

Roles Expected of Independent Directors in Listed Companies with Controlling/Quasi-controlling Shareholder

Tokyo Stock Exchange, Inc. Listing Department

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In listed companies with a controlling or quasi-controlling shareholder, independent directors have the important role and duty of protecting the interests of minority shareholders.

- This document presents an explanation of the roles of independent directors that are unique to listed companies with a controlling or quasi-controlling shareholder, including examples of specific situations.
- This document covers not only listed companies with a controlling shareholder that holds a majority of voting rights, but also listed companies with a shareholder that does not hold a majority of voting rights but has effective control over the company through, for example, holding a large percentage of voting rights (thereby effectively having the power to elect or dismiss directors)*.
- **Independent directors are requested to refer to this document and, in the case of a listed company with a controlling or quasi-controlling shareholder, perform their duties with an awareness of the added role of protecting the interests of minority shareholders (unlike in ordinary listed companies).**

*In this document, such shareholders are referred to as "quasi-controlling shareholders." Although it is difficult to define the threshold of the percentage of voting rights held that gives rise to effective control, it has been pointed out that even 20% or 30% of voting rights may constitute effective control, if you take into account the ratio of exercise of voting rights at shareholders meetings in recent times and special circumstances such as the conclusion of agreements. Such cases are also covered by this document. For more information on "quasi-controlling shareholders," please refer to page 9.

The term "controlling shareholder" is used throughout this document, but in listed companies where there is a quasi-controlling shareholder, this should be read as "quasi-controlling shareholder."

- ◆ With regard to TSE's financial instruments market, the importance of protecting minority shareholders in listed companies with a controlling or quasi-controlling shareholder has long been pointed out.
- ◆ From the standpoint of TSE as a market operator, in order for the capital market to fully fulfill its functions, it is essential to foster confidence in the fairness of Japan's capital markets and to create an environment in which investors, including minority shareholders, can participate with confidence by protecting the legitimate interests of the unspecified number of investors involved.
- ◆ From this perspective, TSE has compiled this document based on the discussions at the "Study Group to review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies."

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1. Basic Approach to Minority Shareholder Protection

1-1. Reasons for Protecting Minority Shareholders' Interests

- Listed companies have "general shareholders," which are shareholders who can change as a result of secondary market trading of shares and who cannot have significant influence over the management of the listed company.
 - Listed companies gain a variety of benefits from having general shareholders, including smooth financing opportunities.
- **In listed companies with a controlling shareholder (a parent company or non-corporate controlling shareholder), the general shareholders are "minority shareholders" who are those other than the controlling shareholder and do not have control over the management of the company.**
- **In normal cases, since minority shareholders have no stake in a company other than that of a shareholder, the interests of minority shareholders can be equated with the common interests of shareholders, which are consistent with the interests of the listed company.**
 - To put it the other way, a loss for minority shareholders means a loss for the listed company.
 - Where special circumstances exist, however, such as a certain minority shareholder having a unique stake in the company other than that of a shareholder, the interests of said shareholder cannot be equated with the common interests of shareholders, and may not be consistent with the interests of the listed company. This document does not cover cases where such special circumstances exist. In addition, this document uses the term "minority shareholders' interests" with a mind to cases where such interests can be equated with the common interests of shareholders.
- **Therefore, for listed companies to achieve their business goals and aim for sustainable enhancement of corporate value, it is extremely important to appropriately protect minority shareholders' interests in the course of company management.**
- In addition, given that the existence of such minority shareholders is essential for listed companies with controlling shareholders to participate in the capital market, **it is also extremely important to appropriately protect their interests in order to foster trust in the fairness of the capital markets and build an environment in which minority shareholders and investors can participate with confidence.**

1-2. Key Points for Protecting Minority Shareholders' Interests (1)

- In a listed company with a controlling shareholder, **the controlling shareholder and the minority shareholders have the same interests in one respect: that they both benefit from the company's sustainable growth and enhancement of corporate value over the medium to long term (and the resulting increase in common benefits for shareholders).**
 - In particular, controlling shareholders can be expected to perform a supervisory function by exercising their influence over the listed company and its management, and minority shareholders can also benefit from the increase in corporate value resulting from the exercise of such supervisory function.

