DIRECTORS' DUTY OF CARE, DILIGENCE AND SKILL: A COMPARATIVE STUDY OF JAPANESE AND CANADIAN LAW

by

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ABSTRACT

Most of the powers of the modern corporation are vested not in the general meeting, but in the Board of Directors. It is therefore important to see whether these powers are properly controlled. Both Canadian and Japanese company law adopt a similar view on the allocation of the administration and control between directors and shareholders. In addition, directors have two kinds of duties: duties of care, skill and diligence; and fiduciary duties.

However, there are important contrasts between the development of directors' duties in Canada and in Japan. In Canada, the common law has not been nearly as effective in developing a managerial duty and skill as it has been in the elaboration and enlargement of fiduciary duties. There are few cases where directors have been found liable for breach of a duty of care, diligence and skill. Conversely, there are numerous instances in Japanese law where directors have been found liable.

This paper compares and contrasts Japanese and Canadian law regarding directors' liability for mismanagement and negligence in the performance of their duties.

It is suggested that there are two principal reasons for the differences between Canadian and Japanese principles: one is

whether or not directors owe a duty to third parties rather than simply to the company; the other is the strictness of the standards of care, diligence and skill which are owed by directors.

By comparing Canadian and Japanese law, it is intended not only to point out differences but also to suggest possible ways which encourage directors to increase their care, diligence and skill in performing their duties.

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I. INTRODUCTION

The accepted approach in both Canada and Japan in establishing the responsibilities of directors is that directors have two kinds of duties: a duty of care, diligence and skill founded in the concept of negligence; and fiduciary duties based on the concepts of equity.

The position in Canada has been summarized in the following terms:

> "Since directors and officers are entrusted with the management of the property and assets of the corporation, which in turn is owned by the shareholders, they are subject to fiduciary duties. In addition, they must exercise care and skill in managing the affairs of the corporation. The fiduciary duties and the standards of care and skill required of directors and officers have been developed and elaborated in the case law and, to some extent, codified in companies legislation."[1]

On the other hand, the Japanese Commercial Code (Law No. 48, 1889) (hereinafter referred to as the "Commercial Code") contains the essential law governing directors in Japan. It provides that:

> "The relations between the company and the directors shall be governed by the provisions relating to mandates."[2]

As a result, directors have a duty to conduct the business of the company according to the standard of care of a good manager.[3] In addition, the Commercial Code provides that:

> "The directors shall be obliged to obey any law, ordinance and the articles of incorporation as well as resolutions adopted at a general meeting of shareholders and to perform their functions faithfully on behalf of the company."[4]

Moreover, the Code also provides a director's duty to avoid competition and intervention by the company (Article 264), the conditions of a transaction with his company (Article 265) and the method of how to decide directors' remuneration (Article 269).

However, there are important contrasts between the development of director's duties in Canada and Japan. In Canada, the common law has not been nearly as effective in developing standards of managerial duty and skill as it has been in the elaboration and enlargement of fiduciary duties.[5]

The standard of care and skill to be expected at common law depends upon the skill, ability, knowledge and experience which a director has personally. A director is not expected to be a reasonably well-qualified director. Directors' errors in judgement do not themselves create liability, even though the

errors demonstrate the unfitness of the directors to manage corporate affairs. In addition, while a director who attends a Board meeting is presumed to have heard what was discussed and decided at the meeting, a director who is not present at a Board meeting may escape liability for the consequences of corporate affairs discussed in his absence. The courts explain the rationale of the low standard of care, diligence and skill on the basis that the shareholders themselves and their company must take the consequences if they choose to appoint bad directors.

On the contrary, in Japan, while the legal principle of fiduciary duty has not been positively developed,[6] there are many cases where directors have been held liable for their mismanagement or for negligence in performing their duties.

Moreover, it seems that there is another striking contrast between the Canadian and Japanese attitudes with respect to whom duties are owed and to whom a director is liable. At common law, a director's duty in his capacity as a director is to his company only. However, under Japanese law, a director owes a duty and is liable not only to the company (Article 266) but also to any person who has suffered foreseeable damage due to the director's gross negligence (Article 266-3).

From a standpoint of a Japanese civil lawyer, it seems to the writer that the Canadian principle is too lax and too narrow. The standard of care developed by Canadian courts seems to be criticized as inadequate in terms of the modern business environment. Japanese experience suggests a higher standard can be expected and a wider duty, ie. duty beyond to a corporation to third parties, is workable.

Canadian law, indeed, is moving toward the Japanese view in the area of listed corporations. In the Securities Laws, which regulate the small minority of corporations which publicly trade their shares, the increased requirements for reporting will in practice force directors to improve their standard of care.

It is intended in this paper to examine and compare Canadian cases and the Federal and British Columbia statutes with Japanese cases and statutes. In Chapter II, Japanese statutes and cases will be introduced and discussed. In addition, it is proposed to analyze the new amendments to the Commercial Code which was enforced on October 1, 1982 insofar as they cast new duties on directors. Common law principles and Canadian statutes will be then discussed and compared with that of Japan in Chapter III. A detailed comparison between Canadian law and Japanese law will be then made in Chapter IV. Finally, future trends will be discussed.

II. DUTY OF CARE OF A GOOD MANAGER UNDER JAPANESE LAW

A. ALLOCATION AND LEGITIMACY OF POWER AND CONTROL IN THE COMPANY

1. Before 1950

The Commercial Code, using German legal concepts as a basis, was first drafted in 1899 and has been amended in 1938, 1950, 1966, 1974 and 1981. Each such amendment was promulgated pursuant to specific historical needs and circumstances.

As a result of the 1950 amendment, inspired by U.S. models, the present Commercial Code adopts a similar view to that of Anglo-Canadian company law on the allocation of control and the administration between directors and shareholders of the company. Ultimate control lies with the shareholders, who exercise their power through the general meeting. Before 1950, each of the directors had authority not only to administer internal corporate affairs, but also to represent the corporation in dealings with the public.[7] Although decisions on matters which did not come within the exclusive power of the shareholder's meeting had to be made

by a majority of the directors[8], there was not a requirement of law to form a Board of Directors as a corporate organ. Nor was a council system necessary. However, as a matter of fact, in many large corporations Boards of Directors were formed pursuant to the articles of incorporation.[9] Nevertheless, before 1950, the supervisory functions to oversee the execution of the business of the company were conferred on auditors (kansayaku).[10]

2. Directors and Representative Directors

Under the present law which provides for a Board of Directors as a necessary corporate organ, officers are needed who can carry out the resolutions of the Board meetings and of the shareholder's meeting and who can represent the corporation by entering into legal relations on its behalf. Hence, there are two categories of directors: directors (torishimariyaku) without authority to represent the company, and representative directors (daihyo torishimariyaku).

(a) Directors

A stock company must have at least three directors,[11]

and these directors do not have to be Japanese or live in Japan. However, a company may require that the directors have Japanese nationality or residence by a provision in the articles of incorporation.[12]

Directors are appointed by resolution at a general shareholder's meeting.[13] The term of office of directors cannot exceed two years.[14] A director may resign from his office at any time and ceases to hold office when he dies, becomes bankrupt or is adjudged incompetent because the relationship between the company and the director is governed by the provisions relating to mandates.[15] A director may be removed from office at any time during his term by a special resolution at a shareholder's meeting without the need to show cause. However, a director who has been removed from his office before the expiration of his term without a justifiable reason is entitled to recover from the company any damage caused by his removal.[16]

If the shareholder's meeting has rejected a resolution for the removal of a director who has committed a wrongful act, or violated a law, an executive order or

the articles of incorporation, he may still be removed from office. Shareholders who have held at least three percent of the total number of the issued shares of the company for the last six months may apply to a court for removal of the director, within thirty days after the date of the resolution of the general meeting.[17] Pending the resolution of such an action, or in case of an emergency, even before such an action is instituted, the court may, if it deems necessary, suspend the powers of the director and appoint a substitute director (torishimariyaku daikosha) by a provisional injunction order upon application by any person interested.[18]

A director who is not a representative director has the authority and the duty to participate in deliberations and vote at board meetings, but not to represent the company. A director manages the company by acting as a member of a Board of Directors. It is not at all rare for a director who is not a representative director to be simultaneously a chief of a department (bucho) or a branch manager (shitencho). Such employees of high rank have authority to represent the corporation to a statutorily prescribed extent due to

their executive position, not their status as directors.[19]

(b) Representative Directors

The Commercial Code provides for a director or directors to be elected by the Board of Directors to represent the company.[20] There is no statutory limit on the number of representative directors.

A representative director is appointed by resolution at a board meeting and the Board may remove him at any time. There is a controversy as to whether or not the articles of incorporation may provide that representative directors shall be appointed by a resolution of the shareholders at a general meeting. The majority view is negative.[21] This view holds that since the Board of Directors assumes supervisory functions over the representative directors, the Board must have power to remove them as a basic element of that function. The Ministry of Justice adheres to the majority view and employs it in registration procedures. [22]

When a representative director ceases to be a director, by virtue of his removal by the shareholders, expiration of his term of office as a director, or his resignation, he ceases to be a representative director as well. On the other hand, when he is released from office by the Board of Directors, he merely loses his status as a representative director, and continues to be a director.[23]

In the Commercial Code, there is no concept defining the officers such as president, vice-president, secretary or treasurer. However, Japanese companies provide for a president and other officers in the articles of incorporation. In most companies, the president is usually a representative director. Most articles of incorporation provide that the president shall "supervise" management of the company and he is regarded as being ultimately responsible for the management of the company. Some companies provide for a "chairman" (kaicho) in the articles of incorporation. The chairman, generally the former president, usually chairs the meeting of the Board. In some cases, "chairman" is an honourary title for a past president who has no practical powers, but in other

cases the chairman may possess powers superior to those of the president. In the latter cases, the chairman is usually a representative director.

A company often grants, by the articles of incorporation, the titles of vice-president, senior executive directors (senmu-torishimariyaku) and junior executive directors (jomu-torishimariyaku) to some of its directors. They may or may not be representative directors, but usually they are respectively responsible for divisions of the company such as corporate management, marketing, engineering or, divisions divided along the lines of the company's products. These divisions are set up by the company's internal rules.

Representative directors have authority both to manage internal corporate affairs and to represent the corporation. As to the authority to represent the corporation, a representative director is authorized to do all judicial and extra-judicial acts relating to the business of the corporation, and the limitations thereon may not be set up as against bona fide third parties.[24]

When a representative director exercises his power, he may make decisions by himself. However, such matters as are retained within the exclusive authority of the shareholder's general meeting or of the Board of Directors are not within his discretion; he merely has authority to carry out the resolutions.

Even where a stock corporation has two or more representative directors, each of them may exercise his power independently. However, the corporation may, by a resolution of the Board of Directors, bind all or a part of them to act jointly,[25] and such a restriction must be registered.[26]

3. Board of Directors

The Board of Directors is composed of all directors. It makes decisions concerning the administration of corporate affairs and supervises the performance of each director's duties.[27]

The Board of Directors may entrust decisions on certain matters other than the matters which are designated by Article 260(2) of the Commercial Code[28] to a particular

director or a subcommittee of directors. In practice, the president determines and carries out the day-to-day business of the company; he is regarded as being implicitly entrusted with decisions on such matters.

A meeting of the Board of Directors may be called by any director, unless the Board has given this authority to a particular director, usually the chairman or the president; if so, only that director has power to call meetings.[29]

The law does not specify who is to chair meetings of the Board. Customarily, the chairman or the president presides under the provisions of the articles of incorporation. Resolutions of the Board can be adopted by at least a majority vote of the directors present at the meeting; at least a majority of the total number of directors must be present to constitute a quorum. This minimum quorum and majority vote requirement may be increased but not decreased by the provisions of the articles of incorporation.[30] A director may not be represented by proxy at a Board meeting.[31] To transact business, the directors must actually meet at the same place and time;[32] otherwise a resolution passed by them is invalid,[33] even if all of the directors agree with the proposition. Therefore, where the

presence of a nonresident director is required for a quorum, such a director may have to come to Japan for the meeting. Directors who have a special interest in a certain resolution can neither vote on that resolution[34] nor can they be counted for purposes of a quorum.[35]

Statutory auditors have the right to attend Board meetings and to express their opinions, but they have no right to vote.[36]

Business transacted at Board meetings must be recorded in the minutes and subscribed to by the directors and statutory auditors present.[37]

4. Executive Committee

It is said that the Board of Directors envisaged in the legal structure set out in the Commercial Code is divorced from reality and does not carry out its function as a corporate organ of business performance and business supervision for the following reasons:[38]

(a) It is impossible to expect the Board of Directors, especially of a big company, to fulfill its function

promptly. In practice, most big companies may have Board meetings only once a month because the number of directors is large and most of them are employee directors who are simultaneously chiefs of a department (bucho), branch managers (shitencho) or factory managers (kojocho). As a result, they are too busy with their daily business to have frequent and timely board meetings;

(b) There is a risk that the company's business secrets might leak out because of the legal requirements for the taking of minutes of the proceedings of Board meetings and for their lodgment and disclosure at the principal office and at each branch office of the company;[39]

(c) There are three or four ranks of directors[40] and most are inside directors.[41] As a result, the ranking of the directors functions as a barrier to substantial and critical discussion.

Under such circumstances, large companies have come to have executive committees, separate from the Board of Directors, in order to cope with the inconvenience associated with the

Board of Directors. Executive committees are commonly called jomukai or keiei iinkai, and most were established after 1960.[42]

The ratio of corporations having executive committees increases with the size of the corporation and the number of directors. Even rather old statistics show that about 90% of corporations, all of which are listed on the securities exchanges, with a stated capital of 5 billion yen or more, have one or more executive committees. Such committees are found in 84.7% of corporations with 11 to 20 directors, and in all corporations having 21 or more directors.[43]

The most common number of members of an executive committee is four to seven. The second most common range is eight to twelve.[44] Approximately 80% of the executive committees consist of directors only, ie. there are no non-director members.[45] Many of the executive committees consist of all of the representative directors plus some other members.[46]

Although legally an executive committee is a lower branch of the organization than the Board of Directors, in practice the power of executive committees is comprehensive

and a substantial number of corporations leave the decision making to such committees.

The results of the investigation as to whether decisions by an executive committee on proposals later submitted to the Board of Directors have been passed, rejected or altered by the Board of Directors shows that, in about 60% of corporations, executive committee decisions have never been rejected or altered by the Board. In the remaining 40%, the rejections, alterations, etc. of committee decisions have been rare.[47] This indicates that executive committes play quite an important role at present.

B. DUTY OF CARE OF A GOOD MANAGER

1. Outline

The relationship between a company and its directors is governed by the provisions of law relating to mandates.[48] As a result, directors have a duty to conduct the business of the company with the standard of care of a good manager, whether they are representative directors or nominal directors.[49] The care required is of a higher degree than

that with which he is expected to execute his own business.[50] The standard of care of a director is that degree of care that a reasonably competent manager in his position or occupation would be required to take in the particular circumstances in which a decision is made or an action is taken.

Directors who have done any act which violates the duty of care of a good manager are jointly and severally liable in damages for losses caused to the company.[51]

A director who has done any act which violates his duty is liable to the company since he is a mandatory to the company. But a director has no special legal obligation to third parties based on a mandate. However, the Commercial Code does provide for sui generis statutory liability of directors to a third party in order to protect the third party. Directors are also jointly and severally liable to a third party for damage caused intentionally or by gross negligence in the course of performing their duties of care of a good manager.[52] This liability is incompatible with a liability in tort[53] since the essential conditions are not identical.[54]

A "third party" in this context means all persons apart from the company itself, and therefore includes not only creditors but also shareholders, potential investors and stock exchangers.[55]

Under Japanese laws, "foreseeability of damage" is a necessary condition of negligence; however, there is no limitation of liability to "foreseeable plaintiffs". Therefore, if a plaintiff is inside the foreseeable range of injury and suffers loss, his status or special relationship with a defendant does not abridge the duty of a defendant. As a result, a director owes a duty to any shareholder, creditor, victim of a tort or any other third party, whatever his status or special relation to the director is, if he suffers foreseeable damage.

This statutory liability is applicable not only for indirect damages, ie. damages caused by the financial distress of the corporation brought about by the directors' maladministration, but also for direct damages, ie. those suffered by third parties as a direct result of the directors' misconduct without any damage to the corporation.[56]

Furthermore, if the conduct is based upon a resolution of the Board, those directors who have voted for the proposal are deemed to have joined the conduct,[57] and thus are liable jointly and severally with the director who actually committed the act. Directors who attended the Board meeting and did not record their dissent in the minutes are presumed to have assented to the proposal.[58] The liabilities of directors to the company cannot be waived except by the unanimous consent of all the shareholders.[59]

The duty of care of a good manager can be conveniently examined under two heads:

(1) the duty of care with respect to the execution of corporate business and business decisions; and

(2) the duty of care with respect to checking on the conduct of corporate business;

Directors perform their duties by acting as a member of a Board of Directors which has a duty to determine the administration of affairs of the corporation and to supervise the execution of each director's duties.

2. Duty of Care With Respect to the Conduct of Corporate Business and Implementation of Business Decisions

Directors have a duty to conduct the business of the company with the standard of care of a good manager. As we have seen, the care required is of a higher degree than that with which he is expected to execute his own business. The degree of standard of care would differ according to the nature of the corporate purpose (eg. banks and so-called venture businesses), the scale of business and the position or authority assigned to that director.

The purpose of a company is to make a profit. The managers of a business concern must take risks. One of the directors' primary duties is to carry on a speculative business in an attempt to earn profits for the company. It is unusual that directors can make an accurate and perfect forecast of the future economic environment. Therefore, the courts should be conscious of the possible inadequacy in substituting their hindsight for the directors' foresight. Judges should be careful not to condemn directors when they have made business decisions and implemented them faithfully, even though events have proved them wrong and have caused damage to the company.

There are some recent precedents which illustrate this doctrine:

(a) In the judgment of the Osaka District Court on April 20, 1967[60] in a case where a director caused losses to his company by selling their steel materials at a discount of nearly 10% on the purchase price, it was held that:

> "It is not unusual for the managers of a business concern to make business decisions based on long-range judgment and to resign themselves to suffering a temporary loss. We should permit them to take such reasonable risks to some extent."[61]

(b) In the judgment of the Tokyo High Court on January 29, 1975,[62] it was held that:

> "We should sufficiently consider that we may call a director to account based on the result of his conduct under the pretext of loose-spending management, however, in so doing we may harm the director's discretion or elasticity of business management by condemning him easily and extensively."

