The International Bar Association Company Director Checklist – Japan

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Introduction

This checklist is intended to serve as a practical guide to the principal duties and obligations of directors of

- public companies in Japan listed on a stock market, i.e. Tokyo Stock Exchange (the “TSE”), and
- private limited companies in Japan

arising from Japanese law, namely:

- Companies Act (Act No. 86 of July 26, 2005, as amended);
- Financial Instruments and Exchange Act (Act No. 25 of April 13, 1948, as amended) (the “FIEA”); and
- Civil Code (Act No. 89 of April 27, 1896, as amended),

as well as the Securities Listing Regulations of the TSE.
While companies have a variety of forms and organisational structures in Japan, we are focusing on a stock company (*kabushiki kaisha*) with a board of directors. If specifics of listed public companies are relevant, see the third column of this checklist below.

Disclaimer

This checklist is informational in nature only and is neither intended to be comprehensive in all respects nor to serve as a substitute for professional advice. In all cases, specific fact-based legal advice, based upon the current state of the law, should be sought. The views expressed are the authors’ and do not necessarily represent the views of the partners of or the attorneys associated or affiliated with TMI Associates or the firm as a whole.

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<tr><td colspan="4">Before appointment</td></tr>
<tr><td>1. Items to understand</td><td>● Company’s business activities;
● Company’s history;
● Capital structure and shareholders;
● Organisational structure;
● Industry trends;
● Regulations of business in which the company operates;
● Role/responsibilities expected of directors (including if directors will be non-executive directors (see sections 7 and 23), division of duties and reporting line),
● Term of office; and
● Remuneration.</td><td></td><td>● The appointment of directors needs to be approved at a general meeting of shareholders.
● Consider what expertise is expected of a director (e.g. industry expert, legal expert, accounting expert, management reform expert, etc.).
● Consider whether the director’s business and the company’s business are in competition or in conflict.
● The remuneration of directors must be approved at a general meeting of shareholders. In practice, the general meeting of shareholders often only approves the total aggregate amount of directors’ remuneration, and each director’s pay is specifically determined by the board of directors, and the determination can be further delegated to the representative director.
● Under the Foreign Exchange and Foreign Trade Act, foreign shareholders may be required to file a notification in advance when a proposal for the appointment of directors is to be approved at a general meeting of shareholders. In particular, if a director nominee is to be seconded from a shareholder, consideration of whether or not the shareholder is required to file such prior notification must be made.</td></tr>
<tr><td>2. People to meet with</td><td>● CEO (representative director);
● Other directors;
● Management team; and
● Controlling shareholder, if any.</td><td></td><td>As discussed below, directors have a duty to monitor other directors’ execution of the company’s business.</td></tr>
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3. Documents to review	• Articles of incorporation; • Recent minutes of board of directors meetings and other board documents; • Recent minutes of the company's general meetings of shareholders; • Annual business reports; • Financial data for at least the past three years; • Business plan and corporate strategy; • Commercial registration; and • Rules of board of directors.	Recent IR documents (such as annual securities reports, press releases and shareholder newsletters)	
Ongoing duties			
4. Points for attention	• Corporate culture; • Decision-making processes, including at the board of directors and management committee; • Risk capacity/appetite; • Communications with officers and key employees; and • Scope of director's authority (inwardly, the scope of the duties under a director's responsibility; externally, whether the director will have the authority to represent the company).		
5. Legal status of directors	The Companies Act provides that directors are entrusted by the company with the management and administration of the company, and are in a relationship of mandate with the company, and as such, the provisions of the Civil Code regarding mandate applies to this relationship. Under the Civil Code, each director is obligated to manage the affairs entrusted to him or her with the care of a good manager in accordance with the terms of the mandate.		

6. Parties to which duties are owed	As referenced in section 5, as a matter of law, directors owe duties directly to the company.		If directors cause damage to the company by negligently performing their duties, they are liable to compensate the company for the damages (see section 16). If the company does not bring a claim, shareholders can file a shareholder derivative lawsuit on behalf of the company to pursue the directors.
7. Powers of the board of directors	As a legal matter, the board of directors has the authority to make decisions on all matters concerning the execution of the company's business, except for those matters that are required either by law or by the company's articles of incorporation to be approved at a general meeting of shareholders. In practice, the board of directors defines the title and division of each director's duties. Decisions on certain important matters, such as those listed below, must be determined by the board of directors and not by an individual director: ● disposition and acquisition of important assets; ● borrowing a significant amount of funds; ● appointment and dismissal of important employees, including managers; ● establishment, changes or abolition of important organisational structures, including branch offices; ● issuance of bonds; ● establishment of an internal control system; and ● exempting an officer from liability pursuant to the articles of incorporation. In principle, only the company's representative director and the executive director, if any, have the authority to represent and execute the company's		

