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Contributing Editor

Christa Band

Linklaters LLP

Through a series of interviews with expert legal practitioners, *Crisis Management* explores the key factors that businesses must consider when a crisis strikes, and how best to resolve it. Our global panel share their experiences of successfully navigating myriad crises and offer practical advice for preventing crises from arising in the first place.

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Japan

Yoshihiko Matake, Yuta Sugie, Hayato Maruta and Togo Kitajima

Nagashima Ohno & Tsunematsu

Yoshihiko Matake focuses on corporate crisis management, international dispute resolution, consultation on corporate governance and compliance framework and export control. He has advised domestic and foreign clients in various corporate crisis cases, including a high profile criminal trial regarding fraud in clinical research, large-scale data manipulation of product quality by manufacturers and international cartel and foreign bribery and corruptions. He has a great deal of experience of US class actions and mass actions and other international dispute resolution. His practice covers a large variety of corporate matters including export control, international trading regulations, data privacy regulations and other cross border legal matters, in particular involving North America. He worked at Nagashima Ohno & Tsunematsu NY LLP as a senior associate from 2010 to 2013. He graduated with an LLM from Columbia Law School in 2010 and with an LLB from the University of Tokyo in 2003. He was admitted to the Japan Bar in 2004.

Yuta Sugie specialises in representing companies that face complex corporate crises and leading them to successful resolutions. He has provided clients with advice on various corporate crises such as matters involving product data manipulation, misrepresentations to consumers and crimes against corporate property committed by corporate executives. He has extensive experience in advising companies in cross-border corporate crises including investigations by regulators outside Japan such as the US Department of Justice. He has also helped clients thoroughly review and improve their corporate compliance programmes. He completed his LLM programme at University of California, Los Angeles in 2022 and served as an international clerk at Covington & Burling LLP's Washington DC office from 2022 to 2023. He joined Nagashima Ohno & Tsunematsu in 2015 when he was admitted to the Japan Bar.

Hayato Maruta joined NO&T in 2019. His primary focus has been on crisis management, corporate compliance, IT, privacy and security. He was admitted to the Japan Bar in 2018. He is also registered as an information security specialist in Japan.

Togo Kitajima joined Nagashima Ohno & Tsunematsu in 2020 when he was admitted to the Japan Bar. His primary focus has been on crisis management, corporate compliance, mergers and acquisitions, sports law and animal law, and he also handles general corporate matters.

1 THE WORD 'CRISIS' CARRIES WITH IT THE NOTION OF THE SUDDEN AND UNEXPECTED. WHAT CAN A BUSINESS DO IN ADVANCE OF A CRISIS STRIKING TO ENSURE THAT IT IS BEST PREPARED TO NAVIGATE IT?

Advance preparation is essential for a company to navigate a crisis

Generally, when a large-scale corporate crisis, such as product quality fraud (eg, manipulation of test data) or a data breach is identified, the company's actions to manage the crisis are typically phased as follows: (1) initial response, including preservation of evidence; (2) investigation of underlying facts; (3) root cause analysis; and (4) implementation of remedial measures. Companies often announce incidents publicly and communicate with customers, investors, competent regulators, and other stakeholders who may be affected by the crisis in the course of implementing the action phases above. The latter three action phases above should be tailored on a case-by-case basis to address specific issues. Conversely, as the initial response often requires important decisions to be made within a short time frame in high-pressure situations, companies should be well prepared in advance to address typical issues. Establishing such a framework should enable companies to provide an initial response smoothly and appropriately.

Codification of decision-making process

Under the Japanese legal system and common practice, to ensure effective initial responses to crises, the following should be codified: the procedures and criteria for deciding whether an incident should be publicly disclosed, the structure of the investigative body for fact-finding and any other important issues to be addressed in the early stages of crisis management. In Japan, the failure of a listed company to disclose a corporate scandal that likely has material impact on its business or possibility of such a scandal in a timely manner could constitute a violation of disclosure obligations under the Financial Instruments and Exchange Act (FIEA), a Japanese securities law. In recent years, securities lawsuits have been filed claiming such violations after high-profile corporate scandals occurred even if the scandal is not an accounting fraud, and there have been law firms that have actively solicited potential plaintiffs to initiate such securities lawsuits. Although this practice of plaintiff lawyers is still rare and underdeveloped in Japan, more law firms might be interested in pursuing it in the future.

