The Outline for the Companies Act Reform in Japan and Its Implications

Gen Goto[*]

---

* Associate Professor of Law, University of Tokyo, Graduate Schools for Law and Politics.

The author served at the Ministry of Justice of Japan as a part-time officer from March 2010 to July 2013 and participated in the reform project of the Companies Act. However, this article does not represent the view of the Ministry of Justice.

This article is based on the author's presentation at a seminar on Japanese law at Max Planck Institute for Comparative and International Private Law on March 11, 2013. The author would like to thank Professors Jürgen Basedow, Harald Baum, and Souichirou Kozuka for organizing the seminar and all other participants at the seminar for their helpful comments. The author also would like to thank the Japan Society for the Promotion of Science for its financial support (Grant-in-Aid for Scientific Research (A) 24243001) of the work for this article.

I. INTRODUCTION

The Japanese Companies Act,[1] which was enacted in 2005, is now experiencing its first reform. The process toward this reform started on February 24, 2010, during a consultation of then-Minister of Justice Keiko Chiba with the Legislative Council (*Hōsei Shingi-kai*, hereinafter "the Council"). After intensive discussions for two-and-a-half years at the Companies Act Subcommittee (*Kaisha Hōsei Bukai*, hereinafter "the Subcommittee") of the Council, it resulted in "the Outline for the Companies Act Reform"[2] (hereinafter "the Outline"), which was submitted to then-Minister of Justice Makoto Taki on September 7, 2012.

The reform bill based on this Outline was practically finalized by the Ministry of Justice (hereinafter "MOJ"), but as of May 31, 2013, it had not yet been authorized by the Cabinet or submitted to the National Diet. This delay is mostly due to the unstable political situation and is not related to the substance of the reform,[3] so the bill is expected to be submitted to the Diet in its extra session in the autumn of 2013.

After a brief explanation of the timeline of the reform and the composition and decision-making process of the Subcommittee (Part II), this article discusses three major topics from the Outline that might change some ways of thinking in Japanese corporate law (Part III),[4] two topics that were originally on the agenda but were dropped from the final Outline (Part IV), and then concludes with some perspectives for future reform (Part V).

II. OVERVIEW OF THE REFORM PROCESS AND THE COMPANIES ACT SUBCOMMITTEE

1. *Timeline*

As mentioned earlier, on February 24, 2010, then-Minister of Justice Keiko Chiba engaged in a consultation with the Legislative Council to provide an outline for reform

---

1 *Kaisha-hō*, Law No. 86/2005.

2 *Kaisha hōsei no minaoshi ni kansuru yōkō*. Available at *http://www.moj.go.jp/content/000102013.pdf.*

For an overview of the Outline, including topics that are not dealt with in this article, see S. IWAHARA, *"Kaisha hōsei no minaoshi ni kansuru yōkō an" no kaisetsu I–VI* [Commentary on "The Draft Outline for the Companies Act Reform" I–VI], in: Shōji Hōmu 1975 (2012) 4; 1976 (2012) 4; 1977 (2012) 4; 1978 (2012) 39; 1979 (2012) 4; and 1980 (2012) 4.

3 *Kaisha-hō kaisei hōan no kon kokkai heno teishutsu wa miokurareru* [The Reform Bill of the Companies Act Will Not Be Submitted to the Current Session of the Diet], in: Shōji Hōmu 1997 (2013) 70–71.

4 Unfortunately, it is impossible here to refer to all the topics of the Outline. Other important topics dealt with in the Outline include the following: reform of the shareholders' appraisal remedy (Part 2, Section 3); introduction of an M&A injunction when there is a violation of the law or the articles of incorporation (Part 2, Section 4); introduction of an injunction of voting rights for a shareholder who violated mandatory takeover regulation (Part 3, Section 1).

on rules regarding corporate governance, parent and subsidiary companies, and other related matters, from the perspective of gaining a greater level of confidence among the broad scope of interested parties of companies.[5] The Council decided to form the Companies Act Subcommittee to discuss this inquiry, and the Subcommittee started its discussion on April 28, 2010.[6]

On December 7, 2011, the Subcommittee produced the "Interim Proposal for the Companies Act Reform"[7] (hereinafter "the Interim Proposal"). This Interim Proposal, together with its supplementary explanation[8] provided by the Counselor's Office of Civil Affairs Bureau of MOJ (*Hōmushō Minji-kyoku Sanji Kanshitsu*), underwent the procedure of asking for public opinion (public comment procedure) until January 31, 2012.[9] The Subcommittee resumed its discussion in February 2012, and finalized the "Outline for the Companies Act Reform" in September of that year.

2. Political Situation and Its Implication

The consultation with the Legislative Council was made just after the governmental changeover in July 2009 from the Liberal Democratic Party (LDP) to the Democratic Party of Japan (DPJ). Since the DPJ was supported by labor unions and the LDP was supported by industry, this political situation gave two meanings to this reform at the beginning.

First, many suspected that the main purpose of the reform was to introduce rules concerning the interest of employees[10] in the Companies Act, which is based on the shareholder primacy model. Specifically, a DPJ project team made a proposal, based on the opinion of the Japanese Trade Union Confederation (*Rengō*), which stated that some statutory auditors (*kansa-yaku*) should be elected by employees.[11] As will be discussed in Part III A, however, this aspect dissolved in the early stages of the discussion, leaving only a slight indication in the Outline.

---

5 Consultation to the Legislative Council, No. 91, available at *http://www.moj.go.jp/content/000023763.pdf.*

6 The minutes of the meetings of the Companies Act Subcommittee and the materials presented there are available in Japanese only at *http://www.moj.go.jp/shingi1/shingi03500005.html.*

7 *Kaisha hōsei no minaoshi ni kansuru chūkan shian*, available at *http://www.moj.go.jp/content/000082647.pdf.*

8 *Kaisha hōsei no minaoshi ni kansuru chūkan shian no hosoku setsumei*, available at *http://www.moj.go.jp/content/000082648.pdf.*

9 Unofficial English translations of the Interim Proposal and its Supplementary Explanation, which were made by the Tokyo Stock Exchange in order to solicit opinions from foreign investors, are available at *http://www.tse.or.jp/english/news/09/111219_a.html.*

10 Reference to "the broad scope of interested parties of companies" in the consultation was understood to especially include the employees.

11 DPJ Project Team on Public Company Law, *Kōkai kaisha-hō (kashō) seitei ni mukete* [Toward the Enactment of Public Company Law], 3, available at *http://www.nikkei.co.jp/hensei/comp09/pdf/comp09_2.pdf.*

Second, since the DPJ took an unfriendly position against industry at the beginning, this reform was expected to be a good chance to introduce regulations that industry was likely to oppose. The main topics of the agenda were indeed regulatory, but this expectation turned out to be too optimistic. The representative from the Japan Business Federation (*Keidanren*), a business association of large corporations like the Business Round Table of the United States, still had strong bargaining power.

So in the end, the consultation's surrounding political situation in February 2010 does not seem to have had much impact on the substance of the Outline as had been expected when the process started.[12] From this viewpoint, the governmental changeover back to the LDP in December 2012 is not likely to have a negative influence on the treatment of the reform based on the Outline.[13]

3. The Composition and the Decision-Making Procedure of the Subcommittee

Before moving on to the specific topics of the reform, a brief look at the composition and the decision-making rule of the Subcommittee would be beneficial in order to better understand the result of the discussions at the Subcommittee.

The Subcommittee, chaired by Professor Shinsaku Iwahara of the University of Tokyo, consisted of 16 members (including the chairman) and 15 sub-members.[14] Of 16 members, there were five corporate law professors, four representatives of four different business associations,[15] one representative of the Tokyo Stock Exchange, one representative of the Pension Fund Association, one representative of the Japanese Trade Union Confederation, one judge, one attorney-at-law, and two officials of the MOJ. Of the 15 sub-members, there were seven corporate law professors, six officials of the MOJ and other related governmental agencies, one official of the Supreme Court, and one attorney-at-law.

