

6. Commercial Law

An Amendment to the Commercial Law: Creating Laws for Class-Shareholders' Meeting and U.S. Style Committee Governance System etc.

Law No.44, May 22, 2002 (Effective on April 1, 2003).

Background:

The world economy surrounding Japanese corporations has been dramatically changing over the last decade. During this period, many corporations, including large corporations, went bankrupt and the numbers of unemployed persons and suicides have increased extraordinarily. But the Japanese government could not overcome this serious recession in spite of taking many measures. Under these circumstances, significant reforms of corporate governance system have been seriously needed at the level of commercial law.

The law reforms in 2002 are also a part of a series of measures to restructure the commercial law. Particularly, they aim to diversify and improve the ways to manage companies, and they are focusing on one of the core parts of the corporate governance system: the separation of management and observation, that is, the separation of the officer who manages and the director who mainly observes. And it has been also needed to foster venture entities which can play a vital role in the future Japanese economy. This is why the reform also aim to make it easier for venture entities to finance or draw investment from venture capital.

These fundamental changes in the commercial law can be said to comprise certain changes in the Commercial Code that were proposed in the 154th ordinary session of the Diet and were finally enacted in the Diet on May 22, 2002.

The principal contents of these changes are (i) certain revisions regarding the management system of companies and (ii) certain revisions regarding the company's accounting provisions. The former relates to the goal of "Ensuring the efficiency of corporate governance," while the latter speaks to the goal of "Accommodating the internationalization of companies' activities." A draft of the summary of these revisions

(the “Summary”) was prepared by the corporate sub-council of the Council on January 16, 2002 and was finalized by the Council and submitted to the Minister of Justice (the “MOJ”) on February 13, 2002. The MOJ prepared a final draft bill for the proposed changes to the Commercial Code and other relevant laws (the “Bill”) on the basis of the Summary and the Cabinet submitted the Bill to the Diet on March 18, 2002. The Bill was passed in the Diet on May 22, 2002.

Main Provisions:

(a) Introduction of the Committee System

This change gives Large Companies (*Dai-Kaisha*) and some Medium Companies (*Minashi Dai-Kaisha*) the option to adopt a US-type corporate governance system if there is such a provision in the articles of incorporation. More specifically, upon enactment of the revisions, a company adopting such a system (a “Company with Committees (*Iinkai-to-setchi-kaisha*)”) must establish an “Appointment Committee”, “Auditing Committee” and “Compensation Committee”. The appointment committee has the power to nominate candidates for directors and to decide a bill concerning the dismissal of directors (The Law for Special Exceptions to the Commercial Code, 21.8 para. 1). The auditing committee has the almost the same power as statutory auditors (The Law for Special Exceptions to the Commercial Code, 21.8 para. 2, & 21.10). The Compensation Committee has the power to decide the contents of the compensation of individual directors and officers (The Law for Special Exceptions to the Commercial Code, 21.8 para. 3, & 21.11). Importantly, the determination of each committee is the final one, that is, the board may not override it.

Such a company must also have officers (*Daihyou Shikkouyaku and Shikkouyaku*) who manage, and importantly, it may not have auditors, unlike Japanese traditional companies which have representative directors and executive directors, who are members of the board but mainly manage the company, other directors who are just members of the board and who mainly observe the representative directors and executive directors, and statutory auditors. The revisions stipulate that more than half of the members of the above-mentioned committees must be outside directors. At a Company with Committees, the board of directors may

properly delegate substantial management authority to officers. For example, the board may delegate the authority to approve issuances of new shares of capital stock and bonds to officers (The Law for Special Exceptions to the Commercial Code, 21.5, 21.7 para. 3 & 21.12).

By these restructurings, companies can adopt a corporate governance system which accomplishes the separation of management and observation, and is entirely different from the Japanese traditional governance system.

