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JAPANESE EQUITY FINANCING WITH SPECIAL REFERENCE TO ISSUES IN THE UNITED STATES

JOHN B. CHRISTENSEN*

General. Japanese industry since the war has been characterized by a very high rate of growth and a severe shortage of equity capital. Given the attractions of this high growth rate coupled with the political and economic stability of the country, it was natural that foreign equity investment would be attracted to Japan. This is particularly true in view of the disturbed conditions existing in other capital-short areas of the world and the recent stagnation in investment demand in the United States, the largest exporter of capital.

This mating of supply with demand has not been without its difficulties, however. The very need for capital resulted in measures such as foreign exchange control and outright limitations on foreign investment, all designed to harbor what local capital was available. Furthermore, on the private plane differences in legal systems and concepts posed private law problems not found elsewhere to the same degree. The past two years, however, has seen the solution or amelioration of many of these problems as evidenced by the successful issue in the United States of equity securities¹ by a number of Japanese companies.²

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¹ For purposes of this article equity securities include, in addition to stock, debt securities with equity features such as convertible debentures, participating debentures, etc.

² The companies and their issues are as follows:

<i>Company</i>	<i>Security</i>	<i>Number shares</i>	<i>Amount</i>	<i>Date</i>
Sony Corporation	common stock	2,000,000	\$3,500,000	June 1961
Mitsubishi Chemical Co., Ltd.	common stock and notes jointly	2,047,385	5,200,000*	Nov. 1961
Tokyo Shibaura Electric Co. Ltd. (Toshiba)	common stock convertible	30,000,000	9,300,000	Feb. 1962
Hitachi, Ltd.	debentures	16,500,000	Sept. 1962
Shin Mitsubishi Heavy Industries Co., Ltd.	"	10,000,000	Sept. 1962
Toshiba	"	20,000,000	Dec. 1962
Honda Motor Co., Ltd.	common stock	9,000,000	21,775,000	Dec. 1962
Nippon Electric Co., Ltd.	"	10,000,000	6,700,000	Feb. 1963
Kansai Electric Power Co., Ltd.	"	13,000,000	21,775,000	Mar. 1963
Sony Corporation	common stock	3,000,000	6,000,000	Apr. 1963

It is the purpose of this article to describe the economic and legal background of these issues and the legal problems encountered.

Economic Background. Japan emerged from the war with its industrial plant shattered and inflation rampant, with prices rising to more than 300 times the prewar level.³ With their plants in ruins and capital wiped out by inflation, Japanese industrialists had to look to the government for funds to reconstruct. The Bank of Japan, through the emergency Reconstruction Finance Bank, made huge loans to industry which could not be repaid in the face of spiraling costs.⁴ Conditions left no choice; private investment was paralyzed.⁵ Sound finance had to give way in the face of the elemental need to survive.

To add to the difficulty, the Occupation reforms profoundly disturbed the old financial structure. There was a separation of ownership from management which left management with little understanding of, and cut off from, the traditional source of equity funds. Occupation strictures against inter-company stock holdings and limitations on holdings by financial institutions also had their effect. All of this coupled with a low rate of personal savings on the part of individuals who were also hard pressed to survive took its toll.⁶ Last but not least was the dissolution of the *Zaibatsu*, the name given to the prewar business combinations and trusts which dominated so much of Japan's industry, trade and finance. Until the end of the war, the capital requirements of large corporations were met almost entirely by means

<i>Company</i>	<i>Security</i>	<i>Number Shares</i>	<i>Amount</i>	<i>Date</i>
Mitsui & Co., Ltd.	common stock and convertible debentures jointly	2,500,000	12,000,000**	Apr. 1963

* of which \$4,425,000 was the face amount of the notes.

** of which \$10,000,000 was the principal amount of the convertible debentures.

Except in the case of Mitsubishi Chemical, which was a private placement, all the common stock issues were evidenced by American Depositary Receipts. ADRs were also made available for common stock in connection with the Shin Mitsubishi convertible debentures. ADRs were already available from the previous stock offering in the case of the Toshiba convertible debenture issue, while Hitachi was a private placement.

³ COHEN, JAPAN'S POSTWAR ECONOMY 12, 13, 83 (1958).

⁴ *Id.* at 84, 85.

⁵ Japanese stock exchanges were closed in August, 1945 and not reopened until May, 1949.

⁶ For a catalogue of adverse factors including these and others, see Matsui, *Shokenkai no Tōmen no Mondai ni tsuite—Shoken Torihiki Shingikai no Gidai o Chushin ni* (Problems Facing the Securities World—Centering on the Agenda of the Securities Exchange Council), 143 SHOJI HOMU KENKYU (Commercial Law Journal, hereinafter referred to as CLJ) 2, (June 25, 1959). See also, REPORT TO THE MINISTRY OF FINANCE OF THE SECURITIES EXCHANGE COUNCIL (June 22, 1960), as reported in *Zoshi no Sokushin ni tsuite* (Concerning the Promotion of Capital Increase), 181 CLJ 2, (July 1, 1960).

of the issuance of shares to carefully selected subscribers, usually either the banks of *Zaibatsu* combines or the *Zaibatsu* combine holding companies. With these sources removed, equity funds dried up.

With the return of relative stability in 1949 and 1950, with the drastic reforms of the Dodge Mission and with the stimulus to industrial activity provided by the outbreak of the Korean War, the financial structure of Japanese industry was profoundly different from pre-war and from that currently prevailing in other advanced countries. The crisis of the 1940's left a mark which has continued to the present day.

Direct borrowings from the government abated to be replaced by borrowings from commercial banks which in turn availed themselves of the rediscount facilities of the Bank of Japan. The result was that as recently as the latter 1950's reliance on commercial banks was proportionately 13 times as great as in the United States.⁷

Put another way, Japanese industry was operating on a thin margin of equity investment, putting it at the mercy of every twist and turn of government monetary policy and affording little opportunity for long range planning. A few figures will serve to dramatize the situation. In the 1934 to 1936 period debt was 33.5% and equity 66.5% of capital, whereas in 1958 the situation was reversed with equity down to 34% and debt up to 66%.⁸ Comparison with other countries left little room for complacency. Even war-torn West Germany had an equity-debt ratio higher than Japan's while, as was to be expected, England and the United States were much higher, 40 to 60 in the case of the first, 64 to 36 in the case of the second and 66 to 34 in the case of the third.⁹

⁷ COHEN, *op. cit.* *supra* note 3 at 127.

⁸ Matsui, *supra* note 6.

⁹ Tsuneda, *Keiki Choseiki ni okeru Zoshi no Arikata* (Method of Capital Increase in Period of Business Adjustment), 227 CLJ 2, (Nov. 15, 1961). See *The Japan Stock Journal*, No. 303, (Feb. 18, 1963), at 8, where under the heading "Competitive Power" the following figures for specific Japanese and comparable foreign companies in the same industry are given:

<i>Company</i>	<i>Percentage of owned capital</i>	<i>Company</i>	<i>Percentage of owned capital</i>
Steel producers:		Automobile makers:	
Yawata (Japan)	33.6%	Nissan Motor (Japan)	29.2%
U.S. Steel (U.S.)	71.4	Fiat (Italy)	86.9
Tube Investment (Britain)	69.4	General Motors (U.S.)	74.2
Chemical firms:		British Motor (Britain)	50.4
Sumitomo Chemical (Japan)	27.8%	Electrical manufacturers:	
Du Pont (U.S.)	93.9	Hitachi (Japan)	27.2%
ICI (Britain)	71.8	A. E. I. (Britain)	62.4
Montecatini (Italy)	60.2	General Electric (U.S.)	58.9
Bayer (West Germany)	40.7	A. E. G. (West Germany)	45.4

An analysis of the composition of the debt of Japanese companies is also revealing. Of the 66% figure for debt, 21% is short term loans. Only 3% is debentures, showing the small participation of the long term investing public as opposed to banks, on the debt side of the ledger.¹⁰ The poor showing of Japanese equity investment is in contrast to all other indicators. With 100 as the prewar (1934-1936) base indicator, by 1958 per capita national income was 174; bank deposits, 142; loans, 184; and paid up share capital, only 30.¹¹

Recent trends have not been encouraging. A survey of capital procurement in the years 1957 to 1959 showed that of new funds obtained by all juridical persons, equity accounted for only 33.6%. Of this, new stock issues accounted for only 11% with the balance being made up out of retained earnings and depreciation. Of the 66.4% representing debt, 42.3% was short term and 22.1% was long term, of which only 3.7% represented bonds and debentures.¹²

Compared with these figures the statistics of the Tokyo Stock Exchange during the first decade of its postwar operation, while impressive, give scant comfort.¹³ By 1960, with Japan standing on the threshold of trade and capital transactions liberalization, and with

¹⁰ Matsui, *supra* note 6. The debenture market continues weak with the result that this type of security has little appeal to the investing public. See on this problem, *Kisai Shijo Kakudai no Kihon Mondai* (Basic Problems of Enlarging the Bond Issue Market), 154 CLJ 2, (Oct. 15, 1959). REPORT OF THE SECURITIES EXCHANGE COUNCIL (Nov. 17, 1959) meeting in *Shasai Shijo Ikusei no tame no Tomen no Mondai ni tsuite* (Concerning Problems Facing the Development of a Bond Market), 158 CLJ 16, (Nov. 25, 1959). The principal purchasers of bonds and debentures are the banks leaving the issuers equally dependent on the banks as in the case of bank loans, *ibid*. This is all the more true in view of the relatively short maturities of Japanese bonds and debentures, generally only seven years, OKAMURA, *KABUSHIKI KAISHA KINYU NO KENKYU* (Study of Corporate Finance) 356 (Rev. Ed. 1962). See Maeda, *Saikin no Shasai Shijo ni okeru Sho Mondai* (Various Problems in the Present Bond Market), 214 CLJ 2, (June 15, 1961), which points out that only 11 bond and debenture issues are listed on an exchange.

¹¹ Matsui, *supra* note 6.

¹² Oguma, *Shihon Kosei Zesei no Tame no Tomen no Hosaku* (Urgent Policy for Improvement of Capital Structure), 200 CLJ 5, (Dec. 25, 1960/Jan. 5, 1961).

¹³ Upon the reopening of the Stock Exchange in May, 1949 there were 485 companies listed with a total capital of ¥57 billion represented by 1.1 billion shares outstanding. Ten years later there were 559 companies listed with a total capital of ¥1,210 billion represented by 21.5 billion shares outstanding. Daily transactions rose from 1.33 million shares in 1949 to 39 million shares in 1958 for a 30-fold increase, Chairman of the Board of the Tokyo Stock Exchange in *Shoken Torihiki Junen no Kaiko to Tembo* (Review of Ten Years of the Stock Exchange and Prospects), 135 CLJ 2, (April 5, 1959). On the other hand, in the middle of 1962 the market value of all stock of the 833 companies listed on the First Section of the Exchange came to only slightly more than \$16 billion or less than 5% of the \$330 billion for the issues on the New York Stock Exchange, on the basis of which it is said, "The clear inference is that Japanese corporations are badly undercapitalized, by 50% or more by American or European standards," according to an astute article, "Japan's Complex Monetary Structure—Business Walks Tightrope of Chronic Money Shortage and Overstretched Borrowings to Maintain Operations," 2 *The Investor* No. 20, 1, 2 (Sept. 27, 1962).

the resultant competition from foreign imports and the challenge and opportunity presented by the prospect of ever larger foreign investments, remedial action was called for. The postwar period was over for Japan as well as for the rest of the world. That Japanese enterprises would have to be put on a sounder footing to face the new era was apparent to a broad spectrum of Japanese opinion.¹⁴

Among the obvious solutions was the public offering of stock in Japan and abroad at or near the market price. Other remedies recommended included tax reform whereby dividends would be treated wholly or partially as a business expense or the corporate tax rate would be reduced with respect to earnings paid out as dividends.¹⁵ Also suggested was greater taxation of interest payments in the hands of recipients to bring it into line with that levied on dividends, thus making stock more attractive relative to debt securities.¹⁶ Likewise recommended was hastening the incorporation into capital of the revaluation reserve through the issuance to stockholders of gratis shares.¹⁷ There were even some advocates of reform of the stock markets to give investors greater confidence.¹⁸

These problems will be left to others, while this article examines the public offering mechanism in Japan and abroad as a remedy. Before doing so it would be well to pause and examine the legal background.

Legal Background. Japanese corporations operate within the framework of the *Commercial Code* which was originally based on

¹⁴ See among others, Matsui, *supra* note 6; and Oguma, *supra* note 12, representing the views of officials of the Ministry of Finance; OKAMURA, *op. cit. supra* note 10, *passim* representing the views of scholars; REPORT TO THE MINISTRY OF FINANCE OF THE SECURITIES EXCHANGE COUNCIL (June 22, 1960), *op. cit. supra* note 6, which body is composed of 13 members with academic and business experience and which had been reactivated in 1959 to study and report on the critical situation; See COHEN, *op. cit. supra* note 3, *passim* for the view of a qualified foreign observer.

¹⁵ On April 1, 1962, the corporate tax rate was reduced from 38% to 28% on that portion of earnings paid out as dividends thereby showing that recommendations sometimes are acted upon.

¹⁶ REPORT TO THE MINISTRY OF FINANCE OF THE SECURITIES EXCHANGE COUNCIL (June 22, 1960), *op. cit. supra* note 6; Oguma, *supra* note 12.

