

# Share Buyback Rules under Japanese Corporate Law and Shareholders' Return

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## I. INTRODUCTION

This paper deals with the development of rules regulating a corporation's repurchase of its own shares (hereinafter 'share buyback') under Japanese corporate law and analyses recent changes in the attitudes of management and shareholders towards share buybacks. It is interesting to observe that share buyback is recognised today as a popular tool of shareholder return, whereas the deregulation of share buyback rules in the 1990s and early 2000s was originally intended to give management a countermeasure against hostile takeovers under the market situation of stock price decline.

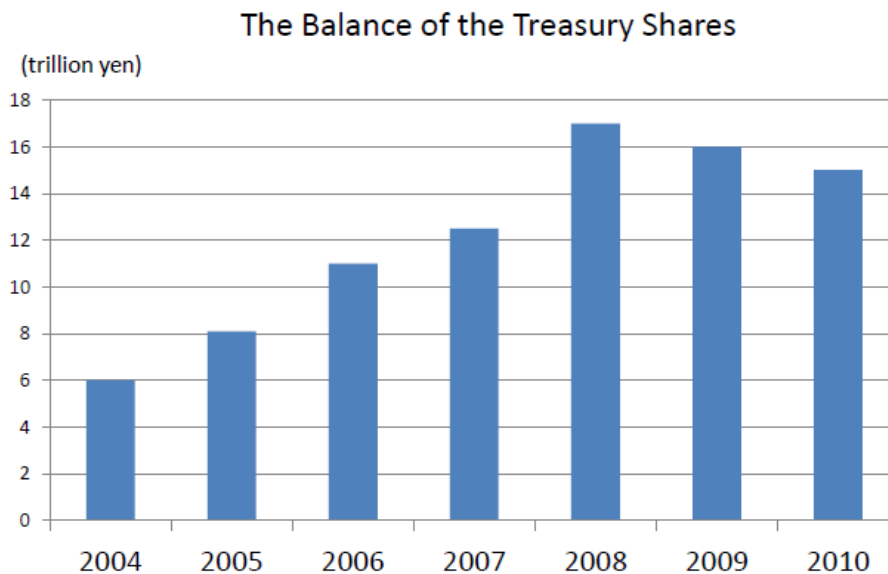
This paper will give an overview of the following points: (1) a history of the development of share buyback rules under Japanese company law; (2) the present rules on share buybacks; and (3) corporations' and shareholders' reaction to share buybacks after the deregulation of buyback rules, especially after the deregulation of treasury shares in 2001.

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Looking at the balance of the treasury shares in the last decade, the increase in the total amounts of buyback in Japan is obvious. According to the statistics of the Policy Research Institute, Ministry of Finance, 2012 (*Diagram 1-1*), the balance of treasury shares of Japanese corporations has increased from around 6 trillion yen (52 billion euro) (hereinafter 1 euro = 115 yen) in 2004 (calendar year as in this diagram) to around 15 trillion yen (130 billion euro) in 2010. Although there might have been a negative influence on this trend by the Lehman Shock in late 2008, before which the peak of the balance of treasury shares was 17 trillion yen (147 billion euro), we can see a trend of share buybacks increasing as a whole during this period.

*Diagram 1-1*



Source: "Financial Statements Statistics of Corporations by Industry", Policy Research Institute, Ministry of Finance, Japan (2012)

The drastic change in share buyback rules in 2001 aimed at preventing stock prices from falling under strong pressure from the unwinding of cross-shareholding and was expected to function as a countermeasure against hostile takeovers. However, stress has shifted today from the original aim of preventing stock prices from falling and preventing hostile takeovers to a new goal of attracting shareholders by distributing profits in other form than as dividends. This means that the share buyback functions not only as a tool to protect corporations from the strong influence of the unwinding of cross-shareholding, but also as a strategic management measure to attract shareholders by increasing earnings per share; however, the legal characteristic of share buyback rules has not changed much since 2001. Before analysing the 2001 reform, we will start with the history of share buyback rules.

## II. DEVELOPMENT OF SHARE BUYBACK RULES UNDER JAPANESE CORPORATE LAW

### 1. *History of the deregulation of buyback rules under Japanese corporate law*

Before the amendment of the Commercial Code<sup>1</sup> in 2001, a share buyback was prohibited in principle since the establishment of the Commercial Code in 1899.<sup>2</sup> Art. 151(1) Commercial Code prohibited a corporation to repurchase its own shares or take them in pledge without exception.<sup>3</sup>

*Art. 151*

A company cannot acquire its own shares or take them in pledge.<sup>4</sup>

Before the amendment of this provision in 1938, the prohibition of share buybacks was explained as follows.<sup>5</sup>

(1) A company cannot be the member of itself

When the corporation acquires its own shares, the corporation was said to become a member of itself. This was considered, at the time, to be logically impossible.

