

# **Commercial Code Revisions: Promoting the Evolution of Japanese Companies**

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Japan's Commercial Code has been revised nearly ten times since the beginning of the 1990s. While the code is one of the six basic laws on Japan's statute books, frequent revisions have been required for various reasons over the past dozen years. In particular, as successive "big-bang" in the financial world have accelerated the deregulation of capital markets, needs have clearly shifted to provide increased support to enterprises facing the rapid moves towards greater shareholder-oriented management.

Perhaps the most controversial and time-consuming issue in the Commercial Code revisions of 1990s was the deregulation of the share repurchasing system. Because corporations had issued a large volume of new shares during the heady days in later half of the 1980s, they wanted to buy back outstanding shares to improve their balance sheets. However, the government pursued a cautious approach in this regard in the interest of maintaining creditor protection.

At the same time, the disclosures of consolidated or market-price accounts were subjecting companies to severe market appraisals on the basis of actual balance sheet results. As a consequence, the Commercial Code was amended to support companies in improving their profitability and effectiveness by defining new business reorganization measures, including share exchanges and spin-offs.

Three steps were taken to revise the Commercial Code in 2001. These included lifting the ban on treasury stock (i.e., shares repurchased and held by the issuing corporation), creating a new stock option called *shinkabu-yoyaku-ken* and expanding the classes of shares, and increasing the authority of statutory auditors. All of these measures were aimed at encouraging management strategies that emphasized increasing shareholder value.

The Commercial Code is to be amended again in the spring of 2002 to introduce new types of corporate governance systems. This will require that management select one of the prescribed systems.

# I Characteristics of Commercial Code Revisions in the 1990s

Since the beginning of the 1990s, Japan's Commercial Code has been revised nearly ten times (see Table 1). While the Commercial Code is one of the six basic codes on Japan's statute books, frequent revisions have been required for various reasons during the past dozen years. These amendments reflect the history of

deregulatory measures in terms of corporate financing and that of strengthened regulations aimed at corporate governance.<sup>1</sup>

## 1 Deregulating the Repurchase of Issued Shares and Efforts to Improve Balance Sheets

### (1) Increased need for stock buybacks

In the later half of the 1980s, listed companies in Japan rushed to increase the amount of direct financing from investors through the issuance of stocks and corporate

**Table 1. Revisions of the Commercial Code and Trends in Other Regulations and Industries**

Year	Revisions of the Commercial Code	Trends in Other Regulations and Industries
1990	<ul style="list-style-type: none"> <li>Introducing a minimum capital requirement system</li> <li>Deregulating the issue of preferred stock</li> <li>Abolishing the limitation on the number of incorporators (seven or more) in establishing a corporation</li> <li>Eliminating the requirement for examiners to inspect in-kind contribution to capital and asset acceptance at the time of incorporation</li> <li>Simplifying the procedures for changing organizations, including joint-stock and limited companies</li> <li>Separating the procedures to incorporate profits available for dividends to capital from the procedures relating to the issuance of new shares</li> <li>Specifying the standards for setting aside reserves</li> <li>Rationalizing the procedure to issue preferred stock dividends</li> </ul>	<ul style="list-style-type: none"> <li>Battle between Boone Pickens and Koito Manufacturing</li> <li>US-Japan structural impediment talks</li> <li>Court approval of Shuwa's lawsuit demanding that third-party allocation of new shares between Chujitsuya and Inageya be suspended (1989)</li> <li>Revisions of the Securities and Exchange Law (report on large securities holdings and reforms of the take-over bid system)</li> </ul>
1993	<ul style="list-style-type: none"> <li>Introducing new systems for the board of statutory auditors and outside statutory auditor</li> <li>Setting a fixed legal fee of ¥8,200 for shareholder class-action lawsuits</li> <li>Reducing the minimum number of shares owned by those entitled to demand to inspect accounting records (from 10% to 3%)</li> <li>Abolishing limitations on the amount of corporate bond issuance</li> <li>Mandating the establishment of corporate bond management companies</li> </ul>	<ul style="list-style-type: none"> <li>Enactment of the Financial System Reform Law (incorporating subsidiaries of banks, securities companies and trust banks)</li> <li>MOF's guidelines on "the restart of capital increases by public offering at market price"</li> </ul>
1994	<ul style="list-style-type: none"> <li>Deregulating the limitations on the repurchase of outstanding shares ① (approving the retirement of outstanding shares by profits and the transfer of such shares to employees)</li> </ul>	<ul style="list-style-type: none"> <li>Asahi Breweries and Amway Japan use profits to retire outstanding shares (1995)</li> </ul>
1997	<ul style="list-style-type: none"> <li>Deregulating the limitations on the repurchase of outstanding shares ② (enactment of the Special Exemption Law for the Retirement of Stock and the introduction of the stock-option system)</li> <li>Simplifying the procedures for company mergers and creating a simplified company merger system</li> </ul>	<ul style="list-style-type: none"> <li>Lifting the ban on the establishment of holding companies</li> <li>A holding company established by Daiei</li> </ul>
1998	<ul style="list-style-type: none"> <li>Deregulating the limitations on the repurchase of outstanding shares ③ (deregulating limitations on capital reserves and stock repurchases by the use of funds gained through land reevaluation (covering the specified duration only))</li> </ul>	<ul style="list-style-type: none"> <li>Enforcing the revised Foreign Exchange Law</li> <li>Approval of the Financial System Reform Law</li> <li>Approval of the Law on Revitalizing Financial Institutions</li> </ul>
1999	<ul style="list-style-type: none"> <li>Creating a stock swap system and stock transfer system</li> </ul>	<ul style="list-style-type: none"> <li>Share exchanges by Sony to incorporate a wholly-owned subsidiaries</li> <li>Approval of the Law on Revitalizing Industries (effective through 2004)</li> <li>Approval of the Law on Revitalizing Civilian Activities</li> </ul>
2000	<ul style="list-style-type: none"> <li>Creating a company spin-off system</li> </ul>	<ul style="list-style-type: none"> <li>Full-scale shift to consolidated accounting system</li> </ul>
2001	<ul style="list-style-type: none"> <li>Lifting the ban of treasury stock and creating a new stock-unit system</li> <li>Creating the shinkabu-yoyaku-ken system</li> <li>Expanding the authority of statutory auditors</li> </ul>	<ul style="list-style-type: none"> <li>Abolishing the Special Exemption Law for the Retirement of Stock</li> <li>Full-scale enforcement of the market price accounting system for financial products</li> </ul>
2002	<ul style="list-style-type: none"> <li>Introducing a new corporate governance system</li> </ul>	<ul style="list-style-type: none"> <li>Start of a new share-purchasing organization</li> </ul>

bonds, as shown by Figure 1. Offering new shares at the market price in response to the very active stock market made it possible for the issuing corporations to acquire huge amounts of internal funding. The funds paid in by shareholders were directed towards the expansion of facility investments and used for various financial transactions. However, the collapse of the bubble economy has left such companies with huge floats in outstanding shares and inefficient or only marginally profitable assets. For several years from April 1990, equity-financing measures were actually suspended and companies turned to corporate bonds, for which the limitations on issue amounts had been abolished.<sup>2</sup> Under these circumstances, companies began to call for the deregulation of stock repurchase limitations as a means of reducing the number of outstanding shares to an appropriate level.<sup>3</sup>

Japanese corporations can issue new shares in a flexible manner on the basis of a resolution of board of directors under the authorized capital provisions. However, companies have faced strict limitations on the repurchase and retirement of issued shares from the viewpoint of creditor protection. In the United States, on the other hand, corporations can acquire and own their stocks without specific objectives. Such repurchased stocks, which are called treasury stocks, have been used for a wide range of purposes, including providing better returns to shareholders, incentive compensation such as stock options, and as countermeasures to offset sudden falls in stock prices.