¹⁷ Oguma, *supra* note 12; the Special Measures Law for Enterprise Capital Fulfillment Through Revaluation Reserve (Law No. 142 of 1954) already provided incentive through imposing a limitation on the amount of dividends that could be paid by companies with less than specified percentages of their revaluation reserves transferred to capital. Nonetheless, by the end of September, 1960 only 26% of the total revaluation reserve had been transferred to capital (38% if electric utilities are excluded from the computation) leaving ¥910 billion still outstanding, with revaluation reserve still 42% of capital (24% if electric utilities are excluded).

¹⁸ See Matsui, *supra* note 6, who dwells on the fact that 70% of stock trades are on a back to back or wash basis (*baikai*) within the securities houses rather than over the exchanges and on the fact that the securities houses are often exposed to conflicts of interest due to their manifold roles of dealer, broker, underwriter, investment fund manager, not to mention trading on their own account.

the German code. The *Commercial Code* went into effect in 1890, but underwent substantial revision in 1899 and 1911 to bring it more into line with Japanese conditions.¹⁹ Thereafter the *Code* continued largely without amendment for over a quarter of a century through the tremendous economic expansion of the First World War and the years immediately following and the vicissitudes of the post-1929 depression years. To meet the needs of the times, however, a substantial reform was promulgated in 1938,²⁰ following on the heels of large-scale revisions of the commercial laws of England, France, Germany, Spain and Switzerland.

In addition to a number of changes of no interest to this article, the 1938 Amendment endeavored to promote freedom of investment by providing for preferred stock,²¹ conversion between different types of stock,²² (*i.e.*, preferred into common and common into preferred) and conversion of debentures into stock.²³ These amendments, however, were severely circumscribed and therefore of little practical effect. For example, although the preferred stock could be issued at any time,²⁴ conversion of stock and debentures took effect only at the close of business in the year in which the demand for conversion was made.²⁵ It remained for the postwar Occupation reforms to make these provisions more flexible and to introduce sweeping changes in other areas.

At the insistence of the Occupation authorities the *Commercial Code* underwent two revisions, the first in 1948 which abolished the payment of shares by installments, and the much broader reform of 1950.²⁶ One aim of the 1950 Amendment, which is not the concern of this article, was the introduction of corporate democracy. Another was the provision of new methods of attracting and inducing capital investment. The latter generally met with the approval of Japanese

¹⁹ *Shōhō* (Commercial Code) Law No. 32 of 1890, Law No. 48 of 1899 and Law No. 73 of 1911, respectively.

²⁰ *Shōhō-chū Kaisei Horitsu Shikō Hō* (Law Enforcing the Commercial Code Amendment Law) Law No. 73 of 1938.

²¹ 1938 COMMERCIAL CODE, arts. 168, 222.

²² *Id.*, arts. 359—363.

²³ *Id.*, arts. 364—369.

²⁴ *Id.*, art. 168.

²⁵ *Id.*, arts. 362, 368.

²⁶ Law No. 148 of 1948 and Law No. 167 of 1950, respectively, the second of which entered into effect in 1951 after some further changes (Law No. 209 of 1951); for the background and substance of these two amendments, see Blakemore and Yazawa, *Japanese Commercial Code Revisions Concerning Corporations*, 12 AM. J. COMP. L. 12 (1953), SUZUKI AND ISHII, *KAISEI KABUSHIKI KAISHAHO KAISETSU* (Commentaries on the Revised Corporation Law) 1-7 (1950); and OSUMI AND OMORI, *CHIKUJO KAISEI KAISHAHO KAISETSU* (Article by Article Commentary on the Revised Corporation Law) 1-4 (1951).

business and legal circles, although there was some opposition to specific provisions.²⁷ It was recognized as necessary to have a variety of equity securities available to appeal to a broad range of investors if the imbalance between debt and equity was to be corrected.²⁸

The big change brought in by the 1950 Amendment, as far as capital procurement is concerned, was the introduction of the system of authorized capital, otherwise described by one Japanese scholar as the "installment stock issuance system."²⁹ Formerly, new stock could be issued only by amending the articles of incorporation to provide the necessary stated capital for that issue, which required stockholder action.³⁰ Prior to 1948 this difficulty had been ameliorated by the provision, abolished in that year, that only one-fourth of the issued stock need be paid up at the time of issuance. The authorized capital system was thus doubly welcome and was hailed as providing greater flexibility in raising capital.³¹

Regrettably the effect of this reform was offset by an unfortunate provision relating to pre-emptive rights. The Occupation reformers, concerned as they were with corporate democracy in the form of stockholder safeguards, hesitated to follow the full implication of the authorized capital system and give full authority to the directors to issue stock at discretion. After much argument with the Japanese members of the drafting committee who wished to provide for pre-emptive rights only where the articles of incorporation specifically so provided, the Occupation members, who favored the general recognition of a pre-emptive right, compromised by inserting a provision to the effect that a corporation must provide in its articles for the existence, restriction, or exclusion of pre-emptive rights.³² This provision was roundly condemned as confusing and as exposing corporations to nullification since the provision was a required provision and therefore if defective could result in the cancellation of the articles of incorporation.³³

²⁷ *Id.* at 22; but one Ministry of Justice official writing a decade after the event saw the 1950 Amendment as a plan on the part of the Occupation authorities to open Japan to foreign investment, particularly American, by making over the *Commercial Code* in the American image, Yoshida, *Shihon Torihiki no Jiyuka to Mugiketsuken Kabu*, (Non Voting Stock and the Liberalization of Capital Transactions), 169 CLJ 14, (Mar. 15, 1960).

²⁸ OKAMURA, *op. cit. supra* at 125; SUZUKI AND ISHII, *op. cit. supra* note 26, at 7-8.

²⁹ *Id.* 232.

³⁰ Pre-1950 COMMERCIAL CODE, arts. 166, 342, 348.

³¹ SUZUKI AND ISHII, *op. cit. supra* note 26, at 8; OSUMI AND OMORI, *op. cit. supra* note 26, at 8.

³² 1950 COMMERCIAL CODE, arts. 166, 347.

³³ See, among others, an article by a Ministry of Justice official, Kagawa, *Shinkabu*

It remained for the Japanese themselves to compound the confusion in the 1955 amendment to the *Commercial Code*³⁴ by abolishing the 1950 requirement but providing that while the directors have the freedom to allocate stock in their discretion, only the stockholders may grant pre-emptive rights to others.³⁵ This provision will be the object of more detailed discussion later in this article. Suffice it to say at this point the freedom of the directors to allocate is also limited by the requirement that paid up stock must always be at least one-fourth of the authorized stock,³⁶ hardly an onerous burden in fact and no doubt owing its origin to the pre-1948 provision that only one-fourth of the issued stock need be paid in at the time of issue.

To give additional financing flexibility the 1950 Amendment also introduced no par stock for the first time to the Japanese scene,³⁷ going one step beyond American law by providing that authorized but unissued stock may be either par or no par at the discretion of the directors unless a limitation is provided in the articles. The board of directors is also free to determine the consideration which a corporation will receive for the issuance of shares without par value and to provide that up to one-fourth of the consideration paid for such shares may be set aside as paid-in surplus.³⁸

Finally, as further inducement to investors in corporations, the 1950 amendment provided for redeemable stock,³⁹ stock dividends,⁴⁰ stock splits,⁴¹ and transfers from reserves to stated capital.⁴²

How these financial implements have been used will be the next subject for review.

PRESENT JAPANESE PRACTICE

Rights Offerings versus Public Offerings of Stock. Rights offerings to stockholders of new stock at par value regardless of the current market price is an ingrained custom which persists to the present day

Hikiukeken ni Kansuru Teikan Kitei Henko Rei ni tsuite no Gutaiteki Kensa (A Practical Examination Concerning Articles of Incorporation Amendments Relating to Pre-emptive Rights), 11 CLJ 2, (Jan. 15, 1956).

³⁴ Law No. 28 of 1955.

³⁵ COMMERCIAL CODE, art. 280-2 (hereafter whenever the COMMERCIAL CODE is referred to without a date, the COMMERCIAL CODE in effect from the 1955 amendment up to the amendment (Law No. 82 of 1962) taking effect on April 1, 1963, which effected changes not germane to this article, is intended.)

³⁶ COMMERCIAL CODE arts. 166, 347.

³⁷ *Id.*, arts. 166, 199.

³⁸ *Id.*, arts. 284-2, 280-2.

³⁹ *Id.*, art. 222.

⁴⁰ *Id.*, art. 293-2.

⁴¹ *Id.*, art. 293-4.

⁴² *Id.*, art. 293-3.

in Japanese stock issues, regardless of the changes in the *Commercial Code*, thereby frustrating the efforts of the *Commercial Code* reformers to achieve flexibility and mobility of corporate capital.⁴³ Public offerings of stock at or near market have grown in recent years, but still represent a very small portion of new stock issued,⁴⁴ despite the fact that the number of companies taking this route since the preemptive rights amendment to the *Commercial Code* in 1955 referred to above is substantial.⁴⁵ The reason is that there are very few companies which issue all, or even a sizeable part, of their new stock on a public offering basis. Generally, a public offering of stock is accompanied by a substantial rights offering at par to the stockholders.⁴⁶ In fact the public offering is often nothing more than a method of disposing of unsubscribed shares or fractional shares or of rounding out the stated capital following a rights offering.⁴⁷

The public offering has occasioned much debate in Japan, and can hardly be said to have received unqualified or widespread acceptance. The arguments on both sides are many and varied. The arguments in favor may be summarized as follows: (1) the premium received over par value improves the capital structure by bringing additional funds into the capital account as capital surplus; (2) since fewer shares are issued in relation to the consideration received, the ensuing dividend burden is less than when a rights offering at par is made; (3) price fluctuations are minimized since speculative investment in anticipation of a rights offering at par is eliminated; and (4) public offering at market is in accord with the framework of the *Commercial Code* as amended during the 1950's, since there is no requirement that the new stock must be issued to particular persons.

The arguments opposed run as follows: (1) despite the present framework of the *Commercial Code*, there is a strong custom in Japan in favor of rights offerings at par and change to a public offering system would undermine present stock prices which are

⁴³ OKAMURA, *op. cit. supra* note 28 at 242.

⁴⁴ In 1961, 96.2% of the amount of capital increases was represented by rights offerings to stockholders as opposed to a high of 99.9% in 1955, the year when the preemptive rights provision of the COMMERCIAL CODE was relaxed, see *Kabunushi Wariate* (Stockholder Rights Offering), 253 CLJ 4, (Aug. 5/15, 1962).

⁴⁵ In 1956, 38 companies issued on the basis of a public offering; in 1957, 45; in 1958, 33; in 1959, 62; in 1960, 131; and in 1961, 292. For the years, 1956 to 1958, inclusive see YAMAICHI SECURITIES CO., LTD., ZOSHI NO JITSUMU (Practical Aspects of Capital Increase), 277 (rev. ed. 1961) and for subsequent years; Yamaichi Securities Research Dept., *Kobo* (Public Offering), 253 CLJ 8, (Aug. 5/15, 1962).

⁴⁶ See tables in YAMAICHI, *op. cit. supra* note 45, 278-281, and in Yamaichi, *Kobo*, *supra* note 45, 10-12, and accompanying text.

⁴⁷ *Ibid.*

based on anticipation of rights offerings, thereby injuring present shareholders who bought on that basis; (2) rights offerings are a strong inducement to stock purchases, so that departing from this system would discourage the much needed equity investment, thereby more than offsetting any advantage to the issuing companies from the premium price (price over par) received; (3) it is difficult to fix the public offering price since the market price changes so often and quickly, and there are few other objective standards, thereby opening up the possibility of abuse; (4) public offering with its greater consideration for the issue of fewer shares will check the desired dividend rate drop, thereby continuing the high dividend level; (5) it is necessary first to dispose of the large revaluation reserve⁴⁸ through free distribution of shares to obtain a proper stock price level before resorting to public offerings.⁴⁹

The middle view is that there is no clear cut answer.⁵⁰ The arguments for public offerings are logical whereas the arguments in opposition are to a great extent traditional and emotional, but then sometimes it is illogical to be logical in the face of conditions as they are. It is not proper to cite the example of the United States where public offerings are common since conditions are different from those in Japan. In the United States there are frequent stock splits to appeal to investors and to reward stockholders whereas these, though permitted by the *Commercial Code*, are largely unknown because of the prevalence of par value stock with a par value at the minimum permitted by law.⁵¹ There is no clearly defined stockholder expectation with respect to rights offerings. Stockholders hold or sell, and investors buy, stock from a variety of motives, so that it is unwise to be dogmatic on this score. In short, one must be pragmatic. Each company must examine its own situation and decide for itself whether and to

⁴⁸ See note 17, *supra*.

⁴⁹ Niwayama, *Kabushiki no Kobo ni tsuite* (Concerning Public Offering of Stock), 152 CLJ 2, (Sept. 15, 1959).

⁵⁰ *Ibid.*, where the middle position is espoused by a Ministry of Finance official with the arguments given in the balance of the paragraph.

⁵¹ Up to 1948 the minimum par value per share was ¥20 if the share was fully paid in at the time of issue and ¥50 if it was not; thereafter to 1950, the minimum par was ¥50 and from 1951, ¥500, see COMMERCIAL CODE, art. 202, which is and has been the provision specifying the minimum. The controlling minimum is the one in effect at the time of incorporation. According to a Ministry of Finance survey as reported in YAMAICHI, *op. cit. supra* note 45, at 85, as of March 31, 1958, of 2,709 listed and unlisted companies, 70% (1,990) had ¥50 par; 22% (591) had ¥500 par; and of the balance there were 13 with ¥20, 1 with ¥25, 22 with ¥1,000 and 28 with ¥4,000 or ¥5,000. Of the 1,194 companies listed at the end of 1962, 1,138 had stock with a par value of ¥50. *Understanding Japanese Stocks—Par Value, Dividend and Capital Boosts Peculiar to Japan Defined*. The Japan Stock Review, No. 54, 15 (Jan. 28, 1963).

what extent a public offering is feasible. The big problem in a public offering is to avoid offering the issue to a favored few or on unreasonable terms. If this is done, public offerings can hardly be said to be a trick of management to take advantage of the stockholders. After all, management and stock holders do have common interests.

