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Shareholders' Rights & Shareholder Activism

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Contents

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1. Shareholders' Rights

1.1 Types of Company

The Companies Act provides four kinds of company: stock company (*kabushiki kaisha*), general partnership company (*gomei kaisha*), limited partnership company (*goshi kaisha*) and limited liability company (*godo kaisha*). The most popular form of company is the stock company (a substantial majority of companies are stock companies) and the second most popular form of company is the limited liability company. A public company is defined as a stock company in which the transfer of all or part of its shares is not restricted in its articles of incorporation. Shares in 3,765 stock companies are listed on the stock exchanges in Japan as of 31 March 2019. Unless otherwise specified, reference to a 'company' means a 'stock company'.

As a general rule, there are no qualification criteria that restrict the shareholders who can invest in Japanese companies. The Foreign Exchange and Foreign Trade Act (the 'FEFTA') provides that a foreign investor is required to file prior notification with the Minister of Finance and the competent minister for the business of the target company and wait for a specified period if:

- the foreign investor intends to acquire any shares of a private company (except in the case of an acquisition of shares of a private company from another foreign investor unless the acquisition may have potential risk of harming Japan's national security) or more than 10% 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 a business related to national security, public order, public security or smooth management of Japan's economy.

A bill to amend the FEFTA was submitted to the diet in October 2019. The bill will lower the threshold for acquisition of shares or voting rights of listed companies from 10% to 1%, and provide exemptions from the prior notification requirement for certain investments, such as portfolio investments.

While the ministers have the authority to order the foreign investor to change or discontinue investor's plan of investment, orders of this kind have rarely been made.

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 broadcasting businesses.

1.2 Type or Class of Shares

Companies can issue different classes of shares with differing rights by setting out this ability in their articles of incorporation with respect to the specific rights and matters that can be differentiated among the different classes such as rights to receive dividends, residual assets or voting rights, as provided for in the Companies Act.

The most common class of shares are preferred shares with preferential rights for dividends and residual assets. These are often accompanied with 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.

1.3 Primary Sources of Law and Regulation

The primary source of law relevant to shareholders' rights is the Companies Act, on which all shareholders' rights are based. For listed companies, the Act on Book-Entry Transfer of Corporate Bonds and Shares provides certain procedures which shareholders must follow to exercise their shareholders' rights. In addition, proxy solicitations, with regard to voting rights at general shareholders' meetings of listed companies, are regulated by the Financial Instruments and Exchange Act (the 'FIEA').

1.4 Main Shareholders' Rights

Shareholders of a company have a variety of shareholders' rights. The shareholder rights that are most common to all shareholders in a company are, among other things, a right to receive dividends and voting rights.

As discussed in **1.2 Type or Class of Shares**, a company may issue classes of shares with differing rights. A private company may also provide in its articles of incorporation to the effect that each shareholder shall be treated differently with respect to rights to receive dividends, residual assets or voting rights. Other than the foregoing, as a general rule, shareholder rights cannot be diminished by setting forth provisions for this in the articles of incorporation, except as explicitly permitted in the Companies Act.

As discussed in **1.6 Rights Dependent on Percentage of Shares**, companies can change the requirements for shareholders to exercise some of the shareholder rights. While the articles of incorporation of a company are not generally available to the public (shareholders of a company have the right to access the articles of incorporation), the articles of incorporation of listed companies are available on the website of Japan Exchange Group, Inc.

As discussed in **1.5 Shareholders' Agreements/Joint Venture Agreements**, a shareholders' agreement executed among shareholders can, in principle, restrict certain shareholder rights of some shareholders unless the restriction violates purposes of the law or public policy. The agreement is generally enforceable against the shareholders who are parties to the shareholders' agreement. While shareholders'

agreements are generally not available to the public, certain agreements among shareholders, with respect to a listed company, need to be disclosed in a large-scale shareholding report.

1.5 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. The joint venture company is usually a private company. Typical provisions in shareholders agreements regarding private companies include the following:

- agreements on governance (process of general shareholders meeting, 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 (transfer restriction, anti-dilution (pre-emptive right), right of first refusal/offer, put/call option, tag-along, and drag-along); and
- other agreements (non-competition, non-solicitation, dividend policy, dissolution/liquidation, and termination).