Various economic organizations in Japan including the Federation of Economic Organizations (Keidanren) have also been calling for relaxing the current stringent restrictions on stock repurchases. In response to these requests, the government has taken gradual steps since 1994 to revise the Commercial Code by easing the limitations on stock buybacks.

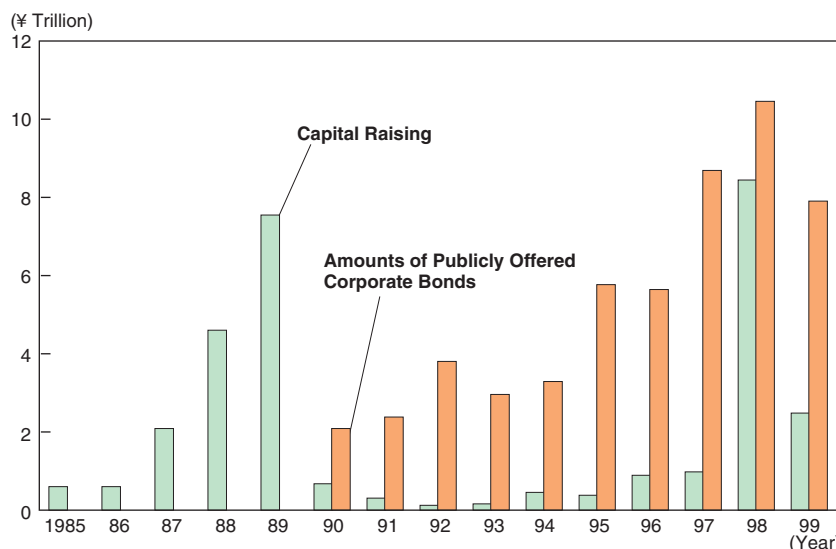
**(2) From the 1994 revisions to the enactment of the Special Exemption Law for the Retirement of Stock**

Originally, Japanese corporations have been able to buy back their own shares in a limited range of cases, such as reducing capital or meeting legal requirements. However, the revised Commercial Code of 1994 also allowed such buybacks in cases that involved: (1) transferring shares to employees with justifiable reasons; and (2) using dividend profits to retire such shares in response to a resolution adopted at a general shareholder meeting.

Moreover, revisions made in 1997 included the following changes to allow greater flexibility in using profits to retire stock issues and in awarding shares to directors and employees as an incentive compensation program. First, a company can acquire its own shares up to a ceiling equivalent to 10 percent of the outstanding shares in order to transfer such shares to its employees, directors and statutory auditors as stock options, and to hold such stocks for a maximum period of 10 years to prepare for the exercise of such options. Second, the Special Exemption Law for the Retirement of Stock was enacted to allow companies to use profits to retire issued shares in accordance with a resolution adopted by a general meeting of shareholders, if such steps are prescribed in the corporation's articles of incorporation.

As an emergency measure for a limited period of time of two years, the scheme for repurchasing and retiring outstanding shares was expanded in 1998 to allow the use of capital reserves for stock repurchases under the Exemption Law. Capital reserves refer to the capital stock accumulated by equity financing that was widely used in the later half of the 1980s. For all listed companies in Japan, the sum of such capital reserves is roughly equivalent to the total in issued share capital

**Figure 1. Changes in Equity Finance by Listed Companies**



Source: Prepared by NRI based on the *White Paper on Capital Raising, 1997* and *Capital Markets Review 2000*, Commercial Law Center.

itself. As the use of capital reserves has traditionally been confined to cover retained losses only, the return of reserves to shareholders as profits was not assumed.<sup>4</sup>

Due to this series of legislative measures, the stock repurchase and retirement scheme has been gradually used by a broad range of companies for the purpose of not only improving their balance sheets, but also of returning surplus cash to shareholders. Learning from the experience of such companies, the ban on treasury stocks (i.e., the repurchase and retirement of shares without restrictions on the purposes behind the transactions) was finally lifted in the spring of 2001.

## 2 Viewpoint of Corporate Governance

“Who owns a joint-stock company?” and “For whom and how should a joint-stock company be managed?” These questions concerning corporate governance—a term born in the United States—have provided a chance for Japanese company managers and shareholders to develop a renewed interest in the basic issues of company management.

Symbolically, Japanese companies first came up against the issue of corporate governance in 1994 and 1995, when the US public employee pension fund CalPERS (California Public Employees’ Retirement System) demanded Japanese companies improve their management strategies. CalPERS also exercised its voting rights against the reappointment of directors in certain companies. The history of battles between corporate management and shareholders relating to corporate governance in Japan can be traced back to the end of the 1980s, when Boone Pickens exercised various shareholder rights against Koito Manufacturing Company. At the time, structural impediment negotiations between the US and Japan to resolve various non-tariff trade barriers were under way, and the US government called for a number of reforms. These demands included the deregulation of stock repurchases and ownership to resolve the cross-holding issue, the introduction of outside directors to Japanese companies, improved disclosure requirements in *keiretsu* (“affiliated company group”) transactions, and the strengthening of shareholder rights.

Japan’s Commercial Code was revised in 1993 to slightly ease the US pressure. Important revisions included: (1) legally requiring large companies subject to the Special Exemption Law under the Commercial Code to introduce a board of statutory auditors and appoint outside statutory auditors; and (2) lowering from 10 percent to 3 percent the shareholding ratio needed by a stockholder to demand the right to inspect financial records. In addition, the fee for shareholder lawsuits was set at ¥8,200, regardless of the amount claimed. This set off a rapid influx of shareholder lawsuits, partly as a result of successive revelations about a host of scandals in Japanese industrial circles.

## 3 Creation of Schemes to Encourage Business Reorganizations

As the Japanese Commercial Code traditionally lacked systematic provisions concerning business reorganizations, large-scale business mergers were handled by means of business transfers and assigning spheres of interest. For small-scale tie-ups, the complicated official procedure was eased with the implementation of a share exchange system. However, in parallel with the rapid promulgation of deregulation measures following the big-bang in the financial world, companies and capital markets were forced to operate in a free, fair and global environment, leading to a much greater need to create and improve the legal underpinnings of business reorganizations.

As the first step in the Three-Year Deregulation Promotion Plan, which the government decided to announce every March starting in 1996, procedures for business mergers were simplified in the 1997 revisions to the Commercial Code. This was finally realized 20 years after it had been initially proposed.

