JAPAN

Law and Practice

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1. Types of Company, Share Classes and Shareholdings

1.1 Types of Company

The Companies Act provides four types of companies: stock company (*kabushiki kaisha*), general partnership company (*gomei kaisha*), limited partnership company (*goshi kaisha*) and limited liability companies (*godo kaisha*). The most popular form of company is a stock company (which comprises a significant majority of companies), followed by a limited liability company. Unless otherwise stated, a reference to a "company" in this article means a "stock company".

1.2 Types of Company Used by Foreign Investors

A stock company (*kabushiki kaisha*) or a limited liability company (*godo kaisha*) is generally used by foreign investors.

1.3 Types or Classes of Shares and General Shareholders' Rights

The Companies Act outlines the rights of general shareholders. Additionally, it allows companies to issue different classes of shares with differing rights by defining the specific rights and matters that can be differentiated among the different classes, such as the right to receive dividends or residual assets or voting rights, in their articles of incorporation.

The most common class of shares is preferred shares with preferential rights for dividends and residual assets. These are often accompanied by rights to convert preferred shares to ordinary shares. While preferred shares are often issued by any type of company (including listed companies), especially for financing purposes, preferred shares are frequently used by start-up companies.

1.4 Variation of Shareholders' Rights

The Companies Act adopts the principle of equality of shareholders, and thus, a company shall treat its shareholders equally in accordance with the features and number of shares they hold. As discussed in **1.3 Types or Classes of Shares and General Shareholders' Rights**, a company can issue different classes of shares with differing rights by setting out these rights in its articles of incorporation; however, the company shall treat its shareholders holding the same class of shares equally in accordance with the number of this class of shares they hold.

In addition, a company that is not a public company (ie, a transfer of shares of such company is restricted under its articles of incorporation) may include in its articles of incorporation a provision providing that each shareholder shall receive different treatment with respect to:

- the right to receive dividends of surplus;
- the right to receive distribution of residual assets; and
- the right to cast a vote at a shareholders' meeting.

1.5 Minimum Share Capital Requirements

Under Japanese law, there are no minimum share capital requirements for companies.

1.6 Minimum Number of Shareholders

For companies established under Japanese law, there is no minimum number of shareholders and no requirements for shareholders to be resident in Japan.

As a general rule, there are no requirements for shareholders to invest in Japanese companies. Under the Foreign Exchange and Foreign Trade Act (FEFTA), foreign investors must submit prior notification to the Minister of Finance and the competent minister for the target company's business and wait for a specified period if:

- foreign investors intend to acquire any shares of a private company (except if a foreign investor intends to acquire shares of a private company from another foreign investor unless the acquisition may have a potential risk of harming Japan's national security) or 1% or more of the shares or voting rights (including through proxies) of a listed company; and
- the target company engages in certain restricted businesses identified in the FEFTA, including businesses related to national security, public order, public security or smooth management of Japan's economy.

For the purposes of the prior notification requirements, the FEFTA provides exemptions for investments that meet certain criteria in order to qualify as passive investments. The FEFTA also provides a post-acquisition notification requirement for foreign investors.

Additionally, there are some restrictions on the holding of shares by a foreign investor in a company engaging in certain types of business, such as airlines and the broadcasting business, under laws regulating those specific business sectors.

1.7 Shareholders' Agreements/Joint Venture Agreements

When a shareholder intends to engage in a joint venture with other persons, a shareholder commonly enters into a shareholders' agreement or joint venture agreement with other shareholders. While the joint venture company is usually a private company, in public or listed companies, shareholders sometimes enter into a shareholders' agreement with other shareholders.

1.8 Typical Provisions in Shareholders' Agreements/Joint Venture Agreements

Shareholders' agreements regarding private companies typically include the following provisions:

- agreements on governance (eg, process of general shareholders' meetings, board composition, designation of representative directors, process of the board, shareholders/board reserved matters, veto rights, deadlock process, composition of statutory auditors, designation of an accounting auditor and information rights);

- agreements on shares (eg, transfer restrictions, anti-dilution (pre-emptive right), right of first refusal/offer, put/call option, tag-along, and drag-along); and
- other agreements (eg, non-competition, non-solicitation, dividend policy, dissolution/liquidation and termination).

The validity or enforceability of shareholders' agreements depend on the types of provisions in question. Voting agreements, such as an agreement to exercise voting at a general shareholders' meeting to establish an agreed board composition and to exercise veto rights with regard to certain material matters, are generally considered valid, unless they violate the purposes of the laws or public policy, and are generally enforceable to some extent among the shareholders who are parties to the shareholders' agreement.

However, if a shareholder exercises its voting rights in violation of a voting agreement entered into between some (but not all) shareholders of the company, the voting agreement would not generally be binding on the company, and a resolution made based on that exercise of voting rights would not generally be subject to revocation. Conversely, if all shareholders of the company are parties to the voting agreement, the resolution made through such a process may be revocable.

As to an agreement between shareholders regarding a restriction on transfer of shares, in general, a transfer of shares in violation of such an agreement would not generally be void in relation to the company and third parties. By contrast, agreements between shareholders and the company restricting the transfer of shares might be void because it could be used by the management to exert control over the company.

Shareholders' agreements involving private companies are not disclosed to the public, while certain agreements involving shares in listed companies are disclosed in large-scale shareholding reports filed by shareholders or security reports or extraordinary reports filed by target companies (see **3.4 Disclosure of Interests** and **7.1 Duty to Report**).

2. Shareholders' Meetings and Resolutions

2.1 Types of Meeting, Notice and Calling a Meeting

A stock company must hold an annual general meeting (AGM) within a certain period of time following the end of each business year, and usually a company's articles of incorporation specify the timing of the AGM.

