

7. Commercial Law

Amendments to the Commercial Law: Creating laws which provide for the lifting of the acquisition of one's own shares by resolution of the board of directors based on the articles of incorporation and the manner of calculating a limit for the interim dividend.

Background:

1. Restrictions on the acquisition of one's own shares

Traditionally, it has been prohibited, except in some cases, for a company to acquire its own shares in Japan. But because of the need to overcome the long recession since 1991, "the law regarding the special exception to the proceedings of the cancellation of shares" which relaxes the restrictions on the acquisition of one's own shares, was legislated by House members in 1997. This statute allowed that a publicly-held corporation could cancel its own shares by its profit or capital reserve by the resolution of the board of directors.

In June 2001, "the law for the amendment to the Commercial Law", which permits the acquisition and possession of one's own shares without regard to its purpose ("2001 Act"), was legislated by House members. By this amendment, a company has been able to purchase its own shares by the resolution of its shareholders' meeting in principle.

However, even at the time of this amendment, the business world desired the capability of acquiring one's own shares by the resolution of the board of directors, not by the resolution of the shareholders' meeting.

2. Restrictions on the manner of calculating a limit for the interim dividend.

The 2001 Act provided the proceedings to reduce the capital reserve or the retained earnings reserve (Arts. 289, para. 2–4).

This 2001 Act also provided in Art. 210, para. 4:

"In cases where the annual shareholders' meeting mentioned in paragraph 1 has adopted a resolution listed in either of the following items,

the balance of the total amount to be subtracted under the preceding paragraph after the subtraction of the amount in such items shall be deemed to be the total amount to be subtracted under the preceding paragraph.

(1) a resolution to reduce the capital reserve or retained earnings reserve under Art. 289, para 2: the balance of the total amount of the capital reserve and retained earnings reserve to be reduced after the subtraction of the total of the amounts provided in each item of said paragraph; or

(2) a resolution to reduce the stated capital under Art. 375, para. 1: the balance of the amount the stated capital to be reduced after the subtraction of the total of the amounts provided in each item of the said paragraph.”

But this 2001 Act provided that when a shareholders’ meeting determined a limit to the acquisition of its own shares, it was necessary to subtract the total acquisition price of the shares from the net asset of the company (Art. 293.5, para. 3. no.3), which meant a double subtraction. This is why some companies could not pay an interim dividend even if they had sufficient financial resources to do so.

Main Provisions:

In this situation, “the law for the amendment to the Law for Special Exception to the Commercial Code” which revises the provision concerning the acquisition of one’s own shares (“2003 Act”), was legislated by House members on July 23, 2003, promulgated on July 30, and effected from September 25. The above-mentioned desires from business world and some other problems being taken into consideration, the provisions regarding ① the lifting of the acquisition of one’s own shares on the decision of a board based on the articles of incorporation and ② the manner of calculating a limitation for the interim dividend, were provided.

1. Acquisition of one’s own shares by a resolution of the board of directors based on the articles of incorporation

2003 Act provides in Arts. 211.3, para. 1. no.2 & 210, para. 9:

“A company may purchase its own shares by a resolution of the board of directors in the following events:

(2) if its articles of incorporation provide that the company may purchase its own shares by resolution of the board of directors, and the

company purchases its own shares in the manner provided in the main clause of paragraph 9 of Art. 210.”

“A purchase of shares based on a resolution adopted pursuant to paragraph 1 shall be made by way of a transaction in the market or a tender offer as provided in Chapter II-2, Section 2 of the Securities and Exchange Law; provided, however, that this shall not apply in cases where a resolution is adopted with respect to the matter listed in paragraph 2, item (2).”

It is possible for a company to purchase its own shares by the resolution of its shareholders’ meeting as provided in the 2001 Act.

When a company exercises interim dividends based on its articles of incorporation, it must do it within the source for interim dividends (Arts. 211.3, para. 3 & 293.5).