As for a public or listed company, shareholders sometimes enter into a shareholders' agreement with some other shareholders. As discussed in **1.14 Disclosure of Shareholders' Interests in the Company**, if shareholders of a listed company enter into certain agreements regarding share transfer or exercise of voting rights or other shareholder rights, their shareholding ratios must be aggregated in light of the requirement to file large-scale shareholding report. If their aggregated shareholding ratios exceeds 5%, they are required to file a large-scale shareholding report as joint holders. In a large-scale shareholding report, shareholders need to state certain material agreements with respect to the shares held by them.

The validity or enforceability of shareholders' agreements depends 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 veto rights with regard to certain material matters, are generally considered valid unless they violate purposes of the law or public policy, and they would generally be enforceable to some extent between the shareholders who are parties to the shareholders' agreement. However, if a shareholder exercises its voting rights in violation of the voting agreement (in which the company is not a party thereto), the voting agreement would not generally be binding on the company and other shareholders who are parties to the voting agreement, and a resolution made based on such exercise of voting rights would not generally be subject to revocation. In contrast, if all shareholders of the company are a party to the voting agreement, the resolution made through such process might be revocable.

The validity and enforceability of agreements regarding share transfer is discussed in **1.15 Shareholders' Rights to Grant Security over/Dispose of Shares**.

1.6 Rights Dependent Upon Percentage of Shares

The Companies Act sets requirements for shareholders to exercise some of their rights in order to prevent shareholders from exercising their rights abusively and, in turn, harming the interests of the company and other shareholders. There are two kinds of requirements:

- the percentage or number of shares or voting rights held by the shareholder exercising a particular shareholder right; and
- the period a shareholder holds shares or voting rights.

Specific requirements vary depending on the type of shareholders' rights or type of company (eg, public or private). Companies can relax the requirements set forth in the Companies Act regarding shareholders' exercise of shareholder rights by setting forth any variance in the company's articles of incorporation. Companies cannot make such requirements stricter.

If multiple shareholders jointly exercise their shareholders' rights, the percentage or number of shares or voting rights held by shareholders can be aggregated in relation to the exercise requirements.

1.7 Access to Documents and Information

Shareholders have rights to request a company to provide access for them to inspect or copy certain documents of the company. The following describes the major rights regarding such access to documents:

- Shareholder registry - a shareholder has 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), board of directors' meetings (Article 371 of the Companies Act) and board of statutory auditors' meetings (Article 394 of the Companies Act). In companies with a statutory auditor, three committees or an audit and supervisory committee, shareholders need to obtain permission of the court to access the minutes of meetings

of the board of directors. Shareholders are also required to obtain permission of the court to access the minutes of meetings of the board of statutory auditors.
- 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. Exceptions include 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). The exceptions described above regarding access rights to the shareholder registry also apply to access rights to account books.
- 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) and proxies (Article 310 of the Companies Act) with respect to voting rights at a general shareholders' meeting.

1.8 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 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.

As a general rule, 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 give consents to agenda items to be resolved at a general shareholders meeting in writing, a resolution is deemed to be obtained.

1.9 Calling Shareholders' Meetings

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 the directors to 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 effected 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.

1.10 Voting Requirements and Proposal of Resolutions

Voting Requirements/Quorum

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.

Certain important matters, such as amendments to the articles of incorporation, issuance of new shares (excluding those which may be carried out by a resolution at a board of directors meeting), merger, share exchange, company split, share transfer or material business transfer (excluding those which a short-form or small size exception is applied to), 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, 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.

The Companies Act also provides stricter requirements for resolutions for certain limited matters. Furthermore, many listed companies have eliminated the quorum requirements for ordinary resolutions and decreased the quorum for extraordinary resolutions from a majority to one third of the votes of the shareholders entitled to vote, setting forth such provisions in their articles of incorporation.

Shareholder Proposal

Unless otherwise provided for in the articles of incorporation, a shareholder of a public company with a board of directors who owns, 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 directors of the company to present proposals submitted by the shareholder as an agenda at the general shareholders' meeting (Article 303 of the Companies Act); and
- demand the directors to describe the summary of the proposals in convocation notices of the general shareholders' meeting (Article 305 of the Companies Act).