In the case of corporate scandals that could harm the health, safety, or wellbeing of consumers, a delayed announcement of the relevant issues could trigger civil damage lawsuits not only against the company but also against its senior executives that were involved in the decision-making process and that are alleged to have failed to perform their duties. Further, in some precedents involving product safety issues where physical damage was sustained, senior executives were charged for criminal offences. In contrast, in practice, competent regulators and major business partners often expect prompt notice of a serious scandal before a public announcement is made. Late notification to such parties could jeopardise relations with them, making subsequent crisis management more challenging. Therefore, for listed companies in Japan, the decision on the timing and information to be disclosed in public announcements of corporate crises is crucial and difficult even if the company successfully identifies the issues and maintains confidentiality in the initial stages. To tackle such challenges at the beginning of crisis management, internal rules organising a crisis response task force and information management policy will be useful, and provisions on procedures and the decision-making authority for public disclosure of crises will be important among such internal rules. In addition, in order to achieve timely and appropriate decision-making at an initial stage of a crisis, it is extremely important for companies to gather information regarding the crisis internally within a limited time frame. However, reports of serious misconduct at subsidiaries and other affiliated companies is often delayed or absent. It is, therefore, essential to establish a reporting system within the

company group to ensure that this information is shared with the parent company in a timely manner.

Under the Japanese practice of investigating large corporate scandals, companies sometimes set up an investigation committee that is independent of the company to some extent and will publicly release the committee's investigation report to restore its reputation and trust among its stakeholders affected by the scandal. Although the Japanese Bar Association has non-binding guidelines for such an investigation committee, there are no other statutory requirements or guidelines to follow. Therefore, decisions on whether to set up an investigation committee, the extent to which it should be independent of the company and the composition of its members and supporting personnel are left to the discretion of each company facing a crisis. In light of this, it would also be advisable for companies to prepare the criteria and procedures for decision-making on matters related to the investigation committee in advance.

Framework for preserving evidence

In preparation for a possible extensive investigation after the initial stage of crisis management, companies should consider efficient methods of preserving the relevant evidence before dealing with the major crisis. The Japanese litigation system does not have expansive discovery requiring parties to produce a large amount of evidence or preserve documents. Therefore, the main purpose of preservation in corporate scandals is to assist internal fact-finding investigations, as long as the subject matter has no effect outside Japan and is unlikely to be subject to the jurisdiction of foreign courts. For example, in recent times, product quality fraud against customers has been a frequent occurrence among Japanese manufacturers. In these cases, the data related to product quality or performance is often managed solely by a certain business division. As a result, the company may often not promptly identify quality tests that do not meet test conditions agreed upon with its customers. This is often due to engineers making unilateral decisions and manipulating data to conceal quality standards breaches.

To effectively manage crises caused by such misconduct, a key step is to put in place a process for preserving the relevant documents and data, such as product quality test conditions and test results that cannot be compromised by possible misconduct. Since the Japanese legal system does not provide for extensive discovery, many traditional Japanese companies prefer to create and retain written records, even if the relevant information they contain could be damaging in the event of civil litigation. In many of the major cases of product quality fraud, the fraud has continued for many years, and it is not unusual for some companies to retain old documents after the applicable document retention period has expired. For better risk management, companies should periodically check which documents need to be retained and which can be discarded and review internal rules for document retention and deletion from the perspective of future crisis management. It is also important to digitise and organise documents, as large volumes of physical documents often impede a quick and appropriate initial response.

