

The Revision of Japanese Company Law and its Modernisation

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I. Introduction

The Japanese government, which fell a bit behind the UK in the Company Law modernisation programme, also launched a plan to update and modernise the Japanese Company Law system comprehensively. The Legislative Council of the Ministry of Justice, through its sub-council on company law, undertook a review of the whole of Japanese company law system. After hearing from all the interested entities and organisations, the Council has prepared and published a summary for the proposed revisions of the Japanese Company Law System to modernise it and then finalised it on 9 February 2005. The Japanese Companies Bill which was basically based on the Summary was submitted to the 162nd Japanese Parliamentary session. The Bill was passed with some slight amendments and the Companies Act (hereinafter referred to as the Companies Act 2005) was promulgated on 26 July 2005. It comes into force on 1 May 2006.

Anyway, the company law reform in 2005 overhauls the Japanese company law system which has provided the legal basis for the Japanese economy for more than one hundred years, so that the amendments are quite many. Also, as far as my research is concerned, the accent is on the issues of corporate governance, and the key intention of the reform is to update the regulations on the issues to make company management more flexible and to bridge the gap between the law and the business reality in the Japanese economy. This is why I focus on mainly the changes to the corporate governance regime under the Japanese Commercial Code.

In addition, one of the essential goals that the reform intends to

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implement is to promote more companies to be set up and to ensure efficient company management in order to enable Japanese companies to win the current global economic competition. For that purpose, the minimum capital requirement which all limited liability companies had to meet under the Japanese Commercial Code is abolished. It will make Japanese company law approximate to UK company law in this respect.

II. Former institutional framework for companies in Japan

1. Types of companies under Japanese law before 2005 reform

I think it's appropriate to refer to an institutional framework for companies under former Japanese Commercial Code, i.e., the law before the 2005 reform, before I explain the proposed company law amendments.

In Japan, it is the Commercial Code, the Private Limited Liability Companies Act of 1938, and other related legislation that have provided the framework for long time. The Commercial Code was made in 1899 and then the provisions relating to structures of companies, especially companies limited by shares, have undergone a number of significant changes so far. Originally the Code was based on the German law system, because the then Japanese government invited a German legal consultant, *Herman Roesler*, to advise on the drafting of the Code. Since the end of the World War II, the Japanese Commercial Code has been influenced by the US corporate law system. Under Japanese Commercial Code there were four types of company in Japan.

The first one was a *Goumei-kaisha*. The Japanese word "*Kaisha*" means "company". This type of company amounts to an unlimited company under the UK Companies Act.

The second was a *Goushi-kaisha*. This consisted of both at least one unlimited liability member who was in charge of the management and one limited liability member who was silent. I could say this is roughly equivalent to a limited partnership in the UK, with the exception that the former has a legal personality, while the latter did not.

The third one was a *Kabushiki-kaisha*. "*Kabushiki*" means shares

in a company. It is a limited liability company under Japanese law, and therefore it is the same as a company limited by shares in the UK. It was originally designed for large sized, public enterprises.

The fourth was a *Yugen-kaisha*, which was similar to a private limited company under UK law. It was enacted in 1938 in order to enable members in small-sized or medium-sized companies to enjoy a limited liability. This is because the *Kabushiki-kaisha*, i.e. the company limited by shares was originally designed for large-sized and public companies in Japan and was not suitable for small businesses. The *Yugen-kaisha* came from a German Limited Liability Company, i.e. *Gesellschaft mit beschränkter Haftung*. It did not have a share capital. As far as internal management was concerned, more flexibility was given to this company. For example, it needed only one director, and an appointment of a statutory corporate auditor was voluntary unlike the Japanese company limited by shares. Meanwhile the transfer of membership should be approved by the general meeting of members as the Act prescribed, because the company was mainly for small or medium sized business entities and so the members usually wanted to prevent a third party from disturbing a close relationship among them. Also, the number of members in a *Yugen-kaisha* was not allowed to be more than fifty.