---

12 This is not to deny that there was a considerable impact on the selection of agenda and the discussions in the Subcommittee.

13 It is worth noting that some LDP politicians even require stricter rules regarding the appointment of outside directors to improve corporate governance. LDP, *Nihon keizai saisei honbu chūkan teigen* [Interim Proposal of the Headquarters for Revitalizing Japanese Economy] (May 10, 2013), 29–30, available at *https://www.jimin.jp/policy/policy_topics/pdf/pdf100_1.pdf.*

14 The list of members and sub-members as of August 1, 2012 is available at *http://www.moj.go.jp/content/000101639.pdf.*

15 Namely, Japan Business Federation (*Nihon Keizai Dantai Rengō-kai* or *Keidanren*; representing large companies), Japan Chamber of Commerce and Industry (*Nihon Shōkō Kaigi-sho*; representing small and medium companies), Japan Audit & Supervisory Board Members Association (*Nihon Kansayaku Kyōkai*; organization of statutory auditors) and Japan Venture Capital Association.

Formally, the decision of the Subcommittee is to be made by a simple majority vote of the members attending the meeting.[16] It is customary, however, to make a decision by a unanimous vote.[17] This custom seems to give considerable bargaining power to each member, especially those from related interest groups such as Keidanren, and makes the final conclusion a moderate one.[18]

III. MAJOR TOPICS OF THE REFORM WHICH MAY CHANGE WAYS OF THINKING IN JAPANESE CORPORATE LAW

1. Outside Directors and Corporate Governance

Let's begin with the largest topic of this reform, promotion of corporate governance of large public companies by outside directors.

a) Current Law and Statistics of Listed Companies at Tokyo Stock Exchange

aa) Companies Act[19]

Under the current Companies Act, there are two alternatives as the governance structure for large public companies in Japan. One is a company with a board of statutory auditors (*kansa yakukai setchi kaisha*),[20] and the other is a company with committees (*i'in-kai setchi kaisha*).[21]

A company with a board of statutory auditors is the traditional option. In this type of company, there must be more than three statutory auditors; at least half of them must be outside statutory auditors,[22] but there is no need to appoint an outside director. The business of a company with a board of statutory auditors is executed by directors,[23] and the role of statutory auditors is to audit the execution of business by the directors, including but not limited to accounting.[24]

---

16 *Hōsei shingi-kai rei* (Governmental Order No. 134/1949), Art. 7, para. 2–3.

17 For example, see S. KOZUKA/J. LEE, The New Japanese Insurance Act: Comparisons with Europe and Korea, in: ZJapanR/J.Japan.L. 28 (2009) 73, 77, 87.

18 The formation and function of this unanimous vote custom would be an interesting topic of research on the Japanese law-making process.

19 For a more detailed description of the current Japanese law on the board of statutory auditors and the company with committees, see I. KAWAMOTO/Y. KAWAGUCHI/T. KIHIRA, Corporations and Partnerships in Japan (Alphen aan den Rijn, 2013) 282–304.

20 Art. 2, no. 10, Companies Act.

21 Art. 2, no. 12, Companies Act.

22 Art. 335, para. 3, Companies Act.

23 Art. 363, para. 1, Companies Act.

24 Art. 381, para. 1, Companies Act.

Statutory auditors must attend the meetings of the board of directors,[25] but they do not have voting rights at those meetings. In addition, although we use the same word, *kansa yakukai,* as the Japanese translation for the German *Aufsichtsrat*, the board of statutory auditors does not have the power to elect and remove directors. Directors are elected and removed by majority vote at the shareholders' meeting.[26]

On the other hand, the company with committees represents a new system based on the United States model introduced in 2002. This type of company must create three committees – the audit committee, nomination committee, and compensation committee[27] – under the board of directors instead of a board of statutory auditors. Each committee consists of at least three directors, and the majority of them must be outside directors.[28] Also, unlike companies with a board of statutory auditors, the execution of business is done not by directors[29] but by executive officers (*shikkō-yaku*)[30] who are appointed by the board of directors.[31]

The role of the audit committee is similar to that of the board of statutory auditors.[32] The nominating committee decides on candidates for the director positions,[33] and the compensation committee decides the amount of compensation for each executive officer and director.[34]

bb) Statistics of Listed Companies at the Tokyo Stock Exchange

Having looked at two alternatives, the next question will be how they are used by Japanese companies. The answer is quite impressive. Within the listed companies at the Tokyo Stock Exchange (TSE) as of September 10, 2012,[35] the percentage of companies with committees is very small, only 2.2 %.[36] It appears that the introduction of the company with committees was hardly a success. The reason for this is said to be that

---

25 Art. 383, para. 1, Companies Act.

26 Art. 329, para. 1 and Art. 339, para. 1, Companies Act.

27 Art.2, para.12, Companies Act.

28 Art. 400, para. 1 and para. 3, Companies Act.

29 Art. 415, Companies Act. Directors are not prohibited to hold the position of executive officers at the same time (Art. 402, para. 6, Companies Act).

30 Art. 418, no. 2, Companies Act.

31 Art. 402, para. 2, Companies Act.

32 Art. 404, para. 2, Companies Act.

33 Art. 404, para. 1, Companies Act.

34 Art. 404, para. 3, Companies Act.

35 There were 2,275 listed companies at the Tokyo Stock Exchange (all sections combined) as of September 10, 2012.

36 TOKYO STOCK EXCHANGE, INC., *Tōshō jōjō kaisha kōporēto gabanansu hakusho 2013* [TSE-Listed Companies White Paper on Corporate Governance 2013] (Tokyo, 2013) 15, available at *http://www.tse.or.jp/rules/cg/white-paper/b7gje60000005ob1-att/white-paper13.pdf*. English version of this document is expected to be available at *http://www.tse.or.jp/english/listing/cg/* by the end of 2013.

Japanese companies don't like to completely give away to outsiders their powers regarding nomination and compensation.

The data above means that the other 97.8 % are companies with the board of statutory auditors, which has no legal obligation to appoint an outside director. Indeed, the appointment of outside directors is not a very common practice in Japanese companies. The ratio of companies appointing at least one outside director is gradually growing, and now it is slightly more than half, 54.7 % for all listed companies and 53.7 % for all listed companies with board of statutory auditors[37], but this ratio is still low compared to other countries. Also, it is not so popular to appoint more than 2 outside directors. The ratio of companies with board of statutory auditors which appoint more than two outside directors is 24.5 %[38].

In addition, it must be noted that these outside directors include those from parent company or major trade partners. They are "outside" directors under the definition of Companies Act[39], but they are thought to be generally not suitable as "independent" directors as defined by the listing rules of the Tokyo Stock Exchange[40]. 44.6 % of all outside directors appointed by companies listed at the TSE are not "independent"[41]. Also, the ratio of companies designating at least one "independent" director is 34.4 %, and the other 65.6 % of listed companies have only "independent" statutory auditors.[42, 43]

37 TOKYO STOCK EXCHANGE, *supra* note 36, 21–22.

38 TOKYO STOCK EXCHANGE, *supra* note 36, 21–22. The percentage of companies with a board of statutory auditors that have an outsider majority board of directors is only 1.1 %. *Ibid.*

39 Art. 2, para. 15, Companies Act. "Outside director" means a director who is not and has never been an executive director nor an employee of the company or its subsidiaries.

40 Since 2010, the Tokyo Stock Exchange requires its listed companies to secure at least one "independent director/auditor" (*dokuritsu yakuin*), which means a director or statutory auditor who is unlikely to have conflicts of interest with general investors (Tokyo Stock Exchange Securities Listing Regulations, Rule 436-2). Being related to a parent company or major trade partners does not necessarily negate the director's capacity to be "independent," but the company is required to disclose the reason for designating him/her as such even though he/she has such relations (Tokyo Stock Exchange Enforcement Rules for Securities Listing Regulations, Rule 211, para.4(5)).

