The Movement towards the Creation of a Share Exchange System Intensifies

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Many companies face an urgent need for drastic reforms of their organizations. Although the ban on the exclusive holding companies was lifted in 1997 and a new legal framework for business reorganization was approved, the procedures for that purpose are still beset by some impediments under the existing laws. In the course of discussions on these problems, the demand for the establishment of a share exchange system has been growing. With the announcement of "a report on the study of problems in the Commercial Code concerning holding companies" by the Ministry of International Industry and Trade (MITI) in April 1998 and one on "the problems of the legal systems for parent and subsidy companies" by the Legislation Council in July 1998, the feasibility of the plan for creating the share exchange system within 1999 has increased.

1. Background to Discussions about the Share Exchange System

1) Establishment of a Holding Company under the Present Commercial Code

The amended Anti-monopoly Law was enforced on December 17, 1997, and the ban on the exclusive holding company not exercising excessive business control was removed. The Japanese version of financial "Big Bang" is already taking place in the forms of business tie-ups between Sumitomo Bank and Daiwa Securities (announced on July 28, 1998) and tie-ups among another four companies, Tokyo Mitsubishi Bank, Mitsubishi Trust Bank, Meiji Life Insurance and Tokyo Marine and Fire (announced on September 11, 1998). In the midst of the advancing Big Bang, the move toward collaboration across different types of business has been accelerating, especially in promising areas such as investment banking, derivatives and asset management. This trend toward business reorganization hinges on holding companies.

The Commercial Code allows no specific concept of a holding company, but a holding company can be established by following the procedures for an ordinary company even under the present law. There are three methods for an ordinary company to shift to a holding company..

In the first method, a company intending to be a holding company can establish a subsidiary through investment in kind and transfer of its operations. The problem with this method is that it is subject to inspection and requires a very complicated procedure for the transfer of fixed mortgage as a collateral on credit for investment in kind. With the second method, a new company, which is to be a holding company, is first established, and this company acquires shares from shareholders

of the existing company through such means as takeover bids. This method also presents some problems. A big company may have difficulty in following this method because it involves a large amount of funds. Moreover, the shareholders who have agreed to a TOB or exchanging their shares must pay transfer gain taxes. Minority shareholders who are opposed to changing their company into a holding company may not offer their shares. In the third method, a new company, which is to be a holding company, is established, and this company increases capital by allotting shares to the shareholders of the existing company and requests them to offer their shares for investment in kind. The success of this method depends on whether shareholders agree to its specific form of capital increase as in the case with the acquisition method. There may be some minority shareholders who will not agree to the purchases of their shares.

Another problem is the limit put on the number of shares to be issued by the new company under the Commercial Code (Clause 1-3, Article 166 of the Commercial Code).

These methods entail troublesome procedures and substantial costs in taking the prescribed procedures. It is now necessary to reduce the difficulties posed by the present commercial and tax Codes and create new procedures.

In the deliberations of the Diet in 1997, a reform of the Anti-monopoly Law was debated. It was decided to postpone to a future date consideration of the engagement in the operations of subsidiaries by shareholders of holding companies and the protection of the rights of people concerned with subsidiaries. In addition, considerations were also held on the subject of share exchange systems, etc. to ensure that changes in the structure of companies are carried out smoothly such as the establishment of holding companies.[1]

2) Introduction of a Triangular Merger Method

(1) A New Method to Establish a Holding Company

In order to facilitate the establishment of a holding company in the banking sector, the special bill for the establishment of a bank holding company[2] was enacted (promulgated on December 12, 1997 and enforced on March 11, 1998).

The special law for the establishment of a bank holding company is intended to realize the triangular merger approach through forced investment of new shares in the form of “investment in kind”, so that the existing shareholders of a bank become the shareholders of a bank holding company. In this triangular merger approach, in acquiring “Bank T” wholly, “Bank A” establishes 100% a owned subsidiary, “Company B”, and realizes the merger of “Banks A and T”. The merger takes the following steps.