The year 1999 also saw the introduction of a new stock swap and transfer scheme, under which companies were allowed to use their own shares in purchasing other businesses and in establishing holding companies. In 2000, a company division scheme was created that made it possible for companies to spin-off and purchase business operations by allocating their own stocks for such purposes. The introduction of such new mechanisms has clearly contributed to rapid progress in business reorganizations.

As described above, the revisions in the Commercial Code realized in the 1990s have been successful in expanding the scope of options in financing and business organization tools, and have helped Japanese companies in achieving their evolutionary business strategies.

## II Three Successive Revisions of the Commercial Code in 2001

Throughout 2000, the Japanese stock market continued to experience plummeting prices as a result of the collapse of IT-related economic bubbles and the deepening financial crisis. Both business firms and financial institutions rushed to sell off cross-holdings in response to such regulatory changes as the requirement for full-scale market-price disclosure of stock holdings as well as the strict reexamination of bad debts held by financial institutions.

At the beginning of 2001, the three leading parties (the Liberal-Democratic Party, the Komeito and the New Conservative Party) held a conference to discuss an

emergency economic package designed to shore up the securities markets and venture businesses. The resulting stimulus package was announced on April 6, 2001 by a ministerial meeting on economic measures, and served as the basis for legislation proposed in the Diet for a partial revision of the Commercial Code. Following this first revision in the year 2001, two further bills to revise the Commercial Code were adopted in the extraordinary session of the Diet in the autumn of 2001.

## 1 Revitalizing Japanese Securities Market and Providing Support for Venture Businesses

On May 18, 2001, the Commercial Code was revised to ease regulations concerning corporate financing tools, including a lifting of the ban on treasury stocks and revising the trading unit for shares.

### (1) Approval of treasury stocks

Regulations regarding the acquisition of outstanding stocks by the issuing companies were eliminated in principle in the revision of the Commercial Code passed in the spring of 2001. In the past deregulation process, stock repurchase systems had gradually been approved under certain restrictions, allowing only the use of profits to retire such shares and/or provide stock options. As a result, the provisions that allowed the repurchase of shares for retirement or the granting of stock options were eliminated and the Special Exemption Law for the Retirement of Stock was also abolished.

The following three means were newly provided for share repurchases: (1) repurchases under the authorization of a regular general shareholders meeting; (2) purchasing shares owned by subsidiaries based on a resolution of the board of directors; and (3) legally acquiring shares by offering to buy back the shares of any shareholders owning less than *tangen-kabu* (a new unit of shares). Treasury stocks can also be used as an alternative means in place of new stock issues at the time of mergers or share exchanges.

### (2) Increased flexibility in lowering investment units

In the past, the face value of shares issued in establishing a corporation was legally set at ¥50,000, and shares could be split only on condition that the net asset value of the share after a split was ¥50,000 or more (regulation on net asset value). However, the venture securities markets that have rapidly expanded since 1998 saw cases in which the price of certain Internet-related companies rose to more than ¥100 million per share, as those generally had a low trading liquidity and high growth expectations. In such cases, the net asset value regulation prevented such ventures from splitting their shares to reduce the stock price to more reasonable levels with the aim of increasing liquidity and making them easily accessible to individual investors. Under

these circumstances, some of these firms have changed their par-value shares to non-par value shares and increased their capital by making new stock distributions to shareholders at a price of ¥1 per share, thus lowering the unit for investment while avoiding the restrictions imposed by the stock-split regulation.

The revised Commercial Code has eliminated such net asset value requirements in order to allow companies to reduce their share prices to a level that makes their shares more easily obtainable by individual investors, while at the same time improving liquidity and preventing extreme price fluctuations by increasing the number of shares outstanding. Under the revised code, moreover, companies can increase the number of authorized shares even without a resolution of a general shareholders meeting. The new code also eliminates the requirement on the total amount of stock capital (i.e., the requirement that the per-share par value multiplied by the number of outstanding shares does not exceed the stock capital) for corporations with outstanding par-value shares that wish to split their stocks. In short, all stocks have been changed from par-value shares to non-par value shares.

The elimination of the net asset value requirement has also led to the abolition of the *tanni-kabu* system. In the Commercial Code revision of 1981, the minimum face value was increased from ¥50 to ¥50,000. Companies established before 1981 had to change the face value of their stock to ¥50,000, which required the implementation of reverse stock splits. To avoid saddling companies with excessive costs, the *tanni-kabu* (e.g., a stock-unit standard that considered 1000 shares of ¥50 face value shares as ¥50,000) system was introduced. At the time, it had been stipulated that this *tanni-kabu* unit would be merged into one share. In consideration of the significant effects this would have on companies and markets, however, the *tangen-kabu* system was created instead. Just as in the case of the *tanni-kabu*, the *tangen-kabu* represented a certain number of shares that was set as the minimum unit for exercising voting rights. The *tangen-kabu* is also used as a trading unit in securities exchanges.

The new stock unit has voting rights. The number of component shares making up the new stock unit should not exceed 1,000 shares, nor should it exceed 1/200th of the total number of outstanding shares. The new stock unit differs from the previous provisions in that the company can freely determine the number of shares that will be included in a new stock unit, as the shares have no par value. Furthermore, the number of shares included in the new stock unit must be specified in the articles of incorporation. The system can be abolished and the number of stocks can be reduced based on a resolution of the board of directors, as such measures will not negatively affect the interests of existing shareholders.

## 2 Diversified Means of Equity Financing and the Response to Information Technology

The precedent for the legislation proposed in the Diet was the long-standing argument over a radical revision of Commercial Code. In September of 2000, the Corporate Law Division of the Legislative Council decided to study the Commercial Code with a view to (1) creating effective corporate governance, (2) meeting the needs of a society based on highly developed information technology (IT), (3) improving the means of procuring funding, and (4) adapting to the internationalization of corporate activities. The ensuing debate resulted in an interim draft revision of the Commercial Code, which was announced on April 18, 2001. This proposal advocated flexibility in corporate management in terms of fiscal strategies and called for improved corporate governance through far-reaching changes in the code (see Table 2).

Additionally, the division proposed that revisions should be made in principle at the next regular Diet session of March 2002, while items requiring faster action, such as the expansion of the stock-option system and responses to corporate disclosure documents and other matters pertaining to the IT environment should be acted on in the extraordinary Diet session in autumn of 2001. Accordingly, the House of Councilors took the first step in realizing the interim draft by approving the revisions to the Commercial Code on November 21, 2001. These revisions went into effect on November 28 of the same year.<sup>5</sup>

### (1) Expanding the stock-option system:

#### *shinkabu-yoyaku-ken*

The revisions made in the autumn of 2001 did away with the restrictions that had limited the maximum number of shares granted in stock options, and expanded the period for exercising option rights (10 years) and the beneficiary categories (namely, the directors and