(c) This doctrine was well-stated in the Judgment of the Tokyo District Court of March 1, 1978[63] where a director borrowed money on behalf of his company when his company's finances were tight.

> Business management is commonly associated with some risky activities. Therefore, it is not always appropriate to place legal responsibility for failure in the director's duty to the company on a director who merely carried out a transaction, which was risky to a naturally anticipatable extent as a matter of business, on behalf of his company, based on his experience, insight and reasonable estimate as a business manager, even though events have unfortunately proved him wrong.

Courts should be wary to substitute their hindsight for the directors' foresight and to condemn the directors easily when the directors' business decisions later have proved to be wrong, since such an approach would make directors shrink from business management and make business management passive. From this point of view, I think, these lower courts' precedents should be upheld. Attention must be called to the case of Unknown v. Unknown decided by the Supreme Court.[64] In this case where the defendant director's company became swept up in a chain-bankruptcy (rensa-tosan), linked to its customer's bankruptcy, it was held that:

> It is illegal[65] that the original decision condemned the representative director since it acknowledged the representative director's transaction was loose-spending lending on the basis of only one fact, namely that when the customer company went bankrupt, the amount of the loan from his company to the customer company was more than the amount of construction work orders held by the customer company.

The Judges suggested that the original decision should have been based on a consideration of when the customer company's impossibility of repayment to his company has become known to the representative director, or when the customer company's impossibility of repayment to his company become foreseeable to the representative director, and whether the representative director lent money to the customer company after that time, or how much money the representative director lent the customer company after that time and so forth. The consideration provides a basis for deciding whether or not the representative director's lending to the customer company was loose-spending lending.

It seems that this line of cases has become almost established as judicial precedents.[66] [67]

In addition to them, Dr. Osakadani has insisted that Japanese courts should apply the American "business judgement rule"[68] and should be careful not to decide unnecessarily director's activities are negligent.[69] Needless to say, the general standard of care required of a director is not that of an omniscient and omnipotent business manager. However, it is proper to condemn a director who has clearly erred in a judgement with respect

to a business decision or policy required of him as a business manager and has caused damage to the company, even if he managed its affairs faithfully.[70]

It is a breach in the duty of care of a good manager if the directors' exercise of his business judgement is obviously unreasonable in consideration of the state of affairs at the time the director took the step in question when measured against the criteria of the standard of ability and insight required of an ordinary business manager with reasonable skill and prudence in a like position.[71]

The following are two Supreme Court decisions which are examples that adopt appropriate criteria for evaluating a director's conduct. In the Judgment of the Supreme Court on October 26, 1976,[72] it was held that it was a breach of the duty of care of the representative director to draw a promissory note to a company that had become bankrupt before such drawing since there were no special circumstances where it was reasonable to expect that the promissory note would or could be settled by the bankrupt company. Again, in the Judgment of the Supreme Court on June 3, 1976,[73] it was held that a representative director who did neither research on the business affairs and

standing of the customer which was in fact short of funds, although he knew of customer's financial difficulties, nor prepare his company for the eventuality of the customer's bankruptcy and desultorily continued with the transaction, was liable.

Needless to say, representative directors who raise funds by keeping the company's financial difficulties secret and thereby cause damage to the creditors are negligent.[74] Representative directors who begin a business enterprise without a reasonable funding plan also are liable in negligence. In the Judgment of the Tokyo District Court on November 28, 1979,[75] it was held that:

> "When the company intends to set about and carry out a large scale enterprise, eg. constructing the golf links in question, which required special know-how and a large amount of money and had an effect on many creditors' interests, before they begin the enterprise, the directors of the company should first carry out extensive research on whether the new enterprise will succeed or fail and also should establish an objective and reasonable plan that endorses the funds raised for the construction and operation of their new enterprise. However the defendant representative directors did not do anything about this in this case. They swallowed the explanation of the local persons concerned regarding the purchase of the site for the golf links, and the construction fund. Then, they began to construct the golf links simply relying on the expectation of enrollment securities deposited by candidates for membership in the

completed links. As a result, they ended up abandoning their enterprise since they could not purchase the site for the golf links. Therefore, we must conclude that the defendant representative directors committed gross negligence in the execution of their duty as representative directors."

3. The Duty of Care With Respect to the Observation of Corporate Business Activities

(a) The Representative Directors' Duty of Observation (Kanshi Gimu)

(1) Basis for the Duty of Observation

Japanese courts have held that representative directors who do not check on the other directors' business conduct in order to prevent illegal activities are themselves liable.[76] This representative directors' duty to prevent other directors from engaging in illegal business activities by checking on their performance is called the duty of observation (kanshi gimu). Although representative directors owe a duty to try to prevent other directors from engaging in illegal business activities, they are not visited with absolute liability if they fail to prevent other directors from carrying on illegal business activities. The existence of the duty to try to

prevent other directors from engaging in illegal business activities, and the existence of the possibility of discovering the other directors' illegal business activities are the necessary conditions of liability.

However, there has been a lot of argument about the basis for the duty of observation of the representative directors. Scholars have debated whether their duty of observation is grounded on the characteristic position of the representative director, or on their membership of the Board of Directors, or on the internal chain of command in a corporation with respect to business activities.

The attitude of the Supreme Court in this regard is unclear. In Senbi Kozai K.K. v. Muto[77] where the representative director Muto left the affairs of a company to the other representative director since he was busy with his other work as a member of a prefectural assembly, a veterinarian and a patent attorney, the Supreme Court held only that:

> "Representative director Muto failed to perform his duty through mala fides, or by gross negligence because although a representative director has a duty to give attention generally to the affairs of his company, Mr. Muto entirely left the affairs of his company to the other representative directors and overlooked the other representative directors' unfair practices and disobedience of his duty."

In my opinion, this decision may be interpreted so that it does not provide any grounds for a duty of observation of representative directors. Under the Commercial Code, representative directors are authorized to do all judicial and extra-judicial acts relating to the business of the company.[78] There is no restriction placed on the representative directors' comprehensive rights without joint representation.[79] As representative directors have such comprehensive and unrestricted authorities, it is improper to impose a duty of observation on them in relation to their collegues' activities based on their position of representative director itself.

In addition, it is improper to give representative directors authority to observe the activities of ordinary directors who assume

executive positions because directors are not inferior in the organization to representative directors. On the contrary, they are members of the Board of Directors which has a duty to supervise the execution of the duties of the representative directors.[80] [81] Therefore, the duty of observation cannot be grounded on the characteristic position of the representative director.[82]

In contrast, it shall be understood that the duty of observation results from the position of each director as a constituent member of the Board of Directors, whose duty is to supervise the execution of each director's duties.[83] For the Board to properly exercise this function, every director must have the right to check on the activities of every other director.

Moreover, directors occupying superior positions in the corporate structure may have the authority to supervise the conduct of directors in an inferior position. In most Japanese companies, three or four ranks of directors are set up by

the Articles of Incorporation or the By-Law Rules which divide up the directors' duties. The By-Laws are prepared by the Board of Directors. The directors of most companies come from the ranks of the employees. The lowest level of director is that of the ordinary director (hira torishimariyaku), who might be a factory manager, department head or the second in command of a division. The next rank is that of managing director (jomu torishimariyaku), who is usually responsible for two or three departments or a division. Above him are the senior managing directors (senmu torishimariyaku) and the vice-presidents (fuku shacho) in charge of larger units of the company, with the president (shacho) and the chairman of the board (kaicho) at the top. In such an office organization, the law should be interpreted so that the directors holding superior positions have a duty to supervise the activities of directors in inferior positions in the performance of their functions, on the basis of the general business authority of control and supervision by a superior.[84] However, this duty is not a duty that can be

derived from the position of representative director itself since this duty is grounded on the authority of control and supervision of the superior to the inferior which is based on the autonomous supervisory duty in the organization of the office.[85] The office of representative director is intended to assist the company in its dealings with outsiders. It does not carry with it any inherent supervisory power within the company, although as we have seen, many representative directors also will hold senior executive positions within the corporate hierarchy and will have to observe the duty of observation on that basis.

(2) Duty of Observation on a Matter Which was not Brought up for Discussion at Board Meetings

Courts have broadly acknowledged the representative directors' duty of observation in relation to another director's breach of duty which was not brought up for discussion at Board meetings. This applies whether the director whose conduct is in question was a representative director[86] or an ordinary director.[87] Scholars also approve of

these precedents. However, it seems that there is a contrast between the extensive discussion of the grounds for the ordinary directors' duty of observation on matters which were not brought up for discussion at Board meetings and the brief discussion of the grounds for the representative directors' duty of observation on these matters. In some decisions, it is held that a representative director owes a higher standard than an ordinary director because a representative director who has the authority to conduct certain business may have more frequent opportunities to observe the other directors' activities.[88] Some scholars also argue that a representative director's duty is stricter because he owes not only a duty of observation based on the authority to audit the business which he has as a member of the Board of Directors, but also a supervisory duty based on the authority of control and supervision of a superior to an inferior.[89]

However, firstly although it seems that a representative director may have more frequent opportunities to observe the other directors'

activities than an ordinary director, especially part-time directors, in general, it does not always mean that the representative director in question himself had actually known of the other director's wrongful activity or should have known of the other director's activity. Secondly, even supposing that a representative director owes a higher standard of care, this is not a matter of the sphere of a duty of observation but a matter of the degree of the duty of observation, and it can't be the answer to the question of why a representative director should be required to owe a positive and ceaseless duty of observation in relation to another director's breach of duty which were not brought up for discussion at board meetings. Thirdly, the argument that a representative director's duty is stricter because he owes a supervisory duty based on the authority of control and supervision of a superior to an inferior, in addition to the duty of observation based on the authority of business audit as a member of the Board of Directors, cannot explain why a representative director owes a strict duty in the following situations:

a) A representative director of a corporation whose office organization does not authorize him to assume the general business authority of control and supervision is fixed with the duty.

b) A representative director who is not involved in the organization of the office is liable.

c) There is a mutual duty of observation between or among representative directors who have the same rank or positions under the organization of the office.

d) The duty of observation is required of a director even though he is under another representative director's authority or control and supervision in the organization of the office.

Therefore, I am of the opinion that it is not correct that a representative director's duty of observation should generally be stricter than an ordinary director's duty of observation, or that

a representative director generally and inevitably owes a duty of observation on a matter which was not brought up for discussion at Board meetings.

Although, as was discussed above, a representative director in a superior position has the duty to supervise the execution of the duty of the directors in inferior positions, which is based on the autonomous supervising duty in the organization, in addition to the duty of observation which is derived from holding the position of a constituent member of Board of Directors, there is no duty of observation which is derived from the position of representative director itself. Consequently, we should place a stricter responsibility on a representative director only when he actually has the authority for control and supervision over other directors. Moreover, we should not call a representative director to account only because he may have more frequent opportunities to observe the other directors' activities. We should adopt as the criteria of wilful or gross

negligence the test of whether the representative director in question either knew or should have known of the other director's illegal activity.

As a result, we should consider that whether the matter in question was brought up for discussion at Board meetings or not is not an independent criteria for liability, but just one of the judgemental factors in deciding whether the representative director either knew or should have known of the other directors' illegal business activity or not.

(3) Duty of Observation of the Representative Director Who is in Charge of a Specific Part of Corporate Management

Viewed from the basis of the theory discussed above, it would seem that the fact that there has been an organizational decision relating to the division of the business among the representative directors and the illegal business activities in question did not come under the division of business under the charge of a representative director may be one of the important judgemental factors for deciding whether he either knew or

should have known of the other directors' illegal business activities. It cannot be an independent defence (koben).

In Taiyo Kogyo K.K. v. Kurosawa,[90] it was held that:

> "Even if the area of activity under the defendant representative director's charge was 'business' (eigyo), he owed a duty of observation over the business activities of the other representative director who was in charge of accounting (keiri). This is because he owes a duty to pay attention to corporate business generally as he is a person who has the authority to execute corporate business generally as a representative director. However, in this case the director did not commit an act of gross negligence because he did not know of the illegal business activities of the other representative director who was in charge of accounting, and he had examined the accounting documents which did not reveal the unlawful appropriation. Those documents were submitted by the representative director who was in charge of accounting at the monthly management meetings whose constituent members were all directors."

Then the court held that the corporate management of the defendant representative director was not negligent.

Although I cannot agree with the reasons given by the court, I can agree with its result that a representative director who is in charge of a specific part of corporate management does owe a duty of observation to protect against illegal business activities by another director who is in charge of another specific part of corporate management.

In my view, a representative director should be liable if he knew or ought to have known of the other's misconduct. However, in most situations of divided management responsibility, the representative director will neither know nor be in a position where he should know of the other's misconduct. Similarly, even if he has a duty of observation for the reasons spelt out in the decision in the Taiyo Kogyo case, that case suggests that in most cases he will be found to have acted without negligence.

(4) Duty of Observation of the Nominal Representative Director

a) Background. According to the material

supplied by the Ministry of Justice, the total number of the corporations in Japan as of October, 1982 was 2,901,247, of which 1,509,367 were stock corporations and 1,123,532 were limited liability corporations.[91] However, the total number of the stock corporations which list their stock on the Tokyo Stock Exchange is approximately 1,400.[92] It is said that stock corporations with a capital of less than 10 Million yen (approximately Cdn. $50,000.00) account for more than 80 percent of all companies, and those capitalized at less than 50 Million yen (approximately Cdn. $250,000.00) account for 96 percent of all Japanese corporations.[93] Therefore, it may be said that most corporations are small and/or closely held corporations (heisa gaisha). The number of tiny corporations has increased remarkably since World War II. Most of these small stock corporations have been transformed from sole proprietorships in recent years. This recent tendency to incorporate enterprises, especially into stock corporations, is called "hojin nari" (the incorporation movement).[94]

It is easy to form a stock corporation because the minimum requirement for stated capital is only 350,000 yen (approximately Cdn. $1,750.00).[95] At least seven promoters are required. But this requirement is meaningless because of the routine use of nominees. The registry officials only review documents for conformity with legal forms; they do not check them for business efficacy.

The result of a survey of the motives for using the stock corporation form shows that the dominant motive is an expectation that a stock corporation will have business advantages.[96] This is because the public at large still regards stock corporations in general as large enterprises.

However, it is not unusual for such corporations to have nominal directors, including representative directors, who are not expected to do any substantial work. They are needed to make up the minimum number of directors required by the Commercial Code

which specifies that a stock corporation must have at least three directors.[97] Indeed, there are lots of corporations whose president is the husband, vice-president is the wife and senior managing director is their eldest son. Moreover, it is not unusual for such corporations to have nominal directors simply to utilize the nominal directors' social confidence and reputation to gain business and social credit for the company.

Of course the individual directors on the one hand and the business corporation on the other are in law separate personalities. Therefore, although a person who carries on a transaction with a stock corporation should place his trust in the corporate property, it is not unusual for businessmen to carry on transactions with these tiny stock corporations, which are similar to sole proprietorships, while placing their trust in the personal reputation and wealth of the directors. In general, the property founda-

tion of these tiny corporations is very weak and in fact it is common in contracts with such tiny corporations for the other party to require the directors to act as personal legal guarantors.[98] It is fair to say that people incorporating small companies in Japan are more interested in the business prestige involved than in limited liability.

However, of course not all parties can be given such guarantees and when the corporation has become insolvent those who cannot recover their loss from the corporate property have come to pursue the directors for liability under Article 266-3(1) of the Commercial Code.[99] This article covers not only the liability of the representative directors in charge of business management but also the liability of nominal representative directors. In such situations, the courts have displayed a tendency to hold nominal representative directors liable.[100]

b) Subjective Conditions of Liability. Nominal

representative directors have been described above as representative directors who are not expected by the directors or the shareholders to discharge any duty. As a result, they normally do not directly participate in the illegal business activity that has caused damage to a third party. It is simply fanciful that they have any intention to violate a third party's rights. Therefore, the basic issue relating to the grounds for the liability of the nominal representative director to a third party under Article 266-3(1) is whether the article requires a subjective intention or gross negligence in his failure to discharge his director's duty, or whether the intention or gross negligence relates to the violation of the third party's rights.

The leading case in this regard is Senbi Kozai K.K. v. Muto[101] where the representative director Muto, who left the affairs of a company to the other representative director since he was busy with his other works, was

sued by a possessor of a dishonoured bill, although the other representative director drew and dishonoured the bill in question without Muto's consent. In this case, the Supreme Court declared that the purpose of Article 266-3(1) is to protect third parties, and went on to hold that:

> "The above [principle] is not inconsistent with the theory that if a director who in the course of the execution of the undertaking violates intentionally or negligently the right of a third party, he is bound to make compensation for damage arising therefrom in compliance with the general provisions relating to unlawful acts.[102]
>
> However, a third party who has suffered damage from the director's failure to discharge his duty can recover his loss from that director on the basis of the provisions of article of 266-3 of the Commercial Code and the plaintiff need only assert and prove the director's intention or gross negligence in relation to his breach of his duty. The third party does not have to assert and prove the director's intention or gross negligence in relation to the violation of his rights. Moreover, there is no need to limit the third party's right of compensation for damages in compliance with the provision of article 266-3 to a case where the company itself bears

> the responsibility to compensate for loss to the third party under article 44 of the Civil Code,[103] on the premise that the director had an intention, or was negligent in the violation of the third party's right."

Then, the Supreme Court held the nominal representative director liable.

Subsequent Supreme Court decisions[104] and lower court decisions[105] follow the approach of this decision.

(5) Limitation of the Duty of Observation

Although Section 266-3 of the Commercial Code is designed to protect third parties, there are two pre-requisites to director's liability: the need for a causal relationship between the director's business activity and the third party's damage;[106] and the need to prove the director's intentional or grossly negligent act in contravention of a law or the charter. Both these factors are very important in limiting the representative director's duty of observation to a reasonable extent.

