

## SHAREHOLDERS' ACCESS TO COMPANY'S INFORMATION: TOWARDS ENSURING SHAREHOLDERS' MONITORING RIGHT AND MINORITY SHAREHOLDERS' PROTECTION

*Junko Ueda\**

### Abstract

This article aims to revisit how minority shareholders' right to company's information can be secured under Japanese company law to execute their substantial rights (to collect proxies, to sue management, etc.) particularly in the process of mergers and acquisitions. Section I overviews the structure of shareholders' monitoring rights under Japanese company law against their historical background. Section II focuses on the shareholders' rights to company's information and its significance amongst shareholders' rights and its linkage with other shareholders' rights. Section III analyses leading cases before the Japanese courts regarding shareholders' rights of inspection. Section IV surveys the shareholders' right under Japanese company law to have access to company's information in parallel with their right to apply for the courts to appoint inspectors who investigate into company's business activities and financial situations. Section V assumes an expected shareholders' role in association with the other monitoring function ensured under company law and pursues a "good governance" system.

**Keywords:** Japanese Companies Act of 2005, minority shareholders, right to inspect a register of shareholders, right to inspect books and records, right to appoint inspectors who investigate into company's business activities and financial situations, internal auditors, expected shareholders' role, good corporate governance, mergers and acquisitions (M&As)

*\*Professor, PhD (London), LL.D (Nagoya), Shizuoka University, Shizuoka, Japan*

### Introduction

This article conducts a review of how shareholders under company law can monitor management (directors and officers) through executing their right to inspect company's information on their own initiative. The scope is limited to governance within the company. Thus, disclosure of a company's financial information from a public interest perspective is not dealt with in this article.

Section I overviews the structure of shareholders' monitoring rights under Japanese company law and outlines their historical background along each right. Section II focuses on the shareholders' rights to company's information and its significance amongst shareholders' rights and its linkage with other shareholders' rights. Section III analyses leading cases before the Japanese courts regarding shareholders' rights of inspection. Section IV surveys the shareholders' right under Japanese company law to have access to company's information in parallel with their right to apply for the courts to appoint inspectors who investigate into company's business activities and financial situations. Section V assumes an expected shareholders' role in association with the other monitoring function ensured under company law and pursues a "good

governance" system. The last part of this article draws a tentative conclusion.

The new Japanese Companies Act has introduced flexible governance structures particularly for private companies.<sup>1</sup> Therefore, companies whose share capital is less than 500 million yen and total debt is less than 20 billion yen, and which restrict transfer of their shares wholly may have a most simple structure of shareholders' meeting with one director (one shareholder is one director). However, this article considers the standard structure based on a power balance between shareholders' meeting and board of directors.

### I. Structure of Shareholders' Monitoring under Japanese Company Law

Shareholders are legally defined as owners of the company. They subscribe shares in exchange for their

<sup>1</sup> Until the new companies act came into being in 2006, there was a special act for limited liability companies to allow a one director one shareholder structure for that type of a company. The new act no longer allows formation of a limited liability company but a share company can adopt the same structure instead. Most deregulating provisions for private companies largely succeed to the former provisions in the Limited Liability Companies Act (enacted in 1938).

money or assets. The fund collected as such is used for the company's business activities. Thus, it is natural that they manage the company to make profits and distribute them among themselves. However, modern share companies, in particular when they are large enough to be financed by the public, do not necessarily assume that they are run by shareholders themselves. Division of power between shareholders and management<sup>2</sup> is inevitable as shareholders in large companies have a reasoned apathy to company management. Management does not necessarily consist of shareholders but rather with professional skills and care. Shareholders elect management and have monitoring power over management. They monitor management through general meetings, but in addition they monitor through executing their specific monitoring rights. The latter complements functional limitation of general meetings which are subject to a majority rule.

The monitoring rights can be divided into those which are vested with every single shareholder (regardless of whether he/she has voting rights), those which can be executed by any single shareholder with a voting right and those which are vested with shareholders of specified percentage or number of voting rights or shares. The line is drawn between the three to consider the balance of ensuring shareholders' rights with protecting companies from shareholders' venomous or frivolous claims.

