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**ANDERSON MORI**

**Directors, Officers and Managers Liability  
The Legal Position in Japan**

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## **Directors, Officers and Managers Personal Liability The Legal Position in Japan**

### **1-Structure of Japanese Corporate Entities**

Under the laws of Japan, as for corporate entities with commercial purposes, there are:

- (1) two forms of unlimited liability corporations, the *gomei kaisha* (partnership type corporation) and the *goshi kaisha* (limited partnership-type corporation); and
- (2) two forms of limited liability corporations, the *yugen kaisha* and the more popular joint stock corporation, being the *kabushiki kaisha*, established under Article 165 et. seq of the Commercial Code (Law No. 48 of 1899, as amended) (hereinafter referred to as the "Code").

#### **Unlimited Liability Corporations**

In respect of unlimited liability corporations, all of the equity holder of the *gomei kaisha* and a part of the equity holder of the *goshi kaisha* owe joint and several unlimited liability for all the debts of the corporations. Since these corporate entities are much less popular than the *yugen kaisha* and the *kabushiki kaisha*, these entities shall not be discussed any further.

#### **Limited Liability Corporations**

In respect of the *yugen kaisha*, its capital base and minimum capital requirement is only ¥3 million. It is commonly prescribed<sup>1</sup> that the *yugen kaisha*, having its limited liability of equity holders and closed and private in nature, is regarded as similar to the Gesellschaft mit beschränkter Haftung, or G.m.b.h., of German laws, and closely held companies of the United States legal systems.

The *kabushiki kaisha*, as another form of limited liability corporation, is most commonly established in Japan. For the current purpose, due to its common establishment in Japan, the workings of the *kabushiki kaisha* is paramount.

### **2-Who are Directors, Officers and Managers?**

#### **Directors**

Article 254, Paragraph 1 of the Code prescribes that directors are individuals appointed by

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<sup>1</sup> Takeo Suzuki, "Corporate Law," Kobundo, November 30, 1994 at p.361

way of resolution at a shareholders' meeting. Upon such appointment, all the directors of the corporation shall consist of a board of directors, and the board of directors is the organ in the *kabushiki kaisha* which determines the corporation's business (Art. 260 of the Code). In order to execute and conduct its business, the board of directors appoints one or more representative director(s)<sup>2</sup> (*daihyo torishimariyaku*) among its directors, and authorize the representative director to represent the corporation in all aspects (Art 261 Para 1, Para 3, and Art. 78 of the Code). The relationship between the *kabushiki kaisha* and its directors is governed by the law relating to mandates (Art. 254 Para 3 of the Code) and directors have a duty to conduct the business of the corporation with the standard of care of a good manager<sup>3</sup>. The standard of care is higher than that expected in one's own business. Directors also have a duty to abide by the law, the articles of incorporation and the resolutions of the general meetings<sup>4</sup> and, to faithfully execute the business of the corporation.<sup>5</sup>

### **Officers and Managers**

Japanese laws relating to the authority, powers and obligations of officers appears to be less extensively developed than, for example, in leading commercial jurisdictions, such as the United States. This is because of the central legal position of the representative director(s) under the Code, both as an intra-corporate matter and with respect to the corporation's dealings with third persons. It is of course very common for one and the same person to hold both the representative director and officer positions, but in such cases, as a legal matter, his authority derives primarily from his status as a representative director.

Titles in Japanese corporations under the Code other than directors are *shihainin* (manager, Art. 37), *banto* and *tedai* (Art. 37). *Shihainin* is authorized to represent the corporation with respect to a particular business by the board of directors (Art. 38 of the Code). *Banto* and *tedai* are employees who are authorized to represent the corporation with respect to particular items and/or things in certain business. However, these names or titles have not been commonly used in corporations and the Code does not clearly prescribe the liabilities of these positions by itself. Further it is difficult to say that these positions are equivalent positions of an "officer" or "manager" under certain laws of jurisdictions. Accordingly, for the current purpose of this memorandum, these titles are intentionally omitted.

In the absence of detailed statutory provisions concerning the appointment of officers, it is considered that corporations are free, given an adequate foundation in the articles of incorporation, to appoint such officers as they see fit and to assign to them such titles, authority and powers as are considered advisable. Ordinarily, the articles of incorporation will confer upon the board of directors the authority to make the appointments within limits, if any, specified there. Please note, however, the practice of appointment of officers differs significantly from corporation to corporation.

