Chapter XX

JAPAN

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I OVERVIEW OF GOVERNANCE REGIME

i Sources of law and enforcement

In general, companies in Japan are regulated by the Companies Act.[2] Listed companies are also regulated by the Financial Instruments and Exchange Law (FIEL)[3] and the Securities Listing Regulations (SLRs) published by each securities exchange. In publishing these regulations, the securities exchanges generally follow the SLRs published by the Tokyo Stock Exchange (TSE), which is the largest securities exchange in Japan. For this reason, the information we provide hereafter focuses on the regulations published by the TSE, and references to 'SLRs' are to the TSE regulations.

In the event that a company violates the Companies Act, depending on the specific provision that is violated, shareholders or creditors of a company are generally entitled to bring a lawsuit against the company. The Financial Services Agency of Japan is responsible for enforcing the FIEL and, depending on the specific provision that is violated, may levy monetary fines, prison sentences, or both, in connection with certain violations thereof. SLRs are enforced by the specific securities exchange that published the applicable regulation. Violations of the SLRs generally lead to the securities exchange requiring that company to submit an improvement plan. In extreme cases, securities exchanges may even delist the shares of the company.

ii Nature and recent developments in the corporate governance regime

The Companies Act, which has been in effect since 2006, allows a company some flexibility with its governance organisation, such as whether to have a board of directors and whether to have a corporate auditor. Revisions to the SLRs on 30 December 2009, however, require a listed company to have one or more independent directors or corporate auditors (i.e., outside directors or corporate auditors (as defined below) who are not likely to have a conflict of interest with the company's shareholders). If an independent director or corporate auditor has business or other relationships with the company (e.g., if the director or corporate auditor is a main business partner, consultant or a major shareholder of the company), this relationship must be disclosed, and the reasons the person was appointed as an independent director or corporate auditor must also be provided in the company's corporate governance reports

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2 Act No. 86 of 26 July 2005.

3 Act No. 25 of 13 April 1948.

under the SLRs. Further, the Companies Act reform bill was enacted on 1 May 2015, and the Reform Act of 2015 states that if a large public company that is required under the FIEL to file a securities report does not have an outside director, it must explain the reason for this in its business report and at its annual shareholders' meeting; in addition, the Companies Act reform bill, which passed the Diet in December 2019 but has not yet been put into force,[4] requires a large public company that is required under the FIEL to file a securities report to have one or more outside directors. On 5 February 2014, the TSE announced a revision to the SLRs requesting that listed companies make efforts to elect at least one independent director because, in practice, most listed companies had elected an independent corporate auditor.

In addition, the TSE released Japan's Corporate Governance Code (the Code) on 1 June 2015, which was most recently revised on 1 June 2018.[5] The Code, which is applicable to all companies listed on securities exchanges in Japan, establishes fundamental principles for effective corporate governance, including a structure for transparent, fair, timely and decisive decision-making by companies, which pay due attention to the needs and perspectives of shareholders and those of customers, employees and local communities. The Code stipulates that listed companies should appoint at least two independent directors, and should examine whether the purpose of cross-shareholdings is appropriate and whether the benefits and risks from each holding cover the company's cost of capital.

There were essentially two types of governance systems in Japan prior to enactment of the Reform Act of 2015: a company with a corporate auditor and a company with committees.[6] In a company with a corporate auditor, the corporate auditor is an organisation that audits the directors' execution of their duties. This type of organisation is the primary type of company in Japan. On the other hand, in a company with committees (without a corporate auditor), three stipulated committees perform auditing and monitoring functions: a nominating committee that decides on the agenda of nominating or dismissing directors at shareholders' meetings; an audit committee that audits the execution of duties of executive officers and directors; and a compensation committee that determines compensation for each executive officer and director.

A majority of each of these committees must consist of outside directors. In a company with committees, because a board may delegate substantial parts of its decision-making authority over the management of the company to the executive officers, the board is expected to monitor the execution of the executive officers' duties rather than to make decisions (although a director can serve concurrently as an executive officer). This type of organisation was introduced in 2003 and is used by only a limited number of large companies in Japan.

The Reform Act of 2015 introduced another type of governance structure – a company with an audit committee – anticipating that this structure makes it easier for Japanese companies to select a monitoring model involving outside directors. A reduction of costs for selecting the monitoring model is achieved by decreasing the number of outside directors and

4 This Companies Act reform bill comes into force on 1 March 2021, provided that part of the reform bill, including the revision establishing the electronic provision system for shareholder meeting materials, comes into force on a day designated by cabinet order within three and a half years from the time of promulgation (i.e., 11 December 2019).

5 The Corporate Governance Code is available at www.jpx.co.jp/english/equities/listing/cg/tvdivq0000008jdy-att/20180601.pdf.

6 Following enactment of the Reform Act of 2015, companies with committees are now called companies with nominating committee, etc, but the meaning of the term is unchanged. As a matter of convenience, we hereinafter refer to this type of company as a 'company with committees'.

outside corporate auditors. A company with an audit committee is not required to possess a nominating committee or a compensation committee. The audit committee must have three or more directors as members, and the majority of them must be outside directors.

