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Results of the Compliance Committee Investigation of Remuneration for Part-Time Service, etc., by Executives after Resignation

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On March 14 this year, it was pointed out by a third party committee with regard to remuneration for part-time service, etc., by executives after resignation, that it was intended in part to compensate for the "additional taxes paid when filing amended returns related to the problem of acceptance of cash and gifts" and "reductions in executive remuneration when the company had been in financial trouble in the past."

Subsequently, we confirmed the facts promptly within the company and tried to recover the full amount of such remuneration paid for part-time work, etc. We also decided to verify the results from an objective external perspective on the Compliance Committee.

[Announcement of March 30, 2020]

The company has today received the report on the investigation by the Compliance Committee of remuneration for part-time service, etc., by executives after resignation. The findings made as a result of the objective survey by that committee are shown in the attached investigation report.

We would again like to express our sincere apologies to customers and society for the great deal of trouble caused by this matter.

We are making efforts to restore trust based on the Business Improvement Plan formulated in March this year by transitioning into a company with a nominating committee, etc., that separates the execution and supervision of management clearly, strengthening the supervisory functions of the Board of Directors and promoting reforms aimed at the strengthening of compliance functions.

By accepting sincerely the recommendations made in this report aimed at the prevention of reoccurrence and utilizing them in future initiatives, we will enhance the effectiveness of various measures and foster an organizational culture that emphasizes compliance. We will make all efforts to regain the trust of society.

End

Attachment: Investigation Report (Overview)

Investigation Report (Overview)[1]

Part 1 Overview of the investigation

1 Aim of this investigation

The Kansai Electric Power Co., Inc., (hereinafter referred to as “KEPCO”) established a third party committee on October 9, 2019 to investigate the problem of executives of the company receiving cash and gifts from external related parties (hereinafter referred to as “Cash and Gifts Problem”) and received a report on the investigation from the committee dated March 14, 2020 (hereinafter referred to as "Third Party Committee Report"). In that report, it was pointed out that some executives who had resigned (hereinafter referred to as “Former Executives”) received remuneration when later performing part-time work that was intended in part to compensate for the “additional taxes paid when filing an amended return related to the Cash and Gifts Problem” and “reductions in executive remuneration when the company had been in financial trouble in the past.”

In response, KEPCO confirmed the facts internally and found that: [1] from July to October 2019, one Former Executive was paid remuneration for part-time work, etc. (total amount: 1.2 million yen) as compensation for additional taxes paid upon filing an amended tax return related to the Cash and Gifts Problem; and [2] from July 2016 to October 2019, a total of 18 Former Executives (including the one above) were paid remuneration for part-time work, etc. (total amount: 260 million yen) as compensation for reductions in executive remuneration when the company had been in financial trouble in the past.

KEPCO then judged that it was necessary for the facts of [1] and [2] above (hereinafter referred to as “Compensation Problems”) to be verified from an external objective perspective and decided to conduct an investigation on the Compliance Committee (hereinafter referred to as “Committee”).

2 Matters for investigation

The matters investigated by the Committee are as follows.

[1] Investigation of the facts relating to the following points made in the Third Party Committee Report (including the awareness of concerned parties) and consideration of the legal liability of concerned parties
  - (i) The purpose of compensation for reduced executive remuneration when the company had been in financial trouble in the past
  - (ii) The purpose of compensation for additional taxes paid upon filing an amended tax return related to the Cash and Gifts Problem

[2] Verification of the process leading to the decision to recover the payments

[3] Investigation of similar past cases

3 Method of this investigation

The Committee gathered, scrutinized and considered: [1] documents such as minutes of meetings of the KEPCO Board of Directors, internal regulations, circulated approval documents, policy documents and letters of appointment, and other materials such as memos; [2] the email

[1] Apart from their use in this overview, we also use the abbreviations in the main text of the investigation report.

data of 13 executives and employees of KEPCO stored on the KEPCO mail server, etc., and data stored on the business PCs lent to two staff members of the Secretariat (extracted by keyword search); and [3] data stored on CD-ROMs stored in General Affairs Office.

In addition, the Committee conducted a total of 28 hearings with a total of 25 executives, employees and former executives of KEPCO (although further hearings were requested for some subjects, they responded that they could not comply because lawsuits had been filed against them).

At meetings on May 18 and June 12, 2020 the Committee discussed its policy for dealing with the investigation and shared the state of progress, and at its meeting on August 17, the Committee discussed and approved this report.

