RECHTSPRECHUNG / CASE LAW

Japanese Corporate Law: Important Cases in 2003 and 2004

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I. INTRODUCTION

This paper reports important Japanese corporate law cases in 2003 and 2004. One of the cases suggests that there could still be some companies experiencing difficulties under the current economic state in Japan. In that case, a company could not repay its debts to a bank because a large customer of the company – a famous large theme park – was facing a decline in its business performance, and the company, as a result, was also suffering a decline in its business.[1]

Some amendments have been made to Japanese corporate law in recent years.[2] In the 1999 amendment, share exchange and share transfer systems were introduced.[3] In the 2001 amendment, the rules governing companies acquiring and holding their own shares were liberalized.[4] The cases in this report identify some approaches to issues which have become more controversial as a result of these amendments.[5]

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1 See V. below.

2 For the Japanese Commercial Code in English, see EIBUN-HÔREI-SHA, EHS Law Bulletin Series: Roppô – The Commercial Code (Tokyo 2004). For a comment on Japanese corporate law in German, see I. KAWAMOTO ET AL., Gesellschaftsrecht in Japan (2004).

3 H. KANDA, *Kaisha-hô (dai 5 han)* [Company Law (5th ed.)] (Tokyo 2004) 271.

4 K. EGASHIRA, *Kabushiki kaisha yûgen kaisha-hô* [The Law of Stock Corporations and Limited Liability Companies] (3rd ed.) (Tokyo 2004) 193. For literature in German on the liberalization of rules governing companies acquiring and holding their own shares in Japan, see E. TAKAHASHI / O. KIRCHWEHM, Liberalisierung des Erwerbs eigener Aktien in Japan, in: Recht der Internationalen Wirtschaft (2003) 757.

5 See (III.) and (IV.) below.

II. THE RIGHT OF DIRECTORS TO CLAIM REMUNERATION [6]

1. *Facts*

Y was appointed a director at a shareholders' meeting of X company on 28 August 1984. Y became a representative director on 2 March 1986. According to the articles of incorporation of X company, the term of office of a director expired at the conclusion of an annual meeting of shareholders held in relation to the last period for settlement of accounts within two years after taking office. An annual meeting of shareholders for X company was to be convened within three months from the last day of X company's business year (1 July to 30 June). However, the annual meeting of shareholders in relation to the period for settlement of accounts ending 30 June 1986 was never convened. On 30 September 1986, Y's position as director and representative director was terminated. However, Y retained powers and duties as a representative director until 21 June 1993 when a successor to Y was first appointed.

Y received 42,750,000 yen as remuneration (hereinafter: "the Remuneration") for the office between October 1986 – the month after the termination of the office – and July 1991. In relation to the Remuneration, there was neither a provision in the articles of incorporation of X company nor a resolution of a shareholders' meeting, and there was also no agreement from each shareholder as a substitute for the resolution of a shareholders' meeting.

X company brought an action against Y on the grounds of Article 266 Paragraph 1 Number 5 of the Commercial Code (hereinafter: "ComC"), arguing that Y contravened Article 269 of the ComC by receiving the Remuneration.

The District Court held that Y previously received remuneration with the agreement of each shareholder, and therefore, even though a shareholders' meeting was not held every business year, it was hard to believe that Y's remuneration could be reduced or terminated on the basis of the absence of a shareholders' meeting. Therefore, it held that Y had a right to receive remuneration up to as much as 350,000 yen per month, which was the amount Y previously received with the agreement of the shareholders. The Court dismissed the claim of X company in relation to 20,300,000 yen but allowed it up to 22,450,000 yen.

The Court of Appeals rejected the part of the District Court decision allowing X company's claim and instead dismissed the claim. X company appealed to the Supreme Court to the extent of the Court of Appeals' rejection.

The Court of Appeals held as follows. It is understood as a general rule that in the relationship between a director and a company there is an implied onerous agreement. As long as there is such an agreement, in the absence of a resolution of a shareholders' meeting a director has a right against the company to receive a socially acceptable amount of remuneration. This interpretation does not violate the purpose of Article 269

6 Supreme Court, 21 February 2003, in: Kinyû Shôji Hanrei 1180, 29.

of the ComC – to prevent self-interested decision-making by a director or the board of directors in relation to remuneration – because if there is a resolution of a shareholders' meeting the remuneration would be fixed by that resolution and, if there is no such resolution, the remuneration would be fixed at the socially acceptable amount. A reasonable amount of remuneration for Y to receive would be no less than the amount of the Remuneration Y actually received. Therefore, the giving of the Remuneration to Y was not in contravention of Article 269 of the ComC.

2. *Held*

The holding of the Court of Appeals shall not be allowed. The grounds for this conclusion are as follows.

Unless the articles of incorporation or a resolution of a shareholders' meeting specifies an amount of remuneration, a director does not acquire a right to specific remuneration and therefore cannot make a claim to the company for remuneration. The reason for this is that Article 269 of the ComC gives shareholders the power to specify an amount for a director's remuneration through the articles of incorporation or a resolution of a shareholders' meeting so as to prevent self-interested decision-making by a director, or the board of directors, on their own remuneration.

Since in this case there was, in relation to the Remuneration, neither a rule in the articles of incorporation nor a resolution of a shareholders' meeting, and also no agreement by each shareholder as a substitution for such a resolution, Y does not have a right to make a claim to X company for remuneration, whether or not the amount is socially acceptable.

