Japan

Summary of Current Shareowner Rights

Percentages cited reflect information gathered by GMI about 444 companies in Japan as of 15 May 2008.

Shareowners in the Japanese market face a variety of obstacles to exercising their rights. Shareowners often find it difficult to attend annual general meetings in Japan, partly because so many are scheduled at around the same dates and partly because of the "unit stock system." First introduced to Japanese companies in 1982 to inhibit corporate racketeers, the unit stock system has become common practice in Japanese companies and has driven away individual investors because it fosters a relatively high minimum trading cost. Under this system, most companies designate 1,000 shares as a unit and any entity holding less than one unit, or 1,000 shares, is not entitled to a vote. Additionally, because companies are required to release their proxies only 14 days before the annual meeting, those voting by proxy have a short time to do so. Japanese boards still tend to be composed of a majority of corporate executives; boards composed of independent directors remain a rarity. Poison pill plans, which are being implemented by more and more companies, are usually ratified by shareowners and may be redeemed (canceled) by shareowner vote before the poison pill's scheduled renewal.

Issue	Current Standard or Usual Practice	Level of Practice Adoption, Exceptions to Usual Practice, and Trends (if any)
What is the average percentage of independent board members on public company boards (% independent board members)?	10%	The majority of Japanese companies have none or few independent board members.
What percentage of companies report significant related-party transactions (1% of revenue or more) within the last three years?	3.6%	Relatively rare in the Japanese market
What percentage of publicly traded companies have a controlling shareowner (e.g., family, government, majority block holder)?	7.9%	Some controlling share ownership is a result of the *keiretsu*[11] system.
Is voting by proxy permitted?	Yes	
Must shares be deposited or blocked from trading in order to vote?	No	
Are there share ownership limitations in this market?	Mostly, no	Share ownership limitations are not common but do apply in sensitive industries, such as utilities, arms, nuclear power equipment, and aircraft production.
Are there [other] common restrictions on the rights of shareowners to vote in person or by proxy?	Yes, somewhat	Although not strictly a restriction on appointing a proxy, the unit stock system, which requires units of a number of shares for each vote (e.g., 1,000 shares per vote), can have the effect of restricting voting rights.
Do companies adhere to a majority voting standard in the election of board members?	Yes	Standard in Japan

[11]Keiretsu is a group of companies organized around a single company, usually a bank, for their mutual benefit. These companies often own equity in each other.

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Issue	Current Standard or Usual Practice	Level of Practice Adoption, Exceptions to Usual Practice, and Trends (if any)
Do companies allow for cumulative voting in the election of board members?	No	Never allowed
Are shareowners able to affect a company's remuneration policy through shareowner approval (binding or nonbinding) of the remuneration committee report, the proxy's Compensation Discussion and Analysis section, or otherwise?	Mostly, no	Most Japanese companies still do not use remuneration committees.
Are shareowners able to affect remuneration policy through binding shareowner approval of specific equity-based incentive plans or otherwise?	Yes	This policy is a requirement in Japan.
Are shareowners permitted to introduce dissident resolutions (binding or nonbinding) at an annual meeting?	No	Possible but only with restrictions; all resolutions are binding in Japan.
Do shareowners have a right to convene a general meeting of shareowners outside the annual meeting process (e.g., an extraordinary general meeting or special meeting) if only 10% or less of the shares are represented in the group requesting the meeting?	Yes	This right is standard.
What percentage of companies include golden shares in their capital structure?	0.2%	Only one Japanese company researched for this manual, Inpex Holdings, has a golden share; the share is held by Japan's trade ministry.
Are shareholder rights plans (poison pills) allowed in this market?	Yes	More and more Japanese companies have been adopting rights plans in recent years; 21% of the companies researched for this manual have poison pills in place.
If shareholder rights plans are in use, do they have to be approved by shareowners?	Yes	The majority of the plans are ratified by shareowners.
Do all shareowners have the right to approve significant company transactions, such as mergers and acquisitions?	Yes	This right is standard.
Do companies require a supermajority vote to approve a merger?	Yes	This requirement is standard in Japan.
Are companies subject to a fair price provision, either under applicable law or as stated in company documents (such as the charter or bylaws)?	Yes	This requirement is standard in Japan.
Are class action suits commonly used in this market?	No	They can be filed, but they are not common.
Are derivative suits commonly used in this market?	No	They can be filed, but they are not common.