	business vis-à-vis third parties based on an authorisation by the board of directors or in accordance with the company's internal rules. The main duties of non-executive directors are, in principle, to participate in and to vote at meetings of the board of directors and to monitor other directors' execution of the company's business.		
8. Duty of loyalty	Each director is obligated to perform his or her duties faithfully on behalf of the company. Specifically, each director has a duty not to seek his/her own/a third party's interests at the expense of the company's interests. In Japan, however, the duty of loyalty is not distinguished generally from the duty of care, and is considered to be a part of the duty of care.		
9. Duty of care	As described above in section 5, under the Civil Code each director is obligated to manage the affairs entrusted to him or her with the care of a good manager in accordance with the terms of the mandate. This standard of care is higher than that expected in operating the director's own business.		
10. Duty to have and maintain skills	Japanese law does not require that directors possess any specific skills. However, if a director is appointed because of the expectation of having expertise and experience or skills in a particular field, such as legal or IT, a high level of the duty of care is considered to be required with respect to that field of expertise.	For listed companies, the Corporate Governance Code (see section 21) requires that: ● the board of directors be composed in a manner that provides a balance of knowledge, experience, and ability to effectively fulfil its roles and responsibilities, and it is considered more important for individual directors to be aware of the roles they should play when serving on the board of directors; and	

		• Skills possessed by directors be disclosed.	
11. Additional duties (confidentiality, etc.)	**Obligation to monitor execution of duties by other directors:** Each director also has the duty/authority to supervise the execution of the duties by the other directors. If a director has any doubts about the actions taken by director, the concerned director should take appropriate responsive action, depending on the circumstances, such as requesting an audit and correction at a board meeting, reporting to an audit organisation, or seeking to remove the director from his/her position as such. **Non-compete/Non-solicitation obligation:** While each director is generally not prohibited from engaging in other businesses, if a director intends to engage in transactions for him/herself or a third party that is in line with the company's business, he/she must disclose material facts about the transactions and obtain the approval of the board of directors. Further, it is also considered a violation of a director's duties of loyalty and care to solicit employees of the company for his/her own business or own company. Some companies enter into employment agreements which clarify the scope of business or companies which their directors are prohibited from engaging in or working for.		• With respect to the duty of monitoring, once an appropriate internal control system is in place at a company, directors may rely on the appropriateness of the work of other directors unless there are special circumstances that should raise doubts about the performance of the other directors (see section 21). • A director may be liable for negligence of duty if a competing transaction causes damage to the company. In such cases, if the competing transaction was conducted without the approval of the board of directors, the amount of profit gained by the director/third party as a result of such transaction is presumed to be the amount of damages suffered by the company.
12. Delegation of powers/authority	While some of the board's powers may not be delegated to individual directors as noted in section 7, it is not prohibited to delegate to others the powers of an individual director.		

13. Conflicts of interest (inc. intragroup dealings)	When a director intends to engage in any of the following transactions which involve conflicts of interest, the director must disclose material facts about the transaction and obtain the approval of the board of directors: ● Direct transactions (transactions which a director enters into for benefit of himself/herself or a third party); and ● Indirect transactions (transactions which result in a conflict of interest between the company and the director, such as a guarantee of a director's debt).		The director engaging in such a transaction may not participate in the vote on the consideration of the matter at the board of directors meeting, as the director has a special interest in the resolution. If a company incurs damages as a result of such transaction, the directors who were involved in or had approved such transaction are presumed to have neglected their duties, and consequently may be liable for the damages incurred.
14. Compliance with statutory obligations	Directors have an obligation to perform their duties in compliance with law and regulation and the company's articles of incorporation. If a director violates a law, regulation or the articles of incorporation for reasons attributable to him/her and the company incurs damages as a result, the director is liable for negligence in the performance of his/her duties (see section 16).		
15. Disclosure obligations	**Materials for Annual General Meeting of Shareholders** Under the Companies Act, a company must prepare a business report and financial statements for each fiscal year, have these materials approved at a board of directors meeting and thereafter submit the materials to the annual general meeting of shareholders. **Commercial Registration** Fundamental information of a company (e.g. its name, address and business purpose, the	Listed companies are required to prepare and file annual and quarterly securities reports under the FIEA, and these documents are publicly available. The main information in annual securities reports discloses: ● Corporate overview (management indicators, business activities, employees, etc.); ● Business conditions (management policies, risks, operation results, important contracts, etc.); ● Status of facilities (capital investment, current status, and future plans, etc.);	A company is obligated to disclose certain information in certain cases upon request of the shareholders, for example: ● a shareholders' list (where the request is for the purposes of securing/exercising the shareholder's rights and not interfering with the execution of the company's operations nor prejudicing the shareholders' common benefit); ● accounting books (when requested by shareholders holding at least 3% of shares in total which are not engaged in a business competing with the company;

