Mandate of the Special Representative of the Secretary-General (SRSG) on the Issue of Human Rights and Transnational Corporations and other Business Enterprises

CORPORATE LAW TOOLS PROJECT

JURISDICTION: JAPAN

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DATE: SEPTEMBER 2009

This report was submitted to the SRSG as part of his corporate law tools project, as explained in his press release of 23 March 2009: http://www.reports-and-materials.org/Corporate-law-firms-advise-Ruggie-23-Mar-2009.pdf. It is the sole work of Cotty Vivant Marchisio & Lauzeral (CVML) and does not necessarily represent the SRSG's views. The SRSG is grateful to CVML for providing this report and for participating in the corporate law tools project.

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A NOTE FROM THE UN SPECIAL REPRESENTATIVE ON BUSINESS AND HUMAN RIGHTS

OCTOBER 2009

This report forms part of a project on corporate law and human rights under my mandate as Special Representative of the UN Secretary-General on Business and Human Rights: the "Corporate Law Tools Project". I am delighted that nineteen leading corporate law firms from around the world are participating in the project, and thank them for their engagement. The willingness of so many firms to provide their services pro bono in order to expand the common knowledge base indicates that corporate law firms worldwide appreciate that human rights are relevant to their clients' needs.

It is important at the outset though to understand how this project fits into my wider work. I was appointed in 2005 by then UN Secretary-General Kofi Annan with a broad mandate to identify and clarify standards of corporate responsibility and accountability regarding human rights, including the role of states. In June 2008, after extensive global consultation with business, governments and civil society, I proposed a policy framework for managing business and human rights challenges to the United Nations Human Rights Council (Council).

The Framework of "Protect, Respect, Remedy" rests on three differentiated yet complementary pillars: the **state duty to protect** against human rights abuses by third parties, including business, through appropriate policies, regulation, and adjudication; the **corporate responsibility to respect** human rights, which in essence means to act with due diligence to avoid infringing on the rights of others; and greater **access for victims to effective remedy**, judicial and non-judicial. You can read more about the Framework in my 2008 and 2009 reports to the Human Rights Council, available at: (2008) http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf; (2009) http://www.business-humanrights.org/Links/Repository/715771.

The Council unanimously welcomed the Framework and extended my mandate by another three years, tasking me with "operationalizing" the Framework—that is, to provide "practical recommendations" and "concrete guidance" to states, businesses and others on the Framework's implementation. There has already been considerable uptake of the Framework by all relevant stakeholders: unanimous backing in the Council; strong endorsements by international business associations and individual companies; and positive statements from civil society.

A key aspect of the first pillar, the state duty to protect, is that states should foster corporate cultures respectful of rights both at home and abroad, through all available avenues. In particular, I have been exploring the opportunities and challenges that corporate and securities law can provide in this regard. Corporate law directly shapes what companies do and how they do it. Yet its implications for human rights remain poorly understood. The two have often been viewed as distinct legal and policy spheres, populated by different communities of practice.

The Corporate Law Tools Project will allow me to explore this area further by mapping in over 40 jurisdictions how national laws and policies dealing with incorporation and listing; directors' duties; reporting; stakeholder engagement; and corporate governance more generally currently require, facilitate or discourage companies from respecting human rights. I have asked the firms to explore not only what laws currently exist, but also how corporate regulators and courts apply the law to require or facilitate consideration by companies of their human rights impacts and preventative or remedial action where appropriate.

The project thus formally comprises part of my work on the **state duty to protect**. It will assist me to understand whether and how national corporate law principles and practices currently encourage companies to foster corporate cultures respectful of human rights. I will in turn consider what, if any, policy recommendations to make to states in this area, following consultation with all relevant stakeholders. However it is just one element of my work on the state duty to protect, which also looks at other areas of the law and national policies which might help states to encourage companies to respect human rights.

The project will also support my work on the corporate responsibility to respect and access to remedy. In relation to the responsibility to respect, I have explained that in addition to compliance with national laws, the baseline responsibility of companies is to respect human rights. To discharge the responsibility, I have recommended that companies conduct ongoing human rights due diligence whereby they become aware of, prevent, and address adverse human rights impacts. The responsibility exists even where national laws are absent or not enforced because respecting rights is the very foundation of a company's social license to operate. It is recognized as such by virtually every voluntary business initiative, including the UN Global Compact, and soft law instruments such as the International Labour Organization Tripartite Declaration and the OECD Guidelines on Multinational Enterprises. Nevertheless, an understanding of national laws, including corporate law, is still relevant to ensure companies understand their national legal obligations. Moreover, corporate law may provide guidance as to what constitutes appropriate human rights due diligence.

For the original press release for this project listing all applicable jurisdictions and participating firms, please see: http://www.reports-and-materials.org/Corporate-law-firms-advise-Ruggie-23-Mar-2009.pdf. The template I asked the firms to follow for the project is available at: http://www.reports-and-materials.org/Ruggie-template-for-corporate-law-tools-project-May-2009.pdf; and a summary report of a June 2009 meeting of the participating firms is available at http://www.reports-and-materials.org/Ruggie-corporate-law-tools-meeting-summary-30-Jun-2009.pdf.

An overarching trends paper will soon be available, bringing together the main themes from all of the firms' reports. That paper as well as all reports will be available as completed at: http://www.business-humanrights.org/SpecialRepPortal/Home/Materialsbytopic/Corporatelaw/CorporateLawTools.

My thanks again to all participating firms.

John G. Ruggie

Special Representative of the UN Secretary-General on Business and Human Rights

EXECUTIVE SUMMARY

1. **SETTING THE LEGAL LANDSCAPE**

Japanese corporate law is mainly governed by the *Company Act*, which became effective in 2006. Human rights are mostly protected by specific provisions of the Japanese Constitution, as well as by many other domestic laws. Human rights enforcement is also fostered by Japan's ratification of international human rights instruments as well as promotion of human rights through private initiatives, like the Keidanren's Charter of Corporate Behavior.