Under the 2005 Japanese Companies Act, right to attend general meetings, to express opinions,<sup>3</sup> to raise questions,<sup>4</sup> to raise motions<sup>5</sup>, voting right<sup>6</sup> at

general meetings, right to inspect proxies,<sup>7</sup> rights to inspect a register of shareholders,<sup>8</sup> financial statements<sup>9</sup> and minutes of general meetings,<sup>10</sup> right to pursue injunction of directors' reckless or illegal act which could drain company's assets out,<sup>11</sup> right to derivative suit,<sup>12</sup> right to contest legality of company's formation, issuance of new shares and of share options, mergers, de-mergers, share exchanges, etc.<sup>13</sup> and legality and validity of resolutions of general meetings before the courts<sup>14</sup> are in the hands of every single shareholder. It is conceivable that except those regarding meetings every single shareholder with or without a voting right executes his/her monitoring right of this type.

Rights to submit agendas of general meetings,<sup>15</sup> to convene general meetings,<sup>16</sup> to apply for a court to appoint an inspector(s) who will investigate procedures and resolutions of general meetings,<sup>17</sup> to inspect books and records,<sup>18</sup> to apply for a court to appoint an inspector(s) who will investigate company's affairs and financial status<sup>19</sup> are executed only by shareholders who meet the requirements of prescribed shareholdings.<sup>20</sup> As in the first type of rights, those concerning general meetings can only be executed by shareholders with voting rights. The present act allows company's constitution to mitigate

<sup>2</sup> Expansion of management structure under Japanese company law might be outside the scope of this report but it might be worth noting here. Since 1950 when board system was introduced into Japanese company law, share companies, regardless of their size, must have boards which consist of directors appointed at shareholders' meetings. Board of directors must appoint representative director(s) who have representing power. This type of company must have internal auditors who organise the board of auditors. However, since 2002 a new management structure has been able to be adopted. This, roughly, follows Anglo-American one-tier board system which has committees of directors organised by at least three directors, the majority of which are outside directors within the board and executive officers (at least one of whom must be a chief executive officer) who are appointed at board. Both types must have an external auditor (a certified public accountant or accounting firm). Under the 2005 new Companies Act, private companies, share capital of which is less than 500 million yen and debt of which is less than 20 billion yen, can have a single director (no board and internal auditor)(see Introduction).

<sup>3</sup> There is no express provision but shareholders' voting right is based on their right to express any opinion relevant to agendas before making their decision by executing their voting right.

<sup>4</sup> Section 314. This right is provided as a directors and officers' duty to answer shareholders' questions.

<sup>5</sup> Section 304.

<sup>6</sup> Section 105 (1)(c).

<sup>7</sup> Sections 310 (7), 311 (4) and 312 (5).

<sup>8</sup> Section 125 (2) and (3). A register of shareholders shows each shareholder's shareholdings; however, substantial shareholders in any listed company who acquire more than 5 % of the issued shares of the company must report the fact to the prime minister. The matter of substantial shareholdings is regulated by the 2006 Financial Services and Market Regulation as part of regulation for takeover bids (Section 27-2).

<sup>9</sup> Section 442 (3).

<sup>10</sup> In contrast, minutes of board of directors, board committees or board of internal auditors are open to shareholders only with permission by the courts (see section 371 (2) and (3)).

<sup>11</sup> Section 360. Directors' act beyond company's object is also a matter for shareholders' injunction.

<sup>12</sup> Section 847.

<sup>13</sup> Section 828.

<sup>14</sup> Sections 830 and 831.

<sup>15</sup> Sections 303 and 305.

<sup>16</sup> Section 297.

<sup>17</sup> Section 306.

<sup>18</sup> Section 433.

<sup>19</sup> Section 358.

<sup>20</sup> 1% (voting right basis) threshold is provided for: the right to submit agendas, the right to apply for the courts to appoint an inspector(s) investigating into procedures or resolutions of general meetings; 3% (voting right basis) threshold is provided for: the right to convene general meetings (also with the requirement for duration of shareholding for public companies); 3% (both voting right and share basis) threshold is provided for: the right to inspect books and records, the right to apply for the courts to appoint an inspector(s) investigating into company's affairs and financial status.

the voting right or shareholding requirements (this means more in the interest of shareholders).