Part 2 Investigations by the Committee

1 Legal liability of concerned parties

(1) Compensation for reduced executive remuneration

(i) Violation of the Regulations on Executive Remuneration

[1] Introduction

According to the factual background revealed by this investigation, KEPCO commissioned Former Executives to perform part-time work or as consultants or executive fellows (hereinafter referred to as “EF”) from June 2016 on. Of the Former Executives who were thus commissioned, those employed as a consultant or EF were paid an amount calculated by dividing the amount in excess of 40% of the reduction in each executive’s remuneration from April 2013 onwards by a certain number of payment months in the form of an addition to their consultant or EF remuneration. Similarly, the other Former Executives concerned were paid remuneration for part-time work calculated on the same basis (hereinafter, this commissioning of work is referred to as “Commissioning of This Case” and the amounts paid to each former executive who had resigned as “Commissioning Remuneration”).

Formally, the Commissioning Remuneration was paid based on a commission contract concluded with each Former Executive, but it is thought that in substance, the payments were made with the intention of compensating for reductions in remuneration those Former Executives had returned voluntarily while in office after they had resigned.

Supposing that Commissioning Remuneration falls under the category of “deferred payment of executive remuneration,” individual amounts to be paid would have to be determined based on a resolution of the Board of Directors (or a decision of the Representative Director based on a resolution by the Board of Directors to give the Representative Director such discretion) or consultation with the corporate auditors within the scope of the upper limit on remuneration for directors resolved upon at a General Meeting of Shareholders, and if payments were made without going through the predetermined process, they would violate the law. Consequently, the following considers whether or not the Commissioning Remuneration falls under the category of “deferred payment of executive remuneration.”

[2] Circumstances suggesting that the Commissioning Remuneration

should be evaluated as "deferred payment of executive remuneration"

(a) The background to, and aim of, starting to consider the Commissioning of This Case

KEPCO was forced to reduce executive remuneration significantly when it applied twice for electricity rate increases. The consideration of the Commissioning of This Case started around October 2015, under the instruction of the then Chairman (Mr. Mori), who asked "Could we cover the excess above 50% after people resign?" and took more concrete form under a policy of "compensating executives after they resign because they only have executive remuneration while in office." As can be understood from this kind of background, KEPCO's aim in starting to consider the Commissioning of This Case was to compensate for reduced remuneration in the past, and the Commissioning was nothing more than a measure to that end.

(b) The background to deciding the amounts of Commissioning Remuneration

Under the instruction of the above-mentioned Chairman (Mr. Mori), the Secretariat decided on a policy of paying the amount of the reduction in remuneration above 40%, and determined the amount of Commissioning Remuneration for each individual by dividing that amount by a figure such as 12 or 24 in accordance with a fixed number of months (commissioning period).

(c) The background to determining the executives subject to commissioning

Of the 22 executives subject to the remuneration reduction measures implemented from April 2013 on, only four were not commissioned to work after resigning because either the amount to be paid was small (cases where the portion of the remuneration reduction rate in excess of 40% was divided by 12 and the amount was less than 100,000 yen) or there was no need for compensation because of the high remuneration paid by the affiliated company they were transferred to.

(d) Explanation at the time of commissioning

The draft prepared by the Secretariat read aloud at the time commissioning was explained stated that "This commission does not compensate for the amount of executive remuneration returned during a term of office, but it may be misunderstood publicly in that way so please keep the details private to yourself." It can be understood from this that the Chairman (Mr. Mori / Mr. Yagi) and the Secretariat, who explained the commissions, were strongly aware that the payments would be criticized as compensation for lost remuneration if the facts of the Commissioning of This Case were made clear.

[3] Circumstances that make it difficult to evaluate the Commissioning Remuneration as "deferred payment of executive remuneration"

Of the 18 former executives who resigned and received Commissioning Remuneration, only Mr. Mori, who made the final decision on the circulated approval document related to the policy, was clearly aware that the amounts of remuneration included compensation for past reductions in remuneration. The other executives are not recognized to be clearly aware that the aim of the commissioning contracts was to compensate for the past reductions in remuneration.

In general, when a commissioning contract is concluded between a company and a former executive who has resigned under the title consultant, advisor or part-time worker, etc., even assuming that one party (the company) really intends to commission part-time work for the purpose of compensating for a past reduction in executive remuneration, if it expresses to the other party (the former executive who has resigned) that it will commission certain work and pay remuneration for it, and the commissioning contract is established without the other party (the former executive who has resigned) realizing the real intention of the first party (the company), said commissioning contract will surely be established validly as a commissioning contract for value.

Therefore, the Commissioning Remuneration paid to most of the 18 former executives who resigned and received commissions shall be evaluated as remuneration based on effectively established commissioning contracts.

[4] Consideration

While objective circumstances have been found by which it should be recognized that, in substance, the Commissioning Remuneration was the “deferred payment of executive remuneration,” on the other hand, many of the former executives commissioned were not aware that the Commissioning Remuneration was “deferred payment of executive remuneration” and it is found that commissioning contracts for value were established validly between KEPCO and those commissioned persons.

