules regarding outside directors

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 have no outside directors to explain why appointing an outside director to the board would be inappropriate (the "comply or explain" rule). Accordingly,

open and large companies (see *Question 2 and Question 37*) that are required to submit annual securities reports must choose between either:

- Having at least one outside director.
- Having no outside directors on the board and explaining why appointing an outside director would be inappropriate.

The Code provides that listed companies should appoint at least two independent directors.

An amendment to the Companies Act which mandates that open and large companies required to submit annual securities reports have an outside director is currently under consideration.

### 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.

Kks are generally classified according to the transfer restrictions imposed on their shares, as follows:

- **Close Kks.** Kks that have provisions in their articles of incorporation that require the company's approval for any acquisition or transfer of the company's shares.
- **Open Kks.** Kks that are not classified as 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 stock companies (KCs) (see *Question 2*) 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.htm](http://www.moj.go.jp/ENGLISH/index.htm)). 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 KCs ([www.fsa.go.jp/en/index.html](http://www.fsa.go.jp/en/index.html)). TSE is responsible for the regulation of listed KCs whose shares are listed on its exchange ([www.jpx.co.jp/english](http://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 (ISS) and other proxy voting advisers also have influence in corporate governance matters.

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#### 4. Has your jurisdiction adopted a corporate governance code?

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The Corporate Governance Code (Code) became effective on 1 June 2015 and was amended on 1 June 2018 (see *Question 1*). The general principles of the Code are concerned with:

- 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 to achieve effective corporate governance.

### CORPORATE SOCIAL RESPONSIBILITY AND REPORTING

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#### 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.

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There are no legally binding requirements relating to corporate social responsibility. However, 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

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

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##### Structure

Open stock companies (KCs) (see *Question 2*) must have a board of directors (board). Close KCs can establish a board, if provided by

their articles, but are not required to. A KC with a board can establish three committees, or a supervisory committee, if provided by its articles. Management structure varies accordingly.

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

**KCs with a board and three committees.** A KC with a board can establish three committees, which are:

- A nominating committee.
- An audit committee.
- A compensation committee.

Although both close and open KCs with a board can choose to have three committees, this structure is not common. As of June 2019, only 70 of the approximately 3,600 listed companies had three committees.

**KCs with a board and supervisory committee.** A KC with a board can establish a supervisory committee. This structure has been widely adopted by KCs with a board. Approximately 940 listed companies had chosen to become KCs with board and supervisory committees as of June 2019.

**Close KCs without a board.** Close KCs can choose not to have a board. Decisions regarding the management of the company in close KCs without a board are made by a majority of the directors.

##### Management

**KCs with a board.** The board must appoint one or more representative directors from among its directors to whom the board delegates the authority to represent the company. Representative directors as well as 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 within the scope of the authority granted.

**KCs with a 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 substantial decision-making authority over the management of the company to the executive officers. Directors can serve concurrently as executive officers.

**KCs with a 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 substantial decision-making authority over the management of the company to representative directors and other executive directors, as long as the articles allow for such delegation or the majority of directors are outside directors.

**Close KCs without board.** Each director of a close KC 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

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

**KCs with a board and three committees.** All board members must be directors of the company. Executive officers must attend

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board meetings when requested by the board and provide explanations on matters requested by the board.

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

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### 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.

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

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### Recognition

**Outside directors.** Outside directors are directors who are not any of the following:

- Executive directors (*gyomushikko-torishimariyaku*), executive officers or employees (including managers) of the company (and any of its subsidiaries), and the parent company (and any of the parent company's subsidiaries).
- People who have occupied any of these positions in the company (or any of its subsidiaries) in the previous ten years.
- Close relatives of directors and executives of the company.

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 directors 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, 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 of the company or any of its subsidiaries in the previous ten years.
- Are not close relatives of directors and executives of the company.

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

### Board composition

**Stock companies (KCs) with a board and three committees or supervisory committee.** For KCs (*see Question 2*) with a board and committee(s), a majority of the members of each committee must be outside directors.

**Listed KCs.** Listed KCs 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, a consultant, or a major shareholder), this relationship must be disclosed upon 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 own standards of independence for independent directors.

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## 9. Are the roles of individual board members restricted?

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

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

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### Appointment of directors

Directors are elected by an ordinary resolution (*see Question 34*) at a shareholders' meeting. Generally, directors are nominated by the board, but in companies with three committees, directors must be nominated 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.

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

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### Stock companies (KCs) 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 KCs (*see Question 2*), this period can be extended to ten years.

### KCs 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.

### KCs with a 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).

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

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### Directors employed by the company

**Stock companies (KCs) without committees.** Although it is not necessary in KCs (see *Question 2*) without committees, in practice, directors often serve concurrently as employees of the company. This does not apply to representative directors, who cannot serve as employees.

**KCs with three committees or KCs with a supervisory committee.** Directors who are members of the 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.