Some of the foregoing arguments merit further consideration. The forces in favor of public offerings received a powerful boost from President, now Chairman, Sato of the Mitsui Bank, who came out unqualifiedly in favor.⁵² He pointed out that market price offerings were essential to replenish the equity funds of corporations. A market price issue enables the company to take advantage of its true worth and at the same time improve its capital structure. Furthermore, by bringing in more funds it avoids the tendency to dividend reduction inherent in rights offerings which in turn causes management to eschew capital increases and resort to bank loans. He demolished the position of those who said resort to market price offerings would cause turmoil in the stock market by pointing out that rights offerings at par do that very thing, since a one-for-one stock issue at par of a stock with a ¥50 par and a cum-rights market price of ¥250 results in an ex-rights market price of ¥150 with the ¥100 profit on the new shares wiped out by the ¥100 drop in the market value of the old shares. By way of contrast, if the company's asset position is improved in relation to the stock issued and there is no dividend cut, as is usually the case with a public offering at market, the stockholders' position is not adversely affected.

Despite the logic of Chairman Sato's position, many, including those in the securities trade, firmly believe that anticipation of rights offerings are an important element in maintaining stock prices.⁵³ The facts tell otherwise since every rights offering is accompanied by a price drop to reflect the dilution, which drop may in fact be accentuated by speculators leaving the security to seek another one ripe for a rights offering.

It is interesting to note that the advocates of the market disruption theory were most vocal during the big rise in the Tokyo stock market from 1958 to July, 1961. During the drop in 1961 which carried over into 1962 and the concurrent tight money policy, the fact that a company was contemplating a rights offering was often a depressing

⁵² *Kabushiki no Jika Hakko o Teisho suru*, (I Advocate Market Price Issuance of Stock), 126 CLJ 2, (Jan. 25, 1959).

⁵³ YAMAICHI, *op. cit. supra* note 45, at 64.

factor since stockholders were hard pressed to raise the funds to subscribe, having to sell part of their holdings to obtain funds to protect their equity position in the remainder from dilution.⁵⁴ Rights offerings might continue to be an attraction in the companies with smaller capitalization but as they grow larger the attraction will decrease and in the meantime the stock split effect of the rights offering serves to keep the market price of the stock dangerously low in relation to par thereby inhibiting future financial flexibility.⁵⁵

On the whole, stock prices would seem to be formed by a number of factors other than, or certainly in addition to, rights offerings. Interest rates in comparison to dividends is certainly one factor, and growth prospects another,⁵⁶ although it must be admitted that United States yardsticks such as the price-earnings ratio are largely ignored in Japan.⁵⁷

The advocates of rights offerings to reduce the high dividend rate seem to stand on equally unfirm ground. High dividend rates are cited, but they are inevitably given in terms of par value, not market price. To the investor, and indeed also to the stockholder who might be able to buy new stock at par but then only to see his old stock sink proportionately in value, the important thing is the relation of the dividend to the market price, that is the yield, which is quite a different thing from the dividend ratio, that is the dividend in relation to par.⁵⁸ Furthermore, both the dividend ratio and stock yield have shown a great drop in recent years due to the increase in the number of shares outstanding which has kept ahead of industrial growth, great as that has been.⁵⁹

⁵⁴ This is particularly true of the so-called "mammoth industrials" such as Hitachi, Toshiba, the steel companies, etc., whose capital was so large that any rights offering called for large sums to be invested. The problem was heightened by the economic recession then in progress which made it likely that the dilution would be accompanied by a dividend cut, as indeed it was among many of the "mammoths." The situation was so critical that the Ministry of Finance had to persuade many of the larger companies to postpone their rights offerings by several months into the spring of 1962.

⁵⁵ The COMMERCIAL CODE, art. 202, prohibits the issuance of par value stock at less than par with the result that when such once proud growth issues as the steels come upon hard times, as in the recent recession, their stock price, already depressed by numerous rights offerings sink below par, thereby preventing future issues.

⁵⁶ Kisamori, *Kabuka o Kosei suru Mono* (Factors Forming Stock Prices), 117 CLJ 5, (Oct. 25, 1958).

⁵⁷ Nagada, *Saikin ni Okeru Kigyo no Haito Seisaku* (Recent Corporate Dividend Policy), 148 CLJ 21, (Aug. 20, 1959). There are signs of change, see *Trading on Market Shifting From Capital Gain to Rate of Yield*, 54 Japan Stock Review, 15 (Jan. 28, 1963).

⁵⁸ Nagada, *supra* note 57, at 21, where it appears that in 1958 the average dividend ratio for all listed companies was 13.5% compared with a yield of only 4.6%.

⁵⁹ *Id.*, where it is shown that the average dividend ratio and yield on all listed companies five years before, in 1953, were 21% and 7.8%, respectively, while dividends paid out had increased from ¥52 billion to ¥121 billion.

If it is necessary to reduce per share dividends even further, that objective can be achieved simultaneously with public offerings, not prior thereto. There are complaints that the large revaluation reserve is not being incorporated into capital fast enough through the issuance of gratis shares.⁶⁰ Certainly its incorporation would have a dramatic effect on per share dividends,⁶¹ but too rapid a drop would be harmful, particularly in the present condition of the market. A better policy would seem to be to couple the disposition of the revaluation reserve with increased public offerings. The public offerings would provide additional assets over the par value to cushion the effect of the necessary outpouring of gratis stock. This would kill two, or better, three birds with one stone by hastening the disposal of the legacy of the inflation-racked years, improving the equity ratio and reducing dividends gradually, if at all.

Fixing the price of stock publicly offered has been made to seem very complicated by the numerous commentators on the subject. It need not be as bad as it seems; this subject will be examined in the description of the public offering as carried out in Japan.

In concluding this section, it might be well once more to cite the June, 1960 report of the Securities Exchange Council. The Council took a middle position on the subject of public offerings.⁶² It stated that new stock issues entirely on a public offering basis were inappropriate in view of the strength of the rights offering custom. It advocated that partial public offerings be used in accord with conditions in each industry and company and to the extent they do not disrupt the stock market, in order to assist in achieving the goal of replenishing equity capital. It pointed out that management should pursue public offerings, if at all, as a consistent policy and not on an opportunistic basis only when stock prices are high.⁶³

The report concluded with the admonition that public offerings should be accompanied by sweeteners to assuage the disappointment of the stockholders. Among the inducements to be offered to avoid stockholder protest would be gratis offerings of shares from capital surplus or the revaluation reserve, a concurrent rights offering and, of all things, a dividend increase. The free distribution of shares from

⁶⁰ Oguma, *supra* note 12.

⁶¹ See Oguma, *supra* note 12, where figures are given to show the effect.

⁶² 181 CLJ 2, (July 1, 1960).

⁶³ This seems highly unrealistic since public offerings inevitably will increase when prices are high, as indeed they should since that is the most advantageous time, from the point of view of the company and its stockholders, to issue stock.

the capital surplus would be "splitting the melon" of the public offering premium among the stockholders. The Report avoided specifics, but a year earlier the Tokyo Securities Dealers' Association had urged that no more than 10% of any single capital increase be accomplished by means of a public offering.⁶⁴

Public Offerings in Japan. The public offering in Japan, or *Kobo*, has been defined⁶⁵ as the method of soliciting subscriptions for stock directly or indirectly from among many unspecified persons without granting pre-emptive rights. The word "indirectly" is used purposely in the definition to include the situation where underwriters subscribe to the stock from the issuing company and then resell to the public.

Issuing companies generally have their public offerings underwritten by the securities houses.⁶⁶ The securities houses in an underwriting⁶⁷ act as subscribers to the stock within the meaning of the *Commercial Code*, thereby becoming stockholders following which they resell to the investing public. The underwriters are entered on the register of stockholders as stockholders. The fact that a contract is signed with specific underwriters and that they do become the initial stockholders to the exclusion of everyone else raises a question as to whether they have been granted pre-emptive rights within the meaning of article 280-2 of the *Commercial Code* thereby requiring stockholder authorization, but this thorny subject is reserved for discussion later.⁶⁸ Suffice it to say here that stockholder authorization has not been obtained for a public offering by underwriting in Japan.

⁶⁴ Yamaichi, *Kobo*, *supra* note 45.

⁶⁵ Goto, *Kobo o Meguru Sho Mondai* (Some Problems Involving Public Offerings), 26 CLJ 6, (June 5, 1956), and repeated by the Yamaichi Securities Research Dept., of which Mr. Goto was the head, in YAMAICHI, *op. cit. supra* note 45, at 274.

⁶⁶ It is estimated that 99% of public offerings in Japan are underwritten, Yamazaki, *Kobo Kagaku no Kettei Hoho ni tsuite* (Concerning the Method of Determining the Public Offering Price), 215 CLJ 2 (June 25, 1961).

⁶⁷ As used in this article "underwriting" means underwriting by purchase (*kaitori hikiuke*) of the entire public offering.

⁶⁸ Naturally this is true only in the case of those companies which took advantage of the 1955 amendment to the COMMERCIAL CODE to remove from their articles of incorporation any restriction on the issuance of shares to other than stockholders. That such removal is now well nigh universal among companies likely to issue stock publicly can be inferred from the fact that as of September 30, 1955, three months after the amendment went into effect, 31% of all listed companies had amended their articles to delete the previously required reference to pre-emptive rights, while "the overwhelming majority" of the remaining listed "were ready to do so," Kagawa, *Shinkabu Hikiukeken ni Kansuru Teikan Kitei Henko Rei ni tsuite no Gutateki Kensa* (A Concrete Investigation Concerning Examples of Amendment of the Provisions of Articles Relating to Pre-emptive Rights to New Stock), 11 CLJ 2, (Jan. 15, 1956).

The first step in a public offering is a board of directors meeting to authorize the issue as required by article 280-2, para. 1, of the *Commercial Code*. Paragraph 1 of that article requires director action on only three points, namely (1) whether or not the new shares are those having par value, (2) the class (*i.e.*, whether common or preferred), the number, the issue price, the payment date and, (3) in the case of no par stock, the amount not credited to the stated capital out of the issue price. Of them all, only the determination of the issue price presents any serious problem.

The object of a public offering in Japan, as elsewhere, is to obtain as much money as possible from the investing public by setting the price as close to market as conditions will permit. This desire for economic benefit is reinforced by the fear of legal sanction contained in articles 280-10, 280-11 and 280-15 of the *Commercial Code*.

Article 280-10 provides that "if the company issues shares . . . at a grossly unfair price and there is any fear of shareholders suffering pecuniary disadvantage thereby, such shareholders may demand of the company for the suspension of such issuance." Article 280-11 puts added fangs in article 280-10 by providing for the payment to the company of the difference between a fair issue price and the unfair issue price by any person who in collusion with any director has subscribed for shares at a grossly unfair price. Article 280-15 is to the effect that a director or stockholder may bring an action for nullification of the issuance of new shares within six months of their date of issuance. Despite its ferocity, or perhaps because of it, article 280-15 is the least worrisome of the three. It does not spell out what constitutes grounds for nullification and furthermore runs counter to the cherished principle in Japanese jurisprudence of "safety of transactions" which among other things holds that it is not proper to undo an issue of stock already in the hands of the public particularly where injunctive relief and monetary recompense are available under articles 280-10 and 280-11.⁶⁹

In view of the strictures of article 280-10 the question arises as to what constitutes a fair price. The *Code* says nothing. Two questions arise in this connection. The first is the amount and the standard by which it is determined and the second is the time as of which the fairness is evaluated. Views on the subject are legion, but the courts have

⁶⁹ YAMAICHI, *op. cit. supra* note 45, at 339; and Yoshida, *Kaitori Hikiuke to Shoho Dai 280 no 2 2-Ko* (Article 280-2 Paragraph 2 of the Commercial Code and Underwriting by Purchase), 268 CLJ 2, (Jan. 25, 1963).

spoken only once, in 1953 in the *Matsuya* case,⁷⁰ and since then have lapsed into a tantalizing silence.

According to the *Matsuya* decision the fairness of the price must be determined as of the date the price is determined by the directors, not the payment date to the company by the underwriters nor the date the public purchases from the underwriters. To have decided otherwise would only have compounded the difficulties of the underwriters and the company without benefiting the stockholders. The directors and underwriters can hardly be expected to take the blame merely because the market price and other factors happen to undergo a radical change between the date the offering price is fixed and the shares paid for. Being human, and in order to do the best job possible, they will endeavor to shorten as much as possible the interval between price determination and payment. This interval has been shortened considerably but not to the extent found in the United States where everything seems to happen with split second speed in underwritten public offerings.

To shorten this interval the directors at the meeting referred to above often postpone the determination of the price to a later date. Following the initial board meeting, a "notification," or registration statement is filed with the Ministry of Finance pursuant to article 5 of the *Securities and Exchange Law*.⁷¹ The notification does not become effective for 30 days but the device of filing a draft notification is available to start the running of the 30-day period. Then after about 25 or 27 days the formal notification is filed with the price fixed and stated therein. The filing of the formal notification is preceded by the signing of the underwriting agreement which is an exhibit thereto.