(2) Violation of ‘confusion principle’

Art. 520 of the Japanese Civil Code provides that if a debt and a corresponding claim belong to one person, they offset each other and disappear as a result of ‘confusion’. This is called the ‘confusion principle’, and this principle was also applied to the rules about shares under the Commercial Code. At that time, it was argued that a share buyback resulted in a situation in which both the debt and the corresponding claim belong to one and the same person, and share buybacks were therefore considered a violation of the confusion principle.<sup>6</sup>

In contrast to this theoretical reasoning, share buybacks were already broadly utilised in practice before the reform of the Commercial Code in 1938. The amendment of the Commercial Code in 1938 reflected the practical needs as to share buyback. For example, Jôji Matsumoto, a major drafter of the amendment of the Commercial Code in

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1 *Shôhô*, Law No. 48/1899.

2 M. POE / K. SHIMIZU / J. SIMPSON, *Revising the Japanese Commercial Code: A Summary and Evaluation of the Reform Effort*, in: *Stanford Journal of East Asian Affairs* (2002) 71-95, describes the political background of the reform of the Commercial Code in 2001, especially elaborating on the interests and activities of each of the main actors.

3 S. YOSHIKAI, *Heisei 5-nen 6-nen kaisei shôhô* [Reformed Commercial Law of 1993 and 1994] (Tokyo 1996) 357.

4 L.H. Loenholm [transl.], *The Commercial Code of Japan and the Law Concerning its Operation*, 5th ed. (Tokyo 1911).

5 YOSHIKAI, *supra* note 3, 357.

6 K. INOMATA, *Kabushiki kaisha honshitsu-ron* [The Essence on the Stock Corporation] (Tokyo 1921) 258-264.

1938, explained the reasons of the introduction of the exceptions of share buyback prohibition as follows:

Art. 151 of the present Commercial Code absolutely prohibits share buybacks. However, share buybacks are temporarily needed in the case of cancellation of shares. Also acquiring a corporation's own shares has been admitted by interpretation when the corporation merges with a liquidated corporation by universal succession. Art. 210 of the reform bill permits share buybacks in the case of taking over the whole business and in the necessity to exercise rights of a corporation as well as the two cases above.... (By these provisions) the bill is planned to serve for the convenience of practical needs.<sup>7</sup>

During the period between the previous reform of the Commercial Code in 1911 and the 1938 reform, Japanese economic and social structure had changed dramatically through the First World War and the economic boom following.<sup>8</sup> The amendment of the Commercial Code in 1938 reflected this change and introduced exceptions in which share buybacks could be carried out. Since then, there have been several amendments to the buyback rules, consisting of adding exceptions to the prohibition (as to the main amendments, see *Table 1*). These changes reflected the requirements of business communities in each period together with the gradual acceptance by academia a part of which followed the trend of the deregulations of buyback rules in other countries.<sup>9</sup>

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7 J. MATSUMOTO, *Shôhô kaisei mondai (2). Kaisei hôan ni okeru kabushiki ni kansuru kitei ni tsuite* [Issues Concerning the Revision of the Commercial Code (2). About the Provisions in the Reform Bill about Stock Corporations], in: *Hôritsu Jihô 8 (1936) 4*.

8 H. KANSAKU / M. BÄLZ, *Gesellschaftsrecht*, in: Baum/Bälz (eds.), *Handbuch Japanisches Handels- und Wirtschaftsrecht* (Köln 2011) 75-77; J. MATSUMOTO, *Shôhô kaisei mondai (1). Shogen narabini sôsoku-hen ni tsuite* [Issues Concerning the Revision of the Commercial Code (1). On the Preamble and the General Provisions], in: *Hôritsu Jihô 8 (1936) 3*; S. ASAGI, *Nihon kaisha-hô seiritsu-shi* [History of the Establishment of Japan's Corporation Law] (Tokyo 2003) 324.

9 YOSHIKAI, *supra* note 3, 361-363.

Table 1:

*Main Amendments of Buyback Rules  
(not comprehensive)<sup>10</sup>*

<i>Year</i>	<i>Main Amendments of Buyback Rules</i>
1899	The abolished Commercial Code absolutely prohibited buybacks.
1938	Exceptional provisions which permit buybacks were introduced: (1) for the aim of cancellation of shares (2) in the cases of M&A (3) in the necessity of exercising the rights of a corporation
1950	Permission of a buyback if shareholders demand that the corporation repurchase its shares
1981	Permission of the pledge of shares up to one-twentieth of the total issued shares
1994	Permission of buybacks to smooth employee share ownership Introduction of limitation of financial resources (buyback and dividends are restricted to distributable profit) and the liability of directors in the case of loss at the end of the fiscal year caused by the buyback
1997	Introduction of stock option rules
2001	By introducing treasury shares system, the principle was changed from the prohibition of share buybacks with some exceptions to permission of the acquiring and holding of a corporation's own shares under certain conditions.
2003	Board of directors may decide on buybacks if the articles of incorporation so provide.
2007	The Old Commercial Code was abolished and the Companies Act <sup>11</sup> was established.