41 TOKYO STOCK EXCHANGE, *supra* note 36, 27.

42 Calculated by the author from data included in the appendix of TOKYO STOCK EXCHANGE, *supra* note 36.

43 Also, the Tokyo Stock Exchange requires its listed companies to "make efforts to secure an independent director(s)/auditor(s) with consideration of the significance of a person(s) who holds voting rights in the board of directors being included in independent director(s)/auditor(s)" (Tokyo Stock Exchange Securities Listing Regulations, Rule 445-4) as a response to the corporate scandals of Olympus and Daio Paper in 2011.

b) The Source of Difference: Basic Roles of Outside Directors and the Board

The state of corporate governance in Japanese listed companies as explained above has been criticized by foreign investors for a long time.[44] This gap between Japanese corporate governance and the monitoring model understood by foreign investors seems to derive from the difference in the understanding of the basic roles of outside directors and the board of directors.

In traditional Japanese companies, the duty of most directors is to execute the business of the company, and the board is thought to be the highest authority for making business decisions rather than being the monitor of the CEO. This is reflected in Article 362 paragraph 4 of the Companies Act, which requires important business decisions such as sales or purchases of important assets to be made by the board, and prohibits delegation of those decisions to individual directors. Because of this requirement, the board of directors needs to meet quite often to make many decisions within a limited time, and this makes it not so easy for outside directors with other jobs to attend every time. Outside directors in such companies are often invited as advisors, or are being sent from major stakeholders to look after their interests. These companies have statutory auditors as monitors, but the focus of their monitoring is on compliance and prevention of illegal acts.

On the other hand, it is now becoming the global standard to have outside independent directors and the board as monitors for the interests of public shareholders, with a focus on the evaluation of the CEO's performance.[45]

The basic idea of this time's reform is the further promotion of this monitoring model in the Companies Act, with the anticipation that it would improve the performance of Japanese companies.[46] There are three important items that will be discussed in detail in the next section.

c) Results of the Reform

aa) Higher Requirements for "Outside" Directors

First, the Outline imposes higher requirements on directors to be "outside," to meet the global standard of "independent" directors to some extent. Specifically, directors who are either current directors/executive officers/employees of the parent company, or

---

44 See, for example, ASIAN CORPORATE GOVERNANCE ASSOCIATION, ACGA Statement on Corporate Governance Reform in Japan (2009), 5–11, available at *http://www.acga-asia.org/public/files/ACGA_Japan_Statement_2009_Dec15_English.pdf.*

45 For a global comparison of board independence, see Institutional Shareholder Services Inc., 2013 Japan Proxy Voting Summary Guidelines (2013) 8, available at *http://www.iss governance.com/files/2013ISSJapanGuidelinesSummaryRev01312013.pdf.*

46 See W. TANAKA / G. GOTO / K. HASEGAWA / Y. ISHII (round table discussion), *Kaisha hōsei no kongo no kadai to tenbō* [Problems and Prospects of Corporate Law for the Future], in: Shōji Hōmu 2000 (2013) 70, 71–72 (statement by Professor Tanaka).

current executing directors/executive officers/employees of other subsidiaries of the parent company (i.e., sister companies), are now excluded from the "outside" directors.[47] Those related to major trade partners, however, are still "outside."

bb) Soft Law Approaches Regarding Appointment of Outside Directors

The second item regards the most controversial topic, whether or not to introduce the obligation to appoint at least one outside director.

During the discussion on this topic, considerable attention was paid to the findings of empirical studies.[48] For example, Professor Takuji Saito showed that though the optimal board structure may differ from company to company, the appointment of outside directors in Japan seems to be decided by the self-interest of incumbent management rather than by the interest of shareholders.[49] He also showed that the appointment of the first outside director has had a positive impact on the company's ROA.[50] This result provided strong support for those insisting on the introduction of the obligation.

However, after a long debate, it was decided not to introduce this obligation, mostly because of strong opposition from Keidanren.[51] It must be noted that many companies that belong to Keidanren, such as Hitachi and SONY, have now adopted a governance structure based on the monitoring model. On the other hand, companies such as Canon and Nippon Steel Corporation, which have held important positions in Keidanren, have not appointed even one outside director so far.[52]

Instead of mandatory appointment of at least one outside director, two soft-law approaches were introduced.

---

47 The Outline, Part 1, Section 1, Subsection 2 (1) no. 1 and 2. No. 3 excludes directors who are spouses or close relatives of current directors/executive officers/senior employees of the company itself from the scope of "outside."
On the other hand, the Outline relaxes the standard in order to make it easier for companies to find someone suitable by allowing past executing directors and employees who worked at the company or its subsidiary more than 10 years ago to be "outside." The Outline, Part 1, Section 1, Subsection 2 (2).

48 The findings of empirical studies were introduced at the 9th meeting of the Subcommittee held on January 26, 2011.

49 T. SAITO, The Determinants of Board Composition when Managers Control Director Selection: Evidence from Japan (2011), unpublished working paper, on file with author.

50 ROA means *return on assets*. T. SAITO, Boards with and without Outside Directors: An Empirical Comparison (2010), unpublished working paper, on file with author.

51 IWAHARA, *supra* note 2, Shōji Hōmu 1975 (2012) 10.

52 Toyota, which was very famous for not appointing even one outside director, announced that it is going to appoint three people as outside directors – the former president of Nippon Life Insurance Company, the president of the Japan Securities Depository Center, and the former vice president of GM – at its annual shareholders meeting in June 2013, in order "to reflect external opinions in management decision-making" (*http://www2.toyota.co.j0070/en/news/13/03/0306_2.html*).

First, the listed companies that do not have an outside director as a board member must disclose in their annual business reports (*jigyō hōkoku*) "the reason which makes appointment of an outside director unreasonable for that company."[53] This is a "comply-or-explain" approach, though it does not state the "comply" part expressly.[54]

This requirement is based on the understanding that it is usually beneficial to have an outside director as a monitor, and that there must be a special reason for not appointing one.[55] The disclosed reason should not be an abstract one, such as "We can't find a suitable person," or "Appointment of an outside director is costly."[56]

Second, by way of supplementary resolution to the Outline, the Council required the stock exchanges to impose the obligation on listed companies to make a sincere effort to appoint at least one "independent director" by their listing rules. Though the stock exchanges are not required to impose sanctions on companies not appointing independent directors, this resolution also shows the view of the Council and the Subcommittee that such an appointment is desirable.

cc) Introduction of a Company with an Audit and Supervisory Committee

The last item regarding corporate governance by outside directors is the introduction of a new type of governance structure, a company with an audit and supervisory committee.[57] This third structure was criticized by some people who said that it will make Japanese corporate law too complicated. Admitting the complexity, however, the idea is that this new structure was necessary to make it easier for Japanese companies to select a monitoring model. In other words, a company with an audit and supervisory committee should not be recognized as a mere mixture of the two existing types, but as a monitoring model based on the company with committees with some slight adjustments.

The reduction of cost for selecting the monitoring model is achieved by decreasing the number of outsiders necessary. The audit and supervisory committee must have more than three directors as members, and the majority of them must be outside directors.[58] This means that companies with audit and supervisory committees must have at least two outsiders, whereas companies with boards of statutory auditors need three outsiders if they appoint one outside director in addition to the two outside statutory auditors.

---

53 The Outline, Part 1, Section 1, Preceding note of Subsection 2.

54 IWAHARA, *supra* note 2, Shōji Hōmu 1975 (2012) 12.

55 T. FUJITA, Corporate Governance and the Rule of *Soft* Law, UT Soft Law Review 5 (2013) 9, 12.

56 K. NAKANISHI / K. KOISO / K. SHIBATA / T. TSUJI, *"Shagai torishimari-yaku o oku koto ga sōtō de nai riyū" no setsumei naiyō to un'yō no arikata* [How the Disclosure of "the Reason Which Makes Appointment of an Outside Director Unreasonable" Should be Applied], in: Shōji Hōmu 1980 (2012) 42, 43–44.