It is the general rule that the underwriters will sell to the public at the same price as their subscription price to the company, receiving a commission or fee as compensation. The underwriters subscribe on the subscription date set by the company and complete the sale to the public by the subscription payment date, which is the date they must make payment to the bank or banks acting as subscription agents for the new shares.⁷² The payment date in turn is the date when the

⁷⁰ Tokyo District Court, 1953, "Yo" No. 127, Feb. 23, 1953. The text of the decision is given in YAMAICHI, *op. cit. supra* note 45, at 289-293.

⁷¹ *Shōken Torihiki Hō* (Securities Exchange Law) Law No. 25 of 1948. This Law represents a combination of the United States Securities Act of 1933 and Securities Exchange Act of 1934 and was introduced into Japan by the Occupation for much the same motives as led to the adoption of its counter-parts in the United States.

⁷² Required by the COMMERCIAL CODE, arts. 175, 280-14.

subscription agent bank pays the proceeds over to the company on behalf of the subscribers.

Generally in a large issue the price must be fixed about 15 days prior to the subscription payment date to allow three days for the formal notification to become effective, two days for the approval of the Tokyo Securities Dealers' Association⁷³ and ten days for the sale to the public.⁷⁴ In the case of a small issue the sale may only take two or three days with the period between the determination of the price and the subscription payment date shortened accordingly.⁷⁵ The total period from the initial directors' meeting to issuance is only 40 to 50 days, although it will be longer if it is coupled with a rights allocation to stockholders, because of the more rigid procedures required.⁷⁶

Price is fixed on the basis of market at the time. The average discount in Japan is 10% but there have been exceptions ranging up to 20%, none of which have invited attack under article 280-10 as grossly unfair, much less nullification under article 280-15.⁷⁷ The *Matsuya* case represented an extreme situation where the market price jumped from ¥260 on the date when the price was fixed at ¥250 to ¥650 on the payment date. Under the circumstances the problem of determining the issue price would appear to be greatly exaggerated. Nonetheless worry persists, with one suggestion having been made that public offerings should be conducted on the basis of competitive bidding to assure fairness in the issue price through the zest that comes from the competition of an auction.⁷⁸

The commission rate in Japan is not excessive, being only 2% to 3% on the average⁷⁹ compared with 8.5% in the United States.⁸⁰ It is customary for many underwriters to participate directly or indirectly. The original underwriters (*moto-hikiukenin*) are the larger

⁷³ This approval takes the form of allocating roles as subunderwriters to the smaller members of the Association, thereby assuring an equitable distribution of publicly offered securities by the "Big Four" securities houses among their lesser brethren, see YAMAICHI, *op. cit. supra* note 45, at 307.

⁷⁴ Yamazaki, *supra* note 66.

⁷⁵ *Ibid.*

⁷⁶ YAMAICHI, *op. cit. supra* note 45, at 294.

⁷⁷ YAMAICHI, *op. cit. supra* note 45, at 288; and Yamaichi, *op. cit. supra* note 45.

⁷⁸ Mizuta, *Kobo Hoho no Kaizen ni Kansuru Ichi Teian* (A Proposal Concerning Reform of Public Offering Methods), 195 CLJ 2, (Nov. 15, 1960). The author is an official of the Ministry of Justice. He points out that this unique method of selling stock was commonly used in Japan from 1912 to 1920 and that it seems to be in accord with COMMERCIAL CODE, art. 175, Paragraph 3, item 3 & COMMERCIAL CODE, art. 280-14, which imply that the subscriber names the price he will pay, the issue price determined by the company being nothing more than a minimum.

⁷⁹ YAMAICHI, *op. cit. supra* note 45, at 300-01.

⁸⁰ GUTHEMAN & DOUGALL, CORPORATE FINANCIAL POLICY, 362 (4th ed., 1962).

houses with the other acting as sub-underwriters (*shita-hikiukenin*). The company contracts with the original underwriters, who in turn contract with the sub-underwriters.

As noted earlier public offerings in Japan are not large in size, either in absolute terms or in comparison with the total of new stock issues. What they lack in size, however, they make up in variety. Japanese companies have been somewhat fearful about approaching the public offering device in a straight forward manner. Instead they have crept up on it in a variety of ways.

As has been indicated earlier, the public offering rarely occurs alone. It is usually accompanied by something for the stockholders in the way of a rights offering at par. In addition, the so-called public offering may be entirely to the stockholders themselves, but with the price fixed near the market. This was the pattern followed by Nissan Motor and Hitachi in 1960, where 15% and 10% of the stock, respectively, were issued to stockholders at 20% and 12% below the market, respectively.⁸¹

The second pattern is the mixed offering whereby a part of the so-called "publicly offered" shares are offered to stockholders on a preference basis with the balance being offered to the general public. Typical of this type was the Toshiba offering in early 1961 where 8% of the new issue was "offered publicly" with 70% of such 8% going to the stockholders and the remaining 30% to the public. The price in both cases was about 10% below the market.

The third pattern is the offering to customers which was typified by the Toyo Kogyo offering in the spring of 1961. In this case 9% of the issue was so offered with the rest going by way of a rights offering to stockholders. The price to the customers was about 8% below the market. Needless to say this type of offering has complications and comes dangerously close to a pre-emptive right to third parties since the selected subscribers are neither stockholders on the one hand nor the general public on the other.

Yawata and Toyo Rayon, both coming out in early 1961, represent the true public offering with all the publicly offered stock, 5% of the issue on the first case and 10% in the second, going to the general public at a discount of slightly over 10%. Finally there is the pattern followed by Sony Corporation at about the same time whereby in addition to the usual rights offering, the public offering was accompanied

⁸¹ Both had the unique feature whereby the small stockholders' right to subscribe was determined by lot to avoid the issue of new shares in other than round numbers.

by a free distribution of shares to stockholders at the rate of one for each ten held. The free distribution represented the transfer, at par value, of capital surplus to capital thereby passing on to the stockholders part of the premium, *i.e.*, that portion of the public issue price over par, which appears as capital surplus.⁸² Sony thus followed the advice of the Securities Exchange Council by offering a sweetener for the stockholders.

There are variations of the foregoing patterns. In fact the ingenuity of corporate financial officers and their advisers seems unbounded, but one thing all the offerings have in common is that they are underwritten.⁸³

Equity Securities Other Than Par Value Common Stock. We have seen how the amendments to the *Commercial Code* over the last quarter century have made available a number of different instruments for equity finance. It remains to examine the use to which these instruments have been put.

Preferred Stock. The oldest Japanese non-common stock equity instrument is preferred stock, which was permitted by the pre-1938 *Commercial Code*, although the 1938 Amendment added the concept of stock convertible into other classes of stock, thereby enabling preferred holders to switch into common if the terms of the issue so provided. The history of preferred stock has not been a happy one. It is neither fish nor fowl, offering neither the security of a debt instrument nor the chance for gain of common stock. The first issue of preferred stock was in 1887 by a company hard-pressed financially. This inauspicious beginning preferred stock has never been able to live down in the eyes of Japanese investors.⁸⁴ There were a few issues in the years before the war but usually under adverse circumstances such as inability to sell common, mergers or capital readjustments under adverse circumstances, and the like.⁸⁵

Issues of preferred are even rarer today in contrast with the United

⁸² The free distribution was made pursuant to art. 293-3 of the COMMERCIAL CODE. The entry of premium in capital surplus is required by article 284-2.

⁸³ The patterns of offerings are described in detail with full discussion of their merits and demerits by the members of the Corporation Law Research Group in *Kobo no Shin Keitai oyobi "Kaitori Hikiuke" Keiyaku ni tsuite* (Concerning "Underwriting by Purchase" Contracts and New Forms of Public Offerings), 218 CLJ 4, (July 25, 1961), an article, and in *Kabushiki Kobo no Mondaiten* (Public Stock Offering Problems), 233 Juristo 6, (Sept. 1, 1961), a verbatim transcript of a roundtable discussion. The Group includes, among others, Professors Suzuki and Yazawa of Tokyo University, and officers of securities houses and corporations.

⁸⁴ OKAMURA, *op. cit. supra* note 28, at 123.

⁸⁵ *Ibid.*

States where, at the end of February, 1954, there were 465 issues listed on exchanges with an aggregate market value of \$8 billion.⁸⁶ Nor is there much likelihood of an increase in popularity in the near future despite the plea of an eminent authority on corporation finance for greater use to tap a new segment of investors.⁸⁷ The fact is that dividend rates on common stock are high in Japan and paid wherever possible in good times and bad at a uniform rate. Therefore the common already has one of the characteristics usually associated with preferred.⁸⁸ As to the preference on liquidation, to a generation nurtured on rising stock prices and rapid business expansion it has lost whatever meaning it may have had.

The fact that under the *Commercial Code* preferred may be made convertible into common, and vice versa for that matter,⁸⁹ has done nothing to invest it with popularity. In fact there has never been an issue of convertible preferred, at least by a listed company, thereby proving, if proof is needed, that it will take more than the conversion feature to make preferred stock popular with Japanese investors.⁹⁰ Preferred stock may also be issued without the right to vote or with the right to vote only when dividends are in arrears, but this hardly adds lustre to an otherwise tarnished security.

No Par Stock. No par common stock enjoys no more popularity than preferred stock. To date there have only been two issues⁹¹ with a third one, by a major Japanese company, called off last summer with the announcement that "further study was necessary."⁹² There are

⁸⁶ *Id.*, citing *Monthly Statistics of the New York Stock Exchange*, for the figures.

⁸⁷ *Ibid.*

⁸⁸ This at least is the opinion of the Securities Exchange Council, which came to the conclusion that it could not recommend the use of preferred stock in Japan, except possibly for issues aimed at foreign investors. See its report of June 22, 1960 to the Ministry of Finance, *op. cit. supra* note 6.

⁸⁹ COMMERCIAL CODE, arts. 222-2 to 222-7 as inserted by the 1938 amendment. Until the 1950 amendment conversion could take effect only at the end of the year in which requested. Since the 1950 amendment conversion takes place when the demand therefor is made, but this removal of an understandably inhibiting restriction has had no effect.

⁹⁰ OKAMURA, *op. cit. supra* note 28, at 98.

⁹¹ By Mitsubishi Warehouse, whose President is reported to be an ex-professor of law and hence interested in novel legal experiments, and Fuji Kanko. Mitsubishi Warehouse issued no par in 1952 to its stockholders as a free distribution upon the occasion of incorporating some of its revaluation reserve into stated capital, while Fuji Kanko issued it on four occasions between 1952 and 1957 to obtain equipment funds, OKAMURA, *op. cit. supra* note 28, at 172; 253 CLJ 24, (Aug. 5/15, 1962). Both companies issued the no par in addition to already outstanding par stock.

⁹² Sumitomo Metals. See 248 CLJ 30, (June 15, 1962) and *Tsugi no Shoho Kaisei Jiko no Kaimei—Mondai no Haikei to Kaisei no Hoko—Mugakumen Kabushiki to Gakumen Kabushiki to no Sogo no Tenkan* (An Analysis of Subjects for the Next Commercial Code Amendment—The Background of the Problem and the Tendency to Amendment—Reciprocal Convertibility Between Par and No Par Stock), 258 CLJ 3, 5, (Oct. 5, 1962). It was reported that considerable pressure was put on the company by the securities houses and the government to call off the issue because of the con-

certainly a number of problems to be resolved before no par stock can be expected to obtain wide spread acceptance in Japan. It is looked upon in some circles as a strange species, too hastily transplanted to Japanese shores by the Occupation in the 1950 amendment without discussion in Japan and with many problems unsolved.⁹³ These problems have received a complete airing in recent months⁹⁴ and may be the subject of an amendment to the *Commercial Code* in the not too distant future,⁹⁵ after which no par stock may attain greater acceptance.

The necessity for no par has been urged as a device to aid companies whose stock is selling at or below par to obtain equity funds,⁹⁶ but this could be very unpopular with the par stockholders who would see others obtaining an equity position at a price lower than they could hope to do. They would be particularly annoyed if the company issued no par rather than incorporating a free distribution in a rights offering to them thereby enabling them to subscribe at less than par.⁹⁷

At any rate to urge no par as a device to bail out companies whose stock has committed the sin of falling below par is hardly to enhance its popularity. Its appearance would be looked upon as a confession that all was not well with the issuer and that hence it, and, for that matter, other issues of no par as well, should be avoided.⁹⁸ We have already seen in the case of preferred stock how a security can become a pariah by being identified with weakness. Even without this stigma, popularity of no par stock may be a long way off in a country accustomed, as is Japan, to having its dividends expressed as a percentage

fusion that might arise on the stock market if a major company issued no par stock in addition to its already outstanding par stock, at least until certain problems with respect to no par stock are resolved; see note 94 *infra*.

⁹³ See the conclusion of the Securities Exchange Council in its deliberations leading up to the Report of June 22, 1960 to the Ministry of Finance as reported in 151 CLJ 15, (Sept. 5, 1959).

⁹⁴ The principal problem is whether no par may be exchanged for par and vice versa. This is a real problem since the COMMERCIAL CODE (arts. 166, 199) goes one step beyond American law and provides that a company may have both outstanding at the same time. A resume of the problems was recently given by a Ministry of Justice official, Yoshida, *Mugakumen Kabushiki o Meguru Sho Mondai* (Some Problems Surrounding No Par Stock), 247 CLJ 2, (June 5, 1962). He concludes that they are not mutually convertible under the present CODE, that no par and par stock certificates cannot be consolidated and that probably a no par preferred could not be issued because in a preferred stock it is customary to express dividends as a percentage of par (although he admits they could be expressed as a yen amount).

⁹⁵ See Reciprocal Convertibility Between Par and No Par Stock, *supra* note 92.

⁹⁶ *Id.*; also OKAMURA, *op. cit. supra* note 28, at 152, 153.