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 such general shareholders meeting (Article 304 of the Companies Act). The requirement of a holding period does not apply to shareholders of a private company.

Under the current Companies Act, the number of proposals an eligible shareholder can submit is not limited. However, there are recent cases where shareholders used their shareholder proposal rights in an abusive manner, such as the submission of multiple proposals by one shareholder or the submission of proposals with frivolous contents. In response to such abusive conduct, in October 2019 a bill to amend the Companies Act was submitted to the diet. The bill includes:

- limiting the number of proposals each shareholder can make to ten, that regard demanding the directors to describe the summary of shareholder proposals in the convocation notice; and
- allowing a company to refuse shareholder proposals which may significantly hinder appropriate operation of the general shareholders' meeting such that it would impair the common interests of the shareholders.

To obtain support from other shareholders in the company, a shareholder submitting shareholder proposals sometimes engages in proxy solicitation. As a general rule, any person who intends to solicit a proxy with respect to shares in a listed company shall comply with the proxy regulations under the FIEA, such as delivering a proxy form and reference documents, containing the information specified in the Cabinet Office Ordinance, to the person solicited and submitting a copy of these documents to the relevant local finance bureau.

1.11 Shareholder Participation in Company Management

The principle of 'separation of ownership and management' is applied to stock companies and directors or a board of directors shall, in principle, decide and execute the operations of the company. However, as discussed in **1.8 Shareholder Approval**, certain material matters provided in the Companies Act or the articles of incorporation of the company need to be resolved at a general shareholders' meeting. Other than the foregoing, as a general rule, shareholders do not have a right to participate in the management of a company or sit on the board of directors. In practice, a shareholder sometimes has its director or employee attend the board of directors of the company as an observer, pursuant to a provision of a shareholders' agreement or another agreement between a shareholder and the company.

1.12 Shareholders' Rights to Appoint / Remove / Challenge Directors

Right to Appoint or 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.

The voting requirement for the appointment or dismissal of directors is, in principle, the same as the requirement of an ordinary resolution, provided that a company cannot decrease the quorum of a general shareholders meeting to the presence of less than one third of the shareholders entitled to vote. 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 quorum by setting forth such increased requirements in the company's articles of incorporation, although an increase of this kind of dismissal is often strongly criticised by shareholders, especially institutional investors. A director who is dismissed is entitled to claim from the company damages arising from the dismissal, 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 such 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 outstanding shares for at least the preceding six months may demand dismissal of such director by filing an action with the court within thirty days from such general shareholders meeting (Article 854 of the Companies Act); such holding period requirement does not apply to shareholders of a private company.

Right to Challenge Directors

Shareholders who are dissatisfied with a decision or action taken by directors or the board of directors may take action to remove relevant directors pursuant to the procedures described above. As discussed in **3.3 Legal Remedies Against the Company's Directors**, a shareholder who meets certain requirements may file to enjoin a directors 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).

1.13 Shareholders' Right to Appoint / 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 **1.12 Shareholders' Rights to Appoint / Remove / Challenge Directors** is also available for dismissal of a statutory auditor.

Certain 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 such dismissal.

1.14 Disclosure of Shareholders' Interests in the Company

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% (Article 27-23 of the 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 jointly acquire or transfer shares in the company, or to jointly exercise the voting or other rights 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, if their shareholding ratios and changes in shareholding ratios meet the foregoing criteria but they do not intend to take actions to materially influence the business activities of the company.

Activist shareholders often use derivatives to build their stakes in target companies. Rights to request delivery of shares under a sales and purchase contract and options to purchase shares and borrow shares are subject to the large-scale shareholding reporting obligations under the FIEA. However, the holding of equity derivatives that are cash-settled and that do not involve the transfer of the right to acquire shares would likely not trigger such reporting obligations.

The guidelines released by the Financial Services Agency (the 'FSA') provide that derivatives that transfer only economic profit and loss in relation to target shares, such as total return swaps, are generally not subject to the disclosure obligations, provided that holding cash-settled equity derivatives may trigger these obligations if a holder purchases long positions on the assumption that a dealer will acquire and hold matched shares to hedge the dealer's exposure.

