

## White Collar Crime - Japan

### The Olympus effect? Recent changes to whistleblower law regime

Contributed by [Nagashima Ohno & Tsunematsu](#)

August 03 2015

[Introduction](#)  
[Olympus fraud](#)  
[Whistleblower Protection Act](#)  
[Sector-specific laws](#)  
[Employment case law protections](#)  
[Companies Act](#)  
[Amendments to Companies Act](#)  
[Corporate Governance Code](#)  
[Comment](#)

#### Introduction

The Olympus accounting scandal (and more recently, the Toshiba accounting irregularities) highlighted various issues in relation to corporate governance in Japan, including questions over whether the country's whistleblower law regime could do more to uncover corporate malfeasance. In particular, concerns were raised as to whether the traditional contact points in company whistleblowing systems are sufficiently independent of company management to ensure the effective functioning of those systems. To address these concerns, Japan recently amended its Companies Act and introduced the Corporate Governance Code to bolster the integrity of the whistleblower law regime.

#### Olympus fraud

The 2011 Olympus accounting fraud saw Englishman Michael Woodford become the most senior corporate figure in history to blow the whistle on his own company. Woodford, who at the time was president and representative director of Olympus, publicly disclosed a \$1.5 billion accounting fraud which involved Olympus board members. An investigation into the causes of the fraud concluded that the Olympus whistleblower system (which was established pursuant to the Companies Act) was defective and one reason why the fraud remained undetected for many years. The hotline was connected only to the compliance department. That department was in part controlled by a member of senior management who himself was complicit in the fraud and who prevented efforts to establish a hotline link external to Olympus.<sup>(1)</sup>

The scandal raised concerns over the effectiveness of whistleblower systems in corporate Japan. However, recent amendments to the Companies Act and the introduction of the Corporate Governance Code are welcome developments responding to such concerns. Before exploring these developments, it is useful to understand other important components of Japan's whistleblower law regime.

#### Whistleblower Protection Act

The most well-known Japanese law concerning whistleblowing is the Whistleblower Protection Act, which came into effect in 2006 and covers both the private and public sector. The focus of the law is the protection of whistleblowers from employer retaliation and the promotion of companies' internal compliance functions. The act prohibits employers from terminating or penalising employees who make protected internal or external disclosures of wrongdoing. The act does not, however, protect directors who make such disclosures – as was the case in the Olympus scandal. Further, the act does not compel companies to establish whistleblower systems. The guidelines for the act in relation to the private sector nonetheless provide detailed guidance on best practice in establishing hotlines and dealing with disclosures.<sup>(2)</sup>

#### Sector-specific laws

At least 10 other less well-known statutes aim to protect whistleblowers in specific industries. An example is the legislation designed to protect nuclear industry whistleblowers, which provides for criminal penalties against employers that breach its provisions.<sup>(3)</sup>

#### Employment case law protections

#### Authors

[Akihisa Shiozaki](#)



[Peter Coney](#)



A body of Japanese employment case law has been developed to protect whistleblowers from employer retaliation. However, Japan's legislators considered that the content and application of this case law were not entirely clear and this concern was a factor behind the introduction of the Whistleblower Protection Act. The case law is nonetheless applied by courts in whistleblower-related employment litigation in the (increasingly) limited circumstances where the Whistleblower Protection Act does not apply.

### **Companies Act**

The Companies Act (and its regulations) require the board of directors of certain larger companies to pass resolutions in relation to the implementation of internal governance controls.<sup>(4)</sup> Although the establishment of a whistleblower hotline is not mandatory under the Companies Act, the aforementioned requirement strongly encourages such companies at least to consider establishing – if not actually establish – a whistleblower hotline.

Consequently, the vast majority of larger companies have voluntarily established whistleblower hotlines. Before the recent amendments to the Companies Act, such whistleblower hotlines were commonly linked to the company board of directors or compliance department – not the company's statutory auditors or any external entity. Statutory auditors are tasked with the risk monitoring of management and directors.