(b) Introduction of the Committee for Important Assets

This change enables a Large Company (other than a Company with Committees), having 10 or more directors (including at least one or more outside directors), to establish a “Committee for Important Assets (*Jyuyozaisan-iinkai*).” This committee should consist of 3 or more directors of the company. The board of the company may delegate its decision-making authority with respect to the disposition or acquisition of important assets and large borrowings to this committee (The Law for Special Exceptions to the Commercial Code, Art. 1.3). The purpose of this change is to allow flexible and prompt management decisions.

(c) Simplification of Procedures for Shareholders’ Meetings

This change primarily relates to medium- or small-sized joint stock companies (*Kabushiki-kaisha*) (hereinafter referred to as a “KKs”). Upon the enactment of the revisions, the procedures pertaining to shareholders’ meetings for medium- or small-sized companies may be simplified, allowing the company to conduct meetings in a manner more akin to a limited liability company (*Yugen-kaisha*) (hereinafter referred to as a “YK”). The specific contents of this item are as follows:

- 1 With the consent of all of the shareholders, such companies may omit the convocation process of shareholders’ meetings (Art. 236).
- 2 Closed Companies (companies requiring, in their articles of incorporation, board approval for transfers of shares) may, upon authorization in the articles of incorporation, shorten the notice period for shareholders’ meetings (Art. 232, para. 1).
- 3 As with a YK, a resolution in writing or in an electronic format will be permitted for general shareholders’ meetings (Art. 253).

(d) Relaxation of the Quorum Requirement for Shareholders' Meetings

Under the former Commercial Code, the statutory quorum requirement for a special resolution of a general shareholders' meeting was a simple majority of the total voting shares. However, a company could not relax this requirement even by its articles of incorporation. Upon the revision, a company is allowed to relax this requirement down to one-third (1/3) of the total number of voting shares by its articles of incorporation. In such a case, the relevant provision authorizing these lesser quorum requirements must be specifically set forth in the articles of incorporation (Arts. 343, para. 1 & para. 2).

(e) Appointment of Directors and Corporate Statutory Auditors in a Class Meeting

This change enables a Japanese company to issue a new class of shares with certain rights regarding the appointment and/or dismissal of directors or corporate statutory auditors.

In order to facilitate the foundations of joint ventures, to make it easier for venture entities to finance from venture capitals, and to protect *legally* shareholders' interests, something which had previously been accomplished by contracts among shareholders, it is provided that a closed company which restricts alienation of shares may issue some types of shares which are different in their contents concerning the appointment and/or dismissal of directors and/or auditors in a class meeting (Art. 222, para. 1). For example, a company may issue Type A shares entitling holders to an exclusive right to elect 3 out of 5 members of the board of directors and Type B shares entitling holders to an exclusive right to elect the remaining 2 directors. These changes serve to supplement the earlier changes regarding shares with limited voting rights. Under the earlier changes, shares having an exclusive right to appoint a certain numbers of directors could not be issued due to the limitation on the number of shares having limited voting rights (i.e., one-half (1/2) of all outstanding shares at the maximum).

When a closed company issues class shares, the directors and/or auditors of the company shall be appointed in the same class meeting, not in a general meeting (Arts. 257.1 & 280), and they shall be dismissed in the same class meeting in principle (Arts. 257.3 & 280).

(f) Nullification Procedures for Share Certificates

This change establishes a new system for handling lost share certificates. Under this new system, a shareholder who has lost a share certificate can request the issuing company to reissue the share certificate without public notice of stock cancellation and in the absence of a stock cancellation judgment by simply registering the loss of the certificate with the issuing companies. Since an application by the shareholder will be made to the issuing company, the company will have an opportunity to check its stock registration book. Therefore, even after the introduction of this system, the rights of a *bona fide* purchaser of such lost shares will be fairly and sufficiently protected (Arts. 230 & 230.2–230.8).

(g) Consolidated Financial Statements

To ensure adequate disclosure, this change requires a publicly traded Large Company to prepare a consolidated balance sheet and profit and loss statement and to report such statements to its shareholders at the annual shareholders' meeting (The Law for Special Exceptions to the Commercial Code, Arts. 19.2 & 21.32).