Opinions are divided over whether or not the Commissioning Remuneration in this kind of case is subject to the Regulations on Executive Remuneration as “deferred payment of executive remuneration.”

It is recognized that if we take the position that the Commissioning Remuneration falls under the category of “deferred payment of executive remuneration,” it would be necessary to comply with the Regulations on Executive Remuneration with regard to its payment, and Director and Chairman Mori, Director and President Yagi and Mr. Yashima, Director and Managing Executive Officer in charge of the Secretariat, who decided the circulated approval documents related to the policy and the commissioning of 2016, would have violated the law (violation of Article 361(1) and Article 387(2) of the Companies Act). On the other hand, President Iwane, who made the final decisions on the circulated approval documents, etc., pertaining to the commissioning in 2017 and 2018, was not aware of the details of the circulated approval document pertaining to the payment policy of June 2016 at that time and it is not certain whether or not he was accurately aware of those details when he made the final decisions on the circulated approval documents from the following year on. As a result, it is not recognized that he made the final decisions on the circulated approval documents concerning commissioning, etc., with clear awareness that the Commissioning Remuneration was the “deferred payment of executive remuneration” (however, the awareness of Mr. Toyomatsu at the time of EF commissioning in June 2019 is described below).

Other directors and former executives who had resigned and received commissions (excluding Mr. Mori) are also not recognized to have violated the law or their supervisory obligations.

(ii) Violation of the duty of care of a good manager

[1] Introduction

If we take the position that the Commissioning Remuneration is not subject to the Regulations on Executive Remuneration, although the directors who decided the circulated approval document related to the policy and the commissioning based thereon (Mr. Mori, Mr. Yagi and Mr. Yashima) would not be recognized to have violated the law (violation of Article 361(1) and Article 387(2) of the Companies Act), there would still be the problem of whether they violated the duty of care of a good manager as directors.

[2] Whether or not the Commissioning of This Case is related to the personal interests of the executives

Consultant or advisor contracts are generally concluded as commission contracts between individuals after they have resigned and the company, but the Commissioning of This Case was a mechanism designed to pay remuneration after resigning from office that was subject to reduction measures during the terms of office of executives, and in light of that substance, it is highly likely to be recognized as something related to the personal interests of the executives.

Actually, if it is supposed that the Commissioning of This Case was executed without the Cash and Gifts Problem being discovered, the people who stood to receive the greatest amount of compensation were Mr. Mori and Mr. Yagi, who served as Chairman and President respectively during the remuneration reduction period from April 2013 onwards. Mr. Yashima, Director and Managing Executive Officer in charge of the Secretariat, would also have received a considerable amount of commission remuneration (all three of these people decided the circulated approval document related to the policy). In addition to that, Mr. Mori, who made the final decision on the circulated approval document related to the payment policy as the person with final decision-making authority, was in a position to be a subject of the Commissioning of This Case soon after he made that final decision.

It is recognized that if we take such circumstances into comprehensive consideration, the Commissioning of This Case was something related to the personal interests of the executives (especially Mr. Mori) and it should be recognized that at least Mr. Mori, who made the final decision on the circulated approval document related to the payment policy, violated his fiduciary duty.

[3] Whether or not there are any careless errors or irrationalities in the process of recognizing the factual premises

Looking at the factual background in the process of consideration of the Commissioning of This Case, the following risks were not verified sufficiently in implementing the Commissioning of This Case, and appropriate attention was not paid in the process of recognizing the facts that constitute the premises for the business decisions.

(a) The risk that the Commissioning Remuneration would fall under the category of "deferred payment of executive remuneration"

If the Commissioning Remuneration falls under the category of "deferred payment of executive remuneration" and it was paid without observing the Regulations on Executive Remuneration (Article 361(1) and Article 387(2) of the Companies Act), those responsible would bear liability as a legal violation so they were required to consider carefully whether or not the Commissioning Remuneration falls under the category of "deferred payment of executive remuneration" and depending on the case, to gather and analyze information, including consulting with and obtaining a legal opinion from a legal expert. Nevertheless, they decided to implement the Commissioning of This Case without engaging in any such consideration of the legal issues.

(b) Risk of violating the purpose of the Regulations on Conflict of Interest

In that the Commissioning of This Case was something considered and implemented for the purpose of compensating for past reductions in executive remuneration, the possibility cannot be denied that it falls under the category of conflict of interest transactions as contracts that return the remuneration that executives returned to the company while in office after those executives resigned. Even assuming that the Commissioning of This Case did not fall under the category of conflict of interest transactions, we have no choice but to say that Mr. Mori's determination of the circulated approval document related to the payment policy and the Commissioning of This Case as the person with final decision-making authority was a problem in light of the purpose of the Regulations on Conflict of Interest.