## II. Shareholders' Rights to Company's Information

From amongst the enumerated rights in the previous section, this article focuses on shareholders' rights to company's information. This sort of rights are most commonly utilised prior to executing other substantial monitoring rights such as voting right at general meetings and the right to bring derivative suits. This section deals with a shareholders' right to inspect a register of shareholders as well as to inspect books and records. These rights are on the subtle balance between secrecy of the company's information and shareholders' remedial actions against management. If they are executed properly, it will be in the best interest of all shareholders of the company and vice versa. The balance is subtle but the conflict between the company (as representing shareholders' common interests) and a claiming shareholder(s) is severe. Recently, some interpretative questions have been raised revolving around these rights in the process of hostile share acquisitions and managerial restructuring.

Section 125 (2) of the Japanese Companies Act provides that every single shareholder and creditor with a statement of its purpose may request inspection of a register of shareholders at any time within company's business hours. Section 125 (3) stipulates five reasons for the company to reject shareholder or creditor's request. This was newly written into a provision,<sup>21</sup> but the wording may have been transformed from Section 433 (2), which was originally introduced by the 1950 amendment. Therefore, the wording of the two provisions is given concurrently in the following outline put for Section 433 (2).

Section 433 (1) of the Japanese Companies Act provides that shareholders who hold at least 3 per cent of the total voting rights or 3 per cent of all issued shares (excluding the company's own shares<sup>22</sup>) may request inspection of books and records at any time within its business hours. As noted, this percentage can be lowered by the company's constitution. The previous act only provided for the voting right requirement but the new act adds the share requirement to it under the consideration that this right can be executed widely by those who do not

have voting rights.<sup>23</sup> The request by a shareholder must be written and with reasons in a concrete manner. Section 433 (2) also expressly provides reasons for the company to reject shareholders' requests. Five reasons are given in the present act almost in the same manner as in Section 125 (3) that reads; (a) where the shareholder has requested on the grounds other than collecting information to secure his/her right or execute his/her right; (b) where the shareholder has requested for the purpose of impeding company's businesses and of undermining common interests of shareholders as a whole; (c) where the shareholder who has made the request is doing materially competing business with the company or an employee of any such business; (d) the shareholder has requested for the purpose of disseminating the information from books and records to a third party for a return; or (e) where the shareholder has disseminated the information from books and records to the third party for a return over the past two years.

Historically, this provision was introduced in 1950 under the GHQ's occupational policy; thus, under the strong influence of states' business corporations' legislation in the USA.<sup>24</sup> But unlike in the USA where causes for the rejection are not expressly provided (developed in common law and case law built up on the relevant provision), as noted above regarding Section 433 (2), the Japanese provision has written them ever since it was introduced.

The questions that have been arising regarding this provision are (1) what are the contents of books and records which can be requested by a shareholder?, (2) does a shareholder who is going to make a request need to identify the name of books or records of the company?, and (3) to what extent a shareholder who wishes to make a request needs to clarify reasons for the request in the form?

<sup>23</sup> T.Aizawa, *Ichimon-itto Shin-kaisha-ho* (Tokyo: Shoji-homu, 2005), p.154. This requirement has been changeable. Before the amendments of June of 2001, company law only provided for the 3% share requirement. The amendment changed it to the 3% voting right requirement. Now a company can widely issue shares without voting rights for instance as a class of shares (section 108(1)(c)).

<sup>24</sup> For the historical background of the provisions, see for example, H.Shinkai, 'Kabunushi no chobo-etsuran-ken (1): Shoho 293-6 wo chushin to shite', (1972) 13-3 Kurume-daigaku Sangyo-keizai-kenkyu 265ff; M.Nagahigashi, 'Showa 25-nen shoho-kaisei: GHQ-bunsho kara mita seiritukeika no kosatsu (1)-(4)', (1995) 30-3 Chukyohogaku 1ff; (1996) 31-1 Chukyohogaku 129ff; (1996) 31-2 Chukyohogaku 21ff; (1997) 31-3 Chukyohogaku 107ff; S.Fujita, 'Chobo-etsuran-ken ni t suite', (2005) 75 Takushoku-daigaku-keiei-keiri-kenkyu 38ff.