- On the other hand, in some situations **there is a structural conflict of interest risk wherein the controlling shareholder exercises its influence for its own interests (other than those as a shareholder), thereby undermining the interests of minority shareholders and benefiting only the controlling shareholder.**
 - Under the Companies Act, controlling shareholders may exercise influence over listed companies and their management based on their voting rights, but are not allowed to gain economic benefits beyond their own shareholding.

Note: International guidelines that express this approach include the G20/OECD Principles of Corporate Governance 2023 (Chapter II, and Principle V.B. and Principle V.E. of Chapter V) and the ICGN Global Governance Principles (Principle 9.7). In addition, the ICGN Global Governance Principles (Principle 10.10) indicate that the views of minority shareholders should be considered regardless of a majority vote result.

- **Therefore, it is essential for there to be monitoring of this kind of risk of structural conflicts of interest between controlling shareholders and minority shareholders in order to protect the interests of minority shareholders in a listed company with a controlling shareholder.**
 - The existence of a controlling shareholder eliminates the so-called agency problem between management and shareholders (the problem that management may not act in a manner that maximizes the interests of shareholders) to a certain extent. On the other hand, the agency problem between controlling shareholders and minority shareholders (the problem that controlling shareholders may take actions that are detrimental to the interests of minority shareholders) can be a serious problem. Therefore, there is a serious agency problem from the minority shareholders' perspective, and this point needs to be recognized first.

- **Appropriate monitoring of structural conflict of interest risks helps to ensure that the interests of the controlling shareholder and minority shareholders are aligned throughout the management and business of the listed company, through preventing situations where the interests of the controlling shareholder and minority shareholders diverge.**
 - To the extent that the interests of the controlling shareholder and minority shareholders are aligned through appropriate monitoring of conflict of interest risks, minority shareholders can be expected to fully profit from the benefits that come from the controlling shareholder having influence over the management team, i.e., exercising its supervisory function.

1-2. Key Points for Protecting Minority Shareholders' Interests (3)

- Minority shareholders also exist **when a listed company has a shareholder (including non-corporate shareholders) that has effective control over the company despite** not falling under TSE's definition of a controlling shareholder (because it does not hold a majority of voting rights, for example). In such cases, the reasons for minority shareholder protection and the **need to monitor the risk of conflicts of interest are still valid.**

➤ It is difficult to determine outwardly whether an entity has "effective control," and it is difficult to define the threshold of the percentage of voting rights held that gives rise to this, but it has been pointed out that even 20% or 30% of voting rights could constitute effective control. In particular, there may be cases where an entity does not have a majority of voting rights, but is deemed to have the power in practice to elect or dismiss directors based on the actual ratio of voting rights exercised at shareholder meetings in recent times, or where an entity is able to exercise strong influence over a listed company based on an agreement with said company.

(Reference) Corporate governance agreements concluded by listed companies with other associated companies

Contents of Agreement	No. of co.	Ratio		No. of co.	Ratio	
1) Nomination of director candidates and senior management, etc.	90	15.5%		7) Maintenance of listing status	17	2.9%
(Obligations, prohibitions, and approvals)	(83)	(14.3%)		8) Appointment and use of independent directors	7	1.2%
2) Maintenance of shareholding ratio and anti-dilution	59	10.2%		9) Respect for independence and autonomy, etc.	33	5.7%
(Obligations, prohibitions, and approvals)	(53)	(9.1%)		Total number of companies	580	
3) Sale/further purchase of shares held by shareholders and other matters on handling of shares	42	7.2%				
(Obligations, prohibitions, and approvals)	(34)	(5.9%)				
4) Exercise of shareholder voting rights	5	0.9%				
(Obligations, prohibitions, and approvals)	(5)	(0.9%)				
5) Prior approval or consultation	58	10.0%				
(Obligations, prohibitions, and approvals)	(26)	(4.5%)				
6) Business coordination and avoidance of business competition	14	2.4%				
(Obligations, prohibitions, and approvals)	(8)	(1.4%)				
Total number of companies	580					

Notes: 1. Survey results as of June 2022
 2. The "total number of companies" at the bottom indicates the number of companies that responded to the survey (including companies that responded that no contracts exist), and the percentages in the table indicate the proportions out of these responding companies.
 3. "Obligations, prohibitions, and approvals" includes only agreements that stipulate obligations or prohibitions and items for which approvals must be obtained, and excludes agreements that only stipulate obligations to consult or to make efforts and items only requiring consultation.
 4. For further details, see TSE's "Study Group to Review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies (2nd Phase) 1st Meeting - TSE Explanatory Material" (January 6, 2023).