Current Engagement Practices and Shareowner Rights Developments

Perhaps the biggest issue in Japanese corporate governance is the lack of independence in the composition of boards of directors; boards are still occupied primarily by management. On average, only 10 percent of the members of the boards researched for this manual are independent. In contrast to boards in other developed markets, a high proportion of company board members are promoted from among employees; joining the board is perceived as the ultimate goal for "salarymen" in Japan.

Another characteristic of the Japanese market is the clustering of most annual general meetings (AGMs) in a short time span. In 2008, 70 percent[12] of AGMs for Japanese companies took place between 24 and 28 June. Although that five-day span was actually an improvement over past years, when as many as 95 percent of companies held general meetings on the same day, it remains a significant deterrent to effective shareowner participation. Originally implemented to fend off the *sokaiya*—organized crime members who disrupt shareowner meetings by asking management tough questions, committing violence unless paid by the company, or even silencing dissenting shareowners for the company—this defensive measure now merely prevents higher shareowner presence at AGMs because shareowners cannot attend more than a few of them.

Corporate law exacerbates the problem of low attendance because companies must hold their AGMs within 90 days of their fiscal year-ends, which is 31 March for most, and companies try to make the most of the 90-day window. Effective voting is also impeded because companies are required to release their proxies only 14 days before the AGM but foreign institutional investors need to follow deadlines set by their custodian banks. Because these deadlines tend to be about 10 days before the meeting, these investors have little time to vote. In response to these issues, the Tokyo Stock Exchange (TSE), Japan Securities Dealers Association, and U.S.-based Automatic Data Processing established an internet voting platform to facilitate the voting process for institutional and foreign shareowners. More than 300 Japanese companies participate in this electronic voting platform.

In Japan, the market for corporate control is not active. However, unwinding material ties represented by cross-shareholdings among the *keiretsu* groups, the decline of shareholdings by major Japanese banks, and the growth of foreign share ownership in recent years have significantly eroded protections against hostile takeovers for Japanese corporations. A milestone revision to the Japanese Corporate Law to allow foreign corporations to acquire Japanese companies through indirect stock swaps became effective in May 2007. Japanese companies are now forced to prepare decisive and sophisticated measures against takeovers rather than relying on massive emergency dividend hikes as in the past.

Subsequent to the Corporate Law revisions, more and more companies have begun to adopt an early-warning rights plan that allows the company's board to take actions to dilute the position of any unwanted acquirers trying to gain 20 percent or more of the company's shares. Many of these plans may be removed or redeemed (cancelled) by shareowner vote; they may contain a sunset provision of one, two, or three years' duration; and they may have an independent review clause. Despite requiring shareowner approval or ratification, these provisions are simply guidelines rather than binding recommendations. All the same, many Japanese poison pills are in compliance with regulators' guidelines.

Proponents of anti-takeover mechanisms in Japan cite as justification cases involving the activities of the hedge fund Steel Partners, including its failed hostile takeover bid for Sotoh in 2003. Unprepared for a takeover bid, Sotoh management could only rely on increasing the company's dividend to hike up its stock price to fend off Steel Partners' bid. Although the defense succeeded, Sotoh experienced a massive cash outflow because of the dividends, whereas Steel Partners sold its position in the company and made a sizable profit thanks to the increased stock price. Then, in 2007, Steel Partners lost an appeal in which it sought to prevent Bull-Dog Sauce Company from implementing anti-takeover defenses to block Steel Partners' takeover bid. Japan's Supreme Court upheld a decision made by a lower court in support of Bull-Dog Sauce's proposed, shareowner-approved poison pill.

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[12]Out of the 444 companies researched for this manual, 82 percent held their AGMs between 18 June and 30 June 2008.

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At the Aderans Holdings Company 2008 AGM, the company's largest shareowner, Steel Partners, was able to block the nominations of most of the board's directors and ousted its president. Steel Partners had one of its representatives appointed to the board when the company named a president shortly thereafter. This activity was reportedly the first time the management of a Japanese company had been replaced by an activist fund.

