

The Corporate Counselor

- Insights into Japanese Corporate Law -

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NUANCES OF CONDUCTING A CORPORATE INTERNAL INVESTIGATION IN JAPAN

A global company with operations in Japan should remain vigilant in understanding how to effectively conduct an internal investigation associated with a corporate crisis emanating from or linked with Japan. A global company operating in Japan may need to initiate a corporate internal investigation following allegations that a Japan-based employee engaged in local conduct (sometimes even permissible local conduct) that resulted in a violation of the laws of the parent company's home jurisdiction. U.S. and European anti-bribery laws, export/import regulations, financial reporting requirements and competition laws are examples of rules and regulations that can apply outside the home market, thereby providing fertile ground for unwitting local missteps that can dearly harm an overseas parent company. Similarly, a Japan-based employee may engage in local misconduct that requires not only the attention of local management, but of the overseas parent company as well due to the parent company's ownership interest in the local subsidiary and the inclusion of the subsidiary's financial results in the reports of the parent company. The foregoing can be compounded if the parent company is subject to real-time disclosure requirements associated with having its securities trading over a stock exchange, as the parent company often will need to act swiftly to reduce the likelihood of the controversy becoming subject to public scrutiny and negatively impacting its stock's trading price.

Awareness of corporate misconduct can arise from a variety of channels, including a government investigation, the commencement of a lawsuit against the company, a complaint made directly to the company's board of directors (such as through an auditor or whistleblower hotline), or a company-initiated investigation conducted in the ordinary course of operations. Not every alleged violation warrants a deep and thorough corporate internal investigation. The level and degree of the internal investigation normally depends on the particularities of the complaint, with anything more than a frivolous allegation requiring some level of investigation. A corporate internal investigation often goes into full gear after a credible violation of the law, a violation of corporate policy or some other misconduct by an employee or other agent is alleged that could significantly hurt the company's reputation, financial condition or long-term ability to conduct its material operations under normal operating conditions.

The Japan operations of a global company are not immune from corporate misconduct by Japan-based representatives. For example, a U.S. company involved in the semiconductor industry conducted an internal investigation after discovering that senior executives in its Japan subsidiary entered unsubstantiated sales into its systems in order to artificially inflate company revenues. The impact of the revenue

enhancement fraud was so severe that shortly after the discovery of the scheme, the company announced that its financial statements over the relevant period could no longer be relied upon and would need to be restated.

There is no one-size fits all methodology to effectively conduct a corporate internal investigation that spans across multiple jurisdictions. The local jurisdiction's legal system and cultural norms often will have an impact on how to initiate, staff and manage an effective corporate internal investigation. The following discusses how key steps in a traditional corporate internal investigation can be affected if the alleged infraction has a nexus to Japan, and how a Japan-based corporate internal investigation can be tailored to maximize the speed and accuracy of the information gained:

1. Oversight of the Investigation. In many countries outside of Japan, law firms frequently assume the lead over the conduct of the corporate internal investigation and serve as a coordinator for the activities of other professionals in an effort to strengthen arguments that the information uncovered during the investigation is protected by applicable legal privilege. In Japan, however, such concerns ordinarily do not apply due to the following features of Japan's discovery system:

- Certain Japanese government regulators can order a party to produce documents to the regulator. No privilege against such order is specifically provided, and failure to comply can lead to stiff penalties.
- In general, no person (including legal counsel) can refuse a warrant calling for the production of documentation in a Japanese criminal case, unless such legal counsel claims that the requested disclosure would violate his/her professional obligation of confidentiality towards his/her client (as discussed below).
- There is no U.S.-style pre-trial discovery in a Japanese civil case that allows a party to broadly request that an opposing party produce any and all relevant documents in the pending litigation. A Japanese court may during a civil trial (upon the petition of a requesting party) issue an order to the opposing party or a third party to produce documents, however, Japan's Code of Civil Procedure requires that the requested documents (i) be specifically identified by the requesting party (which creates the conundrum of being required to identify documents that may be unknown to the requesting party), and (ii) do not fall under a broad category of documentation exempt from production. While judges in a civil case also can request disclosure of non-exempt documents during



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trial, Japanese judges typically do not make voluminous discovery requests and the nature of the documents sought is dependent on the approach taken by the particular judge. Thus, discovery in Japanese civil cases is not a salient feature of the litigation process given its unpredictability, scarcity and its realization very late in the litigation process.

