Japan Corporate & Finance Insights November 2021

Topics

- ✓ **Corporate Indemnity 1**
- ✓ **Amendment of Request for the Inspection or Copying of Voting Forms and Other Amendments 9**

Corporate Indemnity

By Takahiro Fuchigami and Hiroki Tsuda

November 30, 2021

The amendment to the Companies Act (the "**Amended Companies Act**") was enacted on December 4, 2019, and most of the amendment, including the revisions regarding indemnity agreements, came into effect on March 1, 2021. This article outlines these revisions.

I. Corporate Indemnity under the Former Law

"**Corporate Indemnity**" herein means a company's indemnification of an officer thereof for all or part of the following in connection with the performance of his/her duties: (i) expenses arising in the course of handling an alleged violation of laws and/or regulations or a civil claim ("**Defense Costs**") and/or (ii) losses incurred by an officer liable for damages incurred by a third party ("**Losses Due To Liability to Third Parties**").

Corporate Indemnity has the advantage of providing appropriate incentives for executives to perform their duties, preventing them from paralysis in fear of personal liability for damages.

Before the amendment, the Companies Act did not directly provide for Corporate Indemnity, and the

scope of and procedures for Corporate Indemnity were not established in regulations. Accordingly, Corporate Indemnity was not common practice in Japanese companies. It was therefore argued that this situation may be an obstacle to companies inviting executives from abroad, where indemnity agreements are commonly concluded between officers and companies[1].

II. New Law (Article 430-2 of the Companies Act)

A. General

An indemnity agreement is defined as "a contract in which a stock company undertakes to indemnify the officers, etc., of the stock company for all or part of the following expenses, etc." (Paragraph 1).

The individuals to which indemnity agreements may apply are officers, which means directors, accounting advisors, corporate auditors, executive officers, and accounting auditors. Since Article 430-2 does not explicitly state that it also applies to retired officers, it can be interpreted that this Article 430-2 does not apply to retired officers and that Indemnity Agreement can be executed with retired officers notwithstanding the provisions of Article 430-2. However, considering that it is not clear whether it applies to retired officers and that the directors of the company entering into the indemnification agreement have a duty of care, it is recommended to obtain a resolution of the general meeting of shareholders (or the board of directors in the case of a company with board of directors) in accordance with the provisions of Article 430-2.

The Companies Act provides that the scope of indemnification under an indemnity agreement shall be all or part of the following expenses (each Item of Paragraph 1):

(1) Defense Costs;
(2) Losses Due To Liability to Third Parties (including not only losses arising from the compensation of damages by the officer, but also losses arising from the payment of settlements[2] by the officer)

A typical example of the Defense Costs is attorney's fees. Even if an officer engages in willful misconduct or is grossly negligent in performing his/her duties, the stock company may indemnify the

[1] Even under the earlier Companies Act, some scholars believed that indemnification was possible under Article 330 of the Companies Act and Article 650(3) of the Civil Code in cases where officers were not negligent. However, it was not clear whether officers may be indemnified for their cost and losses in cases where officers were negligent.

[2] The settlements include both judicial and extrajudicial settlements.

officer for costs under an indemnity agreement. The specific timing and procedures for paying the officer will depend on the terms and conditions of the indemnity agreement. In addition, any expenses related to the performance of business prior to the conclusion of the indemnity agreement may also be included in the scope of the indemnity agreement.

Losses Due To Liability to Third Parties is limited to the liability of the officer to a third party for damages and does not include the liability of the officer to the company itself. In addition, fines and penalties due to criminal or administrative proceedings may not be included in the scope of an indemnity agreement, because the inclusion of such fines and penalties may circumvent the purpose of the law imposing such fines and penalties.

It is legally permissible for an indemnity agreement to provide that the relevant officer will be paid a reasonable amount before the amount of compensation or settlement that the officer must pay is fixed, as officers may not have the resources to pay such compensation or settlement.

B. Details of Regulations on Corporate Indemnity

1. Procedures for Execution of Indemnity Agreement (Paragraph 1)

A resolution of the board of directors (or of a general meeting of shareholders for a company without a board of directors) is required to execute an indemnity agreement.

At the time of the resolution, the director party to the indemnity agreement is considered an “interested director” under Paragraph 2 of Article 369, which means a director with a special interest in the subject of the resolution in question, and cannot participate in the deliberation or the resulting resolution.