<sup>21</sup> The previous act did not have an express provision but the courts have supported company's rejection when the right is abused by a right holder. However, there has not been any case before the court that relates to a claim by a right holder who runs a competing business of the company.

<sup>22</sup> The company is not allowed to vote at its general meetings for its own shares. Therefore this is relevant only to the case with the share basis requirement.

### III. Some Cases before the Courts

To obtain a clue to solve the above questions, this section refers to the relevant cases before the Japanese courts. Until very recently, only a few cases regarding the provisions, particularly the latter clause of the same provisions regarding rejection<sup>25</sup>, have been brought before the courts. This is mainly because onus of proof is imposed on the company when it contests before the courts that it has any reason to reject the shareholder's request. Normally, it is not easy for the company to show shareholder's purpose and intention. As for Section 433, most cases contested the above three points. The courts have given their views at least to these points. To question (1), the courts have interpreted that the meaning of books and records are confined literally to books and records made and used in accounting practice.<sup>26</sup> To question (2), the courts have consistently held that books and records which are permitted for the inspection are confined to those closely related to and identified by the reason and purpose of inspection.<sup>27</sup> For the last question (3), the Supreme Court has given that requesting shareholders must state clearly and concretely the reasons for their inspection but they are not required to show the facts behind the reasons.<sup>28</sup>

Reported cases regarding the rejection based on Sections 125 (3) and 433 (2) have been to date all grounded on (c). This section refers to these cases.

#### **Case I Tokyo District Court Decision of 4 March 1994**<sup>29</sup>

This was the first reported case regarding the rejection of shareholders' request to inspect company's books and records based on statutory grounds. A shareholder

who had been holding approximately 13.1 per cent of company A's all issued shares made a request to inspect books and records of company A but was rejected for the reason of its competing businesses. Company A's main business was to provide broadcasting services; however, it also had planning film, music, art and sporting events, consulting services regarding intellectual property rights and providing information about politics, economy, culture and living plans, etc. in its object clauses. The shareholder had been a representative director of company A and retained a position of director after retirement from a representative director due to hegemony between the directors, and was well known among broadcasting entrepreneurs and had considerable knowhow of broadcasting businesses as well as economic power. At the time of making a request as a shareholder, he was still a substantial shareholder but had already retired as a director of company A and established his own company B, having taken its representative directorship. Company B's objects were similar to those of company A except broadcasting services, though company B had not yet started actual business.

Tokyo District Court held that, although company B had not yet started its business, since possibility of the information so collected would be disseminated in favour of any future competing business was not zero it must be interpreted as a competing business. In light that the cause for the rejection had been introduced in order to protect a company from any risks of misappropriation of the financial information by shareholders regardless of whether they are actual or potential, predictability of unfair or distorted competition was enough to reject the request.

#### **Case II Nagoya Court of Appeal Decision of 7 February 1996**<sup>30</sup>

Company A held half of all issued shares of company B which had run golf courses. Company A requested inspection of books and records of company B but was rejected. A director of company B was a representative director of company A. Company B was set up by dividing company A into two and company A had run sporting facilities including developing and managing golf courses. The case was brought against the background that there had been a growing conflict between a director and a representative director of company B, who once jointly set up new businesses. The reasons for the rejection invoked were that (a) reasons for the inspection were not clearly and concretely given; (b) books and records it wished to inspect were not

<sup>25</sup> As noted, Section 125 (3) had not been in its existence until the present Companies Act was enacted in 2005. Before that, only a few cases relating to rejection by a shareholder or creditor's request due to a claimant's competing business.

<sup>26</sup> Tokyo District Court Decision of 22 June 1989. The similar statements were given again in Yokohama District Court Judgment of 19 April 1991; Tokyo Court of Appeal Judgment of 29 March 2006.

<sup>27</sup> Sendai Court of Appeal Judgment of 18 February 1974; Takamatsu Court of Appeal Judgment of 29 September 1986; Tokyo Court of Appeal Judgment of 29 March 2006, appealed by both parties from Tokyo District Court Judgment of 2 November 2005.

<sup>28</sup> Supreme Court Judgment of 1 July 2006.

