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Amendment to the Companies Act – Bonds

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An amendment to the Companies Act (the "**Amended Companies Act**") was enacted on December 4, 2019, and most of the amendments, including the revisions regarding administration of bonds, came into effect on March 1, 2021. This article outlines the revisions introduced regarding administration of bonds and the impact of the revisions on practice in the field.

I. Bond Administration Assistant

In cases where a company will issue bonds, the company must specify a Bond Administrator and entrust the receipt of payments, the preservation of rights of claim on behalf of the bondholders and other administration of the bonds to him or her (Article 702 of the Companies Act). Bond Administrators have broad authority and discretion relating to bonds to act judicially or non-judicially on behalf of bondholders (Article 705), and the qualification of Bond Administrators is limited to financial institutions such as banks and trust companies since they are expected to exercise the above authority appropriately (Article 703 and Article 170 of the Enforcement Regulations of the Companies Act). Under the proviso to Article 702 of the Companies Act, there is an exception that the establishment of a Bond Administrator is not required only if the amount of each corporate bond is 100 million yen or more or the number obtained by dividing the total amount of corporate bonds of the same class by the minimum amount of each corporate bond is less than 50 (Article 169 of the Enforcement Regulations of the Companies Act).

In practice, companies do not often appoint Bond Administrators in accordance with the proviso to Article 702 of the Companies Act for the following reasons: (i) the appropriate exercise of a wide range of discretionary authority is required; (ii) the duties, responsibilities and qualification requirements are strict; (iii) due to reasons (i) and (ii), it is difficult to find and secure persons to act as Bond Administrators; and (iv) the cost of establishing Bond Administrators is relatively high.
On the other hand, in the case of bonds issued without a Bond Administrator, bondholders have

disadvantages in bankruptcy proceedings because bondholders have to file proof of their claims on their own. This situation led to the need to legislate a system whereby a company could more easily entrust a third party with certain administrative tasks to assist bondholders in the administration of their bonds.

To respond to such need for legislation, the Amended Companies Act introduced a new system of Bond Administration Assistants by which a company could entrust third parties to assist bondholders in the administration of their bonds. Unlike Bond Administrators, who have broad authority and discretion to administer bonds, the Bond Administration Assistant system is one under which Bond Administration Assistants assist bondholders in administering their bonds on the premise that the bondholders themselves administer their bonds, and as explained in detail in Section 2, their authorities and discretion are more limited than those of Bond Administrators (Note 1).

1. Establishment and Qualifications of Bond Administration Assistants

A company may establish Bond Administration Assistants under the proviso to Article 702, where a Bond Administrator is not mandatory. In addition, whenever a company intends to appoint a Bond Administration Assistant, the company must stipulate that the company does not appoint a Bond Administrator and that the company appoints a Bond Administration Assistant as a subscription requirement for bonds (Article 676, Item 7-2, Item 8-2).

In addition to those who are qualifies as Bond Administrators such as banks and trust companies, lawyers and legal professional corporations are also qualified to be Bond Administration Assistants (Article 714-3 of the Amended Companies Act and Article 171-2 of the Enforcement Regulations of the Companies Act). The reason for this is that Bond Administration Assistants have the authority to perform acts that are part of bankruptcy proceedings, and the authority to perform all judicial or extrajudicial acts necessary to preserve the realization of claims related to bonds within the scope specified in the entrustment contract (Note 2).

2. Authority of Bond Administration Assistants

Under the Amended Companies Act, it is stipulated that Bond Administration Assistants have the following three types of authority: (1) the authority that Bond Administration Assistants always have regardless of whether or not there is a provision in the entrustment contract (Article 714-4, Paragraph 1); (2) the authority that Bond Administration Assistants have within the scope specified in the entrustment contract (Paragraph 2); and (3) among the authorities specified in (1) and (2), the

authority that may not be exercised without a resolution of a bondholders meeting (Article 714-4, Paragraph 3).

While Bond Administrators have comprehensive authority, Bond Administration Assistants have specific authority since the Bond Administration Assistant system is intended to endow Bond Administration Assistants with limited authority and discretion compared to Bond Administrators.

