

## CORONAVIRUS: FINANCIAL DISTRESS - TIP SHEET FOR BOARDS OF DIRECTORS OF COMPANIES IN JAPAN

### WHAT ARE YOUR DUTIES DURING FINANCIAL DISTRESS/INSOLVENCY?

As a general rule of principle, directors owe a duty of care as a good manager (*zenkan chui gimu*) to the company. This duty is generally considered similar to the fiduciary duties. Outside of a distressed situation, such duty is to act for the benefit of your company's shareholders as a whole for the purpose of maximising shareholders' interests. However, exceptionally, where your company is financially distressed and facing potential insolvency, as a director you must also consider the interests of creditors as a whole (not just the interests of any individual creditor or class of creditors). As such, failure to recognise the interests of creditors and take steps to minimise potential losses to creditors at this time can give rise to personal liability.

### WHAT ARE SOME THINGS YOU CAN DO TO PROTECT THE BOARD?

Here are our "top ten" practical steps if your company's financial position is deteriorating:

1. **Meet regularly and stay informed:** appropriate board minutes are a particularly important way of demonstrating you have complied with your duties. Remote meetings using telephone or video system are an accepted means of making board decisions. If written resolutions are prescribed by the Articles of Incorporation (*teikan*), such means are also acceptable.
2. **Seek professional advice:** obtaining appropriate expert advice relating to waivers, standstills, new finance, employee obligations, customer and supplier arrangements, compliance (including continuing disclosure obligations), asset valuation and restructuring or insolvency proceedings can not only help reduce the scale of any losses, but also minimise the risk of your liability, and avoid management being distracted by the consequences of non-compliance. Individual directors may also consider that they need separate advice. If your reliance on such expert advice leads to failure or loss as a result, you would be able to be excused entirely or at least partially from liability.
3. **Consider whether to continue trading:** continuing to trade where there is no reasonable prospect of paying accounts payables to trade suppliers and avoiding insolvent liquidation will inevitably give rise to a risk of directors facing civil and/or criminal liability. However, a company may face financial difficulties and still face a reasonable prospect of becoming insolvent.

Ceasing to trade too early may amplify, rather than minimise, losses to creditors – for example, by causing work-in-progress to be left incomplete, by closing off the possibility of a turnaround/restructuring or of implementing a going concern sale outside of an insolvency process. Likewise, failing to take action may also give rise to liability following the commencement of any insolvency or rehabilitation proceedings. The directors should also continue to evaluate whether they should pay regard to not only the interests of the shareholders but also the interests of the creditors as a whole when your company is in the state of insolvency or nearly insolvent.

4. **Consider restructuring options:** a number of restructuring options exist under Japanese law. It will help the directors to demonstrate that they have complied with their duties if they are able to show that such options have been considered and that the best option(s) have been decided upon, and to document the reasons for that decision. It will almost always be advisable to involve professional advisors when discussing restructuring options. Please also see Section 2 above.
5. **Consider individual companies within the group:** you need to consider the individual companies within a group context and the duties you owe to the stakeholders of each company when making decisions. The risk of cross default or insolvency may also restrict your ability to borrow or make available intra-group funding or enter into intra-group transactions.
6. **Consider key contracts:** while monitoring key contracts (including finance arrangements) will be the company's obligation, you should review relevant provisions (like financial covenants and termination events) in order to develop the best course of action.
7. **Consider transactions:** consider the Company's and the Guarantor's ability to meet their obligations before entering into any transactions and ensure that these obligations are reviewed on a regular basis. Consider carefully (i) whether any transaction being contemplated by the Company would likely benefit shareholders at the expense of creditors, and (ii) whether any transactions entered into by the Company or any Guarantor could potentially be reviewed and set aside – particularly where they are with persons connected with the Company (or any Guarantor). If they are, ensure that the reasons for entering into such transactions are properly recorded.
8. **Ensure proper delegation of authority:** ensure key personnel have properly allocated responsibilities and carefully consider the flow of information to members and employees.
9. **Ensure proper records are kept and timely reporting:** ensure your company's books and records are being kept up to date properly, and ensure regular financial and operational reporting, and the timely escalation of issues.
10. **Think carefully before resigning:** resignation will not discharge your responsibility for any previous conduct. Remaining on the board to drive a successful resolution may be the most effective means of mitigating risk.

## CONTACTS

**Tatsuhiko Kamiyama**  
Partner

**T** +81 3 6632 6395  
**E** tatsuhiko.kamiyama  
@cliffordchance.com

**Natsuko Sugihara**  
Partner

**T** +81 3 6632 6681  
**E** natsuko.sugihara  
@cliffordchance.com

**Michihiro Nishi**  
Partner

**T** +81 3 6632 6622  
**E** michihiro.nishi  
@cliffordchance.com

**Yusuke Abe**  
Partner

**T** +81 3 6632 6332  
**E** yusuke.abe  
@cliffordchance.com

**Clara Shiota**  
Counsel

**T** +81 3 6632 6655  
**E** clara.shiota  
@cliffordchance.com

**Akihiko Takamatsu**  
Counsel

**T** +81 3 6632 6324  
**E** akihiko.takamatsu  
@cliffordchance.com

**Masafumi Shikakura**  
Counsel

**T** +81 3 6332 6323  
**E** masafumi.shikakura  
@cliffordchance.com

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Clifford Chance (Gaikokuho Kyodo Jigyo)

Palace Building, 3rd floor

1-1, Marunouchi 1-chome, Chiyoda-ku, Tokyo  
100-0005, Japan

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