<sup>29</sup> Reported at 1495 Hanrei-jiho 139; 875 Hanrei-times 265; 942 Kinyu-shoji-hanrei 17; 122 Shiryō-ban shoji-homu 135. Case comments by N.Sakamoto, (1994) Kinyu-shoji-hanrei 1; H.Katagi, (1995) 1515 Hanrei-jiho 243; H.Kansaku, (1995) 1068 Jurist (special issue) 104; N.Yoshida, (1995) 30-1 Asia-hogaku 97; U.Tamura, (1996) 12 Shiho-hanrei-remarks 100; M.Nakahigashi, (1997) 938 Hanrei-times 197; Y.Ito, (1998) 1482 Shoji-homu 27; R.Tsuchida, (1998) 1142 Jurist 108.

<sup>30</sup> Reported at 938 Hanrei-times 221. Case comments by K.Kobayashi, (1998) 978 Hanrei-times 168; M.Mori, (2000) 18-1 Matsuzaka-seikei-kenkyu 97.

identified; and (c) a requesting shareholder itself had been conducting competing businesses with company B. Company A in its capacity as a shareholder of company B and its representative director in his capacity as a director of company B jointly brought an action against company B.<sup>31</sup> In the argument concerning the reason (c), Nagoya District Court rejected plaintiff company A's argument that company B must permit company A's inspection as long as company A shows its intention not to misappropriate the information.<sup>32</sup> Company A appealed to Nagoya Court of Appeal. It again rejected company A's argument and said that company B only showed the fact of requesting shareholder's competing businesses in rejecting the request. Or, even if it could be interpreted as what the plaintiff had argued, it had not shown enough to ensure the lack of its intention not to misappropriate the information.

### **Case III Tokyo District Court Judgment of 20 September 2007<sup>33</sup>**

This case was also related to the rejection grounded on (c). But its significance was to regard the holding company's competing business as requesting shareholder's competing business and supported the rejection of the company. Company B was set up in 1951 as a broadcasting company and its shares were traded on the main board of the Tokyo Stock Exchange, Inc. Company A set up an internet technology (IT) venture business in 1997 (changed its business name to its present one in 1999) whose shares were traded on JASDAQ (originally a market for OTC securities), and had shown rapid growth. Company A and its group companies had acquired company B's shares for the purpose of proposing joint businesses pursuing the fusion of broadcasting services with internet providing services. However, company B did not welcome company A's proposal.

A wholly-owned subsidiary of company A (company C) was a substantial shareholder of company B. Company C requested an inspection of books and records of company B. The reasons for the inspection were to (a) check up how company B had invested in other companies which would be white knights to prevent company A and its group companies including company C from more acquiring; that (b) if directors of company B

purchased other companies' shares only to protect the company (ultimately to protect themselves by securing their positions) from share acquisitions by company A, such directors' activities could be assessed as inappropriate management activities, information was necessary to pursue directors' liability, etc.; and (c) there had been a real threat for company C because company B would decide to take defensive measures against company C and group companies by modifying its anti-share acquisition rules at general meetings, thus, company C needed to collect information before voting against such modification at general meetings.

Tokyo District Court held that company A and company C were in the wholly parent-subsidary relationship and inseparably connected. They were not only regarded as having financially the same personality but also the latter has been perfectly commanded by the former. The court also recognised the fact that they jointly collected proxies from company B's shareholders to control company B's general meetings. In conclusion, the court found that company C's request could be rejected for the reason that wholly subsidiary's request could be regarded as parent's request which run competing businesses with company B. Tokyo District Court held in the same direction that once the objective fact of competing businesses of the requesting shareholder (or its parent company) was confirmed, the request had to be rejected without any further proof of shareholder's intention not to misappropriate.

The above cases all rejected the shareholders' request. On the one hand, the court has interpreted competing business as recognisable only by proof of the fact of possibility of competition. Burden of proof is on the company but this is not too difficult. On the other hand, this is attributable to the nature of information itself. Once information leaks, no one can block its flow. Who knows who utilises it and when, where and how it is utilised? An overly protective approach to the threat of misuse of inside information is quite natural.

From the perspective of minority shareholders' protection, criticisms have been made of this series of courts' judgment or decisions. If the courts followed another interpretation that shareholders could prove their intention not to misappropriate the information for their success, some of them should have drawn the opposite conclusions.

