



Legal Pitfalls in Doing Business with Japan

Thomas Witty
thomas.witty@arqis.com

WKO Austria Wien, 24. April 2017

The Japanese Legal System

- **Civil law system with foreign roots**
 - German, French & American influences
- **Court procedures & arbitration**
 - Professional judge system (lay judge system in criminal proceedings)
 - No litigation society
 - Non-reimbursement of attorney fees creates strong disincentive
- **Judgements with a „social“ touch**
 - Courts emphasize the social function of law
- **Legal relationships: substance over form**
 - Contract adaptation: change of circumstances justifies amendment
 - Interpretation: parties' intent may prevail over written terms
 - > E.g. rental agreement (no termination unless fixed term)
- **The legal profession**
 - Lawyers: approx. 27,000
 - Judges: approx. 2,500

Typical Investment Strategies

- **Indirect Investment**

- Distribution
 - > Agent
 - > Commission Agent
 - > Distributor
- Other contracts
 - > License
 - > Franchise

- **Direct Investment**

- Representative Office
- Branch
- Subsidiary
 - > Kabushiki Kaisha
 - > Godo Kaisha
- Joint Venture
- M&A

Overview Investment Schemes

	Investment Structure	Control	Cost	Parent Liability	Taxation	Time for Establishment
Subsidiary	Simple	High	Average	No	Local	Short
Branch	Simple	High	Average	Yes	Local	Short
Joint Venture	Complex	Depending on share ratio	High	No	Local	Long
Agent	Simple	Average	Low	Yes	Parent	Short
Distributor	Average	Low	Low	No	Parent	Short

Distribution Law

- **Complex distribution structure** with too many layers prevails
- **Poor contracts** often do not address terms and conditions of later termination
- **Different expectations** regarding important contractual terms and conditions often prevail, e.g. term of agreement (unlimited), adaptation (whenever necessary), succession of customer base (only against extra payment) etc.
- **Case law** is established but disputes continue to focus on
 - right of termination by the principal (in particular for long term agreements), and
 - duty & amount of agent compensation
 - > for loss of business, customer base etc.
 - > Most important criteria are: (i) period of contractual relation, (ii) degree of economic dependence from principal, (iii) termination notice period
- **Unilateral termination** requires careful assessment of above criteria in addition to terms of contract; termination may be effective if notice term appropriate (1 or 2 years), but often justifiable cause required in addition
- **Choice of law and competent court** often not defined in contract

Note: Termination of distributor contract requires sufficient advance notice and justifiable cause!