The types of authority which Bond Administration Assistants have in any case under Article 714-4, Paragraph 1 are as follows:

- participation in bankruptcy proceedings, rehabilitation proceedings and corporate reorganization proceedings;
- demand for liquidating distribution in compulsory execution or exercises of security rights; and
- filing of claims in liquidation proceedings

The types of authority which Bond Administration Assistants may have under the entrustment contract include the following:

- to receive payment of claims relating to the bonds;
- all judicial and non-judicial acts to preserve claims relating to the bonds, subject to a resolution at a bondholders' meeting;
- with respect to all of the bonds, granting extension for the payment of those bonds, or releasing, or settling liability arising from the failure to perform the obligations of those bonds, prosecuting lawsuits, or proceeding with bankruptcy procedures, rehabilitation procedures, reorganization procedures or procedures regarding special liquidation, subject to a special resolution at a bondholders' meeting;
- acceleration of the total amount of the bonds, subject to a resolution at a bondholders' meeting; and
- to receive a notice about capital reduction, entity conversion, mergers and demerger from a company

3. Responsibilities of Bond Administration Assistants

Bond Administration Assistants must perform the administration of bonds in a fair and sincere manner on behalf of the bondholders (Article 714-7 and Article 704, Paragraph 1), and must administer bonds

with the due care of a prudent manager to the bondholders (Article 714-7 and Article 704, Paragraph 2).
However, the duties and responsibility of Bond Administration Assistants are not strict in comparison with Bond Administrators since Bond Administration Assistants only have limited authority and discretion.

Bond Administration Assistants must report matters concerning the administration of the bonds to the bondholders or take measures to make such matters available to the bondholders pursuant to the entrustment contract (Article 714-4, Paragraph 1).

4. Other Provisions Regarding Bond Administration Assistants

Resignation, Dismissal and Succession to Administration of Bonds

The Companies Act applies the following provisions on resignation, dismissal and succession to the administration of bonds by Bond Administrators mutatis mutandis in order to set forth those of Bond Administration Assistants (Article 714-7);

Bond Administration Assistants may resign in the following cases;

- there is a consent of the Bond-Issuing Company and the bondholders meeting;
- there is any ground provided for in the entrustment contract; or
- there is a permission of the court if there are unavoidable reasons

Bond Administration Assistants may be dismissed by the court upon the request of the Bond-Issuing Company or a bondholders meeting in the following cases;

- if the Bond Administration Assistant has violated its obligations,
- if the Bond Administration Assistant is not fit to handle the administration for which the Bond Administration Assistant is responsible, or
- if there are other justifiable grounds.

Succession to Bond Administration Assistants' Administration of Bonds

In cases where Bond Administration Assistants have resigned or been dismissed, if there are no other Bond Administration Assistants, the Bond Issuing Company must appoint a Bond Administration

Assistant to succeed to the administration of the bonds and entrust the administration of the bonds to such person on behalf of the bondholders.

Provision regarding the case where there are two or more Bond Administration Assistants

Although two or more Bond Administrators must jointly perform the acts within their authority (Article 709), if there are two or more Bond Administration Assistants, they must severally perform the acts within their authority (Article 714-5, Paragraph 1). However, if Bond Administration Assistants are liable to compensate bondholders for losses, they will be both jointly and severally responsible (Article 714-5, Paragraph 2).

Bond Administration Assistants' authority to convene bondholders meetings

Bond Administration Assistants may convene bondholders meetings only if: (i) bondholders demand that a bondholders meeting should be convened pursuant to Article 718, Paragraph 1 of the Companies Act; or (ii) Bond Administration Assistants need to acquire the consent of the bondholders meeting to resign as provided in Article 714-7 and Article 711, Paragraph 1 of the Companies Act (Article 717, Paragraph 3).

5. Expected Influence on Practice

As mentioned in this article, the authority of Bond Administration Assistants is more limited than that of Bond Administrators, and lawyers, legal professional corporations and financial institutions are all qualified to be Bond Administration Assistants. Therefore, the present amendment can be expected to facilitate the securing of Bond Administration Assistants and to lower the costs for bond administration.