### **3-Legal Basis of Directors, Officers and Managers Liability in Japan**

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<sup>2</sup> Subject to extension of each *kabushiki kaisha*, the minimum number of directors are three (Art. 255 of the Code) and representative director is one. Thereinafter, a singular form of director and/or representative director may mean plural depending on the context.

<sup>3</sup> Art. 644 of the Civil Code (Law No. 89 of 1896, as amended) (thereinafter the "Civil Code")

<sup>4</sup> i.e., shareholders' meeting

<sup>5</sup> quoted from Zentaro Kitagawa, "DOING BUSINESS IN JAPAN," at pp. 9-31, LexisNexis, 2001

**a) Statutory, civil or contractual legal framework**

The legal framework which forms the legal basis of Directors, Officers and Managers liabilities in Japan is the extensive provisions of the Code.

**Board of Directors**

With respect to the general powers of the board of directors of a corporation, the Code prescribes “The administration of the affairs of the corporation shall be decided by the board of directors, and supervise execution of duties of directors” and provides in principle that the board of directors shall make certain material and important decisions on its business<sup>6</sup> and may not transfer those powers to directors (including representative director(s)).

Further, the Code contains a large number of provisions conferring specific discrete powers upon the board of directors, including, but without limited to the following matters<sup>7</sup>, requiring action by the board of directors per express statutory provision:

- (i) Appointment or removal of representative directors (Art. 261, Paras. 1 & 2);
- (ii) Approval of transactions in which a director has conflict of interest with the corporation (Art. 265, Para. 1);
- (iii) Approval of competitive transactions by directors (Art 264);
- (iv) Indemnification of directors' liability in accordance with the articles of incorporation (Art. 266, Para 12);
- (v) Procedural decision regarding shareholders' meetings (Art 231);
- (vi) Certain decisions on its capital (Art. 293-3, Art. 293-5);
- (vii) Issuance of new shares and/or debentures (Art. 280-2, Para. 1, Art. 296, Art. 341-2, Paras. 1 & 2, Art. 341-8);

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<sup>6</sup> Paragraph 1 of Article 260 of the Code enumerates four specific items, below, illustratively as coming within the powers of the board of directors, and provides that said four items and "other important matters relating to the administration of the affairs of the corporation" may not be delegated to any of the directors, including the representative director (Art. 260, Para. 2). These four items are: (i) Acquisition or disposition of important assets; (ii) Borrowings in substantial sums; (iii) Appointment and dismissal of managers (*Shihai-nin*) and other important employees; and (vi) Establishment, alteration or abolition of branch offices and other important organization sub-structures.

The Commercial Code does not set forth any guidelines let alone express definitions of the terms "important" and "substantial." What is "important" or "substantial" will have to be considered in terms of concrete and specific situation, for each corporation, varying significantly depending upon a whole congeries of factors as the monetary values involved in relation to the business carried out, the size of the corporation, the nature of business undertaken, its organizational makeup, etc., as well as the conventional practices heretofore pursued, or the practices presently being followed.

<sup>7</sup> Please note that detailed discussion for these matters is intentionally omitted for the purpose of this memorandum.

- (viii) Issuance and/or retirement of stock warrant;
- (ix) Various decisions with respect to the share transfer where the corporation requires the board's approval for the transfer (Art. 204, Art. 204-2, Paras. 1, 2 & 3, Art. 204); and
- (x) Approval of financial statements and detailed schedules thereof (Art. 281).

### **Representative Directors**

As stated earlier, the Code provides that a corporation shall, by resolution of its board of directors, appoint a particular director or directors who shall represent the corporation (Art. 261, Para. 1). It also provides that each of the representative directors has the authority to represent the corporation vis-à-vis third parties, subject to an exception for the possibility of joint representation<sup>8</sup>.

Thus, the authority to manage the business of a corporation resides principally in two organs of the corporation: the board of directors and the representative director(s).

## **b) Duties and requirements of Directors, Officers and Managers**

### **General Duties**

With the care of a good manager in accordance with the terms of the Code, each director is obligated to perform his duties "faithfully" on behalf of the corporation (Art. 254, Para 3). Directors are also specifically obligated by statute to obey any law or ordinance and the articles of incorporation, as well as resolutions of general meetings of shareholders. Further, the relations between the corporation and the directors shall be governed by the provisions relating to "mandates" (*inin*) (Art. 254, Para. 3), and, therefore, each director is obligated under the provisions of the Civil Code (Law No. 89 of 1896, as amended) "to manage the affairs entrusted to him" (Art. 644).