Therefore, there was an obvious breach of law in the holding of the Court of Appeals dismissing X company's appeal by rejecting the decision of the District Court which allowed X company's claim for damages.

3. *Comment*

According to Article 254 Paragraph 3 of the ComC, the relationship between the company and the directors is governed by the provisions relating to mandates. Such provisions are found in the Civil Code. The right of a mandatary to remuneration is prescribed by Article 648 of the Civil Code. According to Paragraph 1 of that Article, the mandatary cannot make a claim to the mandator for remuneration without an agreement on the offer of remuneration. In principle, the right to remuneration does not arise from the mandate relationship as a matter of course.

The Court of Appeals takes a view that there is an express or implied agreement between the director and the company, which is a commonly accepted view amongst

commercial law scholars.[7] According to Article 269 Paragraph 1 of the ComC, the remuneration for a director is specified by the articles of incorporation or a resolution of a shareholders' meeting. The purpose of this provision is construed as being to prevent the directors or the board of directors from specifying the amount of their own remuneration.[8]

It is understood as a principle amongst the judiciary and learned scholars that unless the remuneration is specified by the articles of incorporation or a resolution of a shareholders' meeting, a director does not acquire a right to claim for specific remuneration.[9] However, there have been cases in which neither the articles of incorporation nor a shareholders' meeting specified the amount of remuneration but there was an agreement by each shareholder. Such agreement was considered to be the same as a resolution of a shareholders' meeting and accordingly the directors were allowed to claim the right to their remuneration.[10] The view expressed in these cases is also commonly accepted amongst scholars.[11]

The point of the present case is that the Supreme Court takes the view that where neither the articles of incorporation nor a resolution of a shareholders' meeting specifies the remuneration of directors, the directors will not have the right to claim their remuneration. In the *obiter dictum* of the present case, the Court also takes the view that where there is an agreement by each shareholder then the directors will have the right to claim their remuneration.[12]

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7 See M. YANAGA, *Teikan mata wa kabunushi sôkai no ketsugi ni yotte hôshû no kingaku ga sadamerareteinai ba'ai ni okeru torishimari-yaku no hôshû seikyûken* [The Right of Directors to Claim Remuneration Where the Amount of the Remuneration is not Specified in the Articles of Incorporation or a Shareholders' Meeting Resolution], in: Jurisuto 1269 (2004) 108. M. YAZAWA, *Kigyô-hô no shomondai* [Some Issues in Enterprise Law] (Tokyo 1981) 226; K. OSUMI / H. IMAI, *Kaisha hôron (chûkan) (dai 3 han)* [Company Law (vol. 2) (3rd ed.)] (Tokyo 1992) 165. Osaka Court of Appeals, 14 March 1963, Kinyû Shôji Hanrei 102, 12.

8 M. TATSUTA, *Kaisha-hô (dai 9 han)* [Company Law (9th ed.)] (Tokyo 2003) 80.

9 Osaka Court of Appeals, 14 March 1963, in: Kinyû Shôji Hanrei 102, 12; YAZAWA, *supra* note 7, 226; M. TATSUTA, *Yakuin hôshû* [Remuneration of Officers], in: Bessatsu Jurisuto 39 (1973) 172.

10 Osaka Court of Appeals, 21 December 1989, in: Hanrei Jihô 1352 (1990) 143; Tokyo District Court, 26 December 1991, in: Hanrei Jihô 1435 (1992) 134; Tokyo Court of Appeals, 25 May 1995, in: Hanrei Taimuzu 892 (1996) 236.

11 YANAGA, *supra* note 7, 109; TATSUTA, *supra* note 9, 172; S. OCHIAI, *Dôzoku kaisha no torishimari-yaku no taishokuirôkin* [Resignation Allowances for Directors of Family Companies], in: Jurisuto 616 (1976) 142; M. HAMADA, *Shinpan chûshaku kaisha-hô (6)* [The New Commentary on Company Law (6)] (Tokyo 1987) 387.

12 YANAGA, *supra* note 7, 109.

III. The Amount of Damages for a Company's Unlawful Acquisition of its Own Shares [13]

1. Facts

In this case, shareholder X of O company brought an action arguing that directors Y of O company caused damage to the company by having the company acquire its own shares. X argued that such acquisition was in contravention of the then Article 210 (hereinafter: "former Article 210") and therefore Y should pay damages to O company on the grounds of Article 266 Paragraph 1 Number 5 of the ComC.

O company bought from H company 58,000 of its own shares (hereinafter: "the Shares") for 1,097,940,000 yen on 1 April 1998. Before this acquisition of the Shares (hereinafter: "the Acquisition"), a shareholders' meeting of O company (hereinafter: "the Shareholders' Meeting") was held at which a resolution of greater than two-thirds of the voting shares of shareholders in attendance was reached granting approval for O company to acquire 58,000 of its own shares from H company up to a value of 1,100,000,000 yen. On the same day, after the Shareholders' Meeting, a meeting of O company's board of directors (hereinafter: "the Board Meeting") was held at which an approval was reached for the acquisition of 58,000 shares with a total value of 1,097,940,000 yen, a price of 18,930 yen per share and an acquisition date of 1 April 1998. However, first, there was no mention in the notice to convene the Shareholders' Meeting or in the minutes of the Shareholders' Meeting or the Board Meeting that the purpose of the acquisition was the cancellation of shares. Secondly, at the time of the Acquisition, a company, after acquiring its own shares for the purpose of the cancellation of those shares, was required to take steps to nullify them without delay, but O company did not cancel the Shares after the Acquisition. Thirdly, at the time of the Acquisition, if a company acquired its own shares for a purpose other than the cancellation of those shares, such shares had to be included in the assets of the balance sheet. O company did include the Shares in the assets of its balance sheet. Finally, O company paid dividends and issued new shares to itself as holder of the Shares. The Court made a finding of these actions of O company and inferred that it did not plan to cancel the Shares. The Court held that since O company did not acquire the Shares for the purpose of cancellation it contravened the former Article 210 and therefore Y were liable for damage to O company.