⁹⁷ By this method the free distribution is made together with the rights offering at a ratio of, say, one to five so that in effect a share with Y50 par can be obtained for a subscription price of ¥40, the difference being accounted for by a transfer of ¥10 per share to stated capital from the revaluation reserve.

⁹⁸ OKAMURA, *op. cit. supra* note 28, at 154.

of par and paid on a uniform basis wherever possible.⁹⁹ With no par the old guidelines and landmarks would be gone. Under the circumstances it will be a long time before no par takes hold in Japan.¹⁰⁰

Convertible Debentures. Convertible debentures have hardly fared better in Japan. Introduced by the 1938 amendment they arrived on the scene just in time for the war, with the result that none were issued until 1949, and apparently only then because, in the postwar inflation, ordinary debentures were unsalable.¹⁰¹ Perforce, the first companies to issue convertibles were weak companies, at least at the time of issue, so that once more we find a security condemned by the average Japanese investor at least in part because of association with weakness.¹⁰²

There are other reasons also. Until 1950, as in the case of convertible preferred, conversion took place only at the end of the year in which the demand was made. This was corrected in the 1950 amendment which unfortunately, as we have seen above, added the requirement to the *Commercial Code* that the articles of all companies must contain a statement as to pre-emptive rights. Provision for some degree of pre-emptive rights was common. Since it was generally held that an issue of convertible debentures impinged upon the preemptive rights of stockholders, it was necessary from 1950 to 1955 when the provision was removed, to confine issues of convertibles entirely to the stockholders.¹⁰³ Even with the necessity removed, the custom of issuing only to stockholders continued and still prevails today.

One reason for issuance of convertible debentures exclusively to stockholders is that their characteristics are hardly of the kind to appeal to any one else. They have been described as "too simple and disjointed,"¹⁰⁴ and with good reason. There is no anti-dilution formula, a fatal weakness in a country where rights offerings at par value are endemic.¹⁰⁵ They are convertible during only a part of their life, and

⁹⁹ Yoshida, *supra* note 94, Some Problems Surrounding No Par Stock, admits this is a serious psychological problem and might require considerable adjustment.

¹⁰⁰ The security houses, the stock market and the government, whose pressure can be overwhelming, see note 92 *supra*, are taking a cautious attitude.

¹⁰¹ OKAMURA, *op. cit. supra* note 28, at 359. For a list and description of the 15 domestic issues (by 14 companies) to date see 253 CLJ 28, 29, (Aug. 5/15, 1962).

¹⁰² *Ibid.*

¹⁰³ SUZUKI AND ISHII, *op. cit. supra* note 26, at 304; OSUMI AND OMORI, *op. cit. supra* note 26 at 494, 495; and Ohtori, *Tokushu na Shasai—Rieki Sanka Shasai o Chushin ni* (Special Debentures—Centering on Participating Debentures), 189 CLJ 2 (Sept. 15, 1960) and 191 CLJ 14 (Sept. 25, 1960), Parts I and II, respectively.

¹⁰⁴ OKAMURA, *op. cit. supra* note 28, at 358.

¹⁰⁵ Generally it is understood that there will be no rights offering during the life of the debentures, although there have been at least four cases out of the 15 issues to date where there were such rights offerings, see 101 CLJ 16, (June 1, 1958). Such an

their life is short, generally only three years, although there is one issue with a maturity of seven.¹⁰⁸ Furthermore, during much of the period in which they are ostensibly convertible, they lose this characteristic by reason of the provision of the *Commercial Code*¹⁰⁷ to the effect that a demand for conversion cannot be made during the period the issuer's stock register is closed, which can be four or more months a year.¹⁰⁸

There are some advantages, however. All but two of the 15 issues are secured,¹⁰⁹ which is unusual for a convertible. But more importantly all are convertible on a par basis, that is the face amount of the debenture is convertible into stock with the same aggregate par value, regardless of the market price of the common stock at the time of issue.¹¹⁰ Issuance on such advantageous terms means that only stockholders can legally subscribe.¹¹¹ And in fact it probably means that that is the only basis on which anyone could be induced to subscribe to them.¹¹²

Convertible debentures may become popular on the domestic scene, but only if the issue of convertibles by Japanese companies in the United States captures the imagination of the Japanese investor and if the domestic issues adopt most of the features of such issues. The Securities Exchange Council found itself unable to recommend convertibles to the Ministry of Finance except for foreign issues and then not with the characteristics of the local issues.¹¹³

Other types of semi-equity debentures are theoretically possible under the *Commercial Code* such as participating debentures, income debentures and profit-sharing debentures,¹¹⁴ although one type very

"understanding" has some meaning when all the holders are stockholders, but would be of little value to third party holders.

¹⁰⁸ OKAMURA, *op. cit. supra* note 28, at 358.

¹⁰⁷ Articles 341-5 and 222-5. More will be said on this subject in the discussion of Japanese convertible issues in the United States.

¹⁰⁸ Two months for each of the semi-annual ordinary meetings of stockholders and in addition one or two months each for any extraordinary meeting, rights offering, etc. Japanese companies have the option of adopting a record date system, COMMERCIAL CODE art. 224-2, but few have done so.

¹⁰⁹ 253 CLJ 28, 29, *supra* note 101.

¹¹⁰ *Ibid.*

¹¹¹ See the discussion hereafter in connection with Japanese issues in the United States.

¹¹² OKAMURA, *op. cit. supra* note 28, at 359, 360, states par conversion originated because the terms had to be that favorable if the security was to be sold. He believes, however, this is not necessary today, although it is still being done.

¹¹³ See the Report in 181 CLJ 2, *supra* note 6. The feature that most repelled the Council was par conversion.

¹¹⁴ Ohtori, Special Debentures—Centering on Participating Debentures, *op. cit. supra* note 103; Professor Ohtori, then of Hokkaido University, now of Tokyo University, is an authority on Japanese bonds and debentures.

popular in the United States, namely debentures with stock warrants attached, is not possible.¹¹⁵ Here too the auspices are poor, however. One company endeavored to issue participating debentures, but had to abandon the attempt under pressure.¹¹⁶

The only conclusion to be drawn from the foregoing is that while the *Commercial Code* provides for several types of equity and semi-equity securities, and tacitly permits others, custom and conditions have not yet allowed Japanese companies to take advantage of the financing flexibility the reformers of the last quarter century have so thoughtfully provided. Further changes in the *Code* are no doubt needed, particularly with respect to no-par stock, but whether they would be any more effective in inducing an abandonment of custom than their predecessors is to be doubted.

ISSUES IN THE UNITED STATES

The Foreign Investment Background. Foreign investment in Japanese securities did not wait for Japanese companies to issue securities in the United States or elsewhere abroad. If in the 1950's Japan was not prepared to go to the foreign investor, the foreign investor was most ready and willing to come to Japan. The door was opened with the passage of the *Law Concerning Foreign Investment*¹¹⁷ in 1950 which in effect gave foreign investors in Japanese securities certain

¹¹⁵ *Id.*, because the warrants would be granting pre-emptive rights to third parties thus requiring stockholder approval under article 280-2 of the COMMERCIAL CODE. This approval lapses after six months by the specific provision of paragraph 4 thereof. Convertible debentures are unaffected by this provision as, unlike the other types of semi-equity debentures referred to above, they are specifically authorized by the COMMERCIAL CODE, arts. 341-2 to 341-5, with independent stockholder approval required by art. 341-2. No treasury stock is available for issue against the warrants since the COMMERCIAL CODE, art. 210 prohibits a company, with a few minor exceptions, from owning its own stock. For the background of and reasons for this prohibition, see Ueda, *Jiko Kabushiki no Shutoku ni tsuite* (Concerning Acquisition of Treasury Stock), 111 CLJ 2, (Aug. 25, 1958).

¹¹⁶ The company was Kanto Electric which obtained the blessing of Professor Ohtori (in his two part article referred to in notes 103 and 114 *supra*) and, more important, of the Ministry of Justice in a ruling published in 174 CLJ 38 (Apr. 25, 1960) and explained in 176 CLJ 2 (May 15, 1960), but the Tax Office of the Ministry of Finance found difficulty in deciding whether the participation in excess of the fixed interest would or would not be a business expense to the issuer, 180 CLJ 16, (June 25, 1960). The issue was abandoned on the grounds that "economic instability makes the timing premature" when the Banking Association cited a 1933 bank agreement, still in force, to the effect that banks would not act with respect to, or subscribe to, any unsecured debt security (a bank was to have been the trustee), 184 CLJ 44, (July 25, 1960). An official of the company admitted that the main reason why this unique (for Japan) security was ever contemplated in the first place was certain circumstances peculiar to the company, Yamamoto, *Rieki Sanka Shasai no Hakko Keikaku* (Plans for Issuing Participating Debentures), 169 CLJ 20, (Mar. 15, 1960).

¹¹⁷ *Gaishi ni Kan-suru Hōritsu* (Foreign Investment Law) Law No. 163 of 1950, hereafter cited as the Foreign Investment Law.

benefits not to be found in the *Foreign Exchange and Foreign Trade Control Law*¹¹⁸ enacted the previous year which would otherwise have governed foreign investment.¹¹⁹

With the guarantees implicit in the *Foreign Investment Law*, the integrity of the Japanese government was reinstated with the favorable settlement in the early 1950's of Japan's prewar debt obligations; and with economic and political stability, coupled with an unprecedented growth rate, becoming more and more apparent as the 1950's progressed, foreign investment grew rapidly. Such investment took two forms, direct investment by foreign entities, mainly corporations, on a management participation, or joint venture, basis and investment through the medium of the stock exchange.¹²⁰ Investment through the stock exchange, almost all of which was in common stock in view of the lack of a bond market and non-existence of preferred, grew from \$1,500,000 in 1951 to \$124,800,000 in 1962.¹²¹

Up to 1959, 80% to 90% of all foreign investment was in the form of loans, with 60% of such loans accounted for by the World Bank and the U.S. Export-Import Bank.¹²² Since 1960 the ratio of loans has fallen to 60% to 70% with a corresponding rise in stock investment from about 10% to 30%.¹²³ Before 1959, joint venture investment accounted for more than half of the stock investment, but the ratio of stock market investment has risen sharply since then, reaching 90% in the first half of 1962,¹²⁴ by which time the holdings by foreigners had reached 1.66% of listed stocks.¹²⁵

There were limits, however. First there were the restrictions of

¹¹⁸ *Gaikoku Kawase oyobi Gaikoku Bōeki Kanri Hō* (Foreign Exchange and Foreign Trade Control Law) Law No. 228 of 1949, hereafter cited as the Exchange Control Law.

¹¹⁹ Briefly the distinction between the two laws as far as the foreign investor is concerned lies in the fact that once he has received a "validation," *i.e.*, approval, of his investment under the Foreign Investment Law, he has an undertaking from the Japanese government, personal to him, that the foreign exchange will be made available to remit interest and dividends, principal at maturity and, after the specified holding period, the proceeds of sale of stock. Under the Exchange Control Law the most that the foreign investor received prior to 1960 was permission to buy the security; nothing was said about remittance. See note 206 *infra*.

¹²⁰ This article is concerned only with the latter.

¹²¹ Japanese language materials for use in the seminar entitled "A Comparative Study of U.S. and Japanese Securities Laws" given under the sponsorship of the Commercial Law Journal in Tokyo in October, 1962 by Louis Loss, Professor at Harvard Law School, Part 3, p. 1, for the first figure and *The Japan Economic Journal* (Nihon Keizai Shimbun) Vol. 1, No. 6, p. 2, Feb. 5, 1963, for the second figure.

¹²² *The Investor*, No. 27, 1, (Jan. 10, 1963).

¹²³ *Ibid.*

¹²⁴ *Ibid.*

¹²⁵ Ministry of Finance survey as of March 31, 1962 as reported in 50 Japan Stock Review 2 (Dec. 31, 1962).

the *Foreign Investment Law* itself, principally the holding period, and the restrictions grafted on by administrative interpretation, most notoriously the limitation on foreign equity holdings of Japanese companies.¹²⁶ Second, there were the differences in customs between Japan and foreign countries, particularly the United States. The *Commercial Code*, despite United States grafting since 1950, is essentially of the continental variety little understood by most Americans.¹²⁷

The obvious solution to the first problem was relaxation of the restrictions, which gradually took place.¹²⁸ As to the second, American Depositary Receipts offered a good answer.¹²⁹ American Depositary Receipts (generally known, and hereafter referred to, as ADR's) had been well tested for securities of many other countries,¹³⁰ and afforded Japan a means of raising equity capital through direct issues in the United States that would not otherwise be available.¹³¹

Looked at from the Japanese side, loans and purchases of debt securities by foreigners have always been welcome. When it comes to equity investment, one detects a certain ambivalence. In the middle of the 1950's the Japanese government registered disappointment that it was not higher,¹³² but this was while Western European growth was in full swing and before Castro had come to cast his shadow over

¹²⁶ This is of more concern to the joint venture investor rather than the investor through the stock exchange, particularly since the Ministry of Finance in May 1961 enunciated its policy of validating "as a matter of course" acquisitions through the stock exchange of up to 15% in the aggregate of the stock of Japanese companies (10% in the case of "restricted" companies such as utilities, banks, transportation companies, shipping companies, and the like).

¹²⁷ This problem as well as that of the restrictions, was recognized by Japanese writers, at least by 1960, when with Japan showing a surplus on international transactions for the first time in 30 years, talk of liberalization was in the air, see Ishikawa, *Kabushiki no Kokusai Torihiki to Sono Mondaiten* (Some Problems in Connection with International Stock Transactions), 169 CLJ 10, (Mar. 15, 1960).

