it might be easier to provide relief to parties injured by defective products. However, this Act does not contain any provision which mitigates the burden of proof on the part of plaintiffs, for example, the presumptive provision and the duty-to-disclose provision. Therefore, there remain many difficulties in product liability litigations. It is important that, in Japan, the burden of proof is more strict than in other developed countries (major countries require a "preponderance of evidence" standard but Japan requires "proof beyond reasonable doubt").

For a decision concerning product liability, see "Developments in 1994-Judicial Decisions" (*infra.*)

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3. Commercial Law

An Act to partially amend the Commercial Code and the Limited Liability Company Law.
Promulgated on June 2, 1994. Ch. 66. Effective as of October 1, 1994.

[Background]

Under the Japanese Commercial Code, a stock corporation is, in principle, prohibited from acquiring its own shares. It had been prohibited from doing so since the current Commercial Code was enacted in 1899, except in the cases specified in the particular article in the Commercial Code prior to the 1994 amendment. (The exceptions were increased by the 1938 Reform Act, but only to a limited extent.) A stock corporation could not acquire its own shares, even as a pledge. The 1981 Reform Act, however, allowed it to acquire up to one twentieth of its issued shares as a pledge with no restriction. The 1981 Reform Act also specified in Article 211-1, that a subsidiary corporation (a corporation more than half of whose issued shares are held by another corporation) is prohibited from acquiring shares of its parent corporation (a corporation which holds more than half of the issued shares in that subsidiary corporation), based on previous interpretation of the law.

Japanese scholars generally explain that the reason for this prohibition is a political one, that is, to prevent problems caused by allowing a corporation to acquire its own shares with no restrictions e.g. the acquisition by a stock corporation of its own shares is against the principles of maintenance of capital (a concept based on German law) permitting the acquisition of a company's own shares may allow corporate management to engage in manipulative practices in the stock market and to become involved in insider trading; it may benefit green-mailers, etc. The point is that the best way to solve these problems completely is to prohibit the stock corporations' acquisition of their own stock.

The Japanese business and economic sector, however, has long wanted to alleviate this rigorous prohibition so that a stock corporation can own its own shares as a countermeasure against corporate takeover attempts by foreign corporations, in ordre to introduce a stock option system, so that it can transfer its stock to its own employees, and so on. Recently, it has been asserted that the provisions in Japanese law with regard to prohibition of the acquisition by a stock corporation of its own shares are now much more stringent than those of laws in other countries, such as the English Company Law (which previously prohibited it rigorously), the German Commercial Law, which was a model for the Japanese Commercial Law, and French law; the comparison has been offered as a rationale for relaxing the Japanese requirement. Under these laws, a corporation is allowed to acquire its own stock to a greater extent than is possible under Japanese law. The Japanese Reform Act was enacted partly because its was proposed that restrictions on stock corporations' acquisition of their own stock need to be reviewed in relation to the Japanese government's economic policy, which was initiated in order to solve the dramatic fall of share prices and the decline of the Japanese economy.

[Outline of the 1994 Reform Act]

The 1994 Reform Act added exceptions by which a stock corporation can acquire its own stocks. (The Limited Liability Company Law was amended in the same way except that it did not add the exception permitting the transfer of shares to a corporation's employee, which will be discussed later.) Thus it did not adopt the method adopted by American state laws and the Model Law of Corporations, which allow a corporation in principle to acquire its own shares. It was considered in the process of enacting this Reform Act whether or not to include the phrase "in order to avoid major and current corporate damages," as is provided in German law, but it was decided that phrase would not be used.

The exceptions added in the 1994 Reform Act are that a corporation may acquire its own shares ①: in order to transfer shares to its employees (210-2), ② for the purpose of cancelling dividends based on resolution at a regular shareholders' meeting (212-2), ③ in two instances if a stock corporation is closely held. (Under the Japanese commercial law, there is a dispute about the definition of closely held corporations. It is widely believed to be a corporation which has an article in the articles of association which requires shareholders to get the approval of the board of directors to transfer their shares.)

The first exception was added to make it easier for listed corporations, 95% of which adopt the Employees Stock Ownership Plan (ESOP) system, to buy their own stock on the market for the purpose of transferring their shares to their employees. This also makes it easier for closely held corporations, many of which adopt an ESOP system, to buy shares from their shareholders through face-to-face transactions. Article 210-2 specifically provides that a corporation may acquire its own shares "in order to transfer them to its employees", and furthermore, "with the legitimate reason".

Concerning the second example, under the Japanese Commercial Code prior to the 1994 Reform Act, the cancellation of issued shares had been allowed, but it had been allowed only by following the rigorous process of reducing capital and when the corporation's articles of association provided for the cancellation of shares. In addition to these two previously permitted exception, the 1994 Reform Act permits the cancellation of shares based on the resolution of a regular shareholders' meeting.

