

Japan

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CORPORATE ENTITIES

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

Stock company (*kabushiki kaisha*) (KK)

A KK is the most common form of corporate entity used for business enterprises in Japan.

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

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

Limited company (*yugen kaisha*)

A limited company is a corporate entity established under the Limited Company Law (*yugen kaisha ho*), which was abolished on 1 May 2006. Limited companies established before 1 May 2006 can be converted into KKs by amending their articles. Alternatively, a company can continue to exist as a limited company and be regulated as a type of KK (*tokurei yugen kaisha*).

Other types of corporate entities used for business enterprises in Japan are:

- General partnership company (*gomei kaisha*).
- Limited partnership company (*goshi kaisha*).
- Limited liability company (*godo kaisha*) (GK).

The answers below relate to KKs.

LEGAL FRAMEWORK

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

Corporate governance and directors' duties are regulated by:

- Companies Act (*Act No. 86 of 2005*).
- Order for Enforcement of the Companies Act 2005.

- Ordinance for Enforcement of the Companies Act 2006.
- Accounting Regulations for the Companies Act 2006.
- A company's articles. All companies must establish articles that regulate their corporate governance.

Listed KKs are also regulated by:

- Financial Instruments and Exchange Law (*Act No. 25 of 1948*).
- Securities Listing Regulations published by the securities exchanges. The Tokyo Stock Exchange (TSE) is the largest securities exchange in Japan.

3. Has your jurisdiction adopted a corporate governance code?

In Japan, corporate governance is mainly regulated by the Companies Act, and for the listed KKs, the Financial Instruments and Exchange Law and the TSE Securities Listing Regulations (*see Question 2*). Therefore, no corporate governance codes have been adopted in Japan except for those adopted by private groups or entities, such as the Code of Conduct for Company Auditors (Code) issued by Japan Corporate Auditors' Association.

The Code comprises a set of principles and provisions, and contains guidelines (including best practice) for company audits by company auditors in large, mainly listed, companies (*see Question 27*).

The Code is not based on the comply or explain principle, and no penalty applies in cases of non-compliance. However, if a company auditor does not comply with the Code in performing his duty, this would provide a good basis to argue that he violated the duty of care of a prudent manager (*see Question 33*) and, therefore, should be liable for resulting damages.

The comply or explain approach has not been popular so far. However, the recent amendment to the regulation regarding outside directors and auditors under the Financial Instruments and Exchange Law and independent officers under the TSE Securities Listing Regulations (*see Question 6*) introduced a similar type of approach (for example, if a listed KK does not have outside directors or outside auditors, it must disclose this information in its securities report and state what type of governance system it has adopted in place and the reasons for doing so).



BOARD COMPOSITION AND REMUNERATION OF DIRECTORS

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

Structure

Open KJs must have a board of directors (board), while close KJs can establish a board, if provided by its articles, but are not required to. A KJ with a board can establish committees, if provided by its articles. The management structure varies accordingly:

- **KJs with board.** The board must be unitary and has decision-making authority over the management of the company.
- **KJs with board and committees (*iinkaisecchi-kaisha*).** A KJ with a board can establish committees, which must consist of:
 - a nominating committee;
 - an audit committee; and
 - a compensation committee.

While both close KJs and open KJs can choose to have committees, this is not common and, as of 1 June 2012, only 90 of the approximately 3,600 listed companies had committees (*Japan Corporate Auditors Association*).

- **Close KJs without board.** Close KJs can choose not to have a board. If so, and unless otherwise provided in the articles, a majority of the directors has decision-making authority over the management of the company.

Management

- **KJs with board.** The board must appoint one or more representative directors from among its directors to have authority to represent the company. Representative directors and other directors appointed by board resolution are responsible for carrying out the decisions made by the board and have the authority to represent the company.
- **KJs with board and committees.** The board must elect one or more executive officers (*shikko-yaku*) and must appoint one or more representative executive officers from among the executive officers (if there is only one executive officer, he is deemed to be the representative executive officer). 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 may delegate to executive officers substantial decision-making authority over the management of the company. Directors can serve concurrently as executive officers.
- **Close KJs without board.** Unless the company's articles provide otherwise, each director of a close KJ 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

- **KJs with board.** All board members must be directors of the company. For KJs with company auditor (KJs that have company auditors (excluding auditors whose scope is

limited by the articles to accounting audits (*see Question 30*)) or that are required to have company auditors under the Companies Act), company auditors must attend board meetings and must state their opinions where necessary.

