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TMI Associates

Introduction of the paperless share and electronic public notice

Chapter I Enactment and promulgation of amended law

Recently, the following laws were enacted and promulgated for the introduction of the paperless share and electronic public notice.

- “Law for Partial Amendment of the Laws related to Transfer of Bonds, Etc., to Streamline Settlement for Transactions of Stock, Etc.” (Amendment for the introduction of the paperless share)
Promulgation date: June 9, 2004
Enforcement date: no later than five years after the promulgation date, and to be designated by Cabinet order (hereinafter referred to as the “Enforcement Date” in the Article 1. “The paperless share” of Chapter II)
*The enforcement date for the amended Commercial Code is October 1, 2004 (hereinafter referred to as the “Enforcement Date for the Amended Code” in the Article 1. “The paperless share” of Chapter II).
- “Law for Partial Amendment of the Commercial Code, Etc., for the Introduction of a System of Electronic Public Notice”
Promulgation date: June 9, 2004
Enforcement date: no later than a year after the promulgation date, and to be designated by Cabinet order (Scheduled to be February 1, 2005)

Chapter II Summary of amendment

1. The paperless share¹

(1) Purpose of amendment

Under the current Commercial Code, stock transfer requires physical delivery of the share certificates (Articles 205 (1) and 207 (1)), which precludes the prompt settlement of transactions. Therefore, with the main purposes of promoting prompt settlement for transactions of stock, etc.; reducing the risks involved in loss, theft, etc.; and, in response to the request of public companies, reducing costs for the management of share certificates and their receipt and delivery, the system of non-issuance of share certificates will be introduced and the paperless share will be realized.

(2) Summary of amendment

The introduction of the paperless share will have significantly different effects on a public company and a non-public company.

For a public company, the stock transaction settlement system will be further upgraded, stock will be transferred under a new transfer system (“New Transfer System”) after the elimination of share certificates, and the current custody and transfer system of stocks, etc. (Law Concerning the Custody and Transfer of Stocks, Etc.) will be eliminated (Article 2 of the by-laws of the Amended Code).

On the other hand, a non-public company that has issued its share certificates will be required to take procedures to become a company without share certificates (in that non-public company, a company that requires, by its articles of incorporation, the approval of the board of directors for stock transfer will be permitted a special exception).

¹ In this Chapter, “Amended Code” means the Commercial Code as amended by the “Law for Partial Amendment of the Laws related to Transfer of Bonds, Etc., to Streamline Settlement for Transactions of Stock, Etc.

However, many small and medium-sized companies have not issued share certificates, and for them the introduction of the paperless share just means permitting a stock transfer system similar to the equity transfer system for limited companies (stock transfer becomes effective by the indication of intention). The following is a summary of the amendments.

Provision for non-issuance of share certificates

A joint-stock company may provide in its articles of incorporation that it will not issue share certificates (Article 227 (1) of the Amended Code). Such a company is called a “Company without Share Certificates”.

[Public companies]

A company whose share certificates are subject to the custody and transfer system under the Law Concerning the Custody and Transfer of Stocks, Etc. (all listed companies and over-the-counter companies; hereinafter, “Company Using the Custody and Transfer System”) will be deemed to have resolved to amend its articles of incorporation so that the paperless share will be adopted on the Enforcement Date (Article 6 (1) of the by-laws of the Amended Code). Accordingly, it is not necessary for a Company Using the Custody and Transfer System to take specific procedures to become a Company without Share Certificates, and as a rule, a Company Using the Custody and Transfer System becomes a Company without Share Certificates from the Enforcement Date.

Moreover, a Company Using the Custody and Transfer System may use the New Transfer System from the Enforcement Date², provided

² A Company Using the Custody and Transfer System may separately become a Company without Share Certificates before the Enforcement Date by amending its articles of incorporation (Article 3(1) of the by-law of the Amended Code). However, if the effective date for this amendment of the articles of incorporation (“certain date” as set forth in Article 351 (2) of the Amended Code) is set before the Enforcement Date (which means before the

that the company gives its consent to use the New Transfer System to the transfer body by the deadline for consent (one month before the Enforcement Date), and if it does not give this consent, it shall become a Company without Share Certificates not using the New Transfer System and shall become a delisted company.