2. **REGULATORY FRAMEWORK**

The Japanese jurisdiction belongs to a civil law tradition, and corporate law, like any other in Japan, is regulated at the national level. The main corporate/securities regulators are the Financial Services Agency (control of financial stability, liquidity of financial markets and corporate auditing), the Bank of Japan (monetary issues) and the Tokyo Stock Exchange (power of supervision of transactions on the market).

3. **INCORPORATION AND LISTING**

Despite the existence of the concepts of "limited liability" and "separate legal personality", especially in the Joint Stock Corporations (the most frequent form of company in Japan), such corporations are not required to recognize any duty to society, except for the respect of legality in their activities. Yet, they are allowed to consider such duties, which are essential criteria in the companies' assessment by the two Japanese responsible investment indexes. The participation of corporations to these indexes is mostly non voluntary, as most listed companies are screening based primarily on public information on websites and annual reports. However, a company may submit additional information which will be incorporated in the decision making process.

4. **DIRECTORS' DUTIES**

Directors' duties are mainly owed to the corporation itself, although directors may be, to a certain extent, liable to third parties. Their legal duties clearly provide that directors shall avoid legal risk and damage to the company's reputation. Failing to uphold such duties may have consequences regarding civil or even criminal liability. Directors are not specifically required to consider the impact of the company's (or its subsidiaries') activity on non-shareholders, whether it is inside or outside the Japanese jurisdiction. However, directors may be required to consider such impact as a result of their duties to avoid legal risk and damage to the company, of certain health and safety laws, or certain environmental laws, and when the corporation is in insolvency proceedings.

5. **REPORTING**

Reporting and disclosure requirements of Japanese companies do not include any obligation to disclose the impacts of their operation (or of the action of subsidiaries, suppliers, and other business partners) on non-shareholders, whether occurring inside or outside the jurisdiction (especially human rights impacts), as long as such impacts are not significant for the company. Should such be the case however, it would become mandatory to disclose such information for the public interest or the protection of investors.

In addition, many Japanese corporations boast voluntary publication of Corporate Social Responsibility reports.

6. **STAKEHOLDER ENGAGEMENT**

There is no particular restriction on circulating shareholders proposals dealing with impacts on non-shareholders and the possibility for non-shareholders to address companies' general meetings is subject to the articles of incorporation. Many Japanese institutional investors consider the impact of the company on human rights in their investment strategies.

7. **OTHER ISSUES OF CORPORATE GOVERNANCE**

The Charter of Corporate Behavior of the Japanese Business Federation (Keidanren), as well as individual charters adopted voluntarily by many Japanese corporations, has a key impact on promoting good corporate governance practices In addition, based on the general prohibition of discrimination because of race, creed, sex, social status or family origin in the Japanese Constitution, there can be no discrimination between members of the board for any gender, racial or ethnic reason.

1. **Briefly explain the broader legal landscape regarding business and human rights**

1.1 Legal landscape regarding business

Historically, since 1899 the incorporation, organization, operation and administration of companies in Japan had been regulated by Chapter Two of the Commercial Code, and also by the *Limited Company Law*.

The *Company Act* and the *Law Concerning Coordination, etc, of Associated Laws in Connection with Enforcement of the Company Law* were enacted and came into force effective on May 1, 2006, and Chapter Two of the Commercial Code and the *Limited Company Law* were consolidated into the *Company Act*, which has become the main source of law regulating companies.

The *Company Act* is supplemented by significant specific laws dealing with particular areas of commercial activity such as the *Financial Instruments and Exchange Law* which regulates more specifically matters related to securities, the *Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade* which covers monopolization and unfair business practices or the *Bankruptcy Law*.

Company law is also linked with the Civil Code and commercial custom. In addition, there are court precedents that interpret the legislation. However, court judgments are seldom encountered in Japan for cultural reasons. The Japanese are generally conflict-reluctant and proceedings do not often go to a verdict as judges have, to a certain extent, a role as mediator and encourage parties to come to an agreement. As a result, there are few court judgments which can be regarded as sources of company law.

Lastly, labor law has a significant impact on business activities in Japan. Due to the very important role played by labor unions, labor law is divided into two main parts: laws regulating union-employer relationships[1] and laws focusing on labor contracts and regulating the relationship between employers and employees taken individually[2].

1.2 Legal landscape regarding human rights

1.2.1 Human rights in Japan are mainly protected through the Constitution, which was established just after World War II and guarantees fundamental human rights.

The Constitution establishes the general structure of the State and its governing bodies. A large section is reserved for human rights. The rights "*to life, liberty, and the pursuit of happiness*" are asserted, as well as the fact that "*all people are equal under the law and [that] there shall be no discrimination in political, economic or social relations because of race, creed, sex, social status or family origin*".

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[1] The *Labor Union Act*, which, through concrete provisions, applies the constitutional guarantees of the rights to organize a concerted activity and to bargain collectively; the *Labor Relations Adjustment Act*, which regulates labor disputes and limits or prohibits certain concerted activities, the *Public Corporation Labor Relations Act*, which regulates the collective employment relationships of civil servants working in public corporations.

[2] Mainly the *Labor Standards Act*, which establishes minimum standards concerning hours, holidays, paid vacations and accident compensation; the *Minimum Wage Act*; the *Seamen Act*; the *Act on the Welfare of Working Women*; the *Physically Handicapped Employment Promotion Act*.

A particular emphasis is placed on compliance with employee human rights provisions, especially through the assertion of the right for workers to gather collectively in labor unions and Article 28 of the Constitution which guaranties "*the right of workers to organize and to bargain and act collectively*" can be directly enforced by the employees against employers.

Japan still applies the death penalty.

1.2.2 Japan has adopted domestic laws to protect human rights[3].

One of the major domestic laws relating to human rights, the *Equal Employment Opportunity Act* of 1985, is intended to "*promote securing equal opportunity and treatment in employment for men and women*" and requires the adoption of specific policies relating to women's working conditions and prohibits discrimination against women, including discrimination in promotion, education, or retirement age. The *Equal Employment Opportunity Law* was revised (effective as of April 2007) to prohibit discrimination based on gender at any stage of employment, including indirect discrimination or detrimental treatment due to facts such as pregnancy and childbirth.