- **KJs with board and 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.

Number of directors or members

The statutory minimum for the number of directors varies according to the company's management structure:

- **KJs with board.** Three or more directors are required.
- **KJs with board and committees.** Each committee must have three or more directors. A director can serve concurrently on multiple committees.
- **Close KJs without board.** One or more directors are required.

The Companies Act does not prescribe a maximum number of directors. Generally, the minimum and/or maximum number of directors is specified in the articles.

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

Age restrictions

There are no age restrictions on serving as a director. However, persons under the age of 20 must obtain their parents' consent before becoming a director.

Nationality restrictions

There are no nationality restrictions on serving as a director. The Legal Affairs Bureau requires that at least one representative director (or the representative executive officer for KJs with board and committees) of a company must be a resident of Japan. Only a natural person can serve as a director.

Gender

There are no gender requirements regarding directors.

6. 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 directors are representative directors, directors other than representative directors who are appointed by board resolution to execute the operations of the company and directors other than the first two types of director but who have executed the operations of the company), executive officers or employees (including managers) of the company or any of its subsidiaries, and who have never occupied any of these positions in the past (*Companies Act*).



Independent officers. Independent officers are outside directors or outside auditors (company auditors who have never served in the past as a director, accounting advisor, executive officer, or an employee (including managers) of the company or any of its subsidiaries) who are not likely to have a conflict of interest with the company's shareholders (*TSE Securities Listing Regulations*).

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

Board composition

KKs with board. There are no requirements relating to board composition.

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

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

Independence

Outside directors. There are no requirements relating to the independence of outside directors. In practice, directors of parent companies or companies with a business relationship often serve as outside directors of a company.

If a listed company has one or more outside directors, the company must disclose in its securities report both:

- The relationship between the company and the outside director(s).
- The details of the standards or policy regarding the independence of the outside director(s) from the company for the election of outside directors (if the company does not have these standards or policy, it must disclose this fact).

Independent officers. A listed company must disclose its independent officers' details in its corporate governance reports. If an independent officer has certain relationships with the company (for example, is a main business partner, consultant or a major shareholder), this relationship must be disclosed and reasons must also be provided for the designation of the individual as an independent officer.

Duties and liabilities

Outside directors, independent officers and executive directors' duties and liabilities are generally the same as for other directors or executive officers. Where provided for in its articles, a company can contractually limit outside directors' liability to the extent that they are not:

- Aware of the wrongdoing.
- Grossly negligent in performing their duties.

See *Question 17*.

7. Are the roles of individual board members restricted?

There are no legal restrictions on the roles of individual board members. In practice, a president often serves concurrently as chairman of the board, although some companies have separate individuals in these roles.

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

Appointment of directors

Directors are elected by a resolution at a shareholders' meeting. Generally, the board nominates directors or, in companies with committees, this must be done by the nominating committee.

Removal of directors

Directors can be dismissed at any time by resolution of the shareholders' meeting. Directors can seek damages for dismissal from the company if they are dismissed without justifiable grounds. If there is a possible shortfall in the number of directors prescribed in the Companies Act or the articles, the shareholders can elect substitute director(s) in advance at the same time as a shareholders' meeting is held to elect directors.

An ordinary resolution (*see Question 24*) is required for the election or dismissal of directors. However, the quorum for this resolution cannot be less than one-third of the votes of the shareholders who are entitled to cast their votes and the articles cannot reduce this minimum requirement.

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

KKs without committees

A director's term of office continues until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within two years after the director's election (unless the term is reduced by the articles or by a resolution at a shareholders' meeting). In close KKs, a director's term can be extended by the articles until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within ten years after the director's election.

KKs with committees

A director's term of office continues until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within one year after the director's election (unless the term is reduced by the articles or by a resolution at a shareholders' meeting).

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

Directors employed by the company

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

KKs with committees. Directors cannot serve concurrently as employees, including as managers of the company.