2. Numbers of companies in Japan by type

It was possible to choose between the four types of companies in Japan when setting up a business company. However, the number of the *Goumei-kaisha*, i.e. unlimited companies has been quite small, obviously due to the unlimited liability of members. The *Goushi-kaisha* has been unpopular, too, because the members who were in charge of management owed unlimited liability. In reality, it is the *Kabushiki-kaisha* and the *Yugen-kaisha* that has dominated the vast majority of Japanese companies. According to a survey by the Inland Revenue in Japan, the numbers of the *Goumei-kaisha*, the *Goushi-kaisha*, the *Kabushiki-kaisha*, and the *Yugen-kaisha* are about five thousand nine hundred, thirty two thousand, one million and forty thousand, and 1.42 million respectively in 2003, although the statistics are a bit old. We can find almost the same trend in the UK. According to a report prepared by the UK Department of Trade

and Industry, *Companies in 2003–2004*, the effective number of all companies on the register at 31 March 2004 is one million eight hundred and forty two thousand eight hundred (1,842,800), of which the number of limited liability companies is one million eight hundred and thirty seven thousand nine hundred (1,837,900), while the number of unlimited companies is four thousand nine hundred (4,900).

Taking such common trends in both countries into account, it seems better to focus on the limited liability companies, especially the companies limited by shares.

3. The reality of companies limited by shares in Japan and the overview of the legal framework for them

(1) Analysis of companies limited by shares in Japan by size

As I mentioned above, the *Kabushiki-kaisha*, i.e. the company limited by shares under the Japanese Commercial Code is originally designed for large-sized, public companies. However, a huge number of companies limited by shares in Japan are small-sized companies, as well as in the UK, which was not predicted at first by Japanese legislators. This is because previously the Japanese Commercial Code did not have a minimum capital requirement for a company limited by shares to be set up and so small-sized businesses preferred the *Kabushiki-kaisha* rather than the *Yugen-kaisha* which they should have selected as their corporate form in the opinion of the legislators. I do not know the reason why they adopted a company limited by shares, even though the law provided the corporate vehicle with full limited liability suitable for small businesses, i.e. the *Yugen-kaisha*. As you know, such companies hardly ever issue new shares and almost all of the issued shares are exclusively held by kindred shareholders in Japan, as well as in the UK.

Taking into account the needs to prevent the shares being transferred to a third party, former Japanese Commercial Code allowed the companies to provide in their memorandum of association that any shareholder should need the approval of the board of directors in order to transfer his/her shares to others effectively. We, Japanese academics, often have called such companies as “*share-transfer restricted companies, limited by shares*”. As a result, the companies limited by shares under Japanese

law were divided into two categories. One was a company limited by shares which did not have such a provision as mentioned above; the other was a share-transfer restricted company. It seems to be like the UK regime under which the companies limited by shares consist of public companies limited by shares and private limited companies.

Incidentally, according to the UK DTI's report, the private limited companies dominate the limited liability companies in the UK. They number one million eight hundred and thirty one thousand one hundred (1,831,000) of the total number, one million eight hundred and thirty seven thousand nine hundred (1,837,900) of limited liability companies at the end of March 2004, while that of public companies is only eleven thousand seven hundred.

(2) The legal framework for companies limited by shares under Japanese law before the 2005 company law reform (the Commercial Code)

Now, the Japanese Commercial Code provided for the framework of the *Kabushiki-kaisha*, the Japanese companies limited by shares, especially their internal management or corporate governance structure as follows.

First of all, all the companies limited by shares were required to appoint at least three directors at the general meeting, without any regard to size or whether they were public or private companies. The directors had to form the board of directors, which should appoint one representative director or more who had the authority to make transactions in the name of the company. The day-to-day management was delegated to the representative director or directors, but some important business such as issuance of new shares or selling material assets of the company needed the decision of the board. The board of directors was not only responsible for management, but also played a role as a supervisor over the representative director and other executive directors through the exercise of the powers to decide and approve the significant business and to remove executives.

Secondly, all the companies limited by shares in Japan had to appoint at least one statutory corporate auditor to monitor and ensure that the company was managed in accordance with both relevant laws and reg-

ulations and the provisions of its memorandum of association and association. The main role of the statutory corporate auditor under Japanese law was a management audit which means that it monitored whether the company management was legally done.

Thirdly, Japanese Commercial Code divided some aspects of the structure of corporate governance in companies limited by shares depending on their size.

On the one hand, a large sized company limited by shares, which had either an issued share capital of five hundred million JPY (about two million five hundred thousand GBP) or more, or its total liabilities on the balance sheet of twenty billion JPY (about one hundred million GBP) or more was obliged to appoint three statutory corporate auditors who should form the board of statutory corporate auditors. At least one of them should be a full time corporate auditor and also half or more of them had to be outsiders who had never been directors or employees of the company which they served or its subsidiaries. Furthermore, the large-sized companies limited by shares had to appoint an auditor to have their accounts audited.

