
By Ministry of Justice of Japan

1 Efforts to Modernize Japanese Corporate Law Commence

Confronted with a dynamic and increasingly competitive global economy, the Japanese Government has begun reviewing its corporate laws and rethinking fundamental legal framework which has helped to shape the modern Japanese economy.

More than one hundred years have passed since the basic civil and commercial laws of Japan were first introduced during the Meiji era for the purpose of establishing a modern nation. Many of those laws were drafted using the laws of various European countries including Germany as models. It has been these laws that have provided the legal basis for our economy and enabled the economic growth of Japan ever since. Though the corporate law has undergone a number of significant changes on some important occasions, the further revision of many essential legal concepts and structures is now deemed necessary to enable these laws to conform to the reality of a modern Japanese society in the 21st century.

One particular facet of the Japanese corporate law that should be revised is the area of corporate governance. The current corporate law of Japan generally adopts a "pre-regulating" method of corporate governance. Under this system, the corporate law imposes detailed restrictions on the activities and decisions of the management of a Japanese company in order to ensure the safety and reliability of commercial transactions and to protect the interests of the company's shareholders and creditors. Though such system limits the flexibility of the management of a Japanese company, it make it unnecessary that the management worries about the possible liabilities stemming from their misconduct, so long as they comply with those detailed restrictions. This "pre-regulating" system has worked well in the past because it suited to the Japanese society in the 20th century, which enjoyed long-lasting economic growth.

However, the mismatch of these laws to the current economic environment in Japan has now become apparent. The rapid globalization of the world economy since the end of the cold war and revolutionary changes brought about by advances in information technology has placed Japan squarely in the so-called "Mega Competition" with other nations. Such a business environment demands that management be able to make aggressive business judgments and take accompanying risks. Moreover, the shareholders and other stakeholders are required to invest in Japanese companies, considering the related risks by themselves on the basis of sufficient information disclosed.

In view of the current circumstances, the Ministry of Justice of Japan ("MOJ") now regards changes to the civil, commercial, and criminal laws relating to business activities in Japan as urgent and essential. In this regard, MOJ decided to replace the current "pre-regulating" legal
regime with a "post-remedy" legal system and formed on April 1, 2000 the "Headquarters of
Preparation of Changes in Civil and Criminal Law relating to Economic Activities" for the
purpose of accomplishing such changes within the next 5 years.

Among various changes being proposed, a handful of changes were deemed particularly
urgent in light of the current competitive global environment. Since certain revisions aimed at
accomplishing greater efficiency with respect to management and corporate governance matters
through flexible restructuring had been finished by the time that provisions enabling corporate
demerger (Kaisha-bunkatsu) were enacted in 1999, the following efforts to revise the corporate
law have begun with suggested guidelines for achieving fundamental change in the corporate law.
Any effort to revise the corporate law should address the following goals:

**Goal I)** Ensuring efficient corporate governance;

**Goal II)** Accommodating an advanced information-sharing society;

**Goal III)** Improving the methods through which Japanese companies may obtain financing; and

**Goal IV)** Permitting greater internationalization of companies' activities.

**Goal I)** addresses the need to review the current corporate system such as management
system and appropriate disclosure system from the viewpoint of the assurance of effective
corporate governance by achieving proper management as well as efficiency of the management
of Japanese corporations. The accommodation to international standards is also an important
factor to be considered.

**Goal II)** refers to our need to deal with a rapidly developing advanced information-sharing
society created by advances in various kinds of technology, including the widespread expansion of
computer networks and other revolutionary changes in information technology that have been the
impetus behind the so-called "IT Revolution." Our goal must be to create a corporate legal system
that permits the use of efficient and reliable methods of advanced information-sharing systems in
relation to corporate procedures, including the administration of shareholders' meetings, the
exercise of voting rights by shareholders, record keeping of corporate minutes, and disclosure of
corporate information.

**Goal III)** speaks to the current economic environment and its increased emphasis on the
importance of direct financing (as compared to indirect financing), the increase in the capital
demand of venture and emerging companies, and the development of an OTC market for capital
stock or other securities, all of which require efficient and flexible corporate financing options.
The current corporate legal system relating to shares of capital stock, bonds, CPs and other
financial instruments must be reviewed to ensure that smooth financing, marketability and the fair
protection of investors are all achieved.

**Goal IV)** addresses the need to create a system that accommodates any international
standards implicated during the course of the review process associated with **Goals I), II) and III)**
above. Such endeavor would also require a review of the legal requirements under the
Commercial Code (Sho-ho) relating to the protection of counterparties that deal with non-Japanese companies, an issue that has increasingly become important because of the increase in the number of foreign companies doing business in Japan.

In order to accomplish the foregoing objectives, the Minister of Justice suggested, in January 2001, that the Legislative Council of the Ministry of Justice (the "Council") review the corporate law with these goals in mind and, upon completion, propose a summary of a draft of such changes (the "Summary") to the Minister of Justice.

