INTRODUCTION OF NEW CORPORATE GOVERNANCE CODE

Date: 9 July 2015

Asia Corporate and Transactional Alert

By: J. Ryan Dwyer, III, Tsuguhito Omagari, CJ Hoppel

On June 1, 2015, a new Corporate Governance Code (Code) came into effect for companies listed on the Tokyo Stock Exchange (TSE). The Code is part of the Japanese government's efforts to reform certain long-standing corporate governance practices of Japanese companies that many, both inside and outside of Japan, see as inhibiting growth and shielding boards of directors from accountability to shareholders.

The Code takes a 'principle-based approach' (as opposed to a rule-based approach), which requires each listed company to determine, based on the purpose and spirit of each principle, whether its activities are in line with each relevant principle. Listed companies are expected to consider and take concrete actions which are in line with the purpose and spirit of each principle.

The Code also takes a 'comply-or-explain' approach which requires each listed company to comply with each principle or explain its reasons for non-compliance. The Code requires each company to explain its reasons in its corporate governance report so that the company's stakeholders, including its shareholders, can evaluate those reasons. It is expected that through dialogue with their shareholders, companies will improve their explanations and the actions they take as corporations.

CORE PRINCIPALS

The Code lists five 'General Principles' that all listed companies should focus on in their governance:

1. Securing the Rights and Equal Treatment of Shareholders
   In addition to securing shareholder rights and providing equal treatment for shareholders, companies should also give “adequate consideration […] to the issues and concerns of minority shareholders and foreign shareholders”. The Code also includes provisions requiring companies that are listed on the 1st and 2nd sections of the TSE to disclose any cross-shareholding positions they may hold in other companies and the reasoning behind such cross-shareholding.
2. Appropriate Cooperation with Stakeholders other than Shareholders
   The Code emphasizes that companies should recognize that their sustainable growth and mid-term or long-term corporate value is derived from resources and contributions from not only shareholders but also the various other stakeholders in the company (e.g. employees, customers, etc.) and companies should “appropriately cooperate with these stakeholders”.
3. Ensuring Appropriate Information Disclosure and Transparency
   Under the Code, companies are expected to not just disclose the bare minimum amount of information

required by law and other regulations but should “strive to actively provide information beyond that required” which “will serve as the basis for constructive dialogue with shareholders”.

4. Responsibilities of the Board
   The Code highlights three main roles and responsibilities of the board of directors of a company: (i) setting the broad direction of corporate strategy, (ii) establishing an environment where appropriate risk-taking is supported, and (iii) carrying out effective oversight of directors and management. The Code recommends that companies appoint at least two independent directors to their boards.
5. Dialogue with Shareholders
   The Code recommends that companies have open, 'constructive' dialogue with their shareholders, that the directors should pay attention to shareholders' concerns and that they should clearly explain the business policies of the company to the shareholders.

ISSUES TO NOTE

6. While the Code only applies to publicly listed companies, it is expected that the governance reforms contained in it will also shift governance norms at private companies.
7. One of the principal aspects of the Code that has been highlighted by commentators is that companies that are listed on the 1st and 2nd sections of the TSE must appoint at least two independent directors to their boards. Companies that do not appoint two independent directors are required to explain their reasoning for not doing so.
8. Certain proxy-solicitation firms (e.g. ISS) have already revised their recommendations about how to vote at shareholder meetings based on whether companies bring themselves in compliance with the Code, specifically with respect to whether they have appointed independent directors.

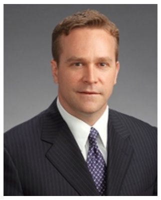
CONCLUSION

As part of the 'third arrow' of Prime Minister Abe's economic reforms over the past few years, the ability to actually reform Japanese corporate governance has been met with some scepticism. But, at least preliminarily, it appears that Japanese companies are actively feeling pressure to undergo at least some governance reform. It will remain to be seen how effective these measures are and whether the reforms translate to corporate governance practices closer to companies in the U.S. and Europe.

K&L GATES TOKYO

K&L Gates' Tokyo office was established in January 2010 and has over 20 lawyers providing full service Japanese legal services in addition to cross-border transactional advice. Our Tokyo office advises international firms in Japan related transactions and all aspects of their operations in Japan and advises Japanese firms on both domestic and cross-border transactions and disputes.

KEY CONTACTS



J. RYAN DWYER, III
PARTNER

TOKYO
+81.3.6205.3601
RYAN.DWYER@KLGATES.COM

TSUGUHITO OMAGARI
PARTNER

TOKYO
+81.3.6205.3623
TSUGUHITO.OMAGARI@KLGATES.COM