1. The present bank establishes a company that is to be a holding company.

2. The company, which will be a bank holding company, establishes a new bank.

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1 For exceptions to the establishment of a bank holding company, see Sadakazu Osaki, “Lifting of Ban on Establishment of Holding Companies and Financial Holding Companies”, *Capital Research Journal*, Spring 1998 Vol 1. No.1.

2 For exceptions to the establishment of a bank holding company, see Sadakazu Osaki, “Lifting of Ban on Establishment of Holding Companies and Financial Holding Companies”, *Capital Research Journal*, Spring 1998 Vol 1. No.1.

3. The present bank merges with the new bank which will be the continuing company.

This form of triangular merger requires the shareholders of the present bank to make a resolution to invest their shares of the new bank (to be given as a result of the merger) in the bank holding company. The bank holding company should then issue new shares in exchange for the shareholders' investment in kind (inspection in this case can be exceptionally exempted). A merger between the existing bank and the new bank is subject to approval by a majority of all shareholders as well as more than two-thirds of all issued shares at a shareholders' meeting.

By this process, the shareholders of the existing bank can all become the shareholders of the bank holding company. Some shareholders of the existing bank who oppose the merger may exercise their appraisal right.

(2) Special Tax Measures

Special tax measures are provided in the amended tax system law of 1998 for a holding company to be established pursuant to the special law for the establishment of a bank holding company as follows.

1. Even when transfer gain arises as a result of share exchange, tax deferment is approved if the acquired value is taken over.
2. With regard to transfer loss from the extinct bank, the portion that has been covered with merger appraisal gain is permitted to be taken over by a merger company.
3. The rate of registration tax on the capital increased as a result of investment in kind in the bank holding company is halved (to 0.35% after a deferment of 2 years).
4. Securities trading taxes on the shares to be provided to the shareholders are exempted, and the rate of the registration license taxes on the registration of transfer of real estate to be received by the surviving bank, or on the registration of transfer of mortgage, is halved (to 0.3% and 0.05% respectively after a deferment of 2 years).

3) Necessity of the Share Exchange System

In the banking sector, the triangular merger method and special taxation measures are approved in establishing an exclusive holding company. But this method is not permitted for ordinary business corporations. Studies are being made on how to establish the share exchange system as a simplified form of triangular merger.

The share exchange system is expected to be widely utilized not only for the purpose of establishing holding companies but also for acquisitions.

When joint-stock companies merge, the shares of the merged company are exchanged with those of the merging company. In the case of acquisition, the shares of the acquired company are usually purchased with cash, not in exchange for the shares of the acquiring company or those held by it. The share exchange system is designed to make the acquired company a wholly-owned subsidiary of the acquiring company by means of shares as the fee for this deal.

2. Recent Studies of the Share Exchange System

The government announced "an action plan for the reform and creation of economic structures" on December 24, 1997 as the first follow-up, including the item for study of the share exchange system. The plan aims "to prepare and announce, about every half year, the problems regarding the share exchange system and the establishment of holding companies, while considering how to protect shareholders and creditors, reach conclusions promptly and take necessary measures". This plan was included in "a plan for promotion of deregulation" announced in March 1998.

Prior to this plan, the Commercial Code Study Group of the MITI (chaired by Kazufumi Shibata, professor of law at Hosei University) examined the share exchange system from July 31, 1997 to January 29, 1998 and compiled and announced "a report on the study of problems of the commercial Code regarding holding companies" in February 1998. The report presents "a model legislation for the share exchange system" and proposes the establishment of the system.

The commercial Code committee of the Legal System Council (headed by Yo Maeda , professor of Gakushuin University) began to study the introduction of the share exchange system in December 1997 and prepared a report on "problems with the legal system for parent and subsidiary companies" in July 1998.

1) MITI Commercial Code Study Group's Model Plan for Share Exchange Legislation

(1) Definition of Share Exchange Procedure

The Commercial Code Study Group gives the following definition of share exchange: The company intending to exchange shares (the exchanging company) and the other party (the exchanged company) make a share exchange contract, and in accordance with the provisions of the contract, the shareholders of the exchanged company offer their shares of the exchanged company to the exchanging company, which provides the shareholders of the exchanged company with shares of the exchanging company.

