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MEMORANDUM

TO: Professor Robert Eccles

FROM: Toshikazu Sakai and Shunsuke Domon
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RE: UN Global Compact Questionnaire

DATE: September 21, 2015

We have written this memorandum in relation to the below several questions. Please note that this memorandum is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice.

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Setting the legal landscape

1 Briefly explain the broader legal landscape regarding the obligations that a company has to its stakeholders or with regard to its impact on stakeholders, and in particular whether its primary duty is or is not to shareholders over all Non-Shareholders.

In Japan, the Companies Act 2005 (“Companies Act”) stipulates the duty of companies and the duty of its directors. It also sets out the various types of companies, and liabilities of the shareholders/unitholders of each type of company. In the following explanations, we will refer to a “company” as a stock company (called “Kabushiki Kaisha” in Japanese), which is the main type of company. Only this type of companies can become a listed company in Tokyo Stock Exchange (hereunder “TSE”).

In Japan, there are no specific and explicit provisions which state who are the “stakeholders”¹ of a company and against whom a company owes obligations and primary duties. Also, we did not find many court precedents and scholars’ articles which focused specifically on this issue. However, it is explicitly or implicitly “interpreted” in general that the ultimate purpose of a company is to maximize the interest of its shareholders. The first reason is that it is “interpreted” that aiming profit is one of the essential element of a company. In this regard, the meaning of aiming profit is conventionally and explicitly “interpreted” to distribute profit

¹ Although there is no specific definition of “stakeholders” in the Companies Act and other laws, generally speaking, a “stakeholder” in this context is interpreted to mean shareholders, creditors (including banks), business partners, employees, consumers and other various persons/entities which have certain interest or relationship with companies.

to its shareholders based on the “interpretation” of a provision that a shareholder of a company needs to have either (i) rights to receive distribution from surplus profit or (ii) residual claims against a company (Article 105, Paragraph 2 of the Companies Act).² The second reason is that, some leading scholars³ have explicitly discussed that, as a result of “aiming profit”, maximizing the interest of its shareholders is a basic principle for a company to determine how to mediate different type of interests among various stakeholders (including shareholders) surrounding the company⁴. In this regard, please also see Question 9 below.

On the other hand, there are no general provisions under the Companies Act which “imply” or can be “interpreted” as a company having obligations and duties against stakeholders other than shareholders (“Non-Shareholders”). The above leading scholars who proclaimed that the principle of maximizing the interest of its shareholders had also explicitly explained that, based on the above “interpretation” of the Companies Act, the primary duty of a company is not to represent and/or mediate different type of interests among Non-Shareholders.⁵ In relation to this, please also see Question 11 below.

However, we need to clarify a few points with regard to this issue.

- (i) First, even as recognised by the above leading scholars, a company is not prohibited but may consider the interest of Non-Shareholders if and to the extent that such interest contributes to the long term interest for shareholders (see Question 12 below).
- (ii) Secondly, generally speaking, to a certain extent, it is recommended that in order to interpret and operate the Companies Act responding to “CSR” (Corporate Social Responsibility)⁶ if and to the extent that it contributes to the long-term interest of shareholders. Nonetheless, details of proposed methods would be different depending on each author. However, it is generally agreed that it is useful for responding to CSR to expand the scope of disclosure mandatory or voluntarily not only limited to financial

² Under Japanese law (including, but not limited to, the Civil Code and the Companies Act), there are various types of corporations, including non-profit organizations (“Koueki Houjin”) the purpose of which is to facilitate public interest and benefit, such as academism, charity, environment, education, etc. On the other hand, a company is legally categorized as a type of corporation “aiming to operate profitable business”, i.e., aiming to distribute profit from the company’s activities to its shareholders.

³ Kenjoro Egashiora, *Laws of Stock Corporations, sixth edition (Yuhikaku, 2015)*, Seichi Ochiai, *The Purpose of Corporation Law – analyzing the principle to maximize the interest of shareholders*, in Seichi Ochiai and other authors, *Modern Laws 7; Corporation and Laws (Iwanami Press, 1998)*, etc.

⁴ We understand that the other scholars and lawyers (including judges) have implicitly agreed to such a conclusion.

⁵ We understand that other scholars and lawyers (including judges) have implicitly agreed to this conclusion.

⁶ Akio Takeuchi, *Social Responsibility of Corporations*, in Akio Takeuchi, *Theories of Corporation Act III (Yuhikaku, 1990)*

information but also includes “non-financial information” (as discussed below) such as “ESG” (Environment, Society, Governance) (see Question 16 below).⁷

- (iii) The third is that there is recently a strong movement to introduce the concept of CSR, ESG or “SRI” (Sustainable and Responsible Investing) into the area of “Soft Laws” such as the Corporate Governance Code and the Stewardship Code (see Questions 11 and 22 below).

⁷ When it was discussed in the 1970’s whether to introduce the CSR Provision (as defined below) in the Companies Act, introducing external directors to reflect various interests in society was proposed as an alternative method for the CSR Provision (see Questions 11 and 15 below). Further, another scholar (Hiroshi Noda, *CSR and Companies Act*, in Kenjiro Egashira (ed.), *Survey of Stock Corporations Law (Yuhikaku, 2013)*) noted that, in order to mitigate legal risks for directors who violated their duties when conducting CSR, interpreting the discretion of directors broadly when directors conduct CSR with or in relation to company’s business would be useful for such methods (see Question 13-2 below).

Regulatory Framework

2 To what legal tradition does the jurisdiction belong, i.e. civil/common law, mixed?

Japan is a civil law country. The underlying framework of the current Japanese legal system was influenced by certain European civil law systems, such as the laws of Germany and France. However, especially after World War II and particularly in the area of business law, Japanese laws and regulations (including but not limited to the Constitution, the Companies Act, the Financial Instruments and Exchange Act and the Corporate Governance Code) have been strongly influenced by the laws and regulations of common law countries (especially the U.S.).

3 Are corporate/securities laws regulated federally/nationally, provincially or both?

Both corporate / securities laws are regulated nationally.

4 Who are the government corporate/securities regulators and what are their respective powers (in summary only)?

There are no specific government agencies or other bodies responsible for generally enforcing statutes.