Shareholders' inspection

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



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

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

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

Determination of directors' remuneration

KKs without committees. Unless otherwise provided in the articles, directors' remuneration is determined by an ordinary resolution (see *Question 24*) at a shareholders' meeting. The board usually determines the proposed remuneration. In practice, only the aggregate remuneration for all of the directors is determined by a shareholders' resolution, and the board determines the distribution of the remuneration among the directors (or the board delegates these responsibilities to the representative director).

KKs with 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.

Disclosure

An open KK must disclose the aggregate remuneration of all of its directors or the respective remuneration of each director to its shareholders in its business report. If directors are given stock options, the company must disclose an outline of the terms and conditions of the stock options granted and the number of directors who have the stock options. An open KK with outside directors must make separate disclosures for directors and outside directors in the business report.

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

- The amount of remuneration and a breakdown by the type of payments (for example, salary, bonus, stock option or retirement payment) for each director, if his remuneration for the relevant fiscal year is JPY100 million or more.
- The total amounts of remuneration for directors and outside directors and a breakdown by the type of payments.
- The explanation of the company's policies for directors' remuneration and how remunerations are determined, if these policies are put in place.

Shareholder approval

An extraordinary resolution at a shareholders' meeting (see *Question 24*) is required to grant stock options to directors of a close KK.

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

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

MANAGEMENT RULES AND AUTHORITY

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

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

The length of notice and quorum for board meetings, and voting requirements for board resolutions, are regulated by the Companies Act and the articles.

Notice of a board meeting (which need not be in writing) must be provided to each director (for KKs with company auditor, to each director and each company auditor) no later than one week before the day of the board meeting, unless this period is otherwise shortened by the articles. This notice can be omitted when approved by all of the directors (for KKs with company auditor, all directors and company auditors).

Unless the articles provide otherwise, 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.

14. 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

Under the Companies Act, 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, accounting advisors (*kaikei-sanyo*) and company auditors.
- Issuing new shares in a close KK.
- Dividends of surplus. (However, KKs with board may provide in the articles that it may distribute a one-time interim cash dividend of surplus by board approval. In addition, in a company with accounting auditors that has a board of company auditors or committees, and the term of its directors is no more than a year, the responsibility to determine the distribution of dividends of surplus can be delegated to the board by the articles.)

Approval for these matters cannot be delegated to the board.

Restrictions

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



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

15. 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?

Close KKs without board

Where there are two or more directors, the directors can delegate specific matters (that do not require shareholders' approval) to individual directors. However, the following matters cannot be delegated:

- Election or dismissal of managers.
- Establishment, relocation or closing of branch offices.
- Holding shareholders' meetings.
- Development of internal control systems.
- Exempting officers (directors, accounting advisors, company auditors, executive officers and accounting auditors) under the articles from liability to the company (see *Question 17*).

KKs with board

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

- Disposing or acquiring important assets.
- Incurring a significant debt.
- Electing or dismissing important employees, including managers.
- Establishing, changing or abolishing important structures, including branch offices.
- Issuing bonds.
- Developing internal control systems.
- Exempting officers under the articles from liability to the company (see *Question 17*).

KKs with board and committees

The nominating committee, audit committee and compensation committee each has its own authority under the Companies Act and cannot further delegate substantial parts of their responsibilities. Apart from the committees' responsibilities, the board has decision-making authority over the management of the company, including matters that cannot be delegated to individual directors, such as:

- Basic management policy.
- Matters necessary for the execution of the audit committee's duties.

- If there are two or more executive officers, matters relating to the interrelationship between executive officers.
- Development of internal control systems.

A board often delegates decision-making authority over the management of the company to the executive officers (see *Question 4*). However, the board cannot delegate certain important matters (in addition to the matters mentioned above) to executive officers, including:

- Approval of a share transfer in close KKs.
- Holding shareholders' meetings.
- Appointment or removal of committee members.
- Election or dismissal of executive officers.
- Contents of agreement or plan of mergers, company splits, share exchanges or share transfers.