<https://www.jpx.co.jp/english/equities/improvements/study-group/b5b4pj0000032jkr-att/dreu250000000w7w.pdf>

2. Roles Expected of Independent Directors



2-1. Importance of Independent Directors in Protecting Minority Shareholders' Interests (1)

- **Directors of listed companies are entrusted by shareholders in accordance with the Companies Act to take on the role and duty of contributing to the sustainable growth of the company and the enhancement of corporate value over the medium to long term in order to maximize the common benefits to shareholders.**
 - Independent directors also have these roles and duties as members of the board of directors.
- **In listed companies with a controlling shareholder, as part of these duties and roles, directors have the role and duty to ensure that the interests of minority shareholders are adequately protected.**
 - Given that the interests of minority shareholders usually coincide with those of listed companies, appropriate protection of the interests of minority shareholders is linked to the sustainable growth of the company and the enhancement of corporate value over the medium to long term.
- **Directors other than independent directors are not necessarily independent from controlling shareholders and are more vulnerable to their influence, so the role and duty of appropriately protecting the interests of minority shareholders falls to independent directors in particular.** (Japan's Corporate Governance Code, Principle 4.7)
 - However, this role is just one aspect of the essential role of contributing to the company's sustainable growth and medium- to long-term enhancement of corporate value (maximization of common benefits to shareholders), on the premise that the interests of minority shareholders can be equated with those of the common interests of shareholders. It should be noted, therefore, that if there are "specific (minority) shareholder interests" that cannot be equated with the common interests of shareholders, independent directors are not expected to protect such interests, but rather to return to the essential role described above.

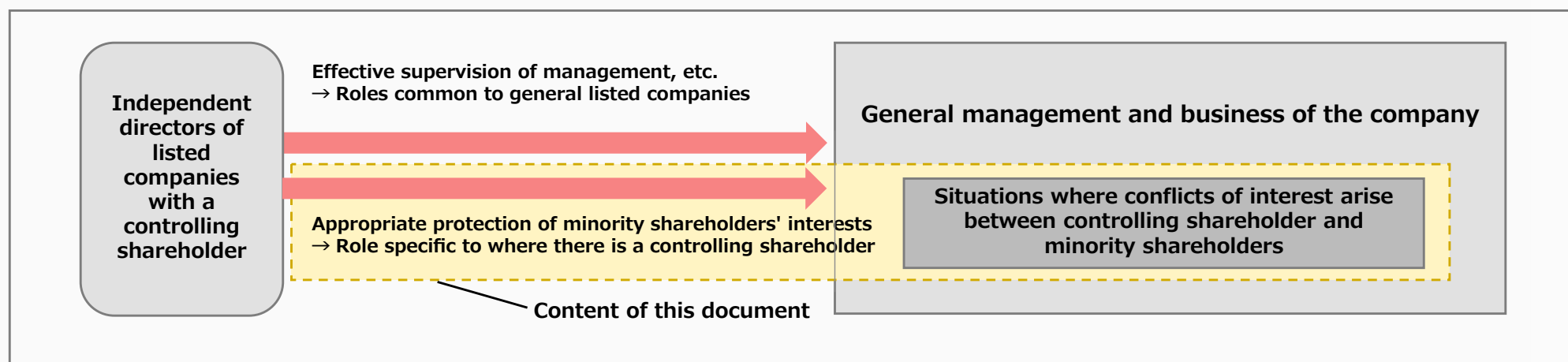
Japan's Corporate Governance Code, Principle 4.7

Companies should make effective use of independent directors, taking into consideration the expectations listed below with respect to their roles and responsibilities:

- i) , ii) (Omitted.)
- iii) Monitoring of conflicts of interest between the company and the management or controlling shareholders; and
- iv) Appropriately representing the views of minority shareholders and other stakeholders in the boardroom from a standpoint independent of the management and controlling shareholders.

