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Important Judicial Decisions Regarding Stock Consolidation

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I. Introduction

In this Article, we will introduce two important decisions issued by Japanese courts in connection with the Companies Act of Japan (the “**Act**”) regarding stock consolidation. The first decision by the Sapporo District Court judged whether a shareholders meeting’s resolution on stock consolidation was invalid under the Act. In the second case, the Supreme Court construed the definition of a “creditor” who has the right to make a request for inspection or copying of the shareholders meeting’s minutes under the Act.

II. Sapporo District Court Decision on Shareholders Meeting’s Resolution on Stock Consolidation for Squeeze-Out of a Minority Shareholder (June 11, 2021)

1. Outline

The plaintiff in this case (in this chapter, the “**Plaintiff**”) held 1,500 of the 40,000 outstanding shares of the defendant (in this chapter, the “**Defendant**”), an unlisted corporation engaged in real estate business. A resolution (the “**Resolution**”) was passed at the Defendant’s shareholders meeting, with the approval of all shareholders other than the Plaintiff, to consolidate 1,569 shares of the Defendant into one share (the “**Stock Consolidation**”).

The Plaintiff, who lost his status as a shareholder due to the Resolution, brought a suit against the Defendant in the Sapporo District Court (in this chapter, the “**Court**”), in which the Plaintiff:

- (i) primarily sought declaration of the invalidity of the Resolution under Article 830, Paragraph (2) of the Act, claiming that the content of the Resolution violated the Act; and
- (ii) preliminarily sought the cancellation of the Resolution under Article 831, Paragraph (1), Item (iii) of the Act, claiming that the Resolution was grossly improper to the Plaintiff due to the exercise of voting rights by shareholders who had a conflict of interests.

A summary of the basis for each claim by the Plaintiff is as follows.

Primary claim:

- Under Article 182-2 of the Act, a stock company that consolidates its shares is required to keep a document stating certain matters regarding the stock consolidation at its head office in advance, but the Defendant violated such obligation.
- Under Article 235 of the Act, a stock company that consolidates its shares is required to dispose of any fractional shares by auctioning or selling the number of shares equivalent to the total number of fractional shares and delivering the resulting cash to the shareholders, but the Defendant violated such obligation.
- Since the Defendant is a closed company with only six shareholders and the Stock Consolidation deprived the Plaintiff of its status as a shareholder, the Defendant's purpose of the Stock Consolidation was squeeze-out of the Plaintiff from being a shareholder, and the Defendant has therefore violated the principle of equality of shareholders under Article 109, Paragraph (1) of the Act.

Preliminary claim:

- The Stock Consolidation will result in squeeze-out of the Plaintiff from being a shareholder of the Defendant and receiving only low-priced consideration, while the other shareholders will retain their positions as shareholders and increase their control over the Defendant, and the shareholders other than the Plaintiff therefore had a conflict of interests in the Resolution.
- The Defendant has not given reasonable consideration to the necessity and reasonableness of the Stock Consideration in relation to its business, and the Stock Consideration did not have any legitimate business purpose and was carried out for the purpose of squeeze-out of the Plaintiff.

2. Court Decision

The Court dismissed all of the Plaintiff's claims.

A summary of the Court decision is as follows:



Regarding the primary claim:

- The Defendant's non-compliance with its obligation to keep a prior disclosure document does not result in the content of the Resolution constituting a violation of the Act.
- The Defendant's non-compliance with its obligation to dispose of the fractional shares does not result in the content of the Resolution constituting a violation of the Act, either¹.
- Concerning stock consolidations, the Act only stipulates that the reason for a stock consolidation must be explained at a shareholders meeting, and does not place any restrictions on the content or appropriateness of the reason for the stock consolidation itself,
- The Act expects that a stock consolidation will result in minority shareholders holding less than one share and losing their status as shareholders, and even if the purpose of a stock consolidation is squeeze-out of minority shareholders, this does not immediately violate the principle of equality of shareholders.

Regarding the preliminary claim:

- The Court did not deny that there is room to consider that the shareholders other than the Plaintiff had a conflict of interests in the Resolution.
- The Stock Consolidation was carried out for squeeze-out of the Plaintiff from being a shareholder to establish control through stable shareholding in order to accelerate the decision-making process of the Defendant, which had reached a turning point in its corporate management, and it cannot be said that the Stock Consolidation was implemented solely on the basis of the “personal feelings of the Defendant's representative” without any legitimate business purpose.
- Under the Act, the share price is not a matter to be resolved in the shareholders meeting resolution regarding the stock consolidation (Article 180, Paragraph 2 of the Act). The price of shares is to be determined by separate procedures (e.g., approval by the court of voluntary sale of fractional shares).
- Accordingly, the Resolution was not grossly improper toward the Plaintiff.

3. Key Takeaways

What deserves the most attention in this case is the process of decision-making on what constitutes a “grossly improper resolution”.