Corporate Law

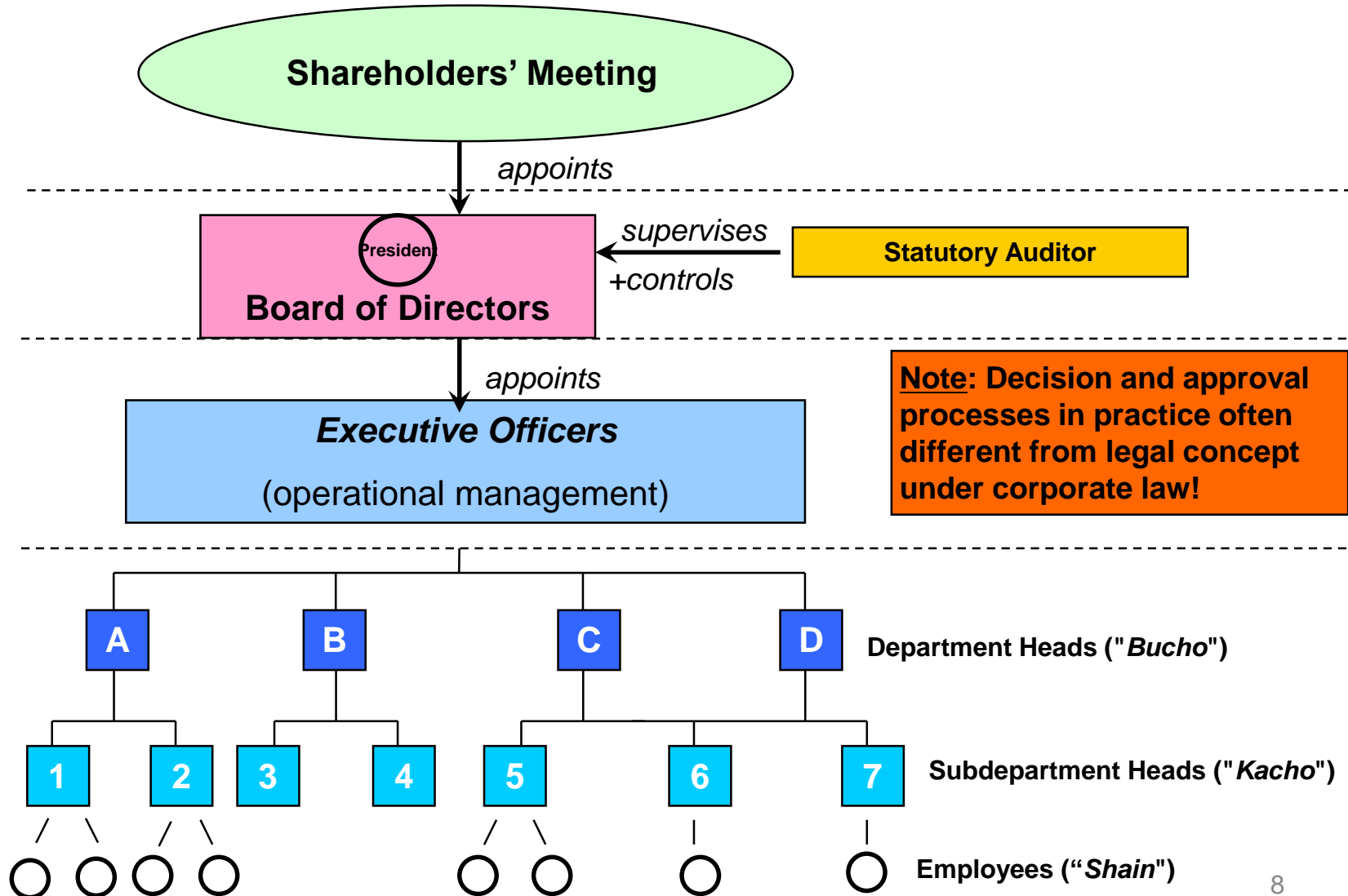
- **Kabushiki Kaisha** is the most common company form
- **Uniform legal structure** established in great majority of companies in Japan
 - distinction between „auditor-type company“ and „committee-type company“ or combined forms in general not applicable to foreign invested companies
- **Strong emphasis on „stakeholders“** as opposed to „shareholders“
- **Shareholders Meeting:** practical function often less than legal competences
- **Board of Directors: wide discretion** to manage company affairs
 - deemed representation of shareholders for signing / sealing of meeting minutes
 - little control due to absence of supervisory board
 - **Principle of sole representation**
 - > no registration of joint representation in registry,
 - > limitation will only be internally effective
 - > no requirement for (representative) director to be resident in Japan
 - **Legal qualification of board members** raises various issues:
 - > statutory term of office may differ from term of engagement
 - > qualification as employee may prevail even after appointment as director
 - > limited tax deductability of bonus payments to directors

Note: Board can sign off shareholders' resolution without the latter's approval!