The application of the share exchange system is limited to (1) the establishment of a holding company; (2) M&A intended by a holding company to bring other companies into its group ; (3) a plan to change a subsidiary into a wholly-owned subsidiary.

(2) Model Legislation Plan for the Share Exchange System

In order to realize the share exchange system according to the amended commercial Code, a model plan for legislation has been prepared, which is based on the characteristics of share exchange and contains provisions similar to merger procedures (Table 1). The model plan shows a series of procedures concluding the share exchange contract between both parties, and for implementing share exchange in accordance with special resolution at their respective shareholders' meetings.

Table 1. Model Plan for Share Exchange System

Article 1	Exchanging shares
Article 2	Resolution to approve the share exchange contract (*)
Article 3	Preservation of the share exchange contracts
Article 4	Opposing shareholders' appraisal right
Article 5	Items to be mentioned in the share exchange contract
Article 6	Survey of the share exchange ratios (*)
Article 7	Granting of company's own shares
Article 8	Share exchange procedure
Article 9	Easy share exchange procedure
Article 10	Suspension of share exchange (*)
Article 11	Filing of a claim for invalidity of share exchange
Article 12	Procedure for a claim for invalidity of share exchange
Article 13	Presentation of collateral
Article 14	Effects of judgment on a third party
Article 15	Exception to the limit to an increase in the total number of shares issued by the company
Article 16	Rules applied to share exchange
Article 17	Penal regulations

Rider: Article 1 Interim measures regarding the exercise of voting rights in writing.

Article 2 Partial amendment of the Commercial Code (addition of "Share exchange" to Clause 1 of Article 211-2).

Note 1(*) denotes more than two plans.

Source: Nomura Research Institute

(3) Other Problems for Consideration

The report offers suggestions about a new framework in the Commercial Code and points out the following measures necessary for taxation and accounting.

As measures regarding the tax Code, the report maintains that exemptions are essential for the registration and license taxes related to capital increase and stamp duty for new share issuing on the company side, and transfer gain taxes on the shareholder side. The report also says that the introduction of the consolidated tax payment system is essential in order to ensure smooth establishment of holding companies that can make the best use of the advantages of company split-up, and to ensure the neutrality of the tax system for organizational changes within unified corporate groups and make quick and functional business expansion possible.

In the area of accounting, when the shares of the company are invested at market price according to accounting principles, the amount of capital increase as a result of transferring half of the issued value to the capital and the rest to capital reserve. In this case, the report mentions a view that transfer of the amount of capital should be covered only when a holding company is established. The report also points to the problem that profit reserve, which existed on the consolidated balance sheet before share exchange, disappears and is unified into capital reserve. This is due to the fact that a part of capital on the consolidated balance sheet becomes almost entirely the part of capital of the parent company, because investment account is offset by capital account by the present consolidated accounting standards.

2) "Problem Points Relating to the Parent-Subsidiary Legal System" Indicated by the Legal System Council

"Problem Points in the Parent-Subsidiary Legal System" (hereafter called "Points") are divided into (A) points regarding the legal system for parent companies and (B) points regarding the reexamination of the asset evaluation standards. Points (A) concern, first, the procedure for the creation of parent-subsidiary company relations (share exchange system) and, second, protection of shareholders of parent-subsidiary companies.

The former points include 15 items and the latter 5. Points (B) concern two items: the necessity of market-price evaluation and the relationship between the maximum amount available for dividend and appraisal gain or loss.

(1) Share Exchange System

The Commercial Code regards a holding company as a parent company. For the purpose of Points, the procedure to allow a company to be a holding company is defined as "the procedure to allow an existing company to be a subsidiary and another to be its parent company", and the procedure to establish a holding company is defined as "the procedure to establish a parent company".

(a) Definition of the Share Exchange System

From the viewpoint of facilitating the procedure to establish a holding company, some means have been worked out, including share exchange, triangular merger (and reverse triangular merger) and acquisitions by excluding minority shareholders. However, some theoretical and practical questions have been raised, saying that triangular merger requires complicated procedure because of the need to establish a bogus company, and that acquisitions by excluding minority shareholders[4] require impractical and rigid conditions. In consequence, the idea of establishing a share exchange system, which requires the simplest procedure, has been taken up.