The Code confers on directors certain rights and powers which they may exercise in their capacities as individual directors rather than by participation in resolutions of the board of directors. The foregoing general duties as prescribed by the Code are, to state the obvious, very abstractly formulated and not particularly helpful as a guide to conduct in specific situations. Unfortunately, academic comment and judicial precedents also fail to provide clear rules in this area because they are marked by wide divergence of views. It is clear enough that good-faith errors of business judgment would not in and of themselves, and in the absence of gross negligence, place even those directors immediately involved in breach of their duties to the corporation. At the other extreme, it is also clear that any director directly involved in an act of bad faith or a grossly negligent act causing injury to the corporation would be in culpable breach of his duties. Very difficult questions

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<sup>8</sup> If so specified by board resolution and duly registered in the corporation's commercial registration. (Art. 261, Paras. 1 & 2, and Art. 188, Para. 2, Item 9 of the Code)

arise; however, as to what extent the general duties borne by directors impose upon them the obligation to inquire into the manner in which other directors are performing their functions. Perhaps the most that may be safely said in this respect is that directors closely involved with the conduct of the corporation's day-to-day operations are held to considerably stricter standards of inquiry into the conduct of other directors than are directors not in the full-time employ of the corporation. It is often stated that directors in the latter category adequately discharge their duties if they are reasonably diligent in attendance at board of directors meetings and make inquiry into any apparent irregularities in the conduct of the corporation's business of which they gain actual knowledge or to which they have been alerted. The Supreme Court (Decision of May 22, 1973, 27 *Saikosai Minshu* 655) has gone beyond this statement of the law and held that every director as an individual, as well as the board of directors as a body, has a duty not only to supervise the carrying out of matters discussed at meetings of the board of directors but also the business operations performed by the representative directors generally; and if necessary each director by himself is obligated to convene or demand convocation of a meeting of the board of directors in order to cause due performance of business operations through resolution and action of the board of directors. The factual situation, upon which this decision was based, however, was extreme in that the corporation had been solely operated by one representative director, with no shareholder's meetings or formal board of directors meetings being held. It is impossible to state how the Supreme Court would react in a less extreme situation; but, as a minimum, each director has a duty to supervise the carrying out of matters discussed at board of directors meetings and, further, to take necessary measures to correct matters which may cause damage to the corporation and of which he has notice or should have had notice<sup>9</sup>.

### **Specific Duties**

There are a number of duties specifically imposed on the directors under the Code, in addition to the general duties referred to above. On a literal reading of the statute, these duties are borne by each director individually as well as by the directors collectively. These rights and powers extend to, but not limited to, the following matters:

- (i) Attendance at shareholders' meetings and meetings of the board of directors (by implication from Art. 237-3, Para. 1 and Art. 259-2);
- (ii) Institution of an action demanding the rescission of a resolution adopted at a shareholders' meeting (Art. 247, Para. 1);
- (iii) Institution of an action to nullify an issuance of new shares (Art. 280-15, Paras. 1 & 2);
- (iv) Institution of an action to nullify the following formation of the corporation (Art. 428, Paras. 1 & 2);

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<sup>9</sup> *Shinpan Chushaku Kaisyaho* (6) (New version of Compendium of Corporate Law (6)) pp. 279-283) (M. Kondo, Ed., 1987)

- (v) Institution of an action to nullify the capital reduction (Art. 380, Paras. 1 & 2);
- (vi) Institution of an action to nullify a merger (Art. 415); and
- (vii) Application for a court-supervised corporate receivership (*kaisha seiri*) (Art. 381).

**c) Is there an equivalent in Japan to the US Business Judgement Rule?**

Although there is no specific express statute, there exist a number of precedents, which admits the extensive discretion of the directors as long as such director in question has no fault or negligence in the course of making business decision and the decision itself seems reasonable under that particular situation. These trends in judgment in Japanese court can possibly be referred to as “the Japan Business Judgement Rule,” even though it is difficult to say that such rule has been established as a firm rule. Based on Anderson Mori’s rough understanding of the US Business Judgment Rule, the different point of such rules between the US and Japan is that the Japanese courts seem to consider not only (i) the occurrences of conflict of interest between the director(s) and the corporation and (ii) due process, but also (iii) reasonableness of such decision<sup>10</sup>.