Table 2. Revised Items in the Interim Draft Revisions of the Commercial Code

Stock-Related Items	Items Relating to Company Organizations	Items Relating to Company Evaluations and Information Disclosure	Other Items
1 Deregulating the limitations on the number of authorized shares and on new share issuance 2 Diversification of classes of shares 3 Convertible stock 4 Rights of holders of class share to appoint and dismiss directors 5 Issuing <i>shinkabu-yoyaku-ken</i> rights 6 System allowing for optional issuance of stock certificates 7 Creating a system to invalidate stock certificates 8 Creating a system allowing shares owned by missing shareholders to be sold off	9 Shortening the effective period to exercise shareholder rights to make proposals 10 Reducing the quorum for special resolutions at general shareholder meetings 11 Selling subsidiary stocks, etc. 12 Simplifying procedures for convening shareholder meetings (i.e., eliminating procedures for convening shareholder meetings based on the agreement of all shareholders, and allowing resolutions to be made in document form for shareholder meetings and board of director meetings. 13 Setting the compensation for directors 14 Decision-making sub-committee regarding major assets 15 Mandating the appointment of outside directors (Note 1) 16 Audits by account auditors for joint-stock companies other than large corporations (Note 1) 17 Shareholder class-action lawsuits relating to the responsibilities of accounting auditors to their companies 18 Determining profit distribution plans and reducing the term of tenure for directors (Note 1) 19 Introducing an audit committee, nominating committee and compensation committee and statutory officer systems (Note 1)	20 Methods of specifying standards for asset evaluation, etc. 21 Introducing a document system for consolidated accounting (Note 1) 22 Disclosing balance sheets and other materials	23 Certifying prices for in-kind contribution to capital, and accepted assets 24 Preparing electronic documents for company accounting purposes 25 Preparing electronic means for public notifications by joint-stock companies 26 Preparing electronic means for public notifications by limited companies 27 Rationalizing the procedures for reducing company capital 28 Non-Japanese companies

Notes: (1) These items apply to large companies subject to the Special Exemption Law of Audit (joint-stock companies with a capital of ¥500 million or more or with debts of ¥20 billion or more); (2) Items 1 through 3 and 24 through 26 were amended in the extraordinary session of the Diet in the autumn of 2001. Other items are to be approved in the ordinary session of the Diet in 2002, excluding Item 6 (which is scheduled for review in the ordinary session of the Diet in the autumn of 2002 or thereafter).

employees of the granting corporation). In other words, this made it possible for the issuing company to grant stock options not only to its own directors and employees, but also to the directors and employees of its subsidiaries and affiliated companies.

Concomitant with this revision in the stock-option system, subscription rights were renamed *shinkabu-yoyaku-ken* (Section 19, Article 280 of the Commercial Code as revised).

*Shinkabu-yoyaku-ken* rights are defined as the “obligation of a corporation to permit the acquisition of shares at a prescribed price.” The subscription rights under the Commercial Code prior to these revisions placed restrictions on the recipients and the method of issuance. For example, the rights were granted to (the company’s) directors and employees, and/or issued together with company bonds like warrant bonds. In contrast, the new rights to reserve shares included no restrictions on recipients, and allowed for the issuance of such rights alone. In addition, these issues can be made free of charge or carry a price. And the new shares can be issued when authorized by a resolution of the board of directors in a manner similar to that for the issuance of new shares.

A company that issues *shinkabu-yoyaku-ken* rights can, when notified of an intention to exercise such rights, respond by issuing new shares or by releasing shares it already owns (treasury stock). As restrictions on the repurchase of shares have already been relaxed, a company can use repurchased shares to meet the exercise of such rights without any fear of diluting market positions. The issuance of rights to reserve new shares will be utilized to meet various management needs for long-term incentives within the remuneration system—most typically through stock options and the ability to acquire and dispose of treasury shares.

Since stock options allow for no-cost rights to purchase new shares, they are considered to be issued at relatively low prices, which requires a special resolution of a general meeting of shareholders. As restrictions on such low priced issues have also been relaxed, it is now possible to extend the validity of such special resolutions for a period of one year after the vote and to offer low priced shares as many times as the board of directors may determine (Sections 2-4 and 21-2, Article 280 of the Commercial Code as revised).

## (2) Diversified classes of shares

The revised Commercial Code has increased the types of shares from the current few such as ordinary and preferred stock in order to recognize the issuance of diversified classes that differ not only in terms of dividends but also of voting rights.

### <Tracking stocks>

In June of 2001, for example, Sony Corporation issued subsidiary-linked tracking stocks (a type of share

linked to the business performance of its subsidiaries) and listed them on the first section of the Tokyo Stock Exchange. While Japanese companies had previously been studying the issuance of tracking stocks (stocks linked to business earnings) by various American firms, it was unclear how far the issuing company was legally bound to spell out the details of subsidiary-linked stocks in its articles of incorporation. Sony Corporation took the approach of including all details of such issues in the company’s articles of incorporation. This type of stock has come to be called performance-linked subsidiary tracking stocks, and the Ministry of Finance has outlined both the listing rules and the disclosure requirements for such issues.

The latest revisions of the Commercial Code allow the details of the stock types to be determined by either a general meeting of shareholders or a meeting of the board of directors, provided that the articles of incorporation set rules on the maximum amount and itemize the other standards used in calculations, even if such matters are not stipulated in detail nor approved at a general meeting of shareholders (Section 3, Article 222 of the Commercial Code as revised). In addition, new rules have been set on “stocks with provisions for mandatory conversion,” so that a company can convert various types of issues into ordinary shares if required.<sup>6</sup>

From now on, enterprises that are oriented towards efficient group management can raise the necessary funds for their growing business segments by issuing stocks linked to the performance of subsidiaries or specified business divisions. Along with the above, they can also combine various finance methods such as issuing *shinkabu-yoyaku-ken* rights in classes of shares to provide incentives to the directors and employees of such subsidiaries.

### <Stocks with limited voting rights>

The 1990 revision of the Commercial Code raised the cap on the number of preferred stocks from one-quarter to one-third of the total volume of the outstanding shares. It also reduced the number of items that required statutory authorization. Conversely, the issuance of preferred stocks has not been clearly defined with respect to how much detail should be prescribed in the articles of incorporation, how to adjust rights among the holders of classes of shares and other matters. This has apparently resulted in the low popularity of certain stock types, except for those occasions when they are adopted by financial institutions to boost their net worth.

In recent years, as the nurturing of venture businesses has come into greater focus, the need has arisen for classes of shares with varied voting rights befitting the requirements of venture capitalists and other investors. Accordingly, the revised Commercial Code permits the issuance of a type of stock (limited voting-right shares) that differs from the others in voting rights as well as in

dividends (Article 222). The limited-voting-right stocks can be issued for up to one-half of the total number of outstanding shares.

When a company has issued classes of shares, the procedures for a general meeting of shareholders can also differ from those in the past. Beyond resolutions by a general meeting of common shareholders, a company may also require an ordinary resolution by a general meeting of the owners of a specific type of stock. Such resolutions are in addition to ordinary resolutions and concern part and/or all of the matters already resolved in accordance with law, pertinent ordinances and the articles of incorporation at a general meeting of shareholders or a meeting of the board of directors.

The Commercial Code is expected to be again revised in the spring 2002. With this revision, the code will enable companies to issue stocks<sup>7</sup> that carry different provisions concerning the right to elect and dismiss directors.

