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CORPORATE GOVERNANCE AND DIRECTORS' DUTIES

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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 came into effect and introduced several reforms in terms of corporate governance, such as the introduction of a company with a supervisory committee (*kansatouiinkai-secchi-kaisha*) in addition to the traditional company models: companies with corporate auditors and companies with committees. Further amendments to the Companies Act were promulgated on 11 December 2019 (Amendment). The Amendment includes changes to the rules governing shareholders' meetings (such as provision of meeting materials to shareholders through the internet and a restriction on the number of shareholder proposals for agenda items), directors' incentives and outside directors. The Amendment will come into effect by June 2021; however, some portions, such as the provision of shareholder meeting materials through the internet will come into effect by June 2023.

The Corporate Governance Code (Code), which became effective on 1 June 2015 was amended on 1 June 2018 by the Tokyo Stock Exchange (TSE) (*see Question 4*). 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.

In addition, the Principles for Responsible Institutional Investors introduced in February 2014 (Stewardship Code) was revised on 24 March 2020. The Stewardship Code sets out principles that are considered helpful for institutional investors in fulfilling their stewardship responsibilities with regard for both their clients and beneficiaries and the investee companies. The recent amendment to the Stewardship Code emphasises consideration for environmental, social and governance factors when making investment decisions, and establishes a new principle regarding the provision of appropriate services to institutional investors by service providers, such as proxy voting advisors and investment consultants.

Rules regarding outside directors

Currently, the Companies Act does not require listed companies to have an 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.

After the conclusion of the first annual shareholders' meeting for the fiscal year-end after the Amendment enters into force, open and large companies required to submit annual securities reports must have at least one outside director.

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. As of 31 July 2018, 93.8% of Japanese corporate entities are KKs.

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

- **Close KKs (private companies).** 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. Close KKs are commonly used in Japan, especially for small and medium-sized companies.
- **Open KKs (public companies).** KKs that are not classified as close KKs. Generally, only securities issued by open KKs can be listed on a securities exchange in Japan. As of May 2020, approximately 3,700 companies are 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 (KKs) (*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). Although Securities Listing Regulations are binding on listed stock companies, some portions (including the Corporate Governance Code) constitute non-binding guidance. The Tokyo

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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/EN/index.html*). The Legal Affairs Bureau is the authority responsible for company registration (*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*).

As of 30 April 2020, approximately 280 institutional investors have accepted the Stewardship Code (*see Question 1*). Institutional investors have been active in monitoring corporate governance matters and many institutional investors have published their 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.

4. Has your jurisdiction adopted a corporate governance code?

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.

The Code adopts a principles-based approach to achieving effective corporate governance based on each company's unique situation. The Code adopts a "comply or explain" approach. Therefore, if a company considers a certain principle inappropriate to its circumstances, the company does not need to comply with the principle, but must fully explain the reasons for non-compliance. Listed stock companies (KKs) (*see Question 2*) are required to submit corporate governance reports describing the status of their compliance with the Code. As of 12 July 2019, 82.3% of listed KKs comply with more than 90% of the Code's principles.

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.

It is relatively common for companies to report on social, environmental and ethical issues. There are no legally binding requirements relating to corporate social responsibility. However, enhancement of the disclosure of governance information in securities reports has been actively discussed and such an atmosphere encourages listed companies to report voluntarily on social, environmental and ethical issues in their securities reports. In addition, the Corporate Governance Code (*see Question 1 and Question 4*) provides that companies should take appropriate measures to address social and environmental issues. As of January 2018, approximately 96% of the 225 major Japanese listed companies voluntarily published reports containing information regarding social, environmental, and ethical issues.

BOARD COMPOSITION AND RESTRICTIONS

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

Structure

Open stock companies (KKs) (*see Question 2*) must have a board of directors (board). Close KKs can establish a board, if provided by their 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 a board. The board must be unitary and has decision-making authority over the management of the company.

KKs with a board and three committees. A KK with a board can establish three committees within the board, which are:

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

Although both close and open KKs with a board can choose to have three committees, this structure is not common. As of May 2020, only 76 of the approximately 3,700 listed companies had three committees.

KKs with a board and supervisory committee. A KK with a board can establish a supervisory committee within the board. This structure has been widely adopted by KKs with a board. Approximately 1,030 listed companies had chosen to become KKs with a board and supervisory committee as of May 2020.

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

Management

KKs 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.

KKs 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.

KKs 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 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 a board or KKs with a 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 a 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.

Employees' representation

Employees are not entitled to board representation under the Companies Act.

Number of directors or members

Close KKs without a board. Close KKs without a board must have at least one director.

KKs with a board. A KK with a board must have at least three directors.

KKs with a board and three committees. A KK with a board and three committees must have at least three directors. Directors can serve concurrently as members of three committees.