As the risk of being deemed to be "deferred payment of executive remuneration" was high when looked at in substance, those responsible should have followed the highly objective and transparent process of submitting the matter to the Advisory Committee on Personnel and Remuneration, etc., and listening to the opinions of independent outside directors, but they did not follow said process.

(c) The risk that the Commissioning of This Case would fall under the category of false explanation to consumers, shareholders and employees

The Commissioning of This Case was intended to compensate executives subject to executive remuneration reduction measures in association with applications to increase electricity rates under the pretext of remuneration for commissioning after resignation unannounced externally prior to reducing those electricity rates, resuming dividend payments or restoring employee bonuses. Assuming it was discovered, they ought to have been able to imagine easily that there would be a high risk it would lead to damage to KEPCO's credit as a false explanation to consumers, shareholders and employees. If so, those responsible should have considered carefully whether they should take said risk and implement the Commissioning of This Case after the General Meeting of Shareholders of June 2016, or do so after waiting for the restart of operations at Takahama Nuclear Power Plant and the associated reduction of electricity rates and resumption of dividends, and after giving an external explanation. Nevertheless, those responsible decided to implement the Commissioning of This Case after the General Meeting of Shareholders of June 2016 without conducting appropriate verification of said risk.

[4] Whether or not there are any conspicuous irrationalities in the logical process and details of decision-making

As described above, the Commissioning of This Case betrayed the trust of consumers, shareholders and employees, but it can be seen that when those responsible started considering said commissioning, they planned initially to implement it as a set alongside the restart of operations at Takahama Nuclear Power Plant and the associated reduction of electricity rates, resumption of dividends and restoration of employee bonuses. In reality, however, they were unable to implement either the reduction of electricity rates, resumption of dividends or restoration of employee bonuses due to the injunction prohibiting the restart of operations at Takahama Nuclear Power Plant. Following this, while reviewing a reduction in the remuneration reduction rate for active executives on the one hand, those responsible determined the circulated approval document related to the payment policy for the Commissioning of This Case without reviewing the scope of compensation (portion exceeding 40%). While hesitating over reducing the rate of reduction even for currently active executives, it cannot be found to be rational to force through compensation for past reductions in remuneration for executives who have resigned for which no objection on grounds of its character as an incentive could possibly be recognized.

[5] Consideration

Even supposing that the Commissioning Remuneration does not fall under the category of “deferred payment of executive remuneration”: [1] the Commissioning of This Case is found to be related to the personal interests of the executives (especially Mr. Mori) and to be a violation of fiduciary duty; [2] the collection and analysis of information on the various risks assumable in the event that the Commissioning of This Case was implemented was insufficient, and carelessness and irrationality is recognized in the process of recognition of the factual premises; and [3] we have no choice but to say that the details of the circulated approval document related to the payment policy for the Commissioning of This Case are extremely irrational in light of the circumstances surrounding KEPCO as of April 2016 and conspicuous irrationalities are recognized in the logical process and details of decision-making. Because of the foregoing, we find that there were violations of the duty of care of a good manager by Director and Chairman Mori, Director and President Yagi and Mr. Yashima, Director and Managing Executive Officer in charge of the Secretariat, who determined the circulated approval document related to the payment policy for the Commissioning of This Case and other circulated approval documents related to the commissioning, and extensions of commissioning periods based thereon. On the other hand, we consider that Director and President Iwane, who made the final decisions on the circulated approval documents, etc., pertaining to the commissioning and extensions of commissioning periods from 2017 on in accordance with existing policy without being involved in the circulated approval document related to the payment policy for the Commissioning of This Case, should not be recognized to have violated the duty of care of a good manager (however, the awareness of Mr. Toyomatsu at the time of EF commissioning is described below).

(2) Compensation for additional tax payments

According to the factual background revealed by this investigation, in commissioning Mr. Toyomatsu, who resigned in June 2019, as an EF, KEPCO calculated the basic amount of EF remuneration, and added to that the amount calculated with the aim of compensating for past remuneration reductions and additional tax payments made when filing an amended declaration. In total, those responsible decided to pay him an amount of remuneration equivalent to a Vice-President (4.9 million yen per month) concluded an EF commissioning contract and paid him the remuneration (hereinafter, the amount paid with the aim of compensating for the additional tax payments is referred to as “Additional Remuneration of This Case”).

The Additional Remuneration of This Case was calculated with the aim of compensating Mr. Toyomatsu for the amount of additional tax he paid after the Kanazawa Regional Taxation Bureau investigated the cash and gifts that Mr. Toyomatsu received from Mr. Moriyama in the process of supervising the operations of Nuclear Power Business Headquarters and he filed an amended declaration. It is clear that the actions of executives who received large amounts of cash and gifts far beyond the scope of courtesy from Mr. Moriyama and consumed some of those cash and gifts fall under the category of serious violations of compliance. We have no choice but to say that the judgment to compensate executives who filed amended declarations due to acts in violation of compliance for the amount of additional tax they bore themselves after they had resigned was remarkably irrational.