Regarding companies with an audit committee, a nominating committee, or auditors, the revised Companies Act clearly states that the board of directors may not delegate decisions regarding the terms and conditions of indemnity agreements to directors or executive officers (Paragraph 5(12) of Article 399-13; Paragraph 4(14) of Article 416).

If the company fails to follow the procedures under the Company Act, the related indemnity agreements will be invalid.

2. Expenses that Cannot be Indemnified under an Indemnity Agreement (Paragraph 2)

There are limits on the expenses for which a company can indemnify an officer under an indemnity agreement. If there were no such limit, the propriety of the officers' performance of their duties might be called into question.

The following costs may not be indemnified under an indemnity agreement pursuant to Article 430-2:

(1) Regarding the Defense Cost, expenses in excess of what is ordinarily required;
(2) Regarding the Losses Due To Liability to Third Parties, expenses for which an officer would be responsible to refund the company pursuant to Paragraph 1 of Article 423, if the company indemnifies the officer for damages to a third party in accordance with Paragraph 1(2) of Article 430; and
(3) Regarding the Losses Due To Liability to Third Parties, all compensation and settlements arising from the officer's willful misconduct or gross negligence in the performance of his/her duties.

3. Refund of Defense Costs in relation to Profit-Making or Damage-Causing Purposes (Paragraph 3)

If a company becomes aware that an officer has sought illegal profits for him/herself or a third party or to cause damage to the company in the course of his/her duties ("**Profit-Making or Damage-Causing Purposes**"), the company may require the officer to refund the amount for which the company indemnified the officer in relation to Defense Costs. Profit-Making or Damage-Causing Purposes are considered to include, for example, breaches of trust, embezzlement, and insider trading for personal benefit. It should be noted that a refund cannot be claimed simply because the officer had malicious intent or was negligent in the execution of his/her duties; he/she also must have had Profit-Making or Damage-Causing Purposes.

While it is believed that a company may refuse to indemnify an officer on the grounds that he/she had Profit-Making or Damage-Causing Purposes, this is not clear in the language of the Amended Companies Act, so we recommend clearly stating this provision in indemnity agreements. Although indemnifying officers even if the company is aware of their Profit-Making or Damage-Causing Purposes is not necessarily prohibited, it is considered necessary for directors of a company to carefully consider whether such decision is appropriate in order to avoid breaching their duty of care.

4. Report to the Board of Directors regarding Indemnification (Paragraphs 4 and 5)

In a company with a board of directors, the director who implements the indemnification and the director who receives the indemnification pursuant to an indemnity agreement must report the material facts of the indemnification to the board of directors without delay. This is a similar regulation as that required in relation to transactions involving conflicts of interest under the Companies Act. As indemnification based on an indemnity agreement constitutes a transaction involving a conflict of interest, this regulation was put in place so that the board of directors may subsequently review the indemnification. (As is explained later, the regulation regarding transactions involving conflicts of interest under the Companies Act does not apply to the implementation of indemnification, which is why this provision was put in place.) This same kind of report is required where an executive officer receives indemnification[3].

The "material facts" to be reported are (i) the indemnification itself and (ii) information sufficient to determine whether the indemnification is appropriate based on the nature and contents of the indemnity agreement, such as the type of loss compensated; the details of the liability regarding the indemnification; and the amount, conditions, and term of the indemnification.

Further, a resolution of the board of directors may be required for the indemnification if it is deemed important to the company in terms of the nature of the case, the amount, etc., and the implementation of the indemnification is itself considered an "important business execution decision" (Paragraph 4 of Article 362).

5. Exceptions to the Application of the Companies Act — Transactions Involving Conflicts of Interest (Paragraph 6)

Under the Companies Act, when an officer enters into a transaction that conflicts with the interests of the company, the officer's liability is presumed if the company suffers damage as a result of such transaction (Paragraph 3 of Article 423), and neither partial exemption from liability nor the conclusion of a liability limitation agreement is permitted (Paragraph 2 of Article 428).

While the conclusion of an indemnity agreement is considered to be a transaction involving a conflict

[3] There is a difference of opinion regarding whether a report by the director implementing the indemnification is required when an officer other than a director or an executive officer (e.g. auditor, accounting auditor, accounting advisor) receives indemnification under an indemnification agreement.

of interest, this regulation does not apply to indemnity agreements, because the application of the regulation to indemnity agreements may result in easily incurred liability of the officers, which would defeat the purpose of such agreements.