Incidentally, under former Japanese law, only the large-sized companies limited by shares could choose the committee and executive officer system instead of the statutory corporate auditor system. It was introduced in 2002 after US corporate law. When a large-sized company limited by shares selected the newly introduced system, it did not need to have any statutory corporate auditor in it, but had to have both nomination, audit and remuneration committees, and one executive officer or more. The three directors or more who needed to be appointed by the general meeting should form the board of directors. It should appoint and remove the executive officer or officers who need not always to be directors. The board of directors might delegate more management matters than the company with the statutory corporate auditor system, while it should play mainly a supervisory role by way of the appointment and dismissal of the executive officers. In this sense, the system may be called a two-tier board system unlike the UK. The UK corporate governance system is still based on a *unitary board*. Furthermore, the board of directors needed to appoint at least three directors to the nomination, audit and remuneration committees. The majority of the directors appointed

to each committee should be outside directors as the Commercial Code prescribed. Each committee had almost the same role as that in UK listed companies, but the audit committee in Japan was in charge of mainly the management audit as mentioned above like the statutory corporate auditor.

On the other hand, in the case of the other companies limited by shares, not large-sized ones, they needed only one statutory corporate auditor and were not obliged to appoint an auditor. However, as long as they were companies limited by shares, it was mandatory for them to appoint three directors to form the board of directors too, no matter how small they were.

Apart from the statutory auditor system and the requirement to appoint an auditor, Japanese Commercial Code had not divided the corporate governance regime by the size of companies or depending on the difference between public and private companies. It is different from UK company law, which has differentiated between a public company and a private limited company in corporate governance structure and allows companies, especially private limited companies to adopt a very flexible management structure. Nonetheless, the share-transfer restricted companies in Japan have been allowed to simplify or skip statutory procedures to convene the general meeting or to adopt the written resolutions there with the unanimous consent of the shareholders. However, as far as company management structure was concerned, the Commercial Code continued to oblige even the small-sized, closed companies with a few shareholders, to appoint not only three directors to form the board but also to appoint the statutory corporate auditor. Compared with UK arrangements, I didn't think the Japanese legal framework was appropriate because it did not necessarily match the reality of Japanese companies. It is partly against this situation that the Japanese government has thought it necessary and important to modernise the company law system.

(3) The legal framework for *Yugen-kaisha*, the Japanese limited liability company without a share capital under current law

Very quickly I am referring to the *Yugen-kaisha* under the Japanese Private Limited Liability Companies Act of 1938. It was a private limited

company that was designed for small-sized companies whose members needed the limited liability. In this respect, it was in the same position as the companies limited by shares. However, in the case of the *Yugen-kaisha*, they normally had only a few members and were basically small in size, and also it was usual that there was no separation between ownership and management, as in many private companies in the UK. In the light of these features, the Japanese Private Limited Liability Companies Act of 1938 provided for a more simple and flexible corporate governance scheme than that of the companies limited by shares, for example requiring only one director to be appointed or making it voluntary for the *Yugen-kaisha* to appoint a statutory corporate auditor. The board of directors was not required there. From the beginning, the *Yugen-kaisha* had been allowed to convene the general meeting with a very simplified procedure and also to make written resolutions there without actually holding a meeting.

Furthermore, in the *Yugen-kaisha*, any member who wanted to transfer his/her membership to others apart from the other existing members needed the approval of the general meeting. In the case of the company, the restriction on change of membership was innately placed by the Act, while for the companies limited by shares it was a matter of choice under their memorandum of association.

Despite that, undeniably the difference between both companies has been being narrowed due to recent company law reform in Japan. This is why the 2005 company law reform toward its modernisation abolishes the *Yugen-kaisha*, i.e. the private limited liability companies and merges them into the companies limited by shares.

(4) Minimum capital requirement

Under former Japanese law, it was mandatory for both the companies limited by shares, *Kabushiki-kaisha*, and the private limited liability companies, *Yugen-kaisha*, to meet the prescribed minimum capital requirements respectively. In the former companies, it was ten million JPY, while for the latter it was three million JPY. The minimum capital was an issued share capital or a paid up capital, not an authorised capital like in UK public companies. The companies could not reduce the amount of their capital below such statutory requirements. The underly-

ing philosophy was that people who made use of limited liability had to pay the relevant cost in the interests of company creditor. However, in the UK there is no such requirement in a private company. Even in UK public companies, which are required to state the amount of their share capital in the memorandum of association, this is not an issued share capital, but just an authorised minimum, fifty thousand GBP, only part of which needs to be issued.