(i) Corporate regulators

The Ministry of Justice (“MOJ”) is a government agency having authorities to enact, amend and interpret as governing agency the Companies Act. Also, the MOJ regulates companies regarding their registration for incorporation and any material changes thereafter (e.g. issuance and basic contents of securities). A department under the MOJ, the Legal Affairs Bureau, deals with such procedures.

(ii) Securities regulators

The Financial Services Agency (“FSA”) is a government agency having authorities to regulate securities laws. The Financial Instruments and Exchange Act (“FIEA”) is the basic governing law applicable to securities transactions, securities business and parties involving in them, including (i) disclosure requirement for investors in case of public offering of securities issued by companies, such as an filing requirement of securities registration statement (“SRS”) with the relevant authority to which the FSA designates its power and authorities and (ii) disclosure requirement for investors applicable to certain issuers of securities (typically, listed companies) such as an filing requirement of annual securities report, quarterly report, semi-annual report, extraordinary report, (iii) registration/license requirement for business operators engaging in securities transactions and securities business and (iv) code of conducts applicable to registered business operators under the FIEA. The FSA has the power to enforce these regulations

with its authorities to impose administrative and criminal sanction (if applicable) to relevant parties.

In addition, for listed companies, the rules of the TSE are enforced through a listing agreement between the TSE and the listed company.

5 Does the jurisdiction have a stock exchange?

Yes.

The TSE has several markets for the securities of the listed companies. The markets vary depending on the number of shareholders, amount of aggregate market price of a company and so on. In the following parts, we treat the stock exchange as the 1st section of the TSE, which is the main and the largest market among the Japanese securities markets.

Incorporation and listing

6 Do the concepts of “limited liability” and “separate legal personality” exist?

The concepts of separate legal personality and limited liability are cornerstones of the Companies Act. However, in exceptional situations the court will ‘pierce’ the ‘corporate veil’ and impose liability on a parent company based on the precedents of the Supreme Court and lower courts in Japan.

7 Did incorporation or listing historically, or does it today, require any recognition by the company or its directors of a duty to society, an obligation to take account of the company’s social or environmental impacts, or to respect its stakeholders?

(i) Incorporation

During incorporation, no such duty or obligation is owed.

(ii) Listing

A company listed or to be listed on the TSE must fulfill various conditions stipulated in the Securities Listing Regulations (“Listing Regulations”) during listing. However, there is no specific duty or obligation in the Listing Regulations in relation to social or environmental impact, except for the condition not to have connection with anti-social groups.

The Listing Regulations require the TSE to consider the possible listing of the company from the “viewpoint of the public interest or the protection of investors”. The “New Listing Guidebook; 1st and 2nd sections” issued by the TSE, which stipulates certain guidelines on how to interpret the Listing Regulations, explains that considering the “viewpoint of the public interest or the protection of investors” means to consider whether the purpose or business of the company infringe public interest or applicable laws and regulations (including the FIEA).

8 Do any stock exchanges have a responsible investment index and is participation voluntary? (See e.g. FTSE4Good, Dow Jones Sustainability Index, the Johannesburg Stock Exchange’s Socially Responsible Investment Index).

No.

The TSE groups all listed companies into 33 categories in accordance with a company’s type of business. Apart from grouping companies into these categories, the TSE has focused on “ESG stocks”, which are considered favorable from the viewpoint of ESG.

In addition, the Ministry of Economy, Trade and Industry (“METI”) and the TSE have jointly selected and publicized listed companies that are exceptional in encouraging women’s success in the workplace, and granted them the “Nadeshiko Brand” designation.

Directors' Duties

9 To whom are directors' duties generally owed?

Under the Companies Act, it is stipulated that directors of a company owe their duties to the company.

Some leading scholars⁸ explicitly “interpret” that this substantially means that a company owes their duties to its shareholders to maximize their interest. One of the reasons is that the purpose of a company is to earn profit and distribute it to its shareholders who have residual claims (see Question 1 above). The second reason is that it is generally “interpreted” that shareholders are owners of a company, the ultimate beneficiaries of the company, based on the “interpretation” of such provisions as the above residual claims and that shareholders have the power and discretion to elect and remove directors (Article 329, Paragraph 1 of the Companies Act).⁹

Please note, however, that it does not mean that directors owe statutory or contractual legal duties directly to each shareholder (please also see footnote 30 in Question 13 below). It means that, whether or not directors fulfill their duties to the company must be substantially determined based on the principle to maximize the interest of all shareholders.

10 What are the duties owed by directors – please state briefly. Please indicate if there are any express or implied duties to avoid damage to the company's reputation.

(i) General duties owed by directors

Under the Companies Act, and as a general rule, it is stipulated that directors of a company owe (i) duty of care of a prudent manager to the company¹⁰ and (ii) duty of loyalty to the company.¹¹ The Supreme Court determined that the duty of loyalty has the same nature as duty of care of a prudent manager and such not stipulated as higher duty than duty of care of a prudent manager.

Also, the relationship between a company and its directors is governed by the provisions on a director's mandate. Directors are required to comply with their respective mandates, the articles of the company, resolutions of shareholders meeting, and the applicable laws.

(ii) Restrictions on Competition and Transactions involving Conflict of Interest

⁸ Kenjoro Egashiora and Seichi Ochiai (please see footnote 3)

⁹ We understand that other scholars and lawyers (including judges) have implicitly agreed to this conclusion.

¹⁰ Article 303 of the Companies Act, Article 644 of the Civil Code

¹¹ Article 335 of the Companies Act

Specifically, for directors, the Companies Act stipulates restrictions on competition and transactions involving conflicts of interest.

The restrictions stipulate that directors can only (1) conduct business that competes with the company's business, or (2) enter into transactions involving a conflict of interest, after said director has made full disclosure of material facts to the board of directors and the company has ratified such conduct by way of a board resolution¹².

In addition, even if board resolutions to this effect have been passed, if such business or transactions cause damage to the company, the director responsible is liable to compensate the company for damage suffered. Other directors who voted in favour of such resolutions are liable to be held responsible for the company's damages¹³.

(iii) Duties to avoid damage to the company's reputation

There are no express duties to avoid damage to the company's reputation. However, as the duties of directors to maximize shareholders' interests, it can be "interpreted" that directors owe implied duty to avoid damage to the company's reputation.