### (3) Introduction of IT-based disclosure procedures

Along with internationalization and coping with the influence of world capital markets, the response to IT-based initiatives has become one of the most urgent tasks in prodding companies to action and facilitating shakeups in Japanese enterprises. As stipulated in the Commercial Code, corporations are required to disclose balance sheets, profit-and-loss statements, business reports and auditing records. The revised Commercial Code allows the creation of these disclosure documents through “electromagnetic means” as well as by written and printed format. Accordingly, companies can now respond to the IT environment by using the Internet, email and related media<sup>8</sup> (Section 2, Article 33 of the Commercial Code as revised). In short, the code has broadly eased communication between companies and shareholders by allowing for PC and Internet services.

From the viewpoint of advancing communication between a company and its shareholders, the introduction or utilization of information technology has an extremely important meaning. In the case of a general meeting of shareholders, for example, the “written or printed information” that can be handled by IT includes notices of shareholders meetings, reference documents and proxy statements and ballots. The latest revision has made it possible for a company to transmit meeting notices and reference materials to shareholders through electromagnetic means. And with the authorization of the board of directors, absentee shareholders can exercise their voting rights by electromagnetic means.<sup>9</sup>

Thanks to these revisions, corporations have been able to reduce the costs associated with a general meeting of shareholders, i.e., the printing and mailing costs of meeting notices and reference documentation, the

hand count of proxy statements and ballots, as well as such complicated shareholders meeting procedures as securing a quorum. Instead, trust banks have established new services to support IT-based shareholders meetings, thereby freeing up the issuing companies from starting the necessary systems from scratch.<sup>10</sup>

## 3 Expanding the Authority of Statutory Auditors and Easing the Liability of Directors

The third revision of the Commercial Code in 2001 was intended to secure the effectiveness of corporate governance. This draft, which had been debated in the Commercial Code Subcommittee of the Liberal Democratic Party’s Legal Commission, was designed to prevent any recurrence of the unsavory criminal behavior that had come to light in 1997, in which a number of companies had given large amounts of money to *sokaiya* (i.e., those who were paid off by corporate management to silence dissenting shareholders and ensure that Japanese shareholders meetings maintained their worldwide reputation for unchallenged brevity).

The panel took steps to strengthen the authority of statutory auditors vis-à-vis directors and reviewed both the procedures to systematically ease the liability of directors to their companies and the regime for class-action litigation by shareholders. These actions came in response to criticism that the skyrocketing incidence of class-action litigation since 1993 had become an excessive drag on effective company management.

### (1) Bolstering the functions of statutory auditors

Statutory auditors are mandated to carry out audits to determine whether directors have lawfully executed and performed the business affairs of a corporation. Whenever a director’s actions appear to be improper, the auditor is required to point out such failings and—depending on the event or the severity of any failing—may even become a plaintiff in class-action lawsuit. Despite the fact that statutory auditors are endowed with such power, we constantly hear complaints voicing dissatisfaction over what is seen as spotty monitoring at best. Among the reasons cited for this are the fact that the right to nominate statutory auditors is left to directors—the very people who are subject to auditor scrutiny. Moreover, the post of auditor has been seen as one that is filled through internal promotions, just as is the case with directors. In contrast, the revised Commercial Code aims at strengthening the monitoring of statutory auditors on two fronts; namely, more rigorous job qualifications and greater authority.

To begin with, a large corporation to which the Special Exemption Law of the Commercial Code applies must have a board of statutory auditors, and outside auditors must make up more than half of the members. In a company with five statutory auditors, for

example, three must be outside statutory auditors. Moreover, while the current law prescribes that those who are qualified as outside statutory auditors cannot have served as a director or employee of the company or its subsidiaries during the five years immediately prior to appointment, the revised law does away with this five-year grace period and mandates that outside statutory auditors must be totally unaffiliated with the company. Thus, the new law does not permit a former company employee who has been transferred to a subsidiary to return to the main company as an auditor (the Special Exemption Law, Section 1, Article 18 of the Commercial Code as revised).<sup>11</sup>

Furthermore, the tenure of statutory auditors has been extended by one year. It begins at the time of appointment and continues until the close of the regular general meeting of the last accounting term that comes within four years of the date of such appointment. In addition, when a large corporation under the Special Exemption Law of the Commercial Code selects its statutory auditors, the consent of its board of statutory auditors is mandatory, as is the case in the selection of accounting auditors. The board is also permitted to submit draft proposals for appointing statutory auditors. Additionally, when an auditor resigns during the designated term of office, the individual must be given the opportunity to state the reasons for the resignation at the first general meeting of shareholders after such resignation. This is a measure to prevent the unwarranted dismissal of statutory auditors who are critical of the board of directors.<sup>12</sup>

The supervisory obligation of statutory auditors has also been broadened. They are required to attend meetings of the board of directors and to voice their opinions when they deem it necessary. Statutory auditors will not only monitor the legality of the directors' activities, but also must be given the chance to monitor the adequacy of directors' activities to ensure the appropriateness of management decisions made by the board of directors.

## **(2) Easing the responsibilities of directors to the company**

In principle, directors are responsible for carrying out business duties and for exercising management judgment in general, regardless of how poorly they carry out their duties (Section 1, Article 266 of the existing Commercial Code), and shareholders can file class-action lawsuits in order to compel statutory auditors to pursue their responsibilities. Since the revised Commercial Code of 1993 set the fee for such lawsuits to a flat rate of ¥8,200 regardless of the amount of compensation claimed, the incidence of such litigation has continued to climb. Although this has ebbed somewhat in response to the waning of highly egregious scandals, it is easy to imagine the great shock felt by corporate management when the court in a Daiwa Bank class-action case<sup>13</sup> handed down a judgment in December of 2000 that recognized

managerial liability and awarded the plaintiffs a huge sum in compensation.

Amid the clamor raised by these cases, many called for reducing or waiving the liability of directors who were guilty of only minor errors in management judgment. This led to an adjustment in the procedure for reducing or waiving liability. While it had been possible up until then to reduce or waive the responsibilities of directors and statutory auditors with the consent of all shareholders (Section 5, Article 266 of the Commercial Code), it was difficult in practical terms to garner such consent in a public corporation.

Thus, the revised Commercial Code stipulated three new regimes for the reduction or waiver of responsibilities. (Sections 7 through 19, Article 266 of the Commercial Code as revised). These new provisions basically consisted of three processes: (1) reducing an individual's responsibility on the basis of a special resolution adopted by a general meeting of shareholders; (2) reducing an individual's responsibility in accordance with general rules to be stipulated in the articles of incorporation and requiring an individual decision by the board of directors;<sup>14</sup> (3) reducing the effect of the Limited Liability Contract stipulated in the articles of incorporation solely for outside directors.

The three procedures above require the consent of all the statutory auditors. Under this new system for reducing liability, the maximum liability can be cut to an amount equal to six-years of remuneration for representative directors, four-years for other directors and two-years for outside directors and statutory auditors. These reductions are restricted to any liabilities arising from acts found to be contrary to law or the articles of incorporation, provided they were carried out in good faith and did not involve gross negligence.

