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## Japanese Government Promulgates New Legislation to Impose Monetary Penalties on Violations of Substantial Shareholding Reporting Requirements

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*Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.*

On June 13, 2008, the Japanese government promulgated legislation that will amend and revise the Financial Instruments and Exchange Law of Japan (the “FIEL”). The amendments to the FIEL will become effective within six months after the date of promulgation (i.e., by December 12, 2008)<sup>1</sup>.

One of the amendments to the FIEL will reform the monetary penalty (*kacho kin*) system, and may have a substantial impact on investors with Japanese listed stock. Specifically, the amended FIEL will introduce monetary penalties for violations of the substantial shareholding reporting requirements, which generally apply to any person holding more than 5% of shares of a company listed on a Japanese stock exchange<sup>2</sup>.

Under the current system, which was originally introduced in April 2005, monetary penalties apply only to misstatements and omissions in offering disclosure documents and securities reports<sup>3</sup>, or violations of provisions prohibiting insider trading, stock market manipulation, dissemination of unfounded rumors and fraudulent conduct. The amended FIEL will expand the scope of violations subject to monetary penalties to cover, among others:

<sup>1</sup> As of the date of this newsletter, the effective date of the amended FIEL has not yet been determined.

<sup>2</sup> For an outline of the substantial shareholding reporting requirements under the FIEL, please see the English-language translation of our January 2007 newsletter titled “Revisions to Substantial Shareholding Reporting System”, available at <http://mofo.jp/news/updates/pdf/070122.pdf>.

<sup>3</sup> “Offering disclosure documents” (*hakko kaiji shorui*) means securities or shelf registration statements, including any amendments, supplemental documents (for shelf registration), and documents referenced in any of the foregoing, which are filed with the local finance bureau of the Ministry of Finance in connection with securities offerings. “Securities reports” (*yukashoken hokokusho to*) means annual, semi-annual or quarterly securities reports and extraordinary reports, including any amendments, which are filed with the local finance bureau of the Ministry of Finance pursuant to the FIEL.

- *Failure to File*: Failure to file a substantial shareholding report or an amendment report (collectively “**Substantial Shareholding Reports**”) in accordance with the requirements under the FIEL<sup>4</sup>, and
- *Material Misstatements/Omissions*: Making any misstatement of a material fact or omitting to state a material fact in any Substantial Shareholding Report<sup>5</sup>.

The monetary penalty for a violation of the substantial shareholding reporting requirements will be the aggregate market value of the relevant company as calculated under the FIEL<sup>6</sup>, multiplied by 1/100,000. Because there are large Japanese companies with more than ¥1 trillion (approximately U.S.\$10 billion) in aggregate market value, a monetary penalty related to shares of any such company could be larger than ¥10 million (approximately U.S.\$ 100 thousand). This formula will apply regardless of the number or percentage of shares held by the person who has violated the substantial shareholding reporting requirements.

The amended FIEL also will introduce a system that reduces the monetary penalty in a failure-to-file case to 50% of the amount calculated under the penalty formula described above, if the person voluntarily reports the violation to the Securities and Exchange Surveillance Commission of Japan (the “**SESC**”) before official investigation commences<sup>7</sup>. In contrast, under the amended FIEL, the monetary penalty will be increased to 150% of the amount calculated under the penalty formula, if the person has previously been subject to a monetary penalty for a violation of the FIEL within the past five years.

One important feature of the monetary penalty system is that the FIEL *requires* the Commissioner of the Financial Services Agency of Japan (the “**FSA**”) to impose monetary penalties on applicable violations. The amount of the monetary penalty is also determined automatically based on the FIEL-stipulated formula, as described above<sup>8</sup>. As the FIEL appears to

<sup>4</sup> For this purpose, any delay, however minor, in filing a Substantial Shareholding Report is likely to constitute a violation.

<sup>5</sup> Failure to file offering disclosure documents or securities reports, failure to comply with the tender offer procedures, illegal stabilization transactions and certain other violations will also become subject to monetary penalties under the amended FIEL.

<sup>6</sup> Market value is generally calculated based on the closing market price as of the day immediately following the (a) deadline for filing the Substantial Shareholding Report that should have been filed, in a failure-to-file case, or (b) filing date of the defective Substantial Shareholding Report, in a material misstatements/omissions case.

<sup>7</sup> According to the September 19, 2008 draft amendment to the cabinet ordinance related to the monetary penalty system, the report must be submitted to the SESC by direct delivery, registered mail or facsimile in the format prescribed in the ordinance. Under the draft amendments, the form must contain specific information regarding the violation. The violation must be reported before the SESC orders the person to submit reports or materials, or dispatches officials to inspect the person’s books, documents or other articles pursuant to Article 27-30, Paragraph 1 of the FIEL. If there are multiple violations, the monetary penalty will be reduced only with respect to the last Substantial Shareholding Report that should have been filed.

<sup>8</sup> The FIEL also provides for criminal sanctions for a failure-to-file or material misstatements/omissions case. Because the aims of monetary penalties and criminal sanctions differ from each other, both can be imposed on the same violation. With respect to criminal sanctions, a prosecutor has discretion to indict or not to indict a person in violation, and the court,

require that the FSA strictly enforce monetary penalties, it is not clear whether and to what extent the FSA has discretion to decide against imposition of any monetary penalty for a violation of the substantial shareholding reporting requirements. For instance, even an inadvertent violation may result in a monetary penalty.

It should be noted, however, that monetary penalties will not be retroactively imposed for violations that occur prior to the effective date of the amended FIEL<sup>9</sup>. Thus, before the amended FIEL becomes effective, you should review your portfolio with respect to Japanese stocks to verify that you are in compliance with the substantial shareholding reporting requirements under the FIEL. As necessary, you should cure any failures to make filings and correct any material misstatements or omissions contained therein, and establish an internal system to ensure timely and accurate filing.

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following indictment, has broad discretion to determine the criminal sanction upon consideration of facts surrounding the violation.

<sup>9</sup> A monetary penalty under the amended FIEL will apply to (a) any Substantial Shareholding Report required to be filed on or after the effective date of the amended FIEL, in a failure-to-file case, or (b) any Substantial Shareholding Report filed on or after the effective date of the amended FIEL, in a material misstatements/omissions case.