The Court then examined the amount of damage caused to O company by the Acquisition. The Court held as follows.

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13 Osaka District Court, 5 March 2003, in: Hanrei Jihô 1833, 146.

2. *Held*

The amount of the damage O company suffered from the Acquisition (namely, the amount of the damage within the appreciable causation of the Acquisition) should be an amount calculated by subtracting the market value of the Shares from the value of actually acquiring the Shares.

In this respect X argues that unless O company sells the Shares to a third party, the amount of O company's damage is the value of acquiring the Shares, which is 1,097,940,000 yen. But this view cannot be taken. In the Commercial Code, as of 1998, there were provisions laid down based on the presupposition that when a company holds its own shares after acquiring them, these shares are assets of the company. According to Article 210-4 Paragraph 2 and Article 212-2 Paragraph 6 of the ComC, where the net assets of the balance sheet at the end of a business year, during which the company acquired its own shares, were less than the amount calculated by subtracting the market value of these shares from the total of each amount listed in the subparagraphs of Article 290 Paragraph 1 of that ComC, a director who acquired those shares would be liable to the company for damages. It provided that the amount of damages for which the director was liable should be the lesser of the following: (a) the difference between the net assets and the amount calculated as above; and (b) the amount reached by subtracting the total value of shares already sold and those shares still held by the company from the value of acquiring those shares. (Article 210-2 Paragraph 2 of the 2001 amendment does not allow a company to subtract the market value of its own shares, which it holds, from the total value of acquiring its own shares. However, this only suggests that after the Acquisition the approach to a company's acquisition of its own shares has been revised, and does not influence the amount of damage caused by this earlier Acquisition.)

3. *Comment*

There have been several amendments relating to a company's acquisition of its own shares in Japanese corporate law.[14] One recent amendment is the 2001 amendment. Before the 2001 amendment the Japanese corporate law, from a preventive point of view, in principle prohibited a company from acquiring its own shares and permitted such acquisition as an exception only if it was necessary. The 2001 amendment, however, in principle permits a company to acquire its own shares and hold them freely.[15]

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14 For the acquisition by a company of its own shares, see E. TAKAHASHI, *Jiko-kabushiki kisei – hensen to genkohô* [Regulations on the Companies Holding their Own Shares – Changes and the Current Law], in: M. Tanabe (eds.), *Saishin tôsan-hô kaisha-hô wo meguru jitsumujô no shomondai* [Practical Issues in the Current Bankruptcy and Corporate Law] (Tokyo 2005) 542, which discusses the issues from the point of view of both German and Japanese law. See also KANDA, *supra* note 3, 78.

15 EGASHIRA, *supra* note 4, 192.

The present case is a case prior to the 2001 amendment. Before this amendment, under Article 210 Paragraph 1 a company was allowed to acquire its own shares for the purpose of the cancellation of those shares. In the present case the Court found that the purpose of the Acquisition was not the cancellation of the Shares and held that the Acquisition was in contravention of that Article. The Court then decided the amount of the damage to O company caused by the Acquisition.

Under the current ComC, deciding the amount of damage a company suffers from acquiring and holding its own shares is a controversial issue.[16] In relation to the calculation of this amount, there are three views amongst the scholars, namely: i) value of acquisition; ii) difference in value between purchase and sale; and iii) difference between the market value and the value of purchase and sale.[17] According to the value of acquisition view, the total outgoing amount for the acquisition is considered to be the amount of the damage. In the difference in value between purchase and sale view, the difference between the purchase value and the sale value is considered to be the amount of the damage. According to the difference between the market value and the value of purchase and sale view, the amount of the damage is the total sum of the difference between the acquisition value and the market value at the time of the acquisition and the difference between the sale value and the market value at the time of the sale.

There have been two cases where a company's acquisition was at issue. One is a Supreme Court case[18] and the other is a Court of Appeals case.[19] In the Supreme Court case, a parent company was prohibited from acquiring its own shares so it instead forced a wholly owned subsidiary to acquire shares in the parent company. The Court treated the acquisition by the subsidiary as an acquisition by the parent company of its own shares. It took the view of appreciable causation and found that the damage to the parent company was the difference between the value of purchase and the value of sale. In the Court of Appeals case, after a parent company acquired its own shares it sold them to a wholly owned subsidiary and then the subsidiary also sold them. The Court of Appeals found that the amount of the damage the parent company suffered was the decline in the value of the subsidiary's shares. In these two cases the parent companies had planned for the subsidiaries to sell the shares.