Assuming for the sake of argument that the acts of receiving cash and gifts from Mr. Moriyama were carried out for the sake of the company, if the company wanted to compensate the executives in question for their additional tax payments, those responsible should have followed the highly objective and transparent process of presenting the matter to the Advisory Committee on Personnel and Remuneration, etc., and listening to the opinions of independent outside directors before making a decision on the Board of Directors. Despite this, those responsible decided the policy on the payment of the Additional Remuneration of This Case secretly in consultations between the President, Chairman and consultants, so no rationality can be recognized in the decision-making process either.

Therefore, Director and Chairman Yagi and Director and President Iwane, who decided to pay Mr. Toyomatsu the Additional Remuneration of This Case, are found to have violated the duty of care of a good manager.

It should also be noted that the amount of EF remuneration paid to Mr. Toyomatsu was determined by adding basic remuneration as an EF, the Commissioning Remuneration and the Additional Remuneration of This Case, and it is possible that Mr. Iwane was aware of the method for calculating the Commissioning Remuneration in the process of its consideration. As described above, it is thought that Mr. Iwane was unaware of the purpose of the Commissioning of This Case or the method for calculating Commissioning Remuneration when he assumed the position of President in June 2016. However, it is possible that he became aware of those matters after assuming the position of President, and supposing that he was clearly aware of said purpose and method for calculation, the possibility cannot be denied that he could be recognized to have had responsibility to verify the risks of the Commissioning Remuneration and stop the commissioning.

(3) Damages

As described above, a director’s violation of the law or the duty of care of a good manager would be recognized with regard to the compensation for reductions in executive remuneration, and a director’s violation of the duty of care of a good manager would be recognized with regard to the compensation for additional tax payments.

However, insofar as KEPCO has recovered the full amount it paid as Commissioning Remuneration and the Additional Remuneration of This Case (including the amount of withholding taxes levied on those commissioned) from the Former Executives commissioned, damages based on a director’s neglect of duty are not recognized.

Apart from that, KEPCO is thought to have suffered a certain amount of credit damage due to: [1] bearing the costs of the investigation due to requesting the Committee to conduct this investigation; and [2] the fact that the Compensation Problems were reported by the media following on from the Cash and Gifts Problem. However, decisions in past judgments are divided on whether or not such investigation costs and credit damage fall under the category of damage due to the neglect of duty by directors so it is considered difficult for the Committee to present a clear judgment at the present time.

(i) Investigation costs

The Committee’s implementation of this investigation is recognized to be appropriate because the Compensation Problems received significant criticism as acts that betrayed the trust of consumers, shareholders and employees, and it was inevitable that a thorough investigation and consideration of measures to prevent reoccurrence would be required.

On the other hand, the Committee was not established for the investigation of the Compensation Problems, but is a permanent committee that KEPCO established newly to strengthen its compliance systems in response to the Cash and Gifts Problem. Therefore, regardless of whether or not the Compensation Problems fall under the category of neglect of duty of directors, it cannot be denied that this investigation is work that should essentially be carried out by the Committee. These are also thought to be circumstances that would deny a legally sufficient cause.

(ii) Credit damage

The Compensation Problems can be regarded as a new scandal of a completely different nature from the Cash and Gifts Problem, and there is no doubt that they damaged KEPCO’s credit significantly. It is recognized to be damage caused by the directors’ neglect of their duties.

However, it is difficult to evaluate this damage in monetary terms. In particular, because the credit damage suffered by KEPCO was caused not only by the Compensation Problems but also by the Cash and Gifts Problem, it is extremely difficult to judge objectively the extent of the financial damage due to the credit damage based on the Compensation Problems. Although some past court cases certifying damages under Article 248 of the Code of Civil Procedure have been recognized, we have no choice but to say that determining the certification of damages in this matter would be extremely difficult at the present time.

2 The process leading to the decision to recover the payments

Based on the awareness that the compensation for both the executive remuneration cuts and for the additional tax payments lacked justification and that the process of determination thereof was inappropriate from the perspective of governance, KEPCO decided on the policy of responding by recovering the money by requesting the voluntarily return of full amounts paid in order to restore trust in the company. The process leading to the decision on said recovery was suitable and we found no legal violations or unjust points.

3 Existence or otherwise of similar incidents in the past

In order to investigate whether or not there have been any similar cases in the past in which a company has in substance compensated an executive for remuneration returned by said executive during their term of office by commissioning duties such as consultancy or part-time work after said executive's resignation, the Committee confirmed the results data for remuneration returned by executives over the past 20 years (remuneration returned because of deteriorating results or scandal) and examined data on the results for payments of remuneration for consultancy and other commissioning over the past 20 years.