What is the necessary causal relationship? In Goyo Shiko K.K. v. Fujiwara et al.,[107] it was held that:

> "the pre-requisite to a claim for indirect damages[108] is a causal relationship between the director's breach of duty, bankruptcy of the corporation and the third party's damage. In addition to this, when the representative director does not participate in corporate management but leaves it entirely to another representative director, the pre-requisite is a causal relationship between an intentional or grossly negligent failure in the duty of the representative director who is left in charge of corporate management, and the bankruptcy of the corporation and the third party's damage. ... However, the bankruptcy of the corporation in this case is a chain-bankruptcy (rensa-tosan) linked to its main customer's bankruptcy. ... It is not enough to acknowledge that there was an intentional or grossly negligent failure by the trusted representative director in not discontinuing the transactions with the main customer in its early stages ... As a result, the plaintiff corporation cannot claim damages from the defendant because there is not a causal relationship between the bankruptcy of the corporation and any violation of duty of observation of the defendant representative director who left the corporate management entirely to the other representative director."

In Maruyoshi Kozai K.K. v. Sato[109] where a nominal representative director of a bankrupt

company was sued for damages by a customer who could not collect bills from the bankrupt company, it was held that:

> "The representative director who was left entirely in charge of the corporate management and actually had taken charge of the management is not liable for damages to a third party since there was no intentional or grossly negligent act in his business activity. The application of the principle of natural reason (jori)[110] indicates that it can never be accepted that the responsibility for damages caused by the transaction can be placed on the other representative director who did not participate in the transaction."

The Judges then denied the existence of a relationship of adequate causation between the third party's damages and the breach of duty of the representative director who had left the corporate management entirely to the other representative directors.

It is quite acceptable to assume a cautious attitude toward the recognition of the existence of a relationship of adequate causation between a third party's damages and a director's

intentional or grossly negligent breach of duty. However, I have some doubts about the theoretical construction adopted in Maruyoshi Kozai K.K. v. Sato. I think it improper to determine the liability of a representative director who left corporate management entirely to the other representative director by resorting to the principle of natural reason (jori) on the basis that the representative director who was left in control of the corporate management is himself not liable. Even when the latter is not liable, there is room for the former's imputability. If courts applied the adequate causation theory properly to Maruyoshi Kozai K.K. v. Sato, the court should assess whether the third party's damages would have occurred or not under normal conditions if the representative director who left the corporate management entirely to other representative directors had discharged his duty of observation. Therefore, if the defendant representative director who has left corporate management entirely to the other directors was the only director who knew that the customer was short of funds, he could have foreseen the

customer's bankruptcy, and subsequently his own company's bankruptcy and third party's damages, and might have prevented the corporation's bankruptcy. In such a situation, we may identify either intentional or grossly negligent acts of the representative director and the relationship of adequate causation between his failure of duty and the third party's damages.[111]

As for what amounts to a grossly negligent act, attention must be called to Taiyo Kogyo K.K. v. Kurosawa[112] where a representative director, who was in charge of the business of a bankrupt company, was sued by a customer with respect to his neglect of his duty of observation relating to business activities of the other representative director who was in charge of accounting and who appropriated corporate money to his personal purpose and caused the company's bankruptcy. It was held that:

> "The defendant did not commit gross negligence because he did not know of the illegal business activities of the other representative director who was in charge of accounting, and he had examined the accounting documents,

> submitted by the representative director who was in charge of accounting at the monthly management meetings whose constituent members were all directors. The unlawful appropriation of money was not revealed in the accounts."

The criteria for distinguishing between intentional and grossly negligent acts is discussed below.

(b) Ordinary Director's Duty of Observation

An ordinary director owes a duty of observation since he is a constituent member of the Board of Directors which has the authority and duty to supervise the execution of the duties of directors.[113] Therefore, an ordinary director should bear the responsibility for a breach of his duty of observation, to a third party, when he neglects to supervise the representative director's execution of duty.[114] There is no objection in either the cases or from scholars' opinions to imposing a duty of observation over the representative directors' or the executive directors'[115] (gyomu tanto torishimariyaku) business conduct relating to matters which were brought up for discussion at board meetings.[116] However, there is a

controversy about whether courts should impose a duty of observation where matters were not brought up for discussion at Board meetings.

(1) Duty of Observation Over Matters Not Brought up for Discussion at Board Meetings

Formerly, lower courts had refused to impose a duty of observation on a director relating to matters which had not been brought up for discussion at board meetings. In Unknown v. Unknown,[117] it was held that:

> "Ordinary directors owe a duty of observation over the business conduct of other directors relating to a matter which was brought up for discussion at board meetings. However, they do not bear a duty of observation over the representative directors' general business conduct in addition to the duty of observation mentioned above. ... the purpose of the provision, which provides where business conduct has been performed in accordance with the resolution of the board meetings the director who has assented to such resolution shall be deemed to have done such act, place the responsibility on only the director who has assented to the resolution. As a converse interpretation, (hantai kaishaku), it should be held that the director does not bear a duty of observation over the business activities of a representative

> director relating to matters not brought up for discussion at board meetings."[118]

Also, in Unknown v. Unknown,[119] it was held that:

> "Since it is practically impossible for an ordinary director (hira torishimariyaku) to supervise the business conduct of the representative director relating to matters not brought up for discussion at board meetings, it should be held that the necessary conditions for the duty of observation over the business activities of the representative director is constituted not only because he is a director but also because it is a matter of business conduct relating to a matter which was brought up for discussion at board meetings or because of special circumstances where he could easily supervise the representative director in the business conduct in question."

However, it is unreasonable not to call a director to account when although he knew that a representative director had neglected his duty relating to a matter which had not been brought up for discussion at Board meetings, he did not take any proper measures, eg. convocation of a special Board meeting and so forth, to prevent the representative director from breaching his duty. Moreover, it is held that the provision

which provides that where a business activity has been performed in accordance with the resolution of the Board meetings, the director who has assented to the resolution shall be deemed to have performed the act does not refer to the liability of a director who did not participate in the resolution and does not imply that a director may not bear responsibility other than responsibility as a director who is regarded as a co-actor.[120] It would be undeservedly favourable treatment for directors to permit them to avoid their responsibilities by neglecting to attend Board meetings.[121]

Thus, the theory that imposes the duty of observation on directors in relation to matters not brought up for discussion at Board meetings, has become dominant among scholars.[122] This tendency has been reflected in lower court decisions.[123] Kobayashi et al v. Hashimoto et al[124] is the first Supreme Court decision to follow this new line. In Kobayashi et al v. Hashimoto et al, directors were sued for damages by possessors of dishonoured bills which were

drawn by their company based on the directors' neglect of their duty of observation relating to the business activities of the representative director who was left in charge of the affairs of a company. The director conducted business activities at his own discretion, did not hold Board meetings at all, drew bills excessively and caused the company's bankruptcy. The court held that:

> "Since the Board of Directors has authority to inspect the conduct of the business of the corporation, a director, as a constituent member of the Board of Directors, owes a duty of observation to the corporation with respect not only to matters which were brought up for discussion at board meetings but also to general matters which were performed by a representative director. Further, a director has the duty to ensure that corporate business is properly carried out through the supervisory duty of the Board of Directors, if necessary, by means of the convocation of board meetings or a request to the director who is appointed by the Board of Directors to convene Board meetings to convene such a meeting."

The Commercial Code at that time did not specify whether each director had authority to convene Board meetings when the Board of Directors had appointed a director to convene the Board meetings. The Commercial Code provided as follows:

> "Article 259. The meetings of the Board of Directors shall be convened by each director; however, this shall not apply in cases where the Board of Directors has appointed a director who is to convene such meetings."

Though influential scholars insisted that where a director requested the director who has been appointed to convene Board meetings to convene such a meeting but that director refused, the director who made the request might convene the meeting by himself,[125] it was desirable that this question should be resolved authoritatively. In answer to this demand, a new amendment to the Commercial Code enforced October 1, 1982 specifies that in cases where the Board of Directors has appointed a director to convene the Board meetings, any director may request him to convene the Board meetings and if within five days of receiving the request the notice convening the Board of Directors has not been dispatched, the director who made the request may convene the Board of Directors by his own authority.[126]

In addition to the above reasons, I think the

Supreme Court decision should be upheld for the following reasons:

a) As I discussed above, we should recognize that the criterion of whether the matter in question was brought up for discussion at board meetings or not is not an independent criterion but no more than one of the factors determining whether the representative director either knew or should have known of the other director's illegal conduct or not. Therefore, we should not reject indiscriminately a duty of observation relating to a matter which was not brought up for discussion at Board meetings.

b) The directors' duty of observation is not derived from their attendance at Board meetings but from their constituent memberships of the Board of Directors.

c) It is insufficient for the effective and proper business auditing function of the Board of Directors to judge matters passively

relating only to matters which were brought up for discussion at Board meetings.[127]

d) Each director is clearly vested with authority to convene a meeting of the Board of Directors.

(2) Duty of Observation of the Executive Director (gyomu tanto torishimariyaku)

Here the term "executive director" is used to mean "directors who are in charge of a specific part of corporate management, such as general administration (somu), business (eigyo), personnel (jinji), finance (zaimu), and planning (kikaku). Almost all corporations assign some directors specific responsibilities.

In a huge company where divisions of business are highly differentiated and each division has highly specialized functions, each executive director may have no choice but to concentrate his thought and care on the specific part of the corporate management under his charge. It may be difficult for such directors to supervise the

business activities of other sectors of the corporation's management. However, such circumstances only have an influence on the decision whether or not the director has committed negligence or gross negligence and do not negate the existence of the duty of observation itself since the directors' duty of observation is derived not from the business structure of his company, but from the fact of his membership of the Board of Directors. In Bank De Rindoshin v. Kuroda et al.,[128] it was held that a director who did not know of the other executive directors' dishonest act, carried out wholly within the division of the company under that other executive director's responsibility, should be judged to have violated his duty of observation. His lack of knowledge did not amount to gross negligence. However, since this case relates to a small company, it seems that there is room for imagining circumstances where it would be practically impossible for directors to discover another director's illegal business activities because of the vast size of their corporation. In such a case, the company's divisions may be

highly specialized and their places of business located at places distant from each other. These factors should be taken into consideration when courts judge whether the director in question committed negligence or gross negligence.[129]

With respect to the executive director's standard of care, there is one scholar who insists that there is an important difference between the executive director's standard of care and the standard of care of a director who is not in charge of a specific part of corporate management.[130] However, since the duty of care of a good manager, which is required of all directors when they discharge their duties,[131] itself indicates the standard to be met in discharging the duty of care,[132] there should be no difference between the standard of care in the executive director's duty of observation and the standard of care in the duty of observation of a director who is not in charge of a specific part of corporate management. The correct interpretation should be that any difference is not a difference between the standard of care

involved in the duty of observation but a difference between the scope of the executive director's duty of observation and the scope of the duty of observation of a director who is not in charge of a specific part of corporate management, which is a reflection of the extent of the business activities under each director's charge.

(3) Duty of Observation of a Nominal Director and of a Director Who Was Absent from a Board Meeting

The nominal director is a director who is elected to a directorship under a special agreement with the corporation that he is not expected to discharge his duty. There are many nominal directors especially in tiny corporations. They have a tendency to try to escape from their liability as a director on the plea that they have made an exculpatory agreement with the corporation. However, it is improper from a corporate policy standpoint to admit the existence of nominal directors who do not owe any duty since the provisions relating to corporate organizations and their duties are mandatory

provisions which aim to regulate definitely and uniformly the legal relations among the many persons related to the corporation. Therefore, special agreements of this type are held invalid.[133]

In order to supervise the representative director's conduct of the company's business by reference to the duty of care of a good manager, a director, whether he is the nominal director or not, should attend board meetings held at proper intervals. These meetings should supervise the representative directors' corporate business activities, acquire the necessary information to allow the board to grasp the state of corporate business and corporate property, and ask for the representative directors' reports with regard to the execution of the corporation's daily business.[134]

In Unknown v. Unknown[135] where a part-time director was sued for damages by a possessor of a dishonoured bill which was drawn by the other representative director, although the court

acknowledged that the defendant director heard a report relating to the corporation's financial difficulties and attended the monthly Board meetings to discuss fund raising, the director was held liable since he did not inspect and examine financial documents and books of account, but relied only on the documents submitted to the board meetings. The court held that his efforts to grasp the actual financial circumstances of the corporation were insufficient.

Again in Takaji Kogu K.K. et al v. Yoshii[136] where the defendant director's company became bankrupt because of the influence of the so-called oil-shock recession and financial restrictions by financial institutions, this principle was applied. The court acknowledged that the defendant director of the bankrupt corporation visited the corporation approximately once a month and that every time he visited the corporation he heard oral business reports from the representative director and sometimes was shown books of account. Moreover, he had given the representative director general advice to

prevent mistakes in business management. Nevertheless, it was held that he had neglected his duty since he simply accepted that the monthly oral business reports were correct. He did not have any doubts about them though he should have, and he failed to perform any strong supervision and intervention.

Furthermore, with regard to the liability of a director who was absent from board meeetings, the majority view among scholars is that an absent director is liable when he has been absent from the board meetings for a long time without sufficient reason or when, although he knew or should have known in advance that an improper subject was listed for discussion, he was absent from the Board meeting and did not take any appropriate measures.[137] The minority view among scholars is, however, that an absent director is liable when he is absent from the Board meeting without sufficient reason and therefore he cannot take appropriate measures to prevent a representative director from illegal business activities.[138] In K.K. Kojin v. Unknown[139] where

the responsibility for a bogus dividend was discussed, it was held that the directors were liable since they were absent from the board meeting where the illegal dividend was brought up for discussion and they neglected to take any proper measures to prevent the illegal dividend being introduced at the shareholders' general meeting.

As this case related to the directors' liability for the settlement of accounts based on window dressing, and the directors should have known the real state of the settlement of accounts in advance, it may be said that this decision follows the majority scholars' theory. However that may be, one may conclude that the problem is not just one of the number or frequency of the director's absences from Board meetings; but whether he has attended Board meetings held at proper intervals to supervise the representative directors' business activities; whether he has acquired the necessary information to grasp the state of the corporation's business; and has taken proper measures to prevent the director

from illegal business activities and so forth. In other words, whether he has properly supervised the representative directors' business activities in accordance with the duty of care of a good manager measured against the criteria of the standard of ability and insight required of an ordinary business manager with reasonable skill and prudence in a like position.

On the other hand, there is one aspect to making a nominal director always subject to the duty of observation which merits sympathy. In most closely held corporations (heisa gaisha), the shareholders elect persons who are not expected to discharge their duty as directors, simply in order to make up the statutory minimum number of directors.[140] Such nominal directors are usually isolated from the corporate management and they usually receive only a small amount of remuneration. These closely held corporations normally do not hold board meetings at all. Taking this circumstance into consideration, there are some precedents which deliberate on the standard of care required to establish a nominal director's negligence in his duty of observation.

In Yamashita v. Segawa et al[141] where a nominal director was sued for damages by a possessor of dishonoured bills which were drawn by the director's bankrupt company, it was held that:

> "A nominal director, who does not receive remuneration as a director, does not invest money in the corporation and does not partake in the corporate management, does not owe a duty of observation on the representative director's business activities which would extend to a duty to the representative director to convene a board meeting unless there are special circumstances wherein he knows or could have known that the representative director will violate his duty or carry out illegal business activities and will cause damage to the corporation or a third party. It is appropriate to interpret the situation so that there is neither mala fides nor gross negligence if he neglects the duty of observation even if he owes such a strict duty of observation."[142]

However, there are some cases that acknowledge mitigating circumstances which may relieve a director of the duty of observation. Specifically, there are cases which deny the director's duty of observation because he lives at a distant place and is busy in his business activities there,[143] or where he has not been participating in corporate management because of

illness and he has had no opportunity to become acquainted with the actual condition of the corporate management.[144] Again, some cases excuse a director where he is an old person of more than 75 years of age and rarely appears in the corporate office,[145] or where he neither invests in the corporation nor receives remuneration; where he only allows his name to be added to the directors list and does not have any special knowledge and experience in corporate management[146]; or where the corporation is managed by an arbitrary, autocratic representative director who holds the real power over corporate management and never allows the other directors to meddle in his management of the business.[147]

However, by law a director should supervise the representative directors' business activities, with the duty of care of a good manager, measured by the criteria of the standard of ability, experience and insight required of an ordinary business manager with reasonable skill and prudence in a like position. He should know the

conditions of corporate business and corporate property in order to supervise the representative directors' business activities. His non-participation in the corporate management should not allow him to evade his duties, and his lack of knowledge of the conditions of the corporation's business and corporate property should not allow him to evade his supervisory duty over the representative directors' business activities. A director can sufficiently supervise the other directors' business activities only when he has a grasp of the real conditions of the corporation's business and corporate property. Therefore, a director's lack of knowledge of the corporation's circumstances may imply that he did not make all efforts to obtain the necessary information to allow him to grasp the corporation's circumstances, and it should not be a reason for mitigation of his supervisory duty to oversee the representative directors' business activities.

Accordingly, courts should not mitigate the director's standard of care by considering the

director's personal circumstances, eg. pressure of work, sickness, old age or lack of knowledge and experience of corporate management. If this were not so, the spirit of the law, which is to ensure proper conduct of business by the representative directors through the supervision of the Board of Directors, will be ignored by companies assigning persons to directorships who in practice cannot be expected to supervise the representative directors' business activities because of their pressure of work, sickness, old age or lack of knowledge and experience on corporate management, etc. Further, it is unreasonable that the more a director comes to know the conditions of the corporation's business and property by his diligence, the more risk is placed on him to assume the responsibility for neglecting his supervisory duties in case of breach. On the contrary, the less he knows of the conditions of the corporation's business and property, the more the risk that should be placed on him for the responsibility for neglecting his supervisory duty.[148] The reasoning that pressure of work,[149] sickness,[150] or lack of knowledge of

corporate management[151] are not causes for mitigation of the representative director's own duty of care also fits the ordinary director's duty of care, i.e. the duty of observation of the representative director's business activities.[152]

Moreover, it is improper to deny the director's duty of observation by reason that the Board meetings have not been held for a long time, since each director has the authority to convene a Board meeting,[153] whether he is an active director or a nominal director.[154] Furthermore, the existence of an autocratic representative director who never allows the other directors to meddle in his business management cannot be a cause for mitigation of those directors' duties of observation. Indeed it is in precisely those corporations where there are autocratic representative directors that strong supervision by a Board of Directors is needed.