There are actually two situations covered by the third exception. With regard to the first one (③-1), the Japanese Commercial Code stipulates in Article 204-2 that when a stock corporation's articles of association require shareholders to get the approval of the board of directors to transfer their stocks, shareholders who wish to sell their stocks must demand that the board of directors approve their claim and/or to appoint a purchaser to whom they should transfer their stock in the event that the board will not approve the shaeholder's demand. However, it is difficult for closely held corporations, whose stocks do not have marketability, to find a candidate to be the purchaser. The 1994 Reform Act allowed a corporation to appoint itself as the purchaser in order to protect the interest of the shareholders who wish to transfer their shares.

A typical example of the second situation (③-2) is when a small closely held, family-owned stock corporation itself can acquire its own stock when an owner-shareholder dies. Under the Japanese Civil Code, the spouse and any children of the decedent divide their inheritance as co-successors. Thus, heirs who had nothing to do with the corporation's management would also inherit shares of the corporation and this could be problematic in the case of sucession in a family-owned corporation. Additionally, since it is not easy for a closely-held corporation to sell its own shares, as stated above, it is advantageous for heirs to have the corporation convert its shares into cash for them.

Thus, the number of exceptions has increased, but at the same time, many regulations have been introduced as countermeasures to the abuse of these exceptions, e.g. regulations with regard to the number of shares to be acquired. Under the first exception, 3% of all issued shares; and under the third exception, one fifth of all issued shares when ③-1 and ③-2 exceptions are available at the same time.

Regulations with regard to financial resources were also introduced. One rule is that the first and second exceptions are allowed only when applying the profits available for dividends, and is regulated by the balance sheet method. Another one is that the third type of exception would be allowed only by applying net assets on the balance sheet. Directors are liable for breach of these regulations by corporations.

Concerning the process of acquisition by a corporation of its own shares, under the first and second exceptions, the acquisition must be authorized by the resolution of a shareholders' meeting. Under the first exception, a listed corporation can acquire its own shares only through the stock exchange market, and a corporation whose securities are traded on the over-the-counter (OTC) market can acquire its own shares only through the OTC market. Under the second exception, a listed corporation can acquire its own shares by means of a tender offer besides the process mentioned above for the first exception. A corporation whose securities do not have public marketability can only acquire its own shares by means of face-to-face transactions with its shareholders. In that case, its shareholders have a right to require the corporation to include itself among the sellers upon notice of the corporation's acquisition of its own shares received at a regular shareholders' meeting which is held to authorize the acquisition by the corporation of its own shares. In this way, shareholders are assured of equal opportunities to sell their shares.

These newly added exceptions should be treated legally as exceptional cases. Therefore, in the case of the cancellation of shares, a corporation must cancel the shares immediately, and in the case of transferring its own shares to its employees it must do so within a six month period. In other cases, it must dispose of its own shares with a legitimate period of time. The holding of so called "treasury shares" is prohibited. If the shareholders' meeting is to be held before the cancellation or disposition of its own shares, the corporation's voting rights will be denied (Article 241(2)) and it will be prohibited from receiving a dividend for its own shares (proviso of Article 293). In that instance, acquired shares will be treated as floating capital on the balance sheet, and the amount of the acquired shares will be deducted from the amount of the net assets when calculating the profit available for dividend (Article 290(1)(v)).

[Comment]

With regard to the second exception among the newly-added exceptions, some problems with tax law were expected to arise at the time of enactment. Under the Japanese income tax law and the corporate tax law, there are articles which assess taxes on shareholders whose shares were cancelled on the yen amount given to them and which also tax shareholders whose shares are not cancelled based on the recognition that the value per share was increased. In 1996, the Tax Agency recognized this problem and as an interim measure, it announced that it would suspend the application of these articles. This caused some listed corporations to start canceling their profits by acquiring their own shares. This indicates that the tax law has a powerful impact on corporate structure and corporate law.

Even with the 1994 Reform Act, the requests of the business and economic sector have not been fully accomplished yet. This is due to the fact that legislators feared increasing problems caused by the acquisition by a corporation of its own shares. One reason is the malfunction of the Japanese Securities Law at that time. Recently, the Committee to Supervise the Securities Exchanges has become activated, however, at the time of the Reform Act, it could not be said that Japanese Securites Laws were fully functional with respect to either insider trading or to manipulative practices, compared with U.S. federal securities regulations, which are a model for Japanese Securites Law. Directors' liabilities were also not fully prosecuted because shareholderd derivative actions were rare prior to the 1993 Reform Act, though the right was introduced into the Japanese Commercial Code in 1950. In this kind of situation, it was natural that there should be hesitation to permit the acquisition by a corporation of its own shares as freely as that in the U.S. There remains a possibility that relaxed rules concerning acquisition will also be created with respect to the stock option system.

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