¹²⁸ A big step was taken in May, 1961 with the shortening of the holding period for stock to two years by elimination of the requirement of installment repatriation over a five year period, the creation of Non-Resident Yen Accounts for funds not directly eligible for remittance, which could be sold to other foreigners or used for other purposes leading to remittability, and the "matter of course" policy referred to in note 126 *supra*.

¹²⁹ This was clearly recognized by the Japanese. See Ishikawa, *supra* note 127, where ADRs were described as "essential" for Japanese stock.

¹³⁰ By 1961 there were ADRs for over 150 issues, with Great Britain heading the list with 78, the Union of South Africa following with 20, West Germany with 19 and the rest found for a wide variety of countries including Italy, the Netherlands, Australia, France, Mexico and Brazil, of which seven were traded on the New York Stock Exchange, 29 on the American Stock Exchange and the remainder over-the-counter, see Merjos, *More ADRs—Buying Foreign Securities in the U.S. Gets Easier All the Time*, *Barron's*, (Jan. 23, 1961), p. 9, reporting on a survey of ADRs made by Barron's.

¹³¹ Ishikawa, *supra* note 127.

¹³² COHEN, *op. cit. supra* note 3, at 127, 130. As the author points out, it was the rules and the attitude of the government itself which kept foreign investment down.

Latin America. Later, with the improvement in Japan's foreign exchange position, her continued growth and stability and prospects for liberalization, Japanese stocks became increasingly attractive to foreign investors.

At this juncture a note of caution crept into the comments of Japanese in all walks of life. It was openly stated that given her different social system and national traits, it was better for Japan to have foreign investment in the form of loans rather than equity, which carries with it management participation.¹³³ Others recognized, however, that the average foreign investor was not interested in straight debt securities.¹³⁴ The lesson of a quarter century of world-wide inflation had not been missed. He would have to have equity if he was to be attracted in large numbers.¹³⁵ But this raised fears, on the part of the government, of management influence, if not control, by foreigners with resultant disruption of the government's economic plans and policies to which Japanese companies adhered as a matter of course.¹³⁶ As a solution some government circles suggested the use of non-voting stock for foreigners to separate share ownership from management participation,¹³⁷ or at least limiting his right to elect directors, although it was admitted this might be contrary to the Treaty of Commerce and Navigation Between the United States and

¹³³ Sasaki, *Gutaika Dankai ni Hairu Gaishi Donyu* (Foreign Capital Induction Enters the Concrete stage), 200 CLJ 15, (Dec. 25, 1960/Jan. 5, 1961).

¹³⁴ Sasaki, *Gaisai Hakko ni Kan suru Sho Mondai—Nyu Yoku ni oite Hakko suru baai no Mondaiten* (Some Problems Relating to the Issuance of Foreign Debentures—Problems in the Case of Issues in New York), 169 CLJ 2, (Mar. 15, 1960).

¹³⁵ The Mainichi Daily News (English language edition), American Depository Receipts Supplement, (Dec. 18, 1960), p. 13.

¹³⁶ Otsutake, *Gaishi Donyu to Sangyo Seisaku* (Foreign Capital Induction and Production Policy), 170 CLJ 2, (Mar. 21, 1960). The author is an official of the Ministry of International Trade and Industry (MITI). See also *Lingering Fears of Foreign Capitals—Complex Regulations Still Tie Up Foreign Investors Seeking Participation in Japanese Management*, 1 The Investor, No. 24, 1 (Nov. 22, 1962), where it is pointed out that the fear stems in part from the fact that "in the bleak years after the war, about \$200 million would have bought up control of practically all major Japanese Corporations." Actually these fears are greatly exaggerated as is shown by the fact as noted above (text at note 125), that foreign investors in 1962 held only 1.66% of listed stock, hardly enough to control anything, even allowing for concentration in certain industries. But these fears are not confined to Japan. At any rate they are prevalent in the France of Charles de Gaulle; see *Chrysler move rouses France—Government wants EEC to curb foreign investment in reaction to Chrysler's increased ownership of Simca, fourth largest French auto manufacturer*, BUSINESS WEEK, No. 1743 at 100 (Jan. 26, 1963), where it is pointed out that despite Simca's assurances that the acquisition would not affect top management the French government was uneasy because it "felt that U.S.-controlled companies too often show little concern for local economic conditions."

¹³⁷ *Id.* See also the views of a Ministry of Justice Official, Yoshida, *Shihon Torihiki no Jiyuka to Mugiketsuken Kabu* (The Liberalization of Stock Transactions and Non-Voting Stock), 169 CLJ 14, (Mar. 15, 1960).

Japan.¹³⁸ The fact that visiting investment groups had indicated that the average investor was not interested in management participation was not enough.¹³⁹

Upon examination, however, non-voting stock was found wanting.¹⁴⁰ In the first place the *Commercial Code*¹⁴¹ confined it to preferred stock and to one quarter of the outstanding capital. It was admitted it would not appeal to most foreigner investors who might feel they were getting a second-class security.¹⁴² Instead, Japanese management was advised to take certain countermeasures such as increasing domestic stock issues, encouraging management and employee stock purchases, and the like.¹⁴³

With fears of management domination laid to one side, Japan moved ahead in 1960 to 1961 to clear the way for issues of equity securities in the United States. In December, 1960 the Ministry of Finance accepted the ADR system and announced a list of 16 candidate companies to issue equity securities in the United States evidenced or accompanied by ADR's.¹⁴⁴ The way was prepared for the issue abroad of Japanese equity securities.¹⁴⁵

Stock and ADR Issues in the United States. Of the 16 candidates, the company selected as the first to issue a security in the United States was Sony Corporation, a famous electronics concern well known in the United States through its excellent products, which were being marketed there in increasing quantities.¹⁴⁶ Sony was recognized as an ideal first candidate with its small, compact size, excellent reputation and strong growth characteristics.¹⁴⁷ In addition Sony had placated

¹³⁸ Ishikawa, *supra* note 127.

¹³⁹ Yoshida, *supra* note 94.

¹⁴⁰ Ishikawa, *supra* note 127.

¹⁴¹ COMMERCIAL CODE, art. 242.

¹⁴² Ishikawa, *supra* note 127.

¹⁴³ *Ibid.*

¹⁴⁴ 202 CLJ 6, (Feb. 5, 1961). At the same time the Ministry selected ADR depositaries from among New York banks and custodians from among Japanese banks which were then paired off and assigned companies among the 16 candidates. The 16 included all those who have issued equity-type securities in the United States so far, see note 2 *supra*.

¹⁴⁵ There had been a number of bond issues abroad before the war, particularly in the 1920's and then again after the war commencing with the Japanese government bond issue in 1959.

¹⁴⁶ Of Sony's production 42% was exported, 30% to the United States, SONY CORPORATION, BEIKOKU SHIJO NI OKERU KABUSHIKI KOBO TO ADR—SONY NO SENREI KARA (ADR and Public Stock Offering in the American Market—the Sony Precedent), 5 (Tokyo, 1962).

¹⁴⁷ Watanabe, *Beikoku no Shijo ni Okeru Hompo Kabushiki no Kobo to Sono Mondaien* (Some Problems in Public Offerings of Japanese Stock in the American Market), 213 CLJ 2, (June 5, 1961).

its stockholders with a one-for-one rights offering, a one-for-ten free distribution, and Japanese investors in general with a public offering in Japan of 2,200,000 shares, or about 6% of the shares outstanding after the resultant capital increase,¹⁴⁸ thereby following the advice of the Securities Exchange Council's report to the Ministry of Finance and of other commentators.¹⁴⁹

With no precedents in Japan for a public offering of stock in the United States, the legal problems faced were formidable. The United States SEC registration statement required a full explanation of the relevant Japanese laws in terms meaningful to an American reader. Every precaution had to be taken also that all relevant laws of both countries were complied within connection with the authorization and issuance of the stock and the ADR's.¹⁵⁰

At the outset the attorneys involved¹⁵¹ were faced with the meaning, within the context of a public offering in the United States, of the second paragraph of article 280-2 of the *Commercial Code*, to the effect that the granting of preemptive rights to others than stockholders requires a special resolution of stockholders, *i.e.*, a two-thirds vote of a quorum consisting of a majority of the outstanding stock.¹⁵² Except for this vague provision stock may be issued by board of director action alone.

The problem was a delicate one because, as noted earlier in this article, shareholder approval had never been obtained in connection with public offerings in Japan, which were handled in much the same way as public offerings in the United States in that the underwriters

¹⁴⁸ At the beginning of 1961 Sony had 18,000,000 shares outstanding with a par value of ¥50 per share and a per share market value in the vicinity of ¥1,400. The public offering in Japan took place in April, 1961 at a price of ¥590 per share or 10% below the then market price of about ¥655 per share, which had been reduced as a result of the free distribution of 1,800,000 shares and the rights offering at the par value of ¥50 per share of 18,000,000 shares at the same time. For the details, see *SONY*, *op. cit. supra* note 146, at 8, 31, and Watanabe, *supra* note 147.

¹⁴⁹ See text and notes under discussion of public offering versus rights offering, *supra*.

¹⁵⁰ For the problems faced in connection with the public offering of foreign securities in the United States, see Stevenson, *Legal Aspects of the Public Offering of Foreign Securities in the United States Market*, 28 *Geo. Wash. L. Rev.* 194-213 (1959).

¹⁵¹ It has been customary to have both company and underwriters' counsel in Tokyo, in addition to underwriters' counsel in New York.

¹⁵² Because of its importance and the controversy surrounding it, the second paragraph of the Article is quoted in full:

"In giving the pre-emptive rights to new shares to persons other than the shareholders, the resolution provided for in Article 343 shall, even in the case where the articles of incorporation provide for thereon, be made as to whether the shares subject to be pre-emptive rights are those having par value or those without par value, the class, the number, and the minimum issue-price. In such case, the directors shall, in a general meeting of shareholders, show the reason why it is necessary to give the pre-emptive rights to new shares to persons other than the shareholders."

purchased for resale to the public under contract, all the stock being publicly offered. A full investigation was made of all the authorities including an interview with Professor Suzuki of the Tokyo University Law School, one of the participants in the drafting of the provision in question.

Although there has been much written since, and squarely in point since the subsequent writing was sparked by the decision made in the case of the Sony offering,¹⁵³ there was little available material at the time the decision had to be made. The provision in question had only been inserted in the *Code* in 1955, making of little help the treatises written prior to that date.¹⁵⁴

In the face of the literal meaning of the provision, statements¹⁵⁵ to the effect that since the underwriters intend to resell to the general public there is no problem, offer little comfort. Preemptive rights to third persons have been defined as the rights given to persons other than stockholders to receive preferential allocation of specific shares.¹⁵⁶ This is certainly the case in an underwritten public offering. The underwriters, not the stockholders, buy, or rather subscribe to, the shares. There is no obligation on the underwriters to sell only to stockholders. They may sell to any one. Under the circumstances it would appear that the underwriters have preemptive rights as soon as they sign the underwriting agreement with the issuer.¹⁵⁷

Now it may be that it was not the intention that public offerings through underwriters be considered the granting of preemptive rights to third parties.¹⁵⁸ The offering price is near the market price so that the amount of harm, if any, done to the old stockholders is kept to a minimum, although the old shareholders see their percentage par-

¹⁵³ See notes 158 to 161, inclusive, *infra*.

¹⁵⁴ SUZUKI AND ISHII, *op. cit. supra* note 26, and OSUMI AND OMORI, *op. cit. supra* note 26, written in 1950 and 1951, respectively, in response to the 1950 Amendment contain little of value on the subject.

¹⁵⁵ See YAMAICHI, *op. cit. supra* note 45, at 339.

¹⁵⁶ Fujisawa, in *Shin Kabu Hikiukeken* (Pre-emptive Rights to New Stock), KABUSHIKI KOSA, Vol. IV. 1264 (1957).

¹⁵⁷ It is the general view that in the case of third parties the obligation of the company to issue stock pursuant to a pre-emptive right comes into existence only when the necessary corporate authorization has been followed, or preceded, by a contract between the company and the third parties specifying the terms, *id.*, 1266-1268.

¹⁵⁸ This is the position of most of those who oppose the view that a public offering through underwriters constitutes the granting of pre-emptive rights. It is stated that offering through underwriters is merely a mechanical convenience since the end result is the same as if there were no underwriters, *i.e.*, the general public, and not the underwriters, ends up as the new stockholders, although it is not denied that the underwriters are the initial stockholders taking the share certificates in their name and endorsing them over to their purchasers, Yoshida (Ministry of Justice official), *Kaitori Hikiuke Keiyaku to Shinkabu Hikiukeken* (The Underwriting by Purchase Contract and Preemptive Rights), 218 CLJ 2, (July 25, 1961).

ticipation in the management diminish.¹⁵⁹ Perhaps price is the important criterion and what article 280-2, paragraph 2, was designed to prevent was the granting to non-stockholders, without special stockholder approval, of the right to subscribe to stock at par or very substantially below the market as is the custom in Japan in stockholder rights offerings.¹⁶⁰ But this is by no means clear, and there have been some with doubts.¹⁶¹

Whatever the merits of these arguments, no chances could be taken with an international issue to be registered with the Securities and Exchange Commission. The consequences of being wrong, or even of being subject to unjust attack and then vindicated, were just too great.¹⁶² Therefore, in keeping with that tried and true maxim that discretion is the better part of valor, stockholder approval was insisted upon and obtained.¹⁶³ The wisdom of the conservative course has

¹⁵⁹ Yatsuki, *Daisansha no Shinkabu Hikiukeken* (Pre-emptive Rights to Third Parties), 78 CLJ 12, (Oct. 5/15, 1957), where the author, a Professor of law at Kobe University, takes the position that such harm is the inevitable consequence of the stockholders' loss of their pre-emptive rights in the 1955 Amendment.