In response, the Council, through its corporate sub-council, undertook a review of the corporate law and prepared and published a preliminary draft of the Summary (the "Draft Summary") in April of 2001. At that time, the Council solicited comments to the preliminary draft from the general public as well as any other interested entities or organizations. After due consideration of all feedback received, the Council made preparations to finalize the Summary for the proposed amendments to the Commercial Code to be submitted to the extraordinary session of the Diet in September 2001. In addition, the Summary for the proposed changes of the Commercial Code to be submitted to the 2002 annual session of the Diet was finalized in February 2002.

In the meantime, at the initiative of members of the Diet, the following revisions were passed in the annual session and extraordinary session of last year, respectively: (i) changes in the Commercial Code regarding the relaxation of certain restrictions on treasury stock and the size of units of stock, and (ii) changes regarding certain limitations on management's liabilities to their companies and revisions relating to the derivative suits system.

2 Status of the Changes in the Corporate Law

The review process of the corporate law of Japan has been conducted in the following stages:

(A) First Stage (Annual session of the Diet in 2001)

As stated above, the first stage in the government's efforts to effectuate fundamental changes in the Japanese corporate law was the passage of revisions to the Commercial Code during the 151st annual session of the Diet in 2001. The changes related to the relaxation of both certain restrictions on the acquisition and holding of treasury stock and those on the size of units of stock. These changes (the "First Stage Changes") became effective on October 1, 2001.

Though technically enacted at the initiative of the members of the Diet, the First Stage Changes actually had its origins in the MOJ at the direction of Mr. Koumura, then Minister of Justice. Upon the request for cooperation by the Board of Policy Determination of Governing Parties to Mr. Mori, the Prime Minister at that time, Mr. Takamura instructed MOJ to accelerate the preparation of the draft, which was originally scheduled to be submitted to an extraordinary session of the Diet in autumn of 2001.

The First Stage Changes relate to Goal III) of the aforementioned goals, and in this regard, constitute a portion of the original fundamental changes that MOJ sought to achieve.

The First Stage Changes are very broad, dealing with stock-related matters generally. The following is a summary of the changes:
(a) Relaxation of restrictions on the acquisition and holding of treasury stock

(i) Acquisition of outstanding stock

By virtue of the First Stage Changes, a Japanese company is now permitted to acquire shares of its issued and outstanding stock upon the adoption of a resolution at an annual meeting of the shareholders specifying the kinds, the total number, and the total purchase price of the stock proposed to be acquired during the one-year period ending with the next annual shareholders' meeting. The total purchase price must be no more than the sum of (x) the amount of distributable profit and (y) the amount of the capital reduction and capital reserve reduction which is approved in the resolution adopted at the previous shareholders' meeting authorizing such acquisition of stock.

(ii) Holding of treasury stock

The First Stage Changes further abolish previous restrictions on the holding of treasury stock. Therefore, a Japanese company that has acquired shares of its outstanding stock in accordance with the above-mentioned procedures may keep such stock with no limitations with respect to holding periods or the number of shares of such stock, etc.

(iii) Disposition of treasury stock

These changes enable a Japanese company, by adoption of a board resolution alone, to cancel shares of treasury stock, sell such shares, or to use such shares in connection with mergers or other corporate changes in place of newly issued stock. The relevant provisions in the Commercial Code regarding the procedures for the issuance of new stock shall also apply to such sales of treasury shares.

(b) Relaxation of the restrictions on size of units of stock

(i) Abolishment of restrictions on the issue price of stock at the time of incorporation

The First Stage Changes abolish the requirement that shares of capital stock have a minimum issue price of 50,000 yen per stock at the time of incorporation.

(ii) Abolishment of restrictions on the minimum net assets, etc. at the time of stock splits

Prior to the First Stage Changes, a stock split having the effect of causing either (i) the aggregate nominal amount of the issued shares to exceed the stated capital or (ii) the amount of net assets per stock to be less than 50,000 yen was prohibited. The First Stage Changes have abolished this prohibition.

(iii) Abolishment of lot stock (tani'-kabu) system

The First Stage Changes abolish the Japanese lot stock (tani'-kabu) system. The lot stock system was introduced in 1981 to ensure that each unit of tradable shares in an issuing company stock would have a per share value of at least 50,000 yen. This lot stock system had been regarded as provisional.

(iv) Establishment of Voting Unit (tangen-kabu) system

The First Stage Changes permit a Japanese company to adopt a new unit stock system
(the "Voting Unit" system) by providing for the adoption of such a system in its articles of incorporation. Under this system, a Japanese company may provide in its articles of incorporation that a certain number of its shares constitute one unit, each of which represent one voting right.

(v) Abolishment of par-value stock

The First Stage Changes abolish par-value stock. The practical effect of this revision is that the difference between par-value stock and no-par stock has disappeared and any regulations applicable only to par-value stock, such as the prohibition on the issuance of par-value stock at an issue price less than its stated par value, have been rendered void.

(vi) Improvement of fractional shares (hakabu) system

The First Stage Changes include certain provisions for various improvements to the fractional shares (hakabu) system such as the abolishment of fractional share certificates.

(B) Second Stage (Extraordinary session of the Diet in 2001)

The second stage in the adoption of fundamental changes in the Japanese corporate law involved changes in the Commercial Code relating to the substantial modification of the stock system and the permission of electronic documentation for certain uses. These changes (the "Second Stage Changes") were passed in the 153rd extraordinary session of the Diet in the autumn of 2001 and will be promulgated on April 1, 2002.

