HOLDING COMPANY SYSTEM IN THE PRIVATIZATION OF NTT*

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In 80's when privatization spread from Britain to other countries, Japan also decided to start with the privatization of three big-sized public corporations (kougaisha): Nippon Telegraph and Telephone Public Corporation (NTTPC), Japan National Railways (JNR) and Japan Tobacco and Salt Public Corporation (JTSPC). For the implementation of this project were adopted separate laws, transforming public enterprises into special joint-stock companies (tokushugaisha) with 100% government ownership. Divestiture was applied only to the privatization of JNR, broken up into six regional private passenger services and one rail freight company, known collectively as the JR (Japan Railways) group(1). At the time of privatization the establishment of holding companies was banned by the Anti–monopoly Law (art. 9), which was amended in 1997 in the sense of partial permission of this and the same month was decided to break up NTT and to transform it into a holding company. Does this transformation of a company under privatization into a holding one change the relation between government as major shareholder, the company itself and its new-created subsidiaries? What kind of problems can arise in this relation? This article will be an effort to analyze those problems from a commercial law point of view.

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* This article was completed in November 1998 before the fourth sale of NTT shares in early 1999. Now the share of the government in NTT is said to be about 59% of all the outstanding shares of the company.

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(1) The shares of the JR were reassigned to the JNR Settlement Corporation along with two-thirds of JNR's debt and any surplus real estate of JNR. For JNR Settlement Corporation itself is a legal entity established by the government, it can be said that the government holds indirectly the shares of JR. Meanwhile, the government decided to proceed with the liquidation of the Settlement Corporation. Nihon Keizai Shimbun, Oct 16, 1998.

1. History of privatization of NTT

Until 1952 NTTPC has been a public corporation, part of the Ministry of Post and Telecommunications (MPT). In 1952 NTTPC was separated from the Ministry but its public corporation's character remained untouched and its business operations continued to be state monopoly.

During the years from 1980 to 1985 the possible reform of the telecommunications industry's structure became one of the issues for discussion at the Provisional Commission on Administrative Reform. The ultimate outcome of reform was, on the one hand, deregulation in the sense of release the market[2] and decreasing the level of state regulations over public enterprises and, on the other hand, privatization in the sense of transformation of public enterprises into private companies, partial introduction of private ownership and private management to public enterprises and increasing of their autonomy.

The reform was accomplished by abolishing the old acts and by enacting new legislation, the Telecommunications Business Act[3] and the NTT Corporation Act[4]. The company was organized as a joint-stock company to which the Commercial Code applies as well. As a general rule, the special acts apply with priority. Some exceptions to the Commercial Code provisions that NTT Corporation Act regulates are as follows:

1) NTT shall be a special company with one-third or more government shareholding (art. 4, para. 1).
2) Approval of the Minister of Post and Telecommunications (Minister of PT) shall be obtained on the following items:
   a) issue of new shares, convertible bonds or bonds with preemptive rights to subscribe new shares,
   b) appointment or dismissal of directors and auditors,

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[2] Release of the market means abolition of domestic state monopoly and introduction of competition.

[3] Law No. 86 of December 25, 1984. This act applies to the telecommunications industry generally.

[4] Law No. 85 of December 2, 1984. This act applies only to NTT.

c) change in the articles of incorporation,
d) disposal of profits,
e) merger and dissolution of the company,
f) business program for each business year and its amendment,
g) transfer or mortgage of telecommunications lines or other important telecommunications facilities,
h) engagement in business activities necessary to achieve the purpose of the company[5].

3) The company shall submit its balance sheets, profit and loss accounts and annual business reports to the Minister of PT (art. 12), and shall be object of special supervision by him (art. 14 to 17).
4) Disposal of shares owned by the government shall be within the limitation on number of shares decided by the Diet in the relevant annual budget (art. 5).

Furthermore, before giving approval on issues a), c)[6], d), e), f) and g) the Minister of PT shall make consultation with the Minister of Finance (art. 17).