1.2.3 Japan is a party to some of the principal international human rights instruments[4]. The Constitution provides that "*treaties concluded by Japan […] shall be faithfully observed*"[5].

2. <u>To what legal tradition does the jurisdiction belong, i.e. civil/common law, mixed?</u>

The modern Japanese Civil Code dates back to the Meiji era (1868 – 1912). Drafters of the Civil Code in 1896 took most of their inspiration from German, French and Swiss law, as well as common law.

The final version of the Japanese Civil Code proved to be close to the German Civil Code, thereby including Japanese law in the tradition of continental civil law. Code revisions in 1947 kept Japan in the same tradition.

However, partly due to growing relations between Japan and the United States of America after World War II, Japanese law is closer to common law than to civil law on certain specific subjects (e.g., examination of witnesses in civil cases, absence of a hierarchy of administrative courts as well as many aspects of labor, corporation and antimonopoly law).

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[3] For example: the *Physically Handicapped Employment Promotion Act* (1960), the *Child Abuse Prevention Law* and the *Child Welfare Law* (revised in 2007), the *Basic Law for Persons with Disabilities* (2004), the *Act on the Prevention of Spousal Violence and the Protection of Victims* (2001), the *Basic Law for a Gender-equal Society* (1999) and the *Second Basic Plan for Gender Equality* (2005).

[4] For example: International Covenant on Civil and Political Rights (entry into force 1979); International Covenant on Economic, Social, and Cultural Rights (entry into force 1979); Convention on the Rights of the Child (entry into force 1994); Convention Against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (entry into force 1999); Convention on the Elimination of All Forms of Discrimination Against Women (entry into force 1985); Convention on the Rights of Persons with Disabilities (signature 2007).

[5] International treaties are initially approved by the Cabinet, then by the Diet. Treaties are then automatically promulgated in the same way as statutory laws and are generally not converted into national law, making thus Japan a monist system. As the treaties need to be ratified by the Diet, it is generally agreed that international treaties are superior to statute laws.

3. **Are corporate/securities laws regulated federally, provincially or both?**

Corporate and securities laws are regulated at the national level in Japan. Japan is a centralized State rather than federal, and only the national level of government holds the power to regulate corporations and securities.

4. **Who are the government corporate/securities regulators and what are their respective powers?**

4.1 The Financial Services Agency

4.1.1 The main government corporate and securities regulator in Japan is the Financial Services Agency (FSA), bringing together several agencies and bodies.

The FSA acts on behalf and under the authority of the Cabinet Office[6]. It is in charge of inspecting and supervising private financial institutions as well as surveilling securities transactions.

The FSA is responsible for ensuring the stability of the Japanese financial system, the protection of depositors and investors, and the establishment of a fair and transparent market.

Two main bodies operate under the authority of the FSA: the "*Securities and Exchange Surveillance Commission*" (SESC) and the "*Certified Public Accountant and Auditing Oversight Board*" (CPAAOB).

4.1.2 The SESC is governed by the provisions of the *Financial Instruments and Exchange Act* and has a duty to enforce fair trading in financial and capital markets in order to maintain the investors' confidence in those markets. It reports any violation found as a result of its investigations to the Commissioner of the FSA. Its duties are (i) market oversight, (ii) inspection of financial instrument firms, (iii) inspection of disclosure documents, (iv) administrative monetary penalty investigations.

4.1.3 The CPAAOB was created by the *Certified Public Accountant Law*. Its authority is exercised independently from the FSA and it ensures reliable auditing and aims at improving the quality control of audit firms.

4.2 The Bank of Japan

The Bank of Japan is the central bank of Japan. It is an independent legal entity established by the *Bank of Japan Act*, and is not a government agency or a private corporation.

The *Bank of Japan Act* sets the Bank's objectives, which are "*to issue banknotes and to carry out currency and monetary control*" and "*to ensure smooth settlement of funds among banks and other financial institutions, thereby contributing to the maintenance of stability of the financial system*".

[6] Headed by the Prime Minister, the Cabinet Office - in cooperation with the Cabinet Secretariat - supports the Cabinet (the executive branch of the Japanese Government) in formulating important policies and in overall coordination of Ministries.

5. **Does the jurisdiction have a stock exchange(s)?**

Based on the volume of trading, Japan operates the second largest stock exchange in the world after the New York Stock Exchange. The Tokyo Stock Exchange (TSE) lists over 2,400 domestic companies and accounts for more than 90% of all securities transactions in Japan. One of the major functions of the TSE is the supervision of those who conduct transactions on the TSE market.

The other main stock exchanges in Japan are the Osaka Securities Exchange, the Nagoya Stock Exchange, the Fukuoka Stock Exchange, the JASDAQ Stock Exchange and the Tokyo Financial Futures Exchange.

6. **Do the concepts of "limited liability" and "separate legal personality" exist?**

The concepts of "limited liability" and "separate legal personality" exist in Japanese corporate law.

Available corporate forms have been deeply modified by the enforcement of the new *Company Act* of May 1, 2006. Four types of companies are now recognized: Joint Stock Corporations (*kabushiki kaisha*), Partnership Companies (*goumei kaisha*), Limited Partnership Companies (LPC or *goushi kaisha*), Limited Liabilities Companies (LLC or *goudou kaisha*). In addition two kinds of partnerships may be created: the Limited Liability Business Partnership (LLBP or *yugen sekinin jigyou kuminai*) and the Partnership (*nini kuminai*).

6.1 The concept of limited liability in the *Company Act*

6.1.1 The concept of limited liability exists in the Japanese *Company Act* and applies to Joint Stock Corporations (which is now the most commonly used corporate form in Japan, where each shareholder is required to make a capital contribution to the joint stock corporation for the shares to which they have subscribed and may not be held liable directly against creditors beyond the amount of their share subscription), LLCs and LLBPs.