The Second Stage Changes address the goals of Goals II) "Accommodating the advanced information-sharing society" and Goal III) "Improving the methods of financing by Japanese companies" of the basic concepts in accomplishing fundamental changes in the corporate law. These changes also take into account the current status of laws and regulations in Japan and various recent legal trends or movements in foreign countries to achieve further the goal of Goal IV) "Accommodating the internationalization of companies' activities."

The Second Stage Changes have two principal purposes. The first principal purpose was to enable the smooth financing by companies and to foster the development of thriving ventures. This purpose was crucial to survive in the recent business environment where demands for financing by companies have increased and various cutting-edge financing methods have appeared. To this end, a number of changes in the stock system under the Commercial Code have been made, including the relaxation of restrictions on the issuance of shares, the increase in the variety of securities permitted and the deregulation of the legal framework for warrants (including stock options) to be issued by a company (introduction of new warrants (Shinkabu-yoyakuken) (hereinafter referred to as "Stock Purchase/Subscription Warrant").

The second purpose of the Second Stage Changes was to improve the administration of companies and to protect the voting rights of shareholders in an increasingly advanced information-sharing society. To achieve this goal, the Second Stage Changes, upon becoming effective on April 1, 2002, has permitted the use of various electronic devices, including the preparation of corporate documents in the form of electronic files and the exercise of voting rights by shareholders in electronic form. This revision is intended to accommodate the emergence of advanced information-sharing society. The Second Stage Changes has become effective as from
April 1, 2002.

As mentioned above, the Second Stage Changes can be divided into two categories, changes in the stock system including the introduction of new stock option system and the permission of use of electronic documentation for certain purposes. The following discussion summarizes these changes:

(a) Relaxation of restrictions on the issuance of shares

(i) Relaxation of restrictions on the issuance of shares - generally

The Second Stage Changes will relax a number of restrictions on the issuance of shares so that Japanese companies can obtain necessary financing more smoothly. The relaxed provisions include the extension, from 6 months to one year, of the effective period for a shareholders' resolution authorizing the issuance of shares to third parties at favorable prices and the creation of an exemption from the regular obligation to prepare certificates of application for purchase (kabushiki-moshikomisho) in the case of the issuance of shares fully underwritten on the basis of an agreement with the issuing company.

(ii) Relaxation of restrictions on the issuance of shares by closed companies

For closed companies (companies requiring, in their articles of incorporation, board approval for transfers of shares), the Second Stage Changes loosen the restrictions on the issuance of shares to a far greater extent than those applicable to other companies. The relaxed provisions include the abolishment of minimum requirements for the number of shares issued at the time of incorporation (for companies other than closed companies the number of shares issued at the time of their incorporation must be at least one-fourth (1/4) of the number of shares authorized to be issued) and the abolishment of the restriction on increases in the number of shares authorized to be issued (companies other than closed companies may not increase the number of shares authorized to be issued in excess of 400% of the then issued shares). This revision is intended to ensure the smooth financing of companies, particularly ventures and emerging companies which often cannot secure financing from banks.

(b) Increase in the variety of stock

(i) Shares with limited voting rights, etc.

The Second Stage Changes, upon becoming effective, will increase the variety of statutory permissible stock by allowing the issuance of shares with limited voting rights. The number of such shares may not exceed more than one-half (1/2) of the total issued shares, an increase from the previous maximum permitted amount of one-third (1/3). As a result, a Japanese company may issue common shares without voting rights as well as preferred non-voting shares. (Preferred non-voting shares have been permitted even under the previous law.)

(ii) Tracking stock, etc.

With respect to the terms of preferred or subordinated shares regarding dividends, the Second Stage Changes will authorize Japanese companies to determine only the maximum amount of such dividends (or other formula for determining such dividends) at their
shareholders' meeting. Thus, the specific amount of dividends can be determined by the board resolution made at the time of specific issuance of such shares. In this regard, the Second Stage Changes will enable flexible arrangements as to the issuance of such shares. They also clarify the permissibility of issuance of tracking stock. Tracking stock is the stock dividends of which are not fixed, but rather linked typically to the results of the operations of a certain segment or a certain subsidiary of the issuing company.

(iii) Granting veto rights for certain items to holders of class stock

The Second Stage Changes will further enable a Japanese company to require, in its articles of incorporation, that certain corporate actions be subject to the approval of both the holders of a certain class of stock (a "specific stockholder resolution") as well as by all shareholders. Creating such arrangement can be adopted only for those corporate actions for which a specific stockholder resolution is deemed to be necessary for the purpose of protecting the interests of a certain class of stock. This system can be viewed as something of a veto system for a class of protected stockholders in the sense that they can block certain action by simply refusing to vote in favor of it.

(iv) Mandatory convertible stock

The Second Stage Changes will permit a Japanese company to issue mandatory convertible stock, which may be converted into another type of stock at the sole discretion of the issuing company, rather than the holders. For the sake of clarity, the revised Commercial Code renames traditional convertible stock which convert at the discretion of the holder "stock with conversion right" in order to distinguish it from newly introduced mandatory convertible stock. Stock with conversion right is not a new creation and was available to a Japanese company even before the Second Stage Changes.