<sup>10</sup> This table is based on the description of M. TATSUTA, *Chikujô kaisetsu kaisha-hô. Dai 2-kan Kabushiki 1* [Commentary on the Companies Act. Vol. 2 Shares 1] (Tokyo 2010) 356-358.

<sup>11</sup> *Kaisha-hô*, Law No. 86/2005.

## 2. *Main reasons for the principle of the prohibition before 2001*

Before 2001, the main reasons for the principle of the prohibition of share buybacks under the Commercial Code were explained as follows:<sup>12</sup>

- (1) Share buybacks may prejudice corporate creditors in the sense that they reduce the capital of the corporation.
- (2) Unfairness would arise when a stock corporation buys its own shares from specific shareholders.
- (3) Share buybacks may unfairly intensify the control of the management when the corporation repurchases its shares from shareholders who oppose the management.
- (4) Share buybacks could impact the fairness of stock markets in the case of manipulation of stock prices and insider trading.

## 3. *Background of the change in buyback rules in 2001*<sup>13</sup>

The background to the change in the principle of buyback rules seems to be composed of the constant requests for deregulation from business communities and the political momentum that reflected the prevailing economic and financial situation. Business communities such as *Keidanren* had asked for the deregulation of the share buyback rule to smooth reorganisation and to gain defensive measures against hostile takeovers, among other reasons.<sup>14</sup> In addition to the constant requests from industry, which had already existed before the Second World War,<sup>15</sup> political momentum can be observed in light of the severe economic and financial environments in the late 1990s when the Japanese economy suffered from the long-lasting stock price decline and the unwinding of cross-shareholding. The ruling party at the time initiated the amendment of the Commercial Code to be able to react to the urgent needs of supporting stock prices and revitalising the economy. Against this economic and political background, and together

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12 A. HARADA / K. YASUDA / D. KÔRIYA, *Jiko kabushiki no shutoku kisei-tô no minaoshi ni kakau kaisei shôhō no kaisetsu (jō)* [Commentary on the Revised Commercial Code Concerning the Reviewed Regulations on the Acquisition of Treasury Shares], in: Shōji Hōmu 1607 (2001) 8-9; K. EGASHIRA, *Kabushiki gaisha-hō* [Laws of Stock Corporations] (4th ed., Tokyo 2011) 238.

13 As an overview of the procedure of the 2001 reform, see HARADA / YASUDA / KÔRIYA, *supra* note 12, 5-8. For literature in English on the political background of the 2001 reform, see POE et al., *supra* note 2. This literature describes the political background of the reform of the Commercial Law in 2001, especially pointing out the interests and activities of each of the main actors.

14 KEIDANREN RIJI-KAI [Board of Directors of Keidanren], *Shōken shijō kassei-ka taisaku ni tsuite* [On Measures to Revitalize the Securities Market], (23 January 2001), available online at <http://www.keidanren.or.jp/japanese/policy/2001/002.html> (last retrieved 25 January 2013).

15 S. IWAHARA, *Jiko kabushiki shutoku kisei no shushi to kisei naiyō* [Purpose and Contents of the Regulations on the Acquisition of Treasury Shares], in: *Jurisuto Zōkan: Shin hōritsugaku no sōten shirūzu 5. Kaisha-hō no sōten* [Jurisuto Special Edition: New Legal Issues Series 5. Issues of the Companies Act] (Tokyo 2009) 66.

with the gradual increase of exceptions since 1938 as a reaction to practical needs, the principle of the buyback rules was changed 'as if a matured *kaki* fruit had fallen down in the end'.<sup>16</sup>

#### 4. *Reasons for the change in share buyback rules*

According to the reform bill amending the Commercial Law, the reasons for the revision are as follows.

It is necessary to maintain rules such as the Commercial Law etc. on the removal of a ban of treasury stock from the point of view of raising the flexibility of the economy and pushing forward economic structure reform in view of the economic situation in these days, and to abolish the amount of net assets regulation to facilitate entries to the equity investments of individual investors.<sup>17</sup>

Specifically, the aim of this bill was explained by officials of the Ministry of Justice as follows.<sup>18</sup>

##### a) *The same effect of the new share issue in the case of reorganisation*

During the reorganisation of corporations, such as mergers and acquisitions or demergers, corporations may transfer their treasury shares instead of issuing new shares. This enables corporations to ease the burden of dividends which follows the issuance of new shares. Also the use of treasury shares in the case of a reorganisation does not affect the ratio of the shareholding of the existing shareholders.

##### b) *To balance the supply and demand of the share*

Share buybacks contribute to the balance of supply and demand of the stock under the pressure of the decline of stock prices as a result of the unwinding of cross-shareholding.

##### c) *Countermeasure against hostile takeovers*

When shareholders reduce cross-shareholding, the released shares could be acquired by investors planning a hostile takeover. In order to prevent such a hostile takeover, corporations may acquire their own shares once share buyback is allowed.

