

New plea bargaining system: a new compliance risk for companies with operations in Japan?

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Introduction

Various initiatives in recent years have set in motion a number of reforms to the Japanese criminal justice system, including the phased-in introduction of the video recording of interviews with criminal suspects. However, the reform of most interest to businesses operating in Japan is undoubtedly the introduction of Japan's first plea bargaining system.

The new system, which was created pursuant to an amendment to the Criminal Procedure Code in May 2016, is due to come into effect by June 2018. Together with the recent introduction of the Principles for Listed Companies Dealing with Corporate Malfeasance and the strengthening of the whistleblowing regime through the new Corporate Governance Code, the new system will likely further incentivise both Japanese and global companies in Japan to take meaningful steps to bolster corporate compliance in order to avoid the sometimes devastating consequences of serious corporate malfeasance.

Overview

In short, the new system allows for a prosecutor to enter into a formal plea bargaining agreement with a suspect or defendant (whether a natural person or corporate entity) to drop or reduce criminal charges or agree to a pre-determined punishment if the suspect or defendant provides certain evidence or testimony in relation to certain types of crime.

In significant contrast to the US plea bargaining system, the new system is available only to parties which provide evidence or testimony in relation to charges against or crimes of other parties. Cooperation by a suspect or defendant in relation to an offence it has (or has allegedly) committed does not entitle it to use the new system in relation to such offence. It is this unique aspect of the new system which observers consider to be aimed at promoting corporate compliance, as it allows a suspect or defendant to disclose its knowledge of the wrongdoing of others in order to have charges against it dropped or reduced, even if the other party's conduct is wholly unrelated to the allegations or charges against the suspect or defendant in question.

The types of criminal offence subject to the new system are different types of narcotics and firearm-related crime and also certain categories of white collar wrongdoing.⁽¹⁾ The principal offences most relevant to corporates which are subject to the new system include:

- bribery;⁽²⁾
- fraud;
- embezzlement;
- certain tax and antitrust-related wrongdoing; and

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- criminal offences concerning the trade in financial products.

Cooperation on the part of a suspect or defendant is required in order for it to avail itself of the new system's benefits. Forms of cooperation contemplated by the new system include:

- the provision of truthful and complete answers to questioning by the authorities at the investigation and trial stages; and
- cooperation with the gathering of evidence and its use in any subsequent criminal proceedings against the other party.(3)

As a *quid pro quo* for cooperation, the prosecutor is permitted to negotiate and enter into a plea bargaining agreement with the suspect or defendant to agree:

- to not lay a certain charge;
- to discontinue an ongoing indictment;
- to charge the suspect or defendant in relation to only a pre-agreed offence and/or with a pre-agreed punishment; and
- numerous other similar forms of arrangement.(4)

The prosecutor must consider a number of factors when deciding whether to enter into an agreement, including:

- the significance of the (alleged) criminal conduct of the other party in relation to which the suspect or defendant is agreeing to provide cooperation;
- the probative value to the prosecution of the evidence that the suspect or defendant is agreeing to provide; and
- the relative seriousness of the charge against the cooperating suspect or defendant in light of the proposed charges against the other party.

Defence lawyers will play a central role in the new system. Such lawyers are required to be involved in negotiations in relation to the terms of a potential plea bargaining agreement(5) and consent to the terms of any agreement reached. This is to protect the rights of their clients and help to prevent any misuse of the new system.

The new system also permits the parties to a plea bargaining agreement to be released of their obligations under the agreement in certain circumstances – in particular, in the event that it becomes clear (perhaps during a subsequent trial) that a suspect or defendant which is party to an agreement has given false evidence or testimony, the prosecutor may no longer be bound by the agreement.

Concerns

A principal concern raised in relation to the new system is that the suspect or defendant may seek to avoid or reduce their own criminal culpability by giving false evidence or testimony to the authorities in an attempt to implicate otherwise innocent third parties in criminal matters.