Of the companies listed on the first section of the TSE (the total being approximately 2,200), the number with an audit committee has reached more than 660 (roughly 30 per cent of the companies listed on the first section of the TSE). This is because, as previously discussed, being a company with an audit committee makes it possible for a listed company with a board of corporate auditors to decrease the number of outsiders. Although the Code stipulates that a listed company should appoint at least two independent directors, if a listed company has a board of corporate auditors, half or more of the corporate auditors need to be outside corporate auditors under the Companies Act. If a company with a board of corporate auditors transforms into a company with an audit committee, the requirement to retain outside corporate auditors would not be applicable.

II CORPORATE LEADERSHIP

i Board structure and practices

Structure and composition

Japanese companies generally use a one-tier board structure. Under the Companies Act, although a company may choose not to have a board of directors, the typical form of management structure is a company with a board of directors, where the board has decision-making authority. In a company without a board of directors, unless otherwise provided in the company's articles of incorporation (articles), a majority of the directors will decide business matters on behalf of the company. As compared with a company with a board of directors, however, shareholders of a company without a board have broader decision-making authority, such as the ability to approve certain competitive activities or to approve activities that result in conflicts of interest of directors.

A company with a board of directors is required to have three or more directors, whereas a company without a board is required to have only one or more directors. A company with committees must also have a board, and therefore is required to have three or more directors. A company with an audit committee is required to have a board as well, and therefore to have three or more directors. Furthermore, in a company with committees and a company with an audit committee, each committee must have three or more directors as members, and the majority of them must be outside directors. No director is required to be a representative of the employees of the company.

Legal responsibilities

Except for a company with committees and a company with an audit committee, a company with a board of directors generally must have a corporate auditor. In a company with a corporate auditor and a board of directors, the board has decision-making authority over the management of the company, and representative directors and other executive directors are responsible for executing the company management decisions. The corporate auditor generally audits the execution of duties by directors, with a view to compliance with law.

In a company with committees, while the board may have decision-making authority over the management of the company, it usually delegates substantial portions of this authority to executive officers, and executive officers are responsible for executing the company management decisions. Accordingly, for example, executive officers may be delegated the

authority to decide on the acquisition of important assets, incurrence of significant debt, appointment of important employees and establishment of important organisational changes, whereas these are matters that would be determined by a board of directors in a company with a corporate auditor. The board of a company with committees would then, *inter alia*, determine the agendas of shareholders' meetings, approve competitive activities and activities that result in conflicts of interests of directors, and appoint committee members. The audit committee audits the execution of duties by directors with a view not only to compliance with the applicable laws, but also the appropriate performance of their duties.

In a company with an audit committee, the core role of the board of directors is to set the basic management policy, develop the internal control system, and supervise the execution of business by other directors, including representative directors and other executive directors. Although important business decisions, such as disposing of or acquiring important assets, are required to be made by the board of directors, its shareholders can, through the company's articles, enable the board to delegate these decisions to individual directors, such as representative directors or other executive directors. In addition, if the majority of the board is held by outside directors, the board can delegate these decisions to individual directors, such as representative directors or other executive directors.

Delegation of responsibilities

In a company with a corporate auditor and a board of directors (which is typical of Japanese companies), the board often delegates decisions on certain matters regarding day-to-day operations to individual directors, such as representative directors or other executive directors. However, the board may not delegate certain important company matters to individual directors, including:

a disposing of or acquiring important assets;
b incurring significant debts;
c electing or dismissing important employees, including managers;
d issuing shares at a fair price; and
e approving audited financial statements.

In a company with committees, the nominating, audit and compensation committees each have their own authority under the Companies Act and cannot further delegate substantial parts of their responsibilities. Apart from the committees' responsibilities, the board has sole decision-making authority over the management of the company with respect to certain matters, which include basic management policy; matters necessary for the execution of the audit committee's duties; and if there are two or more executive officers, matters relating to the interrelationship between executive officers.

Similarly, in a company with an audit committee, the audit committee has its own authority and cannot further delegate a substantial part of its responsibility. Apart from the audit committee's responsibility, the board has sole decision-making authority over the management of the company with respect to certain matters, which include basic management policy and matters necessary for the execution of the audit committee's duties.

A board of directors in a company with committees often delegates decision-making authority over the management of the company to the executive officers (as described above). However, the board may not delegate certain important matters (in addition to

the above-mentioned matters) to executive officers (or to individual directors, because each individual director who does not double as an executive officer in a company with committees generally does not have decision-making authority), including:

a approval of share transfers (if the company is a closed company);
b holding of shareholders' meetings;
c appointment or removal of committee members;
d election or dismissal of executive officers; and
e determining the contents of agreements for mergers, demergers or share exchanges.

In a company with an audit committee, although important business decisions, such as disposing of or acquiring important assets, are required to be made by the board of directors, its shareholders can, through the articles, enable the board to delegate these decisions to individual directors, such as representative directors or other executive directors. If the majority of the board is made up of outside directors, the board can also delegate these decisions to individual directors, such as representative directors or other executive directors.