(4) Directors' Duty and Doctrine of Disregarding the Corporate Entity

It has been said that when Article 266-3 of the

Commercial Code,[155] which provides for the director's liability to a third person, applies to a director of a small corporation, the article fulfills a sustitutional function for the doctrine of disregarding the corporate entity.[156] However, the doctrine of disregarding the corporate entity is a doctrine relating to the responsibility of a substantial dominant actor shielding behind the corporate shield so that the doctrine properly cannot be applied to a director who is not a sole shareholder and concurrently a dominant director of a corporation. On the contrary, courts have come to hold a nominal director liable who does not handle any corporate affairs and does not have a substantial interest in the corporation.

Therefore, it may be said that Article 266-3 fulfills more of a function than does the doctrine of disregarding the corporation entity.[157] In cases where the necessary conditions of both Article 266-3 and the doctrine of disregarding the corporate entity are fulfilled, the former should be given priority in application because

concrete provisions should take priority over general provisions. However, a creditor can call a representative director (a dominant director and concurrently a sole shareholder) to account by disregarding the separate entity of a corporation and, at the same time, call the other director who has property to account by applying Article 266-3, when a representative director's property is not sufficient to cover a creditor's damages.[158]

Since the doctrine of disregarding the corporate entity only affects legal relations between particular parties, the effect of disregarding the separate entity of the corporation does not extend to legal relations between other parties, even in the same fact situation.

(5) Causal Relationship

The existence of a causal relationship between the director's business activity and the damage to the corporation or the third party is a requirement for a director's liability. The

causal relationship has come into question in discussing directors' liability, particularly the nominal director's liability. There is in fact one precedent which denies the director's liability because of the non-existence of a causal relationship.[159]

It is very hard to prove that there is a relationship of adequate causation between a nominal director's intentional or grossly negligent breach of duty of observation and a third party's damage. However, it may be unjustly tolerant for a neglectful nominal director to be able to require a plaintiff to strictly prove the existence of a causal relationship between the nominal director's breach of duty of observation and the third party's damage. Moreover, if a court requires a plaintiff to strictly prove the existence of a causal relationship, the result would be unreasonable in that the more a director pays attention to the other director's business activities, the more possibility there is that he will be called to account because he will have

more opportunity to prevent other directors from unfair business activities.[160]

Therefore, courts have held that there is no need to acknowledge the concrete causal relationship between a director's failure in his duty of observation and the other director's intentional or grossly negligent breach of duty when the latter should bear the responsibility.[161] It may be said that the judgement itself which affirms the duty of observation on a matter which was not brought up for discussion at Board meetings eases the requirement of proving the relationship of adequate causation and, at the same time, dilutes the concreteness and specificity of the duty of care, ie. the duty of observation.[162]

(6) Intentional or Negligent Act

If a director has been guilty of wrongful intent or of negligence in respect of the failure in his duty of observation, he is liable to the corporation for any damages caused to it.[163] If he has been guilty of wrongful intent or of gross

negligence in respect of a breach of duty of observation, he is liable in damages to third persons as well.[164] The duty of observation that is required of a director is the standard of care of a good manager,[165] ie. the standard of care required of an ordinary business manager with reasonable skill and prudence in the director's position in the corporation concerned. A director's negligence or gross negligence in this regard is not his negligence or gross negligence in the violation of the third party's right but that of his breach of duty as a director.[166] Therefore, judging from the function of the Board of Directors, the nominal director who never spares any effort to attend the board meetings nor to read minutes should be adjudged guilty of gross negligence or negligence in respect of this failure in his duty. But there is no general explanation concerning what is negligence or what is gross negligence.[167]

It is impossible to indicate a fixed and abstract criteria concerning defining negligence or gross negligence since they are legal concepts that

should be judged with respect to particular conduct in specific circumstances. Therefore, there is nothing for it but to judge the details of negligence or gross negligence in every particular case. However, it may be said in the abstract that negligence means a failure to exhibit the care which one ought to exhibit, and gross negligence means a failure to exercise even slight care.[168] Therefore, we should acknowledge the director's negligence or gross negligence in every particular case by applying the standard of care which is expected to be used to evaluate a representative director's illegal business activities and/or the degree of difficulty or ease involved in preventing such representative director from carrying out any illegal business activities and apply this as the yardstick to an ordinary director acting with reasonable skill and prudence. The latter's conduct must suit the conditions which include the scale of the corporation concerned, the type and nature of the industry involved, the custom of the industry, present economic conditions, the number of directors, his own allotted duties, the amount of his remuneration and so forth.[169]

> Since the duty of observation is a duty that is based on his position as a director, it should be interpreted that every director is required to conform not only to the standard of care or skill that is expected from a person of his knowledge and experience, but to the standard of the reasonably prudent person in like position and circumstances. A person who accepts appointment as a director shall be considered to have undertaken to perform his duties with the care, diligence and skill which can be expected of a reasonably prudent person.

C. 1982 AMENDED COMMERCIAL CODE

The new amendment to Part II of the Commercial Code (Part II regulates "Corporations") was proclaimed on June 9, 1981 and enforced on October 1, 1982. The most important legislative objective of the new amendments is to enable corporations to review and supervise their business activities internally by strengthening the self-policing mechanisms of corporations -- for example: shareholders' proposal rights at shareholders' general meetings; the duty of directors and auditors to give

appropriate explanations at such meetings; strengthening the powers of auditors; and clarifying the authority of the Board of Directors to observe the execution of the duties of representative directors.

In the draft plan for amendments to the corporate organs (kikan kaisei shian), the business system committee (keiei iinkai) was proposed as a corporate organ that was expected to play a substantial and maneouverable role in corporate management.[170] The proponents of the business committee system considered that it suited the peculiar circumstances of the Japanese corporations which, to some extent, are obliged to have a great number of directors because they have adopted the so-called lifetime employment system and advancement system where most directors are promoted from among the employees of the corporation. They based their recommendations on their experience with the system of executive committees (jomukai).[171] However, the business world unanimously rejected this proposal either on the ground that the executive committee was sufficient for the purpose or that it might reduce the Board of Directors to a shell.[172] As a result, the legislature has tried to improve business control by complementing the functions of the Board of Directors rather than by the business committee system (keiei iinkai).[173]

The following is a rough introduction of those parts of the new amendments which are relevant to the directors' duty of care of a good manager.

1. Persons Disqualified as Directors (Article 254-2)

When a director fails to perform his duty properly, this improper business activity causes damage not only to his corporation but also to the shareholders, creditors and other third parties. Therefore, it is reasonable to prohibit a person who has breached his director's duties from taking office again as a director. However, there was no express provision concerning who was disqualified to act as a director in the old Commercial Code. The new Code puts the disqualification of directorship in a statutory form. The new Code provides that the following persons lack capacity to act as director:

(a) an incompetent person or a quasi-incompetent person;

(b) a person having been adjudged bankrupt, but not reinstated;

(c) a person having been sentenced to a penalty for a

crime prescribed in the Commercial Code, the Law for Special Treatment of Statutory Auditors, or the Limited Liability Company Law for whom two years have not passed since the end of the sentence, or he ceased to be answerable to the sentence;

(d) and a person having been sentenced to a penalty heavier than imprisonment due to a crime other than prescribed in the preceding item for whom the sentence is not expired, or he ceased to be answerable to the sentence. (But those for whom execution is pending are excluded).[174]

In the draft plan for the amendment concerning corporate organs (Kikan Kaisei Shian),[175] it was proposed that persons who may not become a director are minors and any one who has committed economic crimes provided in the Criminal Code, the Company Law, the Bankruptcy Law, the Composition Law, the Corporation Reorganization Law and the Securities Business Law. However, although a minor's capacity is generally restricted under the Civil Code,[176] a minor has the same capacity as a legal adult in relation to the conduct of a business where this has been allowed by a person in parental authority, or some other legal

representative.[177] Therefore, a minor who has obtained his legal representative's consent to take office as a director may be regarded as having the same capacity as a person of full age. Moreoever, if the law prohibits indiscriminately a minor from taking office as a director, the practical effect may be to cause great inconvenience to small, closely held corporations. Also the economic crimes provided for in the above laws do not always concern the management of a corporation. Therefore, the new Code stipulates that the crimes leading to disqualification must be corporate crimes.[178]

2. The Supervisory Authority of the Board of Directors (Article 260(1))

The new article is expected to strengthen the Board of Directors' control over representative directors so as to restrain any arbitrary business decisions or conduct by the representative directors.

Even the old Code was interpreted to mean that the Board of Directors had the authority to supervise the performance of the directors' duties as mentioned above. In practice, however, directors were apt to make light of this authority

since there was no provision relating to this authority.[179] The new Code specifies this authority and provides that the Board of Directors has authority to supervise the performance of the directors' duties. The intent of the legislation is that each director will become conscious of his supervisory duty and the Board of Directors will fulfill its supervisory functions sufficiently.[180]

3. Matters to be Decided Solely by the Board of Directors (Article 260(2))

It is practically impossible for the Board of Directors to make all the decisions on matters concerning the administration of corporate affairs. Therefore, it is necessary for the Board of Directors to vest the representative director with the authority to decide such matters.[181] However, under the old Code, it was not necessarily clear to what extent the Board of Directors had the power to vest the representative director with the authority to decide matters concerning the administration of corporate affairs. Opinion was divided as to what kind of matters might be delegated to the representative director. The wide view was that only the matters that the Board of Directors was authorized to decide under express provisions of the old Code may not be delegated, but all other matters

may be delegated to the representative director. The narrow view was that all important matters concerning the administration of corporate affairs, even if they were not designated by the Code, could not be so delegated.[182]

In order to strengthen the supervisory authority of the Board of Directors, the present Code provides that the statutory authority extends to important matters in general concerning the administration of corporate affairs and gives the following examples of important matters concerning the administration of corporate affairs which must be decided by the Board of Directors and shall not be delegated to the representative director.[183] Article 260(2) of the Commercial Code provides as follows:

> The board of directors cannot make a director decide the following matters or other important administration of affairs:
>
> (1) Disposition and taking over of important property;
>
> (2) Loans of a large amount;
>
> (3) Appointment and dismissal of important employees such as a manager;
>
> (4) Establishment, change and discontinuance of important organs such as a branch.

4. Report to the Board of Directors (Article 260(3))

It is necessary for the Board of Directors to have sufficient information about their corporation's business in order to make the Board of Directors properly exercise their supervisory authority. (Such information is also useful for them to properly decide matters concerning the administration of corporate affairs.)[184] For this purpose, the new Code requires the directors (which term includes not only the representative directors, but also the executive directors) to report to the Board of Directors at least once every three months on the administration of affairs. The purpose of this is to furnish the Board of Directors with sufficient information as to the corporation's business to allow them to properly exercise their authority to decide matters concerning the administration of corporate affairs and to supervise the performance of the directors' duties. Consequently, the director must not only submit financial statements and/or temporary balance sheets, but must also report to the board in concrete terms on the actual administration of corporate affairs.[185] The director who receives such a report owes a duty to seek explanations of any defect or voice his doubts relating to the report.[186]

5. Right to Call a Meeting of the Board of Directors (Article 259(2)(3))

Under the old Code, each director had an authority to convene a Board meeting. However, the Board of Directors might also appoint one director who was designated to convene such meetings. The same applies under the new Code.[187] The reason why corporations appoint a director to convene board meetings is to avoid the possibility of each director convening a meeeting with resulting contradictory resolutions passed at each, when there is a split in the Board of Directors.[188] Influential scholars insisted that even when a particular director was appointed to convene Board meetings, the other directors might also convene meetings.[189] However, this interpretation was not clear under the old Code. The new Code puts each director's authority to convene Board meetings in a statutory form. Under the new Code, a director other than the director who is designated to convene Board meetings may convene a Board meeting by submitting a document in which is entered the matters which are the objectives of the meeting.[190] Further, under the new Code if the director who is appointed to convene the meeting does not give notice of such meeting within five days of the date of such request, or if the date he sets for such meeting does not fall

within two weeks from the day of such request, the director who has made such request may convene a meeting himself.[191]

6. Inspection of the Minutes from the Board Meeting

Under the old Code, any shareholder or creditor of the corporation might, at any time during business hours, inspect or make extracts from the minutes of the meetings, whatever their objective.[192] However, since the minutes often contain business secrets, corporations either were not willing to submit their minutes at all to the free inspection of shareholders or creditors, or some were apt to make the contents of their minutes innocuous by not entering important matters.[193] Therefore, the provisions of the new Code concerning the inspection of the minutes are strengthened so that a shareholder is entitled to inspect or make extracts from the minutes only to the extent necessary to exercise his rights and a creditor of the corporation is so entitled only when it is necessary for an inquiry into the responsibility of the directors or auditors.[194] Under the new Code, when a shareholder or creditor of the corporation seeks to inspect or copy the minutes, he must ask permission from the court by showing that an inspection or copy of the minutes is necessary for

the exercise of his rights or for an inquiry into the responsibility of the directors or auditors. The court cannot give permission to inspect or to copy if it is feared that remarkable damages might result to the corporation, its parent corporation or any affiliated corporation.[195]

III. DIRECTORS' DUTY OF CARE, DILIGENCE AND SKILL UNDER CANADIAN LAW

A. POSITION OF DIRECTORS

Both under the Canada Business Corporations Act (hereinafter referred to as the "CBCA") and the British Columbia Company Act (hereinafter referred to as the "BCCA"), directors have a key position in the operation of the affairs of the company. The BCCA provides:[196]

> "The directors shall, subject to this Act and the articles of the company, manage or supervise the management of the affairs and business of the company."

Although the CBCA does not go as far as the BCCA in broadening the directors' duty to require supervision of the management of the corporation, it adopts the traditional formulation of directors' duty and provides:[197]

> "Subject to any unanimous shareholder agreement, the directors shall manage the business and affairs of a corporation."

In determining what duties are imposed on directors and to whom these duties are owed, their position has been compared with

that of trustees.[198] Indeed, the directors' status is analogous to that of trustees in the sense that in the performance of their duties, they stand in a fiduciary relationship to the company. However, in respect to their standard of care and their relationship to shareholders, the trust analogy is inapplicable. As has been stated:

> "Their position ... is very different from that of ordinary trustees whose primary duty is to preserve the trust property and not to risk it. Directors have to carry on business and this necessarily involves risk, ..."[199]

The courts recognize this and therefore are unwilling to condemn directors when they act honestly but their decisions cause loss to the company.[200]

B. STANDARD OF CARE AND SKILL

1. Common Law

The standard of care developed by the courts and applied to directors and officers was very low. There is an obvious contrast between the directors' elaborated and enlarged fiduciary duties and their very light duties of care and

skill. The standard of care developed by the courts has been criticized as inadequate in terms of the modern business environment.[201]

As was stated in Re City Equitable Fire Insurance Company Ltd.,[202] the authorities do not give any very clear answer to the question of what is the particular degree of skill and diligence required of a director. It is indeed difficult to state any general proposition since the required standard of care which is expected of a director depends upon the particular and specific circumstances of his position, eg. the size and structure of the company, the type and complexity of the corporate business,[203] the magnitude of the transaction, the immediacy of the problem presented, the number of the directors, the composition of the Board of Directors, the distribution of duties amongst directors and officers and his own level of skill. It seems that there is no universal standard of care applicable to all companies in all situations. However, there are several general situations that seem to be appropriate to test the sort of conduct the courts have regarded as producing liability.

(a) Expected Knowledge and Experience

The standard of care and skill to be expected at common law depends upon the skill, ability, knowledge and experience which a director has personally. A director is not required to exercise a greater degree of skill than may reasonably be expected from a person of his ability, knowledge and experience. Directors are not required to have any special qualifications for office.[204] To this extent, the common law standard has a definite subjective element. It is clear that a director's errors in judgement do not themselves create liability, even though the errors may be so gross that they demonstrate the unfitness of the director to manage corporate affairs.

The conventional common law standard was set out in Re City Equitable Fire Insurance Company Ltd.[205]:

> "A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. ... directors are not liable for mere errors of judgement."[206]

Also in Re Denham & Co.,[207] a director was released

from liability for not perceiving the frauds of the chairman of directors in contriving the accounts so as to show a fictitious profit, since he was "a country gentleman and not a skilled acountant".

Moreover, in Re Brazilian Rubber Plantations and Estates Ltd.,[208] the court, in holding the directors not liable for losses sustained in a disastrous speculation in rubber plantations, said that:

> "[A director] may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance."

But if he is acquainted with the company's business he must use that knowledge and experience for the company's benefit when transacting its business.[209] And if a director is appointed on the ground that he is an expert in any field, he must exercise the degree of care and skill to be expected of a person in that position.[210] However, he is not expected to be a reasonably well-qualified director unless appointed as such.

The courts explain the rationale of the low standard of care and skill on the basis that the shareholders themselves and their company must take the consequences if they choose to appoint bad directors. It was held in Turquand v. Marshall[211] that:

> "however foolish the loan might have been ... Whatever may have been the amount lent to anybody, however ridiculous and absurd their conduct might seem, it was the misfortune of the company that they chose such unwise directors."

Also it was held that directors were not bound to be wiser than those who have appointed them.[212]

(b) Attention and Diligence Required to be Devoted to the Company's Affairs

While a director who attends a Board meeting is presumed to have heard what was discussed and decided at the meeting, a director who is not present at a Board meeting may escape liability for the consequences of corporate affairs discussed in his absence.

In Ashurst v. Mason,[213] it was held in relation to the duty to be alert at meetings that:

> "it would be in the highest degree dangerous to permit directors to say ... when any particular incident arise ... 'At what moment my thoughts were elsewhere. I did not hear it ...'"

Also it was held in Land Credit Company of Ireland v. Lord Fermoy[214] that:

> "I quite agree that it is their duty to be awake and their being asleep would not exempt them from the consequences of not attending to the business of the company."

Thus, at common law, directors have a duty to check corporate affairs which were brought up for discussion in their presence at Board meetings. The Board of Directors' authority to select the chairman ensures its control over the executive.[215] Therefore, a director's inattention to corporate affairs which were brought up for discussion at Board meetings renders him liable for breaches of trust which have been committed by other members of the Board of Directors. If a director attends Board meetings, he is presumed to have known what was done at them.

