The Company Law in Japan (1)

LL.D. TAKUMA ISHIYAMA

1 The Historical Background of the Company Law in Japan

When the Meiji Restoration Government was established in 1868, it wanted to form a modern legal system which was equal to that of Western countries, because it desired to deal with Western powers on an equal footing. In the early stage of this modernization process, the attention of the Japanese government was first focused principally on the constitutional monarchy system of the United Kingdom. However, there was one major obstacle which prevented the immediate adoption of the legal system of that country, namely the common law system which is one of main characteristics of English Law. Japan hesitated to accept this system, simply because there had not been a background to accept it. It was Codes that Japan really needed, but the United Kingdom did not have even the Code of Constitution. In the end, the Meiji Constituion, the present Civil Code and Commercial Code were taken into effect in 1889, 1898 and 1899, respectively, being heavily influenced by contemporary German Codes.

After the Second World War, the legal system in Japan was changed dramatically by the political pressure of the United States. First, the Meiji Constituion was completely amended (repealed, in fact), to introduce a number of democratic principles found in the United States Constitution. The other basic Codes were also amended to conform to the spirit of the new Constitution. The Company Law which is a part of the Commercial Code was also amended in significant respects, and some important systems were introduced from the Anglo-American Law. It is said that the Illinois Corporation Law was influential at that time because a person of the Occupation Forces in charge of the amendment came from Illinois.

Besides these revision, some important laws were newly

* Professor of Commercial Law, Waseda University, School of Commerce, Tokyo.

introduced, e.g. the Labour Standard Act, the Labour Relations Adjustment Act, the Labour Union Act, the Anti-Monopoly Act and the Securities and Exchange Act ...... these were closely patterned after respective United States Laws.

The Company Law has been amended several times after the Second World War, and consequently there are now a lot of complicated regulations in it. This article deals with some fundamental subjects in the Company Law in Japan.

2 Types of Business Organizations in Japan

(1) Types of Companies

There are four types of business companies in Japan: 'Goumeigaisha' or 'Gōmei Kaisha' (unlimited partnership company); 'Goushigaisha' or 'Gōshi Kaisha' (partially limited liability company); 'Kabushikigaisha' or 'Kabushiki Kaisha' (stock company); and 'Yūgengaisha' or 'Yūgen Kaisha' (limited liability company). The law relating to 'Goumeigaisha', 'Goushigaisha', and 'Kabushikigaisha' is found in Part 2 (Company Law) of the Commercial Code (1899, law 48) [hereafter cited as C.C.], and the law relating to 'Yūgengaisha' is found in the special Act called 'Yūgengaisha Hou' (Limited Liability Company Act, 1938, law 74) [hereafter cited as L.L.C.A.].

(2) Goumeigaisha

'Goumeigaisha' is a partnership which acquires a legal personality by registration under the Commercial Code. Thus, It is distinguished from the legal personality of its members. It is a suitable business organization form for a small group of people who are acquainted with each other, such as family, relatives and friends. Each member of this company assumes unlimited liability for the obligations and duties of the company and must obtain the approval of all the other members before transferring all or part of his equity in the company (C.C. Art. 73).

Each member has both power and duty to represent the company and to execute its business, unless otherwise provided in the articles of incorporation (C.C. Art. 76). According to the tax statistics in 1991, there were about 6,700 Goumeigaishas actively trading.

(3) Goushigaisha

'Goushigaisha' is composed of two classes of members: members with unlimited liability who are liable for the obligations and duties of the company unlimitedly, and members with limited liability who are not liable for the obligations and duties of the company beyond the value of their contribution (C.C. Art. 146). To transfer his equity, a member with unlimited liability must have the approval of all other members with both limited liability and unlimited liability (C.C. Art. 147). On the other hand, a member with limited liability may transfer his equity with the approval of only the members with unlimited liability (C.C. Art. 154). Only members with unlimited liability have the power and duty to represent the company and to carry out its business (C.C. Art. 151). A members with limited liability have the right to inspect the balance sheet and to investigate the business and the state of the property of his company (C.C. Art. 153I). According to the tax statistics in 1991, there were about 29,500 Goushigaishas actively trading.

(4) Kabushikigaisha

'Kabushikigaisha' is the typical modern company with a great number of anonymous investors. The capital of it should be 10 million yen or more (C.C. Art. 168-4). It can be said that since the ownership and the management of the company are separate from the legal point of view, the identity of members is not so important as with Goumeigaisha and Goushigaisha. Stockholders are not liable for the obligations and duties of the company beyond their subscribed value of shares (C.C. Art. 200I). The par value of a share issued at the time of incorporation shall not be less than 50,000 yen (C.C. Art. 166II). As a general rule, shareholders are free to transfer their shares (C.C. Art. 204I) and realize investment at any time. The decisions concerning to the important management should be made by the board of directors (C.C. Art. 260I·II). Directors who should be three or more persons are elected by the resolution of shareholders' meeting (C.C. Art. 254I, 255). One or more particular directors are designated as representative directors who have authority to represent the company individually (C.C. Art. 261I).