However, no facts or evidentiary materials, etc., suggesting commissioning as a consultant, etc., or an increase in the amount of remuneration for the purpose of effectively compensating for the return of remuneration was recognized, and no other case similar to this case was found to exist.

Part 3 Recommendations aimed at the prevention of reoccurrence

1 Factors and problems that led to the Compensation Problems

(1) Lack of awareness of corporate governance

(i) Factors that led to the Compensation Problems

[1] Tacit understanding that providing favorable treatment to executives who have resigned is the exclusive prerogative of the Chairman

The first thing that should be pointed out is that there was tacit understanding that providing favorable treatment to executives who have resigned is the exclusive prerogative of the Chairman. Only a limited number of members including the Chairman and the President at that time were involved in the consideration of both the Commissioning Remuneration and the Additional Remuneration of This Case. Looking at the process of consideration of the Commissioning Remuneration in particular, it is recognized that the intent of the Chairman (Mr. Mori) was reflected strongly, and that the Secretariat drafted and decided the related policy in consideration of the Chairman's intention.

This tacit understanding of the "exclusive prerogative of the Chairman" is recognized to have been a factor that allowed the Chairman to engage in misconduct and prevented other executives' from risking to stop it.

[2] The Secretariat system and the management group awareness it fostered

Next, the Secretariat system, which planned the treatment of Former Executives under the orders of the Chairman, was also extremely insular and secretive. With regard to both the Cash and Gifts Problem and the Compensation Problems, awareness that "If you want to keep it secret, you can keep it secret" was the premise of everything. Also, said awareness of the management group was backed up by the insularity and secretive nature of the Secretariat, which was in charge of the work related to executives, including the treatment of Former Executives.

At the same time that the treatment of Former Executives was the exclusive prerogative of the Chairman at KEPCO, the Secretariat in charge of its administration was insular and secretive. Consequently, the system was structured so that Former Executives could be treated secretively, outside the company naturally, but also internally. As a result, the understanding that "there is no way this will be discovered" was fostered in the subjective view of the management group, including the Chairman, President and Managing Executive Officer in charge of the Secretariat (Director and Managing Executive Officer). Said awareness of the management group was a factor that caused the Compensation Problems to happen.

[3] Lack of check systems and awareness

The decision-making process related to the treatment of Former Executives at KEPCO was no longer a system that verified the Chairman's intentions from a critical perspective, and related departments also lacked awareness of trying to do so.

As a listed company, KEPCO is equipped with management departments for legal and compliance matters, and there should have been an appropriate management system in place in daily business operations. However, it is inferred that the treatment of Former Executives, regarded as the exclusive prerogative of the Chairman, did not undergo either legal or compliance checks and was not checked by Internal Audit Department or the auditors either. In the Secretariat, the only office involved, they were aware of various risks, but gave priority to the Chairman's intentions. If they did not verify those risks, they never raised their opinions with the Chairman. We have no choice but to say that there was a general lack of awareness of checking the Chairman's decision-making.

(ii) Lack of awareness of corporate governance

[1] Disregard of the Advisory Committee on Personnel and Remuneration, etc.

In response to the application of the CG Code (Supplementary Principle 4-10 (1)), KEPCO established an Advisory Committee on Personnel and Remuneration, etc., in November 2015. The corporate governance report states that "the appointment and dismissal of executives as well as the design of the management remuneration system and the determination of remuneration amounts" and "the commissioning and remuneration of consultants and advisors" were deliberated on by the Advisory Committee on Personnel and Remuneration, etc. In reality, however, the Commissioning Remuneration and the Additional Remuneration of This Case have never been reported to the Advisory Committee on Personnel and Remuneration, etc., and these instances of compensatory remuneration were implemented without the independent outside directors being concerned in the process at all.

Consideration of the Commissioning Remuneration started in response to Mr. Mori's intention of wanting to cover past reductions in remuneration after executives resigned, and it was supposed that would be implemented as a set in combination with a lowering of the rate of reduction of remuneration for currently active executives after the Ordinary General Meeting of Shareholders in June 2016. However, the policy of compensating for past reductions in remuneration after executives resigned has never been reported to the Advisory Committee on Personnel and Remuneration, etc. Nothing such as discussions or opposing opinions during the process of consideration were reported with regard to the lowering of the rate of reduction of remuneration for currently active executives either. Instead, this matter was presented to the Advisory Committee on Personnel and Remuneration, etc., replaced with the good-sounding reason of the introduction of performance-based remuneration in association with the liberalization of the electricity retail market.

As described above, KEPCO established an Advisory Committee on Personnel and Remuneration, etc., in accordance with the CG Code, but did not report or submit inconvenient information. Instead, it reported and submitted only good-sounding "clean information," and disregarded the committee.