Nevertheless regulations were relaxed to a great extent in comparison to the former Public Corporation Act[7], from the above observation of the provisions it is obvious that the power of the government over the new–created company remained very strong. Thus, it is difficult to say that privatization was accomplished. However, the transformation into joint–stock company was meant to make possible the sale of shares and the improvement of managerial performance.

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[5] Approval on b), c), d) and e) is a condition of the resolution of general meeting of shareholders on those matters to take effect, i.e. post factum approval, while on the other items it is necessary the approval to be taken in advance.

[6] In this case the consultation is necessary in respect of resolutions on changes in the total number of shares issued by the company.

[7] Before the reform the investments, the wages and the budget of NTTPC had to be approved by the Diet.

2. NTT divestiture[8]

First, divestiture in the sense of separation of long–distance operations from local network was suggested by MPT as a way of privatization, but this was not implemented.

After that, in 1989, in order to re–examine the NTT's structure, as required by NTT Corporation Act[9], the Telecommunications Advisory Council of MPT issued an interim report outlining three possible types of divestiture: 1) one long–distance company and one big local company, 2) one central and many (five to eight) local companies, and 3) five to nine companies providing both long–distance and local services. But the government opposed the divestiture as a way of restructuring of the corporation in whole.

Later, in its final report in 1990 MPT recommended the divestiture of NTT into one central long–distance and one large local company. Even this time again the proposal to divest NTT was not adopted by the Cabinet, it was required NTT to introduce internal structural changes so as to divide its long–distance operating division from its local service division, and it was decided within 5 years another examination of NTT's structure to be undertaken.

In March 1996 the Telecommunications Council recommended again divestiture of NTT: to split it into one long–distance company allowed to enter the international market and two regional companies (East Japan and West Japan) each of them allowed to expand into cable television and information services in the other's region, but not its own. And this changes to take place by the end of financial year 1998 (March 1999). This recommendation was opposed as well and the question of whether NTT will be broken up remained unresolved

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[8] About the divestiture projects of NTT *see* Inoue Teruyuki, NTT (Nihon no Big Business 01) 190–218 (Outsuki Shoten, Tokyo 1996) (1990); Daniel J.Ryan, The Evolving Telecommunications Environment in Japan *in* Privatization and Competition in Telecommunications – International Developments 21, 26 (Praeger 1997); *NTT to Introduce Pure Holding Company Structure*: NTT News Release Dec 6, 1996. http://pr.info.ntt.co.jp/news96e/961206.html.

[9] NTT's structure shall be re–examine within 5 years after the adoption of the act (supplementary provisions art. 2).

until 1997 when finally a Law for Amendment of NTT Corporation Act[10] was passed in June.

It is not a coincidence that at the same time the Anti–monopoly Law was also revised in the sense of partial permission of holding companies' establishment. Thus, it became possible along with its divestiture NTT itself to be transformed into pure holding company without being engaged in any business operations.

3. NTT–holding company

a) definition of holding company

Before the amendment of the Anti–monopoly Law in June 1997 the term "holding company" was used in its article 9 for a company whose principal business is to control the business activities of a company or companies in Japan by means of stockholding (including partnership share) (para. 3) and, this was banned with art. 9, para. 1 and 2[11]. The amendment of the law made possible in principal the establishment of and the transformation into holding company and defined it as a company where the purchasing amount of stocks in subsidiaries exceeds 50% of its total assets. In addition, it is prohibited the holding company to concentrate business controlling power excessively. Despite its consideration as a measure the managerial efficiency to be increased, the establishment of holding company gives birth to a new series of problems that can not be ignored. This is valid to the same extent in the case of a holding company under privatization like NTT.

b) establishment

According to the Law for Amendment of NTT Corporation Act two regional companies East NTT and West NTT (supplementary provisions art. 2, para. 1) along with one long–distance company (para. 2) shall be established as wholly owned subsidiaries of NTT. NTT itself shall transfer to those companies all its assets according to a plan elab-

[10] Law No. 98 of June 20, 1998.

[11] Pure holding companies have been prohibited in Japan since World War II as a measure to disband zaibatsu (mammoth Japanese combines).

orated by the MPT and shall continue to exist as a company holding all the outstanding shares of the subsidiaries[12]. This method of establishment of a holding company is known by the name of "nukegara houshiki"[13], similar to the method of "spin–off"[14].