2-1. Importance of Independent Directors in Protecting Minority Shareholders' Interests (2)

- This means that where there is a controlling shareholder, on top of the roles generally expected of an independent director at a listed company in working towards sustainable growth and enhancement of corporate value over the medium to long term (directing company strategy, supporting appropriate risk-taking by management, effectively supervising management, etc.), there is the additional important role of appropriately protecting the interests of minority shareholders (i.e. the expected role is expanded), mainly in situations where conflicts of interest arise between controlling shareholders and minority shareholders.



(In the case of a Company with a Board of Company Auditors)

- In a Company with a Board of Company Auditors, company auditors may be entrusted by shareholders in accordance with the Companies Act, in the same way as directors, with some of the role and duty to appropriately protect the interests of minority shareholders. Therefore, independent company auditors are also expected to assume some of the roles and duties expected of independent directors as described in this document, within the scope of their duties and authority as company auditors under the Companies Act.
- Independent directors and independent company auditors are expected to cooperate with each other to fulfill their roles as necessary.

2-2-1. Role on the Board of Directors

- **In their activities as directors on the board, independent directors are expected to fulfill their role and duty in protecting the interests of minority shareholders with respect to the overall management and business of the listed company. The core of this role and duty is to monitor the risk of conflicts of interest between the controlling shareholder and minority shareholders.**
 - Since the role and duty of appropriately protecting the interests of minority shareholders is one aspect of the role expected of the director to work towards the company's sustainable growth and enhancement of corporate value over the medium to long term,
 - It is not always necessary for an independent director to take a negative stance on deals with or instructions from the controlling shareholder.
 - In situations where the risk of conflict of interest between the controlling shareholder and minority shareholders is not an issue, it is not necessary for an independent director to give priority to the opinions of (specific) minority shareholders over those of the controlling shareholder.
 - Where it is beneficial to minority shareholders to cooperate with or seek assistance from the controlling shareholder, independent directors are expected to actively support decisions to do so.
 - A special committee may be established to monitor the risk of conflicts of interest, but even in such cases, the director should still fulfill their role and duty to protect the interests of minority shareholders as a director on the board. (See pages 17-18 for the role of independent directors on special committees.)
- **Such a role should be played not only in specific situations where the board of directors deliberates and makes decisions on a transaction or action that raises conflict of interest risk issues, but also in routine monitoring situations,** including transactions and actions that are not subject to direct deliberation and decision-making by the board of directors.
- In order to fulfill the role of protecting the interests of minority shareholders through such deliberation, decision-making and monitoring, **it is a prerequisite that a system is in place to ensure the appropriate involvement of independent directors, and it is also important that independent directors are involved in the development of such a system.**

- Since transactions and other relationships between listed companies and controlling shareholders are diverse and it is not realistic for independent directors to directly monitor all transactions and actions between the two, **independent directors are expected to exercise appropriate monitoring depending on the significance of the transaction or action and the associated risk of conflict of interest.**
 - Given that independent directors do not work full-time, excessively broadening the scope of direct monitoring by them would be an undue burden, which in turn could hinder the fulfillment of their essential role and duty to contribute to the sustainable growth of the company and the enhancement of corporate value over the medium to long term.
- To this end, **it would be effective to establish a monitoring system that is commensurate with the importance of the transaction/action**, for example:
 - 1) **Direct involvement of independent directors in transactions and actions that involve significant conflict of interest risks;**
 - 2) **For other transactions and actions, monitoring that relies on certain monitoring mechanisms.**In such cases, **it is important that a submission and reporting system is in place to ensure that independent directors can understand when a significant conflict of interest risk exists and can become involved in this case.**
 - For example, it is important to develop appropriate criteria for submission to the board of directors and for reporting.
(See pages 20-22 for the materiality consideration factors for each type of transaction/action.)
- When the board of directors establishes such a system, **it is expected that the independent directors, as parties concerned, will verify whether an adequate system is in place and, if there are shortfalls, will actively seek to establish the necessary systems and support.**