By its definition, the share exchange system requires "a procedure for the shareholders of a company to invest all shares of the company so that the other company can issue new shares", and this is a means to establish a holding company. A view is noted that as is the case with merger (Article 409-2 of the Commercial Code), the other company can use a certain number of its own shares.

(b) Items in Common for a Company Becoming a Holding Company and for a Parent Company Changed into a Holding Company

Share exchange is implemented between the existing companies in one of two possible methods: first, a company becomes a holding company, and second, the existing company establishes a new company, and shares are exchanged between this existing (parent or holding) company and the new company.

Items common to both cases will be discussed.

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4 By this method, when a certain percentage of shareholders of a company agree to a TOB, the shares of shareholders who are opposed to the TOB are extinguished or converted into shares of the other company. This percentage is set at 90% in Britain and 95% in France.

The contents of the share exchange contract to be prepared in exchanging shares are shown in the table below. It is suggested that the share exchange contract be approved by the shareholders' meeting, and that items for resolution need, at least, special resolution, as is practiced in ordinary mergers (Clause 3, Article 408 of the Commercial Code).

Fairness for share exchange ratios, prior disclosure of information, the right to purchase shares of the opposing shareholders, easy share exchange and claims for invalidity of share exchange should be treated in the same way as for mergers. The prevailing view is that the procedure to protect creditors is unnecessary because, unlike mergers, the parties continue to exist.

A check by an inspector is regarded as necessary because of the nature of share exchange that requires new issues for investment in kind (text of Clause 1, Article 280-8 of the Commercial Code). As an exception, a view is mentioned that the check by an inspector can be omitted when the price stipulated by the share exchange contract does not exceed the market price of the shares of either party.

Proposal for Entries in the Share Exchange Contract

a. Provisions of the articles of incorporation when the other party changes these articles as a result of share exchange.

b. The price per share of one party and the total value of shares.

c. Total number of new shares issued by the other party in exchanging shares,face value or non-par, type, issue price, and items regarding allotment of new shares to the shareholders of the other party.

d. The amount of increase in the capital of the other party and items regarding reserves.

e. Rules on the amount of payment, if decided, to the shareholders of the other party.

f. Date of resolution for approval of the share exchange contract at shareholders' meetings of both parties.

g. Date of payment for new issues.

h. The maximum amount when each company pays dividends of profit, or distributes money as prescribed in Clause 1, Article 293-5 of the Commercial Code, by the day of share exchange.

(c) Establishment of a Holding Company out of the Parent Company

In the method for establishing a holding company out of a parent company, the existing company establishes a new company, and exchanges shares with this new company. A suggested alternative method is for the existing company to act as promoter and directly establish a company by investing all of its shares held by its shareholders. It is suggested that this process should be approved. There will be only minor problems when the parent and subsidiary companies are on an equal footing. However, when the parent company is established by more than one company, further study seems necessary.

As this procedure represents a form of company establishment, it is subject to the rules (Articles 165-198) regarding the preparation of the articles of incorporation by the promoter and inspection

by the inspector about investment in kind. It is similar to the procedure for the establishment through offering, but if it has to go through approval of the establishment and the opening of a shareholders' meeting, the procedure will be duplicated. It is therefore suggested that a new method should be adopted in which there is no need to hold the shareholders' meeting for incorporation (Article 180) and directors and auditors of the other company can be selected at the shareholders' meeting that approves the incorporation.

Under the Commercial Code, investment in kind is permitted only to the promoter (Clause 2, Article 168), who is required to accept some shares (Articles 169 and 211-2). However, this provision should be reexamined because it is improper to impose strict responsibilities (Article 194) on the promoter in view of the uncertain intention of the shareholders' meeting. This point should also be restudied.

(2) Protection of Shareholders of both Parent and Subsidiary Companies

Protection of shareholders of both parent and subsidiary companies poses a problem, in which by virtually making the subsidiary perform part of the parent's business, the shareholders of the parent company might be unable to exercise voting and other rights regarding the subsidiary's business, while the parent's instructions might go against the interests of the subsidiary company.

