

# Re: Prospective Amendments to the Companies Act of Japan

The Interim Proposal for Amendment to the Companies Act of Japan (the Proposal) was published in December 2011 and was subsequently submitted for public comments to be made by the end of January 2012. The Companies Act Division of the Council of Legislation (Ministry of Justice), which is in charge of amending the Companies Act of Japan will then resume discussions with the aim of producing a final summary of the amendments.

This Briefing Note explains the major issues set out in the Proposal and the direction of discussions to date.

## Major Discussion Points

The major discussion points in the Proposal are "Corporate Governance" and "Governance of the Parent-Subsidiary Relationship". Amongst the issues generating interest amongst legal practitioners are proposals for (i) the mandatory appointment of external directors; (ii) the introduction of an Audit/Supervisory Committee for the purposes of increased "Corporate Governance;" (iii) the introduction of multiplex derivative actions; and (iv) the cash-out system in respect of "Governance of the Parent-Subsidiary Relationship".

## Mandatory Appointment of an External Director

In the Proposal, the following three alternatives are suggested:

- (a) one or more external director(s) must be appointed to the board of "large open" corporations which have a board of statutory auditors; or
- (b) one or more external director(s) must be appointed to the board of corporations which are required to file a securities report under the Financial Instruments and Exchange Law; or
- (c) no revision will be made to the existing legislation.

There is a strong argument that there has been no need for change to be enacted here as Japanese corporate governance functioned well without the mandatory appointment of external directors. However, several recent examples of ill-functioning corporate governance in relation to certain high-profile Japanese corporations has led to option (b) becoming an increasingly valid alternative.

### Key issues

- Major Discussion Points
- Mandatory Appointment of an External Director
- Introduction of an Audit/Supervisory Committee
- Multiplex Derivative Action
- Cash-out

## Introduction of an Audit/Supervisory Committee

In the Proposal, it is outlined that an Audit/Supervisory Committee be introduced with the same authority as the audit committee of the corporations having the committees (*iinkai secchi kaisha*), and comprised of multiple external auditors who are not executive directors.

If adopted, this proposal would mean adding another corporate governance system in addition to the board of statutory auditors system and the committee system and it is therefore not subject to any particular objections. However, the structure and legal nature of the new system are still largely subject to further discussion in light of the existing systems.

## Multiplex Derivative Action

In the Proposal, it is outlined that the shareholder of a parent company can file a lawsuit to seek the liability of the directors of its subsidiaries (a multiplex derivative action). It is also proposed that, if the multiplex derivative action is not introduced, governance of parent-subsidiary relationships needs to be re-examined.

There has been strong objection to the multiplex derivative action within the financial sector, partly due to its inherent opposition to the derivative suit. However, the issue has long been recognised that, under the current holding company structures, no control can be effectively exercised by the shareholder of a parent company over its subsidiary in which a major corporate governance issue has arisen. The argument is persuasive in that it should be possible to implement measures in order to deal with such issues.

## Cash-out

Lastly, the Proposal suggests that a 'special controlling shareholder' holding 90% or more of the entire voting rights in a *kabushiki kaisha* (joint stock corporation) has a call option to purchase the shares and warrants from the other shareholders. Under the current Companies Act, there are no provisions dealing with a squeeze-out (cash-out) and a squeeze-out (cash-out) can be implemented by invoking class shares with attached call options that have been issued by the company. However, there have been many disputes in respect of the squeeze-out (cash-out) procedure in relation to past MBO (management buy-out) transactions, and legal practitioners are waiting for a revised squeeze-out system to be legislated for in order to achieve more legal stability. No major objection has been made to the introduction of the squeeze-out system and further discussions will take place to create a fair squeeze-out system.

*Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.*

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