A board typically appoints a chief executive officer (CEO) or the equivalent from among its representative directors (in a company with a corporate auditor and a board of directors, and a company with an audit committee) or representative executive officers (in a company with committees). Generally, the CEO will chair the board meeting and will perform the role of chair of the board in this sense.

Remuneration of directors and executive officers

In a company with a corporate auditor and a board of directors, the aggregate amount of remuneration of all directors is determined at a shareholders' meeting (if not provided in the articles), and the board determines the remuneration of each director within the parameters of this aggregate amount; the board can delegate this authority to an individual director, typically the CEO. The same would apply to a company with an audit committee. In addition, in a company with an audit committee, the audit committee is given the power to express its view on the election, dismissal, resignation and compensation of other directors at the shareholders' meeting so that the shareholders can make an informed decision on these matters. The Companies Act reform bill, which passed the Diet in December 2019 and comes into force on 1 March 2021, requires (1) a large public company with a board of corporate auditors that is required under the FIEL to file a securities report and (2) a company with an audit committee to establish the company's policies for determination of the remuneration for each director, except when the remuneration for each director is determined by a shareholders' meeting or the articles.

However, in a company with committees, the compensation committee determines the remuneration of each director and executive officer in accordance with the remuneration policy prescribed by the committee (therefore, shareholders' approval is not required).

A public company (i.e., a company, typically listed, whose articles do not require, as a feature of all or part of its shares, the company's approval for any transfer of those shares, whether it is a company with a corporate auditor, a company with an audit committee or

a company with committees) must disclose the aggregate remuneration of all its directors, corporate auditors and executive officers to its shareholders in its business report.[7] In addition, a listed company must disclose the following information in its securities report:

a the amount of remuneration and a breakdown by type of payment (e.g., fixed compensation, performance-based compensation or retirement payment)[8] for each director, corporate auditor and executive officer if his or her remuneration for the relevant fiscal year is ¥100 million or more (of the 2,403 companies listed as of 3 September 2020, there were 531 directors, corporate auditors or executive officers who received ¥100 million or more as remuneration for the fiscal year ending March 2020);

b an explanation of the company's policies for determining an amount of or calculation method for remuneration of directors, corporate auditors and executive officers;

c for a company that pays directors, corporate auditors or executive officers performance-based compensation, an explanation of the company's policies on the payment ratio of performance-based compensation and non performance-based compensation (if any), indicators for performance-based compensation and reasons why the company chose those indicators, how the amount of performance-based compensation was determined, and the targets and performance for the indicators in the most recent fiscal year;[9]

d the name of a person or organisation who has the authority to determine an amount of or calculation method for remuneration of directors, corporate auditors and executive officers, an explanation of that authority, including the range of discretion;[10] and

e for a company with a committee, including an optional committee, which involves the establishment of company's policies for determination of an amount of or calculation method for remuneration of directors, corporate auditors or executive officers, an outline of procedures for involvement of the committee and activities of the board and the committee in the course of determination of an amount of remuneration of directors, corporate auditors and executive officers in the most recent fiscal year.

The Code stipulates that, in addition to making information disclosure in compliance with relevant laws and regulations, listed companies should disclose and proactively provide

7 The Ordinance for Enforcement of the Companies Act reform bill, which comes into force on 1 March 2021 to improve the level of disclosure regarding the remuneration of directors, corporate auditors and executive officers, requires public companies to disclose in their business reports roughly the same items that listed companies must disclose in their securities reports (as detailed in the following sentence).

8 Currently, the reform is being discussed to clarify that this breakdown by type of payment includes a breakdown of non-monetary compensation and other compensation if performance-based compensation includes non-monetary compensation.

9 To improve the level of disclosure regarding the remuneration of directors, corporate auditors and executive officers, a reform is being discussed to additionally require listed companies to disclose the contents of non-monetary compensation if performance-based compensation includes non-monetary compensation.

10 To improve the level of disclosure regarding director remuneration, a reform is being discussed to require a listed company with a board of directors (excluding a company with committees) whose board of directors actually delegates to a director or other person the authority to determine all or a part of the remuneration of each director (excluding a member of an audit committee) for the last fiscal year to disclose (1) that fact, (2) the name, position and charge of the person as of the date of determination, (3) the contents of the delegated authority, (4) the reason for the delegation, and (5) the contents of measures taken to ensure the delegated authority is exercised properly (if any).

information regarding their boards' policies and procedures for determining the remuneration of senior management and directors to enhance transparency and fairness in decision-making and ensure effective corporate governance.

Board and company practice in takeovers

The typical anti-takeover measure listed companies use is a 'precaution-type anti-takeover measure',[11] whereby a company announces a takeover process rule but does not issue any securities at first. Although there are many variations of this measure, generally a company announces in advance a certain takeover process rule to the effect that a takeover bidder must provide sufficient information to a board of directors about itself and the terms of its bid before the beginning of its takeover, and the bidder refrains from purchasing the shares of the company unless the board of the company completes its analysis of the terms of the bid (albeit that the analysis by the board must be completed within a certain period, such as 60 days). If these procedures are respected by the bidder, the board will not implement anti-takeover measures, but if the board decides that the value of the company would be damaged, or maximising value would be difficult under the takeover (including if the bidder does not comply with the procedures), usually based on analysis by a third-party committee, certain anti-takeover measures may be implemented, typically the issuance of share purchase warrants free of charge to all shareholders that cannot be exercised by the bidder.

