

A New Share-listing System in Japan

Traditionally, most listings on Japanese stock exchanges have been of common shares. The Tokyo Stock Exchange has been working on a new share-listing system intended to cover the listing of non-voting shares and shares with limited voting rights. This will broaden the alternatives available to investors and give companies alternative mechanisms for raising funds.



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Introduction

Both the previously effective *Commercial Code of Japan* and the present *Companies Law of Japan* provide for issuance of various classes of shares, but historically almost all listings on Japanese stock exchanges have been of common shares, and the other permitted classes of shares have rarely been used for raising funds from the public. Recently, however, the Tokyo Stock Exchange (TSE) has been working on a new share-listing system intended in particular to encompass listing of non-voting shares and shares with limited voting rights, thereby broadening the alternatives available to investors in making equity investments, and providing companies with alternative mechanisms for raising funds from the market. This new listing system is scheduled to be initiated around July 2008.

Class share system in Japan

Under Japanese law, a joint stock corporation (*kabushiki kaisha*) may issue two or more classes of shares if the terms of such classes are provided in its articles of incorporation. In 2005, the provisions of the Commercial Code relating to joint stock corporations were replaced by the Companies Law, which incorporated certain fundamental changes with respect to classes of shares. Under the Companies Law, a joint stock corporation may issue two or more classes of shares, with classification permitted with respect to various features, including dividends, distribution of residual assets, voting rights, limitations on transfer, shareholder put options, issuer call options, veto rights relating to certain matters and rights to

appoint directors and corporate auditors.

Notwithstanding this expanded flexibility under the Companies Law, Japanese companies have not yet taken full advantage of the variety of share classes available. Most Japanese companies still have only common shares in issue. Only a limited number of companies, such as banks, have issued shares with preferred dividend rights and special rights with respect to distribution of residual assets. Also, among the preferred shares issued in the past, there has been only very narrow variation in terms and conditions. Many of such preferred shares have been non-voting, but with voting rights attaching during any period for which the preferred dividend remains unpaid.

The share listing system in Japan

The listing rules of Japanese stock exchanges include provisions for the listing of classified shares, but only for shares with preferred dividend rights and so-called tracking stocks,

which are shares on which dividends are paid in conjunction with the business results of a specified consolidated subsidiary of the issuer. Such listing rules do not reflect the variety of share classes provided under the Companies Law. Furthermore, under the current rules, only preferred shares and tracking stocks issued by already listed companies, i.e. companies which have already listed their common shares on the relevant stock exchange, are eligible for listing. Partly because of such limitation, listing of share classes other than common shares has been rare in Japan, with only a few cases of listing of preferred shares. In addition, most such issuances of preferred shares have been made by way of third-party allotment to specific sponsors (including the Japanese government). Issuance of preferred shares for the purpose of raising funds from the public has been very uncommon.

By contrast, in Europe and the US, listing systems for multiple classes of shares are firmly established. Especially in certain European countries, such as Germany, Italy and Sweden, many companies issue non-voting preferred shares and preferred shares with limited voting rights, and such preferred shares are listed and traded on the markets.

It seems clear from these models that allowing listing of various classes of shares can provide investors with alternative avenues for equity investment, while simultaneously providing companies

with increased flexibility in seeking funds from the market. More specifically, if non-voting preferred shares and preferred shares with limited voting rights become eligible for listing, companies will be able to reach investors who choose to prioritize higher dividends over voting rights.

From a different perspective, if it were possible to list only non-voting preferred shares, while maintaining common shares with full voting rights exclusively in private hands, this could constitute a defensive measure against the growing trend toward hostile takeovers in Japan, and could encourage founders of private companies to go public in this way.

Development of shares classified with respect to voting rights

Against the background mentioned above, there has been strong demand for development of a new listing system to enable, in particular, listing of shares classified with respect to voting rights. In 2006, in response to such demand, the Advisory Group on Improvements to the TSE Listing System, a working group of the TSE, commenced discussion of such a new listing system, as well as other issues relating to the current TSE listing system. The Advisory Group published its *Comprehensive Improvement Program for Listing System 2007* in April 2007, and, based on the timetable set in this document, discussed the requirements for listing of shares classified with respect to voting rights and cases in which such shares should not be permitted. The TSE published a draft outline of a new listing system for such shares in April 2008, and solicited public comments thereon through May 2008. As noted, it is expected that the rules for the new listing system will be implemented around July 2008.

Overview of listing system for shares classified with respect to voting rights

The following is an overview of the Outline published by the TSE in April 2008.

Definition of shares classified with respect to voting rights

In the Outline, "shares classified with respect to voting rights" are defined as:

- (i) Shares with no voting rights on any matter;
- (ii) Shares with no voting rights on certain material matters, such as election and dismissal of directors (shares falling within categories (i) and (ii) are collectively defined as "non-voting shares");
- (iii) Shares with voting rights exceeding other classes of shares; and
- (iv) Shares with voting rights fewer than the other classes of shares.