2003 Act provides in Arts. 210.2, para. 1 & 2:

“In cases where the net asset amount on the balance sheet at the end of the business year is likely to fall below the total of the amounts mentioned in each item of paragraph 1 of Art. 290, a company may not purchase shares pursuant to the provision of Art. 204.3, para. 1; para. 1 of the preceding article; Art. 211.3, para. 1; or Art. 224.5, para. 2.”

“In cases where the net asset amount mentioned in the preceding paragraph has fallen below the total amount mentioned in the said paragraph as at the end of the business year, directors who have effected a purchase of shares pursuant to the provisions referred to in the said paragraph shall be jointly and severally liable to compensate the company (i) for the amount of difference, or (ii) if the balance of the total acquisition price of the shares purchased during the business year pursuant to the provisions referred to in the said paragraph after the subtraction of the total amount of any purchased shares that were already disposed of during the business year is less than the amount of such a difference, for such balance; provided, however, that this shall not apply to a director who has proved that he did not fail to exercise due care in having determined that there was no likelihood mentioned in the preceding paragraph.”

And the 2003 Act also provides in Art. 211.3, para. 4:

“In cases where a company has purchased its own shares pursuant to the resolution mentioned in paragraph 1, the reason for the necessity

of purchase of its own shares so purchased after the latest annual shareholders' meeting convened and concluded before such a resolution, as well as the type, the number and the total acquisition price of such purchased shares shall be reported at the first annual shareholders' meeting convened after such a purchase"

2. Amendment to the restriction on the manner of calculating a limit for the interim dividend.

The 2003 Act provides in Art. 293.5, para. 3:

"The cash distribution mentioned in paragraph 1 may be made to the extent of the total of (i) the balance of the net asset amount on the latest balance sheet after the subtraction of the amounts mentioned in items (1) through (4), and the amounts mentioned in items (5) through (7):

(1) the total amount of the stated capital and the reserves as of the end of the latest accounting period;

(2) the total amount of the retained earnings reserve set aside at the annual shareholders' meeting for the latest accounting period and the retained earnings reserve must be provided at the time of the cash distribution;

(3) the total amount determined to be distributed as dividends or paid out from the profits or incorporated into stated capital at the annual shareholders' meeting for the latest accounting period, and the total acquisition price of shares determined by the resolution mentioned in Art. 210, para. 1;

(4) in addition to those listed in the preceding three items, the amounts provided by Order of the Ministry of Justice;

(5) the balance of the amounts of capital reserve and retained earnings reserve that have been reduced after the latest accounting period, after the subtraction of the amounts provided in each item of paragraph 2 of Art. 289 with respect to such reductions of the capital reserve and the retained earnings reserve;

(6) the balance of the amount of capital reduction after the latest accounting period, after the subtraction of the amounts provided in each item of paragraph 1 of Art. 375; and

(7) in addition to those listed in the preceding two items, the amounts provided by Order of the Ministry of Justice."

Editorial Note:

On Feb. 13, 2002, the Minister of Justice (the “MOJ”) submitted two questions to the Legislative Council (the “Council”): (1) Whether or not there is a need to revise the following matters related to the corporate law? If there is, please prepare a draft of the summary of those revisions. ① A company may choose to issue or not physical share certificates. ② The public notice a company makes can be made electronically (no.55), and (2) When we modernize the Commercial Code and Yugen Kaisha Law related to corporate law, please advise us which points we must pay attention to (no.56).

Regarding question (1), the Council prepared the “Summary of introducing of the system which makes it possible not to issue physical share certificates” and “Summary of introducing of an electronic public notice system” on Sep. 10, 2003, and submitted the draft to MOJ. Among them, regarding the system which makes it possible not to issue physical share certificates, “A draft of amendment to the law related to the transfer of bonds etc. in order to rationalize the settlement of transaction of shares etc.” was settled by the Cabinet council and proposed in the 155th ordinary session of the Diet.

Regarding question (2), the corporate sub-council of the Council released “A tentative plan for a summary regarding the modernization of corporate law” on Oct. 29, 2003. This has been opened for public comments until Dec. 24, 2003. From now on, the draft will be proposed in the 156th ordinary session of the Diet in 2005.