Currently some wholly owned subsidiary companies are operating, and are causing few problems. However, there is a major possibility that due to the expected increase in holding companies, the shareholders of an holding company will come to secure a significant stake in the business of the subsidiary company and consequently the problem will come to the fore.

From this perspective, the following items have been taken up in terms of how to protect the parent company shareholders as well as minority shareholders and creditors of the subsidiary company in the parent-subsidiary relationship.

(a) Scope of the Parent Company

Some views on the standards for the scope of the parent company are noted: the scope should be based on the majority of the total issued shares as is the case with the existing Code (Clause 1, Article 211-2); the standard should be based on the case where the percentage of the total value of the subsidiary company's shares exceed 50% of the value of total assets of the parent company (Clause 3, Article 9 of the Antimonopoly Law); there should be some practical standards; or the scope of parent and subsidiary companies should be determined for each item.[5]

(b) Rights of Parent Company Shareholders over Subsidiary Company

As to whether or not the parent company shareholders should be allowed to exercise a certain

5 On September 14, 1998, the Corporate Accounting Council announced a standard that shows the ranges of subsidiary and affiliated companies under the new consolidated financial statements that will become effective from the March 2000 term (financial statements and consolidated financial statements for the fiscal year starting on April 1, 1999). According to this standard, the ranges have been expanded by including in the standard the control and influence on the decision-making organizations of a company, in addition to the present standard that relied only on the proportion of the voting right to distinguish the subsidiary company (with over 50% of the voting right being owned) from affiliated companies (with over 20% being owned). The Ministry of Finance invited views on this plan from outside until September 25. Referring to these views, the Ministry of Finance plans to amend the related ordinances based on the Securities and Exchange Law (rules on financial statements and those on consolidated financial statements), and this is expected in October. The new scope will be approved for the fiscal year starting on April 1, 1999.

right over the subsidiary company, the following problems have been presented.

_ In exercising the voting right for the prescribed voting items at the shareholders' meeting of the subsidiary company, does the parent company need the resolution at its shareholders' meeting in advance from the viewpoint of protecting the interest of the parent company shareholders?

_ Should the parent company shareholders be allowed to have the right to see and copy the information of the subsidiary company (Article 293-6)?

_ Should the shareholders of the parent company be allowed to file a certain suit under the Commercial Code, including the right to file a representative action to question the responsibilities of the subsidiary company directors (Article 267)?

_ When the parent company disposes of the shares of an important subsidiary company, should this be treated in the same way as an important transfer of business and need special resolution at its shareholders' meeting and should the opposing shareholders be provided with the appraisal right (Articles 245 and 245-2)?

_ Should the auditor of the parent company be allowed to extend the right to examine its subsidiary company under the present Code (Clauses 1 and 2 of Article 274-3) to the ordinary right? Should the present practice about the auditor be extended to the general right?

(c) Protection of the Rights of Subsidiary Company Shareholders

A question has been presented as to whether the exercision of the following rights should be approved to protect the interests of the subsidiary company's shareholders.

_ Should the subsidiary company's shareholders be allowed to have the right to see and copy the information of its parent company? (Commercial Code, Article 293-6)

_ If the parent company's directors cause damage to the subsidiary company by exercising influence on the subsidiary company, should the parent company or its director be held responsible for compensation to the subsidiary company?

_ Should the auditor of the subsidiary be allowed, if necessary, to request the parent company to report on its business and examine its business and the state of assets? Should the rights of the auditors be expanded?

(3) Problems Relating to Reexamination of Asset Evaluation Standards

A stance to approve the method to evaluate certain assets at market price has been introduced in order to harmonize with the international accounting standards and ensure the consistency with the financial accounting standards for business enterprises. "Certain assets" include stocks, bonds and others. It is suggested that market-price evaluation should be approved in consideration of a fair accounting practice.