In order to hold an AGM, generally, a company must give a convocation notice to shareholders two weeks before the date of the AGM. However, the Companies Act stipulates the following exceptions:

- if the company obtains the consents of all the shareholders and the company does not use voting cards or electronic voting cards, the notice can be omitted; or
- if the company is a private company (other than private companies that adopt the electronic provision of materials for general meetings of shareholders) and does not use voting cards or electronic voting cards, the notice period will be one week before the date of the AGM, provided that, if the company does not have a board of directors, the period may be shortened by a provision in the company's articles of incorporation.

The convocation notice must provide:

- the date, time and place of the meeting;
- the agendas of the meeting;
- whether voting cards or electric voting cards are used; and
- other matters prescribed by the Ministry of Justice of Japan.

Upon the enforcement of the amendment to the Companies Act and other relevant acts on 1 September 2022, listed companies are required to upload information and materials for the AGM and other such shareholders' meetings to a web page three weeks before the meeting to ensure that shareholders can download them. Other companies that adopt the electronic provision of materials for general shareholders' meetings must do the same.

Common agenda items at an AGM include elections of directors and statutory auditors, distribution of dividends, compensations of directors and statutory auditors, and the approval of financial statements. However, with respect to the financial statements, if the company has an accounting auditor and the accounting auditor opines that the financial statements are accurate and appropriate, only the report of the financial statement to the AGM is required (ie, the approval by the AGM is not required).

A stock company may hold other general shareholders' meetings (apart from the AGM), if necessary.

2.2 Notice of Shareholders' Meetings

There are no significant differences between the convocation notices delivered for an AGM and other general shareholders' meetings.

2.3 Procedure and Criteria for Calling a General Meeting

Directors, as well as certain shareholders, can call a general shareholders' meeting. A shareholder of a public company who owns at least 3% of the voting rights of all shareholders in the company, consecutively for the preceding six months or more, may demand that the directors call a general shareholders' meeting regarding any matter that the shareholder calling the meeting is entitled to vote on, unless otherwise provided for in the articles of incorporation (Article 297 of the Companies Act). The holding period requirement does not apply to shareholders of a private company.

If the calling procedure for a general shareholders' meeting is not implemented without delay after the demand by the shareholder, or if the notice calling the general shareholders' meeting to be held within eight weeks of the date of demand is not dispatched, the shareholder who made the demand may call the general shareholders' meeting with the permission of the court. In this case, the shareholder can prepare and send the convocation notice to all shareholders on behalf of the company.

2.4 Information and Documents Relating to the Meeting

All shareholders are entitled to receive the convocation notice for a general shareholders' meeting except for shareholders who do not have the right to vote on any matter to be voted on at such meeting. In connection with the AGM, directors must provide a business report and financial statements to the shareholders.

Shareholders have the right to request a company to provide them access to inspect or copy certain company documents. The following

describes the major rights regarding their access to documents.

- Shareholder registry: shareholders have the right to make a request for the inspection or copying of the shareholder registry. There are certain exceptions, including requests (i) for purposes other than to conduct research to secure or exercise the shareholder's rights, or (ii) for purposes of interfering with the execution of the operations of the company or prejudicing the common interest of the shareholders (Article 125 of the Companies Act).
- Minutes: shareholders have the right to make a request for the inspection or copying of minutes of general shareholders' meetings (Article 318 of the Companies Act), the board of directors' meetings (Article 371 of the Companies Act), the board of statutory auditors' meetings (Article 394 of the Companies Act), the audit and supervisory committee's meetings (Article 399-11 of the Companies Act) and the three committees' (nominations, audit and remuneration) meetings (Article 413 of the Companies Act). In companies with a statutory auditor, three committees (nominations, audit and remuneration) or an audit and supervisory committee, shareholders must obtain the permission of the court to access the minutes of the board of directors' meetings. Shareholders are also required to obtain permission of the court to access the minutes of the board of statutory auditors' meetings, the audit and supervisory committee meetings and the three committees' meetings.
- Financial documents: shareholders have the right to make a request for the inspection or copying of financial statements (Article 442 of the Companies Act). In addition, a shareholder with 3% or more of the votes of all shareholders, or with 3% or more of outstanding shares, has the right to make a request for the inspection or copying of account books or any materials related to them. There are certain exceptions, including those described above regarding access rights to the shareholder registry and cases where the shareholder operates or engages in a business which is, in substance, in competition with the business of the company (Article 433 of the Companies Act).
- Voting cards/proxies: shareholders have the right to make a request for the inspection or copying of voting cards (Article 311 of the Companies Act), electronic voting cards (Article 312 of the Companies Act) and proxies (Article 310 of the Companies Act) with respect to voting rights at a general shareholders' meeting. The exceptions described above regarding access rights to the shareholder registry also apply to access rights to voting cards, electronic voting cards and proxies.

2.5 Format of Meeting

It is recognised that under the Companies Act, although general shareholders' meetings of Japanese companies cannot be held solely through virtual means (ie, a physical meeting must be held), companies may permit their shareholders to participate or attend remotely through the internet.

In addition, the amendment to the Act on Strengthening Industrial Competitiveness enacted in June 2021 allows a listed company to hold its general shareholders' meeting only by virtual means by amending its articles of incorporation to permit such meeting only by virtual means, and by obtaining a confirmation from the Minister of Economy, Trade and Industry and the Minister of Justice thereof.

2.6 Quorum, Voting Requirements and Proposal of Resolutions

Ordinary Resolution

The Companies Act provides that an ordinary resolution at a general shareholders' meeting is made by a majority of votes of shareholders present at the meeting where the quorum is the presence of shareholders holding the majority of votes of the shareholders entitled to vote, unless otherwise provided for in the articles of incorporation. Many listed companies have eliminated the quorum requirements for ordinary resolutions by setting forth such provisions in their articles of incorporation; however, under the Companies Act, for certain agenda items, including elections or dismissals of directors, quorum cannot be eliminated and must be at least one third of the votes of the shareholders entitled to vote.