III. Overview of the proposed Company Law reforms in Japan toward its modernisation

1. The intention of modernising the Japanese Company Law system

Now, I move off the subject of the former company law system to the overview of the 2005 company law reform in Japan.

Very quickly, the intentions are as follows;

- 1) To modernise the terms of Japanese Commercial Code and adopt the colloquial Japanese.
- 2) To make a single comprehensive company statute gathering up all relevant provisions together which were put in different statutes.
- 3) To correct the institutional imbalance which existed in former law, such as the difference between the companies limited by shares with the statutory corporate auditor and those which adopted the committees and executive officer in directors' liabilities to their companies, which I will refer to.
- 4) To bridge the gap between the statutory structure of corporate governance and the reality of existing companies in Japan, especially small-sized companies.
- 5) To tackle new problems which former Japanese law could not deal with properly; I will mention it later in relation to shareholders' derivative action.

I am giving an overview of practically significant matters out of the company law reform in 2005.

2. Abolishment of the *Yugen-kaisha* and amendments to the types of companies

First of all, the 2005 reform of Japanese Company Law makes a partial change to the types of company, on the one hand abolishing the *Yugen-kaisha* and on the other hand creating a new type of limited liability company which would be more suitable for small-sized businesses. The recent company law reforms have narrowed the gap between the share-transfer restricted companies limited by shares and the private limited liability companies in many aspects of company structure. There was still a difference between them in the amount of statutory minimum capital, but the Companies Act 2005 abolishes the above mentioned minimum capital requirements. As a result, the closer the share-transfer restricted companies limited by shares became to the *Yugen-kaisha*, the smaller the necessity for the latter got. This is why the Companies Act 2005 abolishes the *Yugen-kaisha*, and divides regulations, especially relating to internal structure between public companies limited by shares and private ones, depending on whether they have a provision in their memorandum to the effect that any member shall ask their companies to approve the transfer of their shares to others. Due to the reform, the Japanese Company Law system is thought to be approaching the UK Companies Act in separating the companies limited by shares into the public companies on the one hand and the private ones on the other hand.

However, will only a company limited by shares offer the benefit of limited liability under the Companies Act 2005? The answer is “No”, because the Act introduces a *Goudou-kaisha* which is based on US Limited Liability Company (LLC) mainly for tax purpose, although it is not clear that the new type of companies will be eligible for different preferential taxation from the other types of companies. The *Goudou-kaisha* may be thought of as a Limited Liability Partnership in the UK. This company gives not only the benefits of limited liability but also allows its members to enjoy huge flexibility of organising its internal structure just like a partnership

Therefore, under the Companies Act 2005 people who want to enjoy limited liability when doing business through corporate vehicle will be

able to choose between the companies limited by shares and the LLP-like companies, i.e. the *Goudou-kaisha* in Japan.

Anyway, under the Companies Act 2005 there are the following four types of companies; the *Goumei-kaisha*, the *Goushi-kaisha*, the *Kabushiki-kaisha*, and the *Goudou-kaisha*. Incidentally, the existing *Yugen-kaisha* will be able continue to exist, but will be induced to change to the companies limited by shares or the *Goudou-kaisha*.

3. Abolishing the minimum capital requirements

Secondly, the minimum capital requirements are abolished. In the UK, as the above mentioned report of the DTI, the incorporation of companies has outnumbered dissolution since 1999.

In contrast, according to the Japanese Ministry of Justice, the situation has been opposite. This was partly because the minimum capital requirements have made it more difficult to set up a company limited by shares or a private limited company in Japan. Taking this circumstance into consideration, The Ministry of Economic, Trade and Industry of Japan has made an exception to exempt them from the requirements, provided that they raised their capital over the amount of minimum capital as mentioned above within five years of their incorporation. According to a News Release presented by the Ministry, the total number of the companies which were set up using the exception was over twenty thousand (20,000). As I mentioned, one of the key purposes of the 2005 company law reform in Japan is to reshape the Japanese company law system as an economic infrastructure to help promote the economic recovery of Japan. The Japanese government believed that the minimum capital requirements were inconsistent with the policy. In addition, the requirements which were introduced for the purpose of protecting the interests of company creditors in 1990 could only work to a limited extent, because it did not ensure that a company maintained its assets over the amount of the minimum capital.