In respect of the directors' duty to attend Board meetings, it has been suggested that there is a minimum requirement. In Re City Equitable Fire Insurance Company Ltd.,[216] Romer, J. stated that:

> "A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend all such meetings, though he ought to attend whenever in the circumstances he is reasonably able to do so."

This proposition is directed solely to non-executive directors. Officers must give continuous attention to the affairs of the company.[217]

Though Romer, J. suggested there might be liability if a director fails to attend Board meetings whenever reasonably possible, the cases suggest that non-attendance rarely provides grounds for liability. In Re Denham & Co.,[218] the director had not attended any meetings for four years, and in Re Cardiff Savings Bank,[219] the director had not attended any meeting for seventeen years, but both were not found liable. Moreover, even a director who was party to a resolution initiating an ultra vires lending policy was held not liable since he was absent from Board meetings where specific loans had been made pursuant to the policy.[220] Therefore, directors have a duty to check on corporate affairs which were brought up for

discussion at Board meetings. However, that seems to be the extent of directors' duty to check on corporate affairs. Directors do not need to investigate corporate affairs and do not need to prevent the executive from engaging in improper or illegal business activities if these were not brought up for discussion at Board meetings or if they were absent from Board meetings.

It seems that, at common law, the directors' duty to check on corporate affairs is not derived from their constituent membership of the Board of Directors or is not based on the fact that they knew or should have known of the illegal conduct of the corporation's business, but is derived simply from their attendance at Board meetings.

The attitude of the common law seems to be summed up in the statement of Stirling, J. in Re Cardiff Savings Bank[221]:

> "Neglect or omission to attend meetings is not the same thing as neglect or omission of a duty which ought to be performed at those meetings."[222]

Therefore, one may conclude that it is better not to be diligent at all, and not attend a meeting, rather than be partly diligent, and attend and pay no attention.[223]

(c) Delegation and Reliance on Others

The authorities indicate that a director's duties must not be entrusted to an obviously inappropriate or unqualified official: the handling of the investments of a finance company must not be left to the office boy.[224] Thus, to entrust a person who is not a director, officer or even a shareholder of the company with the uncontrolled power of drawing cheques on the company's account was held negligent.[225]

The general position in this respect is stated by Lord Davey in Dovey v. Cory[226]:

> "[A director] was entitled to rely upon the judgment, information and advice of the chairman and general manager, as to whose integrity, skill and competence he had no reason for suspicion."[227]

Also, reliance without question on the information of

those performing specialist functions, such as lawyers or auditors, has been held to be reasonable.[228]

Thus, where duties have properly been left to officers and agents of the company, a director is, in the absence of grounds for suspicion, justified in trusting those officers and agents to perform the duties honestly.[229] There are cases where directors were held entitled to rely on the information or advice of the chairman of directors,[230] managing directors,[231] general managers,[232] and chief executive officers.[233] These directors are not responsible vicariously for the misdeeds of those officers since the officers are the agents of the company, not of the directors.[234]

In particular, directors are not required to entertain suspicions about the information, advice and conduct of others within their company nor raise questions about them. In Re City Equitable Fire Insurance Company Ltd.,[235] Romer, J. referred to the judgment in Dovey v. Cory,[236] citing the judgment of Lord Davey (at page 492) as follows:

> "I agree with what was said by Sir George Jessel in Hallmark's Case and by Chitty J. in Re Denham & Co., that directors are not bound to examine entries in the company's books. It was the duty of the general manager and (possibly) of the chairman to go carefully through the returns from the branches and to bring before the board any matter requiring their consideration; but the respondent was not in my opinion guilty of negligence in not examining them for himself, notwithstanding that they were laid on the table of the board for reference."

Therefore, directors are required to examine entries in the company's books only when they have been given ground for suspicion by some reasons.

(d) Summary

Although officers are bound to give continuous attention to the affairs of their companies and may be subject to stricter duties of care, skill and diligence than are directors who are not also executive officers, it is clear that common law standards of care, skill and diligence are unduly low. However, most modern companies "expect all their directors to do some homework to familiarize themselves with the company's operations and, despite Romer J.'s remarks, not just to perform intermittently at Board meetings".[237]

It seems that these low standards of care, skill and diligence come from the recognition that directors are frequently elected members of the Board of Directors for reasons other than their business skills. Therefore, the courts have not required directors to have any special qualifications for office and, as a result, the courts cannot condemn incompetent directors for their greater reliance on others. It is indeed the case that the fewer the qualifications for office a director has, the less time and attention he devotes to his office, and the greater the reliance he places on others, and legally the less responsible he is.[238] It is quite clear to the writer that this principle is not fair and does not encourage directors' care, skill and diligence in performing their duties. And it is doubtful that directors should not be required to have any special knowledge, experience or skill for office. One of the features of the modern public company is the separation of the powers of management from the corporate ownership. Shareholders reserve only the powers of decision with respect to the fundamental corporate affairs and minimum authority to check the management of the affairs, and entrust directors to manage or supervise

the management of the affairs and business of the company. From this point of view, the modern public company director should no longer be an amateur director, but a professional director with reasonable skill and diligence. The writer never ignores the fact that the powers of management of closely-held corporations do not separate from the corporate ownerships and that it is next to impossible for small corporations to elect proper professional directors with reasonable skill and diligence. However, it seems to the writer that the courts put the cart before the horse. The standard of care and skill of directors in large corporations should be different from that of directors in small corporations, ie. the public company director should be a professional director with reasonable skill and diligence. In addition, the low standards cannot be rationalized by the liability of shareholders who appointed bad directors since the bad directors' business activities cause losses not only to their company itself, but also to its customers, creditors and other third parties.[239]

Moreover, at common law there are other possibilities

for a lazy director to escape liability. That is the question of causation: it is very difficult to prove that a director's laziness or lack of attention was the substantial cause of the loss for which he is sought to held liable.[240] Furthermore, as Lewtas points out, the common law duty of care, skill and diligence has been "diluted ... by elaborate exculpatory provisions in articles of association and by-laws, which are probably effective except to the extent that they purport to condone fraud or come into conflict with specific statutory provisions."[241]

2. Statutory Modification of Standard of Care and Skill

Both the BCCA and the CBCA provide that the directors and officers have a duty to exercise their powers and discharge their duties with care, diligence and skill.[242]

Both require every director and officer to exercise the care, diligence and skill that a reasonably prudent person would exercise. This standard seems to be lower than that of a reasonably prudent director, a standard of care that was proposed in the recommendation of the Lawrence Committee on Company Law Reform in Ontario.[243] The former

standard does not conform to professional standards of care. However, although it is said that it is doubtful whether this statutory standard of care adds anything to the subject test formulated at common law in the Re City Equitable Fire Insurance Co. Ltd. decision,[244] it seems to the writer that this statutory standard of care upgrades the common law standard of care. Since whereas at common law a director is required to exhibit only that subjective degree of care, diligence and skill that could reasonably be expected from a particular "director of his knowledge and experience", the statutes require that every director conform to the objective standard of an imaginary "reasonably prudent person". The BCCA specifies that this requirement is in addition to, and not in derogation of, any enactment or rule of law or equity relating to the duties or liabilities of directors of a company.[245]

Moreover, the CBCA specifies that every director or officer shall exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.[246] The phrase "in comparable circumstances" is intended to make relevant all of the circumstances in which a decision is made including the significance of the action to the company, the information reasonably available

to the director when making the decision, the time available for making the decision, the alternatives open to the company, the director's position whether he is an outside or an inside director or is in charge of a specific part of corporate management, the director's special qualifications such as a lawyer or an accountant, the peculiar knowledge or lack of knowledge of the director and similar factors affecting the decision-making process.[247] Although there is no similar phrase in the BCCA, it is likely that a court would read such a phrase into it in deciding the facts of a particular case.[248] Actually, in deciding the fact, Cashman L.J. applied the standard that a director is liable for negligence if he fails to exercise such degree of care as a reasonable man might be expected to take in the circumstances on his own behalf.[249]

Furthermore, it is clear that it is no longer possible to lower the standard of care, diligence and skill by provisions in the articles and by-laws. BCCA expressly provides that the provisions of a contract, the memorandum or the articles, or the circumstances of his appointment shall not relieve a director from the duty of care, diligence and skill of a reasonably prudent person.[250] It should be noted that the defence of a nominal director, he

is elected to a directorship under a special agreement with the corporation that he is not expected to discharge his duty, is no longer effective as a means of avoiding liability.

In addition, although at common law a director who did not attend a Board meeting might well have been in a better position in terms of liability than a director who did, the duty of diligence is significantly upgraded. CBCA Section 118(3) provides that a director who was not present at a meeting at which a resolution was passed or action taken is deemed to have consented thereto unless within seven days after he becomes aware of the resolution he causes his dissent to be placed with the minutes of the meeting, or sends his dissent by registered mail or delivers it to the registered office of the corporation.[251]

It is clear that this provision encourages directors to be diligent in attending meetings or, at least, in giving attention to all decisions which have been made.[252] However, even in the CBCA and the BCCA, the duty of diligence is not upgraded enough. In both Acts, it is provided that a director who was absent from a meeting at which a resolution was passed is deemed to have consented

to the resolution only if he does not dissent within seven days after "he becomes aware of the resolution". Therefore, a director who does not pay any attention to read minutes or notice could presumably escape liability.[253] It has been argued that it is advisable to encourage directors' care and diligence, and to provide instead that a director who was absent from a meeting at which a resolution was passed is deemed to have consented to the resolution unless he enters a dissent within seven days after he is given notice of or becomes aware of the resolution.[254] However, until such amendment has been made, the courts may encourage directors to increase the care and diligence by finding them liable for all directors' resolutions, notwithstanding they did not attend the meeting, unless they have specifically dissented thereto. The test should be that of a reasonably prudent person in determining the question of liability. This test would negate the defence of having received a resolution but not having read it or having read it but not understanding it.

In addition, at least in the case of publicly-held corporations, the standard of care, diligence and skill may be inspired by the higher standards required by securities

law. In the United States case Escott v. Barchris Construction Corp.,[255] as to the liability of one outside director, it was held that "more was required of [the defendant director] in the way of reasonable investigation than could fairly be expected of a director who has no connection with [writing the relevant disclosure document and assuring its accuracy] because he was the person most directly concerned with such work".

C. TO WHOM ARE DUTIES OWED?

It seems that there is a striking contrast between the Japanese and Canadian attitudes relating to whom duties are owed and to whom a director is liable. Under Japanese law, as mentioned above,[256] a director owes a duty and is liable, not only to the company,[257] but also to any person[258] who has suffered foreseeable damage. However, under Anglo-Canadian law, in the absence of specific statutory provisions a director's duty in his capacity as a director is to his company alone - and not to the shareholders, creditors, potential investors, stock exchangers, securities commissions or others.[259]

In general, no Plaintiff may recover damages unless the Defendant owes him a duty of care. A tort duty is not owed to

the world.[260] "In every case the judge must decide the question: Is there a duty of care in this case owing by the defendant to the plaintiff ...?"[261] Duties are in many instances abridged by reason of the Plaintiff's status or special relation to the Defendant.[262] However, there are now some authorities indicating a substantial broadening of the persons who are covered by the duty of the Defendant. For example, Denning M.R. declared that:

> "[Duty of care] is owed ... to the person to whom the certificate is issued and whom he knows is going to act on it ... But it is also owed to any person whom he knows, or ought to know, will be injuriously affected by a mistake ..."[263]

The Supreme Court of Canada has displayed a somewhat more conservative attitude in extending the duty of care to third parties. In Haig v. Bamford,[264] in discussing an accountant's duty of care, the court declared that the test of actual knowledge of the specific Plaintiff who will use and rely on the statement was the proper test to apply to the duty of care of an accountant to a third party. The court did not need to decide whether liability could be extended to cover actual knowledge of a class of people to whom the Plaintiff belonged or, more broadly still, to a foreseen Plaintiff.

In New Zealand, in Coleman v. Meyers,[265] Mahon, J. expressed the opinion that the decision in Percival v. Wright was wrong and ought not to be followed. He then decided that there was a general duty owed by directors to shareholders. His decision generated much academic discussion, but has not been widely followed. The Court of Appeal reversed the decision of Mahon, J. and held that the [Mahon, J's] conclusion was too broadly stated and that the standard of conduct required from a director in relation to dealing with a shareholder would differ depending upon all the surrounding circumstances and the nature of the responsibility which in a real and practical sense the director had assumed toward the shareholder.[266]

It is unclear whether Canadian courts will follow the reasoning in Coleman v. Meyers and extend the duty of care of a director to shareholders. It may seem that Allen v. Hyatt[267] earlier followed the reasoning in Coleman v. Meyers. Lord Haldane held that the directors owed a fiduciary duty to the shareholders since they held themselves out to them "as acting for them on the same footing as they were acting for the company itself, that is as agents".[268] If this step is taken, consideration must also be given to creditors or any person who suffered foreseeable damage, or any foreseeable Plaintiff. However, as a civil lawyer, the writer cannot find any persuasive reason

why Canadian tort law should keep the limitation of duty to "foreseeable Plaintiffs". It would seem more reasonable to simply limit the duty to "foreseeable damage". The English House of Lords seems to have moved close to this result, in fact, in recent cases applying the broad principle set down by Lord Wilberforce in Anns Case.[269]

Even if the Canadian courts do not do away with the limitation of duty to foreseeable Plaintiffs, at least one leading commentator has argued that the decision in Haig v. Bamford has moved Canadian law briskly forward and there is every reason to believe that it has not yet ceased advancing and that its ultimate destination will be a duty to all reasonable foreseeable users of accountants' information.[270]

Furthermore, at least as far as the duty of a director to third parties for a company's authorized wrongdoing is concerned, in Scott and Scott v. Riehl and Schumak,[271] where a Defendant director opened a general account in the company's name into which all monies received were deposited and withdrawn, contrary to the trust provisions of the Mechanic's Lien Act, Wilson, J. of the Supreme Court of British Columbia stated that:

> "The directors may be liable to third parties for a company's wrongdoing if they have expressly authorized wrongful acts complained of."

However, perhaps even more significant than the limitation of duty to foreseeable Plaintiffs was the common law procedural rule which barred any action by a shareholder of a company against directors or officers for breaches of duties owed to the company. If the duty to be enforced is one owed to the company, then the primary remedy for its enforcement is an action by the company against those in default. The derivative action exists at common law but its scope has been severely limited. One of the basic principles of the common law is that only a person who has suffered a wrong may maintain an action in respect of that wrong. In Foss v. Harbottle,[272] the court applied this principle to the corporate context and held that the company itself is the only proper Plaintiff in an action to redress a wrong done to the company or to enforce a duty owed to it, and a shareholder cannot initiate and maintain a derivative action against a director for a wrong done to the company.

However, this would work obvious injustices where the directors engaged in the wrongdoing form the majority on the Board of the company and thus prevent the company from suing.[273/274]

Statutory provisions in the CBCA[275] and the BCCA[276] have repealed the rule in Foss v. Harbottle and have attempted to provide for derivative actions in a wider range of situations.[277]

D. STATUTORY REFORM

1. Oppression Remedy

CBCA Sections 234 and 231 provide a remedy to a security holder, director or officer of a company, or any other person who, in the discretion of a court, is a proper person to make an application where the company has unfairly disregarded their interests or has been oppressive or unfairly prejudicial towards them.[278] This provision is an abandonment of the principle of judicial non-interference in business judgement. Although the remedy will be particularly useful for solving disputes in small or closely-held corporations,[279] this does not deny its application to large or publicly-held corporations and therefore this provision may be used for protection of the shareholders or creditors.[280]

2. Derivative Action

Statutory provisions in the CBCA[281] and the BCCA[282] have repealed the rule in Foss v. Harbottle and have attempted to provide for derivative actions in a wider range of situations.[283] For example, BCCA Section 225(1) provides as follows:

> "A member or director of a company may, with leave of the court, bring an action in the name and on behalf of the company
>
> (a) to enforce a right, duty or obligation owed to the company that could be enforced by the company itself; or
>
> (b) to obtain damages for any breach of a right, duty or obligation referred to in paragraph (a),
>
> whether the right, duty or obligation arises under this Act or otherwise."

However, shareholders may still only cause the company to enforce the rights of the company against its directors and officers.[284] CBCA Section 113(1) and BCCA 151(1) specify that directors owe the duties provided in these sections to the company and not to shareholders or creditors. The old principle that the director's sole duty is to the company is still preserved inviolate.[285]

The distinguishing features of the Canadian provisions in comparison with Japanese provisions are:

(a) The derivative action is available not only to shareholders, but to directors or complainants.

(b) The action extends to defending or intervening in an action to which the corporation is a party.

(c) The plaintiffs are required to get leave of the court. Under Japanese law, except cases where irreparable damage may be caused to the company by the company (the auditor) instituting the action, the shareholder may institute the action only after thirty days have passed since he demanded the auditor to institute the action to enforce the director's liability.

(d) The court may take the fact that the alleged breach has been or may be approved by the shareholders into consideration when dealing with the merit of the application. Under Japanese law, the minority may bring a derivative suit even when the majority ratified the act in question.

E. SECURITIES REGULATIONS

There have been recent developments in the standard of care, diligence and skill, and who has a right to sue in securities regulations. Although securities regulations do not cover directors' general liability for mismanagement, they provide for directors' liability for misrepresentation in a prospectus.

With respect to the standard of care, diligence and skill, the Ontario Securities Act provides that in determining what constitutes reasonable investigation or reasonable grounds for belief that there had been no misrepresentation, the standard of reasonableness shall be that required of a prudent man in the circumstances.[286/287]

As for the problem to whom are duties owed, the British Columbia Securities Act provides that a director of a company issuing the securities or a person who signed the certificate is liable to pay compensation to all persons who have purchased the securities for any loss or damage the persons have sustained as a result of the purchase.[288] This may mean that a director is liable to a purchaser for his negligence in making misrepresentations in a prospectus.[289]

Although these securities regulations are only applied to publicly-held corporations, these provisions are expected to encourage directors to increase their care and diligence.