2 SOME CRISES AFFECT A BUSINESS IN UNPREDICTABLE WAYS; OTHERS ARISE FROM WELL-RECOGNISED, THOUGH UNWELCOME, RISKS. WHAT KEY THEMES UNDERLIE THE RISK MANAGEMENT ANALYSIS IN YOUR JURISDICTION? HOW MIGHT THIS ANALYSIS EVOLVE OVER TIME, IN LIGHT OF ANY EMERGING OR POTENTIAL FUTURE RISKS?

Risk of criminal and civil liabilities under Japanese law

Under Japanese criminal law, companies are only subject to criminal liability if employees or other relevant personnel are criminally liable and dual liability provisions are applicable. The Criminal Code of Japan does not contain provisions on dual liability. However, other laws that specifically criminalise certain types of misconduct (eg, bribery of a foreign official) contain dual liability provisions. Furthermore, in practice, corporate scandals do not frequently lead to criminal prosecution of the company or its executives, and the amount of monetary penalties is generally much lower than in Western countries. However, the amount of such penalties has been on the rise in recent years. For instance, in a cartel case involving utilities companies in 2022, the companies involved face a potential monetary penalty of approximately US\$1 billion.

Under Japanese civil litigation procedure, broad discovery of evidence, punitive damages and US-style class actions favourable to plaintiffs are not available. As a result, plaintiffs do not have much strategic leverage, and the risk of civil litigation arising from corporate scandals is low in Japan compared to the US and the UK. However, there is a recent trend under which plaintiff firms have been soliciting investors to initiate securities lawsuits, claiming that the listed companies have not disclosed non-compliance or associated risks in their disclosure documents under the securities regulation. This trend could become a significant risk in corporate crisis management in the near future. There are limited court precedents relating to corporate scandals in Japan and few reliable guidelines for crisis management. However, if not properly handled, a crisis can lead to various negative consequences other than criminal or civil liabilities, for example, the loss of trust with stakeholders, such as regulators, business partners, shareholders and consumers.

Backgrounds of product quality fraud in Japan

In many of the major fraud cases involving Japanese manufacturers regarding product quality, the relevant inappropriate business practices began long before they were discovered. This suggests that Japanese companies may find it difficult to detect and eliminate long-standing inappropriate practices at manufacturing sites involving many employees. In addition, their internal reporting and monitoring systems may not be functioning effectively to escalate the issues relating to such practices. This can be partially attributed to the unique lifetime employment system in Japan. This system, which was introduced in the later half of the 20th century, involves workers staying with one company for their entire career, and was a common practice in Japan. As a result, the allocation of human capital was generally less flexible, with many workers remaining in a business division for a long time, and some divisions becoming 'untouched sanctuaries' where once an inappropriate practice begins, it can easily be concealed from monitoring or auditing by personnel outside the division, or knowledge and know-how are concentrated in a specific person who has engaged in the same job for a long time, and no one can go against them. This unique system of employment and organisation also influences the behaviour patterns and mindset of employees. Those who seek to work for a single company for their lifetime put great importance on securing their places in organisations to which they belong. As a result, company members tend to develop an excessive sense of unity and atmosphere where reporting inappropriate issues are regarded as betrayal to the company or its members. This may create a situation where even if they become aware of a violation of laws or internal policies or any other compliance concerns, they excessively worry about

the risk of retaliation or losing their positions by reporting these issues and tend to think that it is safer to turn a blind eye to the issues. Further, for the same reason, even when there is a compliance concern in a business operation that is a long-standing custom of the organisation, they tend to fall into the mindset of simply following it (sometimes even if they are not explicitly instructed to do so by their supervisor). These organisational characteristics and the employees' mindset appear to part of the causes of long-standing misconduct in Japanese companies.

In addition, in recent decades, the growth of the manufacturing industries in China and other emerging countries has led to increased competition for Japanese manufacturers, which had previously leveraged their high-quality products to gain significant market share. To maintain their businesses, Japanese manufacturers were sometimes forced to commit to extremely high standards of product quality or conditions, which put unreasonable pressure on the manufacturing division. This pressure often led to misconduct in product development, manufacturing and testing.