This is why the Japanese government decided to abolish the minimum capital requirements completely to make it much easier to set up a company limited by shares. In this respect the Japanese company law system is certain to approach UK law. Under the UK Companies Act

there is no minimum capital requirement in a UK private company. Even in a UK public company, which is required to state the amount of its share capital in the memorandum of association, this is not an issued share capital, but just an authorised minimum, fifty thousand GBP, only part of which needs to be issued.

However, the problem is how the interests of company creditors, especially ordinary company creditors can be protected after abolishing the minimum capital requirements of the companies limited by shares. In the UK, not only limited liability companies but also limited liability partnerships all have to file and register their annual accounts and reports in the Companies House to make them publicly available, and they need to have their accounts audited by external auditors except those below the prescribed threshold. It enables company creditors including possible future creditors to collect relevant information to protect their interests.

In contrast, the Japanese government proposed that all companies limited by shares should make their accounts publicly available by way of notice, but the Companies Act 2005 does not introduce criminal or civil sanctions against the breach of the disclosure requirement. In the end, this regulation is unlikely to be effective. In my opinion, the Companies Act 2005 does not strike a balance between promoting the set-up of companies limited by shares and providing appropriate safeguards for company creditors.

Incidentally, the *Goudou-kaisha*, which I referred to earlier as a new type of a limited liability company is required to prepare accounts and make them available for inspection by its creditors on request. However, the company are neither obliged to have its accounts publicly available nor to have them audited by an external auditor, however large it may be.

Anyway, as far as the balance between promoting incorporation of limited liability companies and protecting the company creditors' interests is concerned, I have to say Japan is lagging behind the UK. This is a crucial problem. I think that in order to make economic recovery successful in Japan it is also absolutely necessary to improve the institutional environment so that people can invest in or trade with limited liability companies safely being given sufficient information.

4. The proposed reform of internal structure of companies limited by shares

Thirdly, the central issue of the 2005 company law reform in Japan is an amendment of corporate governance structure of companies limited by shares. The key intention of the reform is to provide for the institutional framework of company management that could help Japanese companies try to do their business successfully and survive in the rapidly changing business environment, or at least to avoid the framework disturbing an efficient, aggressive company management. For that purpose, flexibility is needed. Traditionally, however, the Japanese company law system has not been lack of flexibility, just like a restaurant which serves only a set meal. As I mentioned above, former Japanese company law imposed on all companies limited by shares the requirement that they should appoint three directors or more to form the board of directors. Why is such an arrangement needed for the small-sized companies with only a few shareholders?

In the light of the purpose as mentioned above, on the one hand, it must be made sure that the executives can make aggressive business judgements and take risks within a sound control system. For the purpose a reasonable limited liability ought to be provided for them. Taking these needs into account, the 2005 company law reform, on the one hand, allows the companies limited by shares, especially small or medium sized share-transfer restricted companies to design their management structure more flexibly. Furthermore, an extent to which the liabilities of officers to their companies may be limited is enlarged.

On the other hand, the law must provide a proper arrangement whereby the officers of companies can easily be made to bear liabilities as necessary. The reform takes a necessary step to cure a serious problem relating to the shareholders' derivative action in case of merger as I will explain later.

(1) Allowing companies to design their management structure more flexibly and dividing the corporate governance regime of the companies limited by shares by some criteria

First of all, the 2005 company law reform abolishes the *Yugen-kaisha* system designed for small sized business entities and then merges them into the companies limited by shares after the new Companies Act comes into May 2005. As a result, it becomes necessary to divide the internal structure of the companies depending on both their size and their feature, i.e. whether they are public or private companies. That is done by the Companies Act 2005.

On the one hand, the large-sized limited companies are obliged not only to appoint three directors or more to form the board of directors but also to have an external auditor. There seems to be no change in these points.

Then, on the one hand, the large-sized public limited companies, i.e. the large-sized limited companies all or some of the shareholders in which are free to transfer their shares to whomever they think fit without any restriction, are given the following two options in relation to their governance structure;

Option a-1) they have the board of directors who must be three or more in number and the board of statutory corporate auditors who must be three or more, and half of whom must be outsiders.