KKs with a board and supervisory committee. A KK with a board and supervisory committee must have at least four directors (three supervisory committee members and one executive director).

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

General restrictions

The following persons may not serve as a director:

- A corporation.
- An adult ward, a person under curatorship or a person who is similarly treated under foreign laws and regulations.
- A person who has been sentenced to a penalty for having violated the Companies Act or certain other laws, where two years have not elapsed since the date on which execution of the sentence was completed or the sentence ceased to apply.
- A person who violated other laws and regulations, was sentenced to imprisonment or a more severe penalty and who has not completed the execution of the sentence or to whom the sentence still applies (excluding persons for whom execution of the sentence has been suspended).

The Amendment to the Companies Act to be enforced by June 2021 (Amendment) will delete the second restriction mentioned above and allow an adult ward, a person under curatorship and so on to become a director.

Age

There are no age restrictions on serving as a director.

Nationality

There are no nationality restrictions on serving as a director.

Corporate directors

Only a natural person can serve as a director.

Diversity

There are no legally binding diversity quotas. However, the Corporate Governance Code (*see Question 1 and Question 4*) provides that the board should be constituted in a manner designed to achieve diversity, including gender and international experience.

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 (or any of its subsidiaries) and any of the parent company's subsidiaries.
- Have not occupied any of these positions in the company (or any of its subsidiaries) in the previous ten years.
- Are not directors, executive officers or employees (including managers) of the parent company.
- If they filled any of the role of non-executive director, accounting advisor or company auditor within the company (or any of its subsidiaries) in the past ten years, had not been executive directors, executive officers or employees of the company (or any of its subsidiaries) within ten years before assuming those roles.
- Do not assume control of management of the company.
- Are not 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:

- Have not occupied the position of director, accounting advisor, executive officer, or employee of the company (or any of its subsidiaries) in the previous ten years.
- If they served as company auditors of the company (or any of its subsidiaries) in the past ten years, had not been directors, accounting advisors, executive officers or employees of the company (or any of its subsidiaries) within ten years prior to assuming those roles of company auditors.
- 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.
- Do not assume control of management of the company.
- 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; however, if a company has a supervisory committee or three committees, members of the supervisory committee or the audit committee supervise the management of the company.

Board composition

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

Listed KKs. Listed KKs must have one or more independent officers. Due to the Amendment to the Companies Act to be enforced by June 2021 (Amendment), open and large companies required to submit annual securities reports must have at least one outside director, and must appoint such director(s) on or before the conclusion of the first annual shareholders' meeting for the fiscal year-end after the Amendment enters into force (*see Question 1*).

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 not eligible to be outside directors. However, directors of companies with a business relationship are eligible to be outside directors, and often serve as outside directors of a company in practice.

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.

9. Are the roles of individual board members restricted?

There are no legal restrictions on the roles of individual board members. A chief executive officer of a company can concurrently serve as the chairman of the board. As of July 2018, 98.1% of the listed companies appointed the president or company chairperson as the chairman of the board. However, the Corporate Governance System Guideline published by the Ministry of Economy, Trade and Industry (revised in September 2018) encourages companies to appoint non-executive directors as the chairman.

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, 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.

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

Stock companies (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 (*see Question 2*), 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 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).

DIRECTORS' REMUNERATION

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

Directors employed by the company

Stock companies (KKs) without committees. Although it is not necessary in KKs (*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.

KKs with three committees or KKs 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.

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

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

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

Determination of directors' remuneration

Stock companies (KKs) without committees. For KKs (*see Question 2*) without committees, directors' remuneration is determined by the articles of incorporation or an ordinary resolution (*see Question 34*) at a shareholders' meeting. Approval by a shareholders' meeting is binding. 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).

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 a supervisory committee. The remuneration for directors who are members of a supervisory committee must be determined separately from that of other directors by the articles of incorporation or a shareholders' meeting. Approval by a shareholders' meeting is binding. In practice, only the maximum aggregate remuneration for members of the supervisory committee and other directors is determined by shareholders' resolution, and 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).

The Amendment to the Companies Act to be enforced by June 2021 (Amendment) will require that the boards of open and large KKs that must submit annual securities reports and KKs with a supervisory committee establish a policy for determining the remuneration to individual directors (excluding members of the supervisory committee), unless individual remuneration is established by the articles or a resolution of a shareholders' meeting.

Disclosure

An open KK must disclose the aggregate remuneration 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 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 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/her 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.

The Amendment is likely to require that open KKs disclose their policies for determining the distribution of remuneration to individual directors in their business reports.

Shareholder approval

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

Generally, board approval must be obtained to grant stock or 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 or stock options and this lack of payment is particularly favourable to the directors.
- The amount to be paid for the stock or stock options is particularly favourable to the directors.