While the Court decided that the Resolution in the present case was not grossly improper in light of the Defendant's intention behind the Stock Consolidation, this suggests that a shareholders meeting

¹ The Court also mentioned that the Defendant complied with those procedures for the prior disclosure document and the disposal of fractional shares, and accordingly, the Plaintiff's arguments could not be accepted in any event.

resolution to consolidate stock could be found to be “grossly improper” in cases where such consolidation has no legitimate business purpose. According to this decision by the Sapporo District Court, except for cases based solely on the defendant's personal feelings, etc., if there is a certain legitimate business purpose, it is unlikely that the resolution will be “grossly improper.”

III. Supreme Court Decision on Whether a Shareholder Falls Under a “Creditor” Entitled to Request Inspection or Copying of the Minutes of Shareholders Meetings Under the Act After Receiving Payment of Consideration from the Company (July 5, 2021)

1. Outline

The shareholders meetings of the defendant in this case (in this chapter, the “**Defendant**”) passed resolutions to consolidate 1.25 million shares of the Defendant’s ordinary shares and Class A shares respectively into one share. The plaintiff in this case (in this chapter, the “**Plaintiff**”) had held 44,400 shares of the Defendant (the “**Shares**”) and notified the Defendant of its opposition to the proposal prior to the shareholders meetings, and then actually opposed the proposals at the shareholders meetings and concurrently demanded the Defendant to purchase the Shares at a fair price in accordance with Article 182-4, Paragraph (1) of the Act. The Defendant proposed that it would pay the Plaintiff 13.32 million yen, which the Defendant considered a fair price, but the Plaintiff did not agree with the valuation and filed a petition with the Tokyo District Court seeking a determination of the price of the Shares under Article 182-5, Paragraph (2) of the Act (the “**Appraisal Proceeding**”). Before the Tokyo District Court determined the price of the Shares, the Defendant paid the Plaintiff 13.32 million yen for the Shares. (Please note that this is permissible under Article 182-5, Paragraph (5) of the Act.)

The Plaintiff, who had received payment of the consideration for the Shares, brought a suit against the Defendant in the Tokyo District Court claiming that the Plaintiff fell under the definition of a “creditor” who is entitled to make a request for inspection or copying of the minutes of the shareholders meetings under Article 318, Paragraph (4) of the Act, but such claim was dismissed by the Tokyo District Court. The Plaintiff then appealed to the Tokyo High Court and the claim was granted. The Defendant subsequently appealed to the Supreme Court (in this chapter, the “**Court**”)

A summary of the basis for the allegation by the Defendant is as follows:

- The Plaintiff did not have the right to inspect or copy the minutes because the Plaintiff had already

received the consideration which the Defendant considered a fair price and was no longer a “creditor” unless the price of the Shares judged in the Appraisal Proceeding exceeded the amount of such payment.

2. Court Decision

The Court dismissed the Defendant’s allegation in the same manner as the Tokyo High Court and affirmed that the Plaintiff is a “creditor”.

A summary of the Court decision is as follows:

When a shareholder requests that his/her shares be purchased at a fair price, the “fair price” is determined by consultation (Article 182-5, Paragraph (1) of the Act) or judicial decision (Article 182-5, Paragraph (2) of the Act). This purports to protect the interests of the shareholders and the court is to determine the “fair price” in its reasonable discretion, not by confirming the historical stock price. Thus, the “fair price” is not determined until the consultation is concluded or the judicial decision becomes final, and the right of a shareholder to demand payment of a “fair price” is therefore not extinguished.

Article 318, Paragraph (4) of the Act provides that shareholders and “creditors” of a company have the right to inspect or copy the minutes of shareholders meetings. This is intended to allow the shareholders and creditors the ability to obtain information about the company’s business and property and to protect their interests. Until such time as the “fair price” is determined, the shareholders will have the need to verify the business and financial conditions of the company in order to receive fair consideration.

Based on the above, the Court concluded that a shareholder who has requested the purchase of shares (that would become fractions as a result of the stock consolidation) at a “fair price” is a “creditor” under Article 318, Paragraph (4) of the Act, until the consultation with the company is concluded or the judicial decision becomes final, with respect to the share price, even if such shareholder has received payment from the company.

3. Key Takeaways

This is the first Supreme Court decision to affirm the decision to admit a request for inspection of minutes of shareholder meetings by a shareholder who had already received consideration for its

purchase request prior to the determination of the share price (through the completion of the consultation with the company or the appraisal proceeding).

The Court emphasized the importance of the creditors' right to inspect the minutes of the shareholders meetings and admitted the existence of their inspection right in the present case.

Unlike the minutes of shareholders meetings, there is a greater concern that the disclosure of certain other corporate documents such as accounting books may cause adverse effects such as leakage of trade secrets. Therefore, the Act does not stipulate that a request for inspection of these corporate documents of a company such as accounting books can be made simply by being a shareholder or a creditor of the company, and certain additional requirements (e.g., restricting those who can request inspection to shareholders who own a certain number of shares or more, clarification of reasons for inspection request, and/or grounds for refusal) are stipulated (e.g., Article 433 of the Act). This decision only concerns the applicability of a "creditor," and it is necessary to separately consider whether each corporate document subject to a request for inspection satisfies other requirements.

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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 the attorneys listed below.

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