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Challenges for Japanese companies when responding to overseas regulatory investigations

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A focus by companies in Japan on perceived customer satisfaction can be used to justify non-compliance with laws and regulations. Understanding the single-minded focus on customers can explain – to a certain extent – why some of these companies find it difficult to change the kind of practices that have led to damaging corporate scandals.

Investigations

When lawyers are instructed to investigate a corporate scandal in Japan, they will typically conduct employee interviews. During these interviews, employees report that complying with laws and regulations is onerous: it is both time consuming and expensive. For example, Japanese manufacturing companies that supply goods to the United States or Europe need to invest in legal and compliance departments that have the capacity to understand US or EU laws and regulations (or instruct outside counsel who have that expertise), and then ensure that their colleagues are made aware of and understand the relevant laws and regulations that affect them. This process takes time. Trying to comply with laws and regulations can result in delays to production schedules if compliance challenges are not resourced appropriately and thought through well in advance.

Delays to agreed production schedules can cause companies to lose market shares to competitors. Employees at Japanese companies are generally acutely aware of inconveniencing customers, who expect a product to be delivered to a certain schedule or perform in a certain way. While the Japanese focus on customer service is usually commendable, sometimes the fear of causing customer inconvenience can lead to non-compliance with contractual specifications or even laws and regulations. This non-compliance is, of course, not disclosed to customers or regulators. A company or its employees may then use the absence of a customer complaint that the product is "defective" as an excuse to justify their behaviour, even though the customer is unaware of the misconduct.

There seems to be a widely held view among employees at various Japanese companies that, if a product has no safety issues, this excuses non-compliance with contractual specifications or laws and regulations. The excuse that a particular instance of non-compliance did not lead to harm is often used, such as "We are not Takata",⁽¹⁾ but this seems to miss the point that there are less serious problems than those which Takata faced before it went bankrupt that can trigger regulatory intervention.

Heightened regulatory risk

Sometimes historical misconduct is exactly that: historical. It is a one-off instance caused by an outlying event or a bad actor that is confined to the past. However, regulatory non-compliance due to a misguided focus on not inconveniencing the customer can often be a pervasive and ingrained part of company culture, not just a one-off event that occurred in the past. This makes it much more difficult to stop, and even when historical problems have been identified, there is no guarantee that the misconduct will stop. If acting this way is indeed a part of a company's culture, there is a heightened risk that similar behaviour will continue to occur even once the company starts engaging with regulators about the historic misconduct. This creates significant further legal risk.

One of the prerequisites to minimising fines and creating a more favourable regulatory enforcement outcome is to ensure that the underlying conduct that led to the investigation has stopped – even if this results in difficult discussions with customers (eg, being unable to fulfil order requirements until the product is re-engineered). If the misconduct continues after being discovered, regulators will be more likely to take aggressive action against the company, and customers may abandon the company and not return.

Causes and mitigation

There are several reasons that lead to non-compliance in order to meet what Japanese companies perceive are customers' expectations (it is important to stress that this is indeed perception, as customers typically do not want to receive non-compliant products when they have contracted for products that comply with regulatory standards).

The first reason is the lack of a clear "tone at the top". If senior leadership at the company makes all employees aware that compliance with laws and regulations is the cornerstone or foundation of a successful business, others within the organisation are more likely to focus on and adhere to this.

The second reason is insufficient legal and compliance training of staff. Regulations in certain industries can be complex and difficult to understand – this is where legal and compliance training for staff comes in. Everyone in the organisation needs appropriate training on relevant laws and regulations in order to protect the company, particularly those employees on the front line, whose decisions determine whether laws and regulations are ultimately complied with. Corporate legal and compliance departments have a significant role to play in this regard, but sometimes they will need assistance from outside counsel. For example, it can be very helpful to instruct outside counsel to conduct a company-wide risk assessment to determine:

- what risks the company faces;
- which risks it is mitigating well; and

- which areas may need to be developed further.

Finally, some Japanese companies operate "paper" whistleblowing systems (ie, their systems to report corporate misconduct only exist on paper). These systems often do not function effectively in reality because nearly all employees cannot envisage reporting their colleagues – particularly their more senior colleagues – who engage in misconduct. Although not as critical as the first two points, this is clearly something that needs to change.

Comment

There is a certain irony in thinking that not following laws and regulations will benefit customers – it is actually the opposite. Customers will not be happy to have their products recalled because they do not conform to legally required standards that they were warranted to meet. Not only will this cause a tremendous amount of customer inconvenience, but it is also likely to cause regulatory scrutiny, which, in turn, may lead to large fines and even criminal charges.

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Endnotes

(1) Takata Corporation was a Japanese automotive parts supplier that manufactured airbags with defective inflators. The airbags would rupture and send debris into vehicles' passenger compartments. This led to a number of injuries and deaths. Takata filed for bankruptcy in 2017.