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

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Directors can own shares in the company, however, they are not required to do so. The articles of an open stock company (KC) (see *Question 2*) cannot stipulate that a director must be a shareholder.

## DIRECTORS' REMUNERATION

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

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### Determination of directors' remuneration

**Stock companies (KCs) without committees.** For KCs (see *Question 2*) 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 directors is determined by a shareholders' resolution, and the board, with the authority delegated by the shareholders' resolution, determines the distribution of the remuneration among the directors (or the board delegates these responsibilities to the representative director).

**KCs 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.

**KCs with a 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 KC must disclose the aggregate remuneration of its directors (in KCs 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 stock options. In its business report, a company with

outside directors must make separate disclosures for outside directors and those who are not outside directors.

In addition, a listed KC 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 KC.

Generally, board approval must be obtained to grant stock options to directors of an open KC. 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

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## 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?

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For stock companies (KCs) (see *Question 2*), 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 KCs with company auditors, 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.

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## 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?

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### 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 stock company (KK) (see Question 2).
- Dividends of surplus. However, a KK with a 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, where 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 a board.** Shareholders' meetings can resolve any and all matters regarding the company, and the directors must comply with the shareholders' resolutions.

**Kks with a 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.

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### 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?

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#### Stock companies (Kks) with a board

For Kks (see Question 2) with a board, the board often delegates decisions on certain matters regarding the company's 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 a 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 establishment of basic management policy and the 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 to representative directors and other executive directors (in Kks with a supervisory committee whose articles allow for such delegation, or where a majority of the directors 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 agreements or plans for mergers, company splits, share exchanges or share transfers.

## DIRECTORS' DUTIES AND LIABILITIES

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

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Directors must perform their duties:

- 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.

(Article 644, Civil Code; Article 355, Companies Act.)

Directors who neglect their duties are liable to the company for the 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 the resulting damages.

Directors are also liable to the company for the following:

- Distributions of surplus dividends or repurchases of shares that exceed the distributable amount under the Companies Act at the time of the distribution or repurchase of shares.
- The occurrence of a shortfall of the distributable amount under the Companies Act after the distribution of surplus dividends or repurchase of shares, at the end of the fiscal year when those distributions or repurchases 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.

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

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

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

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

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Any director of a company that submits a securities report (see Question 37) containing misstatements of any important matter or engages in illegal insider trading may be subject to both civil and criminal liabilities.

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

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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

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the court to assess a claim for damages based on a director's liability under his/her general duties.

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

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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.

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

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

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

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Directors who violate applicable laws such as tax laws, employment laws (for example, permission of illegal overtime work, unpaid work, sexual and other forms of 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.

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

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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 who 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 a shareholders' meeting (see *Question 34*), for damages above the minimum liability limits, which are:
  - for representative directors, six times their annual remuneration;
  - for executive directors, four times their annual remuneration; and
  - for other directors, double their annual remuneration.
- For stock companies (KFs) (see *Question 2*) with company auditor(s) that have more than two directors, or KFs with committee(s), 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.

An amendment to the Companies Act is currently under consideration. This amendment (if passed) will allow companies to enter into agreements with directors under which the company will indemnify the relevant director(s) against certain liabilities arising from the performance of his/her duties.

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

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Directors can obtain directors' and officers' (D&O) liability insurance covering personal liability that indemnifies them against the legal costs of a lawsuit, as well as against personal liability to third parties and to the company. The tax authority in Japan recently stated that the company can pay and bear the cost of these insurance premiums, if:

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

An amendment to the Companies Act is currently under consideration. The amendment establishes the necessary procedures for executing D&O liability insurance contracts.

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## 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)?

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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/herself 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.

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## TRANSACTIONS WITH DIRECTORS AND CONFLICTS OF INTEREST

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

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#### Close stock companies (KFs) without a board

For KFs (see *Question 2*) without a board, if a director intends to carry out any transaction between the company and himself/herself (for himself/herself or for a person other than himself/herself) that results in a conflict of interest, approval for the transaction must be obtained at a shareholders' meeting. The director must disclose material facts about the transaction at a shareholders' meeting.

#### KFs with a board

If a director intends to carry out any transactions involving conflicts of interest, 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.

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

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### Close stock companies (KKs) without a board

For KKs (see *Question 2*) without a board, approval at a shareholders' meeting must be obtained if a director intends to carry out transactions that:

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

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

### KKs with a board

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

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

The director that is about to carry out such transaction cannot participate in the vote as he/she has a conflict of interest (see *Question 28*).

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## 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?

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The Companies Act does not restrict the purchase or sale by a director of the 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 stock company (KK) (see *Question 2*) who has come to know material, non-public information about 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

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

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#### Companies Act

Under the Companies Act, a stock company (KK) (see *Question 2*) must keep the following documents at the head and 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 a board must provide shareholders with financial statements and business reports approved by the board when giving notice of an annual shareholders' meeting.