'Kabushikigaisha' is the most popular form of business organization in Japan. According to the tax statistics in 1991, there were about 1,097,400 Kabushikigaishas actively trading.

(5) Yūgengaisha

'Yūgengaisha' is a miniature of the stock company and usually has relatively small number of investors who are members with limited liability. It is limited to fifty members and the total capital of the company must be 3 million yen or more (L.L.C.A. Art. 8, 9). Unlike the 'Kabushikigaisha', there is no share system. The value of each equity in the company must be equal and fifty thousands yen or more (L.L.C.A. Art. 10). A member is free to transfer all or part of his equity in the company to other members but must obtain the approval of a general meeting to transfer his equity to non-members (L.L.C.A. Art. 19I·II). One or more directors are appointed by the company and have authority to represent the company and carry out its business (L.L.C.A. Art. 25, 27). This company is particularly suitable for a business with only a few members. According to the tax statistics in 1991, there were about 1,062,400 Yūgengaishas actively trading.

3 The Legal Structure of Stock Company Organs

(1) First Stage

There are three major problems concerning the legal regulation of stock companies in Japan. The first one is the legal classification of the stock companies. The second is the inactivity of auditors. And the last one is the adjustment of the legal regulation concerning companies' accounts and the development of the accounting. In this article, the explanation about the last of these items will be omitted.

The legal structure concerning the stock companies' organs in Japan has undergone four historical stages in its development. The first stage was the period from 1899 till 1950. The structure was modelled after that of Germany. The shareholders' meeting was characterized as the supreme and almighty organ of the company.

The stock company is, of course, based upon the capital invested by the shareholders. So, it has been traditionally said that shareholders are, in substance, owners of the company. Owners ought to be able to manage their company as they want by the resolution of their meeting. That is why the shareholders' meeting is called the supreme organ. And, at that stage,it had been given a number of rights and authority to do many acts by the Code. So, at the same time it was called an almighty organ.

On the other hand, each director had the authority to manage and represent the company by himself. There was no legal requirement to have a meeting before he acted as a general rule. Each of them was an independent organ of the company. Self-Management and Self-Representation were important legal features of directors at that time.

An auditors was an organ of the company and he had authority to supervise the management and audit the accounts of his company.

However, it was pointed out that this structure entailed some serious problems. One point was that the shareholders' meeting was seldom held in practice because it was very troublesome and expensive to have it at each time the company wanted to act. Another problem was the independent acts of each director. Let us suppose that Y motor car company made a certain new car. Director A made a contract to sell it with D, and directors B and C made similar contracts with E and F respectively. In this case, all contracts are valid, because when a contract is made to sell something, the object is not nesessary to exist at the same time. It is the agreement of each party's will to buy and sell that is indispensable for this contract to be effective. Owing to the authority of each director to make a contract independently, it follows that Company Y made contracts to sell a new car with three persons, despite the fact that there was only one car. Because of its incapability of fulfilling two contracts, Y cannot but take responsibility for paying damages to two persons. To avoid this risk, it was usual that most Japanese companies made a rule that other directors invest their authority to manage and represent to some specified director, and that all directors together constitute the board of directors to make the will of their company by autonomous bylaws.

So, as a result, there had been many boards of directors and representative directors in stock companies in Japan in fact. It should be remembered that these were not legal, but autonomous organs.

The third problem which concerned the company structure of this early period was related to the auditors. Japanese auditors have been famous for their inactivity. In Japan, by the seniority system, directors and auditors have generally been elected among employees of the company. It seems that, in a sense, there was a general feeling that a company is a kind of home and the employees are family members. So, excellent or talented employees were elected directors, while an employee who was not excellent enough to become a director, yet superior to ordinary employees and with a long-standing commitment to the company, was sometimes elected the auditor. This may be considered as a kind of reward for his loyalty to the company. So, most auditors, except of some 'Zaibatsu' (financial combines), actually did not do any work, but only approved of what directors had done. How can auditors audit directors who made them nominees for auditors?

(2) Second Stage

The second stage, then, is the period after the amendmend of the Company Law in 1950 untill 1974. As mentioned above, the old Company Law was amended under the influence of the United States Corporation Law in 1950. The shareholders' meeting was still characterized as the supreme organ of the company, but the characteristic of its being almighty disappeared. Now, a board of directors system was introduced, and the board of directors inherited the almighty rights and authority which had belonged to the shareholders' meeting before. It has considerable authority to decide the will of the company through its meeting. So, it is called a will-making organ. Each directors is now only a member of this meeting and not a legal organ himself as he used to be. Also, a new legal organ, the representative director, was established. One or more representative directors have to be elected among the members of the board of directors. He has the authority to deal with third persons and to exert internal management, representing his company under the control of the board of directors. Lastly, the auditor lost the authority to supervise corporate management. The legislators wanted him to concentrate on auditing the accounts only.