57 The Outline, Part 1, Section 1, Subsection 1.

58 The Outline, Part 1, Section 1, Subsection 1 (3).

This existence of at least two outside directors means that there are some outsiders who can vote for the removal of the CEO if his or her performance was not satisfactory from the viewpoint of the shareholders in general. This is the basis of the company with an audit and supervisory committee as a monitoring model.

In addition to its power that is similar to that of the statutory auditors,[59] the audit and supervisory committee is given the power to express its view on the election, dismissal, resignation, and compensation of other directors at the shareholders' meeting[60] so that the shareholders can make an informed decision on these matters. Thus, the committee is expected to be a substitute for nomination and compensation committees to some extent.[61] This is the reason why the name of the committee is "audit *and supervisory*" rather than simply "audit."

Also, an ex-ante approval by the audit and supervisory 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.[62] This power of the committee was introduced as a "carrot" in order to induce Japanese companies to become companies with an audit and supervisory committee.[63]

The role of the board of directors is also clarified. The core roles of the board of a company with an audit and supervisory committee are to set the basic management policy, to build up the internal control system, and to supervise the execution of business by other directors, including the CEO.[64] These are almost the same as those of the board of the company with committees,[65] but the board of the company with the board of statutory auditors is not explicitly required by law to set the basic management policy.[66]

In addition, even though that the Outline still requires important business decisions such as sales or purchases of important assets to be made by the board of directors, as in companies with statutory auditors[67] the shareholders can enable the board to delegate these decisions to the CEO by the articles of incorporation.[68] This is based on the understanding that the board should concentrate on the monitoring and evaluation of the CEO rather than making business decisions by itself.[69] Also, if the majority of the board

59 The Outline, Part 1, Section 1, Subsection 1 (4) no. 1–6.
60 The Outline, Part 1, Section 1, Subsection 1 (4) no. 7–8.
61 IWAHARA, *supra* note 2, Shōji Hōmu 1975 (2012) 7–8.
62 Art. 423, para. 3, which presupposes the existence of a violation of duty in self-dealing transactions, The Outline, Part 1, Section 1, Subsection 1 (4) no.9.
63 IWAHARA, *supra* note 2, Shōji Hōmu 1975 (2012) 8.
64 The Outline, Part 1, Section 1, Subsection 1 (6) no. 1.
65 Art. 416, para. 1, Companies Act.
66 See Art. 362, para. 2, Companies Act.
67 The Outline, Part 1, Section 1, Subsection 1 (6) no.4.
68 The Outline, Part 1, Section 1, Subsection 1 (6) no. 6.
69 IWAHARA, *supra* note 2, Shōji Hōmu 1975 (2012) 9–10.

itself is held by outside directors,[70] then the board can delegate these decisions to the CEO by operation of law. This implies that the company with an audit and supervisory committee is introduced as an entrance to the monitoring model, not as a goal, and that the reform act anticipates a development toward an outsider-majority board.

These have been the monitoring-model aspects of the company with an audit and supervisory committee that resemble the company with committees. The aspects that are similar to the company with a board of statutory auditors regard the securement of the position of the members of the audit and supervisory committee, such as procedures for their appointment, removal, and compensation.[71] Their appointment to the committee is done by the shareholders' meeting rather than by the board, which might be dominated by insiders, and their total compensation is decided by the shareholders' meeting to be divided by the members themselves. These protections were thought necessary because without nomination and compensation committees, the bargaining power of the members of the audit and supervisory committee against the management may not be strong enough.

dd) Summary

So what is the meaning of all this reform? In this author's view, the most important point is that even though it is done in an indirect way, the Companies Act now expresses that monitoring by outside directors is desirable in general. This may sound like nothing special, but this is the first time for the Japanese legislation to express such a view, and it is not a small step when considering that there was a strong unofficial objection from Keidanren even to such an expression.

However, it might be too optimistic to think that the appointment of outside directors or the number of companies with an audit and supervisory committee will increase rapidly. The disclosure of the "unreasonableness" of non-appointment of an outside director might be a driving force toward this direction, but there is no reliable sanction against improper disclosure except the pressure from the market.[72] This might be similar to the situation of "comply-or-explain" rules in the corporate governance codes of the United Kingdom or Germany. Thus, there is a (not so small) possibility that the situation will not change much notwithstanding these reforms; in such a case, discussion for another reform is likely to take place in the (distant) future.

2. Regulating Large Private Placement of Shares

The next topic of the Outline that may have an impact on the traditional way of thinking is the reform regarding the procedure for the large private placement of shares.

---

70 The Outline, Part 1, Section 1, Subsection 1 (6) no. 5
71 The Outline, Part 1, Section 1, Subsection 1 (2).
72 FUJITA, *supra* note 55, 13. See also, NAKANISHI ET AL., *supra* note 56, 49–50.

a) *Current Law*[73]

aa) *Companies Act and Case Law*

Under current Japanese law, public companies are permitted to issue shares by the sole decision of the board of directors unless the issuance price is "particularly favorable" to the subscriber, in which case a special resolution of the shareholders' meeting is required.[74] The rationale for this rule is the public companies' need to raise funds promptly by equity financing. From the viewpoint of existing shareholders, however, this means that there is a danger that the management, when faced with the risk of being dismissed by shareholders, will try to issue a large amount of shares to themselves or their friends to protect their positions.

The Companies Act tries to balance the interest of shareholders by allowing shareholders whose interest is likely to be impaired by a share issuance – a hostile bidder, for example – to seek a court injunction of the issuance (i) when the issuance violates the applicable laws and regulations or the articles of incorporation, or (ii) when the issuance is done "by using a method which is extremely unfair."[75] The second item is the one that matters here.

In lower instance courts, whether a share issuance is done "by using a method which is extremely unfair" or not is decided by "the primary purpose rule."[76] According to this rule, a share issuance is done by such a method when the primary purpose of the issuance is the preservation of control of the incumbent management.

This may sound like a standard strict enough to sufficiently restrain self-interested share issuances by the management. However, this rule has been applied rather softly. For example, the Tokyo High Court rejected a motion by the principal shareholder for provisional injunction of a large share issuance that made the subscriber a new parent company by giving it 51 % of shares, even though it recognized that the management which was in a conflict with the principal shareholder might have intended to maintain their control by the issuance.[77] The reasoning of the court was that the issuance was done to raise cash necessary for a reasonable business alliance plan with the subscriber. Some recent judgments show some signs of a change toward a stricter standard,[78] but the standard is still unclear.

---

73 For a more detailed description of current Japanese law on the procedure of share issuance, see KAWAMOTO et al., *supra* note 19, 179–201.

74 Art. 201, para. 1 and Art. 199, para. 3, Companies Act.

75 Art. 210, no. 2, Companies Act.

76 For developments in case law on the primary purpose rule, see T. FUJITA, Commentary to Tokyo High Court 23 March 2005, M. BÄLZ et al. (ed.), Business Law in Japan – Cases and Comments, (Alphen aan den Rijn, 2012) 313, 316–318.

77 Tokyo High Court, August 4, 2004, Kinyū Shōji Hanrei 1201 (2004) 4.

78 Saitama District Court, June 22, 2007, Hanrei Taimuzu 1253 (2008) 107 and Tokyo District Court, June 23, 2008, Kinyū Shōji Hanrei 1338 (2010) 40.

bb) Listing Rules of the Tokyo Stock Exchange

The situation above has been criticized by investors, and in 2009, the TSE introduced a regulation on large private placement of shares in its listing rules.[79] Under this new regulation, a listed company seeking to make a share issuance that issues more than 25 % of the shares which are already issued, or leads to a change of the controlling shareholder, is required to take either of the following procedures: (i) receipt of an opinion regarding the necessity and suitability of the issuance by an entity who has a specific degree of independence from the managers, such as an outside statutory auditor, outside director, or independent committee; or (ii) confirmation of the shareholders' intention regarding the issuance, for example, by resolution of the shareholders' meeting.