Another challenge to takeover defenses in Japan worth noting is the 2008 case in which the Japanese government ordered U.K. activist fund Children's Investment Fund (TCI) to cease its plan to raise its equity stake in Electric Power Development. TCI had tried to force Electric Power to accept TCI executives as board members. After Electric Power rejected the plan, because foreign investors seeking a stake in Japanese utilities greater than 10 percent must first receive official approval, TCI asked the Japanese government's permission to raise its stake in the company from 9.9 percent to 20 percent. The government order for TCI to cease cited Japan's foreign exchange law as the authority under which foreign companies may be prevented from acquiring 10 percent or more in a domestic power supplier if the result of the acquisition may be deemed a threat to stable power supply or the maintenance of public order in Japan.

Increasing pressure for shareowner rights has come also from domestic asset managers, such as the Pension Fund Association (PFA), which represents Japan's corporate pension funds and oversees more than USD100 billion of assets. Tomomi Yano has led the fund in promoting shareowner interests since becoming head of investment in 2001 by having companies downsize their large boards, pay higher dividends, and provide better disclosure for shareowners. The PFA has stated it will not automatically support management at the companies in which it has holdings unless certain investment standards are met; the PFA also has committed to vote against board members who seek to implement poison pill plans and other takeover defenses if those plans do not have shareowner approval.

Legal and Regulatory Framework

In Japan, shareowner rights are largely determined by the Japanese Corporate Law Code, which is one of six codes that make up the main body of Japanese statutory law.

The Japanese regulatory system is generally, given the absence of formal enforcement mechanisms, based on guidelines rather than requirements. Government agencies issue "recommendations," "directions," "suggestions," and "warnings," and the implication is that, although these guidelines are not requirements, those who do not comply will in some way be obstructed by the agency in the future.

For example, the amended Corporate Law that addressed enhanced disclosures in annual regulatory filings for fiscal years commencing after April 2003 was issued as guidelines only. Although it was an instruction provided by the Financial Services Agency, rather than a legal requirement under the code, for companies to disclose collective remuneration and fees paid to accounting firms, the vast majority of companies have followed these guidelines. The same adherence to guidelines has been demonstrated with the implementation of rights plans, as described in the previous section.

Shareowner rights in Japan are influenced by the investor's share ownership position. One percent (or 300 share units) shareowners can, among other rights, propose voting resolutions for the shareowners' meeting. A 3 percent shareowner may call for an extraordinary general meeting at any time and ask a court for the dismissal of a board member or auditor who has breached his or her obligations; a 10 percent holder may ask the court for dissolution of the corporation in certain circumstances. Shareowners with 33 ⅓ percent holdings can veto resolutions concerning mergers, board member dismissals, and changes to the articles of incorporation. Shareowners with 50 percent and greater holdings enjoy all of these rights and more. The Japanese Corporate Law was amended to allow shareowners to oust a board member by a simple majority, as opposed to the two-thirds majority previously required. Companies may alter their bylaws, however, to restore the two-thirds requirement. Companies typically do not allow cumulative voting in the election of board members.

Although minority shareowners may propose candidates for the board and the process is relatively easy, this right is not exercised frequently. All board members are subject to election on a periodic basis by majority vote, and more and more companies are moving toward annual elections.

A Financial Instruments and Exchange Law was proposed in June 2006 in response to corporate scandals in previous years; it has been dubbed "J-SOX" (meaning, the Japanese version of the Sarbanes–Oxley Act). This law was enacted in April 2008. J-SOX requires that the management of listed companies evaluate, document, and issue a report on their companies' internal processes and control procedures.

On 27 May 2008, the TSE announced that it was conducting hearings and surveys to gather opinions from investors aimed at "improving conditions to enhance the corporate governance of listed companies." The TSE hopes to use these data to identify issues and develop measures to improve the listing system.

Key organizations with information relevant to shareowner rights in Japan include the following:

Tokyo Stock Exchange (www.tse.or.jp/english/)

Osaka Securities Exchange (www.ose.or.jp/e/)

Financial Services Agency (www.fsa.go.jp/en/index.html)

Shareholders Ombudsman (http://kabuombu.sakura.ne.jp)

Ministry of Economy, Trade, and Industry (www.meti.go.jp)

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