That said, the recent increase in the discovery of inappropriate business practices in Japanese companies may be linked to a more liquid Japanese labour market as well as increased compliance awareness. The commentary No. 1-2 of the Japan Exchange Group's principle of preventing corporate scandals states that the concept of 'compliance' should encompass not only compliance with explicit laws and regulations but also a commitment to business partners, customers, employees and other stakeholders. This is also evident in the growing awareness of compliance in Japanese society and the broadening view of corporate social responsibility.

As the baby-boom generation retires and the practice of lifetime employment becomes obsolete, the liquidity in the labour market should also improve the flexibility of Japanese companies' business organisation, which may highlight existing inappropriate practices or corporate culture. In addition, whistle-blower reporting systems tend to be more effective in identifying compliance risks after the amendment to applicable laws and the improvement of compliance awareness.

Although the Japanese economy continues to play a significant role in the global supply chain, there may still be some Japanese companies engaged in ongoing, yet undiscovered, inappropriate business practices. Although statutory sanctions against corporate scandal in Japan are currently not as severe as in some other jurisdictions, improved compliance awareness may lead to more rigid enforcement or enactment of penalties, and civil claims, including securities lawsuits, related to corporate scandals. The risks associated with serious and long-standing misconduct should never be underestimated.

3 IN A CRISIS, STAKEHOLDER EXPECTATIONS OF A CONTINUING NARRATIVE AND EXPLANATION ARE HIGH AND THE INTERESTS OF VARIOUS GROUPS ARE NOT NECESSARILY ALIGNED. HOW DOES A BUSINESS MEET VARYING EXPECTATIONS OF WHAT TO SAY AND WHEN TO SAY IT? HOW DOES A BUSINESS MAINTAIN AN OPEN NARRATIVE WHILE BEST MINIMISING LEGAL RISK?

The content and timing of publication differ between cases where disclosure and publication are mandatory and those where disclosure is not required by applicable laws and regulations. These two cases are discussed below (see under the following header for initial disclosure).

Cases where disclosure and publication are required by applicable laws and regulations

In this case, the timing and content of the disclosure will need to comply with the disclosure timing and publication requirements of the applicable laws and regulations. For example, according to article 402 of the Securities Listing Regulations of the Japan Exchange Group, if there is any event that requires timely disclosure, the details of this event will need to be disclosed immediately. In many instances, a listed company's crisis requires timely disclosure as it involves 'important facts relating to the operation, business, or property of the listed company or the listed share certificates, etc. concerned, which significantly affect the investment decisions of investors', as stated in provision x of article 402 of the Regulations. In addition, according to article 402-2 of the Enforcement Rules for Securities Listing Regulations, when an event that requires timely disclosure occurs, the details, overview and future outlook of the event will need to be disclosed.

Further, under the Act Against Unjustifiable Premiums and Misleading Representations Act (the Premiums Act) (see article 5, paragraph 1 of the Premiums Act), in the event of a violation of the prohibition against misleading representations, the Commissioner of the Consumer Affairs Agency generally issues an order. This order requires that measures be taken to ensure that the general public is made aware that the company's representation was in violation of the Premiums Act (see article 7 of the Premiums Act: Order for Measures). Furthermore, when there is a significant risk of harm to the rights and interests of individuals caused by leaks, loss, damage and other situations pertaining to personal data, the business handling relevant personal data must notify the identifiable person of the occurrence of the situation, and report it to the Personal Information Protection Commission (see article 26 of the Act on the Protection of Personal Information).

There are also cases where failure to disclose a crisis is considered a breach of the duty of due care of a prudent manager owed to the management of the board of directors, among others, even though this is not clearly required by laws and regulations (see the 9 June 2006 Decision of the Osaka High Court).