[Non-public companies]

A company other than a Company Using the Custody and Transfer System (a non-public company) may voluntarily adopt the paperless share after the Enforcement Date for the Amended Code. Whether it becomes a Company without Share Certificates or not is determined by the articles of incorporation, and if the company wants to become a Company without Share Certificates, relevant procedures to change to such a company will be necessary.

If a company resolves to amend the articles of incorporation so that share certificates will not be issued, in order to inform the parties concerned of the change to a Company without Share Certificates and to ask shareholders who have not completed the transfer on register of their stock to do so, the company must give a public notice no later than two weeks before a designated day, and individually inform shareholders and registered pledgees that (i) the company has stipulated in the articles of incorporation that share certificates will not be issued, and that (ii) the share certificates will become void on the designated day (Article 351 (1) of the Amended Code). After these procedures, the amendment of the articles of incorporation will become effective and the share certificates will become void on the designated day mentioned in (ii) above (Article 351 (2) of the Amended Code).

commencement of the New Transfer System), the company will become a Company without Share Certificates despite the unavailability of the New Transfer System, and thus the company will depart from the Custody and Transfer System to become a delisted company.

To change to a Company without Share Certificates, a company only has to amend the articles of incorporation as stated above, and follow the above public and individual notification, and has no responsibility to recover its share certificates. However, as invalid share certificates may be misused, it is advisable to recover the share certificates to the extent possible.

A company that has not issued any share certificates at the shareholders' request of non-possession of the share certificates, or a company that requires board of directors' approval for stock transfer and has not issued any share certificates ("Company without Issued Share Certificates") must only individually inform shareholders (including shareholders with fractional shares), registered pledgees, and persons with warrant rights (*shinkabu-hikiukeken*) or stock subscription rights (*shinkabu-yoyakuken*), and public notice is not necessary (Article 351 (4) of the Amended Code).

Out of pledgees who have acquired, as collateral, shares of a company that will become a Company without Share Certificates, summary pledgees (*ryakushiki shichiken-sha*) can establish an exceptional registered pledge (*tokurei touroku-shichi*) (Article 351(3) of the Amended Code) to maintain perfectability, and can maintain perfectability by requesting the company by themselves to state the pledge on the shareholder register from the date of the company's notice to the date of the elimination of share certificates.³

Special exception for the timing of issuance of share certificates for restricted transfer companies, etc.

A company that requires, by its articles of incorporation, the approval

³ However, since "statement requested by pledgee" is entered in the shareholder register, this pledge is not effective as a registered pledge (Article 209 of the Commercial Code: Claim for dividend, distribution of residual property, etc.).

of the board of directors for stock transfer, does not need to issue share certificates, unless requested by the shareholders, even if the company does not provide in its articles of incorporation that it will not issue share certificates, notwithstanding Article 226 (1) of the Amended Code (proviso of Article 226 (1)). However, when a shareholder transfers or pledges its shares, delivery of share certificates is necessary.

To manage share certificates when the shareholders request non-possession of the share certificate, two methods are stipulated in the current Commercial Code: deposit of share certificates (depositing the share certificates with banks, etc.), and non-issuance of share certificates (elimination of the share certificate). Under the Amended Code, the deposit system is eliminated and these two methods are unified to the paperless share (Article 226.2 (2) of the Amended Code).

Manner of stock transfer and transfer on register

In a Company without Share Certificates, when a shareholder transfers its shares by stock transfer, pledge, etc., delivery of share certificates is not necessary (Exclusion of application of Articles 205 (1) and 207 (1) as set forth in Articles 227 (2) of the Amended Code). Also, for the transfer of stock subscription rights, the delivery of a certificate of subscription rights is not necessary (Exclusion of application of Article 280.34 as set forth in Article 280.30 (4) of the Amended Code).