Extraordinary Resolution

Certain important matters, such as amendments to the articles of incorporation and the issuance of new shares (excluding those which may be carried out by a resolution at a board of directors' meeting), mergers, share exchanges, company splits, share transfers or material business transfers (excluding those to which a short-form or small-sized exception is applied), must be resolved by an extraordinary resolution made by a majority of two thirds of the votes of shareholders present at a general shareholders' meeting, with the required quorum being shareholders holding a majority of the votes of the shareholders entitled to vote being present, unless otherwise provided for in the articles of incorporation. Many listed companies have decreased the quorum for extraordinary resolutions from a majority to one third of the votes of the shareholders entitled to vote by setting forth such provisions in their articles of incorporation.

Other Special Matters

The Companies Act also provides stricter requirements for resolutions for certain limited matters.

2.7 Types of Resolutions and Thresholds

As discussed in **2.6 Quorum, Voting Requirements and Proposal of Resolutions**, the Companies Act generally provides for certain types of resolutions that must be voted on, thresholds for those resolutions and which type of resolution is necessary for a particular agenda.

2.8 Shareholder Approval

In a company that does not have a board of directors, any matter regarding a company can be resolved at a general shareholders' meeting of the company. By contrast, in a company that has a board of directors, a general shareholders' meeting can only resolve matters that are stipulated for this type of meeting in the Companies Act and in the company's articles of incorporation, as the execution of operations of the company is generally delegated to the board of directors.

It is the general rule that matters material to the company, or its shareholders, require shareholder approval to be obtained pursuant to the procedures set out in the Companies Act. Generally, shareholder approval for agenda items must be obtained by calling a general shareholders' meeting; if all shareholders of the company consent in writing to agenda items to be resolved at the meeting, a resolution is deemed to have been approved. The required percentage of the approval differs depending on the type of the resolution, as discussed in **2.6 Quorum, Voting Requirements and Proposal of Resolutions**.

2.9 Voting Requirements

In order to pass a resolution, a certain number of votes for the agenda item is required, as discussed in **2.6 Quorum, Voting Requirements and Proposal of Resolutions**.

As a general rule, companies are not required to adopt any specific method of counting the votes and they are allowed to use a method that is reasonable depending on the situation. Thus, voting may be conducted by clapping hands or a show of hands.

For shareholders who are unable to attend the meeting to cast votes, the company may provide voting cards and electronic voting cards. Shareholders are also allowed to vote by proxies but many listed companies in their articles of incorporation restrict the recipient of a proxy to another shareholder of the company. Under the Companies Act, if a company has more than 1,000 shareholders who have the right to vote, the company must use voting cards unless it sends shareholders proxy cards with the convocation notice pursuant to the FEIA.

2.10 Shareholders' Rights Relating to the Business of a Meeting

Unless otherwise provided for in the articles of incorporation, a shareholder of a public company with a board of directors who own, consecutively for the preceding six months or more, at least 1% of the voting rights of all shareholders in the company or at least 300 votes in the company, may, by submitting a demand to the directors no later than eight weeks prior to the day of a general shareholders' meeting:

- demand that directors of the company present proposals submitted by the shareholder as an agenda at the general shareholders' meeting (Article 303 of the Companies Act); and
- demand that the directors describe the summary of the proposals in convocation notices of the general shareholders' meeting (Article 305 of the Companies Act).

The requirement of a holding period does not apply to shareholders of a private company.

In addition, shareholders attending a general shareholders' meeting may submit proposals at the general shareholders' meeting with respect to the matters that are within the purpose of that general shareholders' meeting (Article 304 of the Companies Act). Under the amended Companies Act enforced in 2022, the number of proposals that each shareholder can demand the directors to provide summaries of in the convocation notice of the shareholders' meeting is limited to ten.

2.11 Challenging a Resolution

A shareholder may challenge a resolution of a general shareholders' meeting by filing an action with the court within three months from the date of that resolution, in the event of any of the following (Article 831 of the Companies Act):

- where the calling procedures or the methods of a resolution at the general shareholders' meeting violate laws and regulations or the articles of incorporation, or are conducted in a grossly improper manner;
- the contents of the resolution at the general shareholders' meeting violate the articles of incorporation; or
- a grossly improper resolution is passed as a result of a person with a special interest in the resolution at the general shareholders' meeting exercising a voting right.

Even if the calling procedures or the method of resolution of the general shareholders' meeting are in violation of the applicable laws and regulations or the articles of incorporation, the court may dismiss the claim if it finds that the violations are not serious and will not affect the resolution.

2.12 Institutional Shareholder Groups

In Japan, over 300 institutional investors have adopted the Stewardship Code of Japan, which requires institutional investors adopting this code to have constructive dialogues with their investee companies in order to enhance the corporate value of their investee companies. As a result, institutional investors are becoming more active in having meetings with the listed companies in which they invest, and discussing their concerns and issues regarding those listed companies. Listed companies learn about such concerns and issues from such meetings and may take those into account in their management of the companies' business and operations. Many institutional investors set and disclose their voting policies; and such policies also may influence the actions of the listed companies. The shareholding ratio of foreign institutional investors in listed companies of Japan has been growing during the last 20 years, and it is now becoming ever more difficult for such listed companies to ignore the opinions or demands of their investors.

2.13 Holding Through a Nominee

As a general rule, if a person holds shares in listed companies through nominees, the companies must treat those nominees as shareholders. Therefore, that person does not directly have information rights or voting rights, and may have to cause its nominees to exercise such information rights or voting rights. In general, neither does that shareholder have the right to attend shareholders' meetings of such listed companies. However, the National Association of Shareholder Affairs (*Zenkokukabushikikonwakai*), the association composed of Japanese practitioners, published the "Guideline on Attendance at the General Shareholders Meetings of Japanese Listed Companies by Global Institutional Investors", which explains issues and procedures for allowing those persons to attend such shareholders' meetings, and some listed companies permit those persons to attend them in accordance with the guideline.