6. Disclosure

(a) Disclosure in business reports

As indemnity agreements may affect the propriety of the performance of the duties of officers, etc. and generally involve highly conflicting interests, information regarding indemnity agreements is important for shareholders. Particularly in cases where all directors have entered into similar indemnity agreements, it may not be possible to sufficiently supervise the nature of such agreements solely by resolutions of the board of directors. Therefore, when a public company has entered into an indemnity agreement with an officer or implemented indemnification based on an indemnity agreement, the company is required to disclose the following information in relation to the indemnity agreement in its business report to the shareholders.

Execution of Indemnity Agreement	i) Name of the officer ii) Outline of the indemnity agreement iii) Details of the measures taken to ensure that the propriety of the officer's duties is not impaired by the indemnity agreement (if any)
Indemnification of Defense Costs	Information regarding the company's knowledge of an officer's violation of laws and/or regulations or liability in a civil action (including in relation to officers who retired before the end of the business year preceding the relevant business year) and any compensation of Defense Costs based on an indemnity agreement provided by the company to the relevant officer
Indemnification of Compensation/Settlement	Information, including the amount thereof, regarding the compensation of officers based on an indemnity agreement (including officers who retired before the end of the business year preceding the relevant business year) in relation to compensation or settlement

Disclosing information material to shareholders, including a general outline, the scope of the loss that may be compensated, and the conditions for indemnification, is considered sufficient in relation to outlines of indemnity agreements.

(b) Disclosure in reference documents for shareholders meetings/annual securities reports

If an indemnity agreement has been or will be concluded with a candidate for an officer position to be elected at a shareholders' meeting, the details of the indemnity agreement should be stated in the reference documents for the relevant shareholders meeting.
Additionally, a listed company must state the details of all indemnity agreements with its officers in its annual securities report.

III. Use of Indemnity Agreements and D&O Insurance

Indemnity agreements and D&O insurance both aim to secure excellent human resources and to provide appropriate incentives to executives. However, indemnity agreements and D&O insurance differ in that indemnity agreements are not required to set a limit on the indemnification amount and can cover the full amount of any contemplated expense, while D&O insurance can cover damages to the company but might not cover the full amount of damages due to exemptions, deductibles, and payment limits that are often set in an insurance contract. Therefore, indemnity agreements and D&O insurance have complementary roles.

IV. Transitional Measures

The provisions of the Amended Companies Act regarding indemnity agreements apply only to agreements entered into after the amendment came into force (on or after March 1, 2021) and do not apply to agreements entered into prior to this date (Article 6 of Supplementary Provisions). If the amendment were to apply to indemnity agreements concluded before its enforcement, the regulations on transactions involving conflicts of interest under the Companies Act would not apply to indemnity agreements concluded without a resolution of the board of directors, which might cause such agreements to be abused.

Although indemnity agreements executed before the enforcement of the amendment are still effective, concluding a new agreement with a resolution of the board of directors is desirable, as the interpretation of existing agreements (such as the scope of indemnification) is unclear.

*　　*　　*

If you have any questions regarding the matters covered in this memorandum, please reach out to your usual TMI contact or any of the attorneys listed below.

Authors

Takahiro Fuchigami
Phone: +81 3 6438 4552
Email: tfuchigami@tmi.gr.jp

Hiroki Tsuda
Phone: +81 3 6438 6143
Email: htsuda@tmi.gr.jp

Amendment of Request for the Inspection or Copying of Voting Forms and Other Amendments

By Akihiro Goda and Taro Matsumoto

November 30, 2021

We have issued newsletters explaining the amendments concerning the major issues of the amendment of the Companies Act ("**Amended Companies Act**"). In this article, we will provide an overview of the amendment regarding (i) the inspection or copying of Voting Forms,[4] (ii) settlement in a lawsuit pertaining to an action for pursuing liability, (iii) information for advance disclosure concerning consolidation shares, (iv) registration concerning share options and the location of branch offices of a company, and (v) qualifications of directors.