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16 TATSUTA, *supra* note 10, 358.

17 *Shôh-tô no ichibu o kaisei suru tô no hôritsu* [Law Partially Amending the Commercial Code] Law No. 79/2001 (see under '*kaisei no riyû*' [Reasons for the Amendment]).

18 HARADA / YASUDA / KÔRIYA, *supra* note 12, 9.

### 5. *Measures to prevent negative effects of share buybacks*

To prevent the negative effects of the deregulation of share buybacks, the following measures were introduced.<sup>19</sup>

*i) Share buybacks may prejudice corporate creditors in the sense that it reduces the capital of the corporation.*

The total amount of the share buyback should be limited to the Distributable Amount defined under Art. 461 (1) item 2 and 3 of the present Companies Act. In addition, if the management fails to exercise due care – *i.e.* the share buyback causes losses in the business year that contains the day on which the share buyback is carried out – the members of management shall be jointly and severally liable to compensate losses arising from the performance of their duties (Art. 465(1) item 2 and 3).

*ii) Unfairness would arise when a stock corporation buys its own shares from specific shareholders.*

As a general rule, share buybacks should be carried out in the market or by means of a tender offer. If a corporation repurchases its own shares from specific shareholders, it must obtain approval for the share buyback through a resolution of the shareholders' meeting.

*iii) Share buybacks may unfairly intensify the control of the management when the corporation repurchases shares from shareholders who oppose the management.*

To prevent unfair concentration of management power by way of share buyback, the procedure of disposal of the shares which were obtained through share buyback should follow the same strict rules as an issuance of new stock.

*iv) Share buybacks could impact the fairness of stock markets in the case of manipulation of stock prices and insider trading.*

A new provision was introduced in the Securities and Exchange Law<sup>20</sup> (Art. 24-6 of the present Financial Instruments and Exchange Act), listing the decision to carry out a buyback as an 'important fact' (*jūyō jijitsu*) which should be published no later than the decision was made.

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<sup>19</sup> Ibid, 9.

<sup>20</sup> *Shōken torihiki-hō*, Law No. 25/1948. After amendment renamed *Kin'yū shōhin torihiki-hō* (Financial Instruments and Exchange Act), Law No. 65/2006.



## 6. *Present rules*

In many cases of share buyback as a measure to increase shareholder return today, buybacks are carried out by agreements with shareholders based on Art. 155 item (3) and Art. 156 of the Companies Act.<sup>21</sup>

### *Article 155*<sup>22</sup>

A Stock Company may acquire shares issued by such Stock Company only in the following cases:

(iii) Where a resolution has been made under paragraph (1) of the following article;

### *Article 156*

- (1) A Stock Company shall prescribe the following matters by resolution of a shareholders meeting in advance in order to acquire for value own shares by agreement with its shareholders; provided, however, that the period under item (iii) cannot exceed one year:
  - (i) The number of shares to be acquired (or, for a Company with Class Shares, the classes of the shares and the number of shares for each class); and
  - (ii) The description and total amount of the Monies, etc. (excluding the shares, etc. of such Stock Company. The same shall apply hereinafter in this Subsection.) that will be delivered in exchange for the acquisition of the shares; and
  - (iii) The period during which the shares can be acquired.

The resolution of a shareholders' meeting provided in Art. 156 (1) shall be made by a majority of the votes of the shareholders present at the meeting (Art. 309).

In addition, the amendment in 2003 conferred to the board of directors the right to determine share buybacks when the corporation set out the rule in its articles of incorporation.

### *Art. 165*

- (2) A Company with Board of Directors may provide in its articles of incorporation to the effect that the acquisition of own shares by Market Transactions may be prescribed by resolution of a board of directors meeting.

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21 There are many other methods of share buyback in the present Companies Act as shown in Art. 155. See KANSAKU / BÄLZ, *supra* note 8, 100-104. The Companies Act provides 24 articles dealing with share buybacks. The reason behind such a large number of provisions is explained as follows: the Companies Act admits share buybacks in most of the cases and simultaneously provides detailed procedures to prevent negative effects in each case (TATSUTA, *supra* note 10, 356).

22 All provisions in this article are quoted from an unofficial translation of the Companies Act which can be found on the website of the Ministry of Justice: Japanese Law Translation, [www.japaneselawtranslation.go.jp](http://www.japaneselawtranslation.go.jp) (last retrieved 21 January 2013).

As will be seen below, there are strong requests to conduct share buyback from the shareholders' side today in Japan, while many corporations take a negative stance regarding the buyback of their shares for various reasons. As seen above, the initiative of a share buyback is basically in the hands of management. A majority of the votes of the shareholders present at a shareholders' meeting is necessary to obtain the resolution of share buyback in the meeting.