- As one of their duties as a director, independent directors are required to supervise the company's business executors, including executive directors and executive officers, and as part of such supervision, **they are expected to appropriately monitor the risk of conflicts of interest between the controlling shareholder and minority shareholders in the execution of business operations.**
 - Bearing in mind that executive directors and executive officers, who are not necessarily independent from the controlling shareholder, and employees who receive instructions and orders from them are particularly susceptible to the influence of the controlling shareholder, independent directors must check whether business executors are prioritizing the interests of the controlling shareholder over those of minority shareholders.
- **In order to make sure that risks of conflict of interest in day-to-day transactions and actions are not overlooked, independent directors must keep an ongoing and close watch on this risk through periodic deliberations and reports at board meetings.**
 - As a method of monitoring that does not create an excessive burden, criteria regarding transactions and actions with the controlling shareholder could be established, with the application of these being checked and verified and the criteria reviewed regularly.
- **Ongoing dialogue with the controlling shareholder (especially its independent directors) regarding the group management policy and the situation surrounding the risk of conflicts of interest is also desirable.**
 - It is important for listed companies, the controlling shareholder, and minority shareholders to have the same perspective toward improving corporate value, and for this reason it is desirable to have a dialogue with the controlling shareholder, who is the company's largest stakeholder.
 - It is important to foster a common understanding with the controlling shareholder that it is required to respect the common interests of the company and its shareholders and not treat minority shareholders unfairly (see the Notes of General Principle 4 of the Corporate Governance Code).

- When the board of directors deliberates and makes decisions on a specific transaction or action that raises a conflict of interest risk, **this is a situation where a conflict of interest arises between the controlling shareholder and minority shareholders, and where the role of independent directors in protecting the interests of minority shareholders becomes particularly important.**
- **Independent directors are expected to review the transaction or action from the perspective of whether it will be in the interest of minority shareholders, to express their opinion, and point out any problems.**
 - In addition to the necessity of the transaction and the reasonableness of the terms, it is also important to consider the fairness of the procedures.
 - It could also be useful to carry out comprehensive deliberations and decision-making for routine, recurring, and ongoing transactions. In such cases, since individual transactions will not be discussed at board meetings once the initial deliberations and decisions are finished, it is important to periodically and comprehensively review the appropriateness of approval.

Notes: 1. For specific factors to be considered for each type of transaction/action, see pages 20-22.

2. See also Case 8 in METI's 「社外取締役向けケーススタディ集—想定される場面と対応—」 (Case studies for outside directors - anticipated situations and responses) for examples of specific actions.

<https://www.meti.go.jp/press/2023/06/20230630011/20230630011-2.pdf> (Japanese Only)

2-3-1. Reasons for Establishing a Special Committee

- Listed companies with a controlling shareholder may establish a special committee to deliberate and review transactions and actions that pose a risk of conflict of interest. (See Supplementary Principle 4.8.3 of the Corporate Governance Code)
 - Such special committees are not required under the Companies Act, but are established on a voluntary basis by each company after examining the need for such a committee.
- Since special committees are established to **enable deliberation and examination mainly on issues of conflict of interest in an environment consisting only of members who are independent from the controlling shareholder**, they may be used for the following purposes.
 - 1) **When the ratio of independent directors on the board is not high, to enhance the effectiveness of monitoring of conflicts of interest by having the independent directors complement monitoring by the board of directors by functioning as a single group.**
 - 2) **Regardless of the ratio of independent directors, to ensure that where there is a need to be particularly careful on conflicts of interest, no unfairness based on conflicts of interest arises in any individual transaction or action by taking a process of substantively involving independent directors in the negotiation process of transaction terms and conditions and other details.**
 - For example, in situations where a company becomes a wholly owned subsidiary, which will mean minority shareholders being paid to exit their positions, it is recommended and is a well-established practice to establish a special committee from this perspective (see METI's "Fair M&A Guidelines.").
- Since a special committee does not have statutory authority or responsibilities, **it is important to ensure that the results of the special committee's deliberations are reflected in the deliberations of the board of directors and the execution of business by the company.**

2-3-2. Role on the Special Committee

- When a special committee is established in a listed company with a controlling shareholder, **the special committee should, in principle, be composed mainly of independent directors.**
 - It is conceivable that a person other than an independent director may be a member, but even in such a case, the independent directors are expected to play the central role, such as serving as the chairperson.
- In the deliberations of the special committee, **the independent directors are expected to examine the transaction/action from the viewpoint of whether it is in the interests of minority shareholders, and to clearly state the special committee's view on this point to the board of directors.**
 - In addition to the necessity of the transaction and the reasonableness of the terms, it is also important to consider the fairness of the procedures.
- Beyond this, **depending on its position** (e.g., if it is established for the purpose of **2**) on the previous page), **the special committee is expected to act in accordance with its authority from the perspective of maximizing the benefits to minority shareholders.**
 - In accordance with the design of the special committee, it is important to act to secure more favorable conditions for minority shareholders by, for example, negotiating directly on behalf of the business executor when given such authorization, or by establishing a negotiation policy with the business executor, confirming the status of negotiations, and giving instructions or making requests regarding the content of negotiations.