In the present case, after the company acquired its own shares it continued to hold the shares. The Court in this case decided that the amount of the damage to the com-

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16 TAKAHASHI, *supra* note 14, 557. K. EGASHIRA ET AL., *Kaisei kaisha-hô seminâ, jiko-kabushiki 3* [Seminar on Company Law Reform, Companies Holding their Own Shares 3], in: Jurisuto 1249 (2003) 84.

17 TAKAHASHI, *supra* note 14, 557. For details of the views amongst scholars, see E. TAKAHASHI, *Kanzen ko-gaisha wo tsûjite no oya-gaisha kabushiki no shobun to oya-gaisha torishimari-yaku no sekinin* [Liability of Parent Company Directors and Disposal of Parent Company Shares through a Wholly-Owned Subsidiary], in: Hanrei Taimuzu 975 (1998) 11.

18 Supreme Court, 9 September 1993, in: Minshû 47, 4814.

19 Tokyo Court of Appeals, 29 August 1994, in: Kinyû Shôji Hanrei 954, 14.

pany was the difference between the value of the Acquisition and the market value of the Shares at the time of the Acquisition. The Court held that the company, through the Acquisition, had contravened the former Article 210. As a result of the 2001 amendment, a company will not, in principle, contravene the current law by acquiring its own shares and holding them continuously. The present case suggests one of a number of possible approaches to calculating the amount of damage a company suffers where it holds its own shares after acquiring them.

The German law also has a trend towards the liberalization of rules governing companies acquiring their own shares (Article 71 Paragraph 1 Number 8 of the Joint Stock Corporation Act).[20] However, in German law there is not much discussion[21] on the issue of the calculation of the damage a company suffers from the illegal acquisition of its own shares. The discussion in the Japanese law will provide ideas on this issue to the German law.

IV. Legal Standing of Shareholders in Derivative Actions During Which They Become Shareholders of a Parent Company Through Share Exchange [22]

1. *Facts*

Shareholder X of S company brought an action against director Y of S company. S company intervened in the action on Y's behalf. X argued that when a meeting of the board of directors of S company was held to approve the rental of a building, owned by S company, to a real estate company, Y gave a false report and did not report on some important matters. As a result, a resolution to cancel the rental contract was concluded at the meeting, and therefore Y's act was a breach of the duty of care. X pursued the liability of Y for damages to S company.

The District Court dismissed the action because it found no facts relating to the breach of the duty of care by Y. X appealed.

After X appealed, P company became a 100% parent company of S company. P company issued shares in P company to the shareholders of S company in exchange for their S company shares. Through this share exchange, X's shares in S company were transferred to P company. As a result of the share exchange X became a shareholder of P company.

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20 H. BAUM, Rückerwerbsangebote für eigene Aktien: übernahmerechtlicher Handlungsbedarf?, in: ZHR 167 (2003) 580.

21 OECHSLER, in: Münchner Kommentar zum Aktiengesetz, Bd. 2, 2. Aufl., München 2003, § 71 Rn. 301; LUTTER, in: Zöllner (Hrsg.), Kölner Kommentar zum Aktiengesetz, 2. Aufl., Köln 1998, § 71 Rdnr. 82.

22 Tokyo Court of Appeals, 24 July 2003, in: Hanrei Jihô 1858, 154.

In the present case the issue was whether X lost the legal standing as a party concerned in the action upon losing standing as a shareholder of S company when X became a shareholder of P company through the share exchange.

The Court dismissed the appeal of X.

2. *Held*

A director owes the company a duty of care in performing his/her duties (Article 254 Paragraph 3 of the ComC; Article 644 of the Civil Code). A director also owes the company a duty to obey any law, the articles of incorporation and any resolutions adopted at a shareholders' meeting, and to perform his/her duties faithfully on behalf of the company (Article 254-3 of the ComC). If a director causes damage to the company by breaching these duties owed to the company, the director will be liable to the company for damages (Article 266 Paragraph 1 of the ComC). Basically, the company will pursue the liability of the director for damages. However, since it is contemplated in the Commercial Code that the company might fail to fulfill the pursuit of the liability, a provision for derivative actions has been introduced in order to protect the interests of the shareholders as a whole – the substantial owners of the company (Article 267 of the ComC). Via the derivative action each shareholder is entitled, as one of their shareholder rights for the common benefit, to bring an action on behalf of the company to seek the liability of the director for damages. In the Commercial Code "any shareholder who has held a share continuously at least for the last six months" may "institute an action to enforce the liability of the director on behalf of the company" (Article 267 Paragraphs 1-3 of the ComC).

Article 267 of the ComC, as mentioned above, allows a shareholder to institute a derivative action on behalf of "the company". One must look to other provisions of the ComC to determine the meaning of this term. In Article 260-4 Paragraph 7, the terms "company", "parent company" and "subsidiary" are used separately in the one clause. In other provisions (for example, Article 211-2, Article 244 Paragraph 6, Article 263 Paragraph 7, Article 274-3, Article 282 Paragraph 3 and Article 293-8 among others), these terms are also used separately. Therefore the term "company" is not used with the intention of including parent companies and subsidiaries.

The provisions for share exchange and other arrangements found in Article 352 of the ComC and the articles following it were introduced by the 1999 amendment in order to simplify proceedings for transforming a company into a 100% parent company or a 100% subsidiary. Article 267 was not amended along with these provisions in the 1999 amendment. With the introduction of these provisions, if a shareholder of a parent company is allowed to pursue the liability of a director of the subsidiary in an action (a so-called "double derivative action"), provisions for such an action should be introduced. Yet, the ComC has not been revised.