Moreover, where the articles of incorporation so provide the board of directors can decide on a share buyback. A corporation can use this system only when it limits the term of office of the board of directors to one year (Art. 459(1)), while their term of office is normally limited to two years (Art. 332(1)).<sup>23</sup> This means that the amendment of the Commercial Code in 2001 delegates to the board of directors the right to determine the disposal of profits and, simultaneously, strengthens disclosure and monitoring of the management's decision-making. *I.e.* the Commercial Code gives the board of directors a broad discretion with regard to the distribution of profits, as dividends and by means of buybacks, while the board of directors is obliged to disclose its policy broadly and shareholders can check the management at every shareholders meeting<sup>24</sup> by using the majority of votes of the shareholders present at a shareholders' meeting to make the board resign. In addition, once the policy of incorporation provides that the shareholders' meeting shall not resolve the distribution (Art. 460(1)),<sup>25</sup> shareholders may amend the articles of incorporation by two-thirds of the majority of votes of the shareholders present at a shareholders' meeting if the shareholders want to set distribution by themselves. This means that it is hard for most shareholders to realise their will to request a corporation to carry out share buybacks.

However, it is interesting to observe that some Japanese corporations set out medium and long-term commitments to the market about certain amounts of buyback together with those of dividends in advance. In such an environment, shareholders' requests for a buyback are substantially followed up because they can observe the results of the commitments of the corporation, and third-party comments such as analyst reports are usually published just after shareholders' meetings. As with dividends, this is how shareholders' requests and the results of share buyback commitment are monitored in the Japanese market today.

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23 EGASHIRA, *supra* note 12, 365.

24 S. MORIMOTO, *Kabushiki kaisha ni okeru kikan kengen bunpai hōri* [The Legal Principles Concerning the Division of Responsibilities Between the Executive Bodies of the Stock Corporation], in: *Jurisuto Zōkan: Shin hōritsu-gaku no sōten shirūzu 5. Kaisha-hō no sōten* [Jurisuto Special Edition: New Legal Issues Series 5. Issues of the Companies Act] (Tokyo 2009) 95.

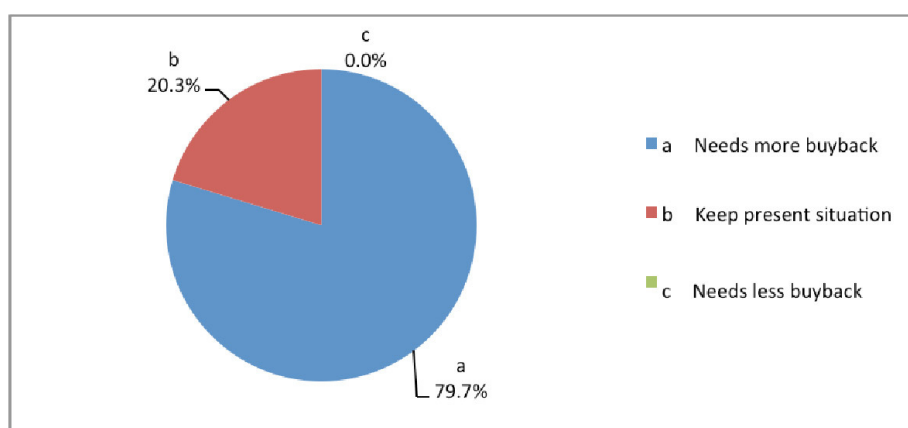
25 EGASHIRA, *supra* note 12, 622-624. Egashira also compares this provision with German Aktiengesetz Artt. 58, 174 and 254 together with the corresponding rules in the US and the UK.

### III. INVESTORS' AND CORPORATIONS' REACTION TO SHARE BUYBACK TODAY

#### 1. General recognition of share buyback from the side of investors and corporations

On the shareholders' side, there is a strong expectation that buyback will be used as a means of profit return, just like dividends. A survey by the Life Insurance Association Japan in 2011<sup>26</sup> shows that 79.7% of Japanese institutional investors strongly urge corporations to carry out more buybacks (*Diagram 5-1*).

*Diagram 5-1*



By contrast, a large number of corporations display a negative attitude towards buyback as shown in *Diagram 5-2*, which indicates that 62.2% of corporations have a negative view of buybacks. The reasons are diverse (*Diagram 5-3*), but many corporations seem to want to pay dividends rather than performing buybacks (28.1% of the firms). Although the uncertain market environments when this survey was conducted could have affected the stance of management regarding share buyback, the comparison with *Diagram 5-1* seems to show that shareholders have requested more share buybacks while management offers various reasons against share buyback, depending instead on their individual financial situations and the strategies of their businesses.

26 SEIMEI HOKEN KYÔKAI, *Kabushiki kachi kôjô ni muketa torikumi ni tsuite* [On the Efforts to Increase Stock Prices], available online at <http://www.seiho.or.jp/info/news/2012/0316.html> (last retrieved 21 January 2013). This association has conducted this survey from shareholders' and investors' standpoints since 1974. Samples of this survey were sent to the top 1,200 Japanese listed corporations based on market capitalisation (613 corporations replied) and 152 institutional investors (79 investors replied).