In light of the limited role of discovery in Japanese civil cases, employees in Japan may not fully appreciate the discovery-shielding role of an overseas attorney in a corporate internal investigation. Consequently, Japanese executives and legal staff tasked with assisting the corporate internal investigation should be provided with an upfront explanation about the role of overseas legal counsel so the local leadership team does not undergo unnecessary anxiety or errantly conclude that the matter is not considered sufficiently significant to warrant the direct involvement of home-office executives.

2. Retention of Advisors. While the necessity of including overseas counsel may not be readily apparent to the Japan-based team (but is an obstacle that can be overcome with adequate explanation), the inclusion of Japanese legal counsel normally does not raise concerns with the local leadership team given the perception that (i) Japanese lawyers frequently become involved in significant corporate matters, and (ii) the use of Japanese legal counsel can alleviate the need to involve internal personnel (thereby reducing potential leaks of information to company employees, as maintaining confidentiality about corporate misconduct is often paramount to Japanese senior management). Acceptance by the local leadership team of Japanese lawyers in a corporate internal investigation often will be useful to the overseas parent as well, because qualified Japanese counsel should be able to serve as a conduit between the overseas law firm charged with the investigation and the local leadership team, and can assist with the unique challenges associated with responding to a crisis emanating from Japan.

Clients unaccustomed to working with a Japanese law firm should understand upfront that securing qualified Japanese legal counsel may require the client to stray away from home-country norms that may prohibit a retained law firm from representing the counter-party in another transaction or suit (let alone the counter-party in the matter at hand!) during the course of the corporate internal investigation. Given the dearth of qualified lawyers in Japan in comparison to Western countries, legal conflict of interest provisions under Japanese bar rules are more flexible in comparison to equivalent rules in Western countries. For example, a Japanese law firm is often permitted under local bar rules to represent both sides in a controversy (e.g., multiple companies subject to an illegal cartel claim), so long as an information barrier is established within the firm to separate attorneys representing opposing sides and the parties consent to the multiple representations by the law firm (which consent solicitation process ordinarily would be considered ineffective in other Western countries).

There also is a shortage of professional language translators in Japan who understand legal terminology, so quality interpreters should be promptly retained. An experienced lawyer in Japan should be able to assist in the selection and retention of suitable

translators or perform the translation services himself.

3. Data Collection. Securing and collecting data in Japan may require an overseas parent company to maneuver with extreme finesse. For example, the issuance of a typical U.S.-style “legal hold” notice from the home office to Japanese employees to suspend the normal disposition or processing of records could irritate local executives in light of the perceived preference of Japanese management not to disclose to employees that the company is subject to an internal investigation. Since the cooperation of the local leadership team is often paramount when successfully gathering information, an overseas parent company and its advisors should take extra care in explaining to local executives the need to image laptops, secure back-ups of data servers and email systems, archive hard copy documents, and search employee work spaces, and the parent company should seek the guidance of local executives on how best to implement these procedures in a suitable and non-disruptive manner.

Equally important, the information gathering team should ensure that the manner and scope of their data collection activities comply with Japan’s Personal Information Protection Law. The protection of personal information is vigorously enforced in Japan, and experienced counsel can provide invaluable guidance on how to navigate this complicated statute and assess whether an exception to the statute’s stringent personal information protection requirements applies to the investigation at hand.