Option a-2) they have the board of directors as a supervisor, the nomination, audit and remuneration committees, and the executive officers as management.

It is the same position as under former law.

However, in the case of the large-sized private limited companies, which are the large sized limited companies the transfer of whose shares needs the approval of the board of directors or the general meeting, i.e. the large sized, share-transfer restricted, limited companies, the following four options are given;

Option b-1) this is the same as the option a-1 of the large sized, public limited companies. They have the board of directors who must be three or more in number and the board of statutory corporate auditors who must be three or more, and half of whom must be outsiders as the Companies Act 2005 prescribes, as in the large sized public

companies.

Option b-2) this is the same as the option a-2 of the large sized, public limited companies. They have the board of directors as a supervisor, the nomination, audit and remuneration committees, and the executive officers.

Option b-3) they are able to choose the arrangement under which three directors or more shall be selected to form the board of directors and at least one statutory corporate auditor shall be appointed.

Option b-4) or they will also be able to appoint only one director and one statutory corporate auditor. This option may be adopted in the wholly-owned subsidiary.

On the other hand, in the case of the companies limited by shares below the statutory threshold of large-sized limited companies, which I refer to as small or medium sized limited companies, the appointment of an auditor is voluntary, but they will be able to choose to appoint the auditor if their articles of association provide so. And as to the corporate governance structure, the Companies Act 2005 requires all the public small or medium sized limited companies, i.e. the small or medium sized companies limited by shares other than the share-transfer restricted limited companies of the size, to appoint three directors or more to form the board of directors. Then, they will choose between the following three options. Furthermore, in each option, they will be able to choose to appoint an auditor. After all there will be six ways to be chosen.

【Option c-1】

Option c-1-1) they appoint only one statutory corporate auditor, but without auditor.

Option c-1-2) they appoint only one statutory corporate auditor and choose to appoint an auditor.

【Option c-2】

Option c-2-1) they appoint three statutory corporate auditors to form the board of corporate auditors, but without auditor.

Option c-2-2) they appoint three statutory corporate auditors to form the board of corporate auditors and choose to appoint an auditor.

Anyway, in the option c-2-1 and c-2-2, they are obliged to appoint at least one full-time statutory corporate auditor and also half of the statutory corporate auditors will have to be outsiders.

【Option c-3】

Option c-3-1) they appoint their directors to the nomination, audit, and remuneration committees and the executive officers, without selecting any statutory corporate auditor, nor auditor.

Option c-3-2) they appoint their directors to the nomination, audit, and remuneration committees and the executive officers and choose to appoint an auditor, without selecting any statutory corporate auditor.

In contrast, the private small or medium sized limited companies, i.e. the small or medium sized, share-transfer restricted, limited companies are given more flexibility in designing their internal management structure. Firstly, they are allowed to choose the following options for example, if they choose voluntarily to appoint an auditor;

Option d-1) they appoint at least one director and one statutory corporate auditor.

Option d-2) they appoint three directors or more to form the board of directors and have both the nomination, audit, and remuneration committees made up of at least three directors half of whom must be outsiders and the executive officers, without selecting any statutory corporate auditor.

However, if they do not prefer an appointment of an auditor, surprisingly they will be able to select between the following options;

Option e-1) they appoint three directors or more to form the board, and also one statutory corporate auditor.

Option e-2) they appoint three directors or more to form the board like the option e-1, but choose to select the *Kaikei-sanyo* who the Companies Act 2005 introduces acting as a co-operator in preparing the accounts and who must be either a qualified accountant or a licensed tax accountant (“*Zeirishi*” in Japanese), instead of selecting a statutory corporate auditor.

Option e-3) they appoint at least one director and one statutory corporate auditor.

Option e-4) they appoint at least one director and one *Kaikei-sanyo* as mentioned above, i.e. a person with the prescribed qualification acting as a co-operator in preparing accounts.

Option e-5) they appoint just one director or more as necessary, but without the board of directors, a statutory corporate auditor, the

Kaikei-sanyo, etc. This is the simplest structure.

Frankly, these arrangements seem to be more than enough, but the corporate governance regime provided for by the Companies Act 2005 can be thought a development in the sense that it will make different companies be able to design their management structure more or less as they think fit, although some requirements still remain.