By contrast a very recent case concerning the ground of competing business for rejection under Section 125 (3) is worth attention. Because it was the first case that accepted shareholder's right to request an inspection of a register of shareholders. Soon after the introduction of this ground of rejection, one case was brought before Tokyo District Court.<sup>34</sup> This was

<sup>31</sup> The court also referred to director's eligibility to request an inspection of his/her company. However, this point is not within the scope of this report and not to be dealt with.

<sup>32</sup> Nagoya District Court Decision of 20 February 1995.

<sup>33</sup> Reported at 1985 Hanrei-jiho 140; 1253 Hanrei-times 99; 285 Shiryo-ban-shoji-homu 135; 1276 Kinyu-shoji-hanrei 28. Case comments by K. Toriyama, (2008) 637 Hogaku-seminar 116; M.Yanaga, (2008) Hanreijihō 205; J.Ueda, (2008) 1354 Jurist (special issue) 113, J.Yamada, (2008) 37 Shihō-hanrei-remarks 100; M.Yanaga, (2008) 1357 Jurist 164.

<sup>34</sup> Tokyo District Court Decision 15 June 2007, (2007) 280

the first-ever case regarding rejection grounded on 125 (3). Despite practical concern, the Court interpreted the provision almost in parallel with 433 (2) and rejected a shareholder's request to inspect a register of shareholders. Another case was brought in June 2008, which will be noted below.

#### **Case IV Tokyo Court of Appeal Decision 12 June 2008<sup>35</sup>**

Company A is a real estate agent, developer and real estate asset manager and Company B runs almost the same businesses. Shares of the two companies are listed on the second board of Osaka Stock Exchange, Inc. and the second board of Tokyo Stock Exchange, Inc, respectively. Company A intended to jointly run businesses with Company B and for this purpose it started to acquire Company B's shares on or off-market. However, Company B never agreed on joint businesses with Company A. Company A and its wholly subsidiary acquired 16.16% of Company B's shares and Company A made a request to inspect Company B's register of shareholders. Company A's subsidiary submitted agenda items on 10 April 2008 to the proposed annual general meeting (AGM) of Company B which was scheduled on 27 June 2008, through executing its minority shareholder's right. The purpose of inspection was to identify shareholders with voting rights at that AGM and to win a proxy fight with Company B's management and the other shareholders friendly to the management.

Company B rejected Company A's request for the reason that a) Company A runs competing businesses with Company B (on a ground listed in Section 125 (3)) and b) violating shareholders' privacy without any reason undermines shareholders' common interest and brings disbenefit to Company B. Company A sought a interim relief before courts.

Tokyo District Court made a decision on 15 May 2008 to reject Company A's claim by literally interpreting "competing businesses". By contrast, on appeal, Tokyo Court of Appeal took a different approach to Company A's claim. Whilst recognising Company A's competing businesses with Company B, it held that Company B was successful to show that it had no intention to abuse the information it assumed to obtain from a register of shareholders. When Company A made a request, it submitted a statement that Company A would only check shareholders'

names for the purpose of collecting proxies. Thus, it was the first case to uphold a right holder's request and has attracted attention to date as its real impact on the business world should be serious.

To ensure an effective minority protection scheme within a company law framework, the courts should pursue each right of minority shareholders in the consistency with all other shareholders' schemes and ultimately, so to say, within a governance system of the company as a whole. The next two sections relate to this.

#### **IV. Harmonisation with Minority Shareholders' Right to Apply for the Courts to Appoint Inspectors for Company's Business Activities and Financial Situations**

As noted above, Japanese company law has had minority shareholders' right to apply for the courts to appoint inspectors since its original document's version in 1890.<sup>36</sup> This was introduced by referring to some model legislation particularly that of Europe. A German drafter Hermann Roesler, employed by the then government, noted that he modelled on British companies legislation.<sup>37</sup> Appointing an inspector or a verifier who is external and neutral to the company to collect information to correct malpractice of management was originated in Europe and differed from a USA idea of obtaining the same effect by companies' autonomous corrective interactions (but often with the court's intervention).