1.15 Shareholders' Rights to Grant Security over / Dispose of Shares

Grant 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 whether the company is one that issues share certificates or whether shares of the company are listed (these shares are book-entry transfer shares).

Disposal of Shares

As a general rule, shareholders may transfer their shares to a third party. However, in many non-listed companies, their articles of incorporation provide that any transfer of shares requires approval of the company (by approval of the board of directors, a general shareholders' meeting or the representative director, which is determined in accordance with they type of company and the law or the articles of incorporation). If the company does not approve the transfer, the shareholder may request the company, or a person designated by the company to, purchase the shares. 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.

Shareholders may also transfer their shares to the company. Buyback of shares by the company is subject to the distributable amount of the company. A buyback of shares from a specific shareholder based on an agreement between the shareholder and the company must be approved by an extraordinary resolution at a general shareholders meeting, whereas a buyback of shares by companies with the board of

directors through the market or a tender offer may be carried out by a board resolution, if permitted by the articles of incorporation of the company.

Shareholders often agree to certain restrictions on the transfer of shares of the company in shareholders' agreements. A shareholders' agreement is legally binding on, and enforceable against, the shareholders who are parties to the shareholders' agreement unless the agreement violates public policy. However, the effect of a transfer of shares conducted in violation of the agreement would not generally be void in relation to the company or third parties. By contrast, agreements on a restriction on the transfer of shares between shareholders and the company may be void because it may be used for the control of the company by the management.

1.16 Shareholders' Rights in the Event of Liquidation / Insolvency

Liquidation

A company may be dissolved by an extraordinary resolution at its general shareholders' meeting and go into liquidation. Some companies engaged in regulated businesses may be required to obtain approval from the competent minister of such businesses to be dissolved. Shareholders of a company in liquidation have a right to receive residual assets of the company after the company performs its obligations. Liquidation is eventually concluded upon the approval of the settlement of accounts by an extraordinary resolution at a general shareholders' meeting.

Unless otherwise provided for in the articles of incorporation, a shareholder with no less than one tenth of the voting rights of all shareholders of the company or no less than one tenth of the outstanding shares (excluding treasury shares) of the company may file an action to dissolve the company if either of the following events occurs and there are unavoidable circumstances (Article 833 of the Companies Act):

- the company faces extreme difficulty in executing its business and the company suffers or is likely to suffer irreparable harm; or
- the management or disposition of the property of the company is conducted in an extremely unreasonable manner and puts the existence of the company at risk.

Such action for dissolution is considered to be the last resort for minority shareholders in a private company who cannot sell their shares to prevent them from incurring losses.

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).

Insolvency

A shareholder with one tenth or more of the voting rights of all shareholders of the 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, shareholders 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.

2. Shareholder Activism

2.1 Legal and Regulatory Provisions

The main regulatory provisions that govern shareholder activism are in the Companies Act because, as discussed above, it provides shareholder rights. 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 rules of the stock exchange with respect to disclosure of the companies' engagement with shareholder activists.

Tokyo Stock Exchange Inc. issued the Japan's Corporate Governance Code (the 'CGC') on 1 June 2015 (amended on J1 June 2018) and the Expert Committee of the FSA issued the Japan's Stewardship Code (the 'SC') on 26 February 2014 (amended on 29 May 2017). 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.

2.2 Level of Shareholder Activism

Shareholder activism has become common in Japan in recent years. The environment surrounding the corporate governance of listed companies has significantly changed

since the CGC was issued in 2015 and the SC was issued in 2014, as one of the policies of the cabinet led by Prime Minister Shinzo Abe (known as Abenomics). Consequently, management members of listed companies are increasingly managing their companies by taking into account capital efficiency and by improving the corporate governance of their companies.

Historically, shareholders did not have much influence on the management of companies in Japan because many listed companies had stable shareholders who always supported the management through cross-shareholding. However, the CGC expressly provides that companies should disclose their policies regarding the reduction of cross-shareholdings and that the board should annually evaluate each individual cross-shareholding to determine if it should continue, specifically examining whether the purpose of each cross-shareholding is appropriate and whether the benefits and risks of each cross-shareholding covers the company's cost of capital. As a result of this, the number of cross-shareholdings in the Japanese market has been gradually decreasing.

