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■ CAPITAL MARKETS/CORPORATE GOVERNANCE

Performance shares, restricted stock and share repurchases: capital markets trends after the introduction of the Japanese Corporate Governance Code

I. Corporate Governance Code

Since its introduction in 2015, the Japanese Corporate Governance Code (the 'Code') has been a significant factor in the number and type of corporate transactions undertaken by listed companies in Japan. The Code has been promoted by the Japanese government with the aim of improving the mid to long-term profitability and productivity of Japanese companies with a particular focus on Return on Equity ('ROE'). One example of this kind of activity is the introduction of performance shares and restricted stock. Supplementary Principle 4.2.1 of the Code provides that:

> "*In order for management remuneration to operate as a healthy incentive for sustainable growth, the proportion linked to mid to long-term results and the balance of cash and stock should be set appropriately.*"

In light of this, many Japanese listed issuers are considering increasing the proportion of stock compensation linked to mid to long-term results.

II. New Performance Shares and Restricted Stock

Historically, many Japanese companies adopted stock options to incentivize management and employees. However, during slow economic times when the stock price was substantially lower than the exercise price, conventional stock options did not work as an effective incentive.

Recently, a different type of stock option has become popular among Japanese listed companies. The 'full value stock option' (in Japanese, '*kabushiki houshu-gata*' stock option) is issued with an extremely low exercise price (e.g., one Yen) and in most cases vesting of the stock option is not conditional upon or linked to the performance of the company or the respective directors or executive officers but can be done simply at the time of retirement or after a certain period of time.

Another relatively new arrangement in the past few years is the use of trusts for company directors or executive officers by which they can receive shares in the

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company depending on their performance.

In April 2015, in order to introduce simpler incentivization structures in Japan that do not involve trust arrangements, the Ministry of Economy, Trade and Industry released a report clarifying the legal issues relating to a new scheme of incentivizations; namely, Performance Shares and Restricted Stock.

III. Performance Shares

Here the company issues new shares or transfer treasury shares (with contractual transfer restrictions) or issues non-transferrable class shares directly to directors or executive officers. The transfer restrictions will only be lifted when certain performance criteria are satisfied, such as achieving an ROE target. If the performance criteria are not met, such shares will be acquired by the company for no consideration. Alternatively, the company may issue new shares or transfer treasury shares to directors or executive officers without transfer restrictions only upon satisfaction of certain performance criteria.

IV. Restricted Stock

Here the company issues new shares, transfer its treasury shares (with contractual transfer restrictions) or issues non-transferrable class shares directly to directors or executive officers. The contractual transfer restrictions will only be lifted after serving in office for a prescribed period of time (or until such shares are otherwise acquired by the company for no consideration). Alternatively, the company may issue new shares or transfer its treasury shares to directors or executive officers without transfer restrictions upon completion of continued service for a prescribed period of time.

In the case of both Performance Shares and Restricted Stock, directors and executive officers are expected to make contributions-in-kind as a company is not allowed to issue new shares or transfer treasury shares for no consideration under the Japanese Companies Act. In order to promote this new scheme, the government amended the tax law and related ordinance in March 2016 to allow certain types of performance shares and restricted stock (primarily in the case of performance shares and restricted stock issued with transfer restrictions) to be recognized as a corporate tax deductible.

V. Accelerated Share Repurchases

Another trend among listed Japanese companies is the rise in share repurchases. In the current weak stock market conditions, share repurchases by listed companies have become a popular way to immediately increase ROE or repurchase and reduce 'cross-shareholdings' among business partners. Cross-shareholdings in Japan are usually for the purpose of strengthening business relationships rather than for commercial investment purposes and reducing cross-shareholdings was strongly recommended by the Code in order to improve the capital efficiency of listed companies in Japan.

It is expected that later this year the Accounting Standards Board of Japan ('ASBJ') will issue new guidance with respect to Accelerated Share Repurchases ('ASRs'). In a typical ASR in the US, a company purchases shares of its own stock from an investment bank at a pre-specified price on a specific date (normally the closing market price on that day). The investment bank borrows the shares from its clients and assumes a short position that it will cover through open-market purchases over time - typically within one year. The company compensates the investment bank with additional cash or shares if the average price that the investment bank pays for the shares over the set time is higher than the initial repurchase price paid by the

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company. Conversely, the investment bank delivers extra cash or shares to the company if the average market price over the set time is lower than the initial repurchase price.

Although currently under discussion at the ASBJ, ASRs in Japan operate in a similar manner. A listed company can repurchase a proposed number of its own shares upfront on day one through ToSTNeT-3, a Tokyo Stock Exchange market for share repurchases that is separate from the auction market, at the previous day's closing market price. The number of shares the company has offered to purchase will always be matched by the number of tendered shares because a securities company will borrow the shares from a third party in order to tender them. On the other hand, under the relevant stock exchange rules, if the total number of tendered shares exceeds the number of shares the company has offered to purchase, then purchases from a securities firm trading on its own account (i.e., not acting as a broker), including the securities firm which borrowed the shares, will be subordinate to all other purchases.

Usually, the securities firm which borrowed the shares enters into an agreement with the company whereby:

(i) the company grants a stock option to the securities firm which may be exercised if the average price is higher than the initial repurchase price paid by the company; and

(ii) the securities firm commits to deliver extra cash to the company if the average market price is lower than the initial repurchase price paid by the company.