However, even though laws and regulations may require disclosure and publication, if they are made without thoroughly verifying the facts, inaccuracies in the disclosure would further affect the credibility of the company. Therefore, companies are often required to make a decision on delaying disclosure and publication to the extent necessary to investigate and verify facts while assessing the risk of breach of disclosure obligations. Companies should consider seeking advice from lawyers and other experts on timing of disclosure because of the high level of legal and strategic decisions required.

Cases where disclosure and publication are not required by applicable laws and regulations

In this case, it should be determined whether publication is necessary in the first place. Generally, if a warning is required to prevent or limit potential harm of customers or other parties outside of the company, such as in the case of a product safety issue, disclosure should be made immediately. Disclosure should also be considered where it is difficult to identify potential victims and respond to them individually or where reputational damage would be significant if the scandal were to be discovered in an uncontrolled manner.

Regarding the timing of publication and disclosure, efforts should be made to disclose the discovered facts and the investigation results as early and as quickly as possible, especially where it is highly necessary to prevent or limit potential harm to third parties. However, as

mentioned above, the relevant facts should be thoroughly verified, and accurate information should be published.

For voluntary publication, there are no common standards for the information to be included, and the appropriate content should be determined in light of the timing and purpose of the publication. To limit or prevent potential harm to third parties, the minimum information necessary for the intended purpose should be disclosed, but it is usually acceptable to indicate that information that is not known at the time of publication is being actively 'investigated' and will be disclosed later if necessary.

4 MANY CRISES ARE CRITICAL BECAUSE THEY INVOLVE THE POTENTIAL FOR WIDESPREAD CIVIL LIABILITY AND MANY CLAIMANTS. WHAT CHALLENGES ARISE IN THE RESOLUTION OF MULTI-PARTY CLAIMS AND HOW DOES A DEFENDANT DETERMINE ITS STRATEGY TO MEET THEM?

Litigation for pursuing liability in Japan

The main stakeholders who can seek to hold companies liable for the crisis are shareholders, business partners, consumers, other affected parties and local community members. The typical methods of seeking liability include filing a claim for damages based on general tort or breach of contract. In this answer, we will briefly explain some of the particular methods each stakeholder may adopt in Japan.

Shareholders

In Japan, shareholders' derivative actions are permissible under article 847, paragraph 3 of the Companies Act. If the decision-making or action of a company's directors or officers results in the company incurring losses and the company fails to hold them accountable, shareholders may bring a lawsuit against them on behalf of the company based on prescribed procedures. Even if shareholders were to lose such a lawsuit, in principle, they would not be required to compensate the company for any damage arising from the lawsuit unless the shareholder had malicious intent (see article 852, paragraph 2 of the Companies Act).

In addition, the FIEA allows investors to seek compensation for damage caused by misrepresentations or omissions of material items in disclosure documents such as annual securities reports of a listed company. In relation to claims for damages under the FIEA, all or a part of the burden of proof is shifted to the company or its directors, or proof of certain elements may not be required at all. Thus, the FIEA provides actions that are highly effective in protecting shareholders (see articles 18, 21, 21-2, 22, among others, of the FIEA). For example, if an individual who has acquired shares in an issuing market claims damages against a listed company (article 18 of the FIEA), the company may still be held liable for damages even if it was not negligent in making the misrepresentation. In addition, under the law, the difference between the market price at the time of the claim for damages and the acquisition price of the shares (or if the shareholder has disposed of the shares, the difference between the disposal price and the acquisition price) is deemed to be the amount of damages (see article 19, paragraph 1 of the FIEA), unless the company can prove the lack of causation. Therefore, shareholders are not required to prove a causal relationship between the misrepresentation and the damage, or the amount of damages.

Consumers

While there is no class action system in Japan, there is the Consumer Organization Collective Litigation System (COCOliS), which has some similarities to the class action system. This is a system under which a consumer organisation authorised by the Prime Minister may file a lawsuit, or take other legal action, against an entity on behalf of a group of consumers. As of the end of November 2023, there are 25 consumer organisations. Under Japanese law, a qualified consumer organisation can protect the interests of many unspecified consumers using two methods. The first is by seeking an injunction against an unjust act committed by an entity. The second is through a system under which a specified, qualified consumer organisation that has been newly authorised by the Prime Minister can seek collective recovery of damage on behalf of a consumer against entities that engaged in unjust practices. However, the actual use of the second method is rare (only seven cases as at August 2023).