The *Bull-Dog Sauce* case[12] was the first in which actual share purchase warrants were issued to shareholders as an anti-takeover measure. The Supreme Court found that the decision regarding whether control by a specific shareholder would harm the value of the company, or damage the common interests of shareholders, should be ultimately determined by the shareholders who hold its corporate value, and that if, at a shareholders' meeting, the shareholders decide that the takeover would harm the value of the company or damage the common interests of the shareholders, that decision should be respected. In this case, because the issuance of share purchase warrants was approved by more than 80 per cent of the voting rights, the Supreme Court found that the issuance was valid.

Since this case, we have seen fewer attempts at hostile acquisition.[13] In addition, a tender offer regulation under the FIEL was amended in 2007 to the effect that the offeror must disclose more information prior to the tender offer, and that the target company has the right to issue a questionnaire to the offeror. As a result, the total number of listed companies that have adopted anti-takeover measures has decreased for 12 consecutive years (from 570 at the end of July 2008 to 284 at the end of November 2020).

11 The Code stipulates that anti-takeover measures must not have any objective associated with entrenchment of the management or the board.

12 Supreme Court, 7 August 2007.

13 For example, most recently, in January 2020, City Index Eleventh Co Ltd commenced a hostile takeover bid against Toshiba Machine Co Ltd but withdrew the tender offer in response to anti-takeover measures approved by a shareholders' meeting of the latter. In January 2020, Maeda Corporation, through its wholly owned subsidiary Maeda Comprehensive Infrastructure Co Ltd, commenced a hostile takeover bid against Maeda Road Construction Co Ltd, successfully acquiring 26.46 per cent (up from its previously held 24.71 per cent and ultimately holding 51.29 per cent in total with Maeda Comprehensive Infrastructure Co Ltd). In July 2020, Colowide Co Ltd commenced a hostile takeover bid against Ootoya Holdings Co Ltd, with Colowide Co Ltd successfully acquiring 27.62 per cent (up from its previously held 19.16 per cent and ultimately holding 46.77 per cent).

ii Directors

Appointment, nomination, term of office

Directors are elected by a resolution at a shareholders' meeting. In a company with a corporate auditor and a board of directors, the board generally nominates directors to two-year terms of office, as a maximum (however, in a closed company, the term of office may be extended until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within 10 years of the time of its election). In a company with committees, the nominating committee nominates directors with one-year terms of office (as a maximum). Further, in a company with an audit committee, a director who is a member of the audit committee must be nominated separately from the other directors, and the statutory maximum term of office for a director who is a member of an audit committee is two years, whereas for other directors it is one year.

Directors can be dismissed at any time by a resolution at a shareholders' meeting. Directors can seek damages for dismissal if they are dismissed without justifiable grounds.

Liability of directors

Generally, directors must perform their duties with the duty of care of a prudent manager in compliance with all laws and regulations, and the articles and resolutions of shareholders' meetings, in a loyal manner.

In addition to the foregoing, the business judgement rule in Japan is applied when considering whether a certain decision of a director complies with the director's duty of care as a prudent manager to the company. Under the business judgement rule, even if a director has made a certain decision that has resulted in damage to the company, the director is deemed, in principle, to have complied with his or her duty of care of a prudent manager, unless the director made important and careless mistakes in the recognition of facts, or the process and content of the director's decision-making is particularly unreasonable or improper as determined by a management expert. Nevertheless, the courts are not likely to apply the business judgement rule if it can be shown that the director has a conflict of interest.

In the *Apamanshop* case,[14] the business judgement rule was affirmed by the Supreme Court. Apamanshop Holdings bought out the subsidiary's minority shareholders at a price per share higher than that set forth in the valuation report to make the subsidiary its wholly owned subsidiary. The Court cited the business judgement rule in finding that the directors of Apamanshop Holdings did not breach their duty of care, because a smooth purchase of the minority shareholders' shares was beneficial in maintaining good relationships with Apamanshop's member shops, who were shareholders of Apamanshop, the corporate value of the subsidiary after the restructuring was expected to increase and the decision-making process employed by Apamanshop's directors (i.e., the management committee convened to discuss the purchase and a legal opinion was obtained) was not found to be unreasonable.