There are two views on appraisal profit or loss caused by market-price evaluation. One view is that this loss should be excluded from net assets for the sake of calculating the maximum amount available for dividend (Clause 1, Article 290 of the Commercial Code). The other is that when assets to be evaluated at market price are liquid and highly realizable and are evaluated at market price within the range of appraisal profit or loss, that should be regarded as corporate results for the

term, then there should be no restrictions on dividends for the reason of the said appraisal profit or loss. Opinions are invited as to whether appraisal profit or loss by market-price evaluation should be excluded from the maximum dividend.

The balance of appraisal profit minus appraisal loss can be treated in any of the following three ways: (1) to directly deduct from net assets for the sake of calculating the maximum amount available for dividend; (2) to create legal reserves to save the balance of appraisal profit minus appraisal loss; and (3) to save as capital reserve.

3. Opinions on " Problem Points " from Many Quarters

The Counselor's Office of the Civil Affairs Bureau, the Ministry of Justice, has received many opinions from various quarters about "Problem points regarding the legal system for parent and subsidiary companies". The opinions came in response to the invitation that closed on September 1, 1998. The views of MITI (Commercial Code Study Group), Keidanren (Federation of Economic Organizations) and the Federation of Bankers Association of Japan (FBAJ) are compared in Tables 2, 3 and 4.

Prior to presenting its view, MITI's Commercial Code Study Group prepared a report on the share exchange system, and based on this, it announced a written opinion on July 30, 1998.[6] Keidanren and the FBAJ sent their written opinions to the Ministry of Justice on September 1.

1) The Share Exchange System

The three respondents maintained that a share exchange system should be established promptly by the same procedure as that for mergers under the present Commercial Code. They also wanted the introduction of the procedure to establish a wholly owned company together with share exchange.

Apart from the opinions requested, some views are also shown that point to the need for measures regarding capital and reserves to secure source funds for dividends in regard to profit dividend of the parent company for the first business year after the founding, as well as the need to pay attention to the procedure to submit share certificates in exchanging shares.

6 MITI published its written view on September 1, 1998.

Table 2. Opinions on the Share Exchange System of Related Organizations

	MITI	Keidanren	FBAJ
Position of the share exchange system	Instead of securing fairness in investment in kind in exchange for new issues, the system should be specified as a type of organizational change just like mergers.	A company's own stocks should be utilized for share exchange as in the case of mergers.	The system should be stipulated as a corporate integration similar to mergers.
Necessity of the share exchange system	Yes.	Yes.	Yes.
Preparation of written contract for share exchange	It is advisable to draw up the contract in the same way as for a merger contract.	The price per share and the total value of one party are unnecessary.	————
Approval by the shareholders' meeting	Necessary by special resolution.	Necessary by special resolution (the same as for mergers).	Necessary by special resolution (the same as for mergers).
Securing fairness in the exchanging ratio	Presentation of the written reasons is sufficient as is the case with the merger ratio (involvement of professionals is premature).	Presentation of the written reasons is sufficient as is the case with the merger ratio.	Presentation of the written reasons is sufficient as is the case with the merger ratio (involvement by professionals is premature).
Items for prior disclosure	Agree and mostly suitable.	Agree and entirely necessary.	————
Appraisal right of opposing shareholders	Agree (the same as for mergers).	Agree.	————
Inspection by the inspector	Share exchange should be construed as a special contract under the present law.	Unnecessary (securing of fairness in the exchanging ratio and special resolution are sufficient. Inspection is also unnecessary for mergers).	Unnecessary (securing of fairness in the exchanging ratio is sufficient).
Procedure for protection of creditors	Unnecessary in principle (resolutions by the meeting of CB holders and warrant bond holders is also unnecessary).	Unnecessary (no harm to creditors).	————
Easy share exchange method	Yes (the same as for mergers).	Yes (the same as for mergers).	Yes (the same as for mergers).
Injunction right on share exchange	Rules regarding the claim for the invalidity of share exchange should be established. The injunction right should be studied in consideration of the consistency with the rules on new issues and mergers.	Unnecessary because shareholders' approval (claims for invalidity is sufficient). Ex post disclosure is unnecessary because there is no comprehensive succession of credits and debts).	Unnecessary (claims for invalidity are sufficient).
Procedures for the establishment of the parent company	Procedure to establish the parent company combined with the establishment of a likely holding company and share exchange should be prepared together with share exchange.	"The procedure to establish the parent company" that ensures direct establishment of a wholly owned parent company should be prepared.	————
Other points	Measures for capital and reserves are necessary in regard to profit dividend of the parent company for the first business year after the founding. Exchange with odd-lot shares should be permitted. Circulation of shares at the time of the presentation of share certificates for exchange should be secured.	Utilization of shares by exercising the rights of the issued CBs and warrant bonds; procedure for exchanging share certificates in the same way as stock integration; securing of source funds for dividend payment for the first year of operation of the newly established parent company; tax measures.	Restriction on the number of total shares; utilization of the procedure for the presentation of share certificates; allotment of odd-lot shares; procedure for notification of objection; taking-over of capital account.