This is quite similar to the regulation by the New York Stock Exchange,[80] but there is one important difference. The TSE allows a large private placement to be done without the approval of shareholders if the company obtains an opinion of someone independent, whereas the New York Stock Exchange does not permit substitution by such a procedure. This listing rule was still thought to be insufficient[81] and led to the current reform.

b) Results of the Reform

aa) Limited Requirement of Shareholders' Meeting

The Outline now requires approval by the shareholders' meeting for any large private placement of shares, but in a limited manner.[82, 83]

The scope of the new regulation is limited to private placements through which the subscriber of newly issued shares becomes a new parent company by holding more than half of the shares as a result of the issuance. In such a case, the issuer company must disclose the name and other information about the subscriber so that the shareholders can object to the issuance to that subscriber.[84]

When there are objections from shareholders holding more than 10 % of the voting rights, the allotment to the subscriber must be approved by a normal resolution of the

---

79 Tokyo Stock Exchange, Securities Listing Regulations, Rule 432, and Enforcement Rules for Securities Listing Regulations, Rule 435-2. Exception is granted when the Exchange deems that it is difficult for the company to take either of the procedures due to reasons such as rapidly deteriorating financial situations.

80 New York Stock Exchange, Listed Company Manual, Section 312.03(c).

81 ASIAN CORPORATE GOVERNANCE ASSOCIATION, *supra* note 44, 15–19.

82 Similar rules are also provided for the private placement of share options. The Outline, Part 1, Section 3, Subsection 1 (2).

83 Correspondingly, the Outline also tries to induce listed companies to use rights offerings for equity financing by shortening the time necessary for notice of allotment of share options without contribution. The Outline, Part 1, Section 3, Subsection 3.

84 The Outline, Part 1, Section 3, Subsection 1 (1) no. 1.

shareholders meeting.[85] This approval is not required when the financial condition of the company has greatly worsened and there is an urgent need of share issuance to keep the company alive.[86]

Compared to other topics of the Outline, industry opposition to the reform on this topic was quite weak. The reason for this may be the limited applicability of the new rule because of its high threshold, 51 % ownership by the subscriber after the issuance.[87] Indeed, the proposal to lower the threshold to one-third of ownership met with strong opposition by the representative from Keidanren.[88]

bb) Possible Effect to Issuances Below the 51 % Threshold

What then will the situation be for a private placement of shares that makes the subscriber a holder of more than one-third of the shares issued? Of course, the new requirements by the Outline do not apply.[89]

However, the Outline clearly shows its negative view against the change and allocation of the control of the company by managers using private placement of shares.[90] Also, the final rejection of the proposal to lower the threshold to one-third was based on the reason that holding one-third of the shares does not necessarily mean that the holder has control of the company, because there is a possibility that someone else still has 51 %.[91]

Thus, the fact that the one-third threshold was not accepted does not mean that the Outline thinks that there is no problem in private placement which gives one-third of the shares issued and the control of the company to the subscriber. If the courts take these points into consideration, the primary purpose rule might be applied more strictly in such a case, even though there is a reasonable business plan which requires some cash to be raised by the issuance.

85 The Outline, Part 1, Section 3, Subsection 1 (1) no. 4 and 5.

86 The Outline, Part 1, Section 3, Subsection 1 (1) proviso of no. 4.

87 Other possible reasons may be that this topic was “bundled” with other more sensitive issues, such as the mandatory appointment of outside directors.

88 Minutes of the 19th Meeting (April 18, 2012) of the Companies Act Subcommittee of the Legislative Council, 54–55 (statement by Member Mr. Sugimura), available at *http://www.moj.go.jp/content/000098749.pdf.*

89 Also, under Japanese takeover regulations, the shareholder who acquired the control of a company by way of share issuance is not subject to the mandatory offer rule. See T. FUJITA, The Takeover Regulation in Japan: Peculiar Developments in the Mandatory Offer Rule, UT Soft Law Review 3 (2011) 24.

90 This view is also shared by the Tokyo High Court, March 23, 2005, Hanrei Jihō 1899 (2005) 56. See FUJITA, *supra* note 76.

91 Minutes of the 21st Meeting (June 13, 2012) of the Companies Act Subcommittee of the Legislative Council, 33 (explanation by Officer Uchida), available at *http://www.moj.go.jp/content/000100831.pdf.*

3. *New Procedure for Squeeze-Out Transactions*

The last topic of Part III shall be the introduction of a new procedure for squeeze-out, or to use the wording of the Outline, cash-out transactions.

a) Current Law

Under the current Companies Act, there are roughly two procedures that can be used for squeezing out the minority shareholders by cash.

aa) Merger or Share Exchange Procedure

The first is the merger or share exchange procedure using cash as the consideration to the shareholders of the target company. The difference is that the target company is merged into the acquirer in a merger, whereas the target company becomes a 100 % subsidiary of the acquirer in a share exchange.

In principle, the Companies Act requires a special resolution of the shareholders' meeting for both mergers and share exchanges, which is a resolution by two-thirds of the voting rights present at the meeting.[92] In cases of mergers and share exchanges between a subsidiary and its parent company holding more than 90 % of the shares of the subsidiary, the short-form procedure is available; this does not require a resolution of the shareholders' meeting.[93] Because of tax reasons, however, these procedures are not used for squeeze-out transactions.

bb) Class Shares Subject to Wholly Call

In practice, squeeze-outs are carried out by a procedure using "class shares subject to wholly call" (*zenbu shutoku jōkō tsuki shurui kabushiki*),[94] a process that is too complicated to be explained here. The important point for the moment is that while this procedure does not cause a tax problem, it requires a special resolution of the shareholders' meeting[95] and that no short-form procedure is provided. Thus, when the acquirer obtains 90 % of the shares of the target company by a takeover bid and then tries to squeeze out the remaining minority shareholders, the minorities must wait for the shareholders' meeting to be held even though the outcome is quite clear.[96]

---

92 Art. 309, para. 2, no. 12 and Art. 783, para. 1 Companies Act.
93 Art. 784, para. 1, Companies Act.
94 Art. 108, para. 1, no. 7, Companies Act. For a detailed description of class shares subject to wholly call, see KAWAMOTO ET AL., *supra* note 19, 145.
95 Art. 171, para. 1 and Art. 309, para. 2, no. 3, Companies Act.
96 IWAHARA, *supra* note 2, Shōji Hōmu 1978 (2012) 39.

b) Results of the Reform

aa) Introduction of a New Short-Form Procedure

In the Subcommittee, some professors and the stock exchange representative proposed adopting a more European approach, requiring assent of more than 90 % of all shareholders for squeeze-outs and prohibiting squeeze-outs by the two-thirds majority. This proposal was eventually rejected, however, from the viewpoint that it might cause opportunistic behavior among the minority shareholders in a case of value-increasing squeeze-outs, and that whether the majority of the minority has assented to the squeeze-out or not will be considered in the procedure for appraisal remedy by the courts.[97]

Rather, it was thought better to protect the minority shareholders by shortening the time necessary for squeeze-outs so that the acquirer can make a commitment to do so and thus ease the unstable condition of the minorities.

For this purpose, a new short-form procedure that might not cause tax problems[98] was introduced. In this new procedure, the shareholder holding more than 90 % of the voting rights (special controlling shareholder) of a company (target company) can claim against the other shareholders to sell their shares to itself.[99] Instead of a resolution of the shareholders' meeting, the special controlling shareholder is required to obtain approval from the board of directors of the target company.[100] Also, the minority shareholders unsatisfied with the price paid can ask for an injunction of the process or an appraisal by the court.[101]

bb) Duty of Directors to Protect the Minority Shareholders in M&A

The point worth noting here is the requirement of the board approval. When approving the offer from the special controlling shareholder, the board of directors of the target company must consider the interest of minority shareholders who are going to be squeezed out, such as the adequacy of the price paid or whether the special controlling shareholder has enough funding for the payment.