The holding of directors and officers liability insurance policies[15] is a widespread practice; however, the Companies Act has no specific provision in this regard, and the procedure for conclusion of these types of insurance policies is not sufficiently clear. The Companies Act

14 Supreme Court, 15 July 2010.

15 Strictly speaking, 'directors and officers' in this paragraph and the next means directors, corporate auditors, executive officers and accounting auditors.

reform bill, which comes into force on 1 March 2021, establishes the procedure for conclusion of these insurance policies (i.e., approval of a shareholders' meeting or, for a company with a board of directors, approval of the board of directors).[16]

Further, in Japan, a common view is that a company may indemnify the losses or expenses of its directors and officers (which are limited to the liability they assume in these roles); however, the interpretation of the applicable limitations on and procedures for this indemnification has not been explicit. The Companies Act reform bill establishes rules under which companies (1) need to obtain approval of a shareholders' meeting (or approval of the board in companies with a board of directors) to decide the contents of any agreements to be executed for such an indemnification and (2) may indemnify their directors and officers against expenses incurred in defending an action involving their liability as directors and officers even if they were aware of wrongdoing or grossly negligent in performing their duties. However, a company may not indemnify its directors and officers against losses arising out of payment of compensation or settlement money to a third party involving their liability as directors and officers if those directors and officers were aware of wrongdoing or grossly negligent in performing their duties.[17]

Role and involvement of outside directors

Outside directors are defined under the Companies Act as directors who are not serving and who have not previously (generally for the past 10 years) served as executive directors, executive officers or employees (including managers) of the relevant company or any of its subsidiaries, its parent companies or its sibling companies. In a company with committees, a majority of the members of each committee must be outside directors, with each committee required to consist of three or more members. In a company with an audit committee, the audit committee must have three or more directors as members, and the majority of them must be outside directors. On the other hand, in a company with a corporate auditor and a board of directors, currently there are no such outside director requirements concerning board composition; however, the Companies Act reform bill requires a large public company that is required under the FIEL to file a securities report to have one or more outside directors.

The TSE requires listed companies to have one or more independent directors or corporate auditors (see Section I). Therefore, it is considered that, for example, persons who work for a company's parent company or its business partner, or consultants who receive significant fees from a company, cannot be independent directors or corporate auditors of the company. Further, on 5 February 2014, after submission of the Companies Act reform bill (which states that if a large public company that is required under the FIEL to file a securities report does not have an outside director, it must explain the reason why in its business report and at its annual shareholders' meeting), the TSE announced a revision to the SLRs that requests that listed companies make efforts to elect at least one independent director (see Section I).

16 In addition, the Ordinance for Enforcement of the Companies Act reform bill, which comes into force on 1 March 2021, requires public companies to make a disclosure regarding any directors' and officers' liability insurance policies that they conclude (e.g., an outline of the contents of these types of insurance policies) in their business reports.

17 In addition, the Ordinance for Enforcement of the Companies Act reform bill, which comes into force on 1 March 2021, requires public companies to disclose any such adopted indemnification (e.g., an outline of the contents of an agreement on such indemnification) in their business reports.

The Code stipulates that if the organisational structure of a company is either that of a company with a corporate auditor and a board of directors, or a company with an audit committee, and independent directors do not constitute a majority of the board, to strengthen the independence, objectivity and accountability of board functions in matters of nomination and remuneration of the senior management and directors, the company should seek appropriate involvement and advice from independent directors in the consideration of such important matters as nominations and remuneration by establishing independent advisory committees under the board, such as an optional nomination committee and an optional remuneration committee, to which independent directors make significant contributions.

Legal duties and best practice for outside directors

The legal duties of non-executive directors, including outside directors, are generally the same as those of other directors or executive officers. Where provided for in a company's articles, however, the company may contractually limit the liability (to the company) of its non-executive directors, including outside directors who are not aware of the wrongdoing and not grossly negligent in performing their duties to the extent of the larger of both an amount determined in advance, within the range provided in the articles, and an amount equal to double his or her annual remuneration.

Outside directors generally should review the performance of management, conflict of interest issues, the process and propriety of management decisions and general compliance, and work to improve the corporate culture. Although other directors should take on these roles as well, outside directors are expected to do so more effectively because of their objective position.

Many companies in Japan have organised third-party committees to audit or review conflict of interest issues, such as management buyout transactions, internal investigations and anti-takeover measures, and an outside director is often included as a member of the committee. As the Ministry of Economy, Trade and Industry formulated the Fair M&A Guidelines in June 2019, which stipulate that, in principle, if independent outside directors exist, it is advisable to select members of a special committee[18] from among those directors. Almost all of the special committees established recently in management buyout transactions or acquisitions of controlled companies by controlling shareholders include outside directors as members, respecting the Fair M&A Guidelines.[19]

In a company with a corporate auditor and a board of directors, a company with committees or a company with an audit committee, if a director intends to carry out any

18 Under the Fair M&A Guidelines: Enhancing Corporate Value and Securing Shareholders' Interests, a 'special committee' is defined as a deliberative body that is voluntarily established as an independent organ to supplement or substitute for the role that the target company's board of directors is originally expected to perform when structural conflicts of interest may affect the independence of the target company's board of directors and there is a risk that the goals of increasing corporate value and securing the interests of general shareholders may not be properly reflected in the process of formulating transaction terms.