(C) Introduction of Stock Purchase/Subscriptions Warrants

The Second Stage Changes, upon becoming effective, will redefine the legal concept of a warrant as a right against the issuing company to acquire its newly issued shares or its treasury shares at a fixed price (a "Stock Purchase/Subscription Warrant"). The revisions will permit a Japanese company to issue Stock Purchase Warrants not only in conjunction with other securities (e.g., bonds with warrants) but also as separate and independent securities. While stock options under the former law may be issued only on a non-charge basis, Stock Purchase/Subscription Warrants may be issued with or without charge.

In connection with this change in the corporate law, stock options, which are traditionally perceived as incentive compensation for directors or officers of a corporation, will now be classified as a kind of Stock Purchase/Subscription Warrant that has the characteristic of being issued at a favorable price and allotted to a wider range of persons than previously permitted. Before this change, stock options had been treated as being a unique instrument and, therefore, the Commercial Code made special provision for it. Under the revised Commercial Code, the restrictions placed on (i) persons to whom stock options (which will be a kind of Stock Purchase/Subscription Warrant) can be granted and (ii) the maximum number of such stock options that may be granted and (ii) the permissible exercise period is abolished and (iii) shares issuable under stock options issued or to issued by a company is relaxed. Moreover, though a
special shareholders' resolution is still necessary to authorize certain facets of stock options, the breadth of those facets has been reduced. The details of this change are described below:

1) Certain restrictions placed on grantees of stock options is abolished, and a Japanese company may grant its stock option (a kind of Stock Purchase/Subscription Warrant) to directors or employees of its subsidiary or its legal counsel, accountant, its lending financial institutions or any other persons, if necessary (under the former law, grantees must be a director or an employee of the issuing company itself).

2) Certain restrictions on the total number of shares issuable under stock options issued or to issued by a company is relaxed, and a Japanese company may issue such stock options (a kind of Stock Purchase/Subscription Warrant) representing as many shares of capital stock as is equal to the number of shares authorized to be issued in its articles of corporation minus the number of already issued and outstanding shares of the company (under the former law, the total number of shares issuable under stock options issued or to issued by a company were required to be 10% or less of the total issued shares).

3) The 10-year restriction on the permissible exercise period for stock options is abolished. A company, however, still cannot issue Stock Purchase/Subscription Warrants (including stock options) that feature no limitation as to the term of the exercise period.

4) After the Second Stage Changes take effect, it is no longer necessary to submit certain details of each issuance of stock options, such as the names of grantees, to the vote of the shareholders for their approval and ratification. In addition, with respect to the introduction of the concept of Stock Purchase/Subscription Warrants, the Second Stage Changes have provided for necessary adjustments to the former law relating to convertible bonds and bonds with warrants. The revisions will also enable, in the case of a stock exchange (Kabushikikokan) or a stock transfer (Kabushikiiten), an "absolute parent" to succeed the obligations of a wholly-owned subsidiary relating to independent Stock Purchase/Subscription Warrants (including stock options) issued by that "wholly-owned subsidiary".

(d) Electronic documentation for corporate documents, etc.

(i) Electronic documentation for corporate documents

    In view of the emergence of an advanced information-sharing society, the Second Stage Changes, upon becoming effective, will permit a Japanese company to prepare corporate documents in the form of electronic files.

    The Second Stage Changes provide that if signatures must be affixed to corporate documents, then it shall be sufficient to utilize electronic signatures in lieu of manual signatures in the case of electronic files. The revisions also provide that if shareholders or other parties have a valid right to make demands for the inspection of, or for the delivery of copies of, certain corporate documents stored in electronic format, such demands may be satisfied utilizing an electronic format such as by showing the contents of the relevant file on the screen of a computer terminal or by delivery of the document containing the
information recorded in the relevant electronic file.

(ii) Use of electronic devices for purposes of giving notice and the like by a company or shareholders, etc.

The Second Stage Changes will permit a Japanese company, its shareholders or certain other persons to make a notice or demand or other like communication through the use of electronic devices and formats. The practical effect of this revision is that a company may deliver notice of a shareholders' meeting through the use of an e-mail system, upon each shareholder's consent.

(iii) Exercise of voting rights through electronic devices (permission of "e-vote")

The Second Stage Changes will further permit shareholders of a Japanese company to exercise their voting rights through the use of electronic devices upon the authorization to do so by the board of such company.

(iv) Permission of on-line disclosure of financial statements

The Second Stage Changes will permit a Japanese company to meet its mandatory disclosure requirements for its balance sheets by making the full text of them available for 5 years in an electronic format instead of making public notice of them (or summary of them). It should be noted that a large joint stock company (Kabushiki-kaisha)(hereinafter referred to as a "KK") under the Law for Special Exceptions to Commercial Code concerning Audit, etc. (i.e., a company with a stated capital of 500 million yen or more or with liabilities of 20 billion yen or more, hereafter, a "Large Company") must disclose its profit and loss statements in the same manner as it discloses its balance sheets. Furthermore, because of this change, a Japanese company will not be required to make public notice of its financial statements in a paper-based media, such as official gazettes or daily newspapers, if it displays its financial statements on its Internet homepage for 5 years.