[Public companies]

Since stocks will be transferred under the New Transfer System, there will be no specific changes in the procedures of stock sales from the standpoint of shareholders.

[Non-public companies]

Stock transfer becomes effective by the indication of the parties' intention, and may be asserted against the company and other third parties by recording the transferee's name and address in the shareholder register (Article 206.2 (1) of the Amended Code).

In this case, as a rule, a transfer will be approved for entry on the shareholder register when jointly applied for by the person named in the register (assignor) and the acquirer (Article 206.2 (2), 1 of the Amended Code).

A shareholder of a Company without Share Certificates may request the company to issue a document certifying that he or she is recorded on the register as a shareholder (certification of entry in the shareholder register) (Article 206.2 (3) of the Amended Code). Accordingly, when transferring shares, a shareholder may certify to the person who is going to acquire the shares that he or she is a shareholder by submitting this document.

Special exception for non-issuance of share certificates (effect on company reorganization, etc.)

Since a Company without Share Certificates has not issued any share certificates, it does not need to give a public notice requiring shareholders to submit their share certificates in the case of company reorganization. Under the current registration practice, an application for registration of a reorganized company will not be approved until the public notice period has been completed, even if the company has not issued any share certificates. The Amended Code eliminates this customary practice.

Elimination of closure of the shareholder register
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As for the determination of the persons who are entitled to exercise

rights as a shareholder or pledgee, the system of closing the shareholder register is eliminated and unified to the system of using a date of record (Article 224.3 of the Amended Code).

In accordance with Article 36 (19) of the by-laws of the Amended Code, a company that provides for the closing of the register and does not provide a date of record, will be deemed on the Enforcement Date for the Amended Code to have amended the articles of incorporation to stipulate that the day before the first day of the closing of the register will be the date of record, and the company will be deemed to have adopted the date of record system on the Enforcement Date for the Amended Code. In this case, it is necessary to provide the details of the shareholders' rights at the board of directors meeting held before the Enforcement Date for the Amended Code, and at the next general meeting of shareholders thereafter, provisions in the articles of incorporation regarding the closing of the register will be deleted (or modified), and a new provision will be established in the articles of incorporation regarding the date of record system. This will be a formalistic amendment of parts of the articles of incorporation that are deemed to have already been amended.

When a subscriber for new shares becomes a shareholder

In the issuance of new shares, the day when a subscriber for new shares becomes a shareholder is changed from “the day immediately following the payment day” to “the payment day” (Article 280.9 (1) of the Amended Code). Accordingly, the issuance of new shares will become effective on the payment day, and registration on the shareholder register will also be made on the payment day.

2. Electronic public notice⁴

⁴ In this Chapter, “Amended Code” means the Commercial Code as amended by the Law for

(1) Purpose of amendment

The current Commercial Code requires a joint-stock company to post a public notice in the Official Gazette or a daily newspaper to report its current events (Articles 166 (5), 374.4 (1), 374.20 (1), 376 (1), 412 (1), etc.). However, there are actually few subscribers of the Official Gazette, and a public notice in a daily newspaper may be overlooked. In addition, electronic public notice has already been approved for public notice of financial results, and such electronic public notice of a company by using the internet can play its inherent function of public notice and reduce company costs. Therefore, it was decided to introduce the system of electronic public notice via the Internet as one of the ways of giving public notice.

(2) Summary of amendment

Main amendments made at this time are: (i) to approve electronic public notice as a way for a joint-stock company to give public notice; (ii) to waive the requirement of individual notice, as a rule, if there is a public notice in the newspaper or an electronic public notice, in addition to the public notice posted in the Official Gazette, for procedures protecting creditors of companies; and (iii) to eliminate the obligation of companies, etc., to give public notice of certain matters without any legal effect, such as public notice of lawsuits, etc.

The following is a summary of these amendments.