In details, East NTT and West NTT shall be established by the State and shall take over the business activities in which NTT Corporation has been engaged (supplementary provisions art. 2, para. 1). Activities other than local services shall be provided by a new joint–stock company (long–distance company), established by NTT Corporation (art. 2, para. 2). Succession (taking over) of the business activities, rights and obligations of NTT Corporation by the newly established three companies shall be accomplished according to a basic policy (kihon houshin), elaborated by the Minister of PT (art. 3) after consultation with the Minister of Finance (art. 16, para. 1). On the basis of this policy the Minister of PT shall elaborate a realization program (jisshi keikaku).

An establishment committee, appointed by the Minister of PT shall draft the articles of incorporation of the regional companies and allocate all the shares issued upon the establishment of the companies to NTT Corporation (art. 5, para. 5). The establishment of the long–distance company is related to the undertaking by NTT Corporation of all the shares issued at the time of its incorporation along with those

[12] Purpose and activities of NTT Corporation are as follows: 1) to hold all the outstanding shares of East NTT and West NTT and to exercise the rights of shareholder in those companies, 2) in order to assure the appropriate and stable provision of telephone and telegraph services by the regional companies to give the necessary advices, good offices and other assistance to them, 3) to make research in the field of telecommunications technology, 4) to engage in business activities incidental thereto. Besides those activities NTT Corporation may engage in activities necessary for the achievement of those purposes, subject to the approval (authorization) of the Minister of PT (art. 1, 2 and 5). NTT Corporation may invest also in a legal entity with activity in international telecommunications services upon approval of the Minister of PT.

[13] Motikabukaisha–no houteki–shomondai (Legal Problems of Holding Companies), Shihon–shijou kenkyuukai (1996).

[14] Unlike the typical "spin–off", where the corporation (A) transfers assets to another corporation (B) in exchange to its stock and distributes this (B's) stock to its (A's) shareholoders, in the case of NTT the stock is allocated entirely to the holding company itself.

issued according to a program of succession (art. 6, para. 1). NTT Corporation itself shall invest or transfer assets to the regional companies according to the realization program (art. 5, para. 6) and to the long–distance company according to the program of succession (art. 6, para. 2) respectively.

Hence, NTT Corporation will become a pure holding company not engaged in any business activities, having only the task to hold the shares and to monitor the activities of its new–created subsidiaries.

The transformation of NTT into holding company is a specific case, result not of a decision taken by its general meeting of shareholders[15] but imposed by law[16]. Even in the case of transformation decided by the general meeting of shareholders the result would be the same, because the government, owner of more than 65% of the shares, is still the major and controlling shareholder of the company and the minority shareholders are not able to oppose to its decision. Despite the general case where a minority shareholder has an appraisal right, a demand his or her shares to be bought when he/she is against the decision of the general meeting of shareholders to transfer business (Commercial Code, art. 245–2), in the case of NTT's transformation this right is ignored at all, just because the transfer is decided by law. This is related to the specific characteristic of the company as public utility and the existence of a specific act regulating its activities. But as far as the government does not wholly own NTT, the interests of the minority shareholders should be protected in some form.

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[15] General case of transformation of a company into holding one by the "nukegara" method is related either to transfer of business (eigyou djouto) or to contribution made in the form of property other than money (gembutsu shusshi). Nevertheless which of them will be applied, it is necessary a special decision of general meeting of shareholders to be passed (presence of shareholders owning more than one–half of all the outstanding shares and decision taken with more than two–thirds of their voting rights, Commercial Code art. 245, 246, 343).

[16] Some exceptions to the Commercial Code provisions are regulated in the case of the unusual incorporation (hentai–setsuritsu) of regional companies as well as in the case of post factum incorporation (jigo–setsuritsu) of the long–distance company. For example, the certification of the articles of incorporation by notary, the examination of art. 168 para. 1's (CC) matters by inspector don't apply to the establishment of those companies (suppl. provisions art. 5, para. 12 and art. 6, para. 5).