11 More generally, are directors required or permitted to consider the company's impacts on non-shareholders, including impacts on the individuals and communities affected by the company's operations?

Under the Companies Act, as briefly discussed above, directors are not required but permitted to consider the company's impact on Non-Shareholders including individuals and communities to some extent.

(i) The Companies Act

There are no specific provisions mandating a director to consider such impact.

However, directors are permitted, based on their discretion (see Question 13-2 below), to consider such impact provided directors do not prioritize the interests of Non-Shareholders above the interest of the shareholders in the long-term. Even if certain actions do not appear to be directly related to a company's business, directors may execute such actions as long as the company derives a benefit out of this. However, the directors should be prepared to justify their actions in light of how it will benefit the company and its shareholders.

In connection with the above, there are two further topics to consider.

¹² Article 356, Article 365, Paragraph 1 of the Companies Act

¹³ Article 423, Paragraphs 1 and 3 of the Companies Act

a. Movement to introduce CSR Provision in the 1970's

As a historical matter, in the 1970's, the MOJ circulated a public questionnaire titled "Issues in connection with the Amendment of the Companies Act" including a topic about the appropriate treatment of CSR under the Companies Act, such as whether to stipulate a general provision that directors have duties to comply with CSR ("CSR Provision").¹⁴ However, no amendment was (and has not been) made to directly stipulate legal obligations as to CSR under the Companies Act since the majority of people think that, from a legal perspective, there is no means to stipulate a CSR Provision.¹⁵ Instead, it was proposed that the CSR issue would be resolved by amendments and/or the flexible operation of each provision under the Companies Act to strengthen corporate governance, such as (i) introducing shareholders' proposal rights (see Question 21 below), (ii) introducing external directors (see Question 15 below), and (iii) expanding the scope of mandatory disclosure to include CSR and ESG information (see Question 16 below).

b. Recent Corporate Governance Discussion

In addition to the above (a), one leading scholar¹⁶ noted that the corporate governance issue at present (including the principle of maximizing the interest of shareholders and CSR) would need to be discussed taking into consideration "Law and Economics" (including the position of "nexus of contracts"). Another leading scholar¹⁷ also mentioned the recent academic CSR theory¹⁸ which argues that companies (especially listed companies) should be established and operated under a principle to consider and represent a broader spectrum of interests of Non-Shareholders, as well as the company's shareholders. However, both of the said scholars concluded that, as an "interpretation" of the Companies Act, it is understood in Japan that the principal duty of directors remains the need to

¹⁴ This was the time after rapid economic growth from the 1950's where various social problems in connection with companies occurred such as environmental pollution, defected commodities, window-dressed accounts.

¹⁵ One of the representative comments was that there is no means to stipulate "social responsibility" of companies in law since "social responsibility" is not a legal responsibility. The second representative comment was that, even if there were some means to do so, from a legal perspective, there are so many ambiguous issues such as (i) what is the meaning of "responsibility" when violating CSR (criminal sanction, administrative sanction, civil responsibility, or any others), (ii) who is "society" (employees, creditors (including banks), business partners, consumers, local residents, etc.), (iii) who owes the "responsibility" (only listed companies or all companies, company itself or directors of the company). The third representative comment was that the CSR Provision could lead to a situation where directors have too much power to direct the company, leaving shareholders unable to exercise useful monitoring and control (please also see below).

¹⁶ Seichi Ochiai, *The Purpose of Corporation Law – analyzing the principle to maximize the interest of shareholders*, in Seichi Ochiai and other authors, *Modern Laws 7; Corporation and Laws* (Iwanami Press, 1998)

¹⁷ Kenjoro Egashiora, *Laws of Stock Corporations, sixth edition* (Yuhikaku, 2015)

¹⁸ It has been explained that this CSR theory has its ground on "Incomplete Contract Model" in economics.

“maximize the interest of its shareholders”¹⁹. As a result, the role to protect Non-Shareholders is not owed by companies/directors (under the Companies Act) but by other area of laws that apply to and regulate a company such as labor law, anti-trust law, consumer protection law, environmental law, etc.

Please note, however, that even the above scholars permit certain flexibility and exemptions when applying the principle to each case (see Question 12 below)

(ii) Corporate Governance Code

The FSA enacted the Corporate Governance Code (“Code”) as one of the “Soft Laws” (see Question 1 above) for “seeking sustainable corporate growth and increased corporate value over the mid- to long-term” in March 2015. It is officially explained that the Code is made in compliance with the OECD Principles of Corporate Governance.

The Code specifies (i) five general principles, (ii) principles and (iii) supplementary principles (collectively, the “Principles”). The five general principles are as follows:

- (a) securing the rights and equal treatment of shareholders;
- (b) appropriate cooperation with the Non-Shareholders (including employees, customers, business partners, creditors and local communities);
- (c) ensuring appropriate information disclosure and transparency;
- (d) the responsibilities of the board of directors; and
- (e) dialogue with shareholders.

In response, the TSE amended the Listing Regulations to reflect and include the Principles of the Code. From June 2015, the TSE requires listed companies to comply with the Principles and if they do not, to explain why they are unable to comply (the “comply or explain” approach).

Through the Principles, the Code and the above amended Listing Regulations, the TSE encourages listed companies to cooperate appropriately with the Non-Shareholders (i.e. employees, customers, business partners, creditors and local communities). One of the Principles of the Code also requires that companies make effective use of independent directors. The Code suggests that companies should consider promoting ESG and the encouragement of women’s success in the workplace.

According to the purpose of the Code, listed companies are encouraged to consider their impact on individuals and communities. However, there is no specific description in the Code as to how much companies ought to consider such impact. Further, the

¹⁹ It is due to such concerns that (i) the above CSR theory could harm the economic efficiency of companies and as a result reduces social wealth or (ii) the above CSR theory could lead to a situation where directors have too much power to direct the company, leaving shareholders unable to exercise useful monitoring and control.

Code states that “taking positive and proactive measures toward ESG (environment, social and governance) matters may also be included as part of this cooperation. The appropriate actions of companies based on the recognition of their stakeholder responsibilities will benefit the entire economy and society, which will in turn contribute to producing further benefits to companies, thereby creating a virtuous cycle.” From this, it appears that even the Code recognizes that the guiding principle of companies is to maximize the interests of their shareholders.