IV. CONCLUSION

There are some basic similarities between Canadian and Japanese law relating to the duty of care, diligence and skill of directors and officers. For example, although the great majority of companies in each country are small closely-held corporations, neither company law takes proper measures to meet the situation; the powers of corporate management are separated from the corporate ownership; besides the duty of care, diligence and skill to manage the affairs and business of the company, directors have duty to check corporate affairs; the courts have expressed their reluctance to judge, with the benefit of hindsight, businessmen's decisions; of the decided cases where directors have been sued for breach of a duty of care, a very large percentage of the cases are brought when companies are bankrupt; we cannot place our hopes on the derivative action since it is quite hard for shareholders to obtain positive proof while the directors remain in office and there is no direct pecuniary benefit for shareholders who bring the derivative action. Nevertheless, there is a stark contrast between the large number of Japanese cases where directors have been found liable for their mismanagement or negligence in performing their duties and the few Canadian cases where directors have been found liable.

It seems that there are two principal reasons for this contrast: One is whether or not directors owe a duty to third parties rather than simply to the company; the other is the strictness of the standards of care, diligence and skill owed by directors.

In both Canada and Japan, there are only a small number of cases relating to the directors' liability to their companies.[290] This is a matter of course because directors are naturally reluctant to cause action against themselves or their colleagues and it is quite hard for shareholders to institute a derivative action. Although there are some authorities indicating a broadening of the persons who are covered by the duty of the director,[291] there seems to be no Canadian cases where directors have been found liable to a third party for breach of a duty of care, diligence and skill. On the contrary, there are numerous instances of such cases in Japan.

It is correct to say that the very existence of the Commercial Code, Article 266-3, which provides for directors' liability to third parties, has contributed to the upgrading of the standard of care, diligence and skill of directors. Japanese courts interpret Article 266-3 as a provision for the protection for third parties,[292] and have held directors to have wide

liability to such persons. These decisions are mostly backed up by the fact that there are a great many small companies whose capital foundations are very weak. It seems to the writer that this function and role of Article 266-3 is desirable, and has been adequately fulfilled.

It is unclear whether Canadian courts will extend the duty of care of a director to shareholders. However, at least as far as a fiduciary duty is concerned, there is a statement in Allen v. Hyatt[293] that the directors owe a fiduciary duty to the shareholders since they held themselves out to them as acting for them on the same footing as they were acting for the company itself, that is, as agents.

If this step is taken and this duty is extended, consideration must be given, at the next step, to creditors or any person who suffered foreseeable damage. With respect to the duty of care of a director of a large company to third parties, there may be a possibility that another approach will be made under the influence of securities regulations which suggest that a director is liable to a purchaser for his negligence in misrepresentation in a prospectus.[294]

However, the Commercial Code Article 266-3 has also been used

extensively to lift the corporate veil, and this, although seemingly necessary to accomplish the function of increasing the standard of care, etc., is undesirable. The directors' duty to check corporate affairs (duty of observation) was originally intended to be one of the constituent factors of the corporate self-audit system. When one considers the fact that it is a normal state for small companies not to hold Board meetings, it seems inconsistent with the actual circumstances to put directors of such small companies under the duty to check corporate affairs (duty of observation) that is grounded on the position of constituent membership of the Board of Director. Article 266-3 was not itended to be used to disregard the corporate entity. Therefore, it seems that the fact that the necessity to protect third parties who transacted with a small company like a private enterprise contributes by making the duty to check corporate affairs a strict duty, is one of by-products of the lack of a proper legislative distinction between a publicly-held large company and a closely-held small company.[295]

With respect to the standard of care, diligence and skill, Japanese courts have required higher standards than Canadian courts have required. While the common law adopted a subjective standard and did not require a director to exhibit a

greater degree of skill than may reasonably be expected from a person of his knowledge and experience,[296] the Japanese Commercial Code has adopted an objective standard, the standard of care of a good manager. The standard required is that degree of care that a reasonably competent director would be required to take in the particular circumstances in which a decision is made or an action is taken, and that a higher degree than that with which he is expected to execute his own business.[297] Although both the BCCA and the CBCA require that every director conform to the objective standard of a reasonably prudent person, the Canadian standard of care required of a director is still lower than that of Japan. The standard required by Canadian courts is that degree of care that a reasonable man might be expected to take in the circumstances on his own behalf.[298] Moreover, under the Japanese Commercial Code, there is an interpretation that it is proper to condemn a director who has clearly erred in a judgement with respect to a business decision or policy required of him as a business manager and has caused damage to the company, even if he managed its affairs faithfully.[299] However, under BCCA subsection 152(1) and CBCA subsection 119(1), a director can be indemnified for a breach of his duties of care, diligence and skill if he has acted honestly and in good faith with a view to the best interests of the corporation of which he was a director.

In addition to this difference in the starting point, it seems to me that the following further factors also make Japanese courts impose a higher standard.

1. The interpretation that the directors' duty of observation is not derived from their attendance at Board meetings but from their constituent membership of the Board of Directors is widely accepted.

2. The interpretation that a nominal director is not given any special position in the Commercial Code is widespread.

3. There is no such concept that "it was the misfortune of the company that they chose such unwise director".[300] On the contrary, it is considered in Japan that a person who accepts an appointment as a director should undertake to conduct the business of the company with the standard of care of a good manager.

4. The Boards of Directors of nearly all large Japanese companies include only a small minority of outside directors. It is quite common for there to be only two or three outside directors out of a total of thirty or more. Nearly all companies adopt the "lifetime employment" system

and most of their directors come from the employees. In addition, it is quite rare that Japanese companies have directors resident overseas. This means that a director's negligence reflects on his competence as an employee in the business structure and exposes him to inter-corporate discipline or criticism.

5. Important decisions are usually reached by a collective decision-making process. The person in charge draws up the original plan in written form and obtains the approval of his seniors in ascending order. This system is called the ringi system. Who makes the final decision on the plan depends upon the importance of the matter: it is generally made by the president or chairman for the most important matters, directors for relatively important matters and department heads for routine matters. In general, therefore, directors are well informed on corporate affairs and it is clear where the responsibility rests since approval of a plan is recorded in writing.

6. When a group is involved in trouble, a Japanese group tends to place the responsibility for it not only on the person in charge, but also on the group itself. Therefore, apart from the legal responsibility, it is apt to be considered

proper that a director should bear some responsibility for the negligence of those below him.[301]

However, what seems more fundamental is the difference between the question relating to whether or not a director becomes more diligent if the courts place a strict responsibility on him. Anglo-Canadian thought is that it is doubtful that civil liability for negligent misrepresentation would play a role in improving the quality of directors and deter directors from pursuing negligent courses of conduct.[302] It is thought that an adequate penalty for negligent mismanagement might be the directors' loss of business reputation and his discontinuance in office.[303] On the contrary, Japanese thought seems to be that it is, by itself, not a goal to pursue a director with civil liability for negligent mismanagement. Rather, Japanese courts hold directors liable for their negligent mismanagement in the expectation that this will frighten them into discharging their duties diligently.[304]

There is no available data which indicates that strict civil liability for negligent mismanagement makes Japanese directors more careful and diligent. Therefore, it seems to be difficult to say which school of thought is correct. However, it seems that we should adopt the position that every director has

guaranteed to perform his duties with the care, diligence and skill which can be expected of a reasonably prudent person (Canada) or a good manager (Japan) since a person who accepts appointment as a director takes office or should take office with a good understanding that a director is required to exercise the care, diligence and skill of a reasonably prudent person or a good manager. And, although we cannot expect a stricter legal standard of care, diligence and skill to play a decisive role in improving the quality of directors' activities, the writer is of the opinion that we should pay more attention to developing a proper standard of care, diligence and skill, if it will have any influence, however slight one may be, on improving the quality of directors' activities.

In both Canada and Japan, the courts have expressed their reluctance to judge, with the benefit of hindsight, directors' decisions. Gower expresses his sympathy with this and says that judges are conscious of the possible unfairness in attempting to substitute their hindsight for the directors' foresight.[305] The courts should judge a director's business activities by considering the circumstances that he knew or he could have known when he entered into the business activities in question. Needless to say, the courts should not condemn a

director for his business conduct on the basis of facts which became known only after his conduct was completed. However, this principle is one which should be applied not only in negligence, but also to cases of breach of fiduciary duty. Therefore, the court's reluctance does not seem to be the reason why while Canadian courts place a heavy fiduciary duties on directors, they place only a very light duty of care, diligence and skill on directors.

Moreover, the existence of directors' insurance coverage[306] and the indemnification of directors[307] may make it easier for the courts to upgrade the standard of care, diligence and skill. The standard of care developed by Canadian courts and applied to directors has been considered by many to be inadequate in terms of the modern business environment.[308] We have every reason to believe that Canadian courts will require directors to comply with higher standards of care, diligence and skill in the future. Japanese experience seems to suggest possible ways which encourage directors to increase the care, diligence and skill in performing their duties.

With respect to the two obstacles to upgrading the standard and widen directors' liability in Canada, namely the question of causation between a director's laziness or inactivity and

damage to the company;[309] and the restriction imposed by the need to identify a foreseeable plaintiff, Japanese legal precedents seem to furnish possible alternatives.

In Japan, the courts seem to have recognized the unfairness of requiring a plaintiff to strictly prove the existence of a causal relationship between a director's laziness or inactivity and damage suffered by a third party. Moreover, it is understood that it is unreasonable that the more diligent a director is the more possibility there is that he will be called to court. The courts have eased the requirement of proving the relationship of adequate causation and diluted the concreteness and specificity of the duty of care by holding a director liable for his breach of the duty of observation on a matter which was not brought up for discussion at Board meetings. The courts have held that there is no need to acknowledge the concrete causal relationship between a director's failure in his duty of observation and the other director's intentional or grossly negligent breach of duty when the latter should bear the responsibility.[310] With respect to the concept of foreseeable plaintiffs under Japanese law, although foreseeability of damage is a necessary condition of negligence, there is no limitation of liability to foreseeable plaintiffs. If a plaintiff is inside the foreseeable range of

injury and suffers loss, his status or special relationship with a defendant does not abridge the duty of a defendant. Therefore, a director owes a duty to any shareholder, creditor, victim of a tort or any other third party, whatever his status or special relation to the director is, if he suffers foreseeable damage.

It is very probable that Canadian courts will, in the future, upgrade the standard and widen directors' liability because the concepts of causation and foreseeable plaintiffs will be influenced by the court's assessment of the demands of society for protection from the director's mismanagements.

However, as the U.K. Jenkins Committee rejected the codification of directors' duty of care, it is impossible to define directors' duty of care, diligence and skill exhaustively. In a large modern company, it is impossible to expect every director to have equal knowledge, experience and skill in relation to every aspect of the company's business activities.[311] Moreover, a director cannot be expected to possess the same degree of knowledge, experience and skill in all matters.[312] Furthermore, the required standard of care which is expected of a director varies with the specific circumstances, for example the size and structure of the

corporation, the type and complexity of the corporate business, the magnitude of the transaction, the immediacy of the problem presented, and the distribution of duties amongst directors.

Therefore, it is next to impossible to deal in general propositions and it would be impossible to define directors' duty of care, diligence and skill exhaustively. It is unavoidable, to some extent, to rely on abstract general concepts, for example the "reasonably prudent person" or "good manager" and "in comparable circumstances". However, although there are many difficulties,[313] it seems to be desirable to explore not a single objective standard but a multiplicity of different standards in order to meet the complexity and variety of the business management of modern companies.[314] From this point of view, the courts are expected to interpret abstract general concepts flexibly in deciding a fact, and explore a multiplicity of different standards.

NOTES

1 Iacobucci et al, Canadian Business Corporations, 286.

2 Commercial Code, Article 254(3). A mandate contract is concerned with the performance of a juristic act and takes effect when one party commissions another party to perform a juristic act (Civil Code Article 643). A mandate contract differs from employment in terms of the employer's control and direction, and in these regards the mandatary has discretion. It also differs from a contract for work in that it has as its subject the performance of juristic acts or nonjuristic acts, but not the completion of specific work. (Kitagawa, Doing Business in Japan II 1-75). While a mandate contract is not necessarily required, an agency relationship is usually created by means of a mandate contract. Although directors are not regarded as being agents of the companies (since they are indispensable organs of the companies and their intentions are thus identical to those of the companies), it is provided that the relationship between a company and its directors is governed by the provisions of the law relating to mandates.

3 Civil Code, Article 644. Under Japanese law, there are two standards of care. One is the duty of care of a good manager, eg. a director, a mandatory, a bailee for reward, a person having a right of retention, a pledgee, and a guardian. The other is the same care as he uses in respect of his own property, eg. a gratuitous bailee, a person who exercises parental power, and a successor.

4 Article 254-3 (emphasis added). Many scholars interpret that this article is the general provision relating to fiduciary duty. See Akabori, "Torishimariyaku no Chujitsu Gimu (Fiduciary Duty of Directors) 1-4", 85 Hogaku Kyokai Zasshi 1-4, Tanaka, Kaishaho (Company Law), Osakadani, "Torishimariyaku no Chujitsu Gimu (Fiduciary Duty of Directors)" 10 Shiho, Hoshikawa, Torishimariyaku Chujitsu Gimu Ron (Discussion on Directors' Fiduciary Duty), Totsuka, "Eibeiho ni okeru Torishimariyaku no Chujitsu Gimu (Directors' Fiduciary Duty under Anglo-American Law)" 34 Handai Hogaku.

However, the Japanese Supreme Court has not distinguished the fiduciary duty from the duty of care of a good manager and held that:

> "The fiduciary duty provided in Article 254-2 of the Commercial Code is but one of the phases of the duty of care of a good manager provided in Article 644 of the Civil Code, and Article 254-2 of the Commercial Code provides for the fiduciary duty in order to clarify and to make concrete the duty of care of a good manager."
>
> (Arita v. Kojima et al. 24 Minshu 6 625, Supreme Court, June 24, 1970)

Therefore, it has been argued that:

> "Under Japanese law, the legal principle of fiduciary duty has not been positively developed, but the necessity for such development is becoming more apparent."
>
> (Akabori, "Torishimariyaku no chujitsu gimu (Fiduciary Duty of Directors)", 32 Shiho 153 (1970))

5 Beck et al., Business Associations Casebook, 211

6 See supra note 4

7 Commercial Code (before the 1950 amendments) Article 261(1)

8 Ibid., Article 260

9 Kawamoto, Gendai Kaisha-Ho (Modern Company Law) (new revised edition 1980) 313

10 Suzuki, Shinpan Kaisha-Ho (Newly-Edited Company Law) (second edition 1982) 38

11 Commercial Code, Article 255

12 Ohba v. Toyota Motor K.K. 22 Kakyu Saibansho Minji Saibanrei-shu (hereinafter referred to as Kaminshu) 3.4 549 Nagoya District Court, April 30, 1971

13 Commercial Code, Article 254(1)

14 Ibid., Article 256(1)

15 Ibid., Article 254(3), Civil Code Articles 651(1) and 653

16 Ibid., Article 257(1)(2)

17 Ibid., Article 257(3)

18 Ibid., Article 270(1)

19 for example, Commercial Code, Articles 38(1)(2), 42(1) and 43(1) prescribe as follows:

Article 38

(1) A manager is authorized to do on behalf of the proprietor of the business all judicial and extra-judicial acts relating to his business.

(2) A manager may appoint and dismiss senior clerks, junior clerks and other employees.

Article 42

(1) An employee invested with a title indicating that he is the principal person in charge of the business of the principal office or of a branch office shall be deemed to have the same authority as that of a manager of the principal office or of a branch office. This shall not, however, apply in respect of judicial acts.

Article 43

(1) A senior or junior clerk or any other employee who has been entrusted with certain or specified matters relating to the business is authorized to do all extra-judicial acts.

20 Commercial Code, Article 261(1)

21 Ohsumi, Zentei Kaishaho Ron (Treatise on Business Corporation Law) (chu) 113 (revised edition 1959); Nozu, Daihyo Torishimariyaku (Representative Director) in 3 Kabushiki-Kaishaho Koza, 1092 (Tanaka ed. 1956); Hattori, Yakuzuki Torishimariyaku ni tsuite (Directors with Special Title) in 47 Minsho No. 6.10 (1964). See also Chushaku Kaishaho (Company Law Annotation) No. 4, 360.

22 Circular from the Chief of the Civil Affairs Bureau, Ministry of Justice, October 12, 1951

23 Suzuki, Supra note 10, 179

24 Commercial Code, Articles 261(3) and 78, and Civil Code, Article 54

25 Commercial Code, Articles 261(2)(3) and 39(2)

26 Ibid., Article 188(2)ix

27 Ibid., Article 260

28 Ibid., Article 260(2) specifies following matters:

(1) Disposition and taking over of important property;

(2) Loan of a big amount;

(3) Appointment and dismissal of important employee such as a manager;

(4) Establishment, change and discontinuance of important organ such as a branch.

29 Ibid., Article 259

30 Ibid., Article 260-2(1)

31 Kawamoto Supra note 9, 323. The reason that a director is elected on personal trust.

32 Suzuki Supra note 10, 177

33 Nakayama v. Kitagami, 23 Minshu 11 2301, Supreme Court, November 27, 1969

34 Commercial Code, Articles 260-2(2) and 239(5)

35 Kawamoto Supra note 9, 324

36 Commercial Code, Article 260-3

37 Ibid., Article 260-4

38 Kawamoto Supra note 9, 316

39 Commercial Code (before the 1982 amendments), Article 263

Under present law, a shareholder or creditor is entitled to inspect minutes only to the extent necessary to exercise his rights. A creditor of the company may ask for such inspection only when it is necessary to determine the personal liability of directors.

However, such inspection may cause leakage of business secrets and damage business activities and the company's financial position. When such a possibility is feared, the company may refuse to allow the inspection of the minutes.

Under the new Code, when a shareholder or creditor of the company seeks inspection, he must ask permission from the Court by showing that inspection is necessary for the exercise of his rights. Before giving permission, the Court must hear any objections of the shareholders, creditors or the company itself. If the company cannot show that inspection is likely to cause leakage of business secrets, permission shall be granted. Once permission is granted by the Court, the company must allow the shareholder or debtor to inspect or make extracts from the minutes.