6.1.2 In LLCs, as each member has a duty to operate the business affairs of the company, and if a member fails to perform such duty, he may be held liable for damages caused to the LLC or to third parties. In LLBPs, if a partner is malicious or grossly negligent concerning his/her duty, then his/her liability may exceed the amount of his/her contributions to the partnership.

6.2 The concept of separate legal personality in the *Company Act*

Joint Stock Corporations are independent legal entities where any right or obligation arising out of the company's activities belongs to the corporation itself, not to the shareholders. In addition, in such corporations, ownership and management can be legally separated.

In certain specific cases, Japanese courts have recognized a legal theory similar to the "piercing the corporate veil" doctrine and disregarded separate corporate status where such corporate status, when controlled by another person or company, is abused in order to elude statutory or contractual obligations.

The three other kinds of corporations (Partnership Companies, LPC and LLC) do not have a perfectly independent legal personality.

7. **Did incorporation or listing historically, or does it today, require any recognition of a duty to society, including respect for human rights?**

In Japan, no legal provision requires the recognition of a duty to society (including respect for human rights) for a company to be incorporated or listed. In addition, there is no legal provision making it mandatory for article of incorporation to comply with a broader legal landscape. However, the legal affairs bureau where articles of incorporation are filed may reject the application for incorporation of a company where the business objective lacks legality (*tekihousei*).

Therefore, incorporation may be considered as requiring the respect for human rights, through the broader criteria of legality of the business objectives.

In the Japanese culture, corporations are considered as social organizations. As a result, despite the apparent lack of binding provisions, the duty to society owed by corporations is generally naturally accepted.

8. **Do any stock exchanges have a responsible investment index, and is participation voluntary?**

Two responsible investment indexes exist in Japan: the Morningstar Socially Responsible Investment Index and the FTSE4Good Japan Index.

8.1 Launched by Morningstar Japan in 2003, the Morningstar Socially Responsible Investment Index (MS-SRI) selects companies by assessing their social responsibility in five areas: corporate governance, employment, consumer services, environment and social contributions.

A screening of all listed companies was carried out by a non profit organization: the Center for Public Resource Development. 150 companies were selected to be included in the index. In addition, Morningstar Japan provides Corporate Social Responsibility (CSR) reports on the selected companies.

8.2 FTSE4Good launched its own Japanese responsible investment index in 2004: the FTSE4Good Japan Index.

The FTSE4Good Japan Index has a double objective: (i) it is an investment tool for investors, through licenses for investment vehicles; (ii) the index is a precious tool for its members to manage their social, ethical and environmental risks more efficiently. This index has a two-level selection.

8.2.1 The first stage criteria for selection cover environmental sustainability, positive relationships with stakeholders and upholding and supporting universal human rights throughout the implementation of human rights instruments such as ILO Core Labour Standards, UN Global Compact, SA8000 and the Universal Declaration of Human Rights.

8.2.2 Following the first selection, a specific effort is required to encourage a continuous improvement of CSR over time. With this objective in mind, so-called evolving criteria were created. For example, companies with higher social and environmental impacts must meet stricter criteria. Should the companies fail to meet the evolving inclusion criteria, they would be removed from the Index.

8.3 Participation rules

The participation of corporations is mostly non voluntary, insomuch as Morning Star and FTSE4Good screen most listed companies, based primarily on public information on websites and annual reports. Therefore, a company may be included in the index without having to provide additional information. However, a company is welcome to submit such information, which will be incorporated in the decision making process.

9. To whom are directors' duties generally owed (i.e. to the company, non-shareholders etc)?

9.1 General principle

The *Company Act* provides that any director owes a "*duty of care of a good manager*" to the corporation in carrying out his/her duties based on a "*consignment*" relationship with the corporation.

In addition, the *Company Act* provides that each director shall "*comply with the law, the articles of incorporation, and resolutions of shareholders' meeting and to perform his/her duties with loyalty for the corporation*".

Finally, the *Company Act* provides that "*if a director […] neglects his/her duties, he/she shall be liable to such Stock Company for damages arising as a result thereof*".

In light of the above, directors' duties are generally owed to the company itself.

9.2 Liabilities to third parties

In addition to the above-mentioned general principle, pursuant to the Company Act each officer is jointly and severally liable for damage suffered by a third party other than the corporation (such as employees[7], shareholders, creditors of the corporation or any other third parties), which was caused by his/her intentional act or gross negligence in the performance of duties. As a consequence, one could consider that directors owe duties to these third parties.

A director may also be held liable toward third parties in tort under the Civil Code for his/her own willful misconduct or negligence or for the tortuous wrongdoing or misconduct of an employee or officer if the director is regarded as a "*person supervising the business on the employer's behalf*".

[7] Directors' liability to employees has been recognized in some cases. A judgment of the Court of Nagoya (May 18, 2005), ruled that Directors were liable in their own name to employees laid off due to economic difficulties that occurred as direct result of a Director's gross negligence.

10. **Are there duties to avoid legal risk and damage to the company's reputation? If so, are they duties in their own right or are they incorporated into other duties?**

The duty of care and loyalty and duty of supervision are the two main duties owed by directors mainly to the company, and are incorporated in their own right under the Japanese Company Act[8]. These provisions may be considered as introducing a general duty to avoid legal risk and damage to the company's reputation.

10.1 Duties of care and loyalty

As mentioned above, the *Company Act* provides that any director owes a "*duty of care of a good manager*" to the corporation in carrying out his/her duties based on a "*consignment*" relationship with the corporation.

In addition to such duty of care, the *Company Act* provides a duty of loyalty, whereby each director must "*comply with the law, the articles of incorporation, and resolutions of shareholders' meetings and to perform his/her duties with loyalty for the corporation*". According to court precedents, this duty of loyalty must actually be understood as to "*amplify and further clarify the duty of care of a good manager*".

Criteria have been established for the application of these duties. Court precedents have indeed created the so-called "*business judgment rule*" whereby a breach of the duties of care and loyalty is constituted where "*the act is considered grossly unreasonable from the viewpoint of whether or not there were careless mistakes in the recognition of facts and whether or not the choice of action based upon such recognized facts was unreasonable, in light of the knowledge and experience that a normal manager […] should have under the circumstances surrounding the company at the time the action was taken*".