This is a typical example of the inconsistency within Japanese company law due to its following the Continental model during the pre-war period and the USA model after World War II. To harmonise (and even avail from) this right with the above right to inspect books and records, being derived coincidentally from the different models, it should be interpreted that right to inspect company's books and records and right to appoint inspectors are not competing with each other and shareholders who meet 3 per cent threshold (both have the same requirement) can rely on both rights. However, the right to appoint inspectors is not only to investigate financial situations of the company but also to investigate the whole of the company's affairs. In this sense, the

Shiryobanshojihomu 220. Case comments by K.Toriyama, (2007) 641 Hogaku-seminar 121; S.Masai,(2007) 1294 Kinyu-shoji-hanrei 2.

<sup>35</sup> Reported at (2008) 1836 Shoji-homu 104; (2008) 292 Shiryoban-shoji-homu 104; (2008) 1295 Kinyu-shoji-hanrei 12. Case comments by K.Toriyama, (2008) 645 Hogaku-seminar 129; M. Shintani, (2008) 1297 Kinyu-shoji-hanrei 6; M. Yanaga, (2008) 1361 Jurist 146; K.Shimada, et al., (2008) 1841 Shoji-homu 59.

<sup>36</sup> Section 239, the Draft Commercial Code and Commercial Code of 1890; Section 198, the Commercial Code of 1899 (the same provision remains renumbered to date).

<sup>37</sup> See Shiho-sho, *Roesler-shoho-soan* (1)(reprinted) (Tokyo: Shinsei-shuppan, 1995), pp. 443ff; H.Roesler, *Entwurf eines Handelsgesetzbuches für Japan mit Commentar* (reprinted), 1 Band 1996, S. 61, 348. For the historical background and legislative process for the original Commercial Code, see J.Ueda, 'Kabushiki-gaisha ni okeru keiei no kantoku to kensayaku-seido (1)', (1997) 116-1 Minsho-ho-zasshi 47.

scope of the latter is broader than that of the former.<sup>38</sup> Therefore, if shareholders who are suspicious of directors' financial statements, they primarily rely on their right to request an inspection of company's books and records. This is an indoor matter of the company and the courts will intervene only if unsolvable conflicts arise between the company and the requesting shareholders. By contrast, the right to appoint inspectors is to rely on the courts to control over the company which has been unable to expect sound management by its self autonomy. Whatever the background is, the two systems could be harmonised within the Japanese company law framework and advantage should be taken of them to strengthen shareholders' rights.

## V. An Expected Role of Shareholders in Corporate Governance

Japanese company law has struggled for a "good governance" system. Since its introduction of board system in 1950, strongly influenced by USA business corporation law, board has been expected primarily its monitoring function against directors. Through board meetings, directors monitor other directors, regardless of whether they are representative or non-representative, or executive or non-executive.<sup>39</sup> However, in practice most companies were not accustomed to the idea of outside (or more precisely independent) directors and have only internal executive directors. They were deeply committed to the company's daily affairs, while at the same time they were expected to have a monitoring function. Who could imagine that they "bark" at reckless or illegal findings for the act of directors?

Instead, Japanese company law has rather put more emphasis on the roles of an internal auditor(s). Internal auditors are appointed at general meetings.<sup>40</sup> They do not need any professional qualifications.<sup>41</sup>

<sup>38</sup> For the argument suggesting to the possible combination of these two provisions for effective inspection, see K.Yamada, 'Kabunushi no kaikei-chobo-etsuran-seikyūken to kensayaku senninseikyū-ken', in C.Suzuki, *Kaisha to soshō* (Tokyo:Yuhikaku, 1968), pp.553, 568.

<sup>39</sup> The Supreme Court has interpreted that directors have duty to mutually monitor themselves through board meetings (they have power to convene board meetings and they are expected to monitor other directors' activities outside the boardroom by executing that power)(see Supreme Court Judgment of 22 May1973). Right to convene board meetings vested to each director (Section 361) may give actual effect to perform this duty.

<sup>40</sup> Section 329(1).

<sup>41</sup> They do not need to be professionals. However, certain matters which disqualify them (e.g. being a corporate body, a person with limited legal capability, etc.) are provided and also because of the nature of their auditing duty, they are subject to a prohibition that they cannot be at the same time a director, an employee, etc. of the company and its subsidiary (see Section 335).