¹⁶⁰ This is the implication from statements in Izawa, *Shinkabu Hakko no Tetsuzuki*, (Procedure for Issuing New Stock), *KABUSHIKI KOZA*, Vol. IV, 1210 (1957) and in Yamaichi Securities, *Kobo* (Public Offering), 253 CLJ 8, (Aug. 5/15, 1962). Professor Yazawa takes this position in stressing the importance of a fair price in a public offering through underwriters in the round table discussion of the Corporation Law Study Group published under the title of *Kabushiki Kobo no Mondaiten* (Problems of Public Offering of Stock), 233 Juristo 6, 23 (Sept. 1, 1961).

¹⁶¹ See *Daisansha ni Taisuru Shinkabu Hikiukeken no Fuyo* (Granting of Pre-emptive Rights to Third Parties), 258 CLJ 15, (Oct. 5, 1962), where the anonymous author states that while an offering direct to the public would not involve pre-emptive rights, the presence of underwriters "blurs the distinction." See also Yonedzu, *Kaitori Hikiuke wa Daison sha Wariate ni naru ka* (Does an Underwriting by Purchase Constitute an Allocation to Third Parties?), *ZAISSEI KEIZAI KOHO* (Financial and Economic Journal) No. 979 at 4 (Feb. 25, 1963), where the author, a professor of law, flatly declares that an underwriting involves the grant of pre-emptive rights to third parties.

¹⁶² For the importance in public offerings in the United States of the validity and due authorization of the security, see Stevenson, *supra* note 150, at 196. As added reasons for wanting stockholder approval there was the fact that unlike the case of a domestic public offering, the Japanese stockholders could not, because of foreign exchange controls, buy to protect their position. There was also the view expressed by some that stockholder approval was necessary to bring about a binding obligation on the part of the company to issue the stock pursuant to the underwriting agreement on the theory that only one who has been given pre-emptive rights has the right to demand the issue of the security, see Yoshida, *supra* note 147, and again in *Kaitori Hikiuke to Shoho Dai 280 no 2 Dai 2-Ko* (Article 280-2, Paragraph 2 of the Commercial Code and Underwriting by Purchase), 268 CLJ 2, (Jan. 25, 1963). This apparently was the view of Sony itself, see *SONY, op. cit. supra* note 146, at 60. Japanese underwriting agreements contain no obligation on the part of the company to issue or sell to the underwriters, Yoshida, *supra* note 158, but this is not the case in United States underwriting agreements where the underwriters insist on mutuality.

¹⁶³ Sony felt very strongly that pre-emptive rights were not involved because the offering price was near the market price. Since it felt stockholder action was therefore not called for, it felt none could be asked even as a precaution in view of the provision of the COMMERCIAL CODE, art. 230-2, that stockholder resolutions shall only be adopted as to matters provided for in the CODE or the articles of incorporation, ignoring the

since been proven by a decision of the Yokohama District Court in the case of a public offering by Toshiba in the spring of 1961 that a public offering through underwriters constituted the granting of preemptive rights to the underwriters.¹⁶⁴

The stockholder approval itself is quite simple, being confined to a minimum offering price which could be, and was, expressed as "not less than par," leaving to the directors the fixing of the actual price, the maximum and actual number of shares, and the class, *i.e.*, par value common stock. The directors are then free to fix the actual offering price and number of shares to be offered at their meeting immediately before the effectiveness of the registration statement in the United States and the commencement there of the public offering. With such a short interval between the fixing of the price and the offering, and with the offering price generally fixed at no more than 10% to 15% below the market price, there is little danger of attack under article 280-10 of the *Commercial Code* for having sold at a "grossly unfair" price.

Once the question of stockholder approval had been resolved, the question of Japanese government approvals remained to be worked out. The issuance of the stock had to have approval under the *Ex-*

fact that if a resolution under article 280-2 were adopted when not needed its invalidity under article 230-2 would be of no consequence whereas if it were needed, article 230-2 would not apply. At any rate, the compromise solution was adopted by an amendment to Sony's articles to the effect that sale of stock abroad except by a rights offering would require a special resolution of the stockholders. The stockholder approval of the United States offering was obtained pursuant to this new provision of the articles. This same practice has been followed in each of the subsequent public offerings of stock in the United States except in the case of Toshiba where no newly issued stock was involved, a subsidiary being the seller. For Sony's position, see *SONY, op. cit. supra* note 146, at 58-60. It is interesting to note that despite fears of adverse stockholder reaction, stockholder approval was unanimous, a rare event for a publicly held company.

¹⁶⁴ *Nakajima v. Tokyo Shibaura Electric Co., Ltd.*, Yokohama District Court, (Dec. 17, 1962), "WA"-No. 873 (1961), as reported in 266 CLJ 14, (Dec. 25, 1962). The Court declined to void the issue under article 280-15 which would have been the logical result except for the importance attached in Japan to the principle of safety of transactions whereby a security once issued to the public is by custom untouchable with the plaintiff stockholder instead of remedy against the directors for damages under article 266, Paragraph 1, item 5, or, if he moves quickly enough, an action for an injunction to suspend the issuance under article 280-10 before it is made, see *YAMAICHI, op. cit. supra* note 45, at 339, and *Nihon Keizei Shimbun*, Dec. 20, 1962 containing comments on the decision, and *Yoshida*, Article 280-2 of the *Commercial Code* and Underwriting by Purchase, *supra* note 162. See also *Yonedzu, supra* note 161, where the doctrine of "safety transactions" is stressed. In three cases involving the same plaintiff and same subject matter as *Nakajima v. Tokyo Shibaura Electric Co., Ltd.*, *supra*, the Tokyo District Court ignored the question of pre-emptive rights and upheld the three issues in question on the grounds of "safety of transactions;" *Nakajima v. Taisei Constr. Co. Ltd.*, "WA" No. 3337 (1961); *Nakajima v. Shin-Etsu Chemical Co., Ltd.*, "WA" No. 4529 (1961); and *Nakajima v. Kisha Seizo Co., Ltd.*, "WA" No. 4908 (1961), all decided by the Tokyo District Court on February 4, 1963 and all reported in 270 CLJ 12, 13 and 16 respectively (Feb. 15, 1963).

*change Control Law*¹⁶⁵ and the ADR holders had to have the full benefits available under the *Foreign Investment Law* while the company needed approval under the *Exchange Control Law* for the deposit agreement with the ADR depositary in New York.

The first approval was obtained by Sony in the form of a "license on issuance or flotation of securities" issued immediately following the determination of the issue price by the board of directors and just prior to the SEC effectiveness and the signing of the underwriting agreement.¹⁶⁶ The benefits of the *Foreign Investment Law* were assured by the underwriters obtaining validations for the stock under article 11 and the ADR depositary a designation under article 13-2 whereby the benefits of the underwriters' validations were transferred to the depositary (the legal holders of the stock) on behalf of the ADR holders (the beneficial owners).¹⁶⁷ The approval of the deposit agreement took the form of a service contract license obtained by Sony pursuant to article 42 of the *Exchange Control Law* and article 17 of the Cabinet Order Concerning Control of Foreign Exchange.¹⁶⁸

The deposit agreement raised the problem as to whether a split vote is possible under Japanese law.¹⁶⁹ The weight of authority seems to be that it is,¹⁷⁰ but there has been some hesitation in view of the fact there has never been a court decision on the subject.¹⁷¹ But this is gradually disappearing, removing one more problem in the path of ADR issues of Japanese securities.¹⁷²

¹⁶⁵ Article 34 requires a license under the Ministry of Ordinance Concerning Control of Securities, MOF Ordinance No. 70 of 1950, for the "flotation of securities abroad."

¹⁶⁶ The license included permission for Sony to remit in dollars the United States expenses of the offering including the underwriters' commission.

¹⁶⁷ Immediately upon receipt the underwriters turned the stock over to the custodian in Tokyo against the issue to them of the ADRs in New York for sale to the public.

¹⁶⁸ Cabinet Order 203 of 1950.

¹⁶⁹ The depositary in the agreement undertakes to use his best efforts to vote the related underlying stock in accordance with the wishes of each ADR holder.

¹⁷⁰ A literal reading of the pertinent provision of the COMMERCIAL CODE (art. 241) indicates without a doubt that split voting is permitted since it states that "each shareholder shall have one vote for each share." This language indicates that the vote is merely an accumulation of units so that it can be split, rather than a personal attribute which could not. See Hishida, *Giketuskun no Futoitsu Koshi* (Exercise of Split Voting), 258 CLJ 17, (Oct. 5, 1962). Professor Hishida summarizes the authorities and comes to the conclusion that the favorable view is in the ascendency if for no other reason than that the complexities of modern economic life require a split vote in view of the growth of trusts and indeed of ADRs. To the same effect is Yazawa in the round table conference of members of the Corporation Law Study Group reported under the title *Katgai ni okeru Shoken Hakko* (Issuing Securities Abroad), 262 Juristo 6, 14 (Nov. 15, 1962).

¹⁷¹ See comment by Professor Suzuki, another participant in the round table, *Issuing Securities Abroad*, *id.* at 14.

¹⁷² An undertaking to permit split voting would be a necessity for listing on the New York Stock Exchange. At present such listing is not possible anyway because

The SEC registration imposed considerable problems and expense, at least in comparison with those to which Japanese companies are accustomed in domestic public offerings.¹⁷³ The degree of disclosure required came at times as a surprise¹⁷⁴ while the undertaking to register future rights offerings with the SEC for the benefit of United States stock and ADR holders imposed a continuing obligation on the company for the benefit of a minority of the stockholders.¹⁷⁵

Despite the problems, however, the trail having been blazed, other companies followed in Sony's footsteps and indications are they will be followed by others.¹⁷⁶

Convertible Debenture Issues in the United States. Stock issues in the United States proved themselves to be a promising source of equity funds, but the source was limited. Japanese stock issues had to face competition from a large number of both United States and foreign, mainly Canadian and Western European, issuers. In addition the sharp break in the United States stock markets in May, 1962 constricted the market for new stock issues while making U.S. stocks more competitive by greatly reducing price-earnings ratios. At the same time large sources of funds in the United States could not be tapped because of the limitation imposed on the various financial institutions by federal and state laws on the holding of stock, particu-

of the Japanese exchange controls, principally the six months' holding period requirement for stock.

¹⁷³ The cost of the Sony offering was estimated to be about three times that of an offering of the same size in Japan, Watanabe, *supra* note 147. The public offering price was the equivalent of ¥631 per share, or about 14% below the market price compared with 10% below in the case of Sony's public offering in Japan, but Sony was content with the result despite the greater discount and higher cost because of the public relations advantages obtained. *SONY, op. cit. supra* note 146, at 8. The Ministry of Finance was satisfied also, feeling that the advantages outweighed the disadvantages, Watanabe, *supra* note 147.

¹⁷⁴ See *Outmoded Accounting and Tax System—Extensive Overhauling Needed to Straighten Out Confusing Japanese Corporation Accounting Practices and Tax Methods*, 1 *The Investor*, No. 22, 1, where at p. 2 it is stated that the Sony registration statement "for example, contains a mass of information stated with an exactitude and in terms which would be unthinkable by conventional Japanese accounting and business practices."

¹⁷⁵ With the offering of Sony's stock via ADRs in the United States foreign holdings approached 15% and subsequently passed that amount, at one time approaching 20%, the new "matter of course" limitation for validations established by the Ministry of Finance for Sony.

¹⁷⁶ Mitsubishi Chemical took the as yet novel route of issuing notes and stock to investors on a private placement basis in the autumn of 1961. For a description of this transaction see an account by one of the company officials, Himeda, *Wagasha ni okeru Puromisarri Noto Oyobi Kabushiki no Hakko ni tsuite* (Concerning the Issuance of Stock and Promissory Notes by Our Company), 230 *CLJ* 2, (Dec. 15, 1961). While not exactly in point for this article since it represented investment coming to Japan rather than a Japanese issue abroad, The Japan Fund, a United States incorporated, closed end investment company, was formed in April, 1962 with the sale of \$15,625,000 worth of stock and the intention of investing primarily in Japanese growth stocks.

larly stock of foreign issuers. On the other hand straight bonds which the financial institutions could purchase without restriction had little appeal to the institutions. If they were to commit their funds abroad, at least in private companies, they wanted a stake in the equity.¹⁷⁷

The only answer was to issue convertible debentures to supplement the stock issues, thereby appealing to the broadest possible spectrum of investors.¹⁷⁸ The fact that convertible debentures would be an appropriate medium for foreign investment was clearly recognized in Japan.¹⁷⁹ It was only a matter of time until the first issue was brought out. As it happened two came out simultaneously in September, 1962: Hitachi, Ltd. on a private placement basis and Shin Mitsubishi as a public offering with SEC registration.

As in the case of the issue of stock, there was an important question to be answered before the issues could proceed. Here it was the question as to whether and to what extent the law of the place of issuance, namely New York, could, by agreement between the parties, govern the debentures.

If unsecured, and all of the issues to date have been unsecured, convertible debentures are governed by the provisions of § 5 of the *Commercial Code*.¹⁸⁰ The provisions of § 5 with respect to convertible debentures incorporate by reference certain provisions of the *Code* dealing with convertible stock.¹⁸¹ Section 5 consists of three subsections: subsection 1,¹⁸² which is concerned with the limitation on the amount of debentures to be issued, issuance procedures and transfers;

¹⁷⁷ Beginning in 1961 there have been a number of straight debt issues, but not enough, and no prospect of enough, to satisfy Japanese industry's thirst for investment funds.