11-2 Is the answer the same where the impacts occur outside the jurisdiction?

Yes. There is no specific law or regulation for special exemption on this issue.

11-3 Can or must directors consider such impacts by subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?

For the above reasons, directors may consider such impact as long as it is beneficial (including medium and long term benefit) to the company and its shareholders.

12 If directors are required or permitted to consider impacts on nonshareholders to what extent do they have discretion in determining how to balance different factors including such impacts?

When considering the impact on Non-Shareholders, there are no definitive and clear standards as to what extent directors have the discretion in determining how to balance different factors including such impact. Generally speaking, it is up to the directors’ own discretion (see Question 13-2 below), bearing in mind their duty to the company of care of a prudent manager and duty of loyalty (see Question 10 above) and duty to the shareholders to maximize the shareholders’ interests (see Question 9 above).

As noted above, it is generally “interpreted” that the principle of maximizing the interest of its shareholders can be interpreted flexibly to a certain extent and would also have certain exemptions (see Questions 1 and 11 above). A leading Japanese legal scholar²⁰ illustrated several such exceptions: (i) a company’s articles of incorporation may permit the distribution of a certain limited percentage of its profit to charity or social contribution, (ii) directors of a company may make certain contributions to charity within its broad discretion assuming that it corresponds to the social demand to carry out CSR and the amount is appropriate, (iii) to a reasonable extent, a director may procure “long term” profit for shareholders while in the short term, operate by prioritizing other interests such as keeping employment, (iv) in an insolvency situation, it may be illegal for a company to operate with the aim of maximize shareholders’ interests while sacrificing creditors’ interests, and (v) directors cannot pursue the maximization

²⁰ Kenjoro Egashiora, *Laws of Stock Corporations, sixth edition (Yuhikaku, 2015)*

of shareholders' interests if it violates applicable public interest laws, e.g. criminal law, anti-trust law etc.^{21 22}

12-2 What additional liabilities, if any, do the board or individual directors assume in exercising such discretion?

Generally, each member of the board of directors owes the duty to monitor the performance of the other directors, in particular, those who actually execute the company's business (e.g. representative directors).

13 What are the legal consequences for failing to fulfil any of the duties described above; and who may take action to initiate them?

(i) Liabilities to the company

a. Liabilities

The Companies Act states that "if a director neglects her/his duties, s/he shall be liable to such a company for damages arising as a result thereof".²³ In addition, such negligence could be a reasonable ground and a justifiable cause for the shareholders of the company to dismiss the liable directors (please see below). When there is a justifiable cause for dismissal, the dismissed director cannot claim compensation from the company for the dismissal.²⁴

²¹ In the case of (iv) and (v), if directors are knowingly or grossly negligent in performing their duties, such directors would be liable to a third party for damages arising as a result of their negligence. Also, a company is liable for damages caused to third parties by its representative directors or other representatives during the course of the performance of their duties.

²² With regard to this issue, practically and as recent as the early 1990's, certain famous economic scholars traditionally discussed that Japanese corporations had been managed not only for the benefit of shareholders but also to mediate between the interest of different groups, including its employees and banks (e.g. Paul Milgrom/John Roberts, *Economics, Organization & Management* (Prentice Hall, 1992) quoting Mashiro Aoiki, *the Corporate Game Theory of the Firm* (Cambridge; Cambridge University Press, 1984)), based on the special social background in Japan such as the long-term employment system (including a system to elect directors from employees; please also see footnote 35 in Question 15 below) and the so called "main bank" system (although there is no definitive definition of "main bank", "main bank" is generally interpreted to mean such a bank/banks which has the most close relationship with a company not only through finance/lending but also holding certain ratio of shares of the company and sending directors to the company). Another economic scholar has recently noted that Japanese corporate governance has a unique structure where Non-Shareholders such as employees and main bank can influence the management of companies (Masaharo Hanazaki, *Corporate Finance and Corporate Governance - An Informational and Institutional Approach* (Tokyo University Press, 2008)).²² We are not in a position to analyze whether the above analysis is correct or not. From a legal perspective, we have not found articles focusing on the issue of how to interpret the relationship between the principle of maximizing the interest of its shareholders and the above analysis. Our reasonable and best assumption is that the above Japanese style of corporate governance is within the discretion of directors and may be made for the long-term benefit of shareholders.

²³ Article 423, Paragraph 1 of the Companies Act

²⁴ Article 339, Paragraph 2 of the Companies Act

b. Legal entity to claim

(a) Compensation

As noted above, if a director neglects her/his duties, a company may claim compensation for damage suffered as a result against that director. However, in exceptional circumstances, shareholders of the company or, in some circumstances, another interested company (e.g. shareholders of its holding company or shareholders of its subsidiary company) may bring such action for compensation on behalf of the company, instead of the company itself (i.e. a derivative lawsuit).²⁵

(b) Dismissal

Under the Companies Act, directors may be dismissed at any time by a shareholders' resolution.²⁶ However, a director who has been dismissed is entitled to demand damages arising from the dismissal if such dismissal is unjustified.

Under the Companies Act, shareholders who fulfill certain requirements may demand that the company include certain matters (limited to the matters on which such shareholders may exercise their votes.) in the purpose of the shareholders meeting²⁷ (please also see Question 21 below). In this demand, the shareholder may request the company to put "dismissal of the directors" as one of matters to be resolved. Also, shareholders who fulfill certain requirements may demand that the company call the shareholders meeting in exceptional circumstances.²⁸

(ii) Liability to a third party

Under the Companies Act, if directors are knowingly or grossly negligent in performing their duties, such directors will be liable to third parties for damages caused to them as a result thereof.^{29 30}

²⁵ Article 847, Article 847-4 of the Companies Act

²⁶ Article 339, Paragraph 1 of the Companies Act

²⁷ Article 303, Paragraph 1 of the Companies Act

²⁸ Article 297 of the Companies Act

²⁹ Article 429, Paragraph 1 of the Companies Act

³⁰ It is generally interpreted that shareholders of a company is also included in the scope of a "third party", and "damage" includes not only direct damage but also indirect damage where the third party indirectly suffers as a result of direct damage suffered by the company. However, it is general interpreted that shareholders who suffer the

In addition, when a representative director causes damages to a third party, the company is also liable to a claim for compensation from such third party.