However, certain safeguards will be put in place to attempt to minimise these risks, including:

- the compulsory participation of defence lawyers in the agreement negotiation process;(6)
- a procedure which allows the disclosure of the terms of a plea bargaining agreement in specific circumstances; and
- criminal penalties for persons who provide false evidence or testimony or who otherwise abuse the new system.(7)

Notwithstanding these safeguards, there will likely always be a risk that a suspect may give false information in questioning by the police or a prosecutor purely due to the psychological strain suspects sometimes experience during detention and questioning by the authorities. This is especially true given that the Japanese justice system permits comparatively long periods of detention before the prosecutor needs to decide whether charges will be laid.

Potential implications for companies with operations in Japan

As the new system will not be introduced until 2018, it is too early to know the actual impact that plea bargaining in Japan may have on both Japanese and global companies with business operations in Japan. However, there are a number of easily envisaged scenarios in which the new system may present serious corporate governance and reputational challenges to corporate players in Japan.

A number of accounting scandals have rocked corporate Japan in recent years – most notably, the Olympus fraud and the Toshiba accounting irregularities. Accordingly, after the new system comes into effect, a real-life scenario along the following lines seems plausible.

Example

A middle manager whose tasks include managing the financial reporting of a listed company engages in false accounting of the company's financial disclosures in an effort to hide certain losses from the regulators and the market. The employee claims he did this at the behest of the company president. After a whistleblower alerts the authorities to the misconduct, the employee is interrogated by the regulator on suspicion of false accounting.

The employee is advised by his personal lawyer that the new system may enable him to avoid criminal charges entirely if he provides information to the authorities about the president's involvement in the misconduct. His lawyer advises him that the prosecutor will be more interested in convicting the well-known president of a listed company rather than an unknown middle management employee.

The employee begins negotiations with the prosecutor about the terms of a plea bargaining agreement designed to facilitate criminal charges being laid against the president and the company itself.

Compliance implications

The risks for the company here are legion. First, if the employee succeeds in executing a plea bargaining agreement, not only the president but other staff and the company itself may be exposed to criminal investigation and possibly criminal penalties. Second, the flow-on consequences may include derivative action by shareholders against the company with all of the consequent risks, including the potential impact on the company's share price and damage to its public reputation.

Crucially, these risks – in particular, the potential impact on the company's share price and corporate reputation – may manifest regardless of the veracity of the employee's account of what happened with regard to the false accounting. Even if the employee's account is false and the president was not involved in the false accounting (but rather the employee himself was the only person involved) and the aforementioned safeguards are in place, these factors may not necessarily prevent the employee from entering into a plea bargaining agreement. This may potentially result in the false allegations being aired in open court, potentially creating a crisis situation for company management.

The possibility of the aforementioned risks manifesting after the new system is introduced serves to underline the critical importance of having a robust compliance culture in place. The following will likely take on a new level of importance after the new system comes into effect:

- senior management involvement in risk assessment and management;
- clear and well-understood internal investigation protocols;
- effective whistleblower hotlines; and
- media management strategies and policies to prevent the recurrence of malfeasance.

Comment

Compliance officers should now start considering the practical steps that they can take to protect their company in the event that a suspect or defendant tries to misuse the new system by making false accusations against the company. These steps may include protocols for contacting the personal lawyer of a person who has entered into a plea bargaining agreement and made serious criminal accusations against a company. Effective media strategies for dealing with what may be

potentially damaging false accusations against the company and its management may also need to be considered. In the meantime, the relevant Japanese authorities are gradually releasing further details about how the new system is expected to operate.

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Endnotes

- (1) Criminal Procedure Code, Article 350-2, Sub-section 2.
- (2) Criminal Code, Article 198.
- (3) Criminal Procedure Code, Article 350-2, Sub-section 1.1.
- (4) Criminal Procedure Code, Article 350-2, Sub-section 1.2.
- (5) Criminal Procedure Code, Article 350-4.
- (6) Criminal Procedure Code, Article 350-4.
- (7) Criminal Procedure Code, Article 350-15, Sub-section 1.

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