19 Under the Companies Act, once an outside director executes the operations of a company, that director would not meet the outside director requirements, and the meaning of 'executes the operations of a company' is unclear; so as not to unreasonably restrict the performance of outside directors, the Companies Act reform bill, which comes into force on 1 March 2021, enables a company to delegate the execution of operations to outside directors by a decision of a director (as for companies with a board of directors, by a resolution of the board of directors) if there is a conflict of interest between the company and directors or executive officers or there is a risk of harming the interests of shareholders arising from execution by directors or executive officers.

transactions involving a conflict of interest, approval must be obtained at a board meeting in which that director may not participate. At the board meeting, the potentially conflicted director must disclose material facts about the transaction. After the transaction, the director must also report material facts about the transaction to the board without delay.

In addition, in a company with an audit committee, an *ex ante* approval by the audit committee of a self-dealing transaction between a director and the company has the effect of switching the burden of proof regarding the violation of a director's duty from the director to the plaintiff shareholders.

iii Auditors

In a company with a corporate auditor, the corporate auditor audits the execution of the directors' duties, including preparation of financial statements. If a company has a board of corporate auditors, the company is required to have three or more corporate auditors, and half or more of them must be outside corporate auditors. To ensure the independence of the corporate auditor, its term of office must continue until the conclusion of the annual shareholders' meeting for the most recent fiscal year, which ends within four years of its election (in a closed company, the term of office may be extended until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within 10 years of its election).

A company with committees does not have a corporate auditor. Instead, the audit committee, which consists of directors whose terms of office are one year (as a maximum), audits the execution of directors' duties, including preparation of financial statements (see Section II). Similarly, a company with an audit committee does not have a corporate auditor. In a company with an audit committee, which consists of directors whose terms of office are two years (as a maximum), the audit committee is responsible for auditing the execution of directors' duties, including preparation of financial statements.

In addition, a large company (i.e., one with either stated capital in the balance sheet at the end of the most recent fiscal year of ¥500 million or more, or total liabilities as of the end of its most recent fiscal year of ¥20 billion or more) and a company with committees are required to have an accounting auditor, which must be either a certified public accountant or an audit firm. An accounting auditor's term of office must continue until the conclusion of the annual shareholders' meeting for the most recent fiscal year, which ends within one year of their election.

To ensure the independence of corporate auditors, the following are given the power to determine the contents of proposals regarding the election and dismissal of accounting auditors to be submitted to a shareholders' meeting: a corporate auditor or a board of corporate auditors in a company with a corporate auditor, an audit committee in a company with committees and an audit committee in a company with an audit committee.

III DISCLOSURE

i Financial reporting and accountability

A representative director or representative executive officer must prepare a financial statement within three months of the end of each business year. A large company that is required to file a securities report under the FIEL (e.g., a listed company or a company with at least 1,000 shareholders as of the end of any fiscal year within the past five years is required to file a securities report) must prepare a consolidated financial statement under the Companies Act. However, the FIEL requires all listed companies to prepare a securities report that includes

consolidated financial statements (unless they do not have any subsidiaries to be consolidated under the FIEL), as well as a quarterly report. In addition, a representative director or representative executive officer of a listed company must submit a confirmation letter as an attachment to its securities report or other reports, in which he or she confirms that the description of the report is written properly in accordance with the FIEL.

A company with a board of directors must attach financial statements and business reports to the convocation notice of its annual shareholders' meeting. The company must also keep those documents at its head office for five years, beginning two weeks (one week, in the case of a company without a board) prior to the date of the shareholders' meeting. Under the FIEL, a listed company is required to file its securities report within three months of the end of its fiscal year.

ii Communications with shareholders

Under the Companies Act, directors, corporate auditors and executive officers must sufficiently explain the specific issues concerning the agenda of the shareholders' meeting if an enquiry is made by a shareholder at a shareholders' meeting. To improve investor relations, Q&A sessions during shareholders' meetings are now actively encouraged in Japan. Furthermore, Japanese listed companies often hold informal meetings with investors about financial statements and related issues.[20]

IV CORPORATE RESPONSIBILITY

i Internal control

Boards of large companies must develop internal control systems that ensure that directors comply with the laws and the company articles, and that company operations are appropriate. However, there is no legal requirement for internal control systems for companies that are not categorised as large companies or companies that do not have a board of directors.

Additionally, in a company with committees, regardless of its size, the board must develop internal control systems that ensure that executive officers comply with the laws and the articles, and that company operations are appropriate. A listed company must file internal control reports that describe the systems that are in place to ensure that the financial reports of the company are properly made in compliance with the laws.

Similarly, in a company with an audit committee, regardless of its size, the board must develop internal control systems that ensure that directors comply with laws and the company articles, and that company operations are appropriate.

Specific contents of internal control systems may be decided at the discretion of companies. In its internal control rules, a company often provides for general matters concerning the control of information and documents, crisis management systems, necessary internal rules and organisations, and compliance programmes, among other things.

20 The Code stipulates that listed companies should, proactively and to the extent reasonable, respond to requests from shareholders to engage in dialogue so as to support sustainable growth and increase corporate value in the mid to long term, and that the board should establish, approve and disclose policies concerning the measures and organisational structures aimed at promoting constructive dialogue with shareholders.