6. Schedule

Transitory provisions regarding bond issuing process

If matters on bonds for subscription under Article 676 of the Companies Act have already been determined before the Amended Companies Act came into effect, it is not required that both the fact that no Bond Administrator is to be appointed and the fact that Bond Administration Assistants are to be appointed be determined as such matters.

Transitory provisions regarding classes of Bonds

Under the Amended Companies Act, bonds regarding which no Bond Administrator is appointed and those regarding which Bond Administration Assistants are appointed constitute different classes of bonds. When it comes to bonds issued before the amendment, however, it is unclear whether bonds issued before the Amended Companies Act are classified as those regarding which no Bond Administrator is appointed.
To avoid this ambiguity, the Amended Companies Act deems bonds existing as of the date of enforcement of the Amended Companies Act to be bonds regarding which no Bond Administrator is appointed.

Transitory provisions regarding bond certificates

Under the Amended Companies Act, if the Bond-Issuing Company has determined that no Bond Administrator will be appointed or that a Bond Administration Assistant will be appointed, such matters must be written on the bond certificates. However, this provision shall not apply to bonds existing as of the date on which the Amended Companies Act comes into effect.

II. Amendments Regarding Bondholders Meetings

1. Outline of Bondholders Meetings

Bondholders meetings are extraordinary meetings by bondholders. This meeting may resolve matters provided for in the Companies Act (such as granting an extension for the payment of those bonds, or releasing, or settling liability arising from the failure to perform the obligations of those bonds with respect to all of the bonds), as well as matters in relation to the interests of the bondholders (Article 716).

Bondholders meetings are, in principle, convened by the Bond-Issuing Company or Bond Administrators (Article 717, Paragraph 2). At bondholders meeting, bondholders (except for the Bond-Issuing Company itself) have voting rights in proportion to the total amounts of bonds of the relevant Classes they hold (excluding amounts already redeemed) (Article 723).

Basically, in order to pass a matter to be resolved at a bondholders meeting, the consent of persons who hold more than half of the total amount of voting rights of voting rights holders present at the meeting must be obtained, while the consent of persons who hold not less than one fifth (1/5) of the

total amount of voting rights of voting rights holders, being not less than two thirds (2/3) of the total amount of voting rights of voting rights holders present at the meeting, must be obtained to pass certain matters specified in the Companies Act (Article 724: the former proceeding is called an "ordinary resolution", and the latter is a "special resolution").

2. Amendments

Regarding the reduction or release of the principal and interest of a bond

Before the present amendment to the Companies Act, it was common practice for a bond administrator to reduce or release the principal and interest of a bond on the basis of "settling" under Article 706, Paragraph 1, Item 1 of the Companies Act: however, it is not clear as to whether this practice actually conforms to the provisions of the Companies Act (Note 3).
In light of the above, the Amended Companies Act grants Bond Administrators the authority to release the obligation of the bond on the condition that a resolution at a bondholders meeting is obtained (Article 706, Paragraph 1, Item 1), thereby resolving the interpretational ambiguity issue.

Omission of resolutions at bondholders meeting

Under the previous Companies Act, it was considered that resolutions at bondholders meeting must not be omitted even by the consent of all bondholders (Note 4); however, under the Amended Companies Act, resolutions at bondholders meetings may be omitted if all bondholders consent (Article 735-2, Paragraph 1). This amendment is expected to help improve the promptness and smoothness of decision-making at bondholders meeting.

3. Schedule

The provision of Article 735-2, Paragraph 1 does not apply to the case where the Bond-Issuing Company has proposed matters that form the purpose of the bondholders meeting prior to the enforcement of the Amended Companies Act.

Note 1: Toshikazu Takebayashi et al., *Explanation IV on the Amended Companies Act of 2019*, 2227 Junkan Shojihomu 4 (2020).
Note 2: *Id.* at 6.
Note 3: *Id.* at 10.
Note 4: *Id.* at 11.

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If you have any questions regarding the matters covered in this memorandum, please reach out to your usual TMI contact or any of the attorneys listed below.

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