	names of its directors/auditors, and the address of a representative director) is recorded in its commercial registration, which is publicly available.	● Status of the company (stock status, dividend policy, outline of corporate governance, etc.); and ● Accounting status (financial statements, etc.). Further, in accordance with the Securities Listing Regulations of the TSE, the company is obligated to make timely disclosures when certain significant events occur, such as when the company determines to issue new stock, reduce the amount of stated capital, distribute dividends of surplus, etc. and when there is a change in major shareholders.	and where the request is for the purposes of securing/exercising the shareholder's rights and not interfering with the execution of the company's operations, prejudicing the shareholders' common benefit, nor disclosing the information to third parties for profit); and ● minutes of board of directors meetings (where necessary for exercising the shareholders' rights and subject to court permission).
16. Potential liability	**Liability to the company:** A director neglecting his/her duties is liable to the company for damages arising as a result thereof. **Liability to third parties:** If directors act in bad faith or with gross negligence, they could be personally liable to a third party for damages arising therefrom based on tort under a special provision of the Companies Act. Although the situations where such liability arises are limited, directors may be liable to business partners and creditors. **Liability in case of deficit:** A company may not pay dividends from surplus or purchase its own shares in excess of the "distributable amount" (roughly speaking, the amount equivalent to the company's surplus). If the company breaches this restriction, the directors who were committed such breach and who made the proposal at the general meeting of shareholders will be jointly and severally		In order to prevent any chilling effect on the exercise of business judgement by directors and to enable rational risk-taking, it is considered that directors should have wide discretion in their business decisions. Specifically, a director shall not be considered to breach the duty of care so long as there is nothing extremely unreasonable in the director's decision-making process or in the management decision in light of the knowledge and experience of ordinary managers in the industry at the time of the action was decided upon. However, this will not apply in cases where a director has committed an illegal act or a director has engaged in transactions with conflicts of interest (see section 13).

	liable, along with the recipient of the dividends or the purchase price, to the company to cover the excess amount. **Failure of registration and public notice:** A company must register and give public notice without delay upon the occurrence of certain events. Failure of a company to register or publish a public notice may result in the imposition of a fine as a sanction on directors. **Criminal liability:** Directors can be subject to criminal liability under the Companies Act in the following circumstances and with the indicated potential punishment: ● Aggravated breach of trust (an act in breach of duties for the purpose of promoting his/her or a third party's interest or inflicting damage on the company, causing financial damages to the company): imprisonment for up to 10 years and/or a fine of up to 10 million yen; ● Putting the company's property at risk (fraudulent acquisition of shares on the company's account, distribution of dividends in violation of law, and disposition of the company's property for fraudulent purposes): imprisonment for up to 5 years and/or a fine of up to 5 million yen; and ● Giving benefits in relation to exercise of shareholders' rights: imprisonment for up to 3 years and/or a fine of up to 3 million yen.		

	Further, insider dealing (see section 20) is prohibited by the FIEA and violators are subject to a criminal penalty: imprisonment for up to 5 years and/or a fine of up to 5 million yen; and disgorgement of any properties obtained through the insider dealing. Apart from these potential penalties, violators also can be subject to an administrative fine equal to the amount of financial benefit obtained, which is calculated as provided under the FIEA.		
17. Duration of duties	Directors' terms of office continue until the conclusion of the annual general meeting of shareholders held in relation to the last business year ending within two years of his or her assumption of office, though a term may be shortened or prolonged for one year up to ten years by the company's articles of incorporation, which can be amended by a resolution of the shareholders.	In the case of listed companies (and public companies not listed), directors' terms of office can only be shortened for one year, and at the longest are for a term of two years.	A company may remove a director at any time by a resolution approved at a general meeting of shareholders. However, if there are no justifiable grounds for the removal, the director may seek damages from the company (which are usually considered to be equivalent to the compensation for the remainder of the director's term of office).
Special circumstances			
18. Bankruptcy	If a company is in insolvent and there is no prospect of restructuring the business, the directors should consider commencing liquidation (special liquidation) or initiating a bankruptcy proceeding for the company. If the company continues its business in these circumstances and, as a result, causes damages to its creditors, i.e. the company is not able to repay all its debts, the directors may be liable to the creditors for their losses. When an order of commencement of bankruptcy proceedings is made, the directors will be affected as follows:		