Under the Whistle-blower Protection Act, the employer of a whistle-blower is prohibited from treating the whistle-blower in any disadvantageous manner, such as by demotion or reducing his or her salary, if this is in response to the employee's whistle-blowing.[21]

ii Corporate social responsibility to employees and wider society

A company in Japan is required to hire a certain number of persons with a disability and to take measures to continue to employ elderly persons under affirmative action-related laws. Activities concerning corporate social responsibility by some companies involve actions to be taken in the interests of their stakeholders, such as preserving the environment, supporting volunteer work and creating jobs, although these are not generally required by law.

V SHAREHOLDERS[22]

i Shareholder rights and powers

Voting rights

In general, a company must treat its shareholders equally depending on the class and number of shares owned, and therefore each voting share has the same voting right. The Companies Act does allow for the following exceptions, however: certain minority shareholders' rights, such as rights to propose an agenda for a shareholders' meeting, to inspect accounting books and to apply to a court for dissolution of the company; and different treatment for each shareholder in closed companies in terms of rights to dividends or distribution of residual assets, or voting rights at shareholders' meetings pursuant to the articles.

In a company with a board of directors, matters provided for in the company's articles and the Companies Act may be resolved at a shareholders' meeting. In the sense that each director must observe resolutions passed at shareholders' meetings, shareholders have an influence on the board.

Under the Companies Act, shareholders' approval is required for certain matters, including the following:

a amending the articles;

b mergers, corporate demergers, statutory share exchanges, statutory share transfers, assignment of business and reduction of stated capital;

c election or dismissal of directors and corporate auditors; and

d decisions regarding dividends of surplus (if a company has an accounting auditor and a board of corporate auditors or committees, however, and the term of office of its directors is no more than one year, the authority to determine the distribution of dividends of surplus can be delegated to the board by the articles).

21 The Code stipulates that as a part of establishing a framework for whistle-blowing, companies should establish a point of contact that is independent of the management, and that internal rules should be established to ensure the confidentiality of the information provider and prohibit any disadvantageous treatment.

22 The Companies Act reform bill, which will come into force on a day designated by cabinet order within three and a half years of the date of promulgation (i.e., 11 December 2019), establishes an electronic provision system for materials (including business reports, financial statements, reference documents for shareholders' meetings, and voting right exercise forms) for shareholders' meetings. This aim of this reform is to reduce company costs for printing and sending materials for shareholders' meetings and to prompt early provision of materials for shareholders' meetings.

Rights of dissenting shareholders

Shareholders who object to the proposed agenda specifically listed under the Companies Act, such as certain amendments to the articles and certain mergers and acquisitions, may demand that the company purchase their shares at a fair price. This price will be determined through negotiation between the parties (i.e., the company and the dissenting shareholder) or by court decision. If a demand is made and the parties are able to come to an agreement on the share price, the company must make the payment to the dissenting shareholder within 60 days of the effective date of the transaction contemplated in the proposed agenda to which the dissenting shareholder objected. If the parties are unable to reach an agreement with regard to the share price within 30 days of the effective date, either the dissenting shareholder or the company may file a petition to a court for a determination of a fair price within 30 days of the expiry of the initial 30-day period.

In the *Tecmo* case,[23] the Supreme Court presented a framework for determining a fair price under appraisal proceedings if a joint share transfer (in which two or more companies form a new holding company under the Companies Act) creates synergies. In this decision, the Court found that:

a a fair price should, in general, be the value that the share should have had on the date on which the shareholder made a demand to the company for the repurchase of the share, on the assumption that the share transfer ratio designated in the share transfer plan is fair; and

b if a share transfer comes into effect through procedures that are generally recognised as fair, the share transfer ratio should be seen as fair unless special circumstances existed that hindered the shareholders' ability to make reasonable decisions in the shareholders' meeting.

ii Major shareholders' duties and practice

Under the Companies Act, shareholders do not owe duties to the company other than paying the required share capital contribution for the shares to which they have subscribed. However, under the SLRs, if a listed company conducts certain transactions with its controlling shareholder, such as issuing shares or conducting mergers or business alliances, the company must obtain an opinion from a third party who is independent of its controlling shareholder that the transaction would not undermine the interests of minority shareholders of the company.

There are no specific duties of controlling shareholders to the company or other minority shareholders under the Companies Act. In an extreme case where a controlling shareholder abuses the company or other minority shareholders (e.g., a transaction with the company involving extremely unfair consideration or a squeeze-out of minority shareholders at an extremely low price), it may be liable for the abusive acts under the Civil Code or other laws, although there are no clear-cut standards for this type of case.

23 Supreme Court, 29 February 2012.

iii Shareholder activism

Derivative actions

Under the Companies Act, a shareholder can demand that the company file an action to pursue, *inter alia*, directors or corporate auditors for their liabilities to the company if the shareholder has held shares of the company for the preceding six consecutive months or more. If the company does not file an action within 60 days of receipt of the demand from the relevant shareholder, the shareholder can file an action on behalf of the company.