Of course, it will be quite difficult for the directors to oppose an offer from a shareholder holding more than 90 % of the voting rights of the company, and it might be too naive to think that this requirement will protect the minority shareholders sufficiently. However, this requirement is important for Japanese corporate law in that it implies the directors owe a duty to protect the interests of individual minority

---

97 IWAHARA, *supra* note 2, Shōji Hōmu 1978 (2012) 55 note 54.

98 It is unclear whether the new procedure will definitely not cause tax problems because tax treatments will be determined by the Ministry of Finance after the reform act is enacted.

99 The Outline, Part 2, Section 2, Subsection 1 (1).

100 The Outline, Part 2, Section 2, Subsection 1 (2) no. 2.

101 The Outline, Part 2, Section 2, Subsection 1 (3) no. 1 and 2.

shareholders even in a case where the interest of the company itself is not affected.[102] Previous case laws have recognized the duty of directors in M&A to consider interests of shareholders as a class,[103] which is approximated to the company itself, but not the interest of individual shareholders.

Since it may not make sense to limit the scope of this duty to protect the interest of individual shareholders only to cases regarding the new short-form squeeze-outs, this requirement of board approval may and should lead to the recognition of such a duty in other types of M&As.

The problem left is the standard of this duty. For example, do the directors have to act like an auctioneer when they put the company up for sale, like the Revlon standard in Delaware? The Outline itself has no answer on this point, but the reform this time may have opened the door for such future development to occur in Japan.

IV. TOPICS THAT WERE DROPPED FROM THE REFORM

Let's move on to Part IV, the topics that were first on the agenda but were not included in the final Outline.

1. *Statutory Auditors Elected by Employees*

The first topic should be the statutory auditor elected by employees, which was the hottest issue at the very beginning of the discussion.

As mentioned previously,[104] some DPJ politicians, together with labor unions, proposed that some of the statutory auditors should be elected by the employees of the company. This proposal was made public just after the governmental changeover in July 2009, which was about a year after the Lehman shock. At that time, non-permanent workers were being fired and some media were criticizing the shareholder primacy model of the United States. People believed that the intention of the DPJ and labor unions was to introduce a co-determination system into Japanese corporate law in order to protect the interests of employees, even though the board of statutory auditors in Japan is different from the German *Aufsichtsrat* in that it doesn't have the power to elect and dismiss the directors.

Many counterarguments were made from the traditional shareholder primacy model, but soon the labor union representative insisted that they were not trying to push the interests of employees against shareholders; instead, the representative maintained that they were trying to make whistleblowing easier, and that this would also benefit the share-

102 IWAHARA, *supra* note 2, Shōji Hōmu 1978 (2012) 43.
103 E.g., Tokyo District Court, February 18, 2011, Kinyū Shōji Hanrei 1363 (2011) 48.
104 See *supra* note 11 and accompanying texts.

holders.[105] The logic of the labor unions was that the employees would feel more secure to engage in whistleblowing if they had someone they could trust at the board of statutory auditors.

It cannot be said for sure whether this was their real intent, but the Subcommittee took this explanation at face value and finished the discussion on this topic by making some changes to the internal control system and its disclosure.[106]

2. Liability of the Parent Company against its Subsidiaries

The next topic, the liability of the parent company against its subsidiaries, was given more importance throughout the discussions at the Subcommittee.

a) Current Law

aa) Problem of "Listed Subsidiaries"

One of the characteristics of Japanese corporate groups is that they tend to list the stocks of their subsidiaries while keeping them under their control. These subsidiaries are called "listed subsidiaries." One of the reasons given for this practice is that, in Japan, it is easier for the subsidiary to attract employees with more competence when it is a listed company.

From the viewpoint of the minority shareholders of the listed subsidiary, this practice contains a risk of the listed subsidiary being exploited by the parent company through its influence on the terms of parent-subsidiary transactions or the allocation of business resources and chances among corporate groups, as some foreign investors have criticized. It has also been reported that some DPJ politicians were considering prohibiting listed companies from listing their subsidiaries.[107]

According to a recent empirical study, however, Tobin's *q* and the ROA of listed subsidiaries were better in a statistically significant way than those of the compared companies without controlling shareholders.[108] This fact suggests that exploitation

---

105 Minutes of the 2nd Meeting (May 26, 2010) of the Companies Act Subcommittee of the Legislative Council, 22–23 (statement by Member Mr. Ōmi), available at *http://www.moj.go.jp/content/000049083.pdf*, in Japanese.

106 The Outline, Part 1, Endnote to Section 1.

107 *Minshutō "oyako jōjō no kinshi" gutai-ka he; Yaku 400 sha ga taiō semarareru* [DPJ Materializing "Prohibition of Listing Both Parent and Subsidiary": About 400 Companies Will Be Affected], Bloomberg, December 15, 2009, available at *http://www.bloomberg.co.jp/news/123-KUFDJF0D9L3501.html.*

108 H. MIYAJIMA / K. NITTA / Z. SHISHIDO, *Oyako jōjō no keizai bunseki – Rieki sōhan mondai ha hontō ni shinkoku nanoka* [Economic Analysis of Parent-Subsidiary Listing – Is Conflict of Interest a Serious Problem?], in: H. Miyajima (ed.), *Nihon no kigyō tōchi* [Corporate Governance in Japan] (Tokyo, 2011) 289, 315–325.

asserted by foreign investors does not seem to be taking place at least universally, and that the practice of listed subsidiaries should not be totally prohibited.

Nevertheless, there are some cases of exploitation. For example, in the case of Kasuga Electric Works, a company named Ainsutera acquired control of Kasuga by buying its shares in the market. It then made Kasuga lend a substantial amount of money to Ainsutera. This loan was not repaid, and Kasuga was finally forced to enter into a corporate reorganization procedure.

bb) Problems of Current Japanese Law

The problem of current Japanese law is that it doesn't have an effective measure that the minority shareholders can use to attack the controlling shareholder in such an extreme case. First, unlike the United States or Germany, the fiduciary duty of a controlling shareholder in relation to minority shareholders has not so far been recognized by Japanese courts. Second, the controlling shareholder might be subject to tort liability[109] in relation to the company for such exploitation, but a tort claim of the company is not included in the list of rights that the shareholders can enforce by derivative actions under the Companies Act.[110] Third, an application of rules regarding the prohibition of the provision of benefits by the company in relation to the exercise of the shareholders' rights[111] may not be a realistic solution here, since this prohibition was originally introduced as a measure against corporate racketeers (*sōkai-ya*), and is accompanied by criminal sanctions that might be applied even to officers and employees of the company.[112]

This also means that the honest parent companies of listed subsidiaries cannot make a reliable commitment not to exploit their subsidiaries and will suffer discounts when selling shares of the subsidiary to the public.

cc) Proposal from the Academics

Many academic proposals have been made to introduce regulations and liabilities for the parent-subsidiary relationship, most of which were based on insights from the case law of the United States and the *Konzernrecht* of Germany. The most famous is Professor Kenjirō Egashira's proposal to impose liability on the parent company for damages of its subsidiary resulting from transactions between the subsidiary and itself whose terms

109 Art. 709, Minpō (Civil Code), Law No. 89/1896.
110 Art. 847, para. 1, Companies Act.
111 Claim for repayment of the benefits provided in relation to the exercise of the shareholders' rights (Art. 120, para. 3, Companies Act) can be enforced by derivative actions (Art. 847, para. 1, Companies Act).
112 Art. 968, para. 2, Companies Act.

were not based on the arms-length standard, and to let the subsidiary's minority shareholders enforce this liability by derivative actions.[113]

There are also counterarguments from economists against this proposal. One of them argues that efficiency of the corporate group as a whole will be hindered by requiring the terms of parent-subsidiary transactions to be based on the arms-length standard.[114]

b) Interim Proposal and Its Rejection

aa) Interim Proposal

Taking all of these arguments into consideration, the Interim Proposal suggested introducing a new rule for liability of the parent company.[115] This differed from Professor Egashira's proposal on an important point: the standard of liability.[116]

The basic idea of the Interim Proposal is that since the parent company is a shareholder of the subsidiary and not a director of it, it should be able to pursue its own interests and those of the group as a whole. In other words, a parent company is not a fiduciary of the minority shareholders of the subsidiary.