10.2 Duties of supervision and to establish internal control systems

In addition, under the *Company Act*, directors are liable for their duty of supervision, whereby each director must ensure that the representative director and all other directors comply with the law and articles of incorporation.

The *Company Act* also gives directors a duty to establish internal control systems[9].

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[8] The duty of care and loyalty is provided by Article 355 of the Company Act: "*Directors shall perform their duties for the Stock Company in a loyal manner in compliance with laws and regulations, the articles of incorporation, and resolutions of shareholders meetings*";
The duty of supervision is provided by article 357 cl 1 of the Company Act: "*If directors detect any fact likely to cause substantial detriment to the Stock Company, they shall immediately report such fact to the shareholders (or, for a Company with Auditors, the company auditors)*".

[9] Such control systems are meant to ensure compliance of "*directors' performance of their duties […] with the law and the articles of incorporation and other systems designated by the Ministry of Justice ordinance as necessary to ensure appropriate business activities of the stock company*".

11. **More generally, are directors required or permitted to consider the company's impacts on non-shareholders, including human rights impacts on the individuals and communities affected by the company's operations? Is the answer the same where the impacts occur outside the jurisdiction? Can or must directors consider such impacts by subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?**

11.1 **Are directors required or permitted to consider the company's impacts on non-shareholders, including human rights impacts on the individuals and communities affected by the company's operations?**

There is no law which specifically requires directors to consider the company's impacts on non-shareholders.

However, directors may be required to consider the company's impacts on non-shareholders as mentioned herein (see para 9.2, 13.2 and 13.3) and as a result of:

- directors' duties of care of a good manager and of supervision (see para 10),
- the fact that directors could be criminally liable in case of violation of certain health and safety laws, or certain environmental laws,
- the specific duties of directors toward third parties and specific protection of creditors when the corporation is in insolvency proceedings.

In addition, directors are fully allowed to consider impacts on non-shareholders, and encouraged to do so by the Charter of Corporate Behavior of the Nippon Keidanren (see para 22.1) which insists on the necessity for companies and their directors to take into account consumers, members of society as a whole as well as environmental issues. Directors have a significant amount of discretion in determining how to do so.

11.2 **Is the answer the same where the impacts occur outside the jurisdiction?**

Directors may be required to consider impacts on non-shareholders which occur outside the jurisdiction as a result of directors' general duties of care of a good manager and of duties of supervision but there is no law which specifically requires directors to consider the company's impacts on non-shareholders occuring outside the jurisdiction.

However, directors are permitted to do so and even encouraged by the Charter pursuant to which, "*members shall observe laws and regulations applying to their overseas activities and respect the culture and customs of other nations and strive to manage their overseas activities in such a way as to promote and contribute to the development of local communities*". The Implementation Guidance for the Charter mentions more specifically that members must "*pay attention to local partners' progress on measures to fulfill their social responsibilities [and] if necessary support their efforts to enhance implementation*".

11.3 **Can or must directors consider such impacts by subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?**

Directors may be required to consider impacts by subsidiaries on non-shareholders which could affect the company as a result of directors' general duties of care of a good manager and of duties of supervision but there is no law which specifically requires directors to consider the company's subsidiaries impacts on non-shareholders, whether the impacts occur in or outside the jurisdiction.

12. **If directors are required or permitted to consider impacts on non-shareholders to what extent do they have discretion in determining how to do so?**

There are no specific laws and rules that require the directors to consider the company's impacts on non-shareholders in Japan. Directors are only required to consider impacts on non-shareholders in order to respect their general duty of care and the specific duties mentioned above regarding in particular the health and safety and the environmental laws (see para 10 and 11.1).

However, directors are fully allowed to consider impacts on non-shareholders, and, as mentioned above (see para 11.1), encouraged to do so by the Charter. Directors have a significant amount of discretion in determining how to do so.

13. **What are the legal consequences for failing to fulfill any duties described above; and who may take action to initiate them? What defenses are available?**

13.1 Civil Liability towards the company

When a director fails to fulfill his/her duties owed to the company, he may be held liable to compensate the company for any damage resulting from his/her failure to perform as required.

Where a company wishes to take action against a director, it is required to prove (i) a breach by the director of his/her duty, (ii) the amount of damage suffered by the company and (iii) the causation link between the two; i.e., that the breach caused the damage.

For certain matters – such as the unlawful distribution of dividends, unlawful provision of benefits in relation to the exercise of shareholders' rights or transactions in conflict with the company's interests – there are special rules imposing a presumption of negligence or strict liability and specifying the amount that the company can claim without proving the existence of specific damage.

The corporation itself is supposed to sue directors which have violated any of these duties. Yet, if a corporation does not sue directly, shareholders are entitled to sue the director by exercising the company's rights on behalf and in the name of the company.

In such case, the corporation itself may intervene in the lawsuit as assisting intervener on the side of the director upon the agreement of all company auditors.

Directors may be partially exempted from liability for damage to the corporation. Shareholders are entitled to make such a decision through a special resolution of the shareholders' meeting, as well as a resolution of the board if the articles of incorporation empower the board to do so. The *Company Act* provides a minimum limit to which the directors' potential liability can be reduced by the shareholders or the board of directors.

13.2 Civil Liability for damages towards third parties

Each officer is jointly and severally liable for damage suffered by a third party other than the corporation that was caused by his/her intentional act or gross negligence in the performance of duties.

In this case, as a result of the duty of supervision provided by the Company Act (see para 10), not only is the director who commits any such misconduct liable, but any other director who does not exercise a due level of care in monitoring that director may also be held liable to compensate the third party for damage resulting from his/her misdeed.

A director may also be held liable to third parties in tort under the Civil Code for the tortious wrongdoing or misconduct of an employee or officer if the director is regarded as a "*person supervising the business on the employer's behalf*". The onus is on the director to prove that he/she was not negligent in supervising the relevant employee or officer.