The Outline sets forth certain requirements for any company

wishing to issue two classes of shares having different voting rights. It does not specify requirements for any company wishing to issue three or more classes of shares having different voting rights. In any such case, the Outline indicates, the TSE will decide whether to list each class on a case-by-case basis, taking into account any concern that the interests of existing shareholders might be impaired.

Cases in which listing of shares classified with respect to voting rights will be approved

(a) Listing of non-voting shares

If the company in question is a public company (i.e. a company whose common shares are already listed), such company may also list its non-voting shares on the TSE. If the company in question is a private company applying for listing, such company may list its common shares and non-voting shares simultaneously, or may list only its non-voting shares.

(b) Listing of shares with voting rights exceeding or fewer than other classes of shares

If the company in question is a public company, such company may not list shares with voting rights exceeding or fewer than such common shares. If the company in question is a private company applying for listing, such company may list shares with fewer voting rights than its common shares, but listing of shares with voting rights exceeding its common shares will not be approved.

Examination of application for listing of shares classified with respect to voting rights

The examination of an application for listing of shares classified with respect to voting rights will consist of a formal examination and a substantive examination. The formal examination will determine whether the shares classified with respect to voting rights as to which listing is sought meet certain prescribed criteria (e.g. minimum number of shares, minimum number of shareholders, minimum market capitalization). Such criteria are similar to those applicable in the case of listing of common shares. The substantive examination will determine whether the scheme of the relevant shares "respects the interests of shareholders."

The Outline provides that the following six requirements must be met for the relevant scheme to be deemed to respect the interests of shareholders:

- (a) It must be possible to terminate the relevant share scheme in the event that any person who has made a proportionately very small investment nonetheless has control over the company.

The details of mechanisms to be adopted to enforce this

requirement are still under discussion. It has been suggested, for example, that if a shareholder were to gain control of more than a certain percentage (e.g. 75%) of total outstanding shares, the scheme of shares classified with respect to voting rights should be terminated and the relevant classified shares converted into common shares or granted full voting rights, because in such case a founding shareholder holding common shares with full voting rights (representing less than 25% of the total outstanding shares) should not be entitled to retain control over the company.

- (b) It must be possible to take measures to protect the interests of holders of shares classified with respect to voting rights from undue impairment in the event of any conflict of interests among the holders of different share classes.

The details of mechanisms to be adopted to enforce this requirement are still under discussion. For example, for certain material matters, omission of meetings of holders of non-voting shares or shares with limited voting rights might be prohibited.

- (c) If there is a controlling shareholder, it must be possible to take measures to protect minority shareholders in the case of any transaction involving a conflict of interest between such controlling shareholder and the company.

No specific measures have been proposed to satisfy this requirement. The Advisory Group has suggested as an example that disinterested directors or corporate auditors with appropriate expertise, or a special committee, be involved in the approval process for any such transaction.

- (d) In the case of listing of any class of shares with fewer voting rights, there must be a provision in the articles of incorporation that shares of any class having greater voting rights shall, upon any transfer thereof, be converted into shares of the class having fewer voting rights;
- (e) If the shares classified with respect to voting rights have preferred dividend rights, it must in principle be likely that the company will achieve sufficient profit to pay the prescribed dividends for such class; and

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- (f) In addition to (a) through (e) above, there must be no material risk that the interests of shareholders or investors will be impaired.

Movement toward use of shares classified with respect to voting rights

In anticipation of the implementation of the new listing system for shares classified with respect to voting rights, some listed companies are already seeking to utilize the listing of such shares for equity finance. Last year, Ito En Ltd, a large Japanese beverage company, listed preferred shares with no voting rights on the TSE, and made a public offering of such preferred shares. This year, it is expected that another company will amend its articles of incorporation to make possible the issuance of new classes of preferred shares without voting rights, subject to shareholder approval at its general shareholders' meetings to be held in late June. This in turn suggests that preferred shares with no voting rights or with limited voting rights will see increased use for equity financing in Japan in the future.

It can also be anticipated that some companies may seek to utilize the new listing system as a defensive measure against hostile takeovers. In this scenario, as well, it will be necessary to satisfy the six requirements deemed to comprise "respecting the interests of shareholders" outlined above, but further discussion remains necessary both inside the TSE and between the TSE and the relevant companies as to the specific provisions to be included in their articles of incorporation. Accumulation of precedents over time will provide guidance as to what mechanisms will be permitted in the Japanese market.

About the author

Kazuhiro Yoshii is a partner with Anderson Mōri & Tomotsune. His principal areas of practice are securities law and corporate law, including capital market and M&A transactions. He is admitted to practice in Japan and the State of New York. He earned a Bachelor of Laws degree (LLB) from the University of Tokyo in 1997 and a Master of Laws degree (LLM) from the University of California at Berkeley, School of Law, in 2005. He was associated with the New York office of Shearman & Sterling from 2005 to 2006.