Source: Nomura Research Institute

2) Protection of Shareholders of both Parent and Subsidiary Companies

As there have been few specific problems as to protection of shareholders of parent and subsidiary companies, most of third-party opinions about parent company shareholders' rights over subsidiaries and subsidiary company shareholders' rights over the parent company are that the interpretation of these rights should be in line with that of the present laws and in consideration of the progress of group management in the future.

Table 3. Responses on Protection of Shareholders of both Parent and Subsidiary Companies

	MITI	Keidanren	FBAJ
Necessity of new legal measures for the protection of shareholders	The present laws are insufficient. Study of legal measures is necessary in the medium and long terms.	Prudent study is advisable after comparative weighing of advantages and disadvantages.	No need (The need should be met by interpreting the present laws opportunely).
Rights over the subsidiary company shareholders' meeting	Prudent study is advisable: Resolutions at the parent company shareholders' meeting are inadequate for certain matters.	Disagree. The exercision of the voting right entails great practical disadvantages.	Resolutions at the parent company shareholders' meeting should be made unnecessary.
Disclosure of information on the subsidiary company	Further study of the scope of the target subsidiary company is necessary.	The range of the parent company shareholders' request for public inspection of information on the subsidiary company should be carefully studied. Disclosure of consolidated information of the parent and subsidiary companies should be considered in line with the Securities and Exchange Law.	The public inspection of the information only on important subsidiary companies is adequate (The book inspection right of banks' subsidiaries should be denied pursuant to Article 23 of the Bank Law).
Parent company shareholders' complaint about the subsidiary company under the Commercial Code	Inadequate. The reasons are that parent company directors are entrusted with the parent company's overall business, including control and supervision of the subsidiary company, and that they can be held responsible for any negligence of their duties on charge of failure to pay bona-fide attention.	Disagree. The reason is that parent company directors are entrusted with the parent company's overall business including control and supervision of the subsidiary company, and they can be held responsible for any negligence of their duties on a charge of failure to pay bona-fide attention.	Unnecessary because parent company directors can be held responsible for possible negligence of supervision of the subsidiary company's business.
Transfer of subsidiary company shares	Special resolution is inadequate. (The reason is that it was by special resolution that the subsidiary company was established with the transfer of business, and that it is stipulated that no special resolution is necessary when an important subsidiary company is established as a result of acquisition of shares.)	Disagree to special resolution at the parent company shareholders' meeting as well as to opposing shareholders' appraisal right. Transfer of business as a form of organizational change should not be confused with disposal or acquisition of shares.	Agree to special resolution at the parent company shareholders' meeting with regard to the transfer of shares of an important subsidiary company. The criterion for the importance should be distinct and limited.
Auditor's right over the subsidiary company	Expansion of the right should be studied. The range for demanding a report depends on the trading relations between the parent and subsidiary companies under the present law. However, as the subsidiary company becomes more important for the parent, the interpretation of the present law may become inadequate for the parent company auditor in performing his/her duties.	Disagree to expansion of the right. It is very difficult for the parent company auditor to take responsibility for auditing many subsidiary companies. The subsidiary company can be audited according to the parent company's needs under the present law. The same applies to accounting auditing.	Necessary, but role sharing with the subsidiary company auditor should be specified.