2.14 Written Resolutions

Shareholders can pass a resolution without holding a meeting if (i) directors or shareholders submit a proposal of the matter to be resolved, and (ii) all shareholders who have a right to vote on such matter agree to such a proposal in writing or in an electronic or magnetic record (Article 319 of the Companies Act).

3. Share Issues, Share Transfers and Disclosure of Shareholders' Interests

3.1 Share Issues

A private company can issue new shares to either its shareholders or third parties by an extraordinary resolution at a general shareholders' meeting. However, if a private company grants rights to its shareholders to receive an allotment of shares, and its articles of incorporation provide as such, it can issue such shares to the shareholders without the approval of a general shareholders' meeting.

A public company can generally issue new shares to either its shareholders or third parties by a board resolution to the extent of the number of shares authorised in its articles of incorpora-

tion. However, if the issue price for such new shares is particularly favourable to subscribers, a public company must obtain an approval by an extraordinary resolution at a general shareholders' meeting for such share issue. Also, if subscribers would own a majority of total voting rights as a result of a third-party allotment, and shareholders having 10% or more of total voting rights would give a notice to the effect that it dissents to such allotment, the company would be required to obtain approval at a general shareholders' meeting unless the company's financial condition has deteriorated greatly and there is an urgent necessity for such allotment in order for the company to continue in business.

If the share issue (i) violates laws and regulations or the articles of incorporation or (ii) is affected by a method that is extremely unfair, and shareholders are likely to suffer a disadvantage, shareholders may demand that the company cease the share issue (Article 210 of the Companies Act).

3.2 Share Transfers

As a general rule, shareholders may transfer their shares to a third party. However, in many private companies, their articles of incorporation provide that any transfer of shares requires approval of the company (by approval of the board of directors or a general shareholders' meeting, which is determined in accordance with the type of company and the law or the articles of incorporation). The shareholder may request the company to purchase the shares, or to procure a person designated by the company to purchase the shares, if the company does not approve the transfer. The purchase price of this transfer will be determined by an agreement between the shareholder and the purchaser. If they cannot reach an agreement, the court will determine the price upon a petition by the shareholder or purchaser.

As discussed in **4.2 Buybacks**, shareholders may also transfer their shares to the company in accordance with certain procedures provided in the Companies Act, and the buyback of shares by the company is subject to the distributable amount of the company.

As discussed in **3.4 Disclosure of Interests**, certain acquisitions of shares in a Japanese company may require the filing of a prior or post-acquisition notification with, or the permission of, the regulatory authority.

3.3 Security Over Shares

Shareholders may establish pledges over their shares. Procedures to establish and perfect the pledges vary, depending on the types of pledges and on whether the company is one that issues share certificates or whether shares of the company are listed (ie, book-entry transfer shares).

3.4 Disclosure of Interests

A shareholder of a listed company must file a large-scale shareholding report with the relevant local finance bureau (which is available to and accessible by the public through the internet) within five business days of the shareholder's shareholding ratio in the company exceeding 5% (Articles 27-23, FIEA). The shareholding ratio shall be calculated by aggregating shares held by the shareholder with any other shareholders with whom the shareholder has agreed to acquire or transfer shares in the company jointly, or to exercise the voting or other rights jointly as shareholders of the company.

If the shareholding ratio increases or decreases by 1% or more after filing the large-scale shareholding report, the shareholder must file

an amendment to the report within five business days from the date of the increase or decrease. However, certain financial institutions are required to file the large-scale shareholding report only twice a month, even if their shareholding ratios and changes in shareholding ratios meet the foregoing criteria if they satisfy certain requirements under the FIEA, such as not having the intention to take actions to materially influence the business activities of the company.

For listed companies, shareholders who own shares through custodians do not appear in the shareholder registries of these companies because such custodians are registered in the shareholder registries. A company cannot require its shareholders to disclose their beneficial owners of the shares.

As discussed in **1.6 Minimum Number of Shareholders**, a foreign investor may be required to file a prior notification or post-acquisition notification with the Minister of Finance and the competent minister in accordance with the FEFTA, if they acquire a certain amount of shares of a company in Japan.

Under the Anti-monopoly Act, if a company with annual domestic sales (aggregated with domestic sales of its group companies) of more than JPY20 billion intends to acquire shares in a target company with annual domestic sales (aggregated with domestic sales of its subsidiaries) of more than JPY5 billion, and such acquisition would result in the acquiring company holding more than 20% or 50% of the voting rights in the target company, the acquiring company must file prior notification of the plan of acquisition with the Japan Fair Trade Commission (JFTC) at least 30 days prior to the closing of such acquisition (the waiting period may be shortened if the permission of the JFTC is obtained).

In addition, certain laws regulating specific business sectors require investors to file a notification with the regulatory authority if they acquire certain amounts of shares in regulated companies. For instance, the Banking Act provides that a shareholder of a bank must file a notification with the Financial Services Agency (FSA) within five business days of the shareholder having a voting rights ratio in the bank exceed 5%; and, if the voting rights ratio increases or decreases by 1% or more thereafter, such shareholder must file an amendment to the notification. Also, a shareholder that plans to become a shareholder holding 20% or more of the voting rights of the bank must obtain permission from the FSA in advance.

4. Cancellation and Buybacks of Shares

4.1 Cancellation

Companies can cancel their treasury shares by a resolution of their board of directors.

4.2 Buybacks

A company can buy back its shares through the market (including ToSTNeT-3 which is the off-floor trading system of the Tokyo Stock Exchange) or a tender offer by a board resolution, if permitted by the articles of incorporation of the company. Also, a company can buy back its shares from a specific shareholder based on an agreement between the shareholder and the company by an extraordinary resolution at a general shareholders' meeting.