Japan's Corporate Governance Code, Supplementary Principle 4.8.3

Companies that have a controlling shareholder should either appoint at least one-third of their directors (the majority of directors if listed on the Prime Market) as independent directors who are independent of the controlling shareholder or establish a special committee composed of independent persons including independent director(s) to deliberate and review material transactions or actions that conflict with the interests of the controlling shareholder and minority shareholders.

2-4-1. Focuses of Monitoring on Each Type of Transaction/Action with Risk of Conflicts of Interest

- Conflicts of interest can arise in various aspects of a company's activities, but **the basic focus of monitoring is to examine each transaction or action from the perspective of whether it is in the interests of minority shareholders (i.e., whether these interests are being undermined and whether the benefits that should be gained are being gained).**
- Since it is not realistic for an independent director to directly supervise all transactions and actions, **they are required to exercise appropriate monitoring depending on the materiality of the transaction or action and the significance of the associated conflict-of-interest risk.**
- Typical types of transactions/actions that pose a risk of conflicts of interest include (1) direct transactions, (2) business transfers/adjustments, and (3) conversion into a wholly owned subsidiary by a controlling shareholder.
 - Risks of conflicts of interest between the controlling shareholder and minority shareholders may arise not only when the controlling shareholder is the counterparty to a transaction or action, but also when a group company of the controlling shareholder is the counterparty, because the profits of the group company ultimately belong to the controlling shareholder. Therefore, it is important to include such cases in the scope of monitoring.
 - Depending on the relationship between the listed company and the controlling shareholder, conflicts of interest risks may arise in various situations not limited to the above three, including when instructions are given about the business and management, so it is important to appropriately monitor these as well, depending on their materiality. For example, the following cases could be candidates for monitoring:
 - Where an intellectual property development project or other joint project is begun between a listed company and the controlling shareholder (or one of its group companies), a conflict of interest may arise whereby the company is forced to participate in the joint project even though it has little need, or the agreed conditions of the joint project or ownership status of the developed property are disadvantageous to the listed company.
 - In a personnel reassignment between a company and the controlling shareholder (or one of its group companies), a conflict of interest may arise whereby the controlling shareholder's interests are prioritized in the personnel reassignment.

Note: See the following pages for factors to be considered in determining whether a transaction is in the interests of minority shareholders and for submitting and reporting to the board of directors.

2-4-2. Focuses of Monitoring on Direct Transactions

Origins of Conflicts of Interests

- **In the case of a direct transaction between a listed company and the controlling shareholder (or one of its group companies),** a conflict of interest may arise whereby the agreed transaction price and other terms and conditions are disadvantageous to the listed company.
- Such direct transactions include both regular transactions (recurring and ongoing transactions) and non-regular transactions (one-time transactions).

Focuses of Monitoring

Examples of factors to be considered in determining whether transactions are in the interest of minority shareholders

- For transactions that could also be executed with third parties:
 - Comparison with terms and conditions in transactions with third parties;
 - Circumstances outside of the transaction that would potentially be considered in the case of a transaction with a third party (e.g., the possibility of a long-term contract);
 - What benefits the company would gain from the transaction, out of the benefits and synergies that the controlling shareholder or the entire group would gain; and
 - Process of the transaction (e.g., course of negotiations).
- For transactions that are specific to the group:
 - Necessity of the transaction;
 - What benefits the company would gain directly from the transaction;
 - What benefits the company would gain from the transaction, out of the benefits and synergies that the controlling shareholder or the entire group would gain;
 - Comparison with the terms and conditions in (fair) transactions between the controlling shareholder and other companies in the group; and
 - Process of the transaction (e.g., course of negotiations).