There were two important problems relating to this structure. The first was that, hitherto,there had only been one legal framework for the stock company in the Company Law in Japan, despite the fact that companies in operation differed in size. In other words, many regulations concerning the shareholders' meeting, the board of directors and the representative director, etc. were only applicable to large-scale companies. But, since the actual number of large-scale companies was and still is quite few, it had been generally agreed that the Company Law should have classified companies according to size. The other problem concerned the auditors. They continued to audit as ineffectively and carelessly as before. As a result, many well-known bankruptcies happened one after another around 1965. It became necessary to examine the audit system again.

(3) Third Stage

The third stage in the development of the legal structure of company organs was the period from 1974 to 1981. This was the first stage to make some classification of companies. Principally, there are two ways of classifying companies legally. One is to classify according to the amount of capital. The other is to classify according to whether it has actually issued shares or not. In Japan, the former criterion was adopted first, and the companies were classified into three categories.

The first category is the large sized company, that is to say a company with capital of 500 million yen or more. There are two characteristics of this company. One is that an auditor has not only the authority to audit the accounting, but also that of supervising the management of directors. The other is that its documents under Article 281 paragraph 1 of the Commercial Code (a balance sheet, a profit and loss account, a business report, proposals relating to the disposition of profit or loss and annexed specifications thereof) have to be audited not only by its auditors, but also by an accounting auditor who is an independent certified public accountant or a corportion formed by several certified public accountants (Law for special exceptions to the Commercial Code concerning audit, etc. of Kabushikigaisha [Audit Special Exceptions Law, hereafter cited as A.S.E.L.], Art. 2).

The next category is the middle sized company, that is to say a company with capital of less than 500 million yen but more than 100 million yen. The structure of this company is the same as that of the large company. So, the auditor has the authority to audit the company accounts and supervise the management of directors. But, in this case, it was not necessary for the accounts to be audited by an accounting auditor.

The last category was the small sized company, that is a company with capital of 100 million yen or less. The structure of this company is almost the same as that of the middle sized company, but here the auditor dose not have the authority to supervise the directors, nor was it necessary for the accounts to be audited by an accounting auditor.

(4) Fourth Stage

This now brings us to the present period which started in 1982. Almost all characteristics of the categories of this stage are the same as those of the third stage which have been described above. But, irrespective of the amount of capital, a company with debts amounting to 20,000 million yen or more is classified as a large company as well, which means that its accounts have to be legally examined by an accounting auditor.

(5) Criticism of the Present Categories

Lastly, it seems to be necessary to describe the criticism raised against this categorization. When the preparation for the amendment of 1974 was started, it was generally argued and proposed by legal academics that the large company category should include companies with capital of 100 million yen or more, and that the small company category should include companies with capital of 10 million yen or less. However, licenced tax accountants opposed this proposal strongly. Untill 1974, it was generally they who examined company accounts rather than certified public accountants, because there had not been enough numbers of certified public accountants. Licenced tax accountants realized that if this proposal were adopted legally, they might lose much profitable work.

Under the political pressure from the tax accountants, the final definition of large company was therefore raised to 500 million yen. In addition, companies with capital of less than 100 million yen but more than 10 million yen did not want to be categorised as middle-sized companies, because auditors of this kind of company would have authority to supervise the management of directors.

It can be concluded from this that the structure as it looks today is the result of political compromise, and not fit for reality. A company with capital of 100 million yen is not so small size as of 10 million yen, but big in reality. That is why further amendments of the Company Law has been realised several times recently.

4 Recent Amendments of the Company Law

After the amendment of the Company Law in 1981, it has been amended three times in 1990, 1993 and 1994. From the view point of the classification of companies, it can be said quite important that companies are divided into new two classes by the amendment in 1990, namely, publicly held companies and privately held companies. According to Article 280-5-2 in the C.C. which was newly made in 1990, when a company has a stipulation in the articles of incorporation to the effect that transfer of shares needs the approval of the board of directors, its shareholders have pre-emptive right of new shares as a general rule. This kind of companies that have such articles of incorporation can be said privately held companies and there are quite lots of such companies in Japan.

In 1993, there were only 2264 listed companies and 491 companies which issued over-the counter shares. These are all publicly held companies and, of course, they do not have such articles of incorporation. On the contrary, it is no exaggeration to say that all the rest companies have it. So, almost all of the companies in Japan are privately held companies in number.

In 1990, the minimum capital system was introduced (C.C. Art.

168-4) and the formation of a company by one promoter who takes one share was allowed as well (C.C. Art. 165 ...... There is no limitation for the number of pomoters.).

Through the amendment in 1993, some important systems were introduced into audit system, especially, of the large company. First, the number of auditors in large company increased to three persons or more. One of whom should not have been a director, a manager or some other employee of the company or its subsidiary company in five years before taking the office of an auditor (A.S.E.L. Art. 18I). Secondly, a board of auditors sysytem was introduced into large companies under the indirect pressure of Japan-U.S. Structual Impediments Initiative. All of the auditors in large companies must constitute a board of auditors which has authority to determine the policy of auditing, the way how to investigate the affairs of the company and the state of its property, and other matters which concerns the performing the functions of auditors by its resolution, provided that it does not disturb the exercise of authority of an auditor (A.S.E.L. Art. 18-2II). It can be concluded that there are two kinds of audit organs in large companies in parallel.