**d) Duties of Directors towards majority and minority shareholders**

As discussed above, under the Code, each director is obligated to perform his duties “faithfully” on behalf of the corporation (Art. 254, Para. 3), and “to manage the affairs entrusted to him with the care of a good manager in accordance with the terms of the mandate” (Civil Code, Art. 644). Further, directors are also specifically obligated by statute to obey any law or ordinance and the articles of incorporation, as well as resolutions of shareholders’ meetings. As such, there exists no real difference between the duties of directors towards majority or minority shareholders.

**e) Duties of Directors, Officers and Managers in case of bankruptcy**

In case of bankruptcy<sup>11</sup> of the corporation, the corporation loses its power to manage and dispose of its property and the bankruptcy trustee will assume such power<sup>12</sup>. Officers and Managers or other employees of the corporation may support the trustee with respect to the liquidation process, not supervised by the directors. The representative director of the bankrupted corporation shall explain the things

<sup>10</sup> Kenjiro Egashira, "Kabushiki Kaisha and Yugenkaisha Ho," Yuhikaku, 2001, at p. 326.

<sup>11</sup> Bankruptcy is only one of the legal procedures for insolvent person as Japanese law provides other methods, such as liquidation and/or rehabilitation, reorganization procedures for insolvent person, or person who is insolvent threatened. The statement above is presumed to be a bankruptcy case, and other legal procedures will necessitate further discussions.

<sup>12</sup> Art. 7 of the Bankruptcy Law (Law No. 71 of 1922, as amended)

concerning the bankruptcy upon the request of the trustee or creditors' committee<sup>13</sup>. Further, the Directors, Officers and Managers would possibly be subjected to criminal or administrative punishment if they infringe the Bankruptcy Law.

**f) General Liability of Directors**

A director found to be in breach of any of its general or specific duties would be liable to the corporation for resultant injury sustained by it. Two or more directors jointly involved in the offending acts would be jointly and severally liable. In addition, any directors who either knew of the act in question or, who, by close involvement in the day-to-day business affairs of the corporation, were in possession of sufficient information that they should have been aware of it, would also probably be held to share such joint and several liabilities. The same would probably be true of a director who had responsibility for supervision of some aspect of the day-to-day business affairs of the corporation but who, because of a lack of diligence in discharging those responsibilities, failed to gain knowledge or notice of the act in question.

The Code provides that in cases in which the liability of directors is based on an act or transaction performed in accordance with a resolution of the board of directors, all directors who voted affirmatively for the adoption of such resolution shall be jointly and severally liable to the corporation (Art. 266, Para. 2). Further, the Code stipulates that directors who have participated in the meeting of the board of directors at which any such resolution has been adopted shall be presumed to have voted affirmatively for the adoption of such resolution unless their dissent therefrom is specifically stated in the minutes of the meeting (Art. 266, Para. 3). It is considered possible, however, to rebut the statutory presumption by producing appropriate evidence to the contrary.

The scope of liability therefore includes:

- (i) Liability for a specified amount where interim dividends are declared and the net worth of the corporation as of the end of fiscal year declines below the sum of certain specified items, unless the directors can prove that there was no prospect of such decline at the time of the interim dividend declaration (Art. 293-5, Para. 5).
- (ii) Liability for the amount of dividends illegally distributed by the corporation and for the amount of interim dividends illegally declared in excess of prescribed limits (Art. 266, Para. 1, Item 1).
- (iii) Liability for the sum paid or other benefits provided in violation of Article 294-2, which proscribes provision of economic benefits of any kind to anyone in connection with the exercise of the rights as shareholders (Art. 266, Para. 1 Item 2).
- (iv) Liability for a defaulted amount of any loan made by the corporation to a director (Art. 266, Para. 1, Item 3).

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<sup>13</sup> Art. 153 of the Bankruptcy Law

(v) Liability for damages to the corporation resulting from transactions in which interests of the corporation and the director in question conflict, as stipulated in Paragraph 1 of Article 265, (Art. 266, Para. 1, Item 4).

(vi) Liability for damages to the corporation resulting from the performance of any act which is in violation of law or the articles of incorporation (Art. 266, Para. 1, Item 5).

In the cases described in Items (i), (ii), (iii), (iv) and (vi) immediately above, liability may be excused by unanimous agreement of all the shareholders (Art. 266, Para. 5). In the case described in Item (v), agreement of a majority in interest of holders of two-thirds or more of the voting rights is sufficient (Art. 266, Para. 6). It should also be noted that the majority of legal commentators state that, except for the liabilities enumerated in Item (vi) hereinabove, no negligence is required for liability to attach. It is even more difficult to assess what steps must be taken by directors in order to avoid liability with regard to a declaration of interim dividends which subsequently is found to be imprudent by virtue of a decline in the corporation's net worth. In this case, even errors of business judgment may not operate to exonerate the directors from liability.

