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A Nominal Director in a Japanese Corporation and Personal Liability

-Is a nominal director free from liability for lacking in exercise of due care?

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Context

We often see global companies appointing directors that are non-residents of Japan for Japanese subsidiaries. Some are different, but often such directors rarely visit Japan or participate in board deliberations and stay largely inactive for day-to-day responsibilities of the subsidiary. Then something goes wrong and the victim sues not only the company but the nominal director. Under what circumstance can the director be held personally liable for the breach of duty of care? A recent case from Tokyo High Court (March 10, 2022, Hanji 2543=2544 at 75) offers an analytical framework for sorting out this issue by showing straightforward standards.

Underlying law

A director (*torishimari-yaku*) of a Japanese stock corporation (*kabushiki kaisha*) may be personally liable to a third party if the director is found to have had damaging intent or to have been grossly negligent in the performance of his duty, thereby causing third-party damages. Companies Act, Article 429, Para. 1. The purpose of this law is to expand the scope of recovery for third-party losses when circumstances warrant it (by requiring damaging intent or gross negligence).

A Japanese director owes, as in common law, the duty of care and the duty of loyalty.

Issue/Facts

If the director is merely nominal in his appointment and the discharge of duty in the office, would such circumstances constitute a ground to negate his personal liability under Article 429?

In this case, the director was asked to serve on the board only nominally for a company by his boss at a different company that the appointee worked for. He never set foot in the company he served as a director. All he did was provide his seal certificate and agreement to register as a director, but he neither provided any active service for the company nor was he paid by the company. A separate employee of the company had an extremely high work load for a long time and eventually died of a heart failure. The bereaved family sued the director for personal liability under Companies Act, Article 429.

Court's discussion (outline)

The claim granted in relevant part.

The director's role is deemed nominal in that he was neither involved in the management nor was he paid for his services as a director. However, he did at least agree to be registered as a director by providing his seal certificate that is deemed to constitute a valid acceptance of becoming a director.

Once appointed as a director, he will invariably owe the general duty of a full-fledged director. Such duty would include being alert of general work conditions of the employees and prevent damages by implementing appropriate means as needed. This defendant, however, never engaged in such monitoring or implementation of adequate measures.

The fact that the company was, in effect, run by a different executive and that the defendant was never paid for his services is merely an internal issue, and the general duties imposed on a director should not be modified even in light of such circumstances. He is held to the same legally required level of performance as a director, and ancillary facts such as that he relied on others to manage the company or he was too busy working elsewhere, among others, would not provide a ground for excusing him from the general duty imposed on a director. In fact, these circumstances would argue in favor of more stringently applying the statutory standard without modification.

The fact that he was not available to exert the basic duty of care constitutes gross negligence in the performance of his duty. Other forgiving circumstances, like that the real executive would not have listened to the defendant's suggestions even if he made them, are not adequately proven. In the meantime, the defendant failed to detect the workload issue and to implement sufficient measures to address such a problem.

Takeaways

- While a director is often found liable for work-related damages, this is the first case we are aware of that admitted personal liability of a nominal director.
- Agreeing to serve as a director without a genuine intent to provide director services could lead to personal liability of the nominal director. This should be avoided.
- The legal duty assessed on a director will not be negated because he is a nominal director. This policy comes from the need for protection of third party victims.
- Circumstances establishing he is a nominal director largely are irrelevant in assessing personal liability of the nominal director because they will not have an impact on the underlying duty of care once it is determined that he is validly appointed.

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If you have any questions concerning these developing issues, please do not hesitate to contact the following Paul Hastings lawyer:

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