In addition, a third party could bring an action against directors (unless they can demonstrate that there was no negligence) provided that such party has suffered damage as the result of a failure to report as mentioned in 18.3 hereunder.

13.3 Criminal and administrative liability

Some directors' misdeeds result in criminal sanctions (for example, a violation of the duties assigned to directors by insolvency laws).

Should a director fail to comply with the duties defined under the *Company Act*, including the obligation to keep the corporate register up to date, such director may be subjected to administrative fines.

14. **Are there any other directors' duties which might encourage a corporate culture respectful of human rights?**

To our knowledge, there is no other specific duty which might encourage a corporate culture respectful of human rights. However a key point of the revision of the Charter of Corporate Behavior, adopted by the Nippon Keidanren in 2002, was the call to members' top management to strengthen their leadership by implementing ethical improvements in corporate systems and operations.

As a consequence, in compliance with the Charter:

- The members' top management, and therefore the directors of companies, are responsible for implementing the provisions of the Charter and for taking all necessary measures in order to raise awareness in their corporation and inform their group companies and business partners of their responsibilities. Top management shall also heed the voice of their stakeholders, both internally and externally (including local communities), and promote the development and implementation of systems that will contribute to the achievement of business ethics; and
- In the event of incidents contrary to the principles of this Charter, top management must investigate the causes of the incident, develop reforms to prevent recurrence, and make information publicly available regarding their intended actions for reform. After the prompt public disclosure of information regarding the incident, responsibility for the event and its effects should be clarified and disciplinary action should be taken, including the highest levels of management where necessary.

15. **For all of the above, does the law provide guidance about the role of supervisory boards in cases of two tier board structures, as well as that of senior management?**

The *Company Act* gives a lot of flexibility in organizing corporate organs and applies different rules depending on the combination: there are 39 combinations of corporate organs available.

15.1 Most Japanese companies have a two-tiered board structure, with a board of directors holding voting power, and a second tier of non-voting statutory auditors (or board of statutory auditors). In particular, large companies (i.e., with a stated capital of JPY 500 million or more, or liability section of the balance sheet of JPY 20 billion or more) and public companies (i.e., joint stock companies where all or part of the shares are not assignment restricted shares under the articles of incorporation) must have a statutory auditor (or a board of statutory auditors).

The duty of statutory auditors is to audit:

- financial documents, business report and supporting schedules thereof to be submitted to each shareholders' meeting and prepare an audit report for each business year; and
- whether the operation of corporate affairs executed by the directors violates the statutes and articles of incorporation, and involves significantly improper matters.

15.2 A small percentage of corporations have adopted UK and US-style three-committee board structures as encouraged by amendments to the Japanese company law in recent years. Such companies have three committees: an appointment committee, an auditing committee and a compensation committee. A corporation with committees must have a board of directors and accounting director, but cannot have a statutory auditor. Each committee must consist of three or more directors appointed from among the directors by the board of directors and the majority of members of each committee must be external directors[10].

The auditing committee mainly holds the role of supervision. The duties of the auditing committee are (i) to audit the performance of the executive officers (in charge of the operation of business affairs of the corporation and appointed by the board of directors), directors and accounting consultant (certified public accountant, audit corporation, certified public tax consultant or tax consultant corporation in charge of the preparation of financial documents and supporting annexes jointly with the directors), (ii) to prepare an audit report, and (iii) to decide on proposals concerning the appointment, dismissal and refusal of reappointment of an accounting auditor.

In addition, a designated member of the auditing committee can request the executive officers and directors (or a subsidiary) to report on their performance of duties and investigate the status of the business affairs and assets of the corporation (or of the subsidiary).

[10] i.e. a director who is not and was not in the past an executive director, executive officer, general manager or any other type of employees of the corporation or its subsidiary.

16. **Are companies required or permitted to disclose the impacts of their operations (including human rights impacts) on non-shareholders, as well as any action taken or intended to address those impacts, whether as part of financial reporting obligations or a separate reporting regime?**

16.1 Japanese corporations are required to publicly disclose their balance sheet – together with their annual statement of income for large corporations – without delay after each annual general meeting ("AGM") of the shareholders.

Additional information such as AGM reference material and in particular a business report must be disclosed. However there are no specific requirements for such reports to contain particular information regarding the impact of their operation on non-shareholders.

Under the *Financial Instruments and Exchange Law*, a reporting company (i.e., a listed company, an over-the-counter company, a company that was required to file a registration statement or a company with 500 or more shareholders) must file an annual securities report within three months of the end of each business year, and quarterly or semi-annual reports. An audited "*internal control report*" must be attached to such report for listed or over-the-counter corporations.

The annual securities report must include (i) the trade name of the company, (ii) the financial conditions of the company's corporate group, and (iii) any other significant matter concerning the company's business as necessary and appropriate for the public interest or the protection of investors (including information on corporate governance).

However, from a legal standpoint, there is no absolute legal obligation to disclose information related to the impact of the company's activity on non-shareholders (especially human rights impacts) as long as such impact is not significant for the company (should it be the case, for instance in case of environmental litigation with a significant amount of money at stake, it would become mandatory to disclose such information for the public interest or the protection of investors).

16.2 Despite the absence of a legal obligation, Japanese companies are clearly allowed to publish Corporate Social Responsibility (CSR) reports and many do so. Such reports are often part of the annual report and increasingly conform to the guidelines of the Global Reporting Initiative (GRI). The GRI, created in 1997, has established a common framework designed to be used by members to shape harmonized and broadly user-friendly CSR Reports.

The GRI places a specific focus on impacts on non-shareholders, especially as regards human rights, through specific human rights indicators such as the "ILO Tripartite Declaration Concerning Multinational Enterprises and Social Policy" and the "Organisation for Economic Cooperation and Development Guidelines for Multinational Enterprises". GRI compliant reports "*should include the entities over which the reporting organization exercises control or significant influence*", including subsidiaries, joint-ventures or subcontractors.

With 43 Japanese corporations (which are – based on our information – all large corporations), releasing GRI compliant reports in February 2009 (out of 828 in the world), Japan ranks fourth after the United States, Spain and Brazil.