The buyback of shares by the company is restricted to the distributable amount of the company. A buyback of shares that violates such restriction is void, and the sellers of the shares, any executives who performed such

buyback and certain relevant persons are jointly and severally liable to the company for payment of monies in an amount equivalent to the book value of the monies and any other assets delivered to the sellers provided that the executives and relevant persons will not be liable if they prove that they did not fail to exercise due care with respect to the performance of their duties (Article 462 of the Companies Act). Furthermore, if the distributable amount in a financial statement as of the end of the fiscal year in which the buyback is carried out is a negative number, the executives who performed the buyback are jointly and severally liable to the company for the payment of the smaller of the absolute value of the negative amount or the amount paid to the sellers unless the executives prove that they did not fail to exercise due care with respect to the performance of their duties (Article 465 of the Companies Act).

5. Dividends

5.1 Payments of Dividends

As a general rule, a company may distribute dividends to shareholders by obtaining a resolution of its general shareholders' meeting. A company may distribute dividends only once during a business year by a resolution of the board if the company has a board of directors and the articles of incorporation provide for such a distribution. Also, if a company has an accounting auditor and the term of office of directors other than directors who are audit and supervisory committee members is one year, the articles of incorporation may set provisions to allow the board the authority to decide on the distribution of dividends and take away such authority from the general shareholders' meeting on the condition that the accounting auditor opines that the financial statements of the last business year are accurate and appropriate.

The Companies Act does not explicitly restrict the timing of the distribution of dividends. Usually, companies pay the distribution to shareholders promptly after they obtain a resolution for the distribution.

Under the Companies Act, the amount of the distribution of dividends must be within the distributable amount at the time of the effective date of such distribution. The distributable amount is calculated based on the amount of the company's surplus of the company and the details of how to calculate it are provided by the Companies Act and the Regulations on Corporate Accounting.

6. Shareholders' Rights as Regards Directors and Auditors

6.1 Rights to Appoint and Remove Directors

Shareholders who are eligible to submit shareholder proposals may submit, to directors of a company, a shareholder proposal to appoint a person as a director or to remove an incumbent director. If this proposal is approved at a general shareholders' meeting, the person will be appointed as a director or the incumbent director will be removed.

In principle, the voting requirement for the appointment or dismissal of directors is the same as that for an ordinary resolution, provided that the quorum cannot be reduced to less than one third of shareholders eligible to vote at a general shareholders' meeting. In a company with an audit and supervisory committee, however, the dismissal of a director who is an audit

and supervisory committee member must be resolved by an extraordinary resolution.

A company may increase the voting requirement for the appointment or dismissal of directors from a majority of votes of shareholders present at a general shareholders' meeting with a quorum by setting forth those increased requirements in the company's articles of incorporation, although an increase for such dismissals is often strongly criticised by shareholders, particularly institutional investors. A director who is dismissed is entitled to claim damages arising from the dismissal from the company, except in cases where there are justifiable grounds for dismissal.

If, notwithstanding the presence of misconduct or material facts showing violation of laws and regulations or the articles of incorporation in connection with the execution of the duties of a director, a proposal to dismiss that director is rejected at a general shareholders' meeting, a shareholder holding 3% or more of the votes of all shareholders or 3% or more of the outstanding shares for at least the preceding six months may demand dismissal of that director by filing an action with the court within 30 days from the general shareholders' meeting (Article 854 of the Companies Act); this holding period requirement does not apply to shareholders of a private company.

6.2 Challenging a Decision Taken by Directors

Shareholders who are dissatisfied with a decision or action taken by directors or the board of directors may take action to remove the relevant directors as discussed in **6.1 Rights to Appoint and Remove Directors**.

Also, as discussed in **10.2 Remedies Against the Directors**, a shareholder who meets certain requirements may:

- file to enjoin a director's illegal actions;
- bring a derivative action to recover damages and liabilities caused by the company's directors due to a violation of their duty of care and loyalty to the company; and
- directly claim damages arising out of actions conducted in bad faith or with gross negligence in the performance of directors' duties.

In addition, if there are sufficient grounds to suspect misconduct or material facts regarding violation of laws and regulations or the articles of incorporation in connection with the execution of the operations of the company, a shareholder with 3% or more of the votes of all shareholders or with 3% or more of outstanding shares may file a petition for the appointment of an inspector with the court in order to have the inspector investigate the status of the operations and the financial status of the company (Article 358 of the Companies Act).

6.3 Rights to Appoint and Remove Auditors

As with an appointment or removal of directors, shareholders who are eligible to submit shareholder proposals may submit a shareholder proposal to appoint a person as a statutory auditor or remove an incumbent statutory auditor. The voting requirement for the appointment of a statutory auditor is the same as for the appointment of a director, and the voting requirement for the dismissal of a statutory auditor is the same as the requirement for an extraordinary resolution. The action for dismissal described in **6.1 Rights to Appoint and Remove Directors** is also available for the dismissal of a statutory auditor.

Some large companies appoint accounting auditors that are usually external accounting firms. Shareholders who are eligible to submit shareholder proposals may submit a shareholder proposal to appoint a person as an accounting auditor or remove an incumbent accounting auditor. The voting requirement for the appointment or dismissal of an accounting auditor is the same as the requirement for an ordinary resolution.

A statutory auditor or an accounting auditor who is dismissed is entitled to claim from the company damages arising from the dismissal, except where there are justifiable grounds for that dismissal.

7. Corporate Governance Arrangements

7.1 Duty to Report

Companies need to describe certain matters concerning their corporate governance in their business reports which are reported at their annual general shareholders' meetings. Listed companies are also required to state their corporate governance arrangements in their annual security reports and corporate governance reports, both of which are required to be available to the public through the internet.