Particularly noteworthy is the stipulation about reducing the liability of outside directors. Both companies and shareholders are becoming increasingly aware that outside directors who are independent from management should be invited to assume roles in reinforcing supervisory functions over other directors on the board. In reality, however, it is pointed out that candidates for outside directorships are often reluctant to accept such posts because they are subject to no-fault liability. For this reason, outside directors are now exempted from liability under the articles of incorporation by means of limited-liability contracts. The definition of the term outside director as specified in the Commercial Code is as follows: "A person who is presently a director but who is not executing any company business, who has not in the past been a director, manager or other employee executing any business of the company or its subsidiaries, and who currently is neither executing any business of a subsidiary nor is a manager or any other employee of the company or its subsidiaries." Should any outside

director simultaneously become an employee or director/employee (concurrently) after assuming a directorship, the limited-liability contract covering such person shall become null and void.

### (3) Review of stockholder class-action lawsuit system

Statutory auditors are now assuming heavier responsibilities with regard to stockholder class-action lawsuits. Under the current Commercial Code, a stockholder can file a class-action suit if the stockholder has requested the company to initiate a lawsuit to pursue the liability of any director(s), but the company has failed to act within 30 days from the date such a request is lodged. Whether the company will sue the director(s) or not is decided by the statutory auditors acting in behalf of the company. As the 30-day period has actually been deemed too short a period for the statutory auditors to come to a decision, this period has been extended to 60 days under the revised Commercial Code. The code also requires the company to garner the consent of all the statutory auditors if the company elects to join the suit in the capacity of a co-plaintiff in an action against the accused director(s).

In other aspects, a scheme to provide shareholders with information regarding class-action lawsuits has also been organized. Namely, if the company decides to pursue the liability of director(s), it must immediately inform shareholders about the filing of any complaint via a public announcement and/or notice. Similarly, if the company is notified of any stockholder class-action litigation, or when the company offers to join a suit as a co-plaintiff, appropriate notices and/or public announcements become necessary. When any person(s) other than the company (such as the shareholders) agree to an out-of-court settlement with the accused director(s) in the case in question, it is now necessary for said person(s) to individually notify all shareholders of the settlement terms.

Under the Special Exemption Law of the Commercial Code, large companies must respond by the year 2005 to the broadening of the powers and responsibilities that statutory auditors may exercise over the board of directors. It has been said that the corporate governance system in Japan does not permit the smooth functioning of any in-house scrutiny of top management, as the board is mainly composed of inside directors and statutory auditors are recommended by the board of directors. Consequently, it can be said that the latest revisions show some direction towards solving these problems.

## III Prospects for Revisions of the Commercial Code in 2002

Previous revisions of the Commercial Code have helped corporations transform themselves into firms

that attach greater importance to stockholder value by expanding the options available for corporate finance and giving themselves a freer hand. In contrast, the revisions of the Commercial Code in the spring of 2002 aim at reviewing corporate governance as it exists and at proposing a new governance regime. While past revisions concerning corporate governance were prompted in response to corporate scandals, the coming review will be focused on enhancing the international competitiveness of Japanese enterprises.

### 1 Legislation for New Corporate Governance

The current corporate governance scheme in large enterprises that come under the Special Exemption Law basically revolves around the general meeting of shareholders, the board of directors, the board of statutory auditors and account auditors, respectively—each of which functions to monitor the execution of management from its own standpoint. Although a number of Commercial Code revisions were made to reinforce these monitoring functions in the past, the framework that was introduced at the time the Special Exemption Law was incorporated into the Commercial Code in 1974 has basically been kept intact.

The revisions in the spring of 2002 are expected to introduce a new corporate governance regime patterned after American-style boards of directors, and to permit Japanese companies to choose either the conventional or the new approach (see Table 3 and Chart 2).

Additionally, in order to expedite management decisions, provisions will be made for the establishment of a decision-making subcommittee regarding major assets, which can be mandated to consider some of the issues that have been assigned solely to the board of directors up to now.

#### (1) New corporate governance system

A company that adopts a new corporate governance system will be called “companies with three committee boards.” Large companies that come under the Special Exemption Law of the Commercial Code and other public limited companies that are capitalized at more than ¥100 million and whose articles of incorporation stipulate the appointment of account auditor(s), can also become companies with established committees, etc., when they so decide in their articles of incorporation. A company with established committees, etc., is one that meets the following conditions.

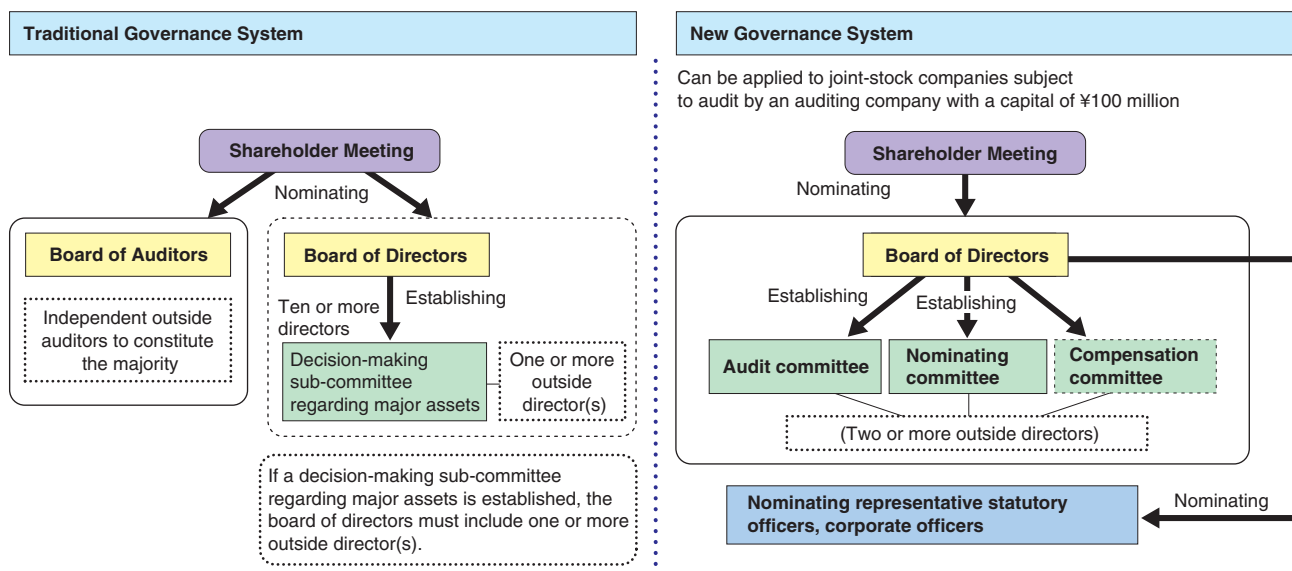
- 1) It is legally required to establish a nominating committee, an audit committee, and a compensation committee, and to appoint statutory officers.
- 2) Each committee consists of more than three persons, of whom more than half are outside directors.

