KOJIMA LAW OFFICES

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Labor & Employment Law Newsletter

Representative Directors – Frequently Asked Questions

Anyone tasked with setting up a Japanese subsidiary of a foreign company has probably experienced the frustration of trying to make sense of what exactly a "representative director" is. Our clients frequently get confused when attempting to figure out the intricacies of hiring and firing a representative director, as well as everything in between. To make it as painless as possible to understand the key points about representative directors in Japan, we have prepared answers to some of the most commonly asked questions on this topic.

What exactly is a "representative director"?

Before we get to that, we need to address the inconvenient reality that the term "representative director" (in English) is in no way an official title or a legal description. It is merely a literal translation of the Japanese term *daihyo-torishimariyaku* (which definitely *is* official, though admittedly a mouthful). How unofficial is the English translation "representative director"? Well, some companies have opted to use such alternate translations as "managing director," "country manager" or even "CEO." The precise translation is not the point here. What's important to understand is that "representative director" or any other English title is simply a translation of the actual Japanese term. These English terms have no independent significance under Japanese law, and are used solely for the convenience of the non-Japanese speaking world.

So there's no advantage in giving a *daihyo-torishimariyaku* an English job title other than "representative director"?

That's right. It doesn't matter what English term a company chooses to call its head person. At the end of the day, it is the official title of *daihyo-torishimariyaku* that will determine how a company handles a variety of issues including hiring, terms of employment, remuneration and termination. With that said, for the remainder of this article, we will refer to the position of *daihyo-torishimariyaku* as "rep director."

Now, getting back to the question. Perhaps the simplest explanation is that every company incorporated in Japan with a board of directors is legally required to have at least one rep director who, well, is able to represent the company in every way possible. This includes the ability to sign virtually any contract on behalf of the company, and make oral representations that will bind the company. A company without a board of directors can still choose to have rep director. If it does not do so, however, then each director may individually represent the company. The company's board supervises the rep director, who has a fiduciary duty to act in the best interests of the company (including avoiding any material conflicts of interest). Although a company may have multiple rep directors, in fact most small to medium-sized companies have only one.

That sounds like a lot of power for one person to have.

It is. In the hands of an unprincipled rep director, this broad authority could be misused, potentially opening the company up to massive liability. Which is why a company needs to be extremely careful in choosing its rep director. This is especially true for a foreign company looking for a rep director to lead its Japanese subsidiary. Unless the company adopts a policy of having everything translated from

Message from the Labor and Employment Practice Group

Kojima Law Offices have provided legal services in the area of labor and employment law since its founding in 1984. Our Labor and Employment Practice Group represents clients in labor disputes and assists them in structuring and implementing HR policies. We work with both foreign headquarters and local management to timely and appropriately resolve employment issues that overseas companies face operating in Japan. As part of our continuing effort to reach out and share our expertise with others, the Labor and Employment Practice Group publishes this newsletter to provide a better understanding of this complex area of law, thereby enabling the reader to make more appropriate employment and labor decisions. We hope you find the newsletter both interesting and informative and welcome any feedback you wish to share with us.

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the original Japanese (a prohibitively expensive practice), much of what happens at the Japanese subsidiary will be inaccessible to the non-Japanese speaker. Because the rep director is sometimes the only person in the company capable of communicating effectively with the foreign parent, he or she can effectively control what information the foreign parent receives. This makes it easier for a rep director to conceal mistakes or unfavorable developments concerning the company. In the worst case, it would not be that difficult for an unscrupulous rep director to hide embezzlement or other serious wrongdoing.

Can the rep director be non-Japanese?

Yes, but at least one rep director must reside in Japan. If the company does not have a board of directors and does not have a rep director, then one of the directors must be a Japanese resident. This could be a challenge for foreign companies wishing to enter the Japanese market but that do not currently have a presence in Japan.

What if a company trying to set up a subsidiary in Japan doesn't have anyone that can serve as a resident rep director?

This is one of the challenges in establishing a branch or subsidiary in Japan. In fact, you'll need a rep director just to clear one of the initial hurdles – registering the company with the legal affairs bureau. You need to list a rep director in the registration application, even if the foreign parent does not yet have any real presence in Japan. This requirement can result in an almost Catch-22 type situation where to set up a company you need a rep director, but it is difficult to retain a suitable rep director until your company is set up. In response, companies have sprung up to assist foreign entities in setting up a Japanese subsidiary. These companies can provide temporary rep directors to satisfy the registration requirements. Once the subsidiary is properly set up, the foreign parent can then replace the temporary rep director with the "real" one.

What's the difference between a company's "president" and its rep director?

