

Trends in Improvements to the Legal Framework Governing Rights Offering

On January 19, 2011, the Japanese Financial Services Agency ("FSA") issued a report on the allotment of stock acquisition rights to shareholders without consideration ("**Rights Offering**").¹ The report discusses the following potential modifications to the regulations governing such Rights Offering:

- (1) flexibility in the manner of delivery of a prospectus,
- (2) revisions to regulations governing the amendment of a Securities Registration Statement ("**SRS**") for the purpose of incorporating continuous disclosure documents by reference,
- (3) revisions to the scope of the "underwriting of securities," and
- (4) changes in regulations governing tender offer bids and large shareholdings reports.

The following is an overview of the contents of FSA's report, a discussion of the purpose of the proposed modifications to the relevant regulations, and a closing remark noting that the report leaves certain matters unaddressed.

I. Contents of FSA report

I.1. Flexibility in the manner of delivery of a prospectus

The report recommends releasing issuers from the obligation to deliver prospectuses to all existing shareholders in cases where (i) stock acquisition rights to be offered in a Rights Offering are listed on a stock exchange in Japan, (ii) the issuer files an SRS when issuing the stock acquisition rights and discloses the SRS through the EDINET system, and (iii) the issuer provides constructive notice to shareholders through daily newspaper advertisements which inform the public of the web address of EDINET and other information.

I.2. Revisions to the amendment of a SRS for the purpose of incorporating continuous disclosure documents by reference

Instead of requiring the issuer of Rights Offering to file an amendment of an SRS through EDINET each time when the issuer files a continuous disclosure document (*e.g.*, annual securities reports, quarterly reports, etc.) during the exercise period of the stock acquisition rights, which can be a burdensome process, the report proposes that the filing of an amendment of an SRS should not be required in cases where the time of filing the continuous disclosure documents is described in the SRS in advance at the time of its initial filing, even if such continuous disclosure documents are filed after the date the SRS comes into effect.

¹ See <http://www.fsa.go.jp/news/22/singi/20110119-5.html>

I.3. Revisions to the scope of the "underwriting of securities" and changes in regulations governing tender offer bids and large shareholdings reports

In the case of a so-called "commitment" type Rights Offering, which involves a firm commitment by an underwriter (*i.e.*, securities company) to acquire all the unexercised stock acquisition rights (such underwriter will thereafter exercise such stock acquisition rights and sell the shares to be acquired upon such exercise through the secondary market), such acts of underwriters are not currently deemed the "underwriting of securities." However, the report proposes to deem such underwriters' acts as the "underwriting of securities", which could impose additional regulations on such underwriters as a result.

In relation to such revision of the scope of the "underwriting of securities", the report proposes that regulations governing tender offer bids should be revised to expand the underwriter's temporary holding period and the period during which an underwriter may be exempted from the duty to file a large shareholdings report. These proposed changes are discussed in greater detail in section II below.

II. Purpose of FSA report

II.1. Remedy burdens under the current laws and regulations

As a Rights Offering is less likely to cause the dilution of the ownership interests of existing shareholders compared to other types of share offerings (such as public offerings and third party allotments), there has been demand for the use of Rights Offerings on a practical level in Japan for some time. Nevertheless, in order to make use of a Rights Offering, there still remain burdens under the current laws and regulations. The purpose of the report, which was published from the perspective of facilitating the use of Rights Offerings, is to present measures to address these burdens under the current laws and regulations.

II.2. Issues common to both non-commitment type and commitment type Rights Offerings

A Rights Offering often involves a burdensome, costly and time-consuming filing procedure, which is a problem that has been raised for some time. For example, requiring an issuer to distribute prospectuses to all existing shareholders may be virtually impossible for some issuers. Also, if a continuous disclosure document is filed between the date an SRS comes into effect and the expiration of the period by when stock acquisition rights are to be exercised, then it is necessary to file an amendment of the SRS in order to incorporate such disclosure document by reference, which is a burdensome procedure as well. FSA's report aims to reduce these burdens and shorten the process for a Rights Offering.

II.3. Issues specific to commitment type Rights Offerings

A commitment type Rights Offering has the advantage that the ratio at which stock acquisition rights will be exercised can be determined in advance because the underwriter is subject to a firm commitment to acquire all of the unexercised stock acquisition rights.

However, the present regulations governing commitment type Rights Offerings present obstacles to underwriters. Specifically, if more than a certain number of shares are acquired by an underwriter, then the underwriter is subject to regulations governing (i) tender offer bids and (ii) large shareholdings reports. FSA's report suggests revising the regulations governing commitment type Rights Offerings in order to exempt underwriters from (i) tender offer bid regulations and (ii) the duty to file large shareholdings reports in connection with stock acquisition rights or shares to be held by underwriters for a limited period of time in a commitment type Rights Offering, assuming that the scope of the "underwriting of securities" will expand to cover the underwriter's acts under the Rights Offering.

III. Remaining Issues

Although FSA's report proposes revisions that are favorable in some respects, the report does not address all areas in which improvements could be made.

III.1. Allotment notice period for Rights Offering

Currently, the issuer has a duty to give notice of (i) the contents of stock acquisition rights allotted to shareholders and (ii) the number of such rights allotted to shareholders under the Companies Act. A two-week waiting period must fall between the date the issuer gives such notice and the commencement date for the exercise of stock acquisition rights. This point has been debated in hearings of the Corporate Law Subcommittee of the Legislative Council of the Ministry of Justice², but FSA's report does not offer any specific recommendations to reduction or elimination of such two-week waiting period.

III.2. Gun-jumping issues

The present regulations in Japan prohibit so-called "gun-jumping," which is the public offering of securities prior to the filing of an SRS or an equivalent document by the issuer of such securities. An example of a controversial behavior is the issuer's contacting a large shareholder and gauging such large shareholder's interest in exercising its stock acquisition rights under a contemplated Rights Offering. FSA's report leaves open to interpretation whether such behavior infringes prohibitions on gun-jumping.

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² See minutes of the fifth meeting of the Corporate Law Subcommittee of the Legislative Council of the Ministry of Justice (<http://www.moj.go.jp/content/000056163.pdf>), p.40, *et seq.*

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