**g) Directors' Special Liabilities to Secure Assets of the Corporation**

The Code further stipulates certain liabilities to secure assets, meaning the paid-in capital, of the corporation. The directors shall be liable for the unpaid amount of subscribed shares at the time of incorporation or newly issued shares thereafter<sup>14</sup>. No negligence on the part of directors is required for the liabilities to attach.

**h) Liability Towards Third Parties**

It is a general proposition that third parties dealing in good faith with a corporation in transactions in the ordinary course of business will be protected even when such transactions were not duly authorized by the Board of Directors and the corporation will be bound, with respect to actions taken on behalf of the corporation by a representative director in principle.

The Code makes explicit provision for the liability of a director to third persons. Two or more directors jointly performing an offending act would be jointly and severally liable. Situations in which directors would be exposed to such liability include the following (Art. 266-3, Paras. 1 & 2):

- (i) Injury to third persons resulting from bad faith or gross negligence in the performance of a director's duties.
- (ii) Injury to third persons resulting from a false statement concerning any material facts contained in application forms for subscription to new shares or debentures, in certificates relating to pre-emptive rights, in prospectuses, in balance sheets, business reports, profit and loss statements, proposals (to

<sup>14</sup> Art. 192, Para. 1, Art. 192, Para. 2, Art. 192-2, Para. 1, Art. 280-13, and Art. 280-13-2, Para. 1 of the Code

shareholders) relating to reserves or the distribution of profits, or in detailed supporting statements.

- (iii) Injury to third persons resulting from false registrations or public notices made by the directors relating to the above statement.

As with respect to the specific liabilities of the directors to the corporation enumerated above, in cases in which the liability of directors is based on an act or transaction performed in accordance with a resolution of the Board of Directors, all directors who voted affirmatively for the adoption of such resolution shall be jointly and severally liable to the corporation (Art. 266-3, Para. 3). Likewise, directors who have participated in the meeting of the Board of Directors at which any such resolution has been adopted shall be presumed to have voted affirmatively for the adoption of such resolution unless their dissent therefrom is specifically stated in the minutes of the meeting. Here again, it is considered possible to rebut the statutory presumption by producing appropriate evidence to the contrary.

The law is far from settled as to the situations in which liability under the items enumerated above would attach to directors who neither had directly performed the act giving rise to liability nor joined in a board resolution approving the act as described in the preceding paragraph. It would appear distinctly possible, however, that such liability would attach to any director who either knew of the act in question or, by virtue of his attendance at board meetings or close involvement in the day-to-day business affairs of the corporation, was in possession of sufficient information that he should have been aware of it. The same might well be true of a director who had responsibility for supervision of some aspect of the day-to-day business affairs of the corporation but who, because of a lack of diligence in discharging those responsibilities, failed to gain knowledge or notice of the act in question.

i) **General Liability of Representative Director**

Representative directors are, of course, directors of the corporation, and as such are subject to the legal duties, and liabilities for breach thereof, applicable to directors generally and as described above. However, the point here is that representative directors will in general be held accountable to more stringent obligations than ordinary directors, in that they are to actively supervise and inquire into the conduct of the corporation's business (although it should be noted that directors, even though not representative directors, bearing direct operational responsibility for some aspect of the corporation's day-to-day business will bear equally heavy or even heavier duties of supervision and inquiry with respect to matters under their charge than directors not bearing such responsibility).

j) **Directors, Officers and Managers criminal liability.**

Apart from liability to injured persons, non-penal, administrative fines in amounts not exceeding ¥1 million are in principle assessable for failure by directors to discharge several of their obligations stipulated in the Code (Art. 498).

In addition to the fines stipulated above, the Code also provides for criminal fines of up to ¥10 million and/or penal servitude for periods of up to ten years in cases of serious and deliberate breaches of trust against the corporation and causing injury to the corporation (Arts. 486 & 492). Lesser criminal penalties are provided for with respect to a number of less serious offences. For example, where directors declare an unlawful dividend or interim dividend, i.e. one impairing its capital or mandatory reserves, fines of up to ¥5 million and/or penal servitude for periods of up to five years may be imposed (Art. 489, Item 3 & Art. 492).