[2] Adverse effects of the influence of the Chairman and consultants

There existed at KEPCO a tacit understanding that the Chairman had an exclusive prerogative with regard to the treatment of Former Executives, but there are concerns that the Chairman's holding of actual authority over personnel matters in this way would inhibit the leadership of the President (p.51 - 52 of the CGS Guidelines).

In addition, at KEPCO, not only the Chairman and President but also a consultant participated in discussions on important aspects such as the handling of Kanazawa Regional Taxation Bureau and the determination of the policy on compensation for additional tax payments. It is highly likely that the consultant's opinion had a significant impact on the direction of management. The exertion of influence in this way by the former top management, who had withdrawn from the management field, as a consultant could also have been a factor that inhibited the leadership of the President (see p.48 of the CGS Guidelines).

(2) Lack of awareness of compliance

Despite legal violations being suspected with regard to the Commissioning Remuneration, those responsible determined the payment policy without verifying this point, and it is unavoidable that the company itself will be deemed to have tolerated acts in serious violation of compliance leading to the Additional Remuneration of This Case. These policies were led by the then Chairman and President, and this was nothing other than a serious violation of compliance by top management.

Violations of compliance by top management are an extremely important problem that neutralize internal controls. Therefore, although the people who should play a role in correcting the dishonest acts of top management are independent outside directors, if they are not provided information, they cannot perform their supervisory function.

Even supposing that internal control systems are devised in a variety of forms from the perspectives of governance and compliance, the correction of acts in violation of compliance by top management is difficult and we have no choice but to say that they are extremely serious offences.

(3) Lack of self-awareness as persons supervising public work

Despite expressing externally that “both management and employees are prepared to put themselves on the line” before increasing electricity rates, KEPCO started only the payment of the Commissioning Remuneration to compensate Former Executives for past reductions in remuneration ahead of all else, while the reduction of electricity rates, resumption of dividend payments and the improvement of employee treatment remained unrealized. We have no choice but to evaluate this as a lack of self-awareness as persons supervising public work.

KEPCO bears social responsibility as a company engaged in public work. Even though the liberalization of the electric power industry has advanced due to the revision of the Electricity Business Act, the companies involved are not positioned as mere for-profit enterprises, but rather as highly public enterprises that are responsible for the electric power industry, extremely important public infrastructure. As such, high level social roles and responsibilities are demanded of them by society. All executives and employees are required to be aware of this and to establish with sincerity a sense of value as a company (a corporate ethos and philosophy) and standards of conduct that go beyond the level of compliance demanded of society widely as a whole.

2 Improvement measures aimed at the prevention of reoccurrence

(1) Preparation and operation of a corporate governance system

(i) Reform of the awareness of the management group

Raising awareness of corporate governance in the management group responsible for management of the company is an urgent need. At KEPCO, it is necessary for management to reflect on how there was a lack of understanding and awareness of governance, and to conduct training thoroughly for everybody to understand the significance of governance (for example, about 5% of the estimated total working hours of senior management for a year could be spent on such training).

And, KEPCO needs to foster awareness of securing transparency in management. One of the essential problems in this case was that decisions were made in a secretive and inward-looking manner, and the external explanations of them were deceptive. KEPCO is required to eliminate this kind of corporate culture and establish the awareness of acting fairly by disclosing information externally.

(ii) Securing the transparency of executive personnel matters and remuneration, etc.

In June 2020, KEPCO will transition into a company with a Nominating Committee, etc., and formally at least, authority concerning the governance of personnel matters and remuneration, etc., will be grasped by the Nominating Committee and Remuneration Committee. Naturally, in order to allow effective governance to function, it will be necessary to arrange and devise mechanisms that allow these committees to function practically.

Whatever is done though, the danger of plans made to suit themselves cannot be denied with regard to executive remuneration during terms of office and the treatment of executives after resignation, so in future, the Remuneration Committee should be consulted not only over the remuneration of currently active executives, but also over remuneration for commissioned part-time work and consultation after executives resign, and the details of work commissioned and the appropriateness of remuneration for it should pass through a process of verification. In addition, in order to restore the confidence lost due to the Compensation Problems quickly, the company should aim for more positive information disclosure, such as publicizing the awareness of problems by its committees widely.

Apart from that, in order to review the corporate culture in which the Chairman and consultants have strong voices from the perspective of corporate governance, it will be important to position the President clearly as the head of business execution, and to establish a system in which the Chairman and consultants do not exert unfair influence by discussing the President’s succession on the Nominating Committee.

(iii) Preparation of systems that support the duties of outside directors

With KEPCO transitioning into a company with a Nominating Committee, etc., having effective supervision conducted by committees composed of independent outside directors, and an independent outside director also serving as Director and Chairman, it will be essential to develop systems that support the duties of outside directors. Specifically, it will be necessary to prepare systems that provide the information required for supervision, and to provide the staff and organizations who will act based on the instructions of the outside directors.