This is a bit confusing. Even a lot of Japanese aren't quite sure. What can muddle the issue even more is the fact that the same individual usually serves both as "president" (*shacho* in Japanese) and rep director. As noted above, the Japanese word for rep director is a legal term. The position carries with it certain rights and duties under Japanese law. On the contrary, the title of "president" is something that companies often confer on an individual on top of his or her official rep director title under the company's articles of incorporation. Strictly speaking, however, unless this "president" is also officially registered as the company's rep director, he or she legally has no right to make decisions for or act on behalf of the company. Regardless, companies should be extremely careful not to allow non-rep directors to call themselves "president."

Why? Because people will assume that the "president" is also the company's rep director even if that's not the case?

Yes. Since most presidents are also rep directors and rep directors have the legal right to bind the company, most people understandably (though incorrectly) assume that all presidents have that authority, even ones who aren't rep directors. To protect these unwitting individuals, Japanese law effectively provides that a company should give the title of "president" only to one with actual authority to represent the company. It does this by making it clear that even a "president" who's not registered as the rep director can bind the company in order to protect third parties who reasonably believe this person has such authority.

So the rep director is basically the highest-ranking employee in the company.

Okay, here's where things start to get a bit tricky. Saying in Japanese that a rep director is "employed" or an "employee" can be costly when the company wishes to terminate the rep director prior to the end of his or her term.

Why? What's so bad about treating a rep director an "employee"?

In Japan, certain workers are classified as "employees" who (at least in the past) are supposed to be virtually layoff-proof. Among these classes, by far the most relevant to a discussion of rep directors is what is popularly referred to as *seishain* employees. This is because most rep directors promoted from within the company were *seishain* prior to their promotion (the same is usually true for rep directors poached from other companies). *Seishain*, which is not a legal term, is usually translated as "full-time employee," "regular employee," or "permanent employee," even though these English terms in no way come close to capturing the full import of what a *seishain* really is. It is not a job title or a position. Instead, *seishain* is an employment *classification*, and a coveted one at that. If you fall into this category, you are usually a *seishain* employee from your first day on the job as a brand-new recruit, and remain a *seishain* employee all the way up until the day you retire. Japan watchers are probably familiar with the *seishain* concept – if not the term itself – because of the "lifetime employment" system that was prevalent in better economic times. For purposes of this discussion, it is enough to know that *seishain* employees enjoy an extremely high level of job security. (For details of how difficult it can be to dismiss employees in Japan, please see the discussion of "ordinary dismissals" in Volume 3 of this newsletter, which is available on our website at http://www.kojimalaw.jp/en/newsletters/index.html.)

So treating rep directors as "employees" risks placing them into the *seishain* category, therefore rendering them dismissal-proof?

In a nutshell, yes. In Japan, it is extremely difficult to

terminate what the law considers an "employee," including of course *seishain*. In fact, it is sometimes impossible to do so if the employee is adamant about staying. In some cases, a court will find that a company had abused its rights as an employer by attempting to terminate the employee without valid legal grounds. In the worst case, the court can issue an order effectively forcing the company to keep the employee on payroll for an indefinite period of time.

Can we avoid this problem by classifying a rep director as an "employee," as long as it's a non-*seishain* employee?

No. But as discussed above, the only class of "employee" that's really meaningful to rep directors is *seishain*, which is why we highlighted it. To be safe, you should scrupulously avoid any mention of or reference to "employee" or "employment" in your correspondence, the directorship agreement, and any other documents related to the rep director.

Okay, but isn't it true that under Japanese law, an individual automatically loses his or her "employee" status upon being appointed as rep director. If so, I don't see a problem.

Yes, that's true. In most companies, this effectively means that a rep director has virtually no chance of being considered an employee (a "standard" director is another story). But the same may not necessarily be true for foreign companies with Japanese subsidiaries. Many rep directors were *seishain* employees prior to the start of their directorships, and some rep directors were *seishain* employees of a parent company prior to being seconded to serve as a director of a subsidiary. For rep directors of foreign companies, it is often unclear which entity the rep director had been an employee of - the foreign headquarters or its Japanese subsidiary. When faced with termination, some rep directors claim that they were in fact hired by the foreign headquarters and seconded to the Japanese subsidiary. This can create enough uncertainty to allow the rep director to argue that his employment status with the foreign headquarters never terminated. Even if the company can ultimately prevail in court, it's usually best to avoid the time, cost and uncertainty of litigation.

How can companies minimize the chance that the rep director will claim to be an employee of the foreign headquarters?