Legal Types of *Kabushiki Kaisha* (auditor-type)

Type of Stock Corporation		Board of Directors	Number of Directors	Term of Directors	Board of Statutory Auditors	Number of Statutory Auditors	Term of Statutory Auditors	External Auditor
Private Stock Corporation with Limitation on Transfer of Shares	small or medium sized	Optional	1 or more	Up to 10 years	Optional	0 or more	4 to 10 years	Optional
	large	Optional	1 or more	Up to 10 years	Optional	1 or more	4 to 10 years	Optional
Public Stock Corporation without Limitation on Transfer of Shares for at least one Class of Shares	small or medium sized	Mandatory	3 or more	Up to 2 years	Optional	1 or more	4 years	Optional
	large	Mandatory	3 or more	Up to 2 years	Mandatory	3 or more	4 years	Mandatory

Legal Organisation of a *Kabushiki Kaisha* (auditor-type)



Legal Organisation of a *Kabushiki Kaisha* (auditor-type)

- **Board of Directors (*Torishimariyakkaï*)**
 - Executive body appointed by shareholders' meeting
 - Elects representative directors from its members
 - Term of office usually 1 or 2 years (max. 10 years for private companies)
- **Statutory Auditor (*Kansayaku*)**
 - Legally independent body with control function
 - Exception: Committee System (committees have decision competence)
- **Executive Officers (*Shikkoyakuin*)**
 - Management appointed by BoD (dual function as board member possible)
 - > No entry in commercial register
- **Department Heads (*Bucho, Kacho*)**
 - Employees with managing function
- **Employees (*Shain*)**
 - Further to be differentiated by occupation groups (part timer etc.)

Kabushiki Kaisha: Legal Representation

- Board members **authorized** by the board to represent the company are representative directors
 - Unlimited authorization to represent company vis-à-vis third parties; limitation only possible internally
 - Joint representation permissible, but cannot be registered
 - No representation through board as collective body
- As **unauthorized** board member with title
 - Liability of the corporation against bona fide third parties for actions of a board member acting without authorization to represent the company when using the following titles:
 - > *President (shacho)*
 - > *Vice President (fuku-shacho)*
 - > *Senior Managing Director (senmu)*
 - > *Managing Director (jomu)*
- Acting in lieu of shareholders: board and shareholders' resolutions are usually sealed / signed by the directors (not the shareholders); this creates need to establish internal compliance procedures
- Seal often replaces signature

Note: Inconsistencies between English legal title and function possible!

Employees: Legal Categories

- **Executives with Employee Function**
 - Members of the Board of Directors (except President)
 - Executive Directors
 - Committee Members (*Committee System*: e.g. Audit Committee)
- **Employees**
 - Managerial Employees
 - Regular Employees
- **Part-Time Workers**
 - Part-time workers
 - “Freeter”
- **Temporary Workers**
 - Service contract with temporary employment agency
- **Fixed Term Employment Relations**
 - Limited term up to 1 year, in special cases renewable up to 5years

Note: Legal qualification varies depending on nature of assignment; legal assessment is often based on substance rather than form of arrangement!

Labor Law:

- **Employment contracts** mandatory but not always existing
 - employment rules replace individual contract
- **Overtime compensation** mandatory but often ignored
 - employees with managerial function exempted
 - strict requirements for regular employees
 - Labor-management agreement (“36 Agreement”) required for extension of regular working hours up to 100 hours (loopholes)
- **Labor Union** influence diminished but still relevant in some industries
 - umbrella organization Rengo also involved in individual labor disputes (in addition to labor office)
 - Union-shop agreements common in large companies
- **Voluntary Retirement & Dismissal**
 - notice term 30 days (employee: 14 days)
 - no dismissal without justifiable cause (even during probation period)
 - unpredictable outcome of court procedures creates strong incentive for settlement
 - voluntary retirement is standard procedure
- **Legal proceedings**
 - No special “labor courts” but “labor tribunal” with lay judges
 - Court rulings inconsistent

Note: High ratio of excess and/or unpaid overtime.

Note: Unilateral termination requires justifiable cause.