KEPCO recently established a Board of Directors Office as an organization that will support the execution of duties by the Board of Directors and directors. However, it is important that this Board of Directors Office is not a mere secretariat of the Board of Directors, but also works with awareness of supporting the execution of duties by the Director and Chairman and other independent outside directors.

Moreover, management needs to be aware that outside directors cannot exercise their supervisory functions if they do not have the appropriate information. The supervisory function of outside directors can be wrecked easily if information is blocked. In order to prevent such supervision from becoming a mere formality, it is extremely important to build systems that support the outside directors firmly, and for the employees who support that system to perform their duties fully aware of the importance of reporting the appropriate information to outside directors.

(iv) Appropriate setting of the authorities of the executive management group

In association with the company’s transition into a company with a Nominating Committee, etc., it will be possible to delegate decisions on business execution broadly to executive officers, but the extent to which such delegation is made will need to be determined by the Board of Directors itself.

If the scope of delegation to executive officers is perceived too conservatively and wastefully just because the Cash and Gifts Problem and Compensation Problems happened, management efficiency will be hindered and atrophic effects could occur. It will be necessary for matters to be discussed and determined appropriately on the Board of Directors with regard to the point of how far the scope of business execution should reach (how far to delegate to the judgment of executive officers), a point to be determined on a Board of Directors dominated by outside directors.

(2) Preparation and operation of a compliance system

(i) Preparation of a system for preparing and storing information

The system for preparing and storing information when executives and employees execute their duties should be prepared again.

Because only a limited number of executives and employees of the Secretariat advanced consideration of the Commissioning of This Case following the intention of the Chairman, the surviving materials are fragmentary and the data was not stored on a server, etc., but on CD-R discs, etc., prepared based on individual judgment, making it difficult to describe them as sufficient for subsequent verification. In addition to those for formal meetings such as meetings of the Board of Directors, Executive Officers' Meetings and the various committees, appropriate records should also be kept for the decision-making processes of executives, informal meetings and instructions from senior executives, and clear operational rules should be created, including the places for the storage of materials prepared in the course of duties, etc.

(ii) Implementation of more effective internal audits, etc.

The building of an effective internal audit system will also be important. All work including that of top management must be subject to internal auditing. In order for the thorough implementation of compliance, it will be necessary to deepen cooperation between the Office of Internal Auditing and the Audit Committee further. Violations of compliance by top management cannot be dealt with by the so-called internal control system of audits by the Office of Internal Auditing alone. The supervisory function of the Audit Committee, centered on independent outside directors, is essential. Everybody is required to perform their duties with full awareness that the organization responsible for part of the important role of providing information for that purpose is the Office of Internal Auditing.

We hope that audits will be conducted based on that kind of problem awareness by the Audit Committee as well.

(3) The arrangement and reawakening of awareness as persons supervising public work

KEPCO is also required to arrange its awareness of its "public nature" as an electricity utility under the current Electricity Business Act. KEPCO must consider, discuss and arrange the meaning of the various levels of its "public nature" based on the state of liberalization of the electric power industry, and reawaken our responsibility as a company in charge of it. That will be an opportunity for KEPCO to consider the meaning of compliance.

(4) Regular monitoring

KEPCO must continue regular monitoring of the state of improvements. In addition, it will be preferable for the effectiveness of the Board of Directors and each committee to be monitored while listening to the opinions of external experts. Being constantly exposed to external evaluation will lead to the improvement of inward-looking thinking, and the Board of Directors showing itself promoting improvements independently will have a positive impact on corporate culture.

Part 4 Conclusions

The Compensation Problems have already been described in the Third Party Committee Report, and a report has also been submitted by the “Director Liability Investigation Committee” established by the Audit Committee. However, the Committee recognized that these problems are extremely important for KEPCO and decided to investigate them independently and thoroughly to pursue the issues. That intention came about because: [1] KEPCO needs to investigate the facts thoroughly and disclose them to all stakeholders in order to carry out corporate reform starting from scratch in the face of the acts of betrayal of users, shareholders, and employees that constitute the Compensation Problems; and [2] we thought that we should investigate the true causes of the Compensation Problems that followed on from the Cash and Gifts Problem and use what we found as the basis for building a new sense of value.

This report exposes KEPCO’s problems and will invite further criticism of the company for the time being. However, by accepting that criticism sincerely and head on, learning from it what was lacking and what was wrong, and considering it thoroughly and deeply, we hope that the company will take the first steps towards regaining the trust of society and restoring the work and pride of executives and employees. That ought to form the core of the new “Compliance Charter.”

Helping that to happen is the mission of the Committee and the reason why we prepared this report.

End