4. Employee Interviews. Japan’s version of the attorney-client privilege also can affect a U.S. counsel’s perception of what constitutes appropriate investigation processes. In Japan, the concept of the attorney-client privilege actually arises from an attorney’s professional obligation of confidentiality owed toward his/her clients (and not a separate doctrine that a communication between an attorney and a client is subject to a special disclosure privilege in order to foster complete and honest discussions between legal counsel and clients, as is frequently seen in common law jurisdictions). The foregoing confidentiality “privilege” in Japan is available only to legal counsel, as there is no corresponding duty of confidentiality that can be claimed independently by a client.

As a result of the foregoing, the recitation of *Upjohn* advertisements to a Japanese employee typically would be unnecessary for Japanese attorney-client privilege preservation purposes, and so doing most likely would make the employee nervous and uncomfortable (which could have a negative impact on the amount and quality of information gained from the subject employee). Nor is there ordinarily any reason to have a joint defense agreement in a Japan dispute because no separate privilege rests with the client. Thus, the sharing of privileged information among a pool of persons will not place such persons in a less advantageous position due to concerns that the sharing of information results in the attorney-client privilege being waived. Should a joint defense agreement be necessary for U.S. legal or other purposes (as information uncovered in a Japan internal investigation could be subject to U.S. discovery), then overseas counsel should assume that the local team will find this request unusual, and overseas counsel

should be ready to provide a comprehensive explanation to the local team.

The manner in which to interview a Japanese employee is also often influenced by local norms. While discussing the numerous cultural differences between Japan and other countries is beyond the scope of this newsletter, there are certain salient differences that an experienced interviewer should know: (i) the answers of a Japanese employee may be considered vague when translated into English due to Japanese language patterns (such as the frequent use of double negatives to confirm a belief), and a general notion that Japanese people prefer not to directly contest controversial views, and (ii) a Japanese employee may become suspicious if questions are asked that contain multiple clauses and then repeated with different twists. Experienced Japanese legal counsel should be able to provide valuable insights concerning the nuance of responses, the way to phrase questions, and appropriate etiquette for the interview process.

5. Delivery of the Report. In jurisdictions where information discovery is robust, the investigative report may be delivered verbally to senior management to help thwart discovery to outside persons. The delivery of a verbal-only report to a board of directors in Japan may be frowned upon by the board not only due to the lack of a perceived need for such protection (as explained above), but a verbal report is not conducive to the use of the typical *ringi* internal approval process deployed by many Japanese companies, whereby a number of departments are required literally to place their stamp of approval on a report before its contents can be adopted by the board (which process would be impossible to complete if a report is not in writing). Therefore, should there be a need to deliver a verbal-only report to a board of directors in Japan, overseas legal advisors may wish to explain in advance the need for such delivery method in order to avoid potential misunderstandings and concerns that the investigators do not stand behind the contents of their report. Japanese counsel also should be involved in discussing whether a board's reliance on a verbal-only report might have an impact on a director's fiduciary duty obligations.

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The inter-connecting web resulting from the globalization of economies has increased the likelihood that a corporate crisis can arise in a jurisdiction outside a parent company's home market. A global company would be well advised to have an effective corporate crisis management plan prepared in advance and updated from time to time in order to be able to deal with the unique challenges that arise when responding to a crisis in a jurisdiction outside the parent company's home market. Without sufficient advance preparations, a corporate crisis could lead to a business-ending corporate catastrophe.

The need for advance preparations is accentuated in Japan as (i) personnel of the subject company may be required to meet with the police and the public prosecutor at the outset of an investigation (which events are frequently leaked to the local press and can easily tarnish the reputation of the company before the full facts of the investigation are known), and (ii) the

subject company may need to promptly furnish detailed reports to Japanese regulators (the failure of which to timely produce accurate and complete disclosures can lead to severe penalties). In such instances, time will be of the essence, and the subject company will need to immediately place into motion a corporate crisis management plan. Thus, if a global company has substantial operations in Japan, a prudent first step would be to secure in advance or identify qualified candidates to assist with a corporate internal investigation in light of the complexities of the Japanese business environment, the nuances of the Japanese legal system, the scarcity of qualified advisors in Japan, and the importance of promptly commencing an internal investigation before critical information is inadvertently lost.