13-2 What defences are available?

There are several defences available to directors. However, in practice, most directors will deny that they neglected to perform their duty as directors.

S/he might claim that the actions which caused the damages were in the scope of her / his performance of duties and broad discretion as a director. In this regard, Japanese courts usually consider whether (i) the director carelessly misunderstood the facts which formed the basis of the decision or (ii) whether the director's decision-making process or the merits of the decision was objectively unreasonable (the "Japanese Principle"). The Japanese Principle is similar to the so-called "Business Judgment Rule" under US law, however, a leading Japanese scholar³¹ pointed out that the Japanese Principle is different from the Business Judgment Rule. This is because under the Business Judgment Rule, a court does not look into whether the decision made by directors was right or not, whereas under the Japanese Principle, a court may look into the reasonableness of the decision if necessary.

Even the above leading scholar who proclaimed that the principle of maximizing the interest of its shareholders³² explicitly noted that the Japanese Principle should be applied when determining whether directors violate the principle of maximizing the interest of its shareholders.³³

It should be noted that in certain cases, there may exist an agreement between the directors and the company under which the directors' liability to compensate the company may be limited.

13-3 Can these issues give rise to other causes of action or regulatory routes whereby a stakeholder can exert pressure on a company with regard to its actions?

N/A

14 Are there any other directors' duties which are relevant to the interests of stakeholders?

loss of share value (indirect damage) may not claim this third party liability to directors since such damage by the company needs to be recovered through a derivative lawsuit for the benefit of all shareholders (please also see Question 9 above).

³¹ Kenjoro Egashiora, *Laws of Stock Corporations, sixth edition (Yuhikaku, 2015)*

³² Seichi Ochiai, *The Purpose of Corporation Law – analyzing the principle to maximize the interest of shareholders*, in Seichi Ochiai and other authors, *Modern Laws 7; Corporation and Laws (Iwanami Press, 1998)*

³³ As noted above, when directors consider CSR, ESG, SRI and/or impact on Non-Shareholders, the Japanese Principle can be used to mitigate legal risk for directors who could violate their duties when conducting CSR if such conduct is made with or in relation to company's business (see footnote 7 in Question 1 above).

There are no other directors' duties which are relevant to the interests of stakeholders.

15 For all of the above, if these exist in your jurisdiction, does the law provide guidance about the role of supervisory boards in cases of two tier board structures.

(i) Traditional structure

The traditional structure of a board of a company is the one tier board structure. In this structure, the board of directors consists of all the directors of the corporation including all representative director(s). The board of directors decides the company's business, and appoints and removes representative directors. On the other hand, a representative director shall report the status of the execution of her / his duties to the board of directors at least once every three months.³⁴ The board may and shall supervise execution of duties by directors.

Please note that there are no specific laws and regulations on the supervision of representative directors.

(ii) Three Committees Structure

Three committees structure ("Three Committees Structure") was introduced in the amendment of the Companies Act in 2002, and it was expected to improve the monitoring of representative directors.³⁵

Under this structure, a company has three committees, which are committees for audit, nomination and compensation, and executive officers appointed by the board.³⁶ Each committee needs more than three directors and the majority of each committee must have external directors.³⁷ Except for the audit committee, the executive officers may also become a member of the committees. Under this structure, executive officers and the board of directors are responsible for making decisions on the company's business.

The board is empowered to decide matters relating to the company's business, appointment of members of these committees and executive officers, and supervising

³⁴ Article 363, Paragraph 2 of the Companies Act

³⁵ Originally, directors and statutory auditors' role was to monitor representative directors. However, in many companies in Japan, almost all directors are from employees of the companies and there is a certain hierarchy or order between directors and the representative directors virtually have powers of nomination of directors and statutory auditors (please also see footnote 22 in Question 12 above). Thus, some say, it is likely to be difficult for directors and statutory auditors to efficiently monitor the representatives. To solve such problems, Three Committees structure was introduced in 2002.

³⁶ Article 326, Paragraph 2 of the Companies Act

³⁷ Article 400, Paragraphs 1 and 3 of the Companies Act

execution of executive officers.³⁸ Please note that some scholars have said that the board under this structure is different from the so called supervisory board since the board resolves not only supervising matter but also the company's business.

However, according to a survey, among the listed companies, only approximately 65 of approximately 3,500 companies (approximately 1.9 %) have adopted the Three Committees Structure as of July 2015.³⁹

(iii) New structure

Under the above circumstances, by the amendment of the Companies Act in 2014, the Companies Act introduced a new structure which includes an audit committee but not a nomination committee nor compensation committee ("Audit-Committee Structure").⁴⁰ This structure consists of the board of directors and an audit committee.

Under the Audit-Committee Structure, the audit committee has the power to express its opinion about the nominations and dismissals of the directors, compensation of officers and so forth during shareholders meetings. Also, if the audit committee allows transactions involving a conflict of interest, the presumption of negligence of the director who is in conflict (see Question 10 (ii) above) does not apply to the specified directors. Through these powers, the audit committee performs supervisory functions.

It is said that this new structure was established in response to the hesitation of representative directors to adopt the nomination committee and/ or compensation committee described in the above and to achieve a way to encourage the company to use external directors more efficiently.

According to a survey, more than 100 listed companies are adopting this structure and a number of listed companies are considering adopting it. Thus, we assume this structure will draw more attention in near future.

15-2 What obligations are owed by senior management who are not board directors? Is this determined by law if no specific contractual provision applies?

N/A

³⁸ Article 400, Article 416 of the Companies Act

³⁹ Some say that this is partly because the representative director might dislike the structure because it would interrupt her / his powers regarding nomination of directors or officers by the nomination committee whose majority was occupied by external directors. Others say that this is partly because the powers of the nomination committee and/or compensation committee are too strong.

⁴⁰ Article 2, Item 11-2, Article 326, Paragraph 2 of the Companies Act

Reporting

16 Are companies required or permitted to disclose the impacts of their operations (including stakeholder impacts) on non-shareholders, as well as any action taken or intended to address those impacts? Is this required as part of financial reporting obligations or pursuant to a separate reporting regime? Please specify for each reporting route whether it is mandatory or voluntary.