(C) Third Stage (Extraordinary session of the Diet in 2001)

The third stage of such fundamental changes in the Japanese corporate law can be said to have been comprised of certain changes in the Commercial Code that were proposed in the 151st annual session of the Diet and finally passed in the 153rd extraordinary session of the Diet upon partial modification. The revisions (the "Third Stage Changes") related to (a) strengthening the functions of corporate statutory auditors, (b) reducing directors' exposure to liabilities to their companies and (c) the improvement of the derivative suit system. These changes had become effective from May 1, 2002.

Though the Third Stage Changes were enacted at the initiative of the members of the Diet and MOJ was not substantially involved in this legislative process, the revisions nevertheless contained important gains as a matter of legal reform and merit discussion herein. A summary of these revisions is as follows:

(a) Strengthening the functions of corporate statutory auditors

(i) Obligations of corporate auditors to attend board meetings and to express their views at those meetings
The Third Stage Changes will, upon becoming effective, specifically provide that corporate statutory auditors must attend meetings of the board of directors and to express their views at those meetings.

(ii) Number of outside corporate auditors

The Third Stage Changes will increase the minimum number of outside statutory auditors for a Large Company. Though, currently, it is sufficient for a Large Company to have only one outside statutory auditor, the revised Commercial Code will require at least half of the members of corporate statutory auditors be outside statutory auditors for any Large Company. In addition, they will also make the qualifications for outside statutory auditors more strict than those under the former law. Under the Third Stage Changes, an outside statutory auditor of a company must be a person who has never been a director or an employee of the company (the former law merely requires that an outside corporate auditor be any person who has not held such office in the company for the most recent 5 years).

(iii) Term of office of corporate statutory auditors

The term of office of corporate statutory auditors will be extended from 3 years to 4 years.

(iv) Corporate statutory auditors' rights to express their opinions with regard to the resignation of a corporate auditor

The Third Stage Changes will grant a resigning corporate statutory auditor and other corporate statutory auditors the right to express their opinions at a shareholders' meeting with respect to his/her resignation.

(v) Rights of the board of corporate statutory auditors to consent to, and make a proposal for, the appointment of a new corporate statutory auditor

After the Third Stage Changes become effective, the board of corporate statutory auditors of a Large Company will be granted the right to consent to any proposal by the company to appoint a new corporate statutory auditor. In addition, the board of corporate statutory auditors will be entitled to propose an agenda for appointment of a new corporate statutory auditor to a shareholders' meeting with or without specifying a candidate for it.

(b) Reduction of liabilities of directors, etc. against their companies

(i) Waiver of directors' or corporate auditors' liabilities

Under the former law, any waiver of a company's directors' or corporate statutory auditors' liabilities to their companies generally requires the unanimous consent of all of the shareholders of the company. The Third Stage Changes will afford greater immunity to corporate directors and others by relaxing this strict requirement for liabilities stemming from violations of laws or the articles of incorporation based on simple negligence. Under the revised Commercial Code, on the condition that one of the procedures described in (1) or (2) below are taken, any such liabilities in excess of the following amounts may be waived without the unanimous consent of shareholders:

(X) Representative director
Amount cannot be waived: If a representative director causes damage to his/her company, the total amount of his/her compensation for 6 years

(Y)  Director other than representative or outside directors

Amount cannot be waived: If a director other than representative or outside directors causes damage to his/her company, the total amount of his/her compensation for 4 years

(Z)  Outside director and every corporate statutory auditor (for this purpose, the treatment afforded an outside corporate statutory auditor and other corporate statutory auditors are the same)

Amount cannot be waived: If an outside director or corporate statutory auditor causes damage to his/her company, the total amount of his/her compensation for 2 years

For this purpose, "compensation" shall include (L), as to a director who also holds office as an employee, any compensation (including salary) received for his/her work as an employee, (M) any retirement compensation for the relevant director or corporate auditor, including that received for his/her work in their capacity as an employee, and, to the extent such retirement compensation relates to his/her work for the period of the most recent 2 years (this 2-year limitation shall be replaced with the 6-year limitation in the case of a representative director and with the 4-year limitation in the case of a director other than representative or outside directors) and (N) any profit gained upon the exercise or transfer of stock options.

Satisfaction of one of the following procedures is necessary to effectuate the above-described waiver of claim for liabilities:

(1)  Special resolution of a shareholders' meeting

      A waiver of liabilities will be permitted where 2/3 or more of the total votes of shareholders attending the general shareholders' meeting have approved such waiver at such meeting. It should be noted that a unanimous consent of all of the company's relevant corporate statutory auditors is required for the company to submit a proposal for such waiver at the shareholders' meeting.