This scheme enables a listed company to acquire a pre-determined number of its own shares (and thereby increase ROE) immediately, subject to the adjustment mechanism described above, and effectively allows the company to repurchase its own shares at the average market price over a specified period of time.

LABOR AND EMPLOYMENT

Affirmative action for female workers in Japan? Developments in gender aspects of workplace laws

I. Introduction

Whilst successive Japanese governments have endeavored to increase female participation in the workforce, these efforts have noticeably doubled under the Abe administration. The number of female employees who continue to work after having children has been gradually increasing following the coming into force in 1985 of the Act on Securing of Equal Opportunity and Treatment between Men and Women in Employment (Act No. 113 of 1972) (the 'Equal Opportunity Employment Act') and in 1992 of the Act on Childcare Leave (Act No. 76 of 1991, currently the 'Act on Childcare and Caregiver Leave') (the 'Childcare Leave Act'). Nonetheless, the number of women holding managerial positions in Japan is still lower than in many comparable countries. According to a 2014 government survey, only 11.3% of managerial posts are held by women.

To address this situation, on April 1, 2016, the Act on Promotion of Women's Participation and Advancement in the Workplace came into force. Under the Act, an employer with more than 300 employees must create an action plan for increasing the number of female staff and their participation in business activities. This requires an employer to set specific numerical targets based upon an analysis of the ratio of newly hired female employees compared to males, the gender gap in relation to period of employment, the ratio of female managers to males and other relevant factors. This Act is considered a progressive step toward fulfilling the government's policy of increasing female labor market participation.

Given this increased focus recently, how to treat employees who are raising children has become a key management issue in Japan. Below is a brief overview of the maternity and childcare leave regimes in Japan and a recent Supreme Court judgment concerning these issues.

II. Maternity and Childcare Leave

In Japan, a female employee is entitled to take maternity leave for six weeks prior to the expected birth date and for eight weeks following that date under Article 65, Paragraphs 1 and 2 of the Labor Standards Act. Furthermore, under the Childcare Leave Act, an employee is entitled to take childcare leave for up to one year, which may be extended up to the date when the child reaches the age of 18 months if particular circumstances exist (e.g., a day care center for the child cannot be found given that in Japan there is a shortage of such centers). Some companies have introduced maternity and/or childcare leave arrangements under their relevant internal policies that are more favorable to female workers than the statutory entitlement.

Statutory protections are afforded to an employee who takes maternity or childcare leave. Article 9, Paragraph 3 of the Equal Opportunity Employment Act provides that an employer must not treat a female employee disadvantageously because she becomes pregnant or takes (or will take) maternity leave. Similarly, Article 10 of the Childcare Leave Act prohibits an employer from dismissing or otherwise treating an employee disadvantageously because the employee takes (or will take) childcare leave.

In this regard, on October 23, 2014, the Supreme Court handed down a judgment concerning maternity leave in the workplace which was on appeal from the High Court. The plaintiff, a female manager, consented to being demoted in order to receive light work duties during pregnancy. The employee also took childcare leave following the maternity leave. However, upon returning to work she was not reinstated by the defendant to her original managerial position. The Court was asked to consider whether such treatment should be regarded as disadvantageous treatment prohibited under Article 9, Paragraph 3 of the Equal Opportunity Employment Act and therefore deemed as unlawful.

The Court held that since Article 9, Paragraph 3 is a mandatory provision, a demotion made in violation of this article must be regarded as invalid. In connection with that premise, the Court held that a demotion for the purpose of receiving light work duties during pregnancy should be regarded as violation of this article, except where the circumstances show that an employee freely consented to such treatment or when there are reasonable

business grounds to justify the demotion. The Court remitted the case back to the High Court to determine whether such exceptional circumstances existed. That Court did not find that such circumstances existed and therefore found the treatment to be unlawful.

Judge Sakurai issued a supplemental opinion stating that Article 10 of the Childcare Leave Act is also a mandatory provision and the concept behind this provision is the same as that of Article 9, Paragraph 3 of the Equal Opportunity Employment Act. As such, it is likely that any disadvantageous treatment of an employee taking childcare leave would be regarded as invalid also.

In light of the foregoing, it is advisable for employers to carefully consider the treatment of workers who return to work after taking maternity or childcare leave. Nonetheless, employers have the discretion to ultimately determine their personnel affairs and need to consider providing equal treatment to their workforce. Japanese labor law does not compel a company to assign an employee who returns from maternity or childcare leave exactly the same previously held position. The company is allowed to transfer that employee to a different position provided that the new position is equivalent to the previous position and must give due consideration to that employee's circumstances if the change of workplace would make it difficult for that employee to take care of the children (Article 26 of the Childcare Leave Act).

III. Conclusion

The concept of workplace 'diversity' has also been gathering increased recognition in Japan. For example, in November 2015, a male employee who gender-identified as female sued his government employer, alleging that the employer's decision not to allow that employee to use the ladies' room was illegal. This is a rare case in Japan where an LGBT employment management issue was litigated. Employers would be well served to include workplace diversity as a top-of-mind issue when managing human resources in Japan.

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