Diagram 5-2

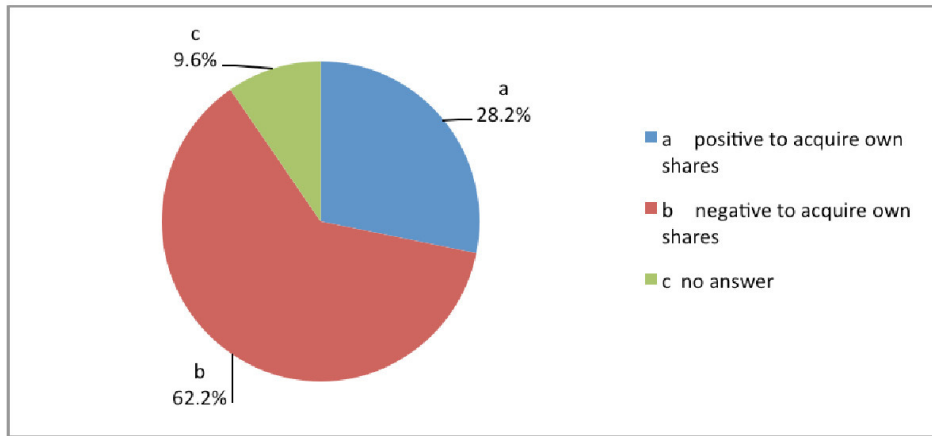
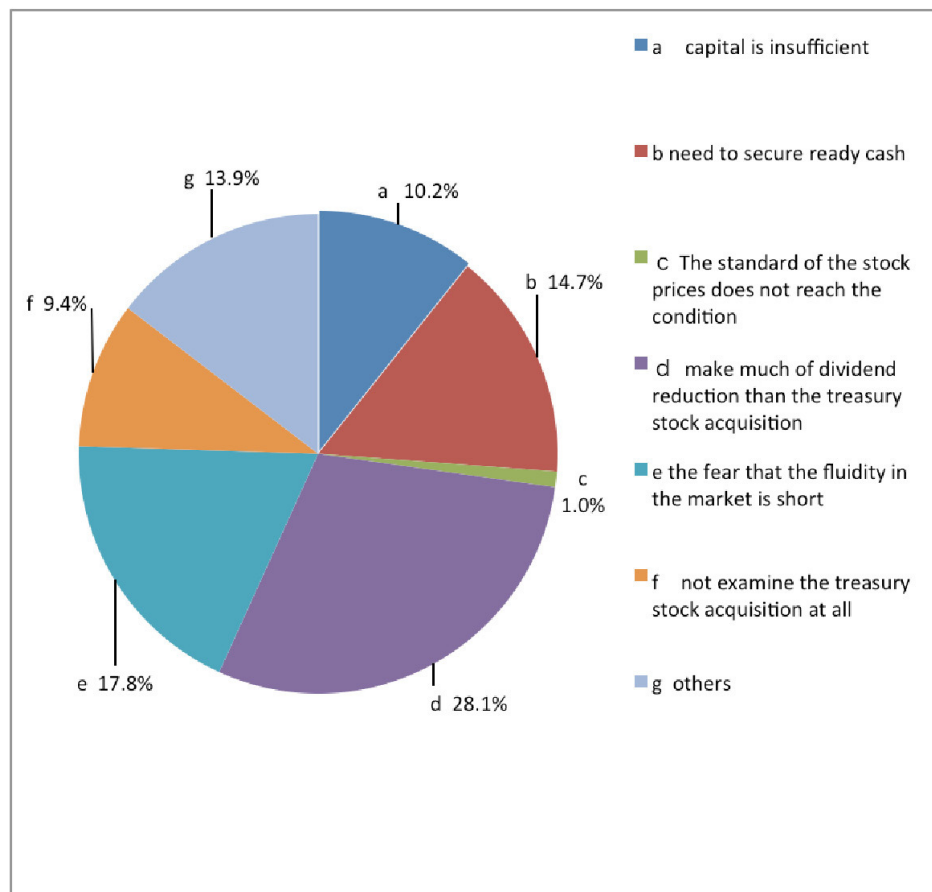


Diagram 5-3



## 2. *Commitments on share buybacks made to the market*

In contrast to the generally negative attitudes of corporations towards share buybacks in the above-mentioned research, we can see a variety of commitments of Japanese corporations regarding share buyback today. Although a comprehensive study on this issue goes beyond the scope of this paper, we will look at some patterns of their commitments about distribution, including dividends and share buyback.<sup>27</sup>

### *Table 2, 3*

#### *(1) Announcement prior to each buyback and no general policy on distribution policy*

This type of announcement simply expresses the corporation's basic policy on share buybacks.