The amendment to the Cabinet Office Order on Disclosure of Corporate Affairs, which came into force in April 2024, provides that after 1 April 2025 certain material agreements entered into between a listed company and its shareholders will need to be disclosed in an annual security report or extraordinary report of such listed company. Such material agreements include: (i) agreements between a listed company and its shareholder regarding nomination of candidates for director, restrictions on exercising voting rights or prior consent rights on matters to be resolved at a shareholders' meeting or board of directors' meeting; and (ii) agreements between a listed company and its shareholder who has filed a large-scale shareholding report regarding restrictions on transfer of shares, standstill regarding accumulation of shares, share subscription rights or such company's call options.

8. Controlling Company

8.1 Duties of a Controlling Company

The Companies Act does not stipulate explicit duties and liabilities of a controlling company with respect to the shareholders of a company it controls. Although it is theoretically recognised that a controlling company may be liable to the minority shareholders of its subsidiary in respect of its management of the subsidiary, the law is not clear on what triggers this liability. Because of this uncertainty, in Japan the issue of conflict of interests on a transaction between a controlling company and its subsidiary is generally expected to be solved by the election of independent directors for the subsidiary who are independent from the controlling company, and letting such independent directors conduct their duties for the benefit of the minority shareholders of the subsidiary.

9. Insolvency

9.1 Rights of Shareholders If the Company Is Insolvent

Under the Companies Act, a company may be dissolved by an extraordinary resolution at its general shareholders' meeting and go into liquidation. The shareholders of a company in liquidation have a right to receive residual assets of the company after the performance of its obli-

gations is complete. Liquidation is eventually concluded upon the approval of the settlement of accounts by an extraordinary resolution at a general shareholders' meeting. Shareholders of a liquidating company may file a petition for the commencement of special liquidation, which is a liquidation procedure carried out under supervision of the court in cases where circumstances prejudicial to the implementation of the liquidation exist or there are suspicious reasons or factors for the insolvency of the company (Article 511 of the Companies Act).

A shareholder with one tenth or more of the voting rights of all shareholders of a company has the right to file a petition for the commencement of corporate re-organisation proceedings against the company if there is a risk that grounds for commencement of bankruptcy proceedings may occur pursuant to the Corporate Re-organisation Act; however, shareholders do not have a right to file a petition for commencement of bankruptcy proceedings or civil rehabilitation proceedings (Bankruptcy Act and Civil Rehabilitation Act).

While shareholders are not allowed to be involved in bankruptcy proceedings, they have some rights with respect to, or can participate in, civil rehabilitation proceedings and corporate re-organisation proceedings, to some extent. This is because these are restructuring proceedings, the results of which might be unjustly disadvantageous to shareholders. However, if the company has debts exceeding assets, the shareholders cannot participate in or object to these proceedings.

10. Shareholders' Remedies

10.1 Remedies Against the Company

Shareholders have some rights against a company to remedy actions carried out by its directors or others. The following remedies are typical remedies against a company.

Revocation of a General Shareholders' Meeting Resolution

A shareholder may file for a revocation of a resolution of a general shareholders' meeting by filing an action with the court within three months from the date of that resolution, if any of the following events have occurred (Article 831 of the Companies Act):

- where the calling procedures or the methods of a resolution at the general shareholders' meeting violate laws and regulations or the articles of incorporation or are conducted in a grossly improper manner;
- the contents of the resolution at the general shareholders' meeting violate the articles of incorporation; or
- a grossly improper resolution is passed as a result of a person with a special interest in the resolution at the general shareholders' meeting exercising a voting right.

Even if the calling procedures or the method of resolution of the general shareholders' meeting are in violation of the applicable laws and regulations or the articles of incorporation, the court may dismiss the claim if it finds that the violations are not serious and will not affect the resolution.

Invalidation of Material Corporate Actions

A shareholder in place from the effective date of a material corporate action, such as a merger, company split, share exchange or share trans-

fer, may assert an invalidation of the corporate action due to material defects of the process by filing an action with the court within six months from the effective date (Article 828 of the Companies Act). A shareholder may also file an action with the court asserting an invalidation of a demand for a share cash-out (squeeze-out right) within six months (for a private company, one year) from the effective date of that share cash-out (Article 846-2 of the Companies Act).

Enjoinment of Material Corporate Actions

A shareholder has a right to enjoin an issuance of shares or stock acquisition rights, if either of the following events occurs and the shareholder is likely to suffer a disadvantage as a result of that issuance (Articles 210 and 247 of the Companies Act):

- the issuance of shares or stock acquisition rights violates laws and regulations or the articles of incorporation; or
- the issuance of shares or stock acquisition rights is implemented through an extremely unfair method.

Other than the foregoing cases for enjoinment, as a general rule, shareholders may be permitted to enjoin certain material corporate activities under the Companies Act. A merger, a company split, a share exchange, a share transfer or a share delivery, may only be permitted if the corporate action violates laws, regulations or the articles of incorporation (and shareholders may experience disadvantages); violations of duties of care and loyalty by directors are not deemed to constitute violations of laws in the context of enjoinment by shareholders.

However, in the case of a short-form merger, company split or share exchange or demand for a share cash-out (squeeze-out right), if the conditions of that corporate action (eg, merger ratio) are extremely improper in light of the financial status of the parties thereto and shareholders of the controlled company are likely to suffer disadvantages, the shareholders may enjoin the corporate action.

Appraisal Rights

With respect to mergers or other corporate restructurings, certain shareholders have appraisal rights. For instance, shareholders who objected to a merger at the general shareholders' meeting may demand that the company purchase their shares in the company at a fair price. If dissenting shareholders and the company are unable to reach an agreement on the price of the shares within a specific period of time, either the dissenting shareholders or the company may file a petition to the court for a determination of the fair price. Shareholder activists frequently exercise their appraisal rights, asserting that the purchase price in a merger or other corporate restructuring is lower than the fair price that should be determined by the court.