(2)  Resolution of the board

      The other way to effectuate the waiver of liabilities is to have the board of directors approve the waiver. This method is available only to companies that have made necessary provision in their articles of incorporation authorizing the use of this method. The board of directors may grant the necessary approval of a waiver only if they believe such a waiver is really necessary in view of the totality of the circumstances. Moreover, even if the board approves such a waiver in accordance with the above procedures, the waiver will not be effective if shareholders holding 3% or more of the total votes of shareholders give notice of their objection to such waiver to the company within a certain period specified in the articles of incorporation, which period must be at least one month. Notwithstanding this objection, the company may
still effectuate the waiver in a manner described in (1) above. It is worth noting that the unanimous consent of all of the company's corporate auditors is required for this method, (aa) when the company submits at its shareholders' meeting a proposal for such an amendment to its articles of incorporation to add the provision for authorizing this method of waiver, or (bb) when a director of such company submits to the board meeting a proposal for an approval of a specific waiver.

(ii) Treatments on payment of retirement compensation, etc. after the effective waiver

Under the revised Code, once a waiver is granted to a director or a corporate statutory auditor in accordance with the procedures described in (i) above, an approval of a shareholders' meeting will still be required (aa) when the company tries to pay to such director or corporate statutory auditor his/her retirement compensation, etc. or (bb) when such director or corporate statutory auditor tries to exercise or transfer his/her stock options. It is generally understood that the intent of these restrictions is to discourage fraudulent activities (e.g., the intentional delay of payment of retirement compensation) by decreasing the amount of compensation and, therefore, the amount of liabilities that may not be waived.

(iii) Agreement limiting the liabilities of outside directors based on the articles of incorporation

In addition to the waiver system described in (i) above, an outside director will be permitted to execute an agreement with his/her company limiting his/her liabilities against the company to some extent. This type of agreement (the "Liability Limit Agreement") is permissible only when the relevant company has authorized such contracts in its articles of incorporation. By such agreement, the potential liabilities of an outside director may be contractually limited to the amount equal to the amount specified in such agreement or the amount of compensation for the most recent 2 years, whichever is larger.

It should be noted that similar kinds of arrangements are not available for an outside statutory auditor.

(iv) Disclosure to shareholders before or after the waiver, etc.

As summarized below, certain kinds of disclosure must be made when a company waives its claims for liabilities of its directors or corporate auditors (as described in (i) above) or when a company executes an agreement in accordance with the terms of its articles of incorporation (as described in (iii) above).

(1) When a company effectuates the waiver through a special resolution of a shareholders' meeting, as described in (i)(1) above, the company must disclose at such shareholders' meeting (aa) the cause of such liabilities and an estimate as to the amount of such liabilities, (bb) the amount equal to the amount of such liabilities minus the maximum amount that can be waived as well as the information necessary for the calculation of that maximum amount (e.g., amount of compensation), and (cc) the reason for granting a waiver and the specific amount of the claim for liabilities proposed to be waived.

(2) When a company effectuates the waiver through a board resolution based on the
authorizing provision in the articles of incorporation, as described in (i)(2) above, the company must disclose, by way of public notice, (aa) the cause of such liabilities and an estimate of the amount of such liabilities, (bb) the amount equal to the amount of such liabilities minus the maximum amount that can be waived as well as the information necessary for the calculation of that maximum amount (e.g., amount of compensation), and (cc) the reason for granting a waiver and the specific amount of the claim for liabilities proposed to be waived. Such public notice must be made without delay after the board resolution effectuating the waiver is adopted.

(3) When a company has executed a Liability Limit Agreement with an outside director as described in (iii) above and has notice of the fact that the company may sustain damages due to the conduct of such outside director, the company must disclose, at the next shareholders' meeting, (aa) the cause of such liabilities and the estimate of the amount of such liabilities, (bb) the maximum amount that can be waived and the information necessary for the calculation of that maximum amount (e.g., amount of compensation) (cc) the contents of the Liability Limit Agreement and the reason for execution thereof, and (dd) the specific amount of the claim for liabilities to be limited in accordance with the Liability Limit Agreement.

(c) Improvement of derivative suits system

(i) Qualification of plaintiff

According to the original draft law submitted to the Diet, the current qualification requirement for a plaintiff to bring a derivative suit that the shareholder seeking to bring the suit have held the shares consecutively for 6 months or more (the "6-month Holding Requirement") had been proposed to be abolished. According to the original draft, a plaintiff would be subject instead to an alternative requirement under which a shareholder who has become a shareholder through an assignment of the shares from another person would be prohibited from initiating a derivative suit if at the time of such assignment he/she knew the cause of action for the liabilities of directors, etc. in question (or should have known of it if he/she acted without gross negligence). However, this proposed amendment was deleted from the draft law during the course of deliberations in the Diet, and ultimately no change was adopted in the Third Stage Changes with respect to the 6-month Holding Requirement.

(ii) Extension of the consideration period by corporate statutory auditors

Under the former law, statutory auditors must determine whether or not they will initiate a damage claim suit against director(s) or statutory auditor(s) in question within 30 days after the demand by a shareholder for initiation of the shareholder derivative suit regarding such damage claim of the company. The Third Stage Changes will extend this 30-day period to 60 days.

(iii) 

The Third Stage Changes will permit the waiver of a claim for alleged liabilities of a director, etc. in a settlement at a court proceeding of a shareholder derivative suit (or damage claim suit initiated by the company) without requiring the unanimous consent of all of the shareholders or other statutory procedures that would otherwise be required for such
waiver.

(iv) Participation by a company in a derivative suit to help directors, etc.