DUTIES AND LIABILITIES OF DIRECTORS

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

General duties

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

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

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

Directors are also liable to the company for the following:

- Distributions of surplus dividends or repurchase of shares that exceed the distributable amount under the Companies Act at the time of that distribution or repurchase of shares. The directors' liability is equal to the total surplus dividends distributed or total amounts paid for the repurchase.
- The occurrence of a shortfall of the distributable amount under the Companies Act after the distributions of surplus dividends or repurchase of shares, at the end of the fiscal year when those distributions or repurchase took place. The directors' liability is equal to the lesser of the amount of that shortfall and the total amounts paid to the shareholders through these dividends or repurchase.
- Giving property benefits to any person for the exercise of shareholders' rights. The amount of directors' liability is equal to the property benefits given.

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.



Theft and fraud

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

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

This is punishable by imprisonment with labour for up to ten years and/or a fine of up to JPY10 million.

Securities law

Any director of a company that submits a securities report (see *Question 23*) containing misstatements of any important matter may be subject to both civil and criminal liabilities.

Insolvency law

There is no specific liability for 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 make an assessment decision on a claim for damages based on a director's liability under his general duties.

Health and safety

Directors who violate health and safety laws can be subject to both civil and criminal liabilities.

Environment

Directors who violate environmental laws can be subject to both civil and criminal liabilities.

Anti-trust

Directors who violate anti-trust laws can be subject to both civil and criminal liabilities.

Cyber-crime

Directors who commit a cyber-crime can be subject to both civil and criminal liabilities.

17. 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. However, a director cannot be exempted from his liability for the excess amount if he distributes dividends or repurchases shares that exceed distributable amounts set under the Companies Act (see *Question 16*).
- Directors that are both unaware of the wrongdoing and not grossly negligent in performing their duties, can be partially exempted from liability by an extraordinary resolution of shareholders' meeting (see *Question 24*), for damages in excess of the minimum liability limits, which are:
 - for representative directors, six times their annual remuneration;

- for outside directors, double their annual remuneration;
 - for other directors, four times their annual remuneration.
- For KKs with company auditor that have more than two directors, or KKs with committees, 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 outside directors who are both unaware of the wrongdoing and not grossly negligent in performing their duties (see *Question 6*). 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.

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

Directors can obtain directors' and officers' (D&O) liability insurance for personal liability that indemnifies them against the legal costs of a lawsuit, and personal liability to a third party and the company. The company can pay the insurance premium. However, generally, the portion of the insurance premium corresponding to the D&O liability insurance that indemnifies the director against the legal costs of a lawsuit and his personal liability to the company, is paid by the director.

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

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

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

Close KKs without board

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

KKs with board

If a director intends to carry out any conflicting interest transactions, an approval must be obtained at a board meeting. A director



with a conflict of interest cannot participate in the board meeting (see *Question 13*). 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.

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

Close Kks without board

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

- Compete with the company (for himself or a person other than himself).
- Benefit himself or any third party.
- Involve any conflicting interest (including a guarantee given by the company for the benefit of a director) (see *Question 20*).

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

Kks with board

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

- Compete with the company (for himself or a person other than himself).
- Benefit himself or any third party.
- Involve any conflicting interest (including a guarantee given by the company for the benefit of a director) (see *Question 20*).

The director cannot participate in the vote as he has a conflict of interest (see *Questions 13 and 20*). The director must disclose material facts with respect to the transaction at the board meeting. After the transaction, the director must also report material facts about the transaction to the board without delay.

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

The Companies Act does not restrict the purchase or sale by a director of company's shares and other securities (an open KK is prohibited from providing, in its articles, that its directors must be its shareholders, though a close KK may impose these limits in its articles). However, some restrictions are imposed on a director of a listed company under the Financial Instruments and Exchange Law.

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

A director of a listed KK who purchases or sells shares or other securities issued by that company must submit a report to the

authorities. A listed KK can require a director to return to the company short-swing profits, that is profits from either:

- Selling securities issued by the company on his own account within six months after the purchase.
- Purchasing securities issued by the company on his own account within six months after the sale.

DISCLOSURE OF INFORMATION

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

Companies Act

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

- The articles, at the head office and at branch offices.
- Shareholder registry, at the head office.
- Minutes of shareholders' meetings:
 - at the head office for ten years from the day of the shareholders' meeting; and
 - at the branch offices for five years from the day of the shareholders' meeting.
- Minutes of board meetings (and minutes of committee meetings in the case of Kks with committees), at the head office for ten years from the day of the meeting.
- Financial statements (the balance sheet, profit and loss statement, shareholders' equity statement and specific explanatory notes) and business reports for each fiscal year, with supplementary schedules:
 - at the head office for five years from one week before the annual shareholders' meeting (two weeks for Kks with board); and
 - at the branch offices for three years from one week before the day of the annual shareholders' meeting (two weeks for Kks with board).