**Table 3. Characteristics of Two Corporate Governance Systems**

	Traditional Governance System *	New Governance System
<b>Employing outside personnel</b>	Two or more outside statutory auditors and one or more outside directors	Two or more outside directors
<b>Number of directors</b>	Ten or more	Three or more
<b>Targets of shareholder class-action lawsuits</b>	Directors and statutory auditors	Directors and statutory officers
<b>Term of directors</b>	Two years at the maximum	One year
<b>Establishment of committees</b>	Decision-making sub-committee regarding major assets (three or more members), board of auditors (with a majority of outside statutory auditors)	Nominating, remuneration and audit committees (three or more members per committee, with a majority of outside directors)
<b>Nature of director duties</b>	Supervising representative directors, determining operational policies, and consigning tasks to a decision-making sub-committee regarding major assets	Supervising statutory officers, determining managerial policies, and appointing committee members and statutory officers
<b>Execution of business operations</b>	Representative directors and other directors	Representative statutory officers and other statutory officers (directors may be simultaneously appointed as statutory officers)
<b>Disclosure of remuneration</b>	If determined by a general meeting of shareholders that compensation cannot be determined or non-monetary remuneration will be provided, reasons for such compensation should be disclosed.	Determined and reported by the compensation committee

Note: The traditional governance system here is assumed to establish decision-making sub-committee regarding major assets.  
 Source: Nomura Research Institute.

**Figure 2. Schemes of Two Corporate Governance Systems**



Source: Nomura Research Institute.

- 3) Statutory auditors shall not be appointed.
- 4) The board of directors shall monitor business decisions and the execution of business affairs by statutory officers.
- 5) Representative statutory officers shall be decided.
- 6) The board of directors may adopt resolutions on the distribution of profits and authorizations to acquire treasury stock.
- 7) The term of directors and statutory officers is set to one year.

Under this corporate governance system, a new regime will be adopted whereby the functions of the board of directors will focus on the monitoring of management, while planning and the execution of management strategy are assigned to statutory officers.

## (2) The decision-making sub-committee regarding major assets

Among large companies under the Special Exemption Law of the Commercial Code, those that meet the following requirements can establish a decision-making sub-committee regarding major assets by a resolution of the board of directors.

- The board of directors consists of more than 10 persons.
- One or more director is an outside director.
- The committee is composed of three or more directors.
- The committee determines all mandated matters (appropriation and acquisition of major assets, large debts).
- The committee has the duty to report to the board of directors.

The decision-making sub-committee regarding major assets is equivalent to the current managing directors meeting. This is a system that fulfils the requirements for an organization by making it capable of prompt decision-making when there are many members on the board of directors. Legally, the committee is positioned as a decision-making organ on certain matters in lieu of the board of directors.

## 2 Selecting a Corporate Governance System

In recent years, Japanese enterprises have pushed forward with their efforts to reform the board of directors system and have come up with various innovative ideas to try.

### (1) Voluntarily reform of the board of directors

Starting several years ago, enterprises started moving towards reforming their boards of directors, as if they were pre-empting what the coming revision of the Commercial Code would have to offer. These plans included cutting the number of directors on the board, introducing executive officer systems and reducing the tenure of directors to one year.

For example, executive officer systems have been introduced to reinforce the competitiveness of individual business sectors as well as the whole company. This effort consisted of appointing directors who are held responsible for the management of the company as a whole, and in nominating executive officers to execute the business affairs of each individual business sector. These steps are designed to make the enterprise responsive to drastic changes in the management environment. Since Sony Corporation

introduced an executive-officer scheme in 1997, 143 listed enterprises had followed suit by December 2000.<sup>15</sup> Additionally, shortening of tenure of directors to one year (the legal maximum is two years) has also come to be widespread among listed enterprises.

These moves apparently have been prompted by the demand of the Tokyo Stock Exchange for a disclosure of the Summary Financial Results (*Kessan Tanshin*) of “the steps employed to further enhance the management-supervision system (improvement of corporate governance)” after the March 1998 term. When a listed company is practicing or planning concrete measures for improved corporate governance such as the introduction of an executive-officer scheme, the appointment of outside director(s) and/or strengthening of the function of the board of auditors, the company is required to disclose the nature, purpose, expected effects of such measures.

### (2) Background conditions to corporate governance in the United Kingdom and the United States

The new governance scheme to be incorporated in the Commercial Code is reportedly patterned after the schemes in the United States, where steps were first taken to systematize the establishment of directors committees in 1956 when the New York Stock Exchange required companies to set up audit committees consisting of more than two outside statutory auditors. As of 2000, the ratio of committees among corporations listed in Standard & Poor’s Composite Index of 500 Stocks was as follows: 100 percent for audit committees, 99.3 percent for compensation committees and 87.6 percent for nominating committees. The ratio of independent directors was 87.9 percent for audit committees, 98.0 percent for compensation committees and 79.1 percent for nominating committees.<sup>16</sup> Among the full boards of directors, moreover, independent directors accounted for 68.7 percent of the membership. This translates to about 8 members out of the mean membership figure of 11.6.

Boards of directors have been encouraged to appoint independent (outside) directors to enhance the autonomy of the boards as organs to monitor top management. Several factors can be seen behind these moves. These include the tendency of CEO power to expand relentlessly when stock ownership is highly dispersed, and increased apprehension among institutional investors and other shareholders that a runaway CEO may emerge. These concerns have in turn driven investors to strengthen their oversight of top management by the use of their voting rights.

In the United Kingdom, the year 1991 saw the establishment of the Cadbury Committee and three other committees. These bodies, joined by the Bank of England, the London Stock Exchange, and other market participants such as business managers and institutional investors, drew up the “Norm of Best

Practice” as a statement of national consensus in 1998. Based on this formulation, unified rules for disclosure and governance were established at enterprises listed on the London Stock Exchange. Although it is often said that the institutionalization of shareholders is much more advanced in Great Britain than in the United States, not much discipline appears to have been imposed by proactive shareholders so far.<sup>17</sup>

The current governance systems of the 547 companies listed on the London Stock Exchange is as follows.<sup>18</sup>

- The ratio of audit committees consisting entirely of independent directors is 79 percent; for remuneration committees with a similar composition, the figure is 74 percent.
- The ratio of tenure terms set at less than one year is 69 percent.
- The ratio of boards of directors on which outside directors constitute the majority is 53 percent.
- The separation of the posts of CEO and chairperson of the board of directors is seen at 80 percent of enterprises.

Thus, the function of boards of directors and top management are distinctly delineated in both the United Kingdom and the United States. The boards of directors are so structured as to be highly independent of top management, befitting their role as monitors and evaluators of management performance.

**(3) The idea of governance under selective schemes**

The reason the new Commercial Code has opted to envisage the system of corporate governance on a selective basis appears to be found in the respect of legislators for the independence of enterprise management. When they choose a governance system, it is quite thinkable that top management will broadly examine the composition of shareholders, the characteristics of the markets that are the focus of its mainline business (e.g., characteristics of business category) and the strength of the president’s leadership

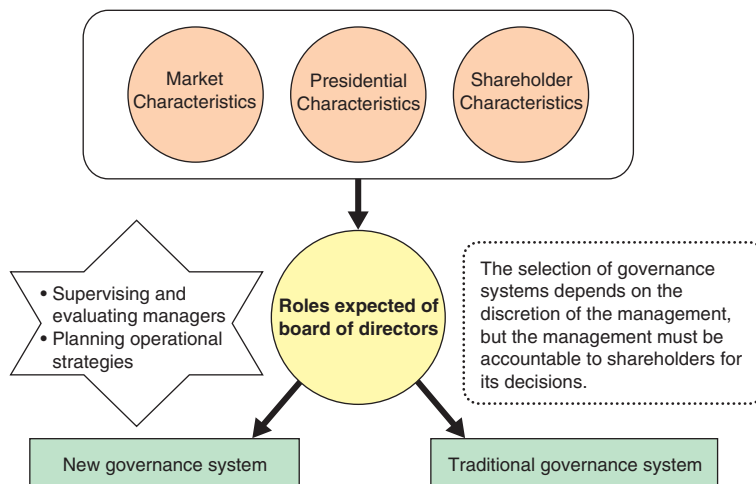
before determining what to expect from the board of directors.<sup>19</sup> In this manner, top management is obligated to select an optimal governance system for advancing the interests of its shareholders (see Figure 3).