If these points – the purpose of the derivative action system, the need for consistency in the construction of the words in Article 267 relating to that system and the words of other provisions in the ComC, and the amendments to introduce the share exchange – are all considered together, it can be concluded that Article 267 of the ComC allows a shareholder who has held a share continuously at least for the last six months to institute an action against the director of the company which has issued that share. It can also be concluded that a shareholder of a company who loses standing as a shareholder and becomes a shareholder of a 100% parent company when the company becomes a 100% subsidiary through share exchange is not allowed to institute an action against a director of that subsidiary. This theory also applies to a case in which, while an action is pending, a shareholder who has filed the action becomes a shareholder of a 100% parent company through share exchange and loses standing as a shareholder of the now 100% subsidiary company (a 100% subsidiary) to which a director who is the other party in that action belonged. Consequently, the shareholder loses legal standing in that action.

3. Comment

In the present case, a shareholder of a company filed a derivative action against its director.[23] The company then became a wholly-owned subsidiary through share exchange. The shareholder lost standing as a shareholder of that company but became a shareholder of the 100% parent company. The Court held that Article 267 would not allow that shareholder to institute an action against the director of the subsidiary and this theory would also apply to a case where, during the derivative action, a shareholder who filed that action became a shareholder of the parent company and lost standing as a shareholder of its wholly-owned subsidiary through share exchange. In the end, the Court dismissed the appeal by X, who previously was a shareholder of S company.

The systems of share exchange and share transfer were introduced in 1999.[24] Share exchange and share transfer are both acts of a company aimed at establishing a relationship of 100% parent and subsidiary companies.[25] If the company which becomes the parent company is already an incorporated company, the share exchange is utilized

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23 For German literature on the derivative action in Japan, see HAYAKAWA, Die Aktionärsklage im japanischen Gesellschaftsrecht, in: Festschrift für Mestmäcker (2005) 891 ff., O. KLIESOW, Aktionärsrechte und Aktionärsklage in Japan (2001); E. TAKAHASHI, Aktionärsklage in der japanischen Rechtsprechung, in: ZJapanR Nr. 6 (1998) 101 ff.

24 KANDA, *supra* note 3, 271. For commentary by the law-makers on the share exchange, see K. HARADA, *Heisei 11-nen shôhô kaisei: kabushiki kôkan, jika hyôka* [The 1999 Amendment to the Commercial Code: Share Exchange and Market Value] (Tokyo 1999). For German literature on the share exchange in Japan, see U. EISELE, Holdinggesellschaften in Japan (2004).

25 EGASHIRA, *supra* note 4, 684.

(Article 352 of the ComC).[26] If the company which becomes the parent company is a newly founded company, the share transfer is utilized (Article 364 of the ComC). This system simplifies the establishment of holding companies.[27]

There are cases of the District Court and the Court of Appeals in which at issue was whether a plaintiff lost legal standing in a derivative action if the plaintiff lost standing as a shareholder – as a result of share exchange or share transfer – of the company to which a director, who was a defendant, belonged. All of the cases, including the present case, denied such legal standing on the grounds of the literal approach to the construction of Article 267 of the ComC.[28]

In contrast, most of the views amongst scholars accept such legal standing.[29] According to the first view, a shareholder who loses standing as a shareholder through voluntary actions, such as assignment of shares, will lose legal standing under Paragraph 1 of Article 267. However, according to this view, since the derivative action is not intended to address the issue of whether a shareholder who was forced to lose his/her standing as a shareholder also loses legal standing for a derivative action, such a shareholder should continue to be a 'shareholder' within the ambit of Article 267 Paragraph 1 and should not lose the legal standing.[30] The second view maintains that a double derivative action – an action by a shareholder of a parent company against a director of a subsidiary – should be allowed. The relationship between the parent company and the subsidiary forms one corporate entity in economic reality. In this relationship there is a relationship of multiple mandates between a shareholder of the parent company and a director of the subsidiary company. Between the effective mandator – the shareholder of the parent company – and the mandatary – the director of the subsidiary – there are the same rights and duties as between the shareholder of the parent company and the director of the parent company.[31] If an action is allowed for the effective mandator to pursue the liability of the mandatary, it will be possible for a shareholder of the parent company to pursue the liability of a director of the subsidiary.

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26 KANDA, *supra* note 3, 271.

27 *Ibid.*

28 E. TAKAHASHI, *Kabushiki iten to kabunushi daihyô soshô no genkoku tekikaku* [Share Exchanges and the Legal Standing of a Derivative Action], in: Shôji Hômu 1719 (2005) 131. An analysis of the cases can also be found in this text.

29 For an analysis of the views amongst scholars, see TAKAHASHI, *supra* note 28, 132.

30 *Tokubetsu zadankai: Kabushiki kôkan / kabushiki iten – seido no katsuyô ni tsuite* [A Special Round-table Discussion: Share Exchanges / Share Transfer – Use of the Systems], in: Jurisuto 1168 (1999) 115 (statement by Professor K. Egashira); K. YOSHIMOTO, *Kabushiki iten ni yoru kabunushi-chi'i no sôshitsu to kabunushi daihyô soshô no genkoku-tekikaku* [Loss of Shareholder Standing through Share Transfer and the Derivative Action], in: Hanrei Hyôron 516 (2002) 38; TAKAHASHI, *supra* note 28, 132.