#### **4-Statute of limitations:**

##### **a) General Statute of Limitation**

The general statute of limitation period for any claim based on civil rights other than specifically stipulated is ten years (Art. 167, Para. 1 of the Civil Code).

##### **b) Contractual disputes**

In respect of contractual disputes with corporations, the limitation period for actions is five years (Art 522, 503, 52).

##### **c) Discrimination actions (as unlawful act)**

The limitation period for discrimination actions is either of shorter period of (i) three years from the time when the injured party or his legal representative became aware of such damage and of the identity of the person who cause it; or (ii) twenty years from the time when the unlawful act was committed (Art. 724 of Civil Code). This action shall be brought as claim based on unlawful act and the above description shall apply to all the unlawful acts' claim.

##### **d) Sexual harassment actions (as unlawful act)**

The limitation period for sexual harassment actions is the same as that of discrimination actions above.

##### **e) Wrongful termination actions and labour related actions**

Employees may (i) sue Directors, Officers and Managers for discrimination, sexual harassment and wrongful employment practices or any other unlawful act at any time by themselves at judicial court, or (ii) bring petition to labour committees, which are administrative but quasi judicial organs, with respect to the corporation's unfair labour practice<sup>15</sup> for the purpose of examination, mediation or arbitration. The statute of limitation for (i) above is the same as that of discrimination actions

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<sup>15</sup> Arts. 7, 20 and 27 of the Labor Union Law (Law No. 174 of 1947, as amended)

above. For (ii) above, the statute of limitation is one year from the time when the unfair labour practice is ceased<sup>16</sup> (the details of the labour committee and relevant administrative action governed by the Administrative Procedure Code (Law No. 139 of 1957) is difficult to summarize in short space and shall be further discussed when examining particular cases).

In addition, in respect of labour related claims based on the Labour Standard Law such as salary payment claims, the limitation period for actions is two years from the time when the right is capable of being exercised<sup>17</sup>.

#### **f) Fraud**

The statute of limitation for the indictment by the public prosecutors is seven years (in principle) (Art. 250 of the Code of Criminal Procedures) and under civil law provisions, one is entitled to avoid any declaration of intention (for any transaction) induced by fraud or duress. The statute of limitation for such right of avoidance is either (i) five years from the time when it became possible to be ratified; or (ii) twenty years from the time of such fraud or duress (Arts. 96 and 126 of the Civil Code).

#### **g) Tax**

The limitation period for tax actions is in general five years after the due date, except that the limitation period (only for the subject amount) shall not run for two years from the due date<sup>18</sup> in case of evasion of tax obligation caused by untrue tax return or other unfair act (General Law of National Taxes, Art. 72).

### **5-Who can sue?**

#### **a) Corporation: (derivative actions)**

In principle, in the case where a corporation institutes action on a director (or where a director institutes action on a corporation), an auditor shall represent the corporation in respect of the action (Art. 275-4 of the Code).

Derivative actions (*Kabunushi Daihyo Soshō*) can be brought by any shareholder of the corporation. Simply, any shareholder who has held shares of a corporation for a continuous period of not less than six months has the right to demand, in writing, that the corporation institute an action to enforce the liability of a director, corporate auditor or incorporator of the corporation (Art. 267, Para. 1 of the Code). There is no

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<sup>16</sup> Art 27 of the Labor Union Law.

<sup>17</sup> Art. 115 of the Labor Standards Law (Law No. 49 of 1947, as amended)

<sup>18</sup> This actually means that the limitation period for the subjected amount extends to seven years in this case (Hiroshi Kaneko, "Tax Law," April 30, 2001 at p.530).

limitation of ratio of holding shares to bring such an action. When the corporation sues a director(s), the corporate auditor shall represent the corporation in the suit as mentioned above. If the corporation does not sue the directors within sixty days from the shareholder's request, then the shareholder is entitled to sue the director on behalf of the corporation. The judgment of the derivative actions shall take effect on the corporation<sup>19</sup>.

According to the website of *Shoji Homu*<sup>20</sup>, being a prominent Japanese law review magazine, it is reported that the overall number of derivative actions in Japan increased at approximately 5-10% annually after 1993 to 1999, however, in 2000 it decreased at about 6 %. It is difficult to outline the severity of law suits since it totally depends on each case; however, it is worthwhile to note that the concept of punitive damages is not adopted in Japan and regarded as incompatible with the public order of Japan.

**b) Shareholders: (direct actions and class actions)**

Unless a shareholder has particular reason to sue particular directors directly not on behalf of the corporation, no shareholder can bring action against directors under Japanese law. The above mentioned derivative actions are only and one method to sue directors on behalf of corporation.