(Commercial Code, Article 260-4)

40 The lowest is that of the ordinary director (hira-torishimariyaku) who might be a department head or the second in command of a division. The next rank is that of managing director (jomu torishimariyaku), who is usually responsible for two or three departments or a small division. Above him are the senior managing directors (senmu torishimariyaku) and the vice-presidents (fukushacho), in charge of large units of the company, with the president (shacho) and the chairman (kaicho) at the top. Clark, The Japanese Company at 100

41 118 of 414 of Japanese stock corporations (28.5%) all of which were listed on one or more of the nine securities exchanges do not have outside directors at all. Twenty corporations (4.8%) have boards composed of more outside than inside directors. But most of these are smaller subsidiary corporations whose stated capital is less than 2 billion yen.

> Kyoto Daigaku Shoho Kenkyukai (Research Association on Commercial Law, Kyoto University), Kabushiki gaisha keiei kiko no jittai (Actual features of managerial structure of stock corporation), SHOJI HOMU KENKYU No. 289 7-20

42 Kyoto Daigaku Shoho Kenkyukai (Research Association on Commercial Law, Kyoto University), Kabushiki gaisha keiei kiko no jittai (Actual features of managerial structure of stock corporation), SHOJI HOMU KENKYU No. 289 7-20

43 Ibid.

44 Ibid.

45 Ibid.

46 Ibid.

47 Ibid.

48 See supra note 2.

49 Civil Code, Article 644

50 See supra note 3

51 Commercial Code, Articles 266(1)v and 254(3), and Civil Code, Article 644

52 Commercial Code, Articles 266-3(1) and 254(3), and Civil Code, Article 644

53 Civil Code, Article 709

54 Senbi Kozai K.K. v. Muto, 23 Minshu 11 2150, Supreme Court, November 26, 1969

The required conditions for this sui generis statutory liability is an intention or gross negligence in the default of director's duty. On the contrary, the required conditions for a liability for tort is an intention or negligence in the violation of a third party's right.

55 Suzuki supra, note 10, 193

56 Supra, note 53

57 Commercial Code, Articles 266(2) and 266-3(2)

58 Ibid., Articles 266(3) and 266-3(2)

59 Ibid., Article 266(5)

60 Hanrei Jiho No. 498, 64

61 All translation of judicial decisions are those of author.

62 Kinyu Shoji Hanrei (Financial Commercial Precedents) No. 448, 2

63 Ibid., No. 562, 36

64 Kinyu Homu No. 884, 27, Supreme Court, December 12, 1978

65 Jokoku appeal to the Supreme Court may be filed only on the ground that there exists misinterpretation of the Constitution or any other contravention of the Constitution in the judgment or that there exists any contravention of laws and orders as clearly affect the judgment (Civil Procedure Code Article 394). When the Supreme Court reverses a lower court judgment on the ground that there exists a contravention of laws or orders as affect clearly the judgment, it commonly refers to the decision as being "illegal" whereas a Canadian court is more likely to avoid calling a decision illegal and simply refers to it as "wrong". Technically, the Canadian lower court decision will be contrary to the law expounded by the higher court, and so "illegal".

66 Unknown v. Unknown, Hanrei Jiho No. 769 89, Tokyo District Court, September 12, 1974; Unknown v. Unknown, Hanrei Jiho No. 795 93, Tokyo District Court, May 27, 1975; Unknown v. Unknown, Hanrei Jiho No. 843 107, Kobe District Court, June 18, 1976; Ohta Kikai Seizo K.K. v. Kishi et al., Hanrei Jiho No. 928 106, Tokyo High Court, March 27, 1979.

67 However, there are some recent judgments which condemned the directors from the judge's hindsight: Unknown v. Unknown, Hanrei Jiho No. 874 85, Tokyo High Court, October 27, 1977; Takaji Kohgu K.K. et al. v. Yoshii, Hanrei Jiho No. 931 119, Osaka High Court, March 23, 1979.

68 In the United States, in questions involving duty of care, the courts concede that a duty exists but will not find in favour of a breach if, in the absence of fraud or dishonesty, the matter was within what they perceive as the sphere of proper business discretion.

69 Osakadani, Torishimariyaku no Sekinin (Director's Liability), Kaishaho Kozo (Lectures on Company Law) No. 3 (1957)

70 Honma, Chushaku Kaishaho (Company Law Annotation) No. 4, 444

71 Kanzaki, Torishimariyaku no Chui Gimu (Director's Duty of Care), 82 Minshoho Zasshi 6 722

72 Kinyu Homu No. 813 40

73 Ibid., No. 801 29

74 Takagi v. Yoshioka et al., Hanrei Jiho No. 954 91, Osaka District Court, September 30, 1979; Saotome Shokai v. Makita, Hanrei Jiho No. 961 113, Tokyo District Court, December 21, 1979; Teraji v. Saito, Hanrei Jiho No. 973 120, Tokyo High Court, June 30, 1980.

75 Hanrei Jiho No. 965 108

76 Unknown v. Unknown, 5 Kaminshu 6 899, Tokyo District Court, June 22, 1954; Unknown v. Unknown, 12 Kaminshu 8 2116, Hiroshima District Court, August 30, 1961; Unknown v. Unknown, Hanrei Jiho No. 384 50, Tokyo High Court, July 31, 1964; Unknown v. Unknown, Hanrei Jiho No. 385 64, Osaka High Court, July 16, 1964; Unknown v. Unknown, Hanrei Jiho No. 188 159, Tokyo District Court, December 16, 1965; Unknown v. Unknown, Hanrei Jiho No. 476 53, Osaka District Court, December 7, 1966.

77 Supreme Court, 23 Minshu 11 2150, November 26, 1969

78 Commercial Code, Articles 261(3) and 78

79 Commercial Code, Article 261(2) provides that it may be provided for that two or more representing directors shall jointly represent the company.

80 Commercial Code, Article 260(1)

81 Sakamaki, Meimokuteki Torishimariyaku no Daisansha ni taisuru Sekinin (Responsibility of the Figurehead Director to the Third Party) Law School No. 12, September 21

82 Shioda and Yoshikawa, Torishimariyaku no Daisansha ni taisuru Sekinin (Responsibility of Director to the Third Party) Sogo Hanrei Kenkyu Sosho (Synthetic Study Series of Precedents) No. 11

83 Commercial Code, Article 260(1). The present Code, which was enforced October 1, 1982, expressly provides that the Board of Directors shall supervise the performance of each director's duties. Before the 1982 amendment, there was no article which provided the supervisory duty. However, even under the former Code, it was interpreted that the Board of Directors has the authority to supervise the performance of the

representative directors' duties because the Board of Directors had the authority to elect representative directors and release representative directors from their office. (former Commercial Code, Article 261(1); Suzuki and Takeuchi, Kaishaho (Commercial Code) at 204)

84 Sakamaki Supra, note 80 24

85 Honma, Torishimariyaku no Daisansha ni Taisuru Sekinin (Responsibility of Director to the Third Party) Law School No. 12 September 17

86 Unknown v. Unknown, Hanrei Jiho No. 385 64, Osaka High Court, July 16, 1964; Unknown v. Unknown, Hanrei Jiho No. 384 50, Tokyo High Court, July 31, 1964.

87 Unknown v. Unknown, Hanrei Jiho No. 476 53, Osaka District Court, December 7, 1966; Takii v. Suginaka et al., 12 Kaminshu 8 2116, Hiroshima District Court, August 30, 1961.

88 Senbi Kozai K.K. v. Muto, 14 Kaminshu 1 93 (1963); Unknown v. Unknown, Hanrei Times No. 205 152, Tokyo District Court, November 15, 1966.

89 Honma, Chushaku Kaishaho (Company Law Annotation) No. 4 at 445; Sugawara, Gendai Kaishaho ni okeru Torishimariyaku no Chii to sono Kanshi Gimu (Status and Duty of Observation of a Director under Modern Company Law); Kigyoho Kenkyu Sokan 10 Shunen Kinen Ronbun-shu (Essays Contributed in Celebration of the 10th Anniversary of the Study of Business Association Law) 120; Aotake, Meimokuteki Torishimariyaku no Daisansha ni taisuru Sekinin (Nominal Director's Liability to the Third Party) Minshoho Zassi 78 346

90 Tokyo High Court, Hanrei Jiho No. 900 103, July 19, 1978

91 Shoji Honmu No. 962 at 9 .

92 Number of listed corporations at each Securities Exchange at the end of 1980:

Tokyo	Osaka	Nagoya	Others
1,417	998	478	1,209

93 Sakamaki supra, note 80 at 21

94 Of course, provisions for stock corporations will not fit small family-type corporations.

95 Before 1982 amendment, the minimum requirement for stated capital was 3,500 yen (approximately Cdn. $17.50).

96 Between 1961 and 1962, the Study Group on Corporate Size (Kaisha kibo kenkyukai), of the Faculty of Law, Kobe University, surveyed stock corporations which had a stated capital of not more than 100 million yen located in Kobe City and its vicinity. After they found that nearly one-half of the stock corporations surveyed had been converted from sole proprietorships, they went on to survey the motives for using the stock corporation form. The results are shown in the following table:

Motives in Forming Stock Corporations

	Kobe City	Vicinity	Total
1. Expectation of more advantage in terms of transactions	207	42	249
2. Clearer accounting	113	35	148
3. Expectation of lighter tax burden	102	29	131
4. Need of larger amount of capital	48	18	66
5. Others	44	19	63
6. Expectation of easier chance to get financing	42	10	52
7. Favour of limited liability	7	2	9
Total	563	155	718

Source: Kaisha Kibo Kenkyukai (Study Group on Corporate Scale), Shokibo kabushiki-gaisha no hoteki jittai (Actual features in legal aspect of small stock corporations), 13 KOBE HOGAKU ZASSHI, Table 19 at 553 (1964)

97 Commercial Code, Article 255

98 In general, Japanese contract negotiation is a method of reaching a true understanding between the parties. Each party will try to learn the personality of the other. In the case of contract negotiations with a tiny corporation, the process involves not only ascertaining

the credit standing and the business policy of the corporation but also the reputation and means of the director.

99 Article 266-3(1) If directors have been guilty of wrongful intent or of gross negligence in respect of the assumption of their duties, they shall be jointly and severally liable in damages to third persons also.

100 The functioning of the provision therefore operates to disregard the separate entity of an insolvent corporation. See Tatsuta, Hijinkaku Hinin no Hori no Saikin no Tenkai (Recent Dvelopment of the Doctrine of the Corporate Entity), in SHOJI HOMU KENKYU (Study of Commercial Law) No. 534 at 6. Moreover, it may be said that the provision goes far beyond merely disregarding the separate entity of an insolvent corporation, since courts also acknowledge the liability of the nominal representative director. See Shibuya, Yugen Gaisha no Torishimariyaku no Daisansha ni Taisuru Sekinin (Liability of the Director of the Limited Liability Company to the Third Party), in JURIST No. 482 92

101 Supra, note 76

102 The general provision relating to the unlawful act is Article 709 of the Civil Code which provides:

> "A person who violates intentionally or negligently the right of another is bound to make compensation for damage arising therefrom."

103 Civil Code, Article 44:

> "A juristic person is liable to make compensation for any damage done to other persons by its directors or other representatives in the performance of their duties."

104 Unknown v. Unknown, Supreme Court, Hanrei Jiho No. 590 75, March 26, 1979; K.K. Nihon Studio v. Nakamura, Supreme Court, 26 Minshu 5 984, June 15, 1972; Kobayashi et al v. Hashimoto et al, Supreme Court, 27 Minshu 5 655, May 22, 1973; Sato v. Kureyama, Supreme Court, 28 Minshu 10 2059, December 17, 1974

105 Unknown v. Unknown, Osaka High Court, Hanrei Jiho No. 757 113, April 17, 1974; Unknown v. Unknown, Tokyo District Court, Hanrei Jiho No. 747 102, November 13,

1973; Unknown v. Unknown, Tokyo High Court, Hanrei Jiho No. 732 94, October 31, 1973; Unknown v. Unknown, Sendai District Court, Hanrei Jiho No. 783 125, September 30, 1974.

106 Both courts and prevailing theory have asserted that a plaintiff is required to prove the existence of adequate causation between the damaging act and the damage in order to claim compensation. This concept of "adequate causation" was asserted originally to restrict the scope of damages. In order to fulfill the adequate causation requirement, a damaging act must have a conditional relation to a specific result based on predictability. That is, the act must be causally linking objectively and directly to the resulting damage in such a way that it is probable and generally foreseeable.

It is assumed that Article 416 of the Civil Code, which sets out the scope of compensation for nonperformance of an obligation-duty, has adopted the principle of adequate causation and this has been applied analogously to determine damage for torts.

Article 709 of the Civil Code requires the existence of damage causation between a damaging act and violation of rights. The prevailing view thinks that this causation is determined first by conditional relationships. A conditional relation is a situation where "without a damaging act there would be no injury". A damaging act is the cause, and injury is the result.

See Kitagawa (ed.) Doing Business in Japan XIII 1-23, Ikuyo Fuho Kooi (Torts) 111, Kato Fuho Kooi (Torts) 152.

107 Nagoya High Court, Hanrei Jiho No. 951 111, September 20, 1979.

108 ie., caused by financial distress of the corporation brought about by the director's maladministration

109 Supreme Court, 24 Minshu 7 1061, July 16, 1970

110 Japanese courts sometimes rely upon jori (natural reason) in reaching a desirable conclusion. This flexible attitude of courts in interpreting the statutes is explained by some scholars that jori is one of the soures of law in Japan. They sometimes cite the following proclamation (fukoku) of the Great Council of State (Dajokan) as a statutory provision to that effect.

Hints for Conduct of Judicial Affairs (Saiban Jimu Kokoroe), Article 3:

"In civil trials, cases where there is no [applicable] written law shall be adjudicated by applying custom, and cases where there is no [applicable] custom, by way of deduction from jori (natural reason)."

(Tanaka, The Japanese Legal System 125)

111 Shibuya, Yugen Gaisha no Torishimariyaku no Daisansha ni taisuru Sekinin (Disability of the director of the Limited Liability Company to the Third Party), in JURIST No. 482 at 92

112 Tokyo High Court, Hanrei Jiho No. 900 103, July 19, 1978

113 Commercial Code, Article 260(1)

114 Supreme Court, 27 Minshu 5 655, May 22, 1973

115 Here the term "executive director" is used to mean "directors who are in charge of a specific part of corporate management"

116 Sakamaki, supra note 81 27

117 Tokyo District Court, 8 Kaminshu 5 923, May 13, 1957

118 See also Kawakami v. Isono et al Tokyo District Court, 9 Kaminshu 11, November 28, 1958; Takii v. Suginaka et al, Hiroshima District Court 12, Kaminshu 8 2116, August 30, 1961; Unknown v. Unknown, Tokyo District Court, Hanrei Jiho No. 394 78, July 30, 1964; Unknown v. Unknown Tokyo District Court, Hanrei Jiho No. 606 83, March 28, 1970

119 Tokyo District Court, Hanrei Jiho No. 606 82, March 28, 1970

120 Takeuchi, Hanrei Hihyo (Case Notes) in 91 Hogaku Kyokai Zassi (Journal of the Jurisprudence Association) 12 1765, Tatsuta, Hanrei Hihyo (Case Notes) in 66 Hogaku Ronso 3 98

121 Shioda and Yoshikawa supra, note 82 272

122 Shioda and Yoshikawa supra note 82 66, Honma supra note 69 444, Kawamoto supra note 9 354, Sakamaki supra note 80 29 Yazawa, Shin Shoho Enshu (New Exercise on

Commercial Code) 2 130, Tanaka, Kaishaho Shoron Jo (Detailed Discussion on Company Law 1) 497

123 K.K. Kofuku Sogo Ginko v. Otani et al, Osaka High Court, Hanrei Jiho No. 897 97, April 27, 1978; Unknown v. Unknown Tokyo District Court, Hanrei Jiho No. 230 274, August 21, 1968; Unknown v. Unknown, Tokyo High Court, Hanrei Jiho No. 643 87, April 30, 1971; Unknown v. Unknown, Tokyo District Court, Kinyu Shoji Hanrei No. 455 11, May 8, 1975; Unknown v. Unknown, Tokyo District Court, Kinyu Shoji Hanrei No. 561 38, March 16, 1978

124 Supreme Court, 27 Minshu 5 655, May 22, 1973

125 Tanaka, Kaishaho Shoron Jo (Detailed Discussion on Company Law 1) 453; Osumi, Zentei Kaishohoron Jo (All Revised Discussion on Company Law 1) 104, Ishii, Kaishaho Jo (Company Law 1) 322 Honma, Chushaku Kaishaho (Company Law Annotation) No. 4 446

126 Article 259(2) and (3)

127 Honma supra note 69 445, Sakamaki supra note 80 28, Shioda and Yoshikawa supra note 82 66, Sugawara, Gendai Kaishaho ni okeru Torishimariyaku no Chii to sono Kanshi Gimu (Status and Duty of Observation of a Director under Modern Company Law); Kogyoho Kenkyu Sokan 10 Shunen Kinen Ronbun-shu (Essays Contributed in Celebration of the 10th Anniversary of the Study of Business Association Law) 121

128 Tokyo District Court, 9 Kaminshu 11 2225, November 13, 1958

129 Tatsuta, Chushaku Kaishaho (Company Law Annotation) 4 491

130 Osakadani, Torishimariyaku no Sekinin (Director's Responsibility) Kabushikikaishaho Koza (Lectures on Company Law) 3 1121

131 Commercial Code, Article 254(3) and Civil Code, Article 644

132 See note 49

133 Takii v. Suginaka et al., Hiroshima District Court, 12 Kaminshu 8 2116, August 30, 1961; Unknown v. Unknown, Tokyo High Court, Hanrei Jiho No. 384 50, July 31, 1964; Kobayashi et al v. Hashimoto et al, Supreme Court, 27

Minshu 5 655, May 22, 1973; Unknown v. Unknown, Tokyo High Court, Hanrei Jiho No. 818 88, December 25, 1975

134 Kanzaki, Torishimariyaku no Chui Gimu (Director's Duty of Care) 82 Minshoho Zasshi 6 727, May 8, 1975

135 Tokyo District Court, Kinyu Shoji Hanrei (Financial and Commercial Case Reporter) No. 455 11

136 Osaka High Court, Hanrei Jiho No. 931 119, March 23, 1979

137 Honma, Torishimariyaku no Daisansha ni taisuru Sekinin (Director's Responsibility to the Third Person) in 12 Law School 19

138 Shioda and Yoshikawa, supra note 82 72; Yazawa Iho Haito (Illegal Dividend) 2; Shin Shoho Enshu (New Exercise on Commercial Code) 130. Note that Japanese Commercial Code provides only that the directors who have participated in the resolution and have not expressed their dissent in the minutes shall be presumed to have assented to such resolution (Article 266(3)), and there is no provision equivalent for BCCA Section 151(6) or CBCA Section 118(3).