The Third Stage Changes make it clear that a company may participate in a shareholder derivative suit to assist the defendant director, etc. alleged to have breached a duty to the company. Such participation will be subject to the prior consent of all the corporate statutory auditors of such company.

(D) Fourth Stage (Annual session of the Diet in 2002)

The third stage of such fundamental changes in the Japanese corporate law can be said to have been comprised of certain changes in the Commercial Code that had been proposed in the 154th ordinary session of the Diet and were finally enacted in the Diet on May 22, 2002.

The principal contents of these changes (the "Fourth Stage Changes") will be (i) certain revisions regarding the management system of a company and (ii) certain revisions regarding the company's accounting provisions. The former relates to Goal I) "Ensuring the efficiency of corporate governance" set forth above while the latter speaks to Goal IV) "Accommodating to the internationalization of companies' activities." A draft of the summary of these revisions (the "Summary") was prepared by the corporate sub-council of the Council on January 16, 2002 and was finalized by the Council and submitted to the Minister of Justice on February 13, 2002. The MOJ prepared a final draft bill for the proposed changes to the Commercial Code and other relevant laws (the "Bill") on the basis of the Summary and the Cabinet submitted the Bill to the Diet on March 18, 2002. The Bill was passed in the Diet on May 22, 2002.

The Fourth Stage Changes can be summarized as follows:

(a) Introduction of the committee system

The Fourth Stage Changes will give a Large Company the option to adopt a US-type corporate governance system. More specifically, upon enactment of the revisions, a company adopting such a system (a "Company with Committees (inkai-to-secchi-kaisha) ") would be entitled to establish an "Appointment Committee", "Auditing Committee" and "Compensation Committee". Such a company would also have officers (Sikkoyaku) but cannot have a corporate statutory auditor. The proposed revisions stipulate that more than half of the members of the above-mentioned committees be outside directors. At a Company with Committees, the board of directors may properly delegate substantial management authority to officers. For example, the board may delegate the authority to approve issuances of new shares of capital stock and bonds to officers.

(b) Introduction of the Committee for Important Assets

These changes will enable a Large Company (other than a Company with Committees) having 10 or more directors (including at least one or more outside directors) to establish a "Committee for Important Assets (Jyuyozaisan-ininkai)." This committee should consist of 3 or more of directors of the company. The board of directors of the company may delegate its decision-making authority with respect to the disposition or acquisition of important assets and large borrowings to this committee. The purpose of this change is to allow for flexible and prompt management decisions.
(c) **Simplification of procedures for shareholders' meetings**

This change primarily relates to medium- or small-sized KKs. Upon the enactment of the revisions, the procedures pertaining to shareholders' meetings for medium- or small-sized companies may be simplified allowing the company to conduct meetings in a manner more akin to a limited liability company (Yugen-kaisha)(hereinafter referred to as a "YK"). The specific contents of this item are as follows:

(i) With the consents of all of the shareholders, such companies may omit the convocation process of shareholders' meetings.

(ii) Closed Companies may, upon authorization in its articles of incorporation, shorten the notice period for shareholders' meetings.

(iii) As with a YK, a resolution in writing or in an electronic format will be permitted for general shareholders' meeting.

(d) **Relaxation of the quorum requirement for shareholders' meetings**

Under the current Commercial Code, the statutory quorum requirement for a special resolution of a general shareholders' meeting is a simple majority of total voting shares, however, a company may not relax this requirement even by its articles of incorporation. Upon the Fourth Stage Changes taking effect, a company will be allowed to relax this requirement down to one-third (1/3) of the total number of voting shares by its articles of incorporation. In such case, the relevant provision authorizing these lesser quorum requirements must be specifically set forth in the articles of incorporation.

(e) **Appointment of directors, etc. in a class meeting**

The Fourth Stage Changes will enable a Japanese company to issue a new class of shares with certain rights regarding the appointment and/or dismissal of directors or corporate statutory auditors. For example, upon the Fourth Stage Changes taking effect, a company may issue Type A shares entitling holders to an exclusive right to elect 3 out of 5 members of the board of directors and Type B shares entitling holders to an exclusive right to elect the remaining 2 directors. These changes serve to supplement the Second Stage Changes regarding shares with limited voting rights. Under the Second Stage Changes, shares having an exclusive right to appoint certain numbers of directors could not be issued due to the limitation on the number of shares having limited voting rights (i.e., one-half (1/2) of all outstanding shares at the maximum).

(f) **Nullification procedures for share certificate**

The Fourth Stage Changes will establish a new system for handling lost share certificates. Under this new system, a shareholder who has lost a share certificate can request the issuing company to reissue the share certificate without public notice for stock cancellation and in the absence of a stock cancellation judgment by simply registering the loss of the certificate with the issuing company. Since an application by the shareholder will be made to the issuing company, the company will have an opportunity to check its stock registration book. Therefore, even after the introduction of this system, the rights of a *bona fide* purchaser of such lost shares will be fairly and sufficiently protected.

(g) **Consolidated financial statements**
To ensure adequate disclosure, the Fourth Stage Changes will require a publicly traded Large Company to prepare a consolidated balance sheet and profit and loss statement and to report such statements to its shareholders at the annual shareholders' meeting.