The parent company, however, should not harm the interests of others, including its subsidiary, just as the tort law requires. Thus, the parent company's liability arises if the transaction is detrimental to the subsidiary compared to the subsidiary's situation if the transaction had not occurred.[117] In other words, the parent company is not liable if there were some benefits for the subsidiary to engage in such a transaction. When judging whether a transaction was detrimental to the subsidiary, not only the terms of the transaction should be considered but also all other circumstances, such as the terms of other transactions between the subsidiary and the parent company or the benefits of belonging

---

113 K. EGASHIRA, *Ketsugō kigyō-hō no rippō to kaishaku* [Reform Proposals and Interpretations on Law Regarding Parent and Subsidiary Companies] (Tokyo, 1995) 93–94, 103–104. There are also other important proposals such as prohibition of competition with the subsidiary (*ibid.* 186–191) and sell-out rights of the minority shareholders when the subsidiary is being exploited (*ibid.* 318–321).

114 S. KANBE, *Kabunushi kan rigai tairitsu* [Conflict of Interest among Shareholders], in: Y. Miwa / H. Kanda / N. Yanagawa (eds.), *Kaisha-hō no keizai-gaku* [Economics of Corporate Law] (Tokyo, 1998) 303, 322–325.

115 The Interim Proposal, Part 2, Section 2, Subsection 1, Plan A. On the 20th meeting of the Subcommittee held on May 16, 2012, some clarification and slight adjustments were added to this Plan A. *Kaisha hōsei bukai shiryō 23* [Material No. 23 of the Companies Act Subcommittee], 5–6, available at *http://www.moj.go.jp/content/000098296.pdf*.

116 The details of the Interim Proposal are explained by E. TAKAHASHI / K. SHINTSU, Einführung eines Konzernrechts in Japan: Der Zwischenentwurf und die ergänzenden Erläuterungen, ZJapanR/J.Japan.L. 33 (2012) 13. However, their explanation that the standard of Plan A is the same as the standard for directors in self-dealing transactions with the company (*ibid.* 16–17) is clearly a misunderstanding of the Supplementary Explanation.

117 The Interim Proposal, Part 2, Section 2, Subsection 1, Plan A, no. 1.

to the corporate group.[118] This judgment may not be an easy one, and the parent company could escape liability if it was not negligent when evaluating whether the transaction was detrimental to the subsidiary.[119]

A shareholder of the subsidiary can enforce this liability by a derivative action.[120]

bb) Opposition from Industry

Even though it was very limited compared to Professor Egashira's proposal based on the arms-length standard, this proposal was unfortunately not able to obtain industry support. Thus, neither the new liability nor the new derivative action is included in the Outline. The only reform that was achieved regarding the protection of a subsidiary's minority shareholders is the enhancement of disclosure.[121]

Keidanren's reasons for its opposition to the new liability were that the standard of the proposal is unclear, it might have a chilling effect on intra-group transactions that are very important for Japanese companies, and also it might invite abusive derivative actions against parent companies.[122] Also, Keidanren pointed out that if there is a problematic transaction, it could be dealt with by liability of the directors of the subsidiary or tort liability of the parent company.[123]

At least in this author's view, however, the Civil Code provision for tort liability is far more vague than the standards of the Interim Proposal. When considering the fact that an alternative proposal[124] to allow the subsidiary's minority shareholders to enforce the parent company's tort liability by a derivative action was also rejected, the real problem for industry seems to be the derivative action.[125]

---

118 The Interim Proposal, Part 2, Section 2, Subsection 1, Plan A, no. 2, *Kaisha hōsei bukai shiryō 23*, *supra* note 115, 5.

119 *Kaisha hōsei bukai shiryō 23*, *supra* note 115, 5.

120 The Interim Proposal, Part 2, Section 2, Subsection 1, Plan A, no. 4.

121 The Outline, Part 2, Endnote to Section 1. The subsidiary must disclose in its annual business report the grounds on which its board of directors judged whether a transaction with its parent company is detrimental to itself, along with other matters. Also, in its audit report, the subsidiary must disclose the opinion of statutory auditors, etc., regarding the judgment and grounds of the board of directors.

122 IWAHARA, *supra* note 2, Shōji Hōmu 1977 (2012) 12.

123 NIHON KEIZAI DANTAI RENGŌ-KAI, "*Kaisha hōsei no minaoshi ni kansuru chūkan shian" ni taisuru iken* [Opinion to "the Interim Proposal for the Companies Act Reform"] (January 24, 2012), 11–12, available at *http://www.keidanren.or.jp/policy/2012/007.pdf*.

124 *Kaisha hōsei bukai shiryō 23*, *supra* note 115, 6–7.

125 IWAHARA, *supra* note 2, Shōji Hōmu 1977 (2012) 15 note 54.

V. TOPICS LEFT FOR FUTURE REFORM

1. *Derivative Actions in Japan*

a) *Uniqueness of Japanese Law*

Shareholder derivative action under Japanese law has some characteristics that are not seen in other countries.[126] First, as mentioned previously, the company claims that are enforceable by derivative actions are limited to those listed by the Companies Act.[127] For example, the liability of senior employees is not included. Second, there is no requirement for the amount of shares necessary to be a plaintiff. And third, there is substantially no measure to interrupt a derivative action against the will of the shareholder who filed the suit. Unless the plaintiff has the intention to profit unlawfully or to harm the company,[128] the court can't dismiss a derivative action even if a special litigation committee or the court itself judges that the continuation of the suit is against the common interests of the shareholders.

The second and third aspects have been used by social activists to raise derivative actions as a means to make political assertions to large companies.[129] There is a strong antipathy against this phenomenon from industry, and the effort to expand the scope of derivative actions faces strong resistance.

b) *Limited Introduction of Multiple Derivative Action*

Thus, it is quite remarkable that the Outline succeeded in widening the scope of the derivative action to introduce the "multiple derivative action," which is a derivative action by a shareholder of the parent company against the director of its 100 % subsidiary, but this was not without limitation. The introduction of the multiple derivative action was another hot issue throughout the discussion, and after an intense debate, the Subcommittee reached an agreement to introduce the multiple derivative action with two limitations.

First, the scope of defendants is still limited. Only directors of a subsidiary that is "important" to its parent company are subject to multiple derivative actions. This limitation was thought to be necessary to make sure not to sue directors of subsidiaries who are virtually equivalent to senior employees of the parent company as

---

126 For a more detailed description of Japanese current law on derivative actions, see KAWAMOTO ET AL., *supra* note 19, 279–281.

127 Art. 847, para. 1, Companies Act.

128 Art. 847, proviso of para. 1, Companies Act.

129 D. PUCHNIAK / M. NAKAHIGASHI, Japan's Love for Derivative Actions: Irrational Behavior and Non-Economic Motives as Rational Explanation for Shareholder Litigation, in: Vanderbilt Journal of Transnational Law 45 (2012) 1; see also ID, in: Puchniak/Baum/Ewing-Chow (eds.), The Derivative Action in Asia. A Comparative and Functional Approach (Cambridge 2012) 128.

defendants.[130] A subsidiary is "important" when the ratio of the book value of the subsidiary's stock to the book value of the parent company's whole assets is more than 20 % on the date of the facts that gave rise to the liability.[131]

Second, the plaintiff is limited to shareholders holding more than 1 % of the shares issued.[132] This limitation will largely suppress the use of multiple derivative actions, especially by social activists, since it may not be so easy for them to hold 1 % of the shares of a large listed company, and this might be the reason for industry's assent.