Their expected function is to check the legality of directors' business activities and of financial statements.<sup>42</sup> They can act as independent watch dogs barking at directors. Japanese company law has amended duties, powers and liability of internal auditors over the decades. Their longer duration than that of directors,<sup>43</sup> duty to attend board meetings,<sup>44</sup> veto to personnel matters of internal auditors at board,<sup>45</sup> submit agendas of appointing new internal auditors to board,<sup>46</sup> statement of reasons and opinions for their appointment, resignation and removal at general meetings<sup>47</sup> have been introduced into company law since the 1970s. However, in corporate practice directors are at the top end and auditors are at the second top of the ladder for employees and they share the feeling of same family members of a corporate house. What is worse is that, albeit the introduction of various manoeuvres strengthening and widening internal auditors' powers, auditors have been regarded just as being subservient to directors. Retiring directors and those who failed to hold the position of director have often been appointed as internal auditors. The long-standing practice has shown that they cannot play any supervisory role over directors.

Shareholders' function becomes significant in particular to supplement auditors' function. As long as shareholders are owners of the company, they should manage and control the company as they wish. Directors are only delegated by shareholders to manage the company. Shareholders' monitoring rights are derived from this delegator-delegated relationship. If minority shareholders' interest collides with that of directors (majority shareholders), the courts should not take a strict interpretation against minority's interest.

## Conclusion

Although the world financial crisis occurred in the middle of 2008 has considerably reduced the total number of proposed mergers & acquisitions (M&As) at global level, Japan still retains a good number of

<sup>42</sup> The scope of auditors' auditing function is controversial. Many commentators have argued that auditors are unlike directors not expected to audit validity of business judgment by directors. They just audit whether or not directors' business judgment is legal.

<sup>43</sup> The duration of auditors is four years (336(1)) while that of directors is two years (332(1)) unless company articles stipulate any shorter period (in case of a company having board committees one year (332(3))). A company whose shares are not allowed to transfer freely may extend the duration of directors and auditors up to ten years if it provides so in its articles (332(2) and 336(2)).

<sup>44</sup> Section 383(1).

<sup>45</sup> Section 343(1).

<sup>46</sup> Section 343(2).

<sup>47</sup> Section 345(4).

M&A cases, particularly in-out M&A cases.<sup>48</sup> M&As as an extravagant, social phenomenon posed again hot discussions about “of whose interest management takes account in running the company?”. In the arena of M&As, money makes power. Shareholders who have suddenly appeared by acquiring certain percentage of the company’s shares obtain power to control management through their voting rights, monitoring rights as above, etc (It should be remembered that the most notable, recent cases above were brought before the courts in the process of hostile M&As). This may inevitably lead to management activities to run the company in the best interest of its shareholders for the two very different reasons: (a) in order to protect the company and its management from hostile bidders, management takes into account the best interest of friendly shareholders for their long-term investment; and (b) management is forced to listen to strong voice of hostile major shareholders who vote for maximisation of the company’s short-term profits. Interests of employees, creditors, customers, communities, etc. are disregarded, or are at best behind those of shareholders. As a counterargument to this, a traditional idea about “shareholders’ supremacy” has ever been strongly proposed to be replaced. However, this article is not to contribute to such an argument. Rather, the article aims to warn that before considering other stakeholders’ interests even shareholders’ interest and rights under the law have not been appropriately ensured.

Japanese companies are said to have taken great care of employees. Each company has its own trade union and negotiation and co-decision of management with its union is common. By contrast, yearly distribution of profits to shareholders stays almost at the same level no matter how much it earns. The M&A trend has gradually changed this practice. Not an approach of “shareholders’ supremacy” but that of “enlightened shareholders’ supremacy” should be explored in the harmonisation with all other stakeholders of the company.

---

<sup>48</sup> At international level, the period 1 January 2008-20 October 2008 saw the cancellation of 1,203 M&A cases. The statistics for Japan shows that target assets involved in M&A cases during the period 1 January 2008-31 October 2008 went 39 per cent up compared to those involved in M&A cases during the same period of the previous year. See, e.g., *The Nihon Keizai Shimbun*, 6 November 2008.