However, there remain some issues. Taking one example, under the Companies Act 2005 the small or medium sized, public limited companies are still be required to appoint at least three directors to form the board. In reality, they are de facto private companies, even though they do not provide the facility of restriction on share-transfer in their memorandum of association. Because the shares in them are usually held exclusively by a few number of kindred shareholders who do not wish a third party to participate in their companies. Under the Companies Act 2005 they are treated in the same manner as the large-sized, public limited companies in management structure. I don't think it is appropriate. It will have to be amended in the future.

(2) Extending the terms of office of director and statutory corporate auditor

Secondly, the Companies Act 2005 lifts the current ban on share qualification of director only for the share-transfer restricted limited companies, whether they are large sized or not. And it allows all the share-transfer restricted limited companies to extend the terms of office of director and statutory corporate auditor (if any) from two years and four years respectively up to ten as necessary, provided that their articles of association have the provision to the effect. The exception is the limited companies which have the both the nomination, audit, and remuneration committees made up of at least three directors and the executive officers, where the terms of office of their directors and executive officers are not be allowed to be extended.

In addition, the Companies Act 2005 amends the ground of directors' disqualification, on the one hand repealing the ground of director's bankruptcy, on the other hand adding the conviction against director for breach of the Securities Exchange Act or the Insolvency legislations as a new ground of directors' disqualification.

(3) Relaxation of the requirement for the general meeting to dismiss director

Very quickly, thirdly, the Companies Act 2005 relaxes the requirement for the general meeting to dismiss director before the end of his/her terms of office changing it from the extraordinary resolution to the ordinary resolution, in the light of strengthened corporate governance.

(4) Allowing a resolution in writing of the board of directors

Fourthly, as a part of making management more flexible, the Companies Act 2005 allows the board of directors to make a resolution in writing, provided that all of them agree on a matter to be proposed and that any statutory corporate auditor or member of the audit committee as case may be does not object to it. The existing authority of Japanese Supreme Court has been that the written resolution of the board of directors should be void. Therefore, the Companies Act 2005 is to change the authority. However, under the new regime this convenient step are not be permitted for the board of statutory corporate auditors or the nomination, audit and remuneration committees, because allowing written resolution in them will distort their functions.

(5) Reform of the directors' liabilities to their company

Fifthly, more importantly, I am going to refer to the reform of the directors' liabilities to their company.

Under former Japanese law the directors were made liable for damages to their company, when they conduct in breach of relevant legislations or their fiduciary duties of care or loyalty and cause damage to it, as well as in the UK. As far as the directors' liabilities to their company were concerned, former Japanese Commercial Code provided for five types of liability.

The first one which arose from unlawful dividend was that the directors who were involved in the board decision for their company to pay dividends exceeding the profits available for distribution to shareholders were jointly and severally liable to pay the amount of dividends to the company.

The second one was that the directors who were involved in bribing racketeer who were also shareholders in the company to persuade them

to exercise shareholders' rights especially voting rights or not to exercise them at the expense of the company or its subsidiary were jointly and severally liable to pay the amount of bribe to it.

The third one arose from a loan to the director by the company. When the director who had been given a loan by the company did not pay the loan back, other directors who had voted for it at the board of directors were jointly and severally liable to pay it back to the company, just like guarantees.

The fourth was that when an unfair self dealing by director caused a company damage, the directors who had voted for it at the board of directors were jointly and severally liable for damages to the company.

The fifth one was from the other illegal conduct including a breach of fiduciary duties.

There was no doubt that the fifth type of liability arose only if the directors concerned were negligent in discharge of their duties as directors. However, it was the authorities and the prevailing academic theory in Japan that the other types of directors' liabilities to the company should be all strict liability. The exception was the large-sized limited companies which chose to adopt the nomination, audit and remuneration committees and the executive officers instead of appointing the statutory corporate auditors, because former Japanese Commercial Code provided explicitly the liabilities of the directors and the executive officers of this kind of company as negligent liabilities. As a result, there was a significant gap in this respect between this type of company and the company which adopted the statutory corporate auditor system.

Furthermore, as far as management responsibility is concerned, strict liability is not reasonable because the directors can not be absolved of it no matter how they take care of company management.

The Companies Act 2005 fills the gap providing that any director and executive officer do not bear liabilities for damages to the company without fault, with the single exception of the liability arising from direct self-dealing between director or executive officer and the company.

(6) Improvements in shareholders' derivative action

Sixthly, the shareholders' derivative action is reformed in following two points.