The Amendment will change the above process and require that a resolution at a shareholders' meeting must be obtained in order to grant stock or stock options as remuneration for directors.

General issues and trends

The Corporate Governance Code (*see Question 1 and Question 4*) 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. Although performance-based remuneration (including equity-based incentives, such as stock options) accounts for a relatively small portion of total remuneration in Japan compared with American or European companies, it has been gradually increasing.

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?

For stock companies (KKs) (*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 KKs 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.

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 (*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.

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?

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.

DIRECTOR'S 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:

- 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.

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

Aggravated breach of trust. A director can be criminally liable for aggravated breach of trust under the Companies Act if he/she 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.

Bribery. A director can be criminally liable for giving or accepting a bribe under the Companies Act and/or Penal Code if he/she accepts, solicits or promises to accept property benefits in connection with his/her duties, in response to a wrongful request.

Fraud. A director can be criminally liable for fraud under the Penal Code.

Embezzlement. A director can be criminally liable for embezzling company property under the Penal Code.

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

Any director of a company that submits disclosure documents such as securities reports (*see Question 31*) and offering documents 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/her general duties.

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

There are various environmental laws (for example, the Soil Contamination Countermeasures Act and the Water Pollution Prevention Act) that regulate the actions of the company. 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, by engaging in 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 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.

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 who are both unaware of the wrongdoing and not grossly negligent in performing their duties (*see Question 18*) 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 (KKs) (*see Question 2*) with company auditor(s) that have more than two directors, or KKs 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 18*). 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.

The Amendment to the Companies Act to be enforced by June 2021 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 under certain disclosure requirements.

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 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. In 2016, the tax authority in Japan 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.

The Amendment to the Companies Act to be enforced by June 2021 will establish the necessary procedures for executing D&O liability insurance contracts as well as certain disclosure requirements.

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/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.

TRANSACTIONS WITH DIRECTORS AND CONFLICTS

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

As part of the duty of care and the duty of loyalty to the company (*see Question 18*), a director has a general obligation not to look to his/her own interests at the cost of the company's interests.

Close stock companies (KKs) without a board

For KKs (*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.

KKs 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.

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

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 (including receiving a loan from the company).
- 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 (including receiving a loan from the company).
- 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*).

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

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

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

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.

If an offering of securities by the company meets certain conditions, the company must submit a securities registration statement.

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

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 stock company (KK) (*see Question 2*) must hold an annual shareholders' meeting and in practice the meeting is generally held within three months after the end of each fiscal year.

Although it is not common, Japanese companies can hold hybrid-type virtual meetings where shareholders can participate or attend electronically, while a physical meeting is taking place simultaneously. Virtual-only meetings are not allowed.

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.

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 (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 six months or more, can also demand that a shareholders' meeting is held by following certain steps (*see Question 35*).

In addition, the Amendment to the Companies Act to be enforced by June 2023 will require that listed companies provide shareholder meeting materials through the internet at least three weeks before the shareholders' meeting.

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*). Officers and shareholders can participate in the meeting via teleconferencing, if prompt and interactive communication is possible. A resolution can be passed by obtaining the written or electromagnetic consent of all shareholders.

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 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.
- Dissolution.

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.

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 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.

The Amendment to the Companies Act to be enforced by June 2021 will limit the number of agenda items that a shareholder can propose to a maximum of ten. This is to prevent abusive proposals.

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:

- 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.
- 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.
- 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.
- Propose dismissal of a director as an agenda item at a shareholders' meeting, if:

- they have held shares consecutively for the preceding six months or more that give them at least 1% of the votes of all the shareholders or 300 votes; and
- the proposal is submitted no later than eight weeks before the relevant shareholders' meeting

- Demand the dismissal of officers by filing a court action, if:
  - they have held at least 3% of the total voting rights or of the issued shares for at least the last six months;
  - there is misconduct or a 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.

In close stock companies (KKs) (*see Question 2*), shareholders need not have held shares consecutively for the preceding six months or more in the last four actions above.

INTERNAL CONTROLS, ACCOUNTS AND AUDIT

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

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 the law 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*).

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*) 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 20*).

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 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.

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 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 also 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 also 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. Large companies (*see Question 37*) also must have an accounting auditor. The 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.

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*). There are no professional requirements for serving as a company auditor.

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*). There are no professional requirements for serving as a member of the audit committee or the supervisory committee. 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.

An audit firm cannot serve as an accounting auditor if:

- The firm has a significant interest in the company.
- A member of the firm who is involved in the audit work has been an employee of the company during the preceding fiscal year.
- The majority of the members of the firm have provided certain non-audit work (such as management consultancy) to the company.
- Certain other relationships with the company exist.

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 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. If an audit firm serves as an accounting auditor, the number of members who perform non-audit work must be less than half.

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/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.

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 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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