**c) Liability to Creditors, Third Parties**

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Creditors and third parties may commence actions against directors for any unlawful act which caused any damage against such creditors or third parties.

**d) Insolvency administrators, Trustees in Bankruptcy**

Similar to liability to creditors and third parties mentioned above, insolvency administrators and trustees in bankruptcy can commence actions if directors are found to have been in breach, (i) of their duties as director before the commencement of bankruptcy<sup>21</sup>; and (ii) of their duties against such insolvency administrators or trustees during the course of bankruptcy<sup>22</sup>.

**e) Regulatory authorities**

(i) Securities and Exchange Surveillance Commission ("SESC") is the body that supervises, among others, illegal securities trading (including insider trading) by any doer, especially any securities firm and/or its directors or employees. If SESC finds an illegal securities trading, they would instruct and control the doers via administrative

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<sup>19</sup> Art. 267 Para 3 of the Commercial Code, Art. 115 of the Japanese Civil Procedure Code (the "CP Code", Law No. 109 of 1996)

<sup>20</sup> <http://www.shojihomu.or.jp/whats01/011018.html>

<sup>21</sup> Art. 266 of the Code, Art 162 of the Bankruptcy Law (Law No. 71 of 1921)

<sup>22</sup> Art. 153 of Bankruptcy Law.

guidance and/or administrative penalty, and in worse case SESC would bring upon such person criminal accusations.

(ii) In principle, Financial Service Agency ("FSA") is the body that supervises financial institutions in short. Directors of financial institutions, as individual, shall also be supervised by the FSA on regulation of side business, qualification, and so on. FSA investigates to confirm that any financial institution directors do not do business inappropriately or illegally. If improper practices occur, administrative guidance would be brought upon such director.

(iii) Japan Fair Trade Commission is the body that supervises various transactions to eliminate unfair trades by any doer and to avoid any markets monopolized under Antimonopoly Act<sup>23</sup>. (The unfair trade condition does not include the doer's title.) If they find improper practice or illegal transaction by any doer (including directors, officers and managers) they would give administrative guidance to the doer, and could bring upon criminal procedure to the doer.

(iv) Labor Standards Bureau is the body that effectuates the Labor Standard Law which prescribes the minimum employment conditions and enforces them by administrative guidance and/or penalty, or in certain circumstances by criminal punishment. For such purpose, their business includes supervision of any employer (for the purpose of this law, including corporations and persons who have certain responsibility for controlling employees' work<sup>24</sup>). They would subject the doer and the corporation with administrative or criminal penalty to defend employees' rights when infringement on them occurs.

f) **Employees**

Please see Section 4. d) above.

## **6-What is the enforceability of a foreign judgement on Japanese Directors, Officers and Managers under Japanese law?**

Generally, if a foreign judgement is instituted against Directors, Officers and Managers in Japan, and the foreign judgement is upheld to be final and binding by such foreign court, Japanese courts will admit such claim if such foreign judgments meets the requirements under the CP Code.

Article 118 of the CP Code stipulates that the effect of final and conclusive judgment by foreign court shall be valid upon the fulfilment of all the following conditions:

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<sup>23</sup> Official name of this law is "Law relating to Prohibition of Private Monopoly and Methods of Preserving Fair Trade" (Law No. 54 of 1947).

<sup>24</sup> The Ministry of Labor, the Labor Standards Supervision Division, "Labor Standard Law (I)," March 1, 2000, at p. 141.

- (i) The jurisdiction of the foreign court is admitted by the laws and ordinances, or treaties;
- (ii) The defeated defendant who has received service of summons or orders (excluding service by publication or other similar service) necessary to commence procedures, or who has responded to the action without receiving such service;
- (iii) The contents of a judgment and the procedure is not incompatible with public order or good morals of Japan; and
- (iv) There exists reciprocal guaranty.

Notwithstanding the above, there exist some Japanese court precedents which have not admitted the enforceability of the judgments rendered by foreign courts. For instance, in relation to Art. 118, Item 3 above, the Supreme Court of Japan has previously held that a US judgment which granted punitive damages (which concept is not adopted in Japan) is incompatible with the public order of Japan and that such judgment cannot be effective or enforceable in Japan. Thus, in the current instance, the likelihood of enforcement to be granted might still vary on the nature of the claim.