Please describe any mandatory reporting requirement, major voluntary initiative or trend towards voluntary reporting with regard to transparency (for example, payments to government or state-owned entities, reports on government orders to undertake surveillance or interception, reports on tax payments etc.).

Companies are not specifically required but permitted to disclose the impact of their operations (including stakeholder impact) on Non-Shareholders, as well as any action taken or intended to address those impacts. Practically, this is permitted in connection with mandatory disclosure or independent voluntary disclosure. The following is the summary of them.

(i) Overview

Disclosing company's information to applicable investors and Non-Shareholders is very important to fulfil the "asymmetric information" gap between the company and stakeholders.

In Japan, there are two forms of disclosure: (i) "system disclosure" where certain disclosure is mandatory, and (ii) voluntary disclosure where the company voluntarily discloses information including the impact of their operations (including stakeholder impact) on Non-Shareholders, such as a CSR report and IR (investor relation) information.

In "system disclosure", there are two different classes of disclosure involved, namely: (a) disclosure under the FIEA ("FIEA Disclosure") and (b) disclosure under the Companies Act ("CA Disclosure"). The purpose of the FIEA Disclosure is to provide necessary information for investment against the company to investors (including potential investors in general) and capital market, and disclosed information is publicly available by any person. On the other hand, the purpose of the CA Disclosure is to provide necessary information to existing stakeholders and creditors of the company; the disclosed information is available only to them.⁴¹

⁴¹ Under the CA Disclosure, a company is required to prepare and disclose (i) "financial statements" under the Companies Act (balance sheet, income statement, statement of shareholder's equity, notes to specified items) and annexed detailed statement and (ii) business report.

Under the FIEA Disclosure, there are two further types of disclosure: (i) the so called “statutory disclosure” (“Statutory Disclosure”) which is required by the FIEA⁴² and (ii) disclosure in stock exchange (“Stock Exchange Disclosure”) where listed company disclose applicable information pursuant to applicable regulation in the stock exchange.

In the following, we will discuss whether companies are required or permitted to disclose the impact of their operations (including stakeholder impact) on Non-Shareholders in “system disclosure”.

(ii) Stock Exchange Disclosure: Report Concerning Corporate Governance (“Corporate Governance Report”)

Based on a timely disclosure required by the TSE (Stock Exchange Disclosure based on the Listing Regulation), listed companies are required to file a Corporate Governance Report which includes specified descriptions on the corporate governance of the company such as the status of efforts to respect positions of various stakeholders, including supplemental explanation as to whether the company makes and discloses its environmental report, CSR report, sustainability report or other similar reports, and so forth. In the Corporate Governance Report, the listed company is required to disclose the extent of the company’s compliance with the Code.

(iii) Statutory Disclosure and CA Disclosure

Under the Statutory Disclosure and the CA Disclosure, there are no provisions specifically requiring companies to disclose the impact of their operations (including stakeholder impact) on Non-Shareholders.⁴³ However, the recent trend is that the scope of disclosing “non-financial information”⁴⁴ has expanded, as far as practical operation of these disclosures.

⁴² Under the Statutory Disclosure, a company is required to disclose a “company profile” containing the following sections: (a) “company overview”, (b) “business condition”, (c) “facilities and equipment”, (d) “company information”, (e) “accounting information”, etc. In the “accounting information” section, in the case of a domestic company, the company is required to prepare and disclose consolidated and non-consolidated “financial statements” under the FIEA (balance sheet, income statement, statement of shareholder’s equity, cash flow statement and annexed detailed statement, etc.).

⁴³ As noted above, when it was discussed in the 1970’s whether to introduce the CSR Provision in the Companies Act, there were proposals to expand the scope of mandatory CA Disclosure to include certain CSR or ESG information (e.g. preventing environmental pollution, consumer protection and any other problems in relation to society, and measures which a company takes against them) in business reports. Also, as a general discussion, a leading scholar at that time (Akio Takeuchi, *Social Responsibility of Corporations*, in Akio Takeuchi, *Theories of Corporation Act III (Yuhikaku, 1990)*) proposed that, from a legal perspective, we need to consider to what extent corporate information must be mandatory disclosed with examining content of disclosed information, parties to be disclosed, method to disclose, expected function and its limit by such disclosure.

⁴⁴ Please note that there is no definitive definition of “non-financial information” under Japanese law. The broadest meaning of “non-financial information” can be all company’s information except for “financial statements” under

First, even under and in connection with Statutory and CA Disclosures, companies are not prohibited from discussing such topics in its business report, annual securities reports or other reports. Actually, we could find many annual securities reports including CSR information. Secondly, in annual securities report, there are some items where “non-financial information” can be included and disclosed: “Business and other risks”, “Status of the Corporate Governance” and so forth. In those sections, the company may refer to the ESG information and would have to do so in the case where it affects the decision of company’s investors.

Also, in the case of Statutory Disclosure, when a company files its annual securities report for the fiscal year which ends after March 31 2015, the annual securities report must also describe numbers of each male and female directors and ratio of female directors.

17 Do legal reporting obligations extend to such impacts outside the jurisdiction; to the impacts of subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?

The company needs to disclose its impact in other jurisdictions if such impact “materially” affects the company and fulfills certain criteria for disclosure. For example, under the Statutory Disclosure, a company has to file an extraordinary report when a company commences a public offering or a public offering by way of secondary distribution (except for those targeted at less than 50 people) by the company outside Japan of equity securities of the company with an aggregate offering price or exercise price of 100 million Japanese yen (“JPY”).^{45 46}

In addition, under the Statutory Disclosure, any event (whether inside or outside of Japan) which would have a material effect on the consolidated companies’ financial condition or operational results, as well as on those of the company itself, must also be disclosed in an extraordinary report.⁴⁷

18 Who must verify these reports; who can access reports; and what are the legal or regulatory consequences of failing to report or misrepresentation? Is there a regulator tasked with investigating complaints of misreporting?

(i) Verification

the Companies Act and the FIEA. However, typical image of “non-financial information” is narrower than it, such as ESG or CSR information.