As the Japanese market is seeing greater numbers of foreign investors, and the SC provides that institutional investors should conduct constructive engagement with investee companies and disclose voting records for each of its investee companies on an individual agenda item basis from the perspective of their stewardship responsibilities, the demands and voting behaviour of institutional investors have become stricter and more demanding. Furthermore, in the past few years institutional investors that have not been recognised as activist shareholders have tended to become more assertive in making demands on the management of companies that are similar to the demands typically seen from activist shareholders.

There are some prominent recent examples of shareholder activism in Japan. In response to the demands of shareholder activists, many Japanese companies have conducted share buybacks. For example, the US based activist fund Third Point urged Fanuc Corporation to repurchase a large amount of its shares and Fanuc Corporation subsequently announced in 2015 that it would make a buyback of its shares and pay a large amount of dividends.

In the 2019 proxy season, there were a number of cases of companies accepting the elections of directors recommended by activist shareholders. For example, Olympus Corporation nominated a partner of ValueAct, the US-based activist fund, as a director, and Kawasaki Kisen Kaisha Ltd nominated a director of Effissimo Capital Management, a Singapore-based activist fund, as a director.

The number of cases of shareholder activism relating to M&A activities has also increased in the past few years. For example, Oasis Management, a Hong Kong based activist fund, waged a public campaign in 2016-17 against the acquisition by Panasonic Corporation of its listed subsidiary, PanaHome Corporation, and in 2017-18 against the integration of a business through a share exchange in which Alps Electric Co., Ltd. would acquire all the shares in its listed subsidiary, Alpine Electronics Inc.

2.3 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. Furthermore, some aggressive activist shareholders use the court processes, including the enjoinment of directors' illegal acts or derivative actions (see **3.3 Legal Remedies Against the Company's Directors**).

Agenda items commonly demanded by activist shareholders included:

- improving capital efficiency, including 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.

2.4 Targeted Industries / Sectors / Sizes of Companies

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 stronger influence over these companies by building larger stakes in such companies. However, some large-cap companies whose market capitalisation's are more than JYP1

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 the target companies when in possession of a small shareholding.

2.5 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, as discussed in **2.2 Level of Shareholder Activism**, domestic and foreign institutional investors have recently become more aligned with activist shareholders in their actions.

2.6 Proportion of Activist Demands Met in Full / Part

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 2017, a shareholder proposal submitted to Kuroda Electric Co Ltd by Reno Inc (which is considered to have some connection with the well-known Japanese activist fund Murakami Fund) to elect an outside director was approved at the annual general shareholders meeting of Kuroda Electric Co Ltd. This case suggests that shareholders in Japan are becoming more comfortable with, and supportive of, shareholder activism. In addition, as discussed in **2.2 Level of Shareholder Activism**, in 2019, a greater number persons nominated as candidates for directors were recommended by shareholder activists at general shareholders' meetings.

Furthermore, in 2019 and the several years prior, several companies increased the amount of their dividends or conducted buyback of their shares through the market or a tender offer in response to activist demands.

The number of cases of shareholder activism 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 engage in public campaigns after these transactions are publicly disclosed.

2.7 Company 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. Throughout this review, management should endeavour to address or improve matters that may cause the company to be susceptible to the interests or manoeuvres of shareholder activists. It is also important for management to regularly engage in dialogue with the company's large shareholders, including institutional investors, to understand what they want management to do and to build good relationships with them.

After 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 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.

3. Remedies Available to Shareholders

3.1 Separate Legal Personality of a Company

Unlike a partnership, a stock company has a separate legal personality that is distinct from the company's shareholders. Shareholders of a stock company are indirectly responsible for the company's liabilities only to the extent of their investments in the company.

3.2 Legal 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 Resolution of a General Shareholders Meeting

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 such resolution, in the event of any of the following:

- 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 (Article 831 of the Companies Act).