Monetary Claim

A company is liable for damages caused to third parties by the company's representative directors or other representatives during the course of performance of their duties (Article 350 of the Companies Act). A shareholder may also make claims for damages against the company, based on tort claims.

10.2 Remedies Against the Directors

Enjoinment of Acts of Directors

If a director of a public company with a statutory auditor, an audit and supervisory committee or three committees (nomination, audit and remuneration) engages, or is likely to engage, in any act in violation of laws and regulations, including a director's duties of care and loyalty under the

Companies Act, or the articles of incorporation, and if such act is likely to cause irreparable damage to the company (substantial detriment is required for types of companies other than those listed in the foregoing), a shareholder (having owned shares consecutively for the preceding six months or more) may enjoin that directors' act, usually by obtaining an order of provisional disposition from the court unless otherwise provided for in the articles of incorporation (Article 360 of the Companies Act). The holding-period requirement does not apply to shareholders of a private company.

Derivative Actions

Unless otherwise provided for in the articles of incorporation, a shareholder of a public company, having owned shares in the company consecutively for the preceding six months or more, may demand that the company file an action to enforce the liability of directors of the company due to negligence in the performance of their duties. If the company does not file an action against the directors within 60 days from the date of the demand, the shareholder may file a derivative action against the directors on behalf of the company (Articles 423 and 847 of the Companies Act). The holding-period requirement does not apply to shareholders of a private company.

Direct Claims

Under the Companies Act, if directors have acted in bad faith or with gross negligence in the performance of their duties, those directors are jointly and severally liable to a third party for damages arising as a result thereof (Article 429 of the Companies Act). Shareholders may also be eligible to claim damages directly from the directors pursuant to this provision. While there are arguments that the remedy for shareholders suffering indirect damages due to the directors' bad faith or gross negligence should be addressed through derivative actions, there may be cases where a shareholder can make claims for indirect damages against the directors.

If directors make false statements with respect to important matters in certain corporate documents, including financial statements and business reports, those directors are jointly and severally liable to a third party for damages unless the directors prove that they did not fail to exercise due care with respect to the performance of their duties.

Furthermore, a shareholder may bring a tort claim against directors for damages.

10.3 Derivative Actions

As discussed in **10.2 Remedies Against the Directors**, shareholders can bring a derivative action for and on behalf of a company in respect of a wrong done to the company.

11. Shareholder Activism

11.1 Legal and Regulatory Provisions

The main legal provisions that govern shareholder activism are contained in the Companies Act, since it provides shareholder rights such as inspection rights, shareholder proposal rights, rights to call for shareholders meetings, and rights to enjoin directors' acts and derivative actions. The FIEA also relates to shareholder activism, as it sets forth, among other things, disclosure rules for large shareholdings, tender offer regulations, proxy regulations, insider trading rules and fair disclosure rules. Listed companies must also comply with the disclosure rules of the stock exchange.

The Tokyo Stock Exchange issued Japan's Corporate Governance Code (the CGC) in 2015 (most recently amended on 11 June 2021) and the Expert Committee of the FSA issued the Japan's Stewardship Code (the SC) in 2014 (most recently amended on 24 March 2020). The CGC and the SC have worked as "the two wheels of a cart" to promote and achieve effective corporate governance from the perspective of listed companies and institutional investors. The CGC and the SC do not adopt a rule-based approach; rather, they adopt a principle-based approach that is not legally binding on companies or institutional investors with a "comply or explain" approach (ie, either comply with a principle or, if not, explain the reasons for non-compliance). The soft laws, including those promulgated by the CGC and the SC, also affect shareholder activism.

11.2 Aims of Shareholder Activism

The most common aim of shareholder activism in Japan is to improve the capital efficiency of Japanese companies. The Tokyo Stock Exchange, taking into account the fact that there are many listed companies in Japan with a price to book ratio (PBR) that is well below 1.0, on 31 March 2023 requested companies listed on the Prime Market or Standard Market of the Tokyo Stock Exchange to analyse their own cost of capital and return on capital, formulate plans to improve them, and disclose such plans to the public. Given this request, activist shareholders often demand that companies with a low PBR increase their shareholder return by conducting a buyback of their shares or increasing dividends. Activist shareholders also often urge companies to carve out their non-profitable or non-core businesses and sell their assets that are not utilised or not related to their primary business, including cross-holding shares.

Activist shareholders often demand that management conducts a strategic review of the company's businesses and business plans by retaining an outside consulting firm. Some activist hedge funds, if they consider that a company is not adequately responsive to their demands, may push the company to elect a person recommended by such activist funds to serve as a director on the company's board of directors. This person would often be a manager or partner of the activist funds, a person who has experience in the management of other companies in the industry to which the company belongs, or a person who has expertise in capital allocation or restructuring.

Improving corporate governance is also a common aim of shareholder activism. Although the corporate governance of many listed companies has changed as a result of the application of the CGC, activist shareholders have continued to advocate for changes in corporate governance, for example, with regards to adopting stock price-linked remuneration for directors, divesting of cross-holding shares, and abolishing takeover defence measures.

Activist shareholders are also engaging in shareholder activism with respect to announced M&A, including mergers, share exchanges or tender offers, in which the support of a certain number of shareholders is necessary to successfully complete such transactions (*bumpitrage*). Activist shareholders demand that the company amend certain terms that are, in their view, inappropriate, such as the purchase price. These cases often occur in management buyouts (MBOs) and acquisitions by a controlling shareholder that involve conflicts of interests between management and/or a controlling shareholder on one hand and minority shareholders on the other. This M&A activism may result in a change

in the acquisition structure or increase of acquisition costs for the transaction. Some activist shareholders also exercise, after completion of the transaction, their appraisal rights as dissenting shareholders, and file a petition to the court for a determination of the fair price for the relevant shares.