⁴⁵ It is equivalent to approximately USD 800,000 or more.

⁴⁶ Article 24-5, Paragraph 4 of the FIEA and Article 19, Paragraph 2, Item 1 of the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc. (“Disclosure Ordinance”)

⁴⁷ Article 24-5, Paragraph 4 of the FIEA and Article 19, Paragraph 2, Item 13 of the Disclosure Ordinance, etc.

Under the Statutory Disclosure, a “financial statement” submitted by a company must be prepared in conformity with the terms, forms and preparation methods prescribed by the authority in accordance with the manner generally accepted as fair and proper.⁴⁸ In addition, such financial statements require an audit certification by a certified public accountant or audit firm.⁴⁹ These auditors, in general, must be independent and cannot have any special interest in said company.

Moreover, under the Statutory Disclosure, a listed company has to submit an “Internal Control Report”, which states the matters necessary for ensuring appropriateness of statements on finance and accounting and other information concerning the company, together with its annual securities report in every fiscal year.⁵⁰ An Internal Control Report also needs the same audit certifications stated above.

Further, under the Statutory Disclosure, a listed company has to submit a letter confirming that statements included in the annual securities report and other specified reports are appropriate under the FIEA and related regulations.⁵¹

(ii) Consequences of failure to report or misrepresentation

a. Laws and regulations

(a) Listing Regulations

The Listing Regulations stipulate some delisting criteria in situations where there is a failure to report or misrepresentation, such as (i) delay in submission of a securities report, submission of some false statements which deems that it clearly difficult to maintain order in the market of the TSE if the listed company is not delisted immediately, or (ii) occurrence of events where the TSE deems that delisting of such security is appropriate for the public interest or the protection of investors.

(b) Criminal punishments

Under the FIEA (the Statutory Disclosure), if a person files a securities report which includes false information about “material” aspects, the penalty is imprisonment or a fine, or both (e.g. in case of a false annual securities report, the term of imprisonment is not more than ten years and the fine is not more than

⁴⁸ Article 193 of the FIEA

⁴⁹ Article 193-2, Paragraph 1 of the FIEA

⁵⁰ Article 24-4-4, Paragraph 1 of the FIEA

⁵¹ Article 24-4-2, Paragraph 1 of the FIEA

JPY ten million).⁵² ⁵³ In addition, the company will also be punished by a separate fine (e.g. in case of a false annual securities report, the fine is not more than JPY 700 million.⁵⁴ ⁵⁵

(c) Administrative penalty

Under the FIEA (the Statutory Disclosure), there is also an administrative penalty imposed on a company which has filed a false report. For example, where a company has submitted an annual securities report containing a misstatement on “material” particular, the Commissioner of the FSA may order said company to pay an administrative monetary penalty to the national treasury.⁵⁶

(d) Civil liabilities

Under the FIEA, if any of the documents contain a false statement about a “material” particular, omits a statement as to a “material” particular that is required to be stated, or omits a statement of “material” fact that is necessary to prevent it from being misleading, the company will be held liable to compensate any person who relied on such false information to acquire securities issued by the company for damages to the extent not exceeding the amount calculated in accordance with the applicable law.⁵⁷

Also, under the FIEA, the person who acquired such securities may claim compensation from the directors of the company.⁵⁸ Such directors will be liable unless they can prove that they did not intentionally or negligently make such false statements.⁵⁹

b. A regulator tasked with investigating complaints of misreporting?

Yes, under the FIEA (the Statutory Disclosure), the Securities and Exchange Surveillance Commission, which is designated certain investigating power by the

⁵² It is equivalent to approximately USD 80,000.

⁵³ Article 197, Paragraph 1, Item 1, Article 197-2, Item 6 of the FIEA

⁵⁴ It is equivalent to approximately USD 5.6 million.

⁵⁵ Article 207 of the FIEA

⁵⁶ Article 172-4 of the FIEA

⁵⁷ Article 21-2 of the FIEA

⁵⁸ Article 22, paragraph 1 of the FIEA

⁵⁹ Article 22, paragraph 2, Article 21, Paragraph 2, Items 1 and 2 of the FIEA

FSA, is tasked with investigating complaints of misreporting. If there are criminal aspects to a misreporting, the police will also get involved.

19 What is the external assurance regime for reporting on a company's impacts on stakeholders? Please specify any mandatory requirements and also where reporting is voluntary what the current market practice is as regards third party assurance. Please summaries any regulatory guidance on reporting that relates to impacts on non-shareholder stake-holders.

Please see Question 16 above.

Stakeholder engagement

21 Are there any restrictions on circulating shareholder proposals which deal with impacts on non-shareholders, including stakeholder impacts?

Yes. Under the Companies Act, shareholders may not raise proposals which violate the law or articles of incorporation.⁶⁰

Under the Companies Act, shareholders may demand that the directors include certain “matters” (limited to the matters on which such shareholders may exercise their votes) in the purpose of the shareholders meeting.⁶¹ Moreover, shareholders who fulfill certain requirements⁶² may demand that (i) the directors include certain “matters” in the purpose of the shareholders meeting and/or (ii) the directors notify the summary of the “proposals” intending to submit to the shareholders meeting to [other] shareholders (collectively “Proposal Rights”).⁶³

Practically, these Proposal Rights may be used (and also actually have been used) in order to propose and reflect interest of various stakeholders (including Non-Shareholders) and to achieve certain social purposes.⁶⁴

22 Are institutional investors, including pension funds, required or permitted to consider such impacts in their investment decisions? What is the legal duty that pension funds owe with regard to investment decisions in this regard?

How does the legal duty of the fund align with term and contractual performance criteria of fund managers – does this facilitate or deter consideration of such impacts?

- (i) Are institutional investors, including pension funds, required or permitted to consider such impacts in their investment decisions?

Institutional investors, including pension funds, are not required but permitted to consider such impacts in their investment decisions. There are no specific provisions that prevent institutional investors from considering interests of the Non-Shareholders.