<i>Corporation</i>	<i>Commitment to Buyback</i>
Corporation A	'We consider share buyback as a measure to return profits to shareholders. We will carry out share buyback properly for the purpose of improving the efficiency of capital.'

#### *(2) Announcement of a certain amount or ratio of share buyback in advance; no reference to cancellation*

Corporation B announces that it will carry out share buyback as well as pay dividends as a measure of shareholders' return. Also, it sets a goal of distribution which is 25% or more of its Total Return Ratio ((dividends + buyback)/net profit). But it does not explicitly disclose its stance on whether it will cancel the treasury shares.

### *Table 2*

<i>Corporation</i>	<i>Commitments to Buyback</i>
Corporation B	'We will invest more in the field of future growth, and will give stable dividends reflecting the result of our business. We set a goal to obtain 25% or more of Total Return Ratio combining dividends and share buyback.'

<sup>27</sup> These descriptions are all found on the website of Japanese listed corporations, but to keep the samples anonymous, necessary changes have been added about those sentences, keeping the same meanings as their original.

(3) *In addition to (2), explanations about the usage of treasury shares as well as goals of Total Return Ratio or those of cancellation*

In contrast to the two cases above, the following corporations explicitly set their goals of cancellation of treasury shares and indicate more detailed commitments of distributional policies.

Table 3

<i>Corporations</i>	<i>Commitments to Buyback</i>
Corporation C	'We will cancel the parts of our treasury shares which exceed 5% out of Issued Shares at the end of our fiscal year.'
Corporation D	'We will cancel the parts of our treasury shares which exceed 5% out of Issued Shares at the end of our fiscal year. The purpose of the treasury share is for a future M&A and strengthening of our business.'
Corporation E	'We consider dividends and share buyback as measures to return profit to shareholders. We hold up to X million treasury shares and will cancel the treasury shares above X million at the end of each fiscal half year. When there is no plan for large financial needs, we will keep the amount of shareholders return of both dividends and share buyback within 100% our Total Return Ratio.'
Corporation F	'As shown in our middle-term business plan, we set our new goal of Total Return Ratio from former Y% to Z%. While we have basically kept treasury shares once we acquired, we will in principle cancel the treasury shares hereinafter.'

There is an argument about whether the deregulation of treasury stocks should be justified. Egashira<sup>28</sup>, for example, claims that the deregulation of treasury shares is unnecessary. One of the reasons for this is that treasury shares would give corporations "double risks"<sup>29</sup> when the stock price goes down and the balance sheet of the corporation gets worse. Another reason is that the deregulation of the cancellation of a corporation's own shares is enough to give managements the tools to follow a flexible financial policy.

28 EGASHIRA, *supra* note 12, 240.

29 As to a counter-argument of the 'double risks', see T. FUJITA, *Jiko kabushiki shutoku to kaisha-hô (jô)* [Treasury Share Acquisition and the Companies Act (1)], in: Shôji Hômu 1615 (2001) 6-9.

On this point, an interesting tendency of some corporations' financial policies can be seen in the cases of Corporations C to F. Looking at the announcements of these corporations, it could be interpreted that they acquire their own shares to raise shareholders' return as well as to keep them as treasury shares – for example, for future possible M&A transactions – instead of cancelling them. However, when the treasury shares reach a certain level, their shareholders might fear that the corporation would resell the treasury shares into the market if they do not utilise them in an M&A transaction, and the resale may depress the share price. Therefore, these corporations announce that they will carry out share buybacks and hold them as treasury shares, but simultaneously announce that the treasury shares will be cancelled<sup>30</sup> when they exceed certain thresholds or when a certain period has passed.<sup>31</sup>

Aside from the legal argument above, we can see that some Japanese corporations try to keep their valuation of shares by showing both positive signs of shareholders' return and a flexible financial policy including treasury shares, and these policies are continuously followed up by market pressure and investors' watchful eyes as well as the power balance between shareholders and management as regards decision-making about share buybacks under the Companies Act.

#### IV. CONCLUSION

We saw in this paper the background of the share buyback rules in Japanese corporate law. As seen above, share buyback was basically prohibited with exceptions for a long time before the amendment of corporate law in 2001. Against this background, the 2001 reform was originally intended to establish countermeasures against hostile buyout and also to cope with the decline of stock prices. A decade has passed, and we can observe investors' positive expectations and corporations' various attitudes towards share buybacks. Furthermore, as an interesting consequence of the deregulation of share buyback rules, some Japanese corporations have set out clear commitments to the market as regards the amounts or the ratio of share buybacks together with dividends. While the attitudes towards share buybacks seems to largely depend on the financial situation and the business strategy of each corporation, share buyback is broadly accepted as one of the major tools providing shareholder returns in Japan today.

