

## 6. Commerical Law

**A case concerning the disposal by a corporation of its material assets on which its board of directors shall be required to decide under Article 260(2) (i) of the Commercial Code and the criterion of materiality.**

Decision by the First Petty Bench of the Supreme Court on January 20, 1994. Case No. (o) 595 of 1993. A claim for confirmation of shareholder status. 943 *Kinyū Shōji Hanrei* 3.

[Reference: Commercial Code, Article 260.]

### *[Facts]*

X Corporation (plaintiff, *kōso* appellant, *jōkoku* appellant) held 121,000 shares (hereinafter referred to as “the relevant shares”), i.e. 7.56% of the total number of issued shares in B Corporation (not a party to this action), whose book value made up 1.6% of the gross amount of X’s assets. On the other hand, B Corporation held 17.86% of the total number of issued shares in X Corporation. Thus there was a cross share-holding relationship between both corporations, but they had no business relations with each other and X Corporation had not attended the shareholders’ meeting of B Corporation.

Under these circumstances, the representative director of X Corporation, A (not a party to this action), thought it better from the viewpoint of X’s financial position to convert the relevant shares into cash, because their rate of return was not very good. A transferred the relevant shares to Y (defendant, *kōso* respondent, *jōkoku* respondent) for ¥79,860,000. The board of directors of X Corporation, however, did not decide on this share transfer, though its board had decided on a transfer of shares in other corporations held by it.

Thus, C (not a party to this action), who was appointed as the representative director of X Corporation on the day after the transfer of the relevant shares, brought an action to have the court confirm X Corporation’s shareholder status in B Corporation. C argued that, because the transfer of the relevant shares, which, under Article 260(2) (i) of the Commercial Code pertaining to disposals by a

corporation of its material assets, was required to be decided by its board of directors, was made without the board decision in contravention of the Code provision, it should be void.

The court of first instance (decision of the Tokyo District Court on March 3, 1992) dismissed X's claim. X filed a *kōso* appeal against the decision. The *kōso* appellate court (decision of the Tokyo High Court on December 15, 1992) also dismissed the *kōso* appeal for the following reasons:

(1) Under the circumstances in this action, certainly the relevant shares were material assets in value, but X's purpose in holding these shares was merely to get dividends from B Corporation, therefore they were not one of the indispensable assets for the maintenance and expansion of X's business.

(2) X could get consideration for the transfer of the relevant shares and did so.

(3) Taking into consideration a comparison between the book value of the relevant shares and the gross amount of X Corporation's assets, the transfer of these shares did not fall under the "disposal by a corporation of its material assets" referred to in Article 260(2) (i).

X Corporation filed a *jōkoku* appeal against this decision.

### **[Opinions of the Court]**

Original judgment reversed and remanded.

It is proper to determine whether the disposal of certain corporate assets comes under the provision concerning disposals by a corporation of its material assets referred to in Article 260(2) (i) of the Commercial Code or not, taking into consideration such factors as the value of the assets, its proportion of the gross amount of corporate assets, the purpose for which the corporation held them, the manner of their disposal, and past treatment by the corporation.

Applying these factors to this case, the book value of the relevant shares, ¥78,000,000, is equivalent to about 1.6% of the gross amount of X Corporation's assets, which were about ¥4,786,400,000. The relevant shares, whose proper current price is difficult to estimate, might have an important effect on both the assets and the

profit and loss of X Corporation, depending on how much the estimated consideration for their transfer was. Additionally, the transfer of the relevant shares did not fall under the definition of transactions made in the ordinary course of business of X Corporation.

Taking these circumstances into account, it cannot be said that, on the basis of the reasons given in the original decision, the transfer of the relevant shares does not come under the provision for disposals by a corporation of its material assets referred to in Article 260(2) (i).

In addition, considering the fact that B Corporation did attend the shareholders' meeting held by X Corporation on May 30, 1992 and then made a motion with respect to the appointment of directors, the transfer of the relevant shares can be regarded as affecting the business relations between X Corporation and B Corporation and as being of great importance for X Corporation. X Corporation had had the transfer of any shares in other corporations held by it decided on by its board of directors in the past, however small the consideration for the share-transfer might have been.

As mentioned above, it is obvious that the original judgment is unlawful not only because it is a premature decision, but also because there is a wrongful interpretation and application of laws and regulations, which may affect the judgment. Therefore, as the original judgment should be reversed and must be tried again, it should be remanded.

### ***[Comment]***

#### **1. Issues in this case**

Article 260(2) (i) of the Commercial Code provides that the disposal by a stock corporation of its material assets must be determined by its board of directors and the representative director cannot make such disposal without a board decision thereon. As a transfer of the shares in B Corporation held by X Corporation to Y is obviously a disposal of corporate assets, the problem is whether this share-transfer comes under the legal provision for the disposal of corporate "material" assets. Since the directors misjudging this point may be

liable to their corporation for damages on breaches of law and regulations, it seems necessary to make the criterion of materiality, on whether the asset disposal in question needs a board decision or not, as clear as possible. In this sense, the Supreme Court decision in the instant case is the first to show such a criterion concretely, and so has great significance.

2. The disposal by a corporation of its material assets referred to in Article 260(2) (i) and the criterion of materiality.

Article 260(2) (i) of the Commercial Code, which is now in force, was introduced in the 1981 amendment of the Commercial Code. Article 260 of the Commercial Code prior thereto provided that the business affairs of a corporation should be determined by its board of directors and then illustrated the statutory matters required to be determined by the board, providing explicitly that the establishment, moving or removal of its branch office and the appointment or dismissal of its managers should always be decided by the board of directors, whose power to determine such matters could not be delegated to the representative director.