Actually, what is the meaning of this restructuring? How it will change the relation between government, the holding company and its subsidiaries?

c) relation between government, holding company and subsidiaries

The relation between government and NTT Corporation will not change a lot after the transformation of the corporation into holding company[17]. The government, still obliged to hold one–third of NTT's shares, will continue to be the major shareholder having influence on decision–making process at the general meeting of shareholders. Decisions on the issue of new shares, convertible bonds or bonds with preemptive rights to take new shares will take effect after an approval has been obtained from the Minister of PT for both NTT Corporation and regional companies. Disposal of shares, owned by the government in NTT Corporation, will remain in the power of the Diet (art. 5, new art. 7). In case of intention to dispose of the shares owned in long–distance company NTT Corporation shall take the approval of the Minister of PT given after consultation with the Minister of Finance (suppl. provisions art. 13, art. 16, para. 2). There is no provision about disposal of shares owned in regional companies, but from the imperative character of the provision about the ownership of NTT in regional companies can be concluded that this is not allowed at present. Hence, from the ownership point of view there will not be any significant changes after the transformation of NTT into holding company. Even more, the power of the government will be strengthened because of the approval necessary to be given on the issue of new shares by the regional companies and the disposal of shares owned in the long–distance company.

The appointment or dismissal of directors and auditors of NTT Corporation as well as of those of the regional companies will remain in dependence on the approval of the Minister of PT (art. 9, new art. 10). For so appointed directors are predisposed to act in the interest of the administrative power rather than in the best interest of the com-

[17] It is expected NTT's divestiture and its transformation into holding company to be carried out in July 1999. Nihon Keizai Shimbun, Oct 8, 1998.

pany, from decision–making point of view it is hard to expect that the situation will change significantly.

Respectively, penalties to directors and auditors in case of violation of the law (omission of taking the approval of the minister for example, art. 23) and in case of bribes (art. 19) will apply to the officers of the regional companies as well.

In addition, it is necessary annual business programs (art. 11, new art. 12), changes in articles of incorporation, mergers and dissolution (art. 10, new art. 11) of both NTT Corporation and regional companies to be approved by the Minister of PT. Approval on disposal of profits will concern only NTT Corporation, on transfer or mortgage of telecommunications trunk lines or other important telecommunications facilities (art. 13, new art. 14) will concern only regional companies[18]. This last provision is the only one directly related to the transformation and new character of NTT Corporation as a holding company.

NTT Corporation as well as regional companies shall subject their financial statements to the Minister of PT (art. 12, new art. 13).

Finally, it is necessary to be mentioned the strengthened control of the Minister of PT over both NTT Corporation and regional companies. This control consists of: 1) possibility the minister under his determination to appoint auditors for specific items and to have them to report him the audit results; the auditors under their determination may submit to the minister opinions based on the audit results (art. 14, para. 2, 3, new art. 15, para. 1 and 2); 2) supervision of the minister and if especially necessary under his determination issue of orders to the companies with respect to their activities (art. 15, new art. 16); 3) possibility the minister to require companies to report their activities (art. 16, new art. 17). The provision on the number of auditors of NTT Corporation (art. 14, para. 1) is deleted. The last point is related to the 1993's amendment of the Law for Exceptions to the Commercial Code Concerning Audit, which requires large sized companies to have three or more auditors, organized in board.

From this observation of the provisions can be concluded that the

[18] In all those situations before giving approval the Minister of PT shall consult the Minister of Finance (art. 18, para. 2).

power of the Minister of PT over NTT Corporation will not be released, moreover it will be extended over new-created regional companies as well. Thus, in addition to the problems related to the government control over the company under privatization (NTT Corporation)[19] arise problems related to its transformation into holding company.

d) problems related to the transformation and divestiture of NTT[20]

① Changes in the shareholding structure

Nowadays, before the transformation of NTT into holding company planed for July 1999, the major shareholder of the corporation is the government, owner of 65.76%[21] of the outstanding shares. The remaining shares are dispersed between financial institutions, other legal entities and individuals. After the transformation all those shareholders of the having business activity corporation will be shareholders of the holding company. And this change will occur without their consent (except for the government), merely by regulation of law. The government will remain the largest shareholder[22] in the holding com-

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[19] About some problems related to government control over the companies under privatization *see* Stoytcheva, Bistra, *Min'eikakatei no kabushikikaisha ni okeru kokka shihai to sono houteki mondaiten (Legal Problems of Keeping the State's Control in Joint-Stock Companies under Privatization)*, 209 Hikaku hougaku, 32-1 (1998).