After the annual shareholders' meeting, a company must give public notice of the information on 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(s) or KKs with a board and committee(s), court permission is required for inspection and copying of 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. They must also disclose summary reports on financial results on a quarterly basis (*TSE Securities Listing Regulations*).

## SHAREHOLDER RIGHTS

### Company meetings

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

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#### Annual shareholders' meeting

A stock company (KK) (see *Question 2*) must hold an annual shareholders' meeting within three months after 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 the 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.

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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.

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

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Directors (or the board, if the company has one) can convene shareholders' meetings by giving two-weeks' notice (one-week's notice in case of a close KK) to shareholders. However, shareholders, holding 3% or more of the voting rights for a period of six months or more, can also demand that a shareholders' meeting is held by following certain steps (see *Question 35*).

For ordinary agenda items, resolutions are passed by a simple majority of the votes cast, and a quorum is represented by a majority of the shareholders entitled to vote (see *Question 34*). A resolution can be passed by obtaining the written or electromagnetic consent of all shareholders.

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

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Most items can be resolved at a shareholders' meeting by a majority of the votes cast, 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 stock company (KK) (see *Question 2*).
- 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 resolution by a majority of all shareholders entitled to vote and a two-thirds supermajority of the total voting rights.

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### 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?

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Shareholders can require the directors to call a shareholders' meeting if the shareholders have held shares for at least the preceding six months and if their shares give them at least 3% of the total voting rights.

In close stock companies (KKs) (see *Question 2*), 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 item(s) at the shareholders' meeting. The level of

shareholding required for this right varies according to the company's board structure:

- **Close KKs without a board.** Any shareholder can demand that the directors include an agenda item(s) at a meeting.
- **KKs with a board.** Shareholders can demand that the directors include an agenda item(s) at a meeting if they have held shares for the preceding six consecutive months or longer that give them at least either 1% of the votes of all the shareholders or 300 votes. In close KKs, shareholders can demand that the directors include an agenda item(s) 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 relevant shareholders' meeting.

An amendment to the Companies Act is currently under consideration. If passed, the amendment will limit the number and content of agenda items that a shareholder can propose. This is to prevent abusive proposals.

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### Minority shareholder action

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### 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?

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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 at least 3% of the total voting rights or the issued shares for at least the last six months;
  - 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 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 stock companies (KKs) (see *Question 2*), shareholders need not have held shares consecutively for the preceding six months or more in the first three actions above.



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## INTERNAL CONTROLS, ACCOUNTS AND AUDITS

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

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#### Stock companies (KKs) without committees

For KKs (see *Question 2*) without a committee, 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 in 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. A board approval is also required if a small company voluntarily develops such an internal control system.

#### KKs with three committees or a supervisory committee

Regardless of size, boards must develop internal control systems that ensure compliance with laws and the articles by executive officers and in 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, a listed KK must disclose the status of its corporate governance (including organisation, related persons and process) in its securities report (*Financial Instruments and Exchange Law*).

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

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#### 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*) and the directors will be 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, or in 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*).

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

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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 stock company (KK) (see *Question 2*) 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.

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

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#### 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 stock companies (KKs) (see *Question 2*) 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.

Company auditors generally have authority to audit directors' execution of their duties. However, the articles of close KKs (excluding KKs with a board of company auditors and KKs with an 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

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company auditors, audit committee or supervisory committee propose candidates for the election of an accounting auditor.

Accounting auditors' 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.

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

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##### 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 and supervisory committee

An 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 a 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/she 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.

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

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##### Company auditors

A company auditor cannot do non-audit work that would violate the restrictions on auditors (see *Question 41*).

##### 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.

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#### 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?

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A company auditor or an accounting auditor who neglects his/her duties, such as through accounting fraud, is liable to the company for resulting damages. If the breach of duty is with the auditor's knowledge or gross negligence, he/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/she can prove that he/she did not fail to exercise due care in the performance of his/her duties.

If an accounting auditor wrongly certifies that there are no misstatements in securities reports that are then submitted, he/she 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 or accounting auditor can be exempted from liability with the unanimous consent of all shareholders.
- If a company auditor or accounting auditor is unaware of the breach and is not grossly negligent in performing his/her duties, he/she can, by an extraordinary resolution of a shareholders' meeting (see *Question 34*), be partially exempted from liability for neglecting his/her duties for amounts in excess of the minimum liability limit, which is double his/her annual remuneration. In stock companies (KKS) (see *Question 2*) with company auditors that have more than two directors or companies with committees, decisions on partial exemption of a company auditor's or accounting auditor's liability may be delegated to directors (or 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 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.

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

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No legal position exists in a Japanese company corresponding to that of a company secretary, although there are many company departments dealing with corporate governance. These include departments such as general administration, legal, management planning, investor relations and financial. Typically, general administration departments or the legal departments handle shareholder matters and internal concerns of the company, including organising annual shareholders' meetings and board meetings, and preparing minutes of these meetings.

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## Practical Law Contributor profiles

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