¹⁷⁸ By process of elimination this was the only combination equity-debt security available to Japanese issuers. Debentures with warrants attached cannot be issued under the COMMERCIAL CODE if the warrants have a life of over six months because of paragraph 4 of article 280-2, as we have seen. Participating debentures, while theoretically possible under the CODE, have not engendered much enthusiasm in Japan, the one abortive issue leaving a legacy of unanswered questions; see note 116 *supra*. One company issued a combination of stock and notes privately in the United States, but there has been no sign of a desire for a repeat performance in either Japan or the U.S., quite possibly because convertible debentures offer more flexibility. See Sasaki, *supra* note 133, where it is stated that combination issues are done in the United States only by unpopular companies.

¹⁷⁹ The Securities Exchange Council in its report to the Ministry of Finance, *supra* note 6, while disparaging the local issues suggested convertible debentures for foreign investors, while others pointed out the popularity of convertible debentures in the United States, Sasaki, *supra* note 133, and the fact that convertible debentures with features to which foreign investors are accustomed could be issued under Japanese law, Ohtori, Special Debentures, *supra* note 103.

¹⁸⁰ COMMERCIAL CODE, arts. 296 to 341-5.

¹⁸¹ *Id.*, arts. 222-2, para. 2; 222-3; 222-5, para. 3; 222-6; and 222-7.

¹⁸² *Id.*, arts. 296 to 318.

subsection 2¹⁸³ which concerns debenture holder meetings; and subsection 3¹⁸⁴ which relates to the issuance and conversion of convertible debentures. In applying to debentures in general, sub sections 1 and 2 apply to convertible debentures.

In issuing bonds or debentures abroad, it is desirable to have the terms and governing provisions as close as possible to those to which the foreign investor and foreign market are accustomed. It makes the issue that much more salable and on better terms than would otherwise be possible. At any rate, tailoring the security to the customs and laws of the place of issue has been followed in practice for a number of years and has received the blessing of authorities in the field of conflict of laws.¹⁸⁵ It remained to be seen if Japanese law would permit the same practice with respect to Japanese debentures, particularly convertible debentures.¹⁸⁶

In addition to general desire to have the convertible debentures conform as much as possible to United States practice, the underwriters and their counsel were particularly concerned about several provisions of the *Commercial Code* which differed quite radically from debenture provisions found in the United States. The first were the provisions of the *Commercial Code*¹⁸⁷ to the effect that acceleration could be brought about only by default in the payment of principal or interest and even then only if preceded by a resolution adopted in a debenture holders meeting and by advance notice to the company. In contrast the usual United States debenture indenture provides for acceleration in the event of any material breach of the indenture or the debentures including but certainly not limited to default in the payment of principal or interest. Furthermore it provides that such acceleration shall take place upon the demand of not less than a specified minority of the debentures, usually one-quarter, without the necessity of a meeting and without advance notice to the company.

¹⁸³ *Id.*, arts. 319 to 341.

¹⁸⁴ *Id.*, arts. 341-2 to 341-5.

¹⁸⁵ The practice first became widespread in the 1920's, although it has no doubt been present in some form almost since money was first loaned across international boundaries; see RABEL, 3 THE CONFLICT OF LAWS: A COMPARATIVE STUDY, 11-31 (1950).

¹⁸⁶ The prewar Japanese bonds issued in the United States had been governed by Japanese law; postwar debt issues in the United States had either been "notes" as to which the COMMERCIAL CODE did not apply, or were bonds of semi-government entities, as to which special legislation relating to applicable law had been enacted, permitting the bonds to be governed in many respects under the laws and customs of the place of issuance, as, for example, the bonds of the Nippon Telegraph and Telephone Company (NTT) issued in April, 1961, as to which see Article 9-2 of the Telegraph and Telephone Bonds Order, Cabinet Order 507 of 1952 as amended in 1961 for this purpose.

¹⁸⁷ COMMERCIAL CODE, arts. 334, 335.

To make matters worse the *Commercial Code* requires that before they can take effect, all resolutions must be approved by a court having jurisdiction over the head office of the issuer.¹⁸⁸ The thought of having to apply to and receive the approval of a Japanese court before their resolution could take effect could give pause to even the hardiest United States investors.

To cite another troublesome problem, the *Commercial Code* requires a quorum of only a majority, and a majority or, in some cases, a two-thirds vote of that quorum to adopt a resolution.¹⁸⁹ On the other hand, United States indentures usually require the affirmative vote of two-thirds of the total outstanding, and in exceptional cases, the unanimous vote of all the debentures.¹⁹⁰

The question of applicable law was given careful study by the counsel involved who consulted several noted Japanese scholars for their views.¹⁹¹ A unanimity of view was reached which may be briefly described as follows:¹⁹²

Article 7 of the *Law Concerning the Application of Laws in General* (known in Japanese, and hereafter referred to, as the "*Horei*")¹⁹³ provides, in effect, that the applicable law is to be that determined by the intention of the parties and if no intention is expressed, the law of the place where the act is done, will apply. That article 7 of the *Horei* applies to foreign currency debt securities has not been in doubt since the decision of the Supreme Court of Japan in 1934 with respect to the Tokyo City French Currency Bonds in 1912.¹⁹⁴ That portion of the decision applying article 7 has the almost unanimous support of the Japanese scholars.¹⁹⁵

Article 30 of the *Horei*, which provides an exception in the case of a violation of public policy, is not applicable since the differences be-

¹⁸⁸ *Id.*, art. 327.

¹⁸⁹ *Id.*, art. 324.

¹⁹⁰ The requirement of unanimity is found in the *Trust Indenture Act* of 1939, Section 316, with respect to change in maturity. Publicly offered debentures are subject to the *Act*...

¹⁹¹ Professors Egawa, Yazawa, Ohtori, and Ikehara.

¹⁹² The views of the last three were set forth in a joint written opinion which was published in modified form by Professor Yazawa under the title *Tenkan Shasai no Kokusaiteki Hakko* (International Issuance of Convertible Debentures), 258 CLJ 26, (Oct. 5, 1962). Professor Egawa provided a separate opinion.

¹⁹³ *Horei* (Law Concerning the Application of Laws) Law No. 10 of 1898.

¹⁹⁴ Supreme Court, 1st Civil Section Decision, (Dec. 27, 1934). "O"-No. 2981 (1933); *Minshu* Vol. 13, No. 23, p. 2386, where it was held that in the absence of an expression of intent by the parties, the laws of the place of issue, namely France, applied according to article 7 of the *Horei*, and therefore the currency clause was invalid as contrary to the laws of France.

¹⁹⁵ Yazawa, *supra* note 192.

tween United States law and practice and those of Japan did not go to fundamentals, as is shown by the fact that another Japanese law dealing with secured debt securities, the *Secured Bonds Trust Law*,¹⁹⁶ has provisions differing from those in the *Commercial Code* on the questions of acceleration,¹⁹⁷ effectiveness of debenture holders resolutions,¹⁹⁸ and the requirements for such resolutions.¹⁹⁹ Furthermore, public policy is aimed at protecting the debenture holders rather than the issuing company which has received money in exchange for its paper, and since the debenture holders are resident abroad, their protection is not a matter of Japanese public policy, but of the place of issue or where they reside.²⁰⁰

The expression of intention of the parties imposed no problem. It could be very specifically set out in the indenture. The only question remaining was the extent to which it was possible to contract out of Japanese law. In this connection the conclusion was that the legal provisions relating to the authorization and issuance of the debentures and their conversion had to be governed by Japanese law for the reason that the issuer was a Japanese entity and the conversion was into stock which was a Japanese security. On this basis, the fact that the debentures were convertible posed no problem. The provisions contracted out of by specific provision in the indenture were those in the *Commercial Code* relating to debentures in general.

Article 341-2 of the *Commercial Code* specifically provides for stockholder approval for the issuance of convertible debentures.²⁰¹ The stockholders have to determine the conditions of conversion, particulars as to the shares to be issued on conversion and the conversion period. The stockholders meeting could be held close enough to the date of issue to permit most of the matters for determination thereat to be decided with safety, so that the company and the underwriters would not find themselves locked in by a resolution of the stockholders on the one hand and a change in market conditions on the other.²⁰²

¹⁹⁶ *Tampo-zuki Shasai Shintaku Hō* (Security Bonds Trust Law) Law No. 52 of 1905.

¹⁹⁷ COMMERCIAL CODE, arts. 79, 80 and 81.

¹⁹⁸ *Id.*, art. 57.

¹⁹⁹ *Id.*, art. 52.

²⁰⁰ That this is the intention of Japanese jurisprudence is borne out by COMMERCIAL CODE, art. 483, which provides for the application of Japanese law to foreign issues in Japan in those matters relating to the protection of the holders.

²⁰¹ In the alternative, they could be authorized by the articles of incorporation, but this was not practical.

²⁰² There is less of a problem in a private placement which is usually negotiated well in advance of the date of issue and thus immune to other than catastrophic changes in conditions.

The exception is the initial conversion price, which is the most delicate of the terms since in effect it determines what the company gives up in the way of stock for the principal amount of the issue, subject of course to adjustment by virtue of the anti-dilution formula. This subject can be handled by the stockholders approving a fixed formula for automatically determining a minimum price above which the directors can fix the actual price in their discretion, thereby meeting the approval requirements of the *Code* while at the same time allowing flexibility for unseen developments.²⁰³ There is no problem about the fairness of the price since it is customary to fix the initial conversion price at or above the current market price of the stock.

The anti-dilution formula, expressed as it is in objective terms, is legal when approved by the stockholders among the "conditions of conversion," provided that it does not result in the conversion of the stock at a price less than its par value, taking into account the amount of yen received by the company at the time of issue of the debentures on the basis of the exchange rate at such time.²⁰⁴

The Japanese government approvals vary from those in the case of issuance of stock. The issuing company makes application to the Minister of Finance pursuant to a Ministry notification²⁰⁵ which provides that once a "notice of recognition" is issued thereunder, the issuer may not only issue the security, but may make all the necessary remittances abroad to service the security and pay the expenses of issuance, including the underwriters' commission.²⁰⁶ Prior to the issuance of the debentures, the purchasers obtain validation of the stock issuable upon conversion at any time during the life of the issue, thereby assuring themselves in advance that the stock received on conversion will have the remittance benefits of the *Foreign Investment Law*.²⁰⁷

²⁰³ See Yazawa, in *Kaigai ni Okeru Shoken Hakko* (Issuances of Securities Abroad), 262 *Juristo* 6 (Nov. 15, 1962), who recognizes the practical requirements and holds that they can be met within the framework of the *Code*.

²⁰⁴ *Ibid.* Also, Yazawa, *International Issuance of Convertible Debentures*, *supra* note 192.

²⁰⁵ Ministry of Finance Notification No. 286 (December 12, 1960).

²⁰⁶ The Notification represents a departure from the Exchange Control Law in that it not only permits the issue of the security but authorizes the necessary remittance as well. Without the Notification procedure the issuer would have to obtain permission to issue under article 34 of the Law and then make a separate application for each payment throughout the life of the issue pursuant to article 27, hardly an appealing prospect for either the issuer or the holder.

²⁰⁷ To facilitate the issuance of convertible debentures, the Ministry of Finance made an exception to its usual rule that validated stock must be acquired within six months of the validation. In the case of debentures publicly issued the ADR depository obtains the validation, rather than the purchasers, since the purchasers will receive ADR's upon conversion with the stock issued in the name of the depository.

In conclusion one further problem merits attention. The *Commercial Code* provides²⁰⁸ that conversion may not be made during the period the stock register is closed.²⁰⁹ Since almost all Japanese companies have the closure system and since the register is often closed at least four months a year for stockholders meetings alone, it has been found necessary for companies issuing convertible debentures to amend their articles of incorporation to provide for the novel, to Japan, record date system.²¹⁰

CONCLUSION

As this is written there appears to be no let up in the issue in the United States of stock and convertible debentures by Japanese companies.²¹¹ There is also talk of offerings in London.²¹² This is as it should be. Capital is a commodity like any other, and its free flow is essential to bind nations together and provide better standards of living.

Japan has come far since the dark days of the 1940's. But much remains to be done. The yen is in reality one of the strongest of currencies,²¹³ but it is fettered by a rigid system of controls, particularly on capital transactions. There has been much talk of liberalization, but Japan's economic strength has grown beyond the liberalization that has actually taken place. What is needed is a wholesale relaxation of controls to permit Japanese industry to tap, without any restriction other than the rules of the market place, the capital that is available abroad for investment in a country that combines rapid growth with economic and political stability, rare ingredients in this troubled world. When that happens the lawyer's work may be less but the opportunities for Japan and for foreign investors will be vastly greater.

²⁰⁸ COMMERCIAL CODE, arts. 341-5, 222-5.

²⁰⁹ It is generally agreed that this provision is mandatory and cannot be waived by the company, OHTORI, TENKAN SHASAI (Convertible Debentures), 5 KABUSHIKI KAISHA HO KOZA 1752 (1961) and Yazawa, *supra* note 192.

²¹⁰ Permitted by article 224-2 of the Code.

²¹¹ See DuBois, *Kawasaki, Sony and Shin—U.S. Investors Are Displaying a Growing Yen for Japanese Securities*, BARRON'S, at 5 (Feb. 11, 1963), where future possible candidates are named and the popularity of the previous Japanese issues in the United States is explained.

²¹² "Japanese Offering in London," 1 The Investor, No. 22, 9 (Oct. 25, 1962). Honda Motors, in connection with its stock offering in the United States in December, 1962, made European Depositary Receipts (EDRs) available in London, following the United States issue.

²¹³ Samuelson, "How Strong Is Japan's Currency? Yen Strength Is Based on Rising Productivity." The Nihon Keizai Shimbun, (English language weekly edition), Jan. 29, 1963, p. 8.