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

After the annual shareholders' meeting, a company must give public notice of its balance sheet (for large companies (see *Question 27*), the balance sheet, and profit and loss statement) without delay. Companies that, under their articles, use an official gazette or a daily newspaper as a method of providing public notice, can give a summary of the balance sheet (for large companies, the balance sheet, and profit and loss statement) in these public notices.

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

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



Financial Instruments and Exchange Law

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

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

- A change in the major shareholders.
- Decision on a merger, share exchange, company split or share transfer.
- A change of representative director.
- A petition for bankruptcy, civil rehabilitation or corporate reorganisation.
- An event that seriously affects the financial condition or operating results of the company's business.

Listing regulations

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

COMPANY MEETINGS

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

Annual shareholders' meeting

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

Financial statements must be provided and approved at the annual shareholders' meeting. However, for companies with accounting auditors (*see Question 30*) the contents of the financial statements need only be reported at the annual shareholders' meeting, and an approval of the financial statements by the shareholders is not necessary where all of the following requirements are satisfied:

- The accounting auditor's audit report states that financial statements correctly represent the status of the company's assets and profits or losses, in accordance with generally accepted accounting principles.
- Company auditors, the board of company auditors or audit committee accepts the accounting auditors' 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 14*) may also be discussed and approved at the annual shareholders' meeting.

Resolutions at a shareholders' meeting

Unless the articles provide otherwise, resolutions at a shareholders' meeting require a majority of the votes cast, where a majority of the shareholders entitled to vote are present (ordinary resolution).

However, resolutions on certain matters require a two-thirds supermajority of the votes cast, where a majority of the shareholders entitled to vote are present (extraordinary resolution).

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

Shareholders can require the directors to call a shareholders' meeting if they have held shares consecutively for the preceding six months or more that give them not less than 3% of the votes of all the shareholders.

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

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

- **Close Kks without board.** Any shareholder can demand that the directors include an agenda at a meeting.
- **Kks with board.** Shareholders can demand that the directors include an agenda at a meeting if they have held shares consecutively for the preceding six months or more that give them not less than either 1% of the votes of all the shareholders or 300 votes. In close Kks, shareholders can demand that the directors include an agenda at a meeting without having held the required shares consecutively for the preceding six months. The demand must be submitted no later than eight weeks before the shareholders' meeting.

MINORITY SHAREHOLDER ACTION

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

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

- Demand the dismissal of officers by filing a court action, if:
 - they have held consecutively for the preceding six months or more no less than 3% of the total voting rights or of the issued shares;
 - there is misconduct or material violation of laws and regulations, or the articles in connection with the execution officers' duties; and
 - the agenda containing the proposal for dismissal of these officers was not approved by the shareholders' meeting.



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

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

INTERNAL CONTROLS, ACCOUNTS AND AUDIT

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

Kks without committees

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

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

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

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

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

Kks with committees

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

Listed Kks

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

28. 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, the acts will be a breach of a director's general duties (*see Question 16, General duties*) and result in the directors being liable to the company, third parties and shareholders for damages arising as a result.

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

Financial Instruments and Exchange Law

If directors submit securities reports containing misstatements of any important matters, the directors can be both civilly and criminally liable for the misstatements (*see Question 16, Securities law*).

29. 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 30*), where it is either:

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

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

Company auditors

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

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



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

Audit committee

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

In KKs with 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.

Accounting auditors

Accounting auditors audit the company's financial statements and are appointed at the general meeting of shareholders. Companies with committees must have accounting auditors and large companies (see *Question 27*) must have them in addition to company auditors. In KKs with company auditors, directors must obtain the consent of the company auditors to submit a proposal 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. Accounting auditors are deemed to have been re-elected at the annual shareholders' meeting, unless otherwise resolved at the annual shareholders' meeting.

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

Company auditors

The following cannot act as directors (and therefore cannot be audit committee members) or company auditors:

- Legal entities.
- Adult wards, a person under curatorship, or a person who is treated similarly under foreign laws and regulations.
- A person who has been convicted of certain crimes under the Companies Act or certain provisions of other laws.