The first one is the introduction of the new restraints whereby shareholders are not allowed to bring a derivative action against directors and other company officers for damages to their company if they abuse the action or the proper interests of the company are reasonably expected to be severely harmed by the action. However, I am very sceptical about the possible effectiveness of the measure, because the courts of law in Japan have been reluctant to dismiss the derivative action finding it is abused so far.

The second improvement is as follows. So far, according to the court decisions in Japan, if one company limited by shares carries out merger with another one by way of so called stock-for-stock exchange, "*Kabushiki-koukan*" in Japanese, whereby the latter company will become a wholly-owned subsidiary of the former only with the extraordinary resolution of the general meeting of each company, while a shareholder in the latter company was bringing a derivative action against the directors of the company, the shareholder lost the locus standi and so the derivative action was dismissed. This is because Japanese Commercial Code provided the requirement that a person who could bring a derivative action had to be a shareholder who continued to hold at least one share in the company which the defendants served as director or other officer, and, after the merger as noted above, the claimant who was a shareholder in a company which was made a wholly-owned subsidiary of another as a result of the merger ceased to be the shareholder and consequently lost the standing for the derivative action prescribed by the former act.

However, such a legal treatment has been crucially criticised by the academics, obviously because it absolutely contradicts enforcement of justice, the heart of law.

The Companies Act 2005 solves the problem to a large extent allowing a shareholder to continue the derivative action even in the above mentioned case, but still it is not perfect. The Companies Act 2005 sets a condition that the shareholder concerned should be a shareholder in a parent company after the merger, while it allows an acquiring company to allot shares in other companies which it holds or other assets including cash. Consequently, in the case as mentioned above, if cash is allotted to the claimant shareholder by the acquiring company, the claimant will

lose a status of shareholder at all and so the derivative action brought by him/her will be dismissed due to lost locus standi.

(7) Reform of the liability of auditor

Finally, I would like to mention about the reform of auditor's liability.

On the one hand, it has been widely believed so far in Japan that the auditor's liability for damages to the company which it served could not be enforced by the shareholders' derivative action. This is because former Japanese Commercial Code specified whom the action could be brought against, but it did not include the auditor. This interpretation, however, has been under bitter criticism from academics. Since the Enron, World com scandals in the USA, more tightened discipline on auditors has been demanded. Taking the circumstances into consideration, the Companies Act 2005 includes the auditor in the defendant whom shareholder can bring derivative action against for damages to the company.

On the other hand, the Companies Act 2005 gives partial immunity to the external auditor from the liability to its client company. Nevertheless, as far as the auditor's liability to a third party such as investors, company creditors is concerned, no cap will be put on it. Considering the relatively large possibility that the direct action will be taken against the auditor by investors and so on, presumably it might be necessary to limit the auditor's liability to the third party, though currently it can be partly covered by liability insurance.

Incidentally, there is one problem remaining relating to the auditor. Under former law any *Yugen-kaisha*, i.e. private limited liability company was not required to have its accounts audited by external accountant at all, however large it was, unlike the UK. Actually there have been some large-sized private limited liability companies in Japan.

However, under the Companies Act 2005 this form of companies are abolished to be merged into the companies limited by shares, so that such an unreasonable gap between the current two types of limited liability companies is filled. It must be an improvement. Nevertheless, if a large-sized business company chooses the *Goudou-kaisha*, it is still exempt from the public disclosure and audit requirements under the proposed Companies Act. The same problem is remaining with the *Goudou-*

kaisha.

IV. Conclusion

In conclusion, the revision of Japanese Company Law taking place through the Companies Act 2005 must be a historical law reform. It is possible to point out several improvements and developments in it.

However, there will be still some issues remaining to be tackled as soon as possible. For example, the ultra vires doctrine which UK law has already abolished will be kept in Japanese law.

Furthermore, in Japan it has been held lawful and valid that even public limited companies provide the requirement in their articles of association that a proxy for shareholders at the general meeting must be a member in the companies who has a voting right. A huge number of Japanese companies do it. In contrast, the UK Companies Act prohibits the requirement. In the light of increased demand for a shareholder-friendly corporate governance regime, I think such a practice of Japanese companies is definitely anachronistic and so must be abolished as soon as possible.

Moreover, there has been the problem of shadow director in Japan, but it will not be covered by the reform.

Therefore, I have to recognise the company law reform in 2005 is by no means the end, but the first step forward.