I. Inspection or copying of Voting Forms

A Outline of the inspection or copying of Voting Forms

Under the Companies Act prior to the amendment, unlike the request for the inspection of the shareholder registry (Article 125 of the Companies Act), (i) a shareholder was not required to specify the reason for requesting inspection and copying of Voting Forms, and (ii) there were no explicit provisions regarding grounds for refusal by the company. However, the Voting Forms may include the name and address of shareholders similarly to the shareholders registry. In this regard, for example, if a request for inspection and copying of Voting Forms was made by a shareholder for the purpose of selling such information to a so-called list broker, it was a general understanding that the company could refuse the request as an abuse of rights (Article 1, Paragraph 3 of the Civil Code). However, the view that provisions regarding the grounds for refusal of a request for inspection and copying of the list of shareholders can apply mutatis mutandis to a request for inspection and copying of

[4] In this Article, the word "Voting Forms" has the meaning of (i) documents and electromagnetic records certifying the right of representation when voting rights are exercised by proxy, (ii) voting forms, and/or (iii) electromagnetic records provided by shareholders for the exercise of voting rights by electromagnetic means.

Voting Forms has been criticized for there being no need, without any explicit provision in the law, to expand such grounds for refusal of a request for inspection and copying of Voting Forms. In addition, practically speaking, it was difficult for a company to refuse an inspection and copying on the grounds of an abuse of rights, since there is no explicit provision in the law for denial. In response to the above concerns, the amendment newly stipulates that "the reason for the request must be clarified" when making a request for inspection and copying of a Voting Form and explicitly defines the grounds for refusal of such request.

This amendment will apply to requests for inspection and copying of Voting Forms submitted after the enforcement of the Amended Companies Act (March 1, 2021).

B Refusal by Company to Request Inspection and Copying

The purpose of the new provision requiring a reason for the request is to make it easier for the company to determine whether or not there are grounds for refusal (Article 310(8), 311(5) and 312(6) of the Amended Companies Act).

For this purpose, the Amended Companies Act specifies the following four grounds for refusal. A company may refuse a request for inspection only if it can prove that the request falls under one of the statutory grounds for refusal. If the company refuses the request for inspection despite that there are no grounds for refusal, the director may be sanctioned with an administrative fine.

a When a request is made for a purpose other than the investigation regarding securing or exercising a right of the requestor

Since the right to request inspection and copying of Voting Forms for exercising voting rights should be exercised by a shareholder for their own interests as a shareholder, a request for a purely personal purpose that is other than for a purpose based on such shareholder's qualification as a shareholder should not be allowed. Examples for refusal based on this ground include cases in which a request for inspection and copying is made for the purpose of sending direct mail about one's own products, or a request for inspection and copying is made for personal interest such as academic interest.

On the other hand, while it will depend on the individual case, it is the view of the proposers of the Amended Companies Act that if a shareholder makes a request for

inspection of Voting Forms for the purpose of soliciting other shareholders to satisfy the shareholding requirement necessary for the exercise of minority shareholders' rights, the shareholder would be considered to make requests to inspect Voting Forms for the purpose of conducting investigations regarding the securing or exercise of the shareholder's rights, and, therefore such case is not immediately considered to be grounds for refusal of a request for inspection and copying.

b When a request is made for the purpose of obstructing the business of the company or harming the common interests of shareholders

Requests for inspection and copying for the purpose of harming the operation of a company's business or the common interests of shareholders are not justified. Specifically, a case where a shareholder unnecessarily makes a request for inspection and copying of Voting Forms several times in succession would be a case in which such ground for refusal applies.

c When a request is made to inform a third party of a fact obtained by the requestor through inspection or copying for a profit

Under the previous Companies Act, there have been reports of cases where requests for inspection and copying of Voting Forms were made in order to sell shareholders' personal information to so-called list brokers. Such requests are not for exercising the rights in the interests of shareholders, and may harm the privacy of shareholders, and, therefore, cannot be justified.

d When the requestor has reported to a third party within the past two years the facts obtained through inspection or copying for a profit

For the same reason as that described in c. above, a company receiving a request from a person who reported to a third party for a profit about certain facts obtained by an inspection or copying within the past two years from the date of such request for inspection and copying may refuse such request. It should be noted that the previous record within the past two years does not have to be related to the company receiving the request for inspection and copying, and it is considered sufficient if such previous record exists for any company.