[20] About different legal problems related to the holding companies *see supra* note 12; Kigyou soshiki-no shinchouryuu – isogareru motikabukaisha kisei-no minaoshi (New wave in the organization of the enterprise – to hurry with the reconsideration of the regulations on holding company), Tsuushousangyoushou, Sangyou-seisakukyoku (1995); Motikabukaisha – sono kinou to dokusen-kinshihou no mondaiten (Holding company – functions and problems related to the Anti-monopoly Law), Shoujihoumu-kenkyuukai (1971).

[21] Nikkei Annual Corporation Reports (1997).

[22] For the total number of outstanding shares of NTT is 62,400,000 even after the sale of one million shares, decided to be fulfilled in 1999 (Nihon Keizai Shimbun, Sept 5,1998), the government will continue to own about 60% of all the outstanding shares of NTT. This will not change a lot the present situation of distribution of power in the corporation. The State will remain the major shareholder and only by means of its ownership can make the corporation run according to its will.

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On the other hand, with the establishment of new companies – subsidiaries, a new shareholder appears at the scene – the holding company itself as owner of all the outstanding shares of the subsidiaries.

② **Holding company – shareholder**

After NTT's divestiture and transformation into holding company the one and only shareholder of its subsidiaries will be the holding company itself. Therefore, problems related to the protection of minority shareholders of subsidiaries will not arise. At the general meetings of the subsidiaries will participate only the representative(s) of the holding company. Hence, the general meeting of the subsidiaries in practice will be transformed in a board of directors meeting, because representatives of the holding company are its directors. Thus, their power will extremely increase. The most important issues concerning the activities of the subsidiaries along with the decision on the appointment and dismissal of directors and auditors of the subsidiaries will be decided by the holding company's directors and not by the shareholders. In such a situation it is necessary the rights of holding company's shareholders to be strengthened in order to have an effective control over the decision-making process in the subsidiaries as well. This is valid in the situation of NTT – holding company under privatization as well as in the situation of its full privatization[23].

③ **Position of holding company's shareholders**

Shareholders of the holding company have voting and controlling rights in the holding company itself but they have no rights in its subsidiaries. They can not vote at the general meetings of the subsidiaries, they can not elect or dismiss subsidiaries' directors and auditors, they can not stop illegal acts of directors neither pursue their liability. Meanwhile, the source of their dividends is profits from the activity of the subsidiaries on the one hand, and on the other hand, their investments are at risk only in relation to the production of subsidiaries

[23] The term of full privatization is used here with the meaning of a company which shares are completely sold and the government does not hold any share, neither an ordinary one nor a "specific share" as in other countries like Britain ("golden share"), France ("action spécifique") etc.

or services provided by them[24]. Hence, despite the lack of direct relation between holding company's shareholders and subsidiaries[25], their investments and dividends depend on the activity of the subsidiaries. Thus, problems related to the protection of holding company's shareholders, especially of the minority shareholders can arise. How those problems can be solved?

Holding company's directors have the duty to exercise the shareholder's rights of the holding company in subsidiaries in its best interest. There could be cases of insufficient supervision over the subsidiaries by them and as a result damages could occur for the subsidiaries, thus for the holding company's shareholders. In theory, in such cases holding company's shareholders have the right to pursue the liability of holding company's directors. But can holding company's shareholders do that? Almost impossible. The problem is that they have not enough information about the situation in the subsidiaries and to prove damages becomes extremely difficult[26]. That means that their rights as holding company's shareholders are limited to a certain extent. Hence, the power of holding company's directors will increase to the same extent.