Examples of factors to be considered in determining materiality

- Quantitative factors such as transaction value and differences in profit margins from transactions with third parties
- The nature of the transaction, such as whether it is a regular or non-regular transaction
- Strength of relationship with the controlling shareholder, such as volume and share of transactions with the controlling shareholder and concurrent management positions

2-4-3. Focuses of Monitoring on Business Transfers and Business Adjustments

Origins of Conflicts of Interests

- As part of the controlling shareholder's business portfolio management of the group:
 - **Where a listed company transfers business to the controlling shareholder (or one of its group companies), a conflict of interest may arise whereby the agreed transfer price and other terms and conditions of the business transfer are disadvantageous to the company.**
 - **Where, in accordance with an instruction by a controlling shareholder, a company suspends entry into a new business field, withdraws from an existing business field, or segregates its business (e.g., by distributing customers) without involving any transactions, a conflict of interest may arise whereby the company loses business and revenue opportunities.**

Focuses of Monitoring

Examples of factors to be considered in determining whether transactions are in the interest of minority shareholders

- For business transfers:
 - Terms and conditions of the business transfer, including the transfer price;
 - Importance of the relevant business to the company at the time of the transfer (e.g., profitability, growth potential);
 - What benefits the company would gain from the transfer, out of the benefits and synergies that the controlling shareholder or the entire group would gain; and
 - Process of the business transfer (e.g., course of negotiations).
- For business adjustments that do not involve transactions:
 - Impact of the business adjustment on the company;
 - Importance of the relevant business to the company at the time of the adjustment (e.g., profitability, growth potential);
 - What benefits the company would gain from the adjustment, out of the benefits and synergies that the controlling shareholder or the entire group would gain; and
 - Process of the adjustment (e.g., course of negotiations)

Examples of factors to be considered in determining materiality

- Quantitative factors such as the size of the relevant business and the transfer price
- Strength of relationship with the controlling shareholder, such as the volume and share of transactions with the controlling shareholder and concurrent management positions

2-4-4. Focuses of Monitoring in Cases of Conversion to Wholly-Owned Subsidiary by Controlling Shareholder

Origins of Conflicts of Interests	Focuses of Monitoring
<ul style="list-style-type: none">• When a controlling shareholder squeezes out minority shareholders to make the listed company a wholly owned subsidiary, a conflict of interest may arise whereby the price paid for the squeeze-out is disadvantageous.	<ul style="list-style-type: none">➤ As this is a situation where minority shareholders are paid to exit their positions, it is a category that requires particularly careful consideration of risks of conflicts of interests, and therefore the involvement of independent directors is essential.➤ Independent directors are expected to act to protect the interests of minority shareholders in accordance with METI's "Fair M&A Guidelines."*

*Ministry of Economy, Trade and Industry "Fair M&A Guidelines — Enhancing Corporate Value and Securing Shareholders' Interests —" June 28, 2019

https://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/fairmaguidelines_english.pdf

2-5. Involvement in Obtaining Opinions Required by Listing Rules

- Under the Code of Corporate Conduct, when carrying out a material transaction or action involving the controlling shareholder, listed companies with a controlling shareholder are required to obtain an opinion from a person who has no interest in the controlling shareholder regarding whether the transaction would undermine the interests of minority shareholders.
- If such procedures are required, **independent directors are expected to be involved in the process by providing such opinions, either themselves or as part of a special committee, which means expressing publicly what they have deliberated and examined from the perspective of protecting the interests of minority shareholders.**
 - It is also common in practice for companies to obtain these opinions from independent directors or special committees that include independent directors as members.
- **Depending on the nature of the transaction, companies could also obtain such an opinion from a third party such as an outside specialist or expert, but even in such cases, independent directors are expected to express, in deliberations and decision-making within the company, a judgment that the transaction does not undermine the interests of minority shareholders, based on the third-party opinion.**

Outline of Securities Listing Regulations, Rule 441-2.

(Matters to be Observed Pertaining to Significant Transactions, etc. with Controlling Shareholder)

A listed company that has a controlling shareholder shall, in the cases referred to in the following items*, obtain opinion from an entity that has no interest in such controlling shareholder, that any decision on the matters prescribed in such items will not undermine interests of minority shareholders of such listed company.