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 transfer, may assert an invalidation of the corporate action due to 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 share cash out (squeeze-out right) within six months (for a private company, one year) from the effective date of such share cash out (Article 846-2 of the Companies Act).

For example, in 2019 Oasis Management filed a suit in court after the completion of the acquisition of Alpine Electronics Inc by Alps Electric Co. Ltd. through the share exchange (as discussed in **2.2 Level of Shareholder Activism**), asserting that the share exchange is invalid. The suit remains pending in court.

Enjoinment of Material Corporate Actions
A shareholder has a right to enjoin certain material corporate actions, such as the enjoinment of 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 such 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 affected through an extremely unfair method.

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

However, in the case of a short from merger, company split or share exchange or demand for share cash out (squeeze-out right), if the conditions of such 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 restructuring, 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 cannot reach agreement on the price of the shares within a certain period, 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 mergers or other corporate restructuring is lower than the fair price that should be determined by the court.

Monetary Claim
A company shall be 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 directors based on tort claims.

3.3 Legal Remedies Against the Company's 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 engages, or is likely to engage, in any act in violation of laws and regulations, including a directors 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 such 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.

As an example of a shareholder activist filing for a provisional injunction with the court to enjoin a directors' act, according to news reports, Oasis Management filed a provisional injunction against the directors of Toshiba Plant Systems & Services Corporation, a listed subsidiary of Toshiba Corporation, with the Yokohama District Court in March 2017 to prevent the directors from depositing funds with Toshiba Corporation. As a result, Toshiba Plant Systems & Services Corporation withdrew the deposit amount, which was approximately JPY88 billion.

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 the company to file an action to enforce the liability of directors of the company due to negligence 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.

As an example of a shareholder activist filing a derivative action, Effissimo Capital Management brought a derivative action to recover damages caused by the directors of Nissan Shatai Co. Ltd, a listed subsidiary of Nissan Motor Co. Ltd, on the grounds that the directors violated their duties of care and loyalty because Nissan Shatai Co. Ltd deposited a large amount of cash in a subsidiary of Nissan Motor Co. Ltd by participating in the cash management system (CMS) of the Nissan Motor group without reasonable reasons, and the directors did not manage its cash efficiently. Yokohama District Court eventually dismissed the case in favour of the directors in February 2012.

Direct Claims

Under the Companies Act, if directors have acted in bad faith or with gross negligence in the performance of their duties, such 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 directly claim damages from the directors pursuant to such 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, such 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 make claims for damages against directors based on tort claims.

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3.4 Legal Remedies Against Other Shareholders

In Japan, the Companies Act and court precedents have not adopted the concept that a controlling shareholder of a company owes a fiduciary duty to the company or other shareholders. Therefore, except in respect to a tort claim, a shareholder of the company is not liable to other shareholders of the company.

3.5 Legal Remedies Against Auditors

As with derivative actions against directors, eligible shareholders may file a derivative action against statutory auditors and accounting auditors with respect to an auditors' negligence in the performance of their duties (Articles 423 and 847 of the Companies Act).

Shareholders may also directly claim for damages against statutory auditors and accounting auditors who have acted in bad faith or with gross negligence in the performance of their duties (Article 429 of the Companies Act). Furthermore, if statutory auditors make false statements with respect to important matters in audit reports, or if an accounting auditor does so in financial audit reports, they are liable to a third party for damages unless they prove that they did not fail to exercise due care with respect to the performance of their duties.

3.6 Derivative Actions

As discussed in **3.3 Legal Remedies Against the Company's Directors** and **3.5 Legal Remedies Against Auditors**, eligible shareholders may file derivative actions against directors, statutory auditors and an accounting auditor on behalf of the company in accordance with the procedures provided in the Companies Act.

3.7 Strategic Factors in Shareholder Litigation

Generally, there is an information asymmetry between a company or its management and its shareholders, and shareholders frequently face difficulty in shareholder litigations to prove or show relevant facts with limited information or evidence. Therefore, to obtain necessary information or evidence, shareholders should consider effectively using their inspection rights as provided for in the Companies Act, and as discussed in **1.7 Access to Documents and Information**, as well as petition to the court for an order to the company to submit certain relevant documents to the court as provided under Article 221 of the Code of Civil Procedure.