31 Y. YAMADA, *Kabunushi daihyô soshô no hôri* [Principles of the Derivative Action] (Tokyo 2000) 310.

According to this view, if the share exchange or share transfer is carried out while a derivative action is pending, such an action will be transformed into a double derivative action and the former derivative action will continue.[32]

The grounds to support the first view are as follows. Firstly, since the parent company does not always take over and fulfill the action, if the action is dismissed there will be fears that restraint on unlawful acts of directors will not be effectuated.[33] Secondly, if the view expressed in the cases is adopted it will be possible to use the share exchange and share transfer improperly to avoid derivative actions.[34] Thirdly, although shareholders who are opposed to the share exchange or share transfer have an appraisal right, such a right does not reflect the interests a plaintiff would recover through a derivative action.[35] In other words, the value of the shares to be purchased from such shareholders is a fair value decided as if there were no resolution to approve the share exchange or share transfer and therefore the relief of the appraisal right does not reflect the value which the shares will be worth if a derivative action is filed and the plaintiff wins the action.[36]

In Article 267, a shareholder is, in principle, a shareholder of the company which issued the shares the shareholder holds, but if the plaintiff is forced to lose standing as a shareholder through the unilateral act of the company and such loss occurs against the will of the shareholder, the Article should be construed so as to imply that the plaintiff will exceptionally continue to be a 'shareholder' laid down in that Article.[37]

In German law there is an issue of whether a shareholder will lose legal standing for an action to rescind the resolution of a shareholders' meeting if the shareholder loses standing because he/she is squeezed out while the action the shareholder files is still pending.[38] The District Court of Mayence (Mainz), on 17 February 2004, held that a shareholder would lose legal standing under such circumstances.[39] Although the discussion on this matter in Japan is different from that in Germany, it does provide a suggestion for the German law.

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32 YAMADA, *supra* note 31, 332.

33 TAKAHASHI, *supra* note 28, 133; KABUNUSHI DAIHYÔ SOSHÔ SEIDO KENKYÛKAI, *Kabushiki kôkan / kabushiki iten to kabunushi daihyô-soshô* [Share Exchanges / Share Transfers and the Derivative Action], in: Shôji Hômu 1680 (2003) 10.

34 TAKAHASHI, *supra* note 28, 134.

35 YOSHIMOTO, *supra* note 30, 38. See also TAKAHASHI, *supra* note 28, 134.

36 See TAKAHASHI, *supra* note 28, 134.

37 TAKAHASHI, *supra* note 28, 134.

38 *Ibid.*

39 District Court of Mayence (Mainz), decision of 17.2.2004, BB 2004, 1132. For criticism against this decision, see HEISE / DREIER: Wegfall der Klagebefugnis bei Verlust der Aktionärseigenschaft im Anfechtungsprozess, BB 2004, 1126.

V. PIERCING THE CORPORATE VEIL [40]

1. Facts

In this case, creditor X, Mizuho Bank, brought an action and claimed payment against a borrower, Y1 company, as well as Y3 and Y4 who were jointly and severally liable on guarantee. In this action X also claimed against Y2 company for payment relating to the debts of Y1 company, arguing that Y2 company operated the business of Y1 company after obtaining it through a transfer, and consequently Y2 company also owed the same liability as Y1 company for the loan on the grounds of the principle of piercing the corporate veil. In the present case the issue was whether Y2 company owed such liability on the grounds of that principle.

Y1 company, which ran a business producing and selling confectionery, delayed repaying its debts on 1 August 2002 because in 2001 Y1 company was influenced by a large customer – the large European theme park Huis Ten Bosch – facing a decline in its business performance, and in May or June in 2001 Y1 company began to be refused loans by financial institutions. Y1 company incorporated Y2 company on 15 July 2002. On 1 October 2002, Y1 and Y2 companies concluded a contract for a transfer of the rights to the business of Y1 company to Y2 company (hereinafter: "the Transfer of Business").

As of 19 November 2002, the representative director of Y1 company was Y3 and its directors were Y4 (the son of Y3), S (the wife of Y4), M and W (the son and daughter of Y4), Q, R, and four other people. Y4 was a senior director. The shareholders of Y1 company were J, the son of Y4 who held 16,770 shares (39.929%), W, holding 14,500 shares (34.524%), M, holding 7,800 shares (18.571%), S, holding 2,210 shares (5.262%) and Z, holding 720 shares (1.714%).

As of 6 February 2003, the representative director of Y2 company was J, its directors were H and Q, and its auditor was R. J was the only shareholder of Y2 company.

Y1 company held a meeting of creditors after the Transfer of Business on 12 November 2002 and explained a plan that, out of the then debts of about 5,400,000,000 yen, Y1 company would repay the debts of about 2,200,000,000 yen and, out of the remaining debts of about 3,100,000,000 yen, Y1 company would pay the debts of 600,000,000 yen over ten years. However, seven financial institutions, including the plaintiff in the present case, rejected the plan.

In July 2002, at the time of the incorporation of Y2 company, J worked at F company, whose business was related to computer system solutions. J resigned from the company in March 2003. J left the proceedings for the incorporation of Y2 company to Y4. J was not very engaged in the management of Y2 company. Y4 played an active role in effectively managing Y2 company, including the Transfer of Business.