A concern raised by the Olympus scandal was the fact that most whistleblower hotlines were linked to company boards or internal departments which, by their nature, are not independent of company management. This was perceived to discourage whistleblowing, particularly in relation to alleged wrongdoing involving directors and other senior management. Commentators believe that these concerns were a factor driving the recent Companies Act amendments and the whistleblower component incorporated into the Corporate Governance Code. Indeed, the alleged involvement of senior management in the accounting scandal at Toshiba underlines these concerns.

### **Amendments to Companies Act**

Effective from May 1 2015, the Companies Act and its regulations have been amended to require, among other things, that the boards of directors of certain larger companies pass resolutions addressing basic principles regarding the following internal governance controls:

- a system whereby directors, company accountants and employees can report matters concerning corporate governance directly to the statutory auditors of the company (rather than the board of directors or the compliance department). This does not prohibit existing whistleblower systems that are linked to the board of directors or the compliance function. The effect of the amendment is to ensure that companies consider whether whistleblower systems should be linked to statutory auditors, rather than the board of directors;
- a system whereby those who report corporate governance matters to the statutory auditor shall be protected from detrimental treatment as a result of such reporting. This appears to reflect the Whistleblower Protection Act in that companies are prohibited from terminating or penalising employees who disclose malfeasance; and
- a system whereby the company's governance controls extend to any subsidiaries of the company.

### **Corporate Governance Code**

Effective from June 1 2015, the Corporate Governance Code generally reflects the Organisation for Economic Cooperation and Development Principles of Corporate Governance and establishes wide-ranging principles of corporate governance for listed Japanese companies, including principles in relation to whistleblower systems.<sup>(5)</sup>

Specifically, the code states that companies should establish a framework for employees to report illegal or inappropriate conduct or other serious concerns without fear of suffering disadvantageous treatment. Further, this framework should allow for a proper assessment and appropriate response to reported issues and the board should be responsible for both establishing and monitoring the enforcement of the framework.

Perhaps most significantly, the code states that companies should set up a whistleblower point of contact that is independent of management (eg, a panel consisting of outside directors and outside statutory auditors). In providing that listed companies should establish a whistleblower link consisting of outside directors and outside statutory auditors, the code goes beyond the amended Companies Act (insofar as the Companies Act does not provide that the relevant statutory auditors should be outside auditors).

### **Comment**

None of the aforementioned laws or the code compels companies to establish whistleblower hotlines. However, the recent emphasis in the amended Companies Act and the code on the independence of whistleblower hotline recipients suggests that regulators in Japan see whistleblowing as an increasingly important component of corporate governance.

Further, the introduction of the code will go some way towards shedding light on corporate Japan's attitude to whistleblowing systems. This is because the code adopts a 'comply or explain' approach, whereby listed companies must publicly disclose the reasons for any non-compliance with the code's

various principles. For most listed companies, the first such disclosures are due at the end of 2015. The disclosures in relation to whistleblowing should shed light on corporate Japan's attitude to these new post-Olympus developments.

*For further information on this topic please contact [Akihisa Shiozaki](#) or [Peter Coney](#) at Nagashima Ohno & Tsunematsu by telephone (+81 3 6889 7000) or email ([akihisa\\_shiozaki@noandt.com](mailto:akihisa_shiozaki@noandt.com) or [peter\\_coney@noandt.com](mailto:peter_coney@noandt.com)). The Nagashima Ohno & Tsunematsu website can be accessed at [www.noandt.com](http://www.noandt.com).*

## Endnotes

(1) Tatsuo Kainaka *et al* trans, "Investigation Report, Olympus Corporation Third Party Committee", December 6 2011, page 133.

(2) Consumer Affairs Agency, "Whistleblower Protection Act Q&A for Private Sector Entities", 2013.

(3) Regulation of Nuclear Source Material, Nuclear Fuel Material and Reactors Act 1957.

(4) Companies Act (Article 362) and Companies Act Regulation (Article 100).

(5) Corporate Governance Code Principle 2.5 and Supplementary Principle 2.5.1.

The materials contained on this website are for general information purposes only and are subject to the [disclaimer](#).

ILO is a premium online legal update service for major companies and law firms worldwide. In-house corporate counsel and other users of legal services, as well as law firm partners, qualify for a free subscription. Register at [www.iloinfo.com](http://www.iloinfo.com).

---

## Online Media Partners



© Copyright 1997-2015  
Globe Business Publishing Ltd