Japan

Summary of Current Shareowner Rights

Percentages cited reflect information gathered by GMI Ratings about 391 companies in Japan as of 31 August 2012.

Shareowners in the Japanese market face a variety of obstacles to exercising their rights. They often find it difficult to attend annual general meetings, partly because so many are scheduled on or around the same dates and 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 among Japanese companies and has served to drive 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, anyone voting by proxy has a short time to do so.

Since 2004, the unit stock system has been revised, making it possible to designate up to 1,000 shares as the stock unit; currently, 1, 100, 500, and 1,000 are the typical numbers of shares for one stock unit. Japanese boards still tend to be composed of a majority of corporate executives, and boards composed of independent directors are still a rarity. Poison pill plans 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)?	15%	The majority of Japanese companies have none or only a few independent board members.
How many companies have fully independent audit committees?	1.3%	
What percentage of publicly traded companies have a controlling shareowner (e.g., family, government, majority block holder)?	6.1%	Some controlling share ownership is a result of the *keiretsu*[1] system.

(continued)

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

Issue	Current Standard or Usual Practice	Level of Practice Adoption, Exceptions to Usual Practice, and Trends (if any)
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?	No, mostly	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	Since 2004, the unit stock system has been revised, making it possible to designate up to 1,000 shares as the stock unit. Currently, 1, 100, 500, and 1,000 are the typical numbers of shares for one stock unit.
Do companies adhere to a majority voting standard in the election of board members?	Yes	This practice is standard in Japan.
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 something comparable?	No, mostly	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 something comparable?	Yes	This practice is a requirement in Japan.
Are shareowners permitted to introduce dissident resolutions (binding or nonbinding) at an annual meeting?	No	Doing so is possible but only with restrictions. In Japan, all resolutions are binding.
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?	0.3%	

Issue	Current Standard or Usual Practice	Level of Practice Adoption, Exceptions to Usual Practice, and Trends (if any)
Are shareholder rights plans (poison pills) allowed in this market?	Yes	
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 are allowed but are uncommon.
Are derivative suits commonly used in this market?	No	They are allowed but are uncommon.

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 members of management. On average, only 15% of the board members researched for this manual are independent. In contrast to boards in other developed markets, a high proportion of company board members are employees who were promoted to the board; 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. 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 (31 March for most) and companies try to make the most of the 90-day window. Corporate law also impedes effective voting 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, investors have little time to vote. In response to these issues, the Tokyo Stock Exchange (TSE), the 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 600 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 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.

In the wake of corporate governance scandals at Olympus, Daio Paper, and Tokyo Electric Power Company (TEPCO) in 2011 and 2012, some investors sought to unlock value at Japanese companies through improved corporate governance. The fund Japan Governance Partners plans to buy controlling stakes of small to mid-size Japanese firms and force corporate governance improvements. Leaders of the fund estimate that many Tokyo Stock Price Index (TOPIX) firms trade below book value, many because of poor governance.

Tokyo Marine Asset Management and London-based Governance for Owners opened the TMAM-GO Japan Engagement Fund. The fund plans to unlock value by tapping the experience of the Japan Engagement Consortium, a joint venture between the two firms that works collaboratively with Japanese companies to improve governance.

The Olympus scandal has prompted the TSE to focus new attention on independent directors. In a consultation released in March 2012, the TSE proposed new listing rules that would require issuers to make a disclosure if independent directors or auditors work for a client of the firm or for a company with which it has cross-directorships. The exchange plans other steps to bolster the role of independent directors, such as a handbook on how they should exercise their duties.

Progress toward higher corporate governance standards, however, is often halting in Japan. Initial steps to improve independence on boards, first proposed in 2011, were watered down in 2012 when the Ministry of Justice issued draft proposals of company law revisions that left out any reference to even one mandatory outside director on corporate boards. Instead, the draft recommends the idea on a "comply or explain" basis and endorses new Tokyo Stock Exchange listing rules that require it.

The aforementioned corporate governance scandals have engendered some shareholder activism in Japan. Shareowner resolutions were filed by several cities for the 2012 proxy season. A proposal submitted by the city of Osaka and backed by the cities of Kobe and Kyoto calls on Kansai Electric Power to phase out all nuclear power, in response to the 2011 meltdown at TEPCO. A resolution filed by the city of Tokyo calls on TEPCO to increase its transparency. Mizuho Financial's 2012 AGM featured relatively strong support for shareowner proposals. A proposal to require the firm to disclose its policy on director training, and actions taken on it, won 28% support. Six other proposals on such issues as separation of the roles of chair and CEO won at least 23% support.

Subsequent to the Corporate Law revisions, a growing number of 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% or more of the company's shares. Many of these plans may be removed or redeemed (canceled) 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.

Proponents of anti-takeover mechanisms in Japan cite as justification for implementing such mechanisms 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's management could rely only 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. 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. The Supreme Court of Japan upheld a decision made by a lower court in support of Bull-Dog Sauce's proposed shareowner-approved poison pill. Recently, a number of companies have extended poison pill options.

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

Another challenge to takeover defenses in Japan worth noting is the 2008 case in which the Japanese government ordered a U.K. activist fund, the 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% must first receive official approval—TCI asked the Japanese government's permission to raise its stake in the company from 9.9% to 20%. The government did not approve the plan, citing Japan's foreign exchange law as the authority under which foreign companies may be prevented from acquiring 10% or more of a domestic power supplier if the resulting acquisition is deemed a threat to a stable power supply or to maintaining social order.

Increasing pressure in support of shareowner rights has also come 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. Since becoming head of investment in 2001, Tomomi Yano has led the fund in promoting shareowner interests by having companies downsize their large boards, pay higher dividends, and provide better disclosure for shareowners. The PFA has stated that it will not automatically support the managements of the companies in which it has holdings unless certain investment standards are met. Also, the PFA 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 fail to comply will be obstructed by the agency in the future.

Shareowner rights in Japan are influenced by an investor's share ownership position. One percent (or 300 share units) shareowners can propose voting resolutions for the shareowners' meeting. A 3% 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% shareowner may ask the court to dissolve the corporation in certain circumstances. Shareowners with 33 1/3% holdings can veto resolutions concerning mergers, board member dismissals, and changes to the articles of incorporation. Shareowners with 50% or greater holdings enjoy even more rights. Japanese corporate law was amended to allow shareowners to oust a board member by a simple majority vote, as opposed to the two-thirds majority vote 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.

The Financial Instruments and Exchange Law was proposed in June 2006 in response to corporate scandals in previous years. Dubbed "J-SOX" (because it is seen as the Japanese version of the U.S. Sarbanes–Oxley Act of 2002, or SOX), this law, which was enacted in April 2008, requires that the management of listed companies evaluate, document, and issue a report on their companies' internal processes and control procedures.

In September 2012, the Ministry of Finance finalized the revision of the Outline of Corporate Laws. Under this revision, the following changes are expected to be implemented: introduction of an audit and supervisory committee that consists of at least two external directors, protection of minority shareholders, and protection of multiple derivative actions.

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)

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

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

Ministry of Justice (www.moj.go.jp)

Kiedanren (www.keidanren.or.jp)