Disclosure of parent company information to subsidiary company shareholders	Disagree. It is improper to request disclosure of the information of the parent company, which is a separate entity.	Disagree. Disclosure would impose a burden of information supply on the parent company, and harm the parent company shareholders' interests.	No right of request is necessary for subsidiary company shareholders.
Responsibilities of the parent company	This should be studied as a medium and long-term subject.	This can be dealt with adequately under the present law.	No new legislation is necessary.
Subsidiary company auditor's right over the parent company	Arrangements should be made for the subsidiary company auditor to have adequate information, but generally the expansion of the right requires careful study.	Unnecessary. The same is true of the auditor.	Unnecessary.

Source: Nomura Research Institute

3) Points about Evaluation of Assets

Assets owned by companies are generally evaluated at booked price ruled by the Commercial Code.

A common view of the issue of how to evaluate assets is that market-price evaluation is necessary, but unrealized appraisal profit or loss should not be included in the maximum amount available for dividends.

Table 4. Responses to Points Regarding Evaluation of Assets

	Keidanren	FBAJ
Necessity of market-price evaluation	It should be approved for certain assets which allow market-price assessment, by ascertaining consistency with the accounting principles. We would propose that "a cross-holding share exchange system" be introduced in connection with the introduction of market-price accounting for cross-holding and in consideration of the impact on the stock market.	Agree. Market-price evaluation should be approved for financial assets which can be assessed at market price, and the appraisal balance should be posted depending on the assets. Securities intended for sale should be assets for profit or loss, and other securities (excluding maturity-holding and subsidiary company shares) should be assets for capital.
Relations with the maximum amount available for dividends	Unrealized profit should not be made profit available for dividend. A new account should be set up for appraisal profit or loss.	Realized market-price appraisal profit or loss should be posted in profit for the current term, and should not be deducted from net assets for the sake of calculating profit available for dividends.

Source: Nomura Research Institute

4. Comments on the Establishment of the Share Exchange System, and Future Outlook

The establishment of the share exchange system will not only facilitate the establishment of holding companies but also vitalize M&A and accelerate bold development of cash-hungry venture businesses. The following four points should be studied in establishing the share exchange system.

First is to promptly establish a share exchange system that can be utilized not only for the establishment of a holding company but for broader purposes.

Second is to take special tax measures along with the creation of the share exchange system. As

a precedent, at the time of establishing bank holding companies the triangular merger approach was established prior to the introduction of the share exchange system. At the same time, special tax measures were taken.

Third is to clarify the scope of the parent and subsidiary companies and the scope of the capital of the holding company at the time of its establishment, and keep consistency not only with the Anti-monopoly Law but also with corporate accounting that will be revealed shortly, in view of the expected introduction of market-price accounting and consolidated accounting.

Fourth is to take measures in advance for protecting the rights of parent company shareholders. This should not be made a medium- or long-term issue at a time when the issue of shareholders of both parent and subsidiary companies is expected to come to the fore in the midst of the growing interest in corporate governance. This issue could be discussed not only in the context of legal systems for parent and subsidiary companies, but also in the process of separate discussions about the "problems of corporate governance".[7]

Keidanren announced its "proposal for a share exchange system for cross-holding" on August 5, 1998, as it mentioned in its response to this survey. The proposal, which is for a specified duration (about three years), is intended to exchange cross-holding shares off the market under the share exchange system, and efficiently dissolve cross holding, without having any impacts on the market, by liquidating its own shares thus acquired. The proposal also seeks special tax measures for a series of actions and suggests that the board of directors implements share exchange and liquidates the company's own shares on the basis of authorization prescribed in the articles of incorporation. However, as the specified duration indicates, the problem of dissolution of cross holding is a temporary matter. Certainly, the share exchange system has been studied as an easy procedure to facilitate the establishment of a holding company.

However, as it represents a new institutional framework comparable to the merger provision under the Commercial Code, the new legal measures should be taken in balance with other provisions of the Code.

7 Legal problems regarding a bank holding company are expected to be solved to some extent through supervision by the bank, while the process of making a general business corporation a holding company will face big problems concerning corporate governance, such as disclosure of information on the holding company group, prevention of unfair transactions, and effective monitoring of managers of the holding company.