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30 Economically, the cancellation of treasury shares increases EPS (Earnings per Share). See Y. MURAMATSU, *Jiko kabushiki no rieki shōkyaku no jitsumu (jō)* [Practice Regarding the Amortization of Treasury Share Profits (1)], in: *Shōji Hōmu* 1399 (1995) 2-3. As regards the procedure, the Companies Act provides that a stock corporation may cancel its treasury shares, and in such cases, the stock corporation shall determine the number of treasury shares it intends to cancel (Art. 178).

31 As to the merit of treasury shares from the corporate side, FUJITA claims that there is basically no difference between the case of holding treasury shares and the case of the cancellation of treasury shares, because the corporation which cancels treasury shares could issue new shares if we ignore the cost to issue new shares. See T. FUJITA, *supra* note 9, 6-9.

## ABSTRACT

*This paper deals with the development of the rules on share buybacks under Japanese corporate law and analyses recent changes in the attitudes of management and shareholders towards this instrument. The authors observe that share buybacks are recognized today as a popular tool of shareholder return, whereas the deregulation of share buyback rules by the reform of 2001 was originally intended to give management a countermeasure against hostile takeovers under the market situation of stock price decline.*

*The first part outlines the gradual deregulation of the rules on share buybacks and the historical development from an absolute ban on share buybacks in the former Commercial Code to today's rules in the Companies Act, which in principle allows for share buybacks and treasury shares provided certain conditions are met. Particular attention is given to the various interests involved in the law-making process, the lobbying by business circles as well as the legislator's aims against the backdrop of the continuing economic slump.*

*In the second part the authors take a closer look at the reaction both by corporations and by shareholders to the deregulation of share buyback rules. Through statistical data it is shown that many shareholders view share buybacks positively and expect the corporation to use this instrument to increase their total return ratio. By contrast, the management of many corporations tends to take a negative view. Still, even corporations increasingly see share buybacks as a useful tool to enhance the attractiveness of their shares and to add flexibility to their financial policy. Some corporations today have made share buybacks an integral part of their strategy and explicitly commit to the market to engage in share buybacks.*

*(The Editors)*

## ZUSAMMENFASSUNG

*Der Beitrag beschäftigt sich mit der Entwicklung der Regeln zum Rückkauf eigener Aktien im japanischen Gesellschaftsrecht. Zugleich wird beschrieben, inwiefern sich die Funktion eines Aktienrückkaufs schwerpunktmäßig verlagert hat: Waren die Vorschriften mit der Reform von 2001 ursprünglich zu dem Zweck dereguliert worden, den Gesellschaften durch die Möglichkeit eines Rückkaufs eigener Aktien vor allem ein Mittel zur Abwehr feindlicher Übernahmeveruche an die Hand zu geben, wird diese Maßnahme seitens des Managements und der Aktionäre zunehmend als ein strategisches Mittel eingesetzt, um den Betrag der Ausschüttung je Aktie und damit die Attraktivität eines Investments in die Gesellschaft zu steigern.*

*Im ersten Teil beschreibt der Beitrag die regulatorische Kehrtwende, die sich vom ursprünglichen absoluten Verbot des Erwerbs eigener Aktien noch im damaligen Handelsgesetz über zwischenzeitliche Lockerungen bis hin zur gegenwärtigen Regelung im*



*Gesellschaftsgesetz vollzogen, nach der nunmehr der Erwerb und das Halten eigener Aktien unter bestimmten Bedingungen grundsätzlich erlaubt ist. Besonderes Gewicht legt die Darstellung dabei auf die verschiedenen Interessen und die Einflussnahme seitens der Wirtschaftsvertreter sowie die Intention des Reformgesetzgebers im Rahmen der weitreichenden Deregulierungs- und Flexibilisierungsmaßnahmen der 2000er Jahre vor dem Hintergrund der anhaltenden wirtschaftlichen Stagnation.*

*Im zweiten Teil des Beitrags gehen die Autoren näher auf die gegenwärtige Sichtweise und Erwartungshaltung von Aktionären und Management gegenüber dem Instrument des Rückkaufs gesellschaftseigener Aktien ein. Anhand statistischer Daten aus einer Befragung wird veranschaulicht, dass der überwiegende Teil der Aktionäre einem Aktienrückkauf durch die Gesellschaft positiv gegenüberstehe und hiermit die konkrete Erwartung an die Gesellschaft verknüpfe, dass diese eine höhere Gewinnausschüttung je Aktie vornimmt. Auf Seiten des Managements lasse sich hingegen aufgrund ganz unterschiedlicher Gründe eine generell negative Einstellung gegenüber einem Rückkauf eigener Aktien durch die Gesellschaft ausmachen. Zugleich werde der Aktienrückkauf jedoch zunehmend als ein geeignetes Mittel wahrgenommen, die Attraktivität der Aktien zu erhöhen und eine flexible Finanzierungspolitik zu betreiben. Jüngste Entwicklungen zeigen, dass einige Gesellschaften Aktienrückkäufe zum Bestandteil ihrer Unternehmenspolitik machen und entsprechend öffentliche Ankündigungen an den Markt tätigen.*

*(Die Red.)*