(h) Delegation of accounting matters to ministerial ordinances

The Fourth Stage Changes will abolish the current provisions in the Commercial Code regarding the details of such accounting matters as the method for valuing assets and delegate such matters to relevant ministerial ordinances. After the Fourth Stage Changes, the Commercial Code itself will have only a basic conceptual provision with regard to the accounting matters. The purpose of this change is to enable the flexible adjustment of accounting regulations under the Commercial Code to the changes in the accounting principles and to ensure unity between the accounting under the Commercial Code and that under the Securities and Exchange Law.

(i) Creation of certification system for the value of assets provided as consideration for new shares, etc.

The Fourth Stage Changes will broaden the scope of the use of certifications issued by professionals such as lawyers, accountants or tax accountants that may be used as an alternative to an inspection by a court-appointed investigator. Under the Commercial Code, such inspection or certification procedures are necessary in various circumstances, including the non-cash discharge of the issue price of new shares.

(j) Abolishment of office requirement for foreign companies

Under the soon-to-be former law, foreign companies that engage in business in Japan on a continuous basis must set up a branch office in Japan. The Fourth Stage Changes will abolish this requirement and, instead, will require more detailed disclosures by foreign companies as a means of ensuring the protection of Japanese parties that may be doing business with such foreign companies. For example, the Fourth Stage Changes will add a requirement that such foreign companies disclose its financial statements in Japan.

In addition to the Fourth Stage Changes, another set of revisions to the Japanese corporate law is scheduled for the annual session of the Diet this year. That set relates to the settlement of corporate bonds and governmental bonds through a book entry system. Specifically, the change will broaden the applicability of the Law regarding the Book Entry Settlement (so-called the "Electronic CP Law", effective from April 1, 2002) to bonds. The Electronic CP Law is a law enabling the issuance and settlement of non-paper-based commercial papers.

(E) Fifth Stage

As described briefly above, revisions to the Japanese corporate law have been and will continue to be made very rapidly. However, the issues remaining after the completion of these four stages is scheduled to be resolved in 2003 and thereafter.

One of these remaining issues relates to the current requirement of the issuance of physical share certificates. For some time now, many closed companies have requested the Japanese government to permit the exemption of such issuance requirements to closed companies. In addition, even for publicly traded companies, it is a rare case that the physical delivery of a share certificate is actually made at the time of a transfer of shares and, in many cases, investors
themselves do not require the physical delivery of certificates by depositing the shares with their securities firms or using the custody and book-entry transfer system. With regard to this issue, the possibility of the non-issuance of physical share certificates on the basis of these circumstances will be discussed as well as the related issues such as the manner to effectuate a transfer of shares.

In addition, as to matters that require coordination with other ministry such as use of electronic devices for public notice, we acknowledge the necessity to make such coordination and to effectuate appropriate changes.

Assuming the smooth progress in substantial changes in Japanese corporate law, the last thing necessary to do is to modernize the terms of the Commercial Code. MOJ has already begun the process of reviewing the problems that will happen if we use the plain Japanese for provisions of the Commercial Code. But since, as a result of the above-mentioned changes, almost all of the provisions of the Commercial Code will be amended in a varying degree, we will accomplish the adoption of the colloquial Japanese after such substantial changes have completed to a large extent.

3 Conclusion

As described above, some changes have already been made to the Japanese corporate law and, further, several consecutive changes are scheduled to be made to it. This is a reflection of our belief that the corporate law should be the principal subject of the improvements of the basic civil laws relating to economic activities.

The Japanese government has acknowledged that the frequent changes in the corporate law over a short period of time are the inevitable result of the current economic environment and the fact that the corporate law is the basic law providing the organizational structure of companies, the financing methods (e.g., stock and bonds) and so forth. Therefore, the Japanese government believes it is its responsibility to accommodate such needs to change the corporate law appropriately and in a timely manner. We will also try to ensure the adequate understanding of the public of the concepts underlying these changes such that no confusion will arise in the course of practical application of these laws.

Notes:
1 Generally referred to as "Youkou" in Japanese.
2 Generally referred to as "Chukan-shian" in Japanese.
3 As to this number of shares, there are a few statutory restrictions from the viewpoint of the protection for minority shareholders.
4 Referred to as "Shinkabu-yoyakuken" in Japanese.
5 The term "absolute parent" means a company that will become a parent company of the "wholly-owned subsidiary" upon a completion of Kabushikikokan or Kabushikiiten.
6 The term "wholly-owned subsidiary" means the company that will become the 100% subsidiary of another company upon the completion of Kabushikikokan or Kabushikiiten.
7 It should be noted that there is a statutory quorum requirement for a special resolution of a
general shareholders' meeting. Under the current Commercial Code, this requirement is a majority of total voting shares. However, it should also be noted that under the Fourth Stage Changes, a company will be allowed to relax this requirement down to one-third (1/3) of the total number of voting shares by its articles of incorporation (as mentioned below).

For example, in order for a company to waive its damage claim against its director(s) or statutory auditor(s) on the basis of their transaction with it, a special resolution at its general shareholders' meeting authorizing such waiver and other relevant procedures must be fulfilled.

There is no statutory requirement as to whether any of such directors must be an outside director.

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