### **7-Can the Directors, Officers and Managers be liable for punitive damages under Japanese law, and are punitive damages insurable under Japanese law?**

As stipulated above, the concept of punitive damages is not adopted in Japan and regarded as incompatible with the public order of Japan.

### **8-Can the Corporation indemnify its Directors, Officers and Managers under Japanese law and under which conditions?**

As for the officers' and managers' misconduct, negligence or failure which led any damage to the corporation, the corporation has discretion to pursue them for compensation. Shareholders are not entitled to directly sue the officers or managers or to initiate any action for such compensation to the officers or managers on behalf of the corporation. Therefore, the Code does not provide any particular device to indemnify them.

However, when it comes to directors' misconduct (mentioned in Section 3. f) above; including, but not limited to, being in breach of law, ordinances or the articles of incorporation) which causes damage to the corporation, directors owe compensation obligation to the corporation. The permission of and consent obtained from all the shareholders of the corporation is, in principle<sup>25</sup>, the only way to indemnify such obligation, other than new instruments summarized in the next paragraph (Art. 266, Para 1, Item 5, Art. 266, Para 5 of the Code). If such approval were not resolved at shareholders' meeting, both

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<sup>25</sup> Please refer to the Section 3. f) above for the description of the exception thereof.

the corporation and the shareholders are entitled to seek compensation from the director as discussed above.

With regard to the compensation obligation mentioned in Section 3. f) (vi) above, a recent amendment to the Code (Art. 266, Paras. 7 through 23 of the Code, which came into effect in May 2002) provides the *kabushiki kaisha* with three instruments to indemnify its directors to some extent.

- (i) ex-post discharge by special resolution of the shareholders' meeting.
- (ii) ex-post discharge by the resolution of the meeting of the board of directors, after this instrument is accepted by the shareholders' special resolution and is introduced to the corporation.
- (iii) ex-ante agreement to limit the responsibility of compensation obligation (available for the outside director only).

Procedural methods for such indemnification and the discharge amount shall vary in case by case basis. It is also worth noting that these methods can not discharge "all the obligation", but only to some extent; for example; by the special resolution of the shareholders' meeting, a director (not a representative director) can be discharged of the amount which is  $(X)-(Y) \times 4$ , whereby:

- (X) = amount of damage to the corporation= amount of liability of the director
- (Y) = any of all of the remuneration (provided by the corporation) in its highest year

## **9-Is Directors, Officers and Managers Liability Insurance Legal?**

### **a) Who can pay the insurance premium?**

The insurance premium shall be paid by the corporation.

### **b) Must the D&O insurance policy be issued by a local admitted insurer?**

Yes, it must.<sup>26</sup>

### **c) If yes, does the same rule apply to a Japanese subsidiary of a multinational carrying a D&O insurance policy in the country of incorporation?**

Yes, it does.<sup>27</sup>

### **d) Issue of tax allocation of local premium for local D&O insurance policy under Japanese law**

<sup>26</sup> Art. 185 and 186 of the Insurance business law (Law No. 105 of 1995)

<sup>27</sup> Art. 185 of the Insurance business law

Most premium for local D&O insurance policy are budgeted at the corporation's expense, however, a part of premium for indemnity, payable in instances where a litigant loses an action, shall be assumed as Directors' fee under Japanese Tax Law.

-END-

## **Qualifications and Assumptions**

The responses set out herein are confined to and given on the basis of the following circumstances and/or documents and may be relied upon only in connection with such circumstances and/or documents:

- (1) strictly governed and limited to the laws and regulations of Japan and do not purport to have any expertise of any law other than the laws and regulations of Japan;
- (2) no investigation on the laws of other jurisdiction has been made and do not express or imply any opinion on the laws of other jurisdiction;
- (3) strictly limited to the questions and matters stated herein, is general in nature with detailed discussion (including exceptions) intentionally omitted and no opinion may be implied or inferred beyond the questions and matters expressly stated herein;
- (4) no obligation to update the responses stipulated herein to reflect any facts or circumstances which may after the date hereof come to Anderson Mori's attention or any changes in law which may hereafter occur;
- (5) respective provisions stipulated herein are, to the best of Anderson Mori's knowledge, referred to in relevance to the questions and matters stipulated and Anderson Mori reserve the right to amend or supplement such references; and
- (6) strictly client specific and intended solely for the benefit of AIG pursuant to the questions and matters stipulated herein and the participants of the AIG project called "International Liabilities Articles", and may not be used, circulated to, quoted, referred to or relied on by any other person without Anderson Mori's prior written consent.