On the other hand, a proposal to grant to the courts the power to dismiss a multiple derivative action that is clearly against the shareholders' common interest was not adopted[133] because such a proposal should be considered for derivative actions in general, not only for multiple ones.[134]

2. Agenda for the Next Reform?

The point worth emphasizing here is that in the discussion at the Subcommittee, some professors acknowledged industry's concern regarding the uniqueness of the Japanese law on derivative actions to stick to the decision of the plaintiff shareholder holding only one share.[135] The 1 % shareholding requirement introduced for the multiple derivative action is one way to solve this problem, but it might not be the best solution since it would make raising derivative actions too difficult after all. Another alternative is the adoption of American rules regarding a special litigation committee, but this solution also entails its own cost.

Though it may not be in the near future, the reform of derivative actions is likely to be on the agenda of the next reform project, combined with measures for further promotion of outside directors.

SUMMARY

This contribution provides an overview of the ongoing reform of company law in Japan. In September 2012, the Companies Act Subcommittee submitted an "Outline for the Companies Act Reform" to the Minister of Justice. A reform bill based on that outline

---

130 IWAHARA, *supra* note 2, Shōji Hōmu 1977 (2012) 7.
131 The Outline, Part 2, Section 1, Subsection 1, no. 4.
132 The Outline, Part 2, Section 1, Subsection 1, no. 1.
133 IWAHARA, *supra* note 2, Shōji Hōmu 1977 (2012) 7.
134 *http://www.moj.go.jp/content/000099708.pdf* (in Japanese).
135 Minutes of the 17th Meeting (February 22, 2012) of the Companies Act Subcommittee of the Legislative Council, 31-32 (statement by Sub-member Professor Fujita), available at *http://www.moj.go.jp/content/000097367.pdf.*

has been practically finalized by the Ministry of Justice and is expected to be submitted to the Diet in its extra session in the autumn of 2013.

The first major issue addressed is an important corporate governance matter: the desirability or necessity of having independent outside directors on Japanese company boards. So far, only slightly more than fifty percent of all listed Japanese companies have appointed at least one outside director on their boards. This figure is low by international standards, and "outside" does not necessarily mean "independent." In the traditional Japanese view, the duty of most directors is to execute the business of the company, and the board is thought to be the highest authority for making business decisions rather than being the monitor of the CEO. However, the emerging global standard is to have outside independent directors on the board to act as monitors in the interest of public shareholders, with a focus on the evaluation of the CEO's performance. The Outline acknowledges – in the author's view for the first time in Japan – the general desirability of outside independent directors. First, the Outline recommends imposing higher requirements on directors to be "outside" to meet the global standard of "independent" directors to some extent. Second, it suggests a soft-law "comply-or-explain" approach regarding outside directors, though it refrains from introducing an outright obligation to appoint at least one outside director. Instead, listed companies that do not have an outside director on their boards must disclose in their annual business reports the reason for this, and the stock exchanges will be required to impose the obligation on listed companies to make a sincere effort to appoint at least one "independent director" by their listing rules. Additionally, a new type of governance structure, a company with an audit and supervisory committee, will be introduced.

Other reform measures include the introduction of an approval requirement by the shareholders' meeting for large private placement of shares and the introduction of a new procedure for squeeze-outs. Furthermore, the article addresses issues that were first on the reform agenda but were withdrawn later. Initially, some DPJ politicians and labor unions proposed that some of the statutory auditors should be elected by the employees of the company. Another initial proposal was to introduce a new rule for liability of the parent company against its subsidiary and to allow a shareholder of the subsidiary to enforce this liability by a derivative action. Both proposals were dropped because of intense objections from industry.

(The Editors)

ZUSAMMENFASSUNG

Der Beitrag gibt einen Überblick über die aktuelle Reform des Gesellschaftsrechts in Japan. Im September 2012 hat der Beratungsausschuss für das Gesellschaftsrecht dem japanischen Justizminister seinen „Bericht zur Reform des Gesellschaftsrechts" übergeben. Ein darauf basierender Gesetzentwurf des Justizministeriums ist weitgehend

fertiggestellt und es wird erwartet, dass dieser dem Parlament in einer Sondersitzung im Herbst 2013 vorgelegt werden wird.

Das erste wichtige Thema der Reform betrifft die Corporate Governance japanischer Unternehmen: Empfiehlt es sich, gesetzlich vorzuschreiben, dass in die Verwaltungsräte auch unabhängige Mitglieder zu bestellen sind? Bislang haben lediglich etwas mehr als die Hälfte aller börsennotierten japanischen Unternehmen zumindest einen „outside director“ in ihre Verwaltungsräte berufen. Diese Zahl ist im internationalen Vergleich sehr gering, und „outside“ bedeutet zudem nicht zwingend unabhängig. Nach überkommener japanischer Ansicht ist es die wesentliche Aufgabe des Verwaltungsrates und seiner Mitglieder, die Geschäfte des Unternehmens zu führen, nicht aber den Präsidenten (CEO) zu überwachen. Diese Auffassung steht indes im Widerspruch zu der inzwischen zunehmend zum internationalem Standard gewordenen Praxis, Leitungsorgane von Unternehmen auch mit unabhängigen Mitgliedern („outside independent directors“) zu besetzten, deren vordringliche Aufgabe die Evaluierung der Geschäftsführung durch den CEO ist. Der Bericht des Beratungsausschusses erkennt – nach Ansicht des Autors erstmalig für Japan – an, dass die Bestellung von unabhängigen Mitgliedern eines Verwaltungsrates grundsätzlich wünschenswert ist. Der Bericht empfiehlt, die Anforderungen an einen „outside director“ so zu verschärfen, dass sie denjenigen entsprechen, die international für unabhängige Mitglieder von Leitungsorganen der Unternehmen gelten. Allerdings empfiehlt der Bericht gleichwohl keine zwingende gesetzliche Regelung, sondern setzt stattdessen auf das Modell des „comply-or-explain“. Danach sollen börsennotierte Unternehmen, die keine unabhängigen Mitglieder in ihren Verwaltungsrat berufen haben, diese Tatsache und die Gründe dafür im jährlichen Geschäftsbericht angeben. Zudem wird den Börsen auferlegt, in ihren Zulassungsregeln von notierungswilligen Gesellschaften zu verlangen, ernsthafte Anstrengungen zu unternehmen, um zumindest ein unabhängiges Mitglied in ihren Verwaltungsrat zu berufen. Ferner soll eine neue Organisationsform geschaffen werden: eine Aktiengesellschaft mit einem Prüfungs- und Überwachungsausschuss.

Andere Reformmaßnahmen sind ein Zustimmungserfordernis der Hauptversammlung für die private Platzierung einer größeren Zahl von Aktien an ausgewählte Dritte und die Einführung eines neuen Squeeze-out-Verfahrens. Der Beitrag spricht zudem Themen an, die zunächst auf der Reformagenda standen, später aber wieder zurückgezogen wurden, wie etwa der von Politikern aus der DJP und den Gewerkschaften unterstützte Vorschlag, einen Teil der unternehmensinternen Prüfer durch die Mitarbeiter des Unternehmens wählen zu lassen. Ein anderer zurückgenommener Reformvorschlag war die Einführung einer Haftung der Muttergesellschaft gegenüber ihrer Tochtergesellschaft, welche die Aktionäre der Tochtergesellschaft im Weg einer Aktionärsklage hätten verfolgen können sollen. Beide Vorschläge sind am Widerstand aus den Kreisen der Wirtschaft gescheitert.

(Die Redaktion)