*Specified actions among the events for timely disclosure (third-party allotment of shares, organizational restructuring, transfer/accession of business/fixed assets, becoming a wholly owned subsidiary, etc.), which involve the controlling shareholder

2-6. Involvement in Nominating Independent Director Candidates

- **In exercising the role and duty of protecting the interests of minority shareholders, it is important that independent directors ensure both independence from the controlling shareholder and independence from management.**
- **Therefore, independent directors are expected to be involved in the nomination of candidates for independent director with the viewpoint of selecting candidates with such independence.**
 - Under the Companies Act, controlling shareholders have the ultimate authority to appoint and dismiss independent directors, but the abovementioned role could be expected in the step before this, i.e., selection of candidates. It is possible for a controlling shareholder to nominate or recommend an independent director, but even in such a case, independent directors are expected to consider said candidate's independence from the controlling shareholder and from the management team from their own perspectives.
 - In most cases, the nomination of candidates for independent directors is not something that causes direct conflicts of interest, but from the perspective of ensuring an effective governance system to prevent the emergence of conflict of interest risks, it is a situation closely related to the protection of minority shareholders' interests.
 - Not only are independent directors expected to play this role on the board of directors, but if a nomination committee is established, they are expected to play this role as its members.
- **In this case, recognizing that if a company has a controlling shareholder, independence from said shareholder is required in addition to the independence from management generally required for listed companies, it is important to select a candidate who not only passes the independence tests set by TSE (e.g., not currently being or having been within the past 10 years an officer of the parent company or a sibling company), but is also independent in practice from both the controlling shareholder and management.**
 - Since the management team is not necessarily independent from the controlling shareholder and may be strongly influenced by the controlling shareholder, ensuring the independence of independent directors from the management team is also significant in preventing the controlling shareholder from influencing the company through the management team that is under its influence.

3. Actions Required of Companies and Boards of Directors

3. Actions Required of Companies and Boards of Directors (1)

- In order for independent directors to fully fulfill their role and duty to protect the interests of minority shareholders, **it is also important for action to be taken on the company side, especially the board of directors.**

Governance Structure Development

- **It is important to establish a governance structure with reference to the Corporate Governance Code's Supplementary Principle 4.8.3**, such as appointing a sufficient ratio of independent directors who are independent of the controlling shareholder on the board of directors and establishing a special committee composed of independent persons including such independent directors.
 - The development of such a system should be undertaken by the board of directors, and in doing so, it is important to respect the opinions of the independent directors regarding the structure and support needed.
 - Since the authority held by each independent director differs depending on the organizational structure under the Companies Act, it is important for each company to establish a system that enables independent directors to appropriately fulfill their role and duty in protecting the interests of minority shareholders based on this authority under the Companies Act.
 - Although the Corporate Governance Code's Supplementary Principle 4.8.3 does not apply to listed companies in the Growth Market, it is still necessary for these companies to develop a governance structure to protect the interests of minority shareholders.
- **It is important to establish a submission and reporting system** for the board of directors and special committee **that enables independent directors to understand completely the origins of material conflict-of-interest risks.**

Note: See also page 14 for information on developing a system to monitor the risk of conflicts of interest.

Operation of Board of Directors

- To make sure that conflicts of interest are adequately discussed at board meetings, **it is important that practical support is provided, such as for the secretariat to notify independent directors in advance briefings that discussion will be needed from a conflict-of-interest perspective.**

Information Disclosure

- Since the monitoring system for conflicts of interest may take various forms depending on the circumstances of each company, **it is important for companies to disclose information about the development and operation of its monitoring system in its corporate governance report or other documents.**
 - Such disclosure will lead to the further development of an effective conflict of interest monitoring system through dialogue with investors, and will also act to provide information to minority shareholders and investors to enable them to invest in the company with confidence.
- In particular, when a special committee is established, **it is important to disclose the specific details of said committee because** it is not a statutory body and **its composition and authority vary depending on the circumstances of each company.**
 - If the company does not disclose specific details (e.g., only disclosing that a special committee is established), it may not be regarded by investors as an effective conflict-of-interest monitoring system, and investors may express such concerns at the annual shareholders meeting as a vote against the reappointment of the representative director. In particular, if the special committee is established on a non-permanent basis, it is important to indicate to investors that an effective monitoring system is in place by disclosing in advance the composition of the committee members and items to be discussed (i.e. the conditions for establishment).