In the past few years, ESG matters, especially environmental and social matters, have been on the agendas of activist shareholders. However, the number of proposals at shareholders' meetings regarding environmental or social matters in Japan has not been particularly high as yet.

11.3 Shareholder Activist Strategies

Most activist shareholders initiate their actions by sending a private letter to the management of listed companies stating their demands to, or requesting to hold a meeting with, the management. At a later and more aggressive stage, activist shareholders may engage in public campaigns in various ways, such as issuing press releases, posting white papers or relevant information on websites prepared by the activist shareholders for the campaigns, placing web advertisements, disseminating letters to shareholders, providing information through the media and holding sessions for other shareholders.

Activist shareholders acquire shares in a target company to have influence on the management of the target company; however, building a large stake in the target company is not necessarily required, as the activist shareholders may have influence on the management, even with a small stake, by asking other shareholders to support their demands. Activist shareholders may also submit shareholder proposals and engage in proxy solicitations with respect to general shareholders' meetings. Some aggressive activist shareholders use the court processes, including the enjoinment of directors' illegal acts or derivative actions (see **10.2 Remedies Against the Directors**). Furthermore, in the last few years, the number of unsolicited tender offers conducted by activist shareholders has rapidly increased.

As discussed in detail in **11.2 Aims of Shareholder Activism**, agenda items commonly demanded by activist shareholders include:

- improving capital efficiency, including the buyback of shares, increasing dividends and divesture of non-core businesses and assets;
- business strategies, such as the conduct of M&A transactions;
- replacement or nomination of directors;
- improving corporate governance; and
- the inappropriate nature of terms and conditions of announced M&A transactions.

11.4 Recent Trends

There are no particular industries or sectors which have been particularly targeted by activist shareholders in Japan. Small-cap or mid-cap companies (ie, companies whose market capitalisation is under JPY100 billion) are more frequently targeted by activist shareholders because it is easier for them to have a stronger influence over these companies by building larger stakes in such companies. However, some large-cap companies whose market capitalisation is more than JPY1 trillion have also been targeted by activist shareholders, as more shareholders have become supportive of activist shareholders and, as a result, activist shareholders may gain the ability to influence such target companies when in possession of a small shareholding.

11.5 Most Active Shareholder Groups

Hedge funds are the most active shareholder activists in Japan. Both Japan-based hedge

funds and foreign-based hedge funds (such as those from the US, the UK, Hong Kong and Singapore) actively engage in shareholder activism. In addition, domestic and foreign institutional investors have recently become more aligned with activist shareholders in their actions.

11.6 Proportion of Activist Demands Met

The number of cases in which shareholder activist demands were met in full or in part has increased in the past few years, although such activist demands would historically not have obtained support from other shareholders in Japan.

In recent years, there have been a number of cases of companies accepting the elections of directors recommended by activist shareholders. For example, in 2019, Olympus Corporation nominated a partner of ValueAct, the US-based activist fund, as a director in accordance with an agreement with ValueAct. After the election, Olympus divested its digital camera business in 2020 and scientific solutions business in 2022 to private equity funds. In 2022, Toshiba Corporation entered into settlement agreements with two of its shareholders, Farallon Capital Management and Elliott Advisors, and accepted the nomination of the employees of such shareholders as directors on the board slate to be voted on at the annual shareholders' meeting.

There are several cases in which activist shareholders obtained board seats through contests. For example, in February 2023, Oasis Management, a Hong Kong-based activist fund, demanded Fujitech to call an extraordinary shareholders' meeting and submitted shareholder proposals to dismiss five incumbent directors and elect six directors designated by Oasis Management. As a result, three of five incumbent directors were dismissed and four of six designated directors were elected at the extraordinary shareholders' meeting.

Furthermore, in response to activist demands, several companies have in recent years increased their dividends or conducted a buyback of their shares through the market or a tender offer.

The number of shareholder activism cases relating to M&A transactions has also increased. Activist shareholders push to increase the purchase price through acquisition of large stakes (eg, 10% or more of outstanding shares) in target companies (to influence the terms of the transactions) or engaging in public campaigns after these transactions are publicly disclosed, especially in tender offers where PBR calculated using the purchase price is lower than 1.0. For example, J-STAR, a Japan based private equity fund, launched a tender offer for Yaizu Suisankagaku Industry Co Ltd in August 2023, but the tender offer failed as a result of the accumulation of shares in Yaizu by Murakami group and 3D Investment after the announcement of the tender offer (each accumulated around 10% of the shares in Yaizu). After the failure, Yaizu conducted a wide-ranging auction to find a bidder. Yaizu engaged with Murakami group and 3D Investment, and a selected bidder, Inaba Foods Co Ltd, and finally succeeded in having them conduct a tender offer in March 2024 for Yaizu at a purchase price that was approximately 20% higher than the purchase price of the tender offer conducted by J-STAR.

11.7 Company Prevention and Response to Activist Shareholders

The most important strategy for the management of a listed company when addressing shareholder activism is to proactively review the company's financial condition, capital efficiency and share price, as well as the composition of

the company's shareholders and their wishes or demands, before shareholder activists invest in the company. During this review, the company's management should endeavour to address or improve matters that may make the company susceptible to activist shareholder interests and manoeuvres. The company's management should also engage in regular dialogues with its large shareholders, including institutional investors, to understand what they want the company to do and to build good relationships.

When shareholder activists emerge, management should respond to the shareholder activists in a reasonable manner, keeping in mind the perspective of financial investors. Most importantly, management should seek to clarify or explain its position to garner the support of the other shareholders (including institutional investors) for the management's position. Although it has not been a common strategy in Japan, management can consider entering into a settlement agreement with shareholder activists to avoid a costly public campaign which may harm the company's image or a potential unfavourable outcome of a shareholders' vote.