For starters, companies should enter into a service (not "employment") agreement with a prospective rep director and make it clear that any prior employment relationship with the company will terminate upon his or her appointment. The service agreement should also explicitly state that the rep director will not be an employee of the company (as "employee" is defined in Japan, as keenly discussed above). Instead, the rep director should be the equivalent of a service provider. Some companies try to include a provision that prohibits the rep director from claiming damages other than those agreed to in advance. In addition, the rep director should not simply be acting under the supervision of the foreign parent. The company should make it clear that the rep director has broad discretion in the performance of his or her duties, and is not merely parroting the foreign parent's directions. This is because, under Japanese labor law, whether or not one is an employee is determined not only by the individual's title, but also by the person's actual authority and work responsibilities.

Okay, so let's assume we manage to avoid having the rep director classified as an employee. Does that mean it's now easy to terminate the rep director?

Here's the dreaded answer – it depends. Because the rep director is not officially an employee but is instead more akin to a service provider, the company can terminate the rep director's services at any time and for any reason.

Sounds simple enough. But then why does it "depend"?

If the company terminates the rep director's services for reasons that are legally justifiable, then it is in fact pretty simple. The shareholders pass a resolution and the rep director is effectively out (okay, technically the company will need to retain the departing rep-director long enough for it to register its new rep director, but you get the point). You normally don't even need to provide any advance notice or severance pay. On the other hand, without "legally justifiable" reasons, the company will probably need to pay the rep director a certain amount of compensation. The default rule is that this compensation is the remaining remuneration and bonuses that the rep director would have received had he or she served out the remainder of the directorship, plus any compensation he or she would have received at the expiration of the directorship (such as a retirement allowance). This amount shouldn't be an issue for a company that wishes to terminate its rep director near the end of the directorship. However, terminating a rep director at any other point in time can get very expensive. Take for example a rep director serving in the first six months of a two-year directorship. A legally unjustified termination could result in this rep director receiving a windfall severance package of a year and a half's worth of pay, plus retirement allowance. Not bad for only six months of work.

Hold on. If that's true, why not limit all directorships to, say, just one year?

If possible, that's the best option. A company can always provide in its articles of incorporation that directorships can last no more than two years. However, many highly-qualified candidates will have to give up the security of a *seishain* employee position at an established Japanese company in order to serve as a rep director. These candidates are very aware that they will no longer be considered "employees" when serving as rep directors. Because of this concern,

some rep director candidates may insist on a multi-year directorship in exchange for the loss of the *seishain*-level job security they currently enjoy. Companies that refuse may find it harder to attract top-level talent. This is probably even more true of foreign companies looking for a qualified rep director. Because most foreign companies will require a bilingual rep director, the pool of available candidates is much smaller.

What are some examples of valid legal grounds that would justify terminating a rep director?

It would be great if there were clear-cut guidelines to answer that question. As you can probably guess, though, it's really a case-by-case determination. Obviously, a company would likely be justified in terminating a rep director who, in connection with his or her directorship, had engaged in illegal activity or who had been found guilty of a serious violation of the company's rules. On the other hand, "merely" exercising poor judgment or making bad decisions that negatively impact the company may not be considered valid grounds for a dismissal.

Are there any other things to be aware of?

Well, there is the issue of the retirement allowance that some rep directors receive just prior to the start of their term.

I'm confused. Why would a rep director receive a retirement allowance before the start of their term? Isn't a retirement allowance meant for someone who is *leaving* the company?

Yes, that's true. However, in certain circumstances rep directors receive a retirement allowance thanks to what can reasonably be described as a technicality. Your confusion is understandable because, by all appearances, the company has effectively promoted one of its employees (and not just any promotion, but a promotion to the highest position in the company). If so, why the need for a retirement allowance? Well, recall some of the issues discussed above. First, some rep directors are hired from within the company. Second, any "employee" status is terminated once the directorship begins. Taken together then, the company is officially terminating the soon-to-be rep director's employment status, and then entering into a service provider-type relationship for the directorship. At least on paper, then, the rep director -to-be is actually being terminated. That's how an employee of the company can receive a retirement allowance one day, and then take control of the company the very next day.

Is there any way to avoid paying a retirement allowance to a rep director-to-be?

Some companies include in their work rules a provision that requires an employee who is "departing" to become a director to receive his or her retirement allowance at the end of the directorship instead of at the end of their official "employment."

How about just eliminating the retirement allowance altogether?

If the company's employment rules grant employees the right to receive a retirement allowance, Japanese courts would probably invalidate any attempt by the company to have an employee waive that right completely.

Do these FAQs represent every single thing I need to know about rep directors?

Shockingly, no. But all kidding aside, this is obviously a very complex area of law and it would take an entire book to cover every facet of the rep director position. The goal of these FAQs was to clear up some of the more confusing issues. It was not designed to be a comprehensive guide. In fact, to make the FAQs as readable and concise as possible we simplified our explanation of certain issues and in some cases omitted quite a bit of detail. If you have any questions about this area of law, you should seek experienced counsel at the earliest stage possible to avoid problems down the line.

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