So, how the control over the holding company's directors has to be exercised? This is a general question in all companies, but it becomes much more important in relation to holding companies, because of the increased power of the directors. One of the solutions could be supervision over the subsidiaries by auditors especially if they are outside ones. In the case of NTT, except the general election of auditors, another possibility for appointment of outside auditors exists. The Minister of PT may issue order and appoint auditors for verification of specific items. Protecting in this way its own interests as a majority shareholder government protects the interests of minority shareholders as well. The problem for minority shareholders is that they can not ap-

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[24] Ousumi Ken'ichiro, Shimpan kabushikikaishahou hensenron (The Development of the Commercial Law) 182 (1987); Maeda Masahiro, *Motikabukaisha* (*Holding Company*), 1466 Shouji-houmu 23, 25.

[25] Between holding company's shareholders and subsidiaries is the holding company itself as a shareholder of the subsidiaries.

[26] Maeda, *supra* note 22, at 26.

point their own auditors and always depend on the discretion of the Minister.

Another way of solution of the above mentioned problem is information regarding financial statements of subsidiaries to be given to holding company's shareholders as well, i.e. disclosure by the subsidiaries[27]. In the case of NTT this is again guaranteed to the government and not to all shareholders.

The same can be said about the decision of important issues related to transfer of operations, transformation, merger, changes in the articles of incorporation, appointment and dismissal of directors, business plans of subsidiaries. All those issues are discussed and voted at the general meetings of subsidiaries, in practice at a kind of enlarged board of directors meetings, about which holding company's shareholders have not information. Thus, they have not any influence over the decisions taken at the general meetings of subsidiaries. And again the government is an exception, because in order to take effect all those issues have to be approved by the Minister of PT.

As a result of this analysis it can be concluded that in a situation of a holding company under privatization, as it is the case of NTT, if the interests of the minority shareholders are not protected at all, at least the interests of the major shareholder, the government, are entirely protected. The means of this protection is the approval that the Minister of PT has to give to important for the company and subsidiaries decisions along with his strengthened control over the companies' activities.

Why not merely split the corporation into few different companies? The reason as explained in the agreement of NTT with the reorganization plan proposed by the MPT in response to a decision of the Japanese Cabinet on the "Revision of Deregulation Promotion Program" is in connection with the protection of shareholders rights[28]. But, as it has been already mentioned, even in the case of transformation of NTT into pure holding company the rights of minority shareholders remain without any protection. Thus, it can be said that the holding company structure is a form of protection but only of the

[27] Maeda, *supra* note 22, at 27.

[28] *NTT to Introduce Pure Holding Company Structure, supra* note 8.

rights of government as major shareholder. If it is not the protection of shareholders rights another explanation for not merely split the corporation can be that probably it is more difficult, more time–costly for the government to exercise control over three or four different companies than only over one holding company.

Conclusions

After the divestiture and transformation of NTT into holding company there will not occur any changes in the ownership structure of NTT Corporation itself. The government will continue to be the major shareholder now not of a company having business activities but of a holding company. And it will be indirectly shareholder of the new–created subsidiaries as well. The special to the Commercial Code NTT Companies Act[29] enlarges the government controlling power over the subsidiaries as well. Decisions on important issues, appointment and dismissal of directors and auditors of both holding company and subsidiaries need the approval of the Minister of PT. His power to monitor and supervise is extended to the subsidiaries as well. That means that the government is protected as shareholder entirely even after the transformation. In the opposite, the rights of minority shareholders are ignored almost as whole.

Resulting in some deregulation of business activities of the corporation and introduction of competition, this transformation might be considered as another step toward privatization. But in order to continue with the privatization it is time maybe to think about a further sale of government owned shares. And as far as the transformation is related to the new for the Japanese law holding company structure, it is absolutely necessary to think about the protection of holding company's shareholders. Protection of the major shareholder, the government, in a holding company under privatization can be a hint for the solution of this problem, but we should not forget the administrative character of this shareholder.

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[29] The name of the act was changed from NTT Corporation Act to NTT Companies Act.