In addition, the Keidanren Charter of Corporate Behavior (see para 22.1) provides that "*members shall engage in communication not only with shareholders but also with members of society at large, including active and fair disclosure of corporate information*".

17. **Do reporting obligations extend to such impacts or actions outside the jurisdiction; to the impacts or actions of subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?**

17.1 As mentioned, there is no particular legal reporting obligation regarding impacts on non-shareholders. However, based on the fact that annual reports shall include any significant matter concerning the company's business as necessary and appropriate for the public interest or the protection of investors (see para 16.1), if the companies believe that impacts or actions of the company outside the jurisdiction or impacts of actions of subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction are significant, companies must report them.

17.2 In addition, when a company decides to report in accordance with the GRI guidelines, the indicators are applicable at the level of the economic organization and not limited to a jurisdiction. In addition, whether human rights are taken into account in investment decisions or in supplier/trading partner selection is part of the indicators retained by the guidelines.

17.3 Finally, as mentioned above, the Keidanren Charter of Corporate Behavior is quite precise regarding activities outside the jurisdiction, whether they are the consequences of the corporation's or its subsidiaries' behavior (see para 11.2).

18. **Who must verify these reports; who can access reports; and what are the legal consequences of failing to report or misrepresentation?**

18.1 Auditing the reports

The assessment of mandatory reports is made at two different levels: internally by statutory auditors and accounting auditors and outside the company under the Financial Services Agency rules.

In corporations with statutory auditors or committees (see para 15), financial documents and associated documents (including the business report) are subject to audits by the statutory auditors (or auditing committees) and accounting auditors, as applicable.

Since 2005, the Financial Services Agency (FSA) may conduct disclosure document inspections. Such inspections are one of the five core missions of the SESC (see para 4.1.2). The Civil Penalties Investigation and Disclosure Documents Inspection Division inspects disclosure documents such as financial statements and registration statements, etc.

18.2 Access to the reports

Some of the reports mentioned above must be released publicly and are therefore freely accessible to anybody. Such is the case for balance sheets, statements of income, annual securities reports, internal control reports, as well as quarterly and semi-annual reports.

Some reports are only accessible to shareholders and statutory auditors, committees and accounting auditors. Such is the case for financial documents and business reports.

CSR Reports which are published on a voluntary basis are freely accessible and generally posted on the company's website.

18.3 Legal consequences of failing to report

Like any violation of applicable statutory regulations and breach of the duty of care of directors, violation of disclosure requirements could cause an action to be brought against an officer or an accounting auditor for the breach of duty to the corporation.

Moreover, a third party could bring an action against directors, unless directors can demonstrate that there was no negligence, if this party has suffered damage as the result of (i) a false statement in the materials used to give an explanation of the business, (ii) a false statement regarding material matters included in the financial documents, the business report, supporting annexes thereto, or the extraordinary financial documents, (iii) a false registration, or (iv) a false public notice[11].

In addition, where it discovers false or misleading statements of material facts contained in disclosure documents in the course of its inspections, the SECS may recommend to the Prime Minister and to the Commissioner of the FSA that they issue an order to pay administrative civil monetary penalties. Such civil penalties were introduced in order to prevent fraudulent disclosures in the Japanese market, which were at the core of scandals in the early 2000s. The civil fines are indeed regarded as more efficient than criminal penalties to prevent disclosure of false or misleading information.

19. Are there any restrictions on circulating shareholder proposals which deal with impacts on non-shareholders, including human rights impacts?

19.1 Under Japanese law, a shareholder who holds a certain ratio or number of voting rights for a certain time period may request that directors introduce a resolution on the agenda of a shareholders' meeting and may request the directors to include particulars of his/her proposal in the notice of convening to be sent to each shareholder.

The prerequisites for this right to be exercised depend on the type of corporation at hand[12].

In order to exercise such right (i) the proposal to be notified must not be in violation of any provision of applicable laws or the articles of incorporation, and (ii) 3 years must have passed since a substantially similar proposal received a favorable vote of less than 10%.

As a consequence, in theory, nothing prevents a resolution from being proposed that concerns impacts on non-shareholders, including human rights impacts and neither the company itself nor the regulators can influence such issue.

[11] We are not aware of any action based on false statements relating to social/environmental reporting.

[12] In the most common form of Joint Stock Company, the shareholder has to own at least 300 or more, or 1% or more, of voting rights held by all shareholders and to hold it for 6 months.

In addition to their proposal rights, each shareholder may submit proposals during the shareholders meeting with respect to the matters that are on the agenda of such shareholders meeting.

19.2 The past few years have seen an increasing number in shareholder proposals. This is due partly to "activist" funds pressuring management to raise corporate value and increase returns to investors[13].

As an example of shareholders' proposals dealing with impacts on non-shareholders, the Kabunushi Ombudsman, an organization supporting shareholder advocacy, presented shareholders' proposals to prevent companies from entering into illegal bid-rigging arrangements with other parties by adopting an amendment to the articles of incorporation. Another feature relating to environmental and societal issues in Japan is the persistent and dynamic shareholders' movement targeting electrical power utilities, essentially as part of the citizens' movement against nuclear power.

20. **Are institutional investors, including pension funds, required or permitted to consider such impacts in their investment decisions?**

We did not identify any institutional investor, including pension funds which are required to consider impacts on non-shareholders, including human rights, of corporations in Japan. Nevertheless, institutional investors are allowed to consider such impacts and some Japanese institutional investors take such impacts into account in their investment decisions.

As of September 2007, the Sociable Responsible Investment (SRI) market in Japan was estimated at JPY 840 billion, including JPY 747 billion in SRI investment trusts. With around 60 funds in 2008 out of 235 in Asia, Japan gathers more SRI funds than any other Asian country[14].

21. **Can non-shareholders address companies' annual general meetings?**

Under Japanese law, there is no particular rule regarding the possibility for a non-shareholder to address companies' annual general meetings.

The answer therefore varies depending on the articles of incorporation of each company, which may limit the access of the annual general meetings to the shareholders.