Anti-Trust Law

- **Act Concerning Prohibition of Private Monopolization and Maintenance of Fair Trade (AML)**
 - **General concept** similar to EU and US standards; aim is to prevent and prohibit:
 - > Private monopolization;
 - > Unreasonable restraint of trade;
 - Restraint must be „**substantial**“
 - > Unfair trade practices;
 - Unjust discrimination (price-setting according to regions, etc.)
 - Unjust pricing (predatory pricing)
 - Unjust inducing and coercion (misleading representations, etc.)
 - Unjust use of bargaining power (imposing one-sided conditions etc.)
 - » **Subcontractor Law**
- **Japan Fair Trade Commission** is the competent authority
 - Can order cessation or prohibition of illegal acts
 - Scale of investigations still comparatively small
 - Penalties for company and individuals (imprisonment & fines)

Note: Basic principles of Japanese Anti-Trust Law similar to those in EU and US. However, less enforcement due to limited capacity of JFTC.

Real Estate

- **Standard Lease Agreement (office and residential)**
 - Defined term with automatic renewal, unless notification of non-renewal with prior notice is made; **effectively unlimited agreement**
- **Fixed Term Lease Agreement (office and residential)**
 - Fixed term with automatic termination, unless renewal agreed between parties; **effectively limited agreement with fix term**
- Sub-lease, dual use as residential and office premise usually **not permitted**
- Lessee generally obliged to obtain **property damage insurance** for premises at own cost
- **Deposit & Key Money (“Reikin”)**
 - Deposit mandatory, commonly with no interest
 - No set-off of deposit claim with rent in case of bankruptcy, unless expressly stipulated in lease agreement!
 - Key money not mandatory and negotiable
- **Restoration** of lease object to original state at lessee’s cost by time of vacating mandatory, but costs negotiable (usually contractor designated by landlord)

Note: Depending on market situation many standard terms are negotiable! Use of outside service providers helpful.

Social Insurance


- **Three Pillars of Social Security System**
 - Labor Insurance (Unemployment and Workers' Accident Insurance)
 - Health and Nurse Care Insurance
 - Pension System
- **Scope of Application of Social Security System**
 - Mandatory for all persons employed in Japan regardless of their nationality
 - > Labor insurance not applicable to self-employed persons and directors
- **Pension Insurance**
 - National Pension System eligible for Japanese residents from 20 to 60 years, e.g. spouses and self-employed persons; fixed contribution
 - Employees' Pension Insurance, eligible for employees in a corporation etc. or an employer with five or more employees; contribution based on percentage of salary
 - Pension Insurance contributions are borne by employer (1/2) and employee (1/2)
- **Exemption from Japanese Pension Insurance**
 - Only if based on treaty (no Social Security Treaty with Austria)

Note: Participation in social security system is mandatory although non-compliance is not yet strictly pursued (no fines yet)!

Criminal Law

- **Substantive Criminal Law Similar to Germany, but Differences in Practice**
 - > Criminal procedure and its practice differ strongly!
 - e.g.: immediate and long detentions (esp. in case of foreign offenders), severe penalties (including death penalty)
- **Principle of Discretionary Prosecution**
 - Strong role of public prosecutors with nearly unlimited discretion
 - Strict obedience of all regulations expected, esp. by foreigners
- **Drug-related Crimes are Punished Severely**
 - E.g. up to 10 years or more even for mere possession of minimal amounts of “light” drugs (marijuana etc.), also for first-time offenders
 - > Risk areas: bars/clubs/discos in certain parts of town
- **Traffic Accidents may entail Criminal Proceedings**
 - > Out-of-court settlement with victim can be advisable
- **A Foreigner Convicted in Japan may be Expelled**
 - > In most cases re-entry to Japan is denied for many years (or for lifetime)
- **Immigration Violations**
 - > A foreigner working/living in Japan with improper visa may be exposed to criminal liability and may be expelled from Japan

Note: High level of discretion of police and prosecution. Efficiency of criminal proceedings rather unpredictable.



Thank you for your attention!