A company auditor cannot concurrently serve as a director, employee (including manager), accounting advisor 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 6*).

Audit committee

The majority of members of an audit committee must be outside directors (see *Question 6*). A member of the audit committee cannot concurrently serve as an:

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

Accounting auditors

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

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

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

Company auditors

A company auditor cannot do non-audit work that would violate the restrictions set out above (see *Question 31, Company auditors*).

Accounting auditors

A certified public accountant who serves as an accounting auditor cannot do certain non-audit work (such as management consultancy) for the company (see *Question 31, Company auditors*).

33. 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?

Company auditors or accounting auditors who neglect their duties, such as through accounting fraud, are liable to the company for resulting damages. If the breach of duty is with the auditors' knowledge or gross negligence, they are liable to third parties or shareholders for damages arising as a result.

Company auditors or accounting auditors who make false statements about important matters in audit reports are liable to third parties and shareholders for resulting damages, unless they can prove that they did not fail to exercise due care in the performance of their duties.

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

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

- A company auditor and/or accounting auditor can be exempted from liability with the unanimous consent of all shareholders.



- If a company auditor and/or accounting auditor is unaware of the breach and is not grossly negligent in performing his duties, the company auditor and/or accounting auditor can, by an extraordinary resolution of a shareholders' meeting (see Question 24), be partially exempted from liability for neglecting his duties, for amounts in excess of the minimum liability limit, which is double his annual remuneration. In KKKs with company auditors that have more than two directors or companies with committees, decisions on partial exemption of a company auditor's and/or accounting auditor's liability may be delegated to directors (to the board where there is one) by the articles.
- If the articles so provide, a company can, through contracts with the outside company auditor and/or accounting auditor, limit their liability to the extent they are unaware of breaches and are not grossly negligent in performing their duties. Liability is limited to the larger of:
 - an amount determined in advance, within the range provided in the articles; and
 - an amount equal to double the annual remuneration.

CORPORATE SOCIAL RESPONSIBILITY

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

There are no legal requirements relating to corporate social responsibility. However, some listed companies voluntarily report social, environmental and ethical issues in securities reports.

COMPANY SECRETARY

- 35. What is the role of the company secretary in corporate governance?**

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

INSTITUTIONAL INVESTORS AND SHAREHOLDER GROUPS

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

The Pension Fund Association has been active in monitoring corporate governance matters. The Pension Fund Association publishes the principles of corporate governance and guidelines on the

THE REGULATORY AUTHORITIES

Ministry of Justice

Main activities. This is the authority responsible for the maintenance and establishment of the legal system relating to companies.

W www.moj.go.jp/ENGLISH/index.html

Financial Services Agency

Main activities. This is the authority responsible for the maintenance and operation of the Financial Instruments and Exchange Law, and the regulation of listed KKKs.

W www.fsa.go.jp/en/index.html

Legal Affairs Bureau

Main activities. This is the authority responsible for company registration.

W <http://houmukyoku.moj.go.jp/homu/static/>

Tokyo Stock Exchange

Main activities. This is one of the largest securities exchanges in Japan. It is responsible for the regulation of listed KKKs whose shares are listed on its exchange.

exercise of shareholder voting rights. Institutional Shareholders Services and other proxy voting advisors also have influence in corporate governance matters.

REFORM

- 37. Please summarise any proposals for reform and state whether they are likely to come into force and, if so, when.**

The government determined the draft outline for the reform of the Companies Act in August 2012. The primary objective of the draft outline includes:

- Reconsideration of the methods of corporate governance, including:
 - whether to require certain companies to disclose, in its business report, reasons why it is inappropriate for the company to have outside directors, if it does not have outside directors; and
 - whether to establish companies with audit and supervisory committees.
- Reconsideration of the regulations regarding parent and subsidiary companies including:
 - whether to permit derivative actions by shareholders with 1% or more of voting rights or issued shares in a parent company against the directors of its wholly-owned subsidiaries; and
 - whether to grant controlling shareholders (with 90% or more of voting rights) the call right to acquire all other shares.



ONLINE RESOURCES

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

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

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

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

W www.tse.or.jp/english/

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

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