For example, in an enterprise where an owner-president who holds an influential number of shares exercises strong leadership, the president would naturally have overwhelming authority, just like the case of a chairman of the board concurrently serving as CEO in an American enterprise. It would be hard to expect management control by internal directors in such a situation. In this case, it would be desirable to organize a committee with participation by a number of outside directors to monitor risk-management for eventualities such as launching new projects with different risk levels, as might be expected from entering into new business sectors. Furthermore, if an enterprise finds itself in critically dire management straits, it is conceivable that it would choose to adopt a new governance scheme that concentrates all the power and authority in its president to carry out bold restructuring moves.

On the other hand, in an enterprise under an internally promoted and elected president, where the business performance is generally satisfactory and a system of mutual monitoring by inside directors is running smoothly, selecting a conventional governance system would not produce much of a difficulty. Consequently, it is more important to show shareholders that an effective management monitoring system has been secured, rather than merely to ponder which system would be better evaluated by the stock market. In addition, it would be essential for top management to clearly explain that the selected governance system serves the purpose of improving stockholder profits.

In terms of their framework, boards of directors under the new types of governance seem to be highly independent of management. It is thought that overseas institutional investors will conclude that the new governance schemes are better suited to serve

**Figure 3. Responses to the Selection of Governance Systems**



stockholder interests. For example, it would be effective for an enterprise that selects conventional governance to disclose details about the standards for the selection, appraisal and compensation of directors to those shareholders who wanted a new governance system.

To summarize the previous series of revisions in the Commercial Code, the following can be stated. Deregulation in the finance sector will diversify the means available for enhancing corporate value. At the same time, stricter regulations in terms of corporate governance are meant to tune up and maintain the system, so that broadened freedom of management will not lead to runaway management. The two different orientations that are visible in the series of revisions can be compared to the two wheels on an axle: one cannot function effectively without the other.

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- (1) "Revisions of the Commercial Code: The Stock Scheme and Corporate Governance as the Core Issues," *Capital Market Monthly Magazine*, September 2001.
  - (2) The Regulations on Corporate Bonds were partly amended in 1993 to do away with limitations on the amount of bond issues and to require the establishment of a corporate bond management company, as it was expected that companies would issue a large amount of corporate bonds in response to the enactment of the Financial Systems Reform Law to ease the strict separation between the financial and securities businesses.
  - (3) Stock repurchases had been limited for the following reasons: (1) repurchases would represent the repayment of investments, which would be disadvantageous to other company creditors; (2) the measure cannot provide all shareholders with an equal opportunity to recover funds invested; (3) it can reduce the number of stocks with voting rights, thereby making it possible for management to acquire a majority of voting shares and unreasonably strengthen its control; and (4) it may easily lead to market maneuvering and insider trading.
  - (4) At the same time, companies that have added land reevaluation amounts to their accounts under the Land Reevaluation Law are allowed to use such amounts as funds to retire their outstanding shares (a temporary legislative measure until March 2002).
  - (5) Yo Maeda, "Explanatory Notes on the Gist of the Draft Bill to Revise the Commercial Code (Part 1 and Part 2)," *Shoji Homu*, Commercial Law Center, September 25, 2001 and October 5, 2001.
  - (6) The term "convertible stock" means a stock with accompanying right that allows its holder to convert the issue into an ordinary share. It is normally considered an issuance condition of classes of shares. In current practice, conversion from a class of share to an ordinary share is based on the demand of the holder of a class of share. However, the diversification in stock types has raised the need for issuing company to be ready to expediently convert classes of shares into ordinary stocks across the board.
  - (7) For example, the common shareholders can elect three directors, class-A shareholders can elect two, and class-B shareholders can elect one.
  - (8) The provisions in the revised Commercial Code relating to account records, the list of registered shareholders and the articles of incorporation were modified to enable the utilization of information technology. For example, the terms "write," and "signature" were changed to "record" and "a signature alternative."
  - (9) Furthermore, the system of voting by the use of ballot documents is now widely possible, regardless of the size of a company or the number of shareholders.
  - (10) "In Support of Using Information Technology in Stockholder Meetings," *The Nikkei Finance Newspaper*, December 18, 2001.
  - (11) Section 1, Article 18 of the revised Special Exemption Law prescribes that "The number of statutory auditors should be more than three, of which more than half shall be persons who have not been directors, managers or employees of the company or its subsidiaries prior to their appointment."
  - (12) The company must send notifications to any auditor who has resigned, announcing the calling of a meeting of shareholders and offering them an opportunity to attend the meeting and explain the reasons for their resignation. Other statutory auditors may also state their opinions about such resignation at the general meeting of shareholders (Sections 2 and 3, Article 275, the Commercial Code as revised).
  - (13) The judgment found that Daiwa Bank directors were guilty of failing in their responsibilities for establishing a system that allowed major clients to avoid stock trading losses, and held them liable for ¥97.5 billion in damages. An out-of-court settlement in December 2001 reduced this liability to ¥250 million.
  - (14) When the board of directors waives liability, it must promptly notify shareholders or make a public announcement of the facts leading to the reduction in liability, the amount of such reduction and the reasons therefore. The notification or announcement must also state that any objection to the calculations and the waiver itself should be voiced within a certain period that is longer than one month in duration (Section 13, Article 266 of the Commercial Code as revised). Should shareholders holding more than 3 percent (original draft was 5 percent) of voting rights state their objections during this grace period, the waiver based on the articles of incorporation is nullified (Section 14, Article 266 of the Commercial Code as revised).
  - (15) According to "Research on the Current State of Corporate Governance Among Listed Companies," a survey of listed companies conducted by the Japan Corporate Governance Forum.
  - (16) Alesandra Monaco, *Board Practices 2000: The Structure and Compensation of Boards at S&P Super 1,500 Companies*, IRRIC, December 2000.
  - (17) In February 2002, a draft law was submitted to the Diet seeking wider institutional investor participation in governance and greater professionalism for pension managers.
  - (18) PIRC, ed., *Corporate Governance 2001*, PIRC Ltd., December 2001.

(19) Although the functions of the board of directors initially focused on supervising management by separating supervisory functions from executive functions, criticisms have been raised about the spring 2002 revisions of the Commercial Code, claiming that such separation is not adequate. See Akira Morita, "Revisions of the Directorship System", *Corporate Accounting*, September 2001.

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