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Important Matters to Note when Causing Directors (Including Representative Directors) to Resign

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1. Introduction

What kind of reasons and procedures are required to cause directors of Japanese stock companies (*Kabushiki Kaisha*) to resign? Also, will a company be required to pay any retirement benefits or severance payments? To answer these questions, you must consider the scope of application of Japanese labor law, as well as the rules under the Companies Act of Japan regarding dismissal of directors and their remuneration (including retirement benefits).

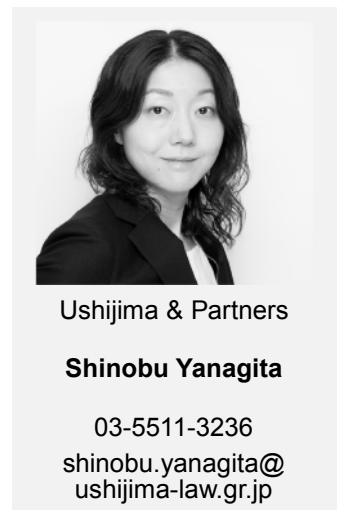
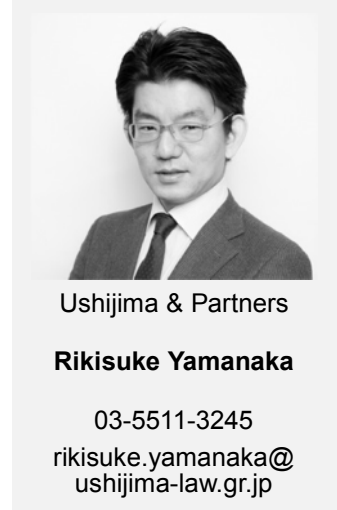
2. What kind of reasons and procedures are required to cause directors to resign?

Under the Companies Act of Japan, companies may dismiss directors at the company's discretion, and at any time, by a resolution of a shareholders meeting.¹

However, if a director is deemed to be an "employee," then the Labor Contracts Act and other Japanese labor laws will apply. Under the Labor Contracts Act², in order to cause such directors to lose their employee status by dismissal, the dismissal must not only have objectively reasonable grounds, but must also be considered to be appropriate in general societal terms. Any dismissal not satisfying these requirements will be invalid. The Japanese courts would not easily accept a company's allegations that these two requirements have been satisfied, so it would not be easy for a company to dismiss employees based on simple reasons such as "poor performance", etc.

Therefore, it is crucial to determine if the director in question has employee status or not. Generally, a person is considered to have employee status when that person carries out his or her work under the direction of his or her employer. For directors in particular, a person who makes decisions regarding the execution of the business of the company is generally not considered to have employee status, while a person who does not make such decisions generally is considered to have employee status.

Representative directors are typically not regarded as employees in principle because they are ordinarily not under the direction or supervision of others, or are not restricted by others, in carrying out their duties, and also because they represent their companies both internally and externally. However, it is important to note that, for Japanese companies that are wholly-owned subsidiaries of foreign companies, representative directors often



¹ Companies Act, Article 339, Paragraph 1

² Labor Contracts Act, Article 16

have very limited actual authority and so could be considered to have employee status.

3. Are severance payments, etc. required when causing directors to resign?

Under the Companies Act, a resolution of a shareholders meeting is required in order to pay remuneration (including retirement benefits) to directors.³ Even if a company has internal rules regarding retirement benefits for directors, and even if it is customary for the company to pay such retirement benefits to a resigning director, the company is not obligated to pay retirement benefits in principle, unless a resolution to such effect is adopted at a shareholders meeting.

However, the Companies Act provides that when a director is dismissed through a resolution of a shareholders meeting, and if such dismissal lacks reasonable grounds⁴, the director may claim compensation from the company for damages in the amount equivalent to his or her remuneration for the remaining term of office.⁵

The term of office of directors is two years in principle⁶; however, in the case of a stock company that is not a public company, the term of office can be extended to as long as ten years by the articles of incorporation.⁷ Therefore, companies should note that, when a company dismisses a director, the company may be obligated to pay an amount equal to the director's remuneration for up to ten years depending upon his or her remaining term of office.

In addition, when a director is considered to have employee status, then the same rules of employment, retirement benefits regulations and other internal regulations that are applicable to employees will also apply to directors, and so the company may be required to pay the directors retirement benefits, etc. pursuant to such internal regulations.

4. Practical measures

When a company decides to cause a director to resign in Japan, it is common practice for the company to first negotiate and agree with the director on certain conditions (such as payment upon the director's resignation), instead of immediately dismissing the director by a resolution of a shareholders meeting.

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³ Companies Act, Article 361, Paragraph 1

⁴ However, the dismissal itself will be valid even if it lacks reasonable grounds.

⁵ Companies Act, Article 339, Paragraph 2

⁶ Companies Act, Article 332, Paragraph 1, main clause

⁷ Companies Act, Article 332, Paragraph 2