40 Fukuoka District Court, 25 March 2004 in: Kinyû Shôji Hanrei 1192, 25.

The actual head office of Y2 company was located at the premises of Y1 company. The office was at a different address from that found in the commercial registration.

Y1 company transferred its production division to Y2 company on 1 February 2003. Y1 company began to lease its factory and machinery to Y2 company. Y2 company began to produce confectionery.

The Court in the present case held that X was allowed to claim against Y2 company for the same rights as against Y1 company on the grounds of the principle of piercing the corporate veil.

2. Held

Y1 company owed debts of about 5,000,000,000 yen in 2002 and was influenced in its business by the decline in business performance of H theme park. Y1 company was refused loans by financial institutions. The Transfer of Business included the transfer of stores and employees, which were crucial parts of the sales division of Y1 company. Y2 company took over the rights to the trademark of Y1 company. O family effectively managed Y1 company. Y4 was a key person in the family and the effective manager of Y1 company. The shareholder of Y2 company was J, who was the second son of Y4. J took the office of the representative director of Y2 company. The actual head office of Y2 company was located at the premises of Y1 company and at a different address from that found in the commercial registration. The Transfer of Business in the end involved the transfer of a part of the confectionary production division from Y1 company to Y2 company. In July 2002, when Y2 company was incorporated, J, who was its representative director, worked at F company. J resigned from the company in March 2003. J left to his father, Y4, the actual proceedings for the incorporation of Y2 company. J was not very engaged in the management of Y2 company. Y4 effectively managed Y2 company and carried out matters on the Transfer of Business, the transfer of the production division and others. The creditors of Y1 company had no other option except execution that would need to be carried out over ten years and against 60,000,000 yen each year, which Y1 company would receive as yearly installments for those transfers. Taking into consideration the matters mentioned above and other matters occurring before and after the Transfer of Business, it is reasonable to conclude that the Transfer of Business was done in order for Y1 company to avoid execution by its creditors.

In that case, Y2 company was incorporated with the intention that Y1 company would avoid the payment of the debts. Such incorporation can be found to be an improper use of corporate entity. Therefore, on the grounds of the principle of piercing the corporate veil, X is allowed to claim against Y2 company the same rights as it can claim against Y1 company.

3. Comment

In the present case the Court held that Y2 company was incorporated with the intention that Y1 company would avoid the payment of debts, and such incorporation was an improper use of the corporate entity. Therefore, on the basis of the principle of piercing the corporate veil, X was allowed to claim against Y2 company the same rights as it could claim against Y1 company.

A Supreme Court precedent allows the piercing of the corporate veil on the grounds that, since the corporate entity is created by legal technique under legislative policy, it is necessary to allow piercing of the corporate veil if the corporate entity is entirely a mere formality or if the corporate entity is improperly used to avoid the application of the law.[41]

The principle of piercing the corporate veil is also accepted by scholars[42] as a general principle of corporate law. Scholars have tried to classify cases to which that principle applies into two categories. The first category is abuse of the corporate entity where the corporate entity is controlled by, and at the will of, a shareholder and that shareholder has an unlawful or unjust intention.[43] The second category is the mere formality of the corporate entity where the judicial person is only nominal, and where the company is virtually the personal business of a shareholder or a subsidiary is merely a business division of a parent company.[44] However, there are only ten cases where the principle of piercing the corporate veil has been allowed in relation to parent and subsidiary companies.[45]

The principle of piercing the corporate veil is a general legal principle and accordingly there is criticism that other rules of law should be applied before this general principle is relied upon. Therefore, there are seldom cases where this principle is acknowledged. The present case is an important rare case where the Court allowed the principle of piercing the corporate veil.

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41 Supreme Court, 27 February 1969, Minshû 23, 511.

42 See EGASHIRA, *supra* note 4, 33. See also K. EGASHIRA, *Kaisha hôjinkaku hinin no hôri* [The Principle of Piercing the Corporate Veil] (Tokyo 1980); S. MORIMOTO, *Iwayuru hôjinkaku hinin no hôri 1 2 3 4* [The So-called Principle of Piercing the Corporate Veil 1 2 3 4], in: Hôgaku Ronsô 89-3 (1971) 1, 89-4 (1971) 28, 89-5 (1971) 1, 89-6 (1971) 82.

43 EGASHIRA, *supra* note 4, 36.

44 Ibid, 37.

45 E. TAKAHASHI, *Doitsu-hô ni okeru kôgaisha saiken-sha hogo no shintenkai* [New Developments in the Protection of Creditors of Subsidiaries in German Law], in: Hôgaku 67-6 (2003)124.

VI. CONCLUSION

Many amendments have been made to Japanese corporate law recently. One of the recent amendments has introduced the systems of share exchange and share transfer. When a shareholder of a company files an action and, while it is pending, the shareholder loses standing as a shareholder of the company but becomes a shareholder of a 100% parent company through share exchange or share transfer, there is an issue of whether the shareholder should lose legal standing for that action. Most scholars consider this to be a defect in the law. This defect will be improved by the "Modernization of Corporate Law 2005" reform.[46]

Another recent amendment has been a liberalization of the rules governing companies acquiring and holding their own shares. A company can now acquire its own shares and hold them freely. There is an issue of how to decide the amount of damage the company suffers from holding its own shares after acquiring them. Although the case in this report was addressed under the old provision of the Commercial Code, it is of significance to the new Company Code of 2005, which liberalizes the rules on a company's acquisition and holding of its own shares.