(h) Delegation of Accounting Matters to Ministerial Ordinances

This change abolishes the provisions in the Commercial Code regarding the details of such accounting matters as the method for valuing assets and delegates such matters to relevant ministerial ordinances. After this change, the Commercial Code itself has only a basic conceptual provision with regard to accounting matters. The purpose of this change is to enable the flexible adjustment of accounting regulations under the Commercial Code to the changes in the accounting principles and to ensure unity between accounting carried out under the Commercial Code and that under the Securities and Exchange Law (Arts. 285 & 281, para. 5).

(i) Creation of a Certification System for the Value of Assets Provided as a Consideration for New Shares, etc.

This change broadens the scope of the use of certifications issued by professionals such as lawyers, accountants or tax accountants, that may be used as an alternative to an inspection by a court-appointed investigator (Arts. 173, para. 2, no.3, 246, para. 3, & 280.8, para. 2).

(j) Abolishment of Office Requirement for Foreign Companies

Under the former law, foreign companies that engage in business in Japan on a continuous basis were required to set up a branch office in Japan. This change abolishes this requirement and, instead, requires more detailed disclosures by foreign companies as a means of ensuring the protection of Japanese parties that may be doing business with such foreign companies. For example, a requirement that such foreign companies disclose their financial statements in Japan is added (Art. 479, para. 2).

Editorial Note:

As stated above, the main purpose of this reform was to diversify and improve ways to manage corporations. Inter alia, a noticeable change in good corporate governance for corporations, particularly large corporations, was made by separating management and observation. It may be said that the purposes of the series of reforms have been almost accomplished by this reform in 2002. The issues remaining after the completion of these reforms are scheduled to be resolved in 2003 and thereafter.

One of these remaining issues relates to the current requirement of the issuance of physical share certificates. For some time now, many closed companies have requested the Japanese government to permit the exemption of such issuance requirements to closed companies. In addition, even for publicly traded companies, it is a rare case that the physical delivery of a share certificate is actually made at the time of a transfer of shares and, in many cases, investors themselves do not require the physical delivery of certificates by depositing the shares with their securities firms or using the custody and book-entry transfer system. With regard to this issue, the possibility of the non-issuance of physical share certificates on the basis of these circumstances will be discussed as well as related issues such as the manner to effectuate a transfer of shares.

Assuming smooth progress in the substantial changes in Japanese commercial law, the last thing necessary to do is to modernize the terms of the Commercial Code. MOJ has already begun the process of reviewing the problems that may occur when the plain Japanese is used for the provisions of the Commercial Code. But since, as a result of the above-mentioned changes, almost all of the provisions of the Commercial Code

will be amended to some degree, MOJ will carry out the adoption of colloquial Japanese after such substantial changes have completed to a large extent.

7. Labor Law

Defined Contribution Pension Law

Law No.88, June 29, 2001 (Effective on October 1, 2001, partially amended on April 1, 2002).

Background:

The average life expectancy of the Japanese has risen considerably in the postwar era. Accordingly the proportion of the elderly is increasing and the number of children is decreasing. Because of such circumstances, the current public pension scheme is facing a difficult situation. Therefore, corporate pension plans are becoming more important as a complement to the public scheme. However, the existing corporate pension plans, i.e., defined benefit plans, also have difficulties in coping with social changes and the economic environment, e.g., the introduction of the new accounting standard for corporate retirement plans, lower investment returns on plan assets, and less portability of the benefit to meet with workforce mobility. In order to address these issues, the defined contribution pension law was passed in the 151st session of the Diet, which concluded on June 28, 2001.

Main Provisions:

Art. 1 provides the purposes of this law, which are, in light of the developments toward an aging population with a reduced birthrate and the changes in the socio-economic condition associated with the diversification of the livelihoods of the elderly, to stipulate essential matters regarding the Defined Contribution Pension Plan in order that individuals may receive payments in their later years, based on each individuals' carrying out the instructions for application of this plan by his/her