	● The authority to manage and dispose of the company's assets will be transferred from the directors to the bankruptcy trustee; ● Existing claim for directors' remuneration will become a bankruptcy claim, which likely will be difficult for the directors to recover in full; ● The directors are obliged to explain to the bankruptcy trustee the matters necessary for the progress of the bankruptcy proceedings; ● Directors may not move from their residence without court permission; and ● The representative director is obliged to attend creditors' meetings.		
19. Takeover bids		When commencing a takeover bid, the purchaser must make a public notice of commencement and file a takeover bid notification in accordance with the FIEA. On the other side, the target company must submit an opinion report stating, for example: ● its approval or disapproval of the takeover bid; ● the grounds for approval/disapproval, including the process which led to the decision; and ● details of measures, if any, to avoid conflicts of interest in transactions involving MBOs.	One of the common defence measures against a hostile takeover is granting of share options which can be exercised only by persons other than the hostile acquirer, thereby diluting the shareholding ratio of the hostile acquiror. However, the legitimacy of this measure is highly controversial. One area of contention is whether approval of the action has been obtained at a general meeting of shareholders. Consequently, in some cases courts have enjoined the defence measure, while in others they have not.
20. Market abuse/insider dealing		Insider dealing is defined as the trading of a listed company's shares or other securities by a person related to the listed company, using undisclosed information about the company and/or its subsidiary, which information the person obtained through his/her duties or position and which may materially influence	For more information on insider dealing regulations, see the Japan Exchange Group's website: https://www.jpx.co.jp/english/regulation/ensuring/preventing/about-unfair-trading/index.html

		investment decisions, regarding the following situations: • Decisions by the company of certain matters (e.g. merger or dissolution); • Occurrence of certain facts (e.g. significant losses, change in major shareholders); • Financial information (significant difference from the last disclosed forecasts); and • Other material facts regarding the company's operations, business or assets that would materially affect investors' decisions with respect to investments in the company. The fourth item (the "Basket Clause") is provided because the other three items cannot cover all facts the use of which in trading shares and securities should be regulated. Commentators have criticised the Basket Clause as being ambiguous. Accounting fraud, material deficiency in main products, and unaccounted-for money are examples of incidents that may be classified as within the "Backet Clause".	
Defences			
21. Good corporate governance	Specifically, a large company (a company with capital of 500 million yen or more or liabilities of 20 billion yen or more) must implement an internal control system that includes: • System for compliance with laws and regulations; • System for retention and management of information in relation to the execution of the duties of directors; • Risk management system; • System for ensuring efficiency in the execution of duties by directors;	The TSE has established a Corporate Governance Code (the "CGC") as a guideline for corporate governance of listed companies. The CGC sets forth five basic principles: (i) Ensuring rights and equality of shareholders; (ii) Appropriate cooperation with stakeholders other than shareholders; (iii) Appropriate disclosure of information and securing transparency; (iv) Fulfilment of duties of board of directors; and (v) Dialogue with shareholders.	The TSE will be rearranging its market sections into the Prime Market, the Standard Market and the Growth Market, effective as of 4 April 2022. Among other things, the CGC provides that companies listed on the Prime Market must have a board of directors comprised of at least one-third outside directors.

	- System for ensuring the appropriateness of the business group's operations; and - System for ensuring the effectiveness of audits by corporate auditors. While a board of directors has discretion as to what kind of internal control system the company should establish, it is considered necessary that a company have a control system with a sufficient degree of protection against misconduct that would normally be expected. Once an appropriate internal control system is in place at a company, it is likely that the directors can rely on other officers and employees, such that directors who otherwise do not have management responsibility will not be held immediately liable for problems, unless there are circumstances that should raise particular suspicions surrounding the directors' involvement.	Although listed companies are not obligated to comply with the CGC principles, if they do not comply, they need to explain the reasons for such non-compliance. The CGC is available at: https://www.jpx.co.jp/english/news/1020/20210611-01.html	
22. Minutes of board meetings and publication requirements	A company must prepare minutes of board of directors meetings and keep the minutes at its head office for at least ten years. The directors present at the meeting must sign their names or affix their seals to the minutes. Minutes are not publicly available, though they must be disclosed to shareholders if such disclosure is necessary for exercising the shareholders' rights and if the shareholders have obtained court permission as stated in section 15.		
23. Discharge and indemnification	**Exemption and limitation of liability:** Liability for the failure to perform duties to the company can be exempted with the consent of all shareholders. If the failure is	When a public company has entered into an indemnity agreement with a director or provided indemnification based on an indemnity agreement, the company is required	