Other stakeholders

Business partners and other stakeholders of the company can claim damages by bilateral civil lawsuits. However, business partners often settle the matter through ongoing businesses (eg, certain business terms favourable for them in their ongoing transactions) rather than filing a lawsuit.

Issues in dealing with lawsuits in Japan

In Japan, it is generally expensive for plaintiffs to bring lawsuits given the court fees, which are based on the amount claimed. For example, to file a lawsuit claiming an amount of ¥1 billion, plaintiffs will need to pay a fee of ¥3 million or more to the court. More importantly, there is no discovery system in Japan, making it challenging for plaintiffs to obtain relevant information and evidence to establish their case. Moreover, since there are no class actions and punitive damages cannot be sought, there are relatively few cases in which a substantial amount of damages are claimed and awarded for fraudulent acts in lawsuits. Against this background, it is not common for the plaintiff lawyer to proactively file civil suits in Japan. However, as mentioned under the header above, companies in Japan may establish investigation committees, which often investigate the detailed facts somewhat independently of the company, and publish an investigation report detailing its results. Generally, these investigation reports are considered highly reliable, and it is practically difficult for a company that handles a crisis based on such reports to deny or dispute the facts in them in the event of litigation. Therefore, it may be challenging to defend a company in a lawsuit if there is an investigation report containing specific facts that constitute causes of action against the company. In recent years, lawyers have been actively soliciting victims in securities lawsuits, claiming that the disclosure of such fraud was inadequate. However, these types of lawsuits do not provide compensation for damage caused by fraudulent acts described in an investigation report.

Litigation response strategy

Large-scale consumer lawsuits are rare in Japan. Instead of taking legal action immediately, even for individual customers, it is more common to attempt to resolve disputes through non-contentious negotiations. To ensure successful negotiations and avoid litigation with

stakeholders in Japan, it is also common for companies to address customer concerns individually to assure them of product performance or safety. In relation to product defects, companies may voluntarily recall products and compensate consumers to gain or regain their trust and satisfaction.

Although there are many precedents for derivative lawsuits against directors and officers responsible for fraud, the extent to which companies will defend the directors and officers in this type of litigation will depend on how the directors or officers are allegedly involved in the fraud and whether the liability of the directors and officers is covered by D/O (directors and officers) insurance policies or by indemnification agreements between companies and directors and officers.

In Japan, it appears that there have been no cases of securities lawsuits arising from corporate crises other than accounting fraud that led to a court decision. According to the FIEA, companies are exempt from liability if they can prove that shareholders were aware of misstatements in the disclosure documents at the time of the acquisition of shares. Therefore, in the event of a scandal at a listed company, prompt disclosure of the relevant facts can minimise potential risk. However, as mentioned under the header 'Shareholders', it is challenging to strike a balance between the time required to verify facts and that required for disclosure.

5 ALONGSIDE MANAGING THE CRISIS IS THE IMPERATIVE TO MAINTAIN 'BUSINESS AS USUAL'. HOW CAN LAWYERS HELP TO ESTABLISH WHAT WENT WRONG AND MINIMISE THE IMPACT OF THOSE ISSUES ON THE UNDERLYING BUSINESS?

Early stage of crisis management

To minimise the impact of a crisis, such as quality improprieties that affect business partners and other stakeholders, it is crucial to prevent or limit potential harm by making announcements to stop using the relevant products and suspending shipments as the first step. Companies should provide customers with explanations that are sincere, accurate and easy to understand, and make public disclosures.