Further, multiple derivative actions are allowed, subject to certain conditions, in which, *inter alia*, a director or corporate auditor of a company might be sued by a shareholder of the company's ultimate wholly owning parent company[24] as long as, *inter alia*, the shareholder owns 1 per cent or more of the total voting rights or outstanding shares of the ultimate parent company, and the book value of the shares of the company constitutes more than 20 per cent of the total assets of the ultimate parent company as of the date of occurrence of the underlying events that gave rise to relevant obligations of the director or corporate auditor.

Proxy battles

The FIEL stipulates the rules for proxy fights in listed companies. Under the FIEL, a shareholder or the company that solicits a proxy must provide the other shareholders with a certain set of documents (including a proxy and reference materials that set forth the agenda). It is generally considered to be difficult for a shareholder to embark on and succeed in such a proxy fight, mainly because the shareholder does not know the agenda of the shareholders' meeting until the convocation notice is sent by the company. In the past, because the Companies Act could be interpreted as allowing companies to refuse to provide the names, addresses and other information of other shareholders to a shareholder who wishes to solicit the proxy if the bidder is or works for a competitor of the company, the bidder could encounter even more difficulties. However, under the current Companies Act, even if the bidder is a competitor of the company, the company may not refuse to provide the information about other shareholders for that reason. In this sense, one of the hurdles to a shareholder embarking on a proxy fight would be alleviated.

iv Takeover defences

As described in Section II.i (Board and company practice in takeovers), the typical anti-takeover measure used by listed companies in Japan is a precaution-type anti-takeover measure. However, since the *Bull-Dog Sauce* case in August 2007, we have seen fewer attempts at hostile acquisition. In addition, the tender offer regulations under the FIEL were amended so that an offeror must now disclose more information prior to a tender offer and a target company has the right to issue a questionnaire to the offeror. In consequence, the number of listed companies that adopt anti-takeover measures has dropped slightly for 12 consecutive years.

24 The company that directly or indirectly owns 100 per cent of the shares of the 'subsidiary' company, but that is itself not a wholly owned subsidiary of any other company.

v Contact with shareholders

Under the Companies Act, directors, corporate auditors and executive officers must sufficiently explain the specific issues concerning the agenda of the shareholders' meeting if an enquiry is made by a shareholder at a shareholders' meeting. To improve investor relations, Q&A sessions during shareholders' meetings are now actively encouraged in Japan. Furthermore, Japanese listed companies often hold informal meetings with investors about financial statements and related issues.

VI OUTLOOK

The Reform Companies Act enacted in May 2015 has improved corporate governance (e.g., the comply or explain rule for the appointment of outside directors), and regulates the relationship between parent companies and their subsidiaries (e.g., clarifying the liabilities and rights of parent companies with respect to their subsidiaries (including derivative actions by shareholders of a parent company against the directors of its subsidiary)). In addition, the TSE formulated the Code in June 2015, which was revised in June 2018. The Code has established fundamental principles for effective corporate governance, including a structure for transparent, fair, timely and decisive decision-making by companies, which pays due attention to the needs and perspectives of shareholders, customers, employees and local communities. Further, the reforms to the Cabinet Office Ordinance on the Disclosure of Corporate Affairs, Etc enacted in January 2019 has improved the level of disclosure regarding the corporate governance of listed companies, including the remuneration of the directors of listed companies.

The Companies Act reform bill, which comes into force on 1 March 2021, further improves corporate governance, such as requiring a large public company that is required under the FIEL to file a securities report (1) to have one or more outside directors and (2) to establish company policies for determining the remuneration of each director.

Furthermore, a matter currently under discussion is whether to require companies that are to be listed on the new market segment, provisionally called 'prime market', of the TSE[25] to have one-third or more of their director positions assumed by independent outside directors. Corporate governance will continue to be a hot topic in Japan.

25 The TSE is contemplating an adjustment of its market segments (the current market segments include the first section, second section, Mothers and JASDAQ, and the contemplated new market segments include prime market, standard market and growth market; these names are tentative). The TSE explains that the prime market is for companies with highly liquid shares and high levels of governance and are committed to sustainable growth (and medium to long-term improvement of corporate value) that centres on constructive dialogue with investors.

APPENDIX 1: ABOUT THE AUTHORS

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Mitsuhiro Harada has been a partner in the M&A and corporate group at Nishimura & Asahi since 2010 and was previously seconded to the US international law firm Sullivan & Cromwell LLP in New York for one year. Mr Harada has represented both Japanese and non-Japanese buyers or sellers in numerous cross-border commercial transactions in various industries, including stock and asset acquisitions, private equity and venture capital investments and strategic alliances. Mr Harada also has been involved in acquisitions and joint ventures in and outside Japan, especially in the South East Asian countries.

Mr Harada graduated from the University of Tokyo (LLB) in 1999 and gained his LLM from New York University School of Law in 2006. He was admitted to the Japanese Bar in 2000 and the New York Bar in 2007.

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Mr Nakayama obtained his LLB from the University of Tokyo in 2004, and his LLM degree and the certificate of merit award in mergers and acquisitions from the University of Michigan Law School in 2012. Mr Nakayama was admitted to the Japanese Bar in 2005 and the New York Bar in 2013.

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