The statutory matters required to be determined by the board, however, were disputed. One opinion was that they should be limited to such matters as the issuance of new shares, which the Commercial Code explicitly required to be decided by the board. The power to determine other matters could be delegated to the representative director. The other opinion was that any material business affairs should be determined by the board of directors, even if not required explicitly so by the Commercial Code, and the power to decide thereon could not be delegated to the representative director. Thus the extent of the statutory matters required to be determined by the board lacked clarity. In fact, there were many cases where even the power to determine material business affairs was delegated to the representative director or to a committee of executive directors subordinate to the board, with the result that the functions of the board were weakened.

The 1981 amendment of the Commercial Code introduced the new Article 260(2), providing the “the disposals or acquisitions of material assets”, “large debts” and other material business affairs

shall be determined by the board of directors and that the determination thereof may not be delegated to the representative director and other subordinate committees. The Article's purpose was to clarify and strengthen the board's powers, and to ensure the proper conduct of business affairs.

Since it is impossible in fact, however, with respect to the "disposals of material assets" referred to in Article 260(2) (i) of the Commercial Code, to set up uniform criterion of materiality applying to every corporation, the common theory is that whether the disposal by a corporation of its assets comes under the Article 260 (2) (i) provision for disposal of material corporate assets must be determined on a case-by-case basis, taking into account the significance and influence which that asset disposal is to have in relation to the conduct of affairs of the disposing corporation. This depends on the size of the corporation, the state of its business or properties, and so on.

The instant Supreme Court decision states that it should be proper to determine whether the disposal of certain corporate assets comes under the Article 260(2) (i) provision concerning disposals by a corporation of its material assets or not, taking into consideration such factors as the value of the assets concerned, their proportion of the gross amount of corporate assets, the reason for the corporation to hold them, the manner of their disposal, and the past treatment by the corporation. This Court decision follows fundamentally the above mentioned theory.

3. Does the transfer of the relevant shares fall under the Article 260(2) (i) provision concerning disposal of material corporate assets?

Now, does the transfer of the relevant shares fall under the "disposal of material corporate assets" required to be determined by the board of directors? This Supreme Court decision answered in the affirmative to this problem for the following reasons:

(a) The transferred price of the relevant shares, (their book value is equivalent to about 1.6% of the gross amount of X Corporation's assets) might be of important influence on both the assets and the profit-loss of X Corporation, depending on how much the consideration for their transfer was estimated to be;

- (b) The transfer of the relevant shares does not fall under the transactions made in the ordinary course of business of X Corporation;
- (c) The transfer of the relevant shares, which may result in dissolving the cross-shareholding relationship between X Corporation and B Corporation, which holds a little more than 17% of the total number of issued shares in X. The transfer may undermine the mutual confidence between both corporations and could disturb the stable management of X Corporation;
- (d) The board of directors in X Corporation has decided on the transfer of shares held by it up to now, however small their transferred price might be.

It may be said that while reason (a) above is a quantitative criterion to determine whether the disposal of a given corporate asset comes under the disposal of material assets provision, reasons (b), (c) and (d) are qualitative criteria. The original judgment by the Tokyo High Court also found that, based on reason (a), the relevant shares should be significant in value, but the original court stated that their transfer could not fall under the “disposal of corporate material assets” provision, taking into account the reason for X Corporation to hold the relevant shares, their small proportion to the gross amount of X Corporation’s assets, and so on.

Thus this Supreme Court decision paid attention not only to the quantitative aspect of the above mentioned share-transfer but also to such qualitative aspects as the manner of a corporate asset disposal (reason (b)), the resulting dissolution of the cross-shareholding relationship between X Corporation and B Corporation, and the influence on X Corporation exerted thereby (reason (c)), and the past treatment of share-transfers by X Corporation (reason (d)). As even an extraordinary transaction, i.e. a transaction made by a corporation out of its ordinary course of business, may not come under the conduct of material corporate affairs if the value of a transferred asset or its proportion to the gross amount of corporate assets is to be relatively small. Reason (b), as such, can not be regarded as a decisive criterion to find a given asset-disposal material. The same is true of reasons (c) and (d). Therefore, it can be said that

reasons (b) ~ (d) are the reinforcing factors for determining whether a given asset-disposal is to come under the disposals of material corporate assets from the viewpoint of the value of a disposed asset (the reason (a) aspect).

This Supreme Court decision would not have regarded the transfer of the relevant shares as the disposal by a corporation of its material assets required to be determined by its board of directors based on reason (b) or reason (d), if the value of the disposed assets or the proportion of their value to the gross amount of the corporation's assets had been relatively small. In this sense, this Supreme Court decision should be analyzed to have held that the transfer of the relevant shares by X Corporation did come under the "disposal by a corporation of its material assets" referred to in Article 260(2) (i) of the Commercial Code, regarding the quantitative criterion, i.e. reason (a) as the central consideration for finding that Article 260(2) (i) applies. At the same time, the Court added qualitative criteria, i.e. reasons (b) ~ (c) above, as reinforcing considerations, and then took all the factors into account.

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## **7. Labor Law**

**A case in which it was held that when a high-school teacher sent the president of the Akita Lawyers' Association documents defaming his employer and gave similar information to a magazine reporter, it is lawful for the employer to dismiss him, because his act violated the confidential relationship existing in the employment contract. The case of Keiai-Gakuen eleemosynary Corporation (Kokugakukan High School).**

Decision by the First Petty Bench of the Supreme Court, on September 8, 1994. Case No. (o) 734 of 1993. 657 *Rōhan* 12.