Cases provide good material for courts to find defects in the law. Lawmakers then try to remove such defects by creating new law. The corporate law cases in 2003 and 2004 are good examples of this development by courts and lawmakers.

ZUSAMMENFASSUNG

Das japanische Gesellschaftsrecht ist in den vergangenen Jahren in verschiedenen Teilbereichen reformiert worden. Die Novelle von 1999 hat die Rechtsinstitute des Aktientausches und der Aktienübertragung eingeführt. Die Reform von 2001 hat die Regeln über den Erwerb und das Halten eigener Aktien liberalisiert. Die hier vorgestellten vier Entscheidungen japanischer Gerichte aus den Jahren 2003 und 2004 setzen sich mit Problemen auseinander, die durch diese Reformen verschärft worden sind.

Der erste Fall betrifft den Vergütungsanspruch eines Mitgliedes des Verwaltungsrates gegenüber seiner Gesellschaft, das nach formeller Beendigung seiner Bestellung zum vertretungsberechtigten Verwaltungsrat diese Position noch fast sieben Jahre lang ausübte und sich dafür auch weiter eine Vergütung auszahlen ließ. Die Gesellschaft

46 Art. 851 Company Code 2005, see HÔSEI SHINGIKAI KAISHA-HÔ BUKAI [WORKING GROUP ON CORPORATE LAW], *Kaisha-hôsei no gendaika ni kansuru yokôan 12/8/2004* [Draft of the Modernization of Corporate Law – 8 December 2004], in: Shôji Hômu 1717 (2004) 15.

verklagte ihn danach auf Rückzahlung gemäß Art. 266 Abs. 1 Nr. 5 HG, da die Entgegennahme der Vergütung Art. 269 HG verletzt habe, der vorschreibt, daß die Höhe der Vergütung eines Verwaltungsrates entweder in der Gesellschaftssatzung bestimmt sein oder von der Hauptversammlung beschlossen werden muß. Der OGH ist dem entgegen den Vorinstanzen gefolgt und hat festgestellt, daß ein Verwaltungsratsmitglied selber kein Recht zur Festsetzung der Höhe seiner Bezüge habe und daß dementsprechend, solange es an deren ordnungsgemäßen Festlegung fehle, überhaupt kein Vergütungsanspruch gegenüber der Gesellschaft bestehe.

Im zweiten Fall geht es um die Höhe des Schadensersatzes, den ein Verwaltungsrat an seine Gesellschaft zu leisten hat, wenn er einen unzulässigen Rückerwerb eigener Aktien durch sie veranlaßt hat. Ein Aktionär, der die Interessen der Gesellschaft durch den Rückkauf geschädigt sah und einen Verstoß gegen Art. 210 HG annahm, hatte eine entsprechende Klage gemäß Art. 266 Abs. 1 Nr. 5 HG erhoben. Das Distriktgericht Osaka hat festgestellt, daß sich der Schaden in einem solchen Fall aus der Differenz zwischen dem Marktwert und dem Rückkaufpreis der Aktien ergebe.

Die dritte Entscheidung befaßt sich mit der Klagebefugnis eines Aktionärs, der eine Aktionärsklage anhängig gemacht hatte, während des Verfahrens jedoch seine ursprüngliche Aktionärsstellung durch einen von der Gesellschaft veranlaßten Aktientausch verloren hatte, und statt dessen Aktionär der Muttergesellschaft geworden war. Der betreffende Aktionär hatte eine Klage gegen ein Verwaltungsratsmitglied auf Zahlung von Schadensersatz an die Gesellschaft erhoben, dem er vorwarf, seine Pflichten gegenüber dem Verwaltungsrat durch falsche und unvollständige Angaben im Zusammenhang mit einem Immobiliengeschäft verletzt zu haben. Während des Berufungsverfahrens wurden sämtliche Aktien des klagenden Aktionärs im Wege des Aktientausches auf eine neu gegründete Muttergesellschaft übertragen, wodurch er seine Stellung als Aktionär der alten Gesellschaft verlor, die zu einer hundertprozentigen Tochtergesellschaft der neuen Gesellschaft geworden war. Das Obergericht Tokyo bejaht einen Verlust der Klagebefugnis in derartigen Fällen.

Im vierten Verfahren geht es um eine Durchgriffshaftung. Aufgrund von Schwierigkeiten auf Seiten ihres wichtigsten Kunden hatte eine verschuldete Gesellschaft einen erheblichen Umsatzrückgang erlitten. Ihr Verwaltungsrat gründete darauf hin eine neue fast identische Gesellschaft, auf die er das Geschäft der alten transferierte. Das Distriktgericht Fukuoka vertritt die Auffassung, daß die neue Gesellschaft nur zu dem Zweck gegründet worden war, eine Rückzahlung der Verbindlichkeiten zu verhindern. Entsprechend hat das Gericht den Gläubigern der Altgesellschaft einen Durchgriff auf die neue Gesellschaft erlaubt, um ihnen eine Befriedigung ihrer Forderungen zu ermöglichen.

(Deutsche Übersetzung durch d. Red.)