139 Tokyo District Court, Hanrei Jiho No. 854 43, July 1, 1977

140 Commercial Code, Article 255 provides that the directors shall be at least three in number.

141 Osaka District Court, Hanrei Jiho No. 963 96, March 28, 1980

142 See also Unknown v. Unknown, Tokyo District Court, Hanrei Jiho No. 606 82, March 28, 1970

143 Unknown v. Unknown, Tokyo District Court, Kinyu Shoji Hanrei No. 561 38, March 16, 1978

144 Unknown v. Unknown, Takasaki Branch Maebashi District Court, Hanrei Jiho No. 780, December 26, 1974

145 Unknown v. Unknown, Tokyo District Court, Hanrei Jiho No. 849 114, August 23, 1976

146 Takaji Kogu K.K. et al v. Yoshii, Osaka High Court, Hanrei Jiho No. 931 119, March 23, 1979

147 K.K. Kofuku Sogo Ginko v. Ohtani, Osaka High Court, Hanrei Jiho No. 897 97, April 27, 1978

148 Kanzaki, Torishimariyaku no Chui Gimu (Director's Duty of Care) 82 Minshoho Zasshi 6 15

149 Unknown v. Unknown, Osaka High Court, Hanrei Jiho No. 385 64, July 16, 1964

150 Unknown v. Unknown, Osaka District Court, Hanrei Jiho No. 476 54, December 7, 1966

151 Unknown v. Unknown, Osaka District Court, Hanrei Times No. 232 208, December 24, 1968

152 Kanzaki supra, note 148 14

153 Commercial Code, Article 259 (1), (2) and (3)

154 Suge et al v. Daido Sanso K.K., Supreme Court, Hanrei Jiho No. 971 101, March 18, 1980

155 Article 266-3 of the Commercial Code provides as follows:

> "If directors have been guilty of wrongful intent or of gross negligence in respect of the assumption of their duties, they shall be jointly and severally liable in damages to third persons also."

156 Tatsuta, Hojinkaku Hinin no Hori no Saikin no Tenkai (Recent Development of the Doctrine of the Corporate Entity) SHOJI HOMU KENKYU (Study of Commercial Law) No. 534 6

157 Shibuya, Yagen Gaisho no Torishimariyaku no Daisansha ni Taisuru Sekinin (Liability of the Director of the Limited Liability Company to the Third Party) JURIST No. 482 92

158 Unknown v. Unknown, Tokyo High Court, Kinyu Homu Jijo No. 842 32, April 28, 1977

159 In Unknown v. Unknown, it is held that the court cannot find a causal relationship between the fact that the director did not supervise the other representative director's illegal act and the third party's damage from only the fact that the director was unconcerned about business (eigyo).

Kobe District Court Itami Branch, Hanrei Times No. 232 210, January 30, 1969

160 Takeuchi, Hanrei Shoho (Legal Precedents on Commercial Code) No. 1 310

161 Kobayashi et al v. Hashimoto et al, Supreme Court 27, Minshu 5 655, May 22, 1973; Maruyoshi Kozai K.K. v. Sato, Supreme Court, 24 Minshu 7 1061, July 16, 1970

162 Sakamaki supra, note 80 32

163 Commercial Code, Article 266(1)

164 Ibid., Article 266-3(1)

165 Commercial Code, Article 254(3) and Civil Code, Article 644

166 Senbi Kozai K.K. v. Muto, Supreme Court, 23 Minshu 11 2150, November 26, 1969

167 Tatsuta, Chushaku Kaishaho (Company Law Annotation) No. 4 487

168 Shioda and Yoshikawa, supra note 82 78

169 Ibid. 79, Tatsuta, supra note 167 489; Honma, note 69 443 and Kobayashi, Torishimariyaku no Tai-Daisansha-Sekinin ni kansuru Jakkan no Mondai (Some Problems with Respect to Director's Responsibility to Third Parties) Hanrei Times No. 370 21

170 The draft plan for amendments to the corporation organs (kikan kaisei shian) 2(3)

171 Inaba, Kaisei Kaishaho (Amended Company Law) 224

172 Kitazawa, Torishimariyaku oyobi Torishimariyakukai (Director and Board of Directors) 747 Jurist 116

173 Inaba supra, note 171 224

174 All translations of the Commercial Code are those of EHS law bulletin series unless otherwise indicated.

175 The draft plan for amendments to the corporate organs (kikan kaisei shian) 2(5)(a)(ii)

176 A minor is required to obtain the consent of his legal representative for doing any juristic act, unless it is an act merely to acquire a right or to be relieved from a duty. (Article 4(1))

177 Civil Code, Article 6(1)

178 Inaba supra, note 171 202

179 Ibid., 227

180 Ibid., 228

181 Motoki, Kaisei Shoho Chikujo Kaisetsu (Article by Article Commentary on the Amended Commercial Code) 113

182 Ibid.

183 Inaba supra, note 171 230

184 Ibid., 235

185 Motoki supra, note 181 115

186 Inaba supra, note 171 236

187 Article 259(1)

188 Motoki supra, note 181 109

189 Supra, note 124

190 Commercial Code, Article 259(2)

191 Ibid., Article 259(3)

192 Old Commercial Code, Article 263(2)

193 Inaba supra, note 171 242, Motoki supra, note 181 121 and Takeuchi, Kaisei Kaishaho Kaisetsu (Commentary on Amended Company Law) 153

194 Commercial Code, Article 260-4(4)

195 Ibid., Article 260-4(5)

196 BCCA s. 141(1)

197 CBCA s. 97(1)

198 Re Forest of Dean Coal Mining Co. (1878) 10 Ch. D 450, Re Lands Allotment Co. (1894) 1 Ch. 616

199 Lindley on Companies, 6th Ed., 519

200 It would also seem that the courts are conscious of the possible unfairness of attempting to substitute their hindsight for the directors' foresight and are therefore reluctant to judge directors' business judgement with the court's wisdom of hindsight. See Gower Principles of Modern Company Law, 4th Ed., 603

201 Feltham, "Directors' and Officers' Liabilities in Canada", The Canadian Business Law Journal Vol. 1, No. 1, 321 (1975) at p. 326

202 [1925] Ch. 407

203 Ibid.

204 Litwin v. Allen, 25 N.Y. 2d 667 (1940, Sup. Ct.) 678. However, both BCCA s. 138 and CBCA s. 100 provide minimum qualifications of directors.

205 Supra, note 202

206 The same statement is found in Re National Bank of Wales [1899] 2 Ch. 629. Note that the proposition applies not only to directors, but also to officers. See Lewtas "Directors', Officers' and Insiders' Liability", Special Lectures of the Law Society of Upper Canada (1972) 183 at p. 186; Feltham, "Directors' and Officers' Liabilities in Canada", The Canadian Business Law Journal Vol. 1, No. 1 321 (1975) at p. 326.

207 [1884] 25 Ch. D. 752

208 [1911] 1 Ch. 425

209 Ibid., at p. 437

210 Lister v. Romford Ice and Cold Storage Ltd., [1957] A.C. 555

211 [1869] L.R. 4 Ch. App. 376

212 Grimwade v. Mutual Society (1885) 52 L.T. 409

213 (1875) L.R. 20 Eq. 225

214 (1870) L.R. 5 Ch. App. 763

215 Paterson, "Reformulating the Standard of Care of Company Directors" 8 Vict. U. of Wellington L.R. 1 (1975) at p. 12

216 Supra, note 202

217 Gower, The Principles of Modern Company Law, 4th Ed., 605; Lewtas, "Directors', Officers' and Insiders' Liability" Special Lectures of the Law Society of Upper Canada (1972) 183 at p. 186; Feltham, "Directors' and Officers' Liabilities in Canada" The Canadian Business Law Journal Vol. 1, No. 1 321 at p. 326

218 Supra, note 207

219 (1892) 2 Ch. 100

220 Cullerne v. The London & Suburban General, Permanent Building Society (1890) 25 Q.B.D. 485

221 Supra, note 219

222 Also see Selangor United Rubber Estates Ltd. v. Cradock (No. 3) [1968] 1 W.L.R. 1555 at 1614. A director who attends Board meetings and rubber-stamps the chairman's recommendations runs a far greater risk than one who does not attend at all.

223 Trebilcock, "The Liability of Company Directors for Negligence" 32 Modern L. Rev. 499 at p. 506

224 Gower, The Principles of Modern Company Law, 4th Ed., 606

225 Gould v. Mt. Oxide Mines Ltd. (1916) 22 C.L.R. 490

226 (1901) A.C. 477

227 This statement was cited and followed by Romer, J. in Re City Equitable Fire Insurance Company Ltd. (1925) Ch. 407

228 eg. Re Owen Sound Timber Co. Ltd. (1917) 33 D.L.R. 487

229 See Re City Equitable Fire Insurance Company Ltd. [1925] Ch. 407 at p. 429

230 See eg. Re Denham & Co. (1884) 25 Ch. D 75; Sheffield & South Yorkshire Building Society v. Aizlewood (1890) 40 Ch. D. 412; Re National Bank of Wales (1899) 2 Ch. 629; Dovey v. Cory (1901) A.C. 477

231 Lucas v. Fitzgerald (1903) 20 T.L.R. 16; Re Dominion Trust Co. (1917) 32 D.L.R. 63

232 Re Kingston Cotton Mill Company Ltd. (1896) 1 Ch. 331; Re National Bank of Wales (1899) 2 Ch. 629; Re City Equitable Fire Insurance Company Ltd. (1925) Ch. 407

233 Re Cardiff Savings Bank (1892) 2 Ch. 100; Prefontaine v. Grenier (1907) A.C. 101 (P.C.)

234 Gower, supra note 224, p. 605

235 (1925) Ch. 407

236 Supra, note 226

237 Gower, supra note 224, p. 605

238 Trebilcock, supra note 223 at p. 508

239 Third party's loss may come into question, especially when the company's funds is insufficient to compensate for the loss.

240 See Gower, supra note 224, p. 605

241 Lewtas, "Directors', Officers' and Insiders' Liability", Law Society of Upper Canada Special Lectures (1972) 183 at p. 186

242 BCCA Sections 142(1)(b), 151, 159 and 226
CBCA Sections 117(1)(b) and 118

243 Interim Report of the Select Committee on Company Law (Ontario) 1967 at p. 53 recommended the following provision:

> Every director of a company shall exercise the powers and discharge the duties of his office honestly, in good faith and in the best interests of the company, and in connection therewith shall exercise that degree of care, diligence and skill which a reasonably prudent director would exercise in comparable circumstances.

244 Slutsky, "Directors and Officers Under the New B.C. Companies Act", The Advocate Vol. 31, Part 4 211 at p. 214

245 Section 142(2)

246 Section 117(1)(b)

247 Feltham, supra note 24 at p. 328; Wainberg, Duties and Responsibilities of Directors in Canada, p. 27

248 Iacobucci et al., supra note 1 at p. 290

249 Re Northwest Forest Products Ltd., [1975] 4 W.W.R. 724

250 Section 143. See also CBCA Section 117(3)

251 Also see BCCA Section 115(6)

252 Iacobucci et al., supra note 1 at p., 293

253 Ibid.

254 Ibid.

255 283 F. Supp. 643 (S.D.N.Y. 1968) See Folk, "Civil Liabilities Under the Federal Securities Acts: The Barchris Case", 55 Va. L. Rev. 1, 29 (1969)

256 See Section II.B.1

257 Commercial Code, Article 266

258 Ibid., Article 266-3

259 Percival v. Wright, [1902] 2 Ch. 421; Bell v. Lever Brothers Ltd., [1932] A.C. 161

260 Linden, Canadian Negligence Law, 213

261 Nova Mink v. T.C.A. [1951] 2 D.L.R. 241 at p. 254

262 Fleming, The Law of Torts, 3rd Ed., 143

263 Ministry of Housing v. Sharp, [1970] 2 Q.B. 233, at p. 268 (C.A.). See also Cari-Van Hotel Ltd. v. Glove Estates Ltd. [1974] 6 W.W.R. 707; Toromon Industrial Holdings v. Thorne, Gunn, Helliwell and Christenson (1975) 10 O.R. (2d) 65

264 [1976] 3 W.W.R. 331 (S.C.C.)

265 1977 (2) N.Z.L.R. 225

266 [1977] 2 N.Z.L.R. 225 (N.Z.C.A.) Per Woodhouse, J. at 324

267 [1914] 30 T.L.R. 444 (P.C.)

268 See also Regina v. Littler (1975), 65 D.L.R. (3d) 467; Gadsden v. Bennetto (1913), 9 D.L.R. 719 (Man. C.A.)

269 Anns v. Merton London Borough Council [1977] 2 W.L.R. 1024

270 Linden, Canadian Tort Law, 3rd Ed., 444

271 (1959) 15 D.L.R. (2nd) 67

272 (1843) 2 Hare 461

273 In North-West Transportation Company v. Beatt 1887, 12 App. Cas. 589 (P.C.), it was held that an interested director, absent fraud or oppressive conduct, could use his votes as a shareholder to ratify his own conduct. However, a shareholder may not exercise his voting power to invade corporate property to his own advantage: Cook v. Deeks, [1916] 1 A.C. 554, or to oppress minority sharehodlers: Brown v. British Abrasive Wheel Co., [1919] 1 Ch. 29.

274 To prevent this kind of inequity, certain exceptions to the rule in Foss v. Harbottle have been worked out and were listed in Edwards v. Halliwell [1950] 2 All E.R. 1064 (C.A.). Also see Beck, "The Shareholders' Derivative Action", 52 Can. Bar Rev. 159 (1974) at p. 167

275 Sections 232, 233 and 235

276 Section 225

277 See Iacobucci et al., supra note 1 pp. 195 - 200

278 See also BCCA Section 224

279 Iacobucci et al., supra note 1, 208

280 See Ibid.

281 Sections 232, 233 and 235

282 Section 225

283 See Iacobucci et al., Canadian Business Corporations pp. 195 - 201

284 Lewtas, supra note 241, p. 187

285 Ibid.

286 Section 128

287 See Simmonds, "Directors' Negligent Mis-statement Liability in a Scheme of Securities Regulation", II Ottawa Law Review 633 at 640

288 Section 141

289 See Johnston, Canadian Securities Regulation, pp. 181 - 184

290 Tamura, "Torishimariyaku no Sekinin (Directors' Responsibility), 500 Jurist at 288

291 See supra note 263

292 Senbi Kozai K.K. v. Muto, Supreme Court, 23 Minshu 11 2150, November 26, 1969

293 [1914] 30 T.L.R. 444 (P.C.)

294 British Columbia Securities Act Section 141

295 Delivative Council on Legal System (Hosei Shingi-kai) has begun to examine how to distinguish a large company from a small company in the Commercial Code. In addition to the present distinction relating to the auditor's authority and the audit by accounting auditor, they intend to distinguish a small company from a large company in its entirety (Japan Economic Journal, October 5, 1982).

296 Re City Equitable Fire Insurance Company Ltd. (1925) Ch. 407

297 See supra note 3

298 Re Northwest Forest Products Ltd. [1975] 4 W.W.R. 724

299 Honma, supra note 70

300 Per Hatherley L.C. in Turquand v. Marshall (1869) L.R. 4 Ch. App. 376, 386

301 For example, anytime when an airline accident causes a death, their president's resignation becomes a subject of discussion. Also, quite recently, two managing directors of one of the largest Japanese banks, who were in charge of international department, were called to account by the bank for the failure of a speculation in foreign exchange committed, in secret to the bank, by a chief of a section of their foreign branch. (Japan Economic Journal, October 14, 1982)

302 See Paterson, supra note 215 at 15, Trebilcock, supra note 223 at 513

303 See Lewtas, supra note 241 at 192

304 See Kawamoto, "Torishimariyaku no Minji Sekinin Tsuikyu no Hoteki Shikumi to Kino" (The Legal System and Function of Pursuing Directors' Civil Liability), 847 Shoji Homu 278

305 Gower, supra note 224 604

306 Several underwriters - Lloyds of London, American Home, Harbour Insurance Company, United States Fire, Canadian Indemnity - offer directors coverage in Canada. See Howard, "Directors and Officers in the context of the Canada Business Corporations Act", Canada Business Corporations Act, Meredith Lectures 282 at 305. On the contrary, so far as the author knows, no Japanese insurance company offers directors insurance coverage.

307 BCCA Section 152 and CBCA Section 119. A director is eligible for indemnification if he has acted honestly and in good faith with a view to the best interests of the corporation of which he was a director. Thus directors can be indemnified for breaches of duties of care, diligence and skill, provided that they have not breached the general fiduciary standards. (Iacobucci et al, supra note 1, 336). There is no equivalent provision which provides for indemnification of directors in the Japanese Commercial Code.

308 Feltham, "Directors' and Officers' Liabilities in Canada", The Canadian Business Law Journal Vol. 1, No. 1, 321 (1975) at p. 326

309 See supra note 142

310 See Gower, supra note 224, 605

311 See Trebilcock, supra note 223 pp. 509 - 510; Iacobucci et al., supra note 1 pp. 235 - 237

312 See Trebilcock, supra note 223, 510

313 For example, how to distinguish an outside director from an inside director, a part-time director from a full-time director, a professional advisor from an ordinary director, a specialist director from an un-specialist director, whether or not a director resident in a foreign country should be distinguished, how to assign a role to a Board of Directors and an Executive Committee (jomukai or keiei iinkai), etc.

314 See Trebilcock, supra note 223, 511; Iacobucci et al., supra note 1, 237; Paterson, supra note 215, pp. 17 - 21

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