	neither intentional nor grossly negligent, it may be partially exempted by a special resolution (resolution adopted by at least two-thirds of the voting rights) approved at a general meeting of shareholders or by provisions in the articles of incorporation. Further, non-executive directors may enter into a liability limitation agreements with the company if the articles of incorporation specifically provide provisions for such an agreement. **Corporate Indemnification:** A company may, by resolution of the board of directors, enter into an agreement to indemnify a director for all or part of the following expenses: (i) Costs of dealing with suspected violations of law and regulation and pursuit of liability (defence costs); and (ii) Liability amounts owed to third parties (compensation/settlement payment). With respect to (i) defence costs, a company may not indemnify the director for any portion of the costs in excess of what is ordinarily required. With respect to (ii) liability amounts owed to third parties, a company may not indemnify the director for wilful misconduct or gross negligence or for any losses for which the director would be responsible to reimburse the company if the company indemnifies the director for damages suffered by a third party.	to disclose the following information in relation to the indemnity agreement in its business report to shareholders: (i) Name of the director; (ii) Outline of the indemnity agreement; (iii) In the case where the company provided indemnification to pay for defence costs, information regarding the company's knowledge of the director's violation of law and regulation, or liability in a civil action; and (iv) In the case where the company provided indemnification to compensate/settle damages suffered by a third party, information, including the amount thereof, regarding the compensation of directors based on the indemnity agreement.	
24. Insurance	The Companies Act sets forth procedures for the execution of D&O insurance agreements, in which the insurer agrees to cover damages arising from directors and officers being held	Public companies must include the following matters related to D&O insurance agreements in their business reports to shareholders: (i) scope of the insured persons; and	

	liable for the performance of their duties or from being sued for such liabilities. A resolution of the board of directors is required for the company to approve the terms of the D&O insurance agreement.	(ii) outline of the insurance agreement (the ratio of premiums to be borne by directors, a description of incidents covered by the insurance, the details of measures to ensure that the insurance will not impair the appropriateness of the directors' performance of their duties, etc.).	
25. Resignation	A director may resign at any time by notifying the company of his/her resignation. However, if the number of directors following such resignation is less than three or the number provided in the company's articles of incorporation, the resigning director shall continue to have the rights and duties of a director until the election of a replacement.	The resignation of the representative director must be disclosed immediately pursuant to the Securities Listing Regulations of the TSE.	A director may be removed by resolution adopted at a general meeting of shareholders (see section 17).
26. Restructuring of assets	When a company is in financial difficulties and wishes to continue its business, filing a petition for commencement of civil rehabilitation proceedings through a resolution of the board of directors meeting is a possible option. In civil rehabilitation proceedings, the company must prepare a proposed rehabilitation plan, which must be submitted to the court and approved by the court and a majority of creditors. The directors continue to manage and operate the company after the commencement of civil rehabilitation proceedings under the control of a supervisor elected by the court.	In some cases, "corporate reorganisation" proceedings are used to restructure the business of a listed company. In corporate reorganisation proceedings, the authority to manage the company's business and dispose of its assets is transferred from the directors to the trustee(s) of the reorganisation. Sometimes the directors of the company are elected as the trustees in order to maintain continuity in management before and after the commencement of the procedure and to utilise the human resources of the management team.	
27. ESG and D&I policies, metrics, reports	There are no legal requirements in Japan regarding ESG policies. As for D&I, various Japanese laws require or encourage companies to have a diverse workforce, for example:	With regard to ESG policies, the CGC states that companies should take appropriate measures to address issues surrounding sustainability, including social and environmental issues; more specifically, that the board of directors should	

	Act on Securing, Etc. of Equal Opportunity and Treatment between Men and Women in Employment; Act to Facilitate the Employment of Persons with Disabilities; and Act on Stabilization of Employment of Elderly Persons.	recognise that dealing with sustainability issues, such as: ● taking into consideration climate change and other global environmental issues; ● respect of human rights; ● fair and appropriate treatment of the workforce, including caring for their health and working environment; ● fair and reasonable transactions with suppliers; and ● having appropriate crisis management with respect to natural disasters, are important management issues that can lead to earning opportunities as well as risk mitigation. The CGC further states that companies should consider addressing these matters positively and proactively in terms of increasing corporate value for the mid- to long-term. The Stewardship Code, issued by a council set up by the Financial Services Agency of Japan, provides that institutional investors must be mindful of mid- and long-term sustainability, including ESG matters. For details on the Stewardship Code, see: https://www.fsa.go.jp/en/refer/councils/stewardship/index.html	