Sincereness is required not only in the content of explanations but also in how to convey it to the public. In a recent case, it was alleged that the company prepared a blacklist of media reporters who would likely pose tough questions and tried to minimise their opportunities to ask questions at the press conference, and the alleged protocol was criticised as insincere behaviour. At the same time, it is advantageous not to provide anything beyond the minimum explanations necessary in view of the risks of potential litigation and other factors when providing explanations to customers and making public disclosures. Involving lawyers with experience in crisis management and legal knowledge can provide an appropriate response that balances legal risk with honest explanations. In addition, companies should detect the spread of fraudulent activities promptly and accurately, and consider countermeasures. For this purpose, it is useful to involve lawyers with appropriate expertise and knowledge in collecting evidence and conducting fact-finding.

Investigation committee

In Japanese practice, lawyers sometimes conduct investigations as members or assistants of highly independent third-party committees, instead of as typical advisers, to ensure that

the investigations are highly reliable. The investigation committee operates independently from the company and may not share the progress of its investigation with the company until the investigation is completed and the investigation report is published. In some cases, it may share the progress of its investigation with the company in a manner that ensures a certain degree of independence, with the company responding to the crisis based on it. In the latter cases, the company may make external responses (eg, public announcements) based on the reliable fact-finding shared by the investigation committee. In the former cases, however, it may be necessary to retain separate counsel responsible for crisis management to gather evidence and conduct fact-finding to handle external responses.

Attorney-client privilege

In addition, it is common for the legal department of a Japanese company not to have a qualified lawyer, so it may be necessary to retain an outside lawyer to establish a confidential attorney–client relationship in cases involving foreign countries. In recent years, the Japanese Antimonopoly Act has introduced the specified communications protection system (ie, the Japanese equivalent of attorney–client privilege to protect communications between lawyers and clients in certain circumstances), under which it may be possible to exclude certain documents from the scope of administrative investigations (see article 23-2, paragraph 1 of the Rules on Examination by the Fair Trade Commission). However, since this protection is limited to cases where an in-house lawyer is working independently, not under the supervision of the company, it is more advantageous to retain outside counsel.

THE INSIDE TRACK

What traits, skills and experience do you think are critical for a lawyer advising on crisis management?

Crisis management practitioners should provide their clients with effective legal advice that alleviates their concerns, enables them to grasp the crucial elements of their crisis, and allows them to make informed decisions on complex issues in the midst of an emergency. In order to provide such advice promptly and within a tight time frame, a lawyer in this field should have broad experience in various practice areas, not just in disputes and investigations, but also in regulatory and corporate laws. The skills to appropriately identify and prioritise critical issues and to build strong relationships of trust with clients are essential for this practice.

In your opinion, what expertise, attitudes, behaviours and practices characterise an effective legal team charged with crisis management?

A law firm's crisis management team should collaborate as 'one team', working as a cohesive unit, sharing a common purpose and adopting a uniform approach to addressing the various issues that may arise in a major crisis. The crisis management team should ideally comprise lawyers with diverse backgrounds and experience, including the main subject matter of the crisis, as crisis management matters often require leveraging knowledge from various areas of the law. The legal team needs strong leadership to effectively assess the scope of, and prioritise, the issues, and utilise team members who can act independently and promptly to address them.

What do you personally find most rewarding and most challenging about advising in this area?

Companies in need of advice on crisis management are often in a state of great panic and find it difficult to make appropriate decisions. Furthermore, the corporate governance of such companies has serious problems in many cases of major corporate crisis. As a result, it is sometimes difficult for outside counsel to maintain a good relationship with the client or help the client make the appropriate decision. On the other hand, it can be rewarding to provide effective crisis management advice to help companies facing a serious threat to their survival, as a successful outcome is highly regarded by such companies, builds trust and enhances reputation as a lawyer.

NAGASHIMA OHNO
& TSUNEMATSU

Yoshihiko Matake

yoshihiko_matake@noandt.com

Yuta Sugie

yuta_sugie@noandt.com

Hayato Maruta

hayato_maruta@noandt.com

Togo Kitajima

togo_kitajima@noandt.com

Nagashima Ohno & Tsunematsu

[Read more from this firm on Lexology](#)