II. Settlement in a Lawsuit pertaining to an Action for Pursuing Liability

When a stock company with statutory auditors, etc. desires to enter a settlement in a lawsuit pertaining to an action for pursuing liability of a director, the consent of the statutory auditors, etc. in accordance with the classification of the stock company shall be required as follows (Article 849-2 of the Amended Companies Act):

Classification of the stock company	Consent required from
Company with Statutory Auditors	Statutory auditor (if there are two or more statutory auditors, each statutory auditor's consent is required)
Company with an Audit and Supervisory Committee	Each audit and supervisory committee member
Company with a Nominating Committee	Each audit committee member

Before this amendment, there were no explicit provisions relating thereto, and procedures for the settlement in a lawsuit pertaining to an action for pursuing liability of a director were unclear. This amendment intends to resolve such ambiguity.

III. Information for Advance Disclosure concerning Consolidation Shares

While the squeezing-out of minority shareholders by delivering cash as consideration is usually conducted by means of consolidating shares, the following items were added as prior disclosure information with respect to the procedure for the treatment of fractional shares less than one share that result therefrom (Article 182-2 of the Amended Companies Act, Article 33-9, Item 1(b) of the Regulation for Enforcement of the Companies Act).

- whether the disposition of the number of shares equivalent to the total sum of the fractional shares is planned to be by auction or sale other than auction;
- the reasons, and expected timing therefor;
- in the case of sale other than auction (excluding transactions conducted in the market), the name of the person who is expected to purchase the shares pertaining to the sale, the method by which such person will secure funds for the payment of the sale price and the reasonableness of such method, and the expected timing of the sale and the expected timing of delivery of the price obtained from the sale to the shareholders; and
- the amount of money to be paid to holders of the fractional shares and the reasonableness

thereof.

If a resolution is passed at a general meeting of shareholders regarding a share consolidation after the effective date of the Amended Companies Act (March 1, 2021), the above regulations will apply.

IV. Registration concerning Share Options and the Location of Branch Offices of a Company

A Registration concerning Share Options

Prior to this amendment, in the case of an issuance of share options for subscription with cash consideration, not only the amount to be paid in for the share options for subscription, but also the calculation method of the amount to be paid in for the share options for subscription were required to be decided in principle, and upon the issuance, these items were required to be registered in the commercial registration even if the amount to be paid in for the share options for subscription has been fixed by the time of the application for registration, which resulted in unnecessary burdens on applicants.

Under the Amended Companies Act, the registration of the amount to be paid in for the share options for subscription suffices in principle, and the registration of the calculation method is not required unless the amount to be paid in for the share options for subscription has not been fixed by the time of the application for registration (Article 911, Paragraph 3, Item 12 (f) of the Amended Companies Act).

The above provisions shall apply to applications for the registration of the matters in connection with the registration of the issuance of stock options for subscription filed after the enforcement of the Amended Companies Act (March 1, 2021). Registrations filed prior to such date shall be governed by the previous provisions of the Companies Act.

B Registration concerning the Location of Branch Offices of a Company

The requirement for the registration of the location of a company's branch office (the former Articles 930 to 932) has been deleted by this amendment due to the fact that there is a strong need to reduce the burden of such practice, and to the fact that the development of the

Internet has facilitated searches.

This amendment shall be implemented from the date specified by a Cabinet Order within a period not exceeding three years and six months from the date of promulgation (December 11, 2019).

V. Qualifications of Directors

Previously, an adult ward (*seinen-hikokennin*),[5] a person under curatorship (*hihosanin*),[6] or a person who is similarly treated under foreign laws and regulations was disqualified from serving as a director. However, this disqualification was removed subject to certain requirements including consent from an adult guardian (*seinen-kokennin*) or a curator (*hosanin*), in response to the demand to promote the use of the adult guardianship system.

* * *

If you have any questions regarding the matters covered in this memorandum, please reach out to your usual TMI contact or any of the attorneys listed below.

Authors

Akihiro Goda
Phone: +81 3 6438 4478
Email: agoda@tmi.gr.jp

Taro Matsumoto
Phone: +81 3 6438 6118
Email: tamatsumoto@tmi.gr.jp

[5] A person who at all times lacks the capacity to discern right and wrong due to a mental disability, and for whom the commencement of guardianship is ordered by the family court (Article 7 of Civil Code).

[6] A person whose capacity is extremely insufficient to appreciate right or wrong due to any mental disability, and for whom the commencement of curatorship is ordered by the family court (Article 11 of Civil Code).