Electronic public notice permitted

As a highly familiar, inexpensive, and simple method of public notice that fits in well with the advanced information society, electronic public

notice via the Internet is permitted (Article 166 (6) of the Amended Code).

[Statements in the articles of incorporation and registration]

To use electronic public notice as a method of public notice, a company must provide for it in its articles of incorporation (Article 166.2 of the Amended Code). The articles of incorporation must only refer to “using electronic public notice as a method of public notice”, and do not need to state the URL of the homepage posting the electronic public notice.

In addition, the adoption of electronic public notice as a method of public notice, and the internet address of the homepage posting the electronic public notice, must be registered (Article 188 (3) of the Amended Code).

[Period of electronic public notice]

The period of an electronic public notice will be in accordance with the respective legal period depending on the type of public notice (Article 166.2 (1) of the Amended Code).

[Short-term discontinuation of public notice]

If a public notice is interrupted due to server failure, etc., alteration of the contents of the public notice by a hacker, periodic inspection of the server, etc., and if the discontinued time in total is one tenth or less of the period for which the public notice should be posted, and the company giving the public notice acts without bad faith and without gross negligence or with a justifiable reason with respect to the discontinuation of the notice, the public notice will not become void due to the discontinuation as long as the company promptly gives a public notice stating the fact of the discontinuation in addition to the original public notice (Article 166.2 (2) of the Amended Code).

In addition, if the electronic public notice fails due to any unavoidable reason, including any trouble for which recovery of the server requires considerable time, the company may post a public notice in the Official Gazette or a daily newspaper, if stipulated in advance in the articles of incorporation (Article 166.2 (4) of the Amended Code). Therefore, it is advisable to provide for this alternative method of public notice in the articles of incorporation as a safety measure.

[Verification by investigative body]

As it is impossible to verify an electronic public notice after the fact to determine whether public notice has been lawfully given, a company giving an electronic public notice should request verification by the investigative body registered by the Minister of Justice, except for the public notice of financial results (Article 457 of the Amended Code).

An electronic public notice that is not verified by the investigative body will not be void if it satisfies other requirements, but will be subject to fines (non-penal fines of not more than 1 million yen) (Article 498 (1), 28.2 of the Amended Code). In addition, for the purpose of proper verification conducted by the investigative body, provisions of incompetency, registration criteria, verification method, etc., were amended (Articles 458 through 475 of the Amended Code).

[Waiver of verification for the public notice of financial results]

Since electromagnetic publication has already been accepted for the public notice of financial results (Article 283 (5) of the Amended Code, and Article 16 (3) of the Special Exceptions to the Commercial Code before this amendment), verification by the investigative body will not be required for an electronic public notice of financial results, and it will be treated the same as an electromagnetic publication. Moreover, a company that does not adopt electronic public notice as a method of public notice is authorized to use electromagnetic publication (Articles 283 (7) of the Amended Code, and Article 16 (5) of the Special

Exceptions to the Amended Code).

[Relationship to public notice of financial results by electromagnetic publication]

A company that adopts electronic public notice as a method of public notice will automatically give public notice of financial results by electronic public notice, thus Article 283 (5) and the proviso of Article 283 (4) of the Commercial Code that set forth publication by the existing electromagnetic method will not apply (Articles 283 (4), (5), and (7) of the Amended Code). In this case, the URL for the public notice of financial results is allowed to be different from the URL for other electronic public notices. Accordingly, if a company that has already given public notice of financial results by using electromagnetic publication adopts electronic public notice, it may give public notice of financial results by using the existing URL.

Simplification of procedures protecting creditors

If public notice is given in a newspaper or by electronic public notice, in addition to a public notice posted in the Official Gazette, for procedures protecting creditors in the case of merger, company split, capital decrease, or decrease in reserves, individual notification will not be required, except for creditors of a split company which committed illegal acts (Articles 374.4 (1), 374.10, 374.20 (1), 374.26, 376 (1), 289 (4), and 412 (1) of the Amended Code).

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