⁶⁰ Article 304 of the Companies Act

⁶¹ Article 303, Paragraph 1 of the Companies Act

⁶² having consecutively for the preceding six months or more (i) not less than one hundredth (1/100) of the votes of all shareholders or (ii) not less than three hundred votes of all shareholders

⁶³ Article 303, Paragraph 1 and Article 302, Paragraph 1 of the Companies Act

⁶⁴ These shareholders’ Proposal Rights were introduced when the Companies Act was amended in 1981, the timing after 1970’s where the introduction of the SCR Provision was not introduced but it was discussed that introducing shareholder’s proposal right could be a n alternative way to reflect various interest in society (please see Question 11 above).

Separately, the FSA published the Principles for Responsible Institutional Investors called “Japan’s Stewardship Code” (“Stewardship Code”) which is aimed to promote sustainable growth of companies through investment and dialogue on February 26 2014.

In the Stewardship Code, “stewardship responsibilities” refers to the responsibilities of institutional investors to enhance the medium to long-term investment return for their clients and beneficiaries by improving and fostering the investee companies’ corporate value and sustainable growth through constructive engagement, or purposeful dialogue, based on in-depth knowledge of the companies and their business environment. The Stewardship Code defines principles considered to be helpful for institutional investors who behave as responsible institutional investors in fulfilling their stewardship responsibilities with due regard both to their clients and beneficiaries and to investee companies.

The Stewardship Code stipulates the following seven principles for institutional investors. These principles state that institutional investors should:

1. have a clear policy on how they fulfill their stewardship responsibilities, and publicly disclose it.
2. have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibility and publicly disclose it.
3. monitor investee companies so that they can appropriately fulfill their stewardship responsibilities with an orientation towards the sustainable growth of the companies.
4. seek to arrive at an understanding in common with investee companies and work to solve problems through constructive engagement with investee companies.
5. have a clear policy on voting and disclosure of voting activity and design such a policy to contribute to the sustainable growth of investee companies.
6. report periodically on how they fulfill their stewardship responsibilities, including their voting responsibilities, to their clients and beneficiaries.
7. in order to contribute positively to the substantial growth of investee companies, have in-depth knowledge of the investee companies and their business environment and skills and resources needed to appropriately engage with the companies and make proper judgments in fulfilling their stewardship activities.

To make institutional investors’ acceptance of the Stewardship Code transparent, the Stewardship Code requires the institutional investors, who accept the Stewardship Code, to publicly disclose on their website their intention to accept the Stewardship Code and information that are required to be disclosed by the principles of the

Stewardship Code, including the policy on how they fulfill the stewardship responsibilities and, if they do not comply with some of the principles, an explanation of the reason that is to annually review and update the disclosed information (the "comply or explain" approach), and to notify the FSA of the address of their website used to disclose the information.

The institutional investors adopting the Stewardship Code are listed and as of June 2015, 191 institutional investors are adopting the Stewardship Code.

(ii) What is the legal duty that pension funds owe with regard to investment decisions in this regard?

In Japan, there is a Government Pension Investment Fund, Japan ("GPIF"). Laws require funded pensions to operate safely and efficiently with a long term perspective in mind.

The GPIF has to submit its operations or investment plan for the funded pension to the Minister of Health, Labour and Welfare for approval. Further, after an annual settlement of accounts, the GPIF has to publish the report regarding its operations.

Also, laws stipulate duties owed by officers of the GPIF, such as officers are to perform their duties on a best efforts basis, and transactions involving conflicts of interest are prohibited.

23 Can non-shareholders address companies' annual general meetings?

There are no laws or regulations which explicitly prevents Non-Shareholders from addressing companies' annual general meetings ("AGM"); however, in general, companies do not allow Non-Shareholders to attend their AGM.

Also, there is a court precedent which states that companies may only allow a shareholder to be an agent for other shareholders at an AGM, but this must be stipulated in the company's articles of incorporation.

23-2 What is the minimum shareholding required for a shareholder to raise a question at a company's AGM?

There is no minimum shareholding required.

Other issues of corporate governance

24 Are there any other laws, policies, codes or guidelines or standards applied in the context of particular contractual relationships (for example project finance) or through adherence to particular sustainability principles (for example the UN Global Compact, the OECD Guidelines for Multinational Enterprises (“OECD Guidelines”) etc.), related to corporate governance that might encourage companies to consider in a structured way their impacts upon and the interests of their wider stakeholders including through a stakeholder engagement process?

In addition to those previously mentioned above, the Companies Act states that the board of directors is required to develop a system which will ensure that directors perform their duties in accordance with relevant laws and the articles of incorporation of the applicable company (so called “Internal Control System”).⁶⁵ This is only applicable for companies whose amount of capital is over JPY 5 billion⁶⁶, and whose debt is JPY 20 billion.⁶⁷

Also, as briefly noted in Question 18 above, under the FIEA, certain companies must file an Internal Control Report with its annual report.⁶⁸ This Internal Control Report was introduced by an amendment to the FIEA in 2006 (and took effect from April 1, 2008) with reference to a financial reporting system under the Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley Act of 2002) in US.

25 Are there any laws requiring representation of particular stakeholder constituencies (i.e. employees, representatives of affected communities) on company boards?

N/A

26 Are there any laws requiring gender, racial/ethnic, religious or other stakeholder constituencies (i.e. employees, representatives of affected communities) on company boards?

Recently the FIEA requires companies that are required to file annual securities report, to disclose the numbers of each male and female officers and ratio of female officers. Other than that, there is no mandatory requirement.

⁶⁵ Article 362, Paragraph 4, Item 6 and Paragraph 5 of the Companies Act

⁶⁶ It is equivalent to approximately USD 40.2 million.

⁶⁷ It is equivalent to approximately USD 160.9 million.

⁶⁸ Article 24-4-4, Paragraph 1 of the FIEA

27 In your jurisdiction is there any legal route whereby a parent company can incur liability with regard to the impacts that one of its subsidiaries has had on stakeholder groups? Are there any serious proposals to impose such responsibility?

As stated in Question 6 above, the Companies Act adopts the principle of limited liability. Thus, in general, a parent company does not owe any liability for its subsidiaries' actions. However, in certain cases where the corporate veil is pierced, the parent company may be liable for the actions of its subsidiaries.

28 Are you aware of any incoming law proposals that are relevant to the issues raised in this questionnaire? If so please describe, providing an indication of the anticipated date the legislation will come into force or be adopted.

N/A

- End