If no provision exists in the company articles of incorporation, the chairperson of the shareholders meeting must maintain the order of such general meeting and organize the business of the meeting. If necessary, the chairperson of the meeting may require anyone who does not comply with his/her orders or who otherwise disturbs the order of such meeting to leave the room.

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[13] In 2007, funds and investment managers, or institutional investors, made 48% of the proposals, but in 2008 the proposals submitted by individual shareholders accounted for 74% of all proposals, while institutional investors made only 13% of the proposals. Regarding the content of shareholder proposals, 43% of the proposals made in 2007 regarded increases to dividends. But in 2008, such proposals went down to about 20% of all proposals.

[14] For example: The Nikko Eco Fund (1999), UBS Japan Equity Eco Fund (1999) or Russel Global Environmental Technology Fund (2008).

22. **Are there any other laws, policies, codes or guidelines related to corporate governance that might encourage companies to develop a corporate culture respectful of human rights, including through a human rights due diligence process?**

22.1 The Keidanren Charter of Corporate Behavior

The initiative of Nippon Keidanren, the Japanese Business Federation, which adopted the Charter of Corporate Behavior in 1991, is the most important example of "industry-driven" Corporate Social Responsibility policies in Japan (see para 11.2, 14, 16.2, 17.2). The last version of this Charter dates back to May 18, 2004 and asserts that companies should "*take social responsibility flexibly and voluntarily*". Agreeing that corporations need to "*enhance their social significance and value*", the Keidanren has written ten principles in its Charter, some of them being directly related to human rights. Although this Charter is a voluntary initiative of the Nippon Keidanren[15] and is not legally binding, the Charter has had significant results in terms of influencing company behavior.

The Charter aims to encourage companies to adopt new standards, including taking into account human rights concerns. Pursuant to the Charter "*Members are expected to respect human rights and to conduct themselves in a socially responsible manner toward the creation of a sustainable society*" and such improvement should "*enhance the social value*" of corporations, especially by meeting the needs of all stakeholders[16].

The Charter also explicitly mentions the need of "*communication […] with members of society at large*" (principle 4), and that "*a positive involvement in environmental issues is […] an essential part of [members'] activities and their very existence as a corporation*" and is thus directly related to CSR.

In addition, the Keidanren Charter of Corporate Behavior insists on the necessity for companies to "*earn the confidence of their consumers and customers, while taking necessary measures to protect personal data and customer related information*" (principle 1), to "*engage in communication not only with shareholders but also with members of society at large, including active and fair disclosure of corporate information*"(principle 3), and to "*recognize that a positive involvement in environmental issues is a priority for all humanity and is an essential part of their activities and their very existence as a corporation* " (principle 5).

In addition, the Keidanren has published Implementation Guidance to facilitate the implementation of the Charter (see para 11.2). It is worth mentioning that the Charter principles seem more precise and restrictive than the principles set out by the Global Compact (see para 22.2). However, the Charter has never been codified as a result of Keidanren's policy to preserve the principle of voluntary application of the Charter.

22.2 The Global Compact

The Global Compact is a UN initiative for businesses willing to align their operations and strategies with ten "*universally accepted principles*" two of which deal with human rights (businesses "*should support and respect the protection of internationally proclaimed human rights*" and "*make sure that they are not complicit in human rights abuses*"). Its goal is to foster good corporate practices and to harmonize CSR throughout the world. This Global Compact gathers over 4700 members, 75 of whom are Japanese corporations and

[15] The Government has no power in administering or providing guidance to the Charter.

[16] The Charter does not mention any international human rights instruments in making this statement and only refers to the "*spirit as well as the letter of all laws and regulations applying to their activities both in Japan and abroad*".

a Compact's local network, the Global Network Japan, has been created in Japan in 2003.

22.3 A natural awareness of human rights concerns in Japanese corporations

Japanese culture strongly differs from others where companies are mainly thought as the property of shareholders. Corporations in Japan have a very special role insomuch as they are considered as social organizations. It is why, despite the apparent lack of binding provisions in statutes or in the law, the duty to society owed by corporations is generally accepted and naturally applied.

As noted throughout this report, through specific laws (see para 12), private initiatives (see para 22.1 and 22.2) as well as individual compliance codes (see para 22.4), Japan has a number of soft law policies and initiatives that encourage companies to develop a culture respectful of human rights.

Human rights and CSR are, to a certain extent, rooted in the Japanese methods of management. The Fujitsu Research Institute underlines that CSR in Japan is "*industry-driven*", as opposed to the United States where CSR is more "*market-driven*" (pressure of investors and shareholders) and to European Union countries where it is "*policy-driven*".

22.4 Individual compliance codes

In addition to the Keidanren Charter, certain Japanese companies have also individually adopted their own compliance code with similar provisions, including references to the respect of human rights. Their role is essentially to prevent corporate misdeeds (corruption, fraud) and to reassure the different stakeholders[17].

23. **Are there any laws requiring representation of particular constituencies (i.e. employees, representatives of affected communities) on company boards?**

No particular constituencies are required to be represented on company boards under Japanese company law. However such requirement may arise from the articles of incorporation.

24. **Are there any laws requiring gender, racial/ethnic representation; or nondiscrimination generally, on company boards?**

Pursuant to the Constitution: "*all of the people are equal under the law and there shall be no discrimination in political, economic or social relations because of race, creed, sex, social status or family origin*".

As a result, there can be no discrimination between members of the board for any gender, racial or ethnic reason and there are no specific provisions under law requiring minimum quotas of different ethnic groups or communities on company boards or in relation to gender representation[18].

[17] Pioneer adopted the *Pioneer Group Charter for Corporate Operations*, Mazda has approved the *Mazda Human Rights Declaration* and established a *Human Rights Committee*, and in 2004 Ricoh has adopted the *Ricoh Group Social Responsibility Charter*, containing eleven principles in four areas: Integrity in Corporate Activities, Harmony with the Environment, Respect for People, and Harmony with Society.

[18] So far there has been no law regarding the introduction of quotas, but it can be assumed that such a law would be declared unconstitutional.