THE ROLE OF THE STATE IN THE PRIVATIZATION OF TELECOMMUNICATIONS

A Comparison Between British Telecom and Nippon Telegraph and Telephone

by

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ABSTRACT

This thesis contains an analysis of the role of the state in the privatization of two of the world's largest telecommunications operators, British Telecom (BT) and Nippon Telegraph and Telephone (NTT), illustrated by a comparative examination of the different means of intervention of the state at the three stages of the process, and the impact that state intervention has on the corporate governance of the enterprises concerned.

Chapter 1 clarifies the notions of privatization and control. On the one hand, privatization is defined in a broad sense as including deregulation, and in a narrow sense as transfer to private ownership. On the other hand, control is divided into two parts: the first, "internal control" consists of two elements; the power to influence decision-making process and the power to appoint and remove directors. The second, "external control", means constraints imposed on a company from outside.

The subsequent chapters are organized on the basis of the percentage of shares held by the state. Chapter 2 analyzes the legal problems accompanying "complete control" of the state during the corporatization stage of privatization, in which there is a one-man stock company with the state as sole shareholder. Chapter 3 outlines the different private and public law devices used by the state in order to exercise "internal control" on the company after the sale of part or all of the government-owned ordinary shares. Chapter 4 focuses on the

"external control" which is the last weapon of the state to monitor enterprises that are already deemed to be "privatized" from an ownership point of view.

The thesis concludes that when the targets of privatization are public utilities, "internal control" by the state is inevitable for a certain period of time. Whether in the form of a "golden share", or a requirement of continuous shareholding by the state, this form of control always has the effect of distorting the market for corporate control. However, in the process of privatization, due to deregulation and liberalization of the sector as whole, the role of the state is gradually reduced and ends up as limited merely to "external control". This "external control", which is always of a public law nature, also takes on different forms: regulation by a newly established regulatory body, or approval by the minister in charge of the industry. And it will continue to exist as long as the "privatized concern" has social objectives to fulfill.

Nowadays, while the technological changes in telecommunications call for privatization and liberalization, protection of "public interests" call for the introduction of safeguards. Privatization of BT and NTT are important examples of the different ways of developing such safeguards.

SOMMAIRE

Cette thèse présente une analyse du rôle de l'État dans la privatisation de deux des plus grands opérateurs de télécommunications du monde entier, British Telecom (BT) et Nippon Telegraph and Telephone (NTT) qui est illustrée par l'examen comparatif des différentes méthodes d'intervention de l'État au cours des trois étapes de la privatisation et de son influence sur « le gouvernement » (le « corporate governance ») des entreprises concernées.

Le Chapitre 1 éclaircit les notions de privatisation et contrôle. D'une part, au sens large, la « privatisation » est définie comme incluant la déréglementation et au sens strict, comme le transfert de l'entreprise au secteur privé. D'autre part, le « contrôle interne » est défini comme composé de deux éléments, le pouvoir d'influencer la prise de décisions et le pouvoir d'élire et de révoquer les administrateurs, tandis que le « contrôle externe » renvoie aux contraintes imposées à l'entreprise de l'extérieur.

Les chapitres suivants sont organisés selon le pourcentage d'actions détenues par l'État. Le Chapitre 2 présente une analyse des problèmes juridiques qui accompagnent le « contrôle absolu » par l'État pendant l'étape de transformation de l'entité en société commerciale par actions dont l'État est l'actionnaire unique. Le Chapitre 3 examine les différentes mesures de droit public ou privé utilisées par l'État afin d'exercer un « contrôle interne » suite à la vente partielle ou totale de ses actions ordinaires. Enfin, le « contrôle externe », qui est la dernière arme de l'État pour surveiller les entreprises

considérées comme complètement « privatisées » du point de vue de la propriété des actions, constitue le thème central du Chapitre 4.

La thèse énonce en conclusion que lorsque les entreprises de service public font l'objet de la privatisation, le « contrôle interne » de l'État s'avère inévitable pendant un certain temps. Que ce contrôle prenne la forme d'une « action spécifique », dite « golden share », ou celle d'une détention continue des actions par l'État, il a toujours pour effet de déformer le marché du contrôle corporatif. Pourtant, du fait de la déréglementation et de la libéralisation du secteur qui se produisent parallèlement à la privatisation, l'intervention de l'État diminue progressivement jusqu'à la phase où elle se réduit au « contrôle externe ». Ce dernier qui est toujours de nature publique se fait sous différentes formes : réglementation par un nouvel organisme constitué pour ce but, ou approbation par le ministre en charge du secteur. Ce contrôle externe continuera à exister tant que l'entreprise a des objectifs sociaux à poursuivre.

Aujourd'hui, l'on peut noter qu'alors que les changements technologiques mènent à la privatisation et la libéralisation des télécommunications, la protection des « intérêts publics » impose l'introduction de mesures de protection. Les privatisations de British Telecom et Nippon Telegraph and Telephone sont d'importants exemples des différentes façons de développer de telles mesures.

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And last but not at least, I must apologize to my family for all these years being away from home.

TABLE OF CONTENTS

ABBREVIATIONS

AA	Articles of Association
BT	British Telecom
CA	Companies Act (Britain)
CC	Corporation Code (Japan)
C & W	Cable and Wireless
DTI	Department of Trade and Industry
EC	European Community
ITJ	International Telecom Japan
KDD	Kokusai Denshin Denwa
MF	Ministry of Finance
MMC	Monopolies and Mergers Commission
MPT	Ministry of Post and Telecommunications
NTT	Nippon Telegraph and Telephone
NTTCA	NTT Corporation Act (NTT Companies Act)
OFTEL	Office of Telecommunications
TA 1984	Telecommunications Act 1984
WTO	World Trade Organization

INTRODUCTION

Over time the state has used different policies to keep or, in some instances to strengthen, its controlling power over enterprises having business activities that are important to the public. One example is the use of administrative methods, such as directions, orders or instructions, or setting out supervisory powers in special laws. In extreme situations the state has gone even further, putting the enterprises under its direct supervision by nationalizing them.

However, in the 1980s, a trend completely opposite to the earlier nationalization trend spread around the world to become a dominant element in the political agenda of almost every country; this was the trend to privatize and liberalize public enterprises. There are various reasons for this, such as dissatisfaction with the manner of managing the enterprises, the increased need for funds, or globalization of the industry. All of them call for restructuring and changes in management and enterprise behavior. Regardless of where privatization is taking place, and what are the specific reasons for it, whenever large enterprises and public utilities with monopoly market position are involved, privatization and liberalization are usually carried out in parallel. In some cases the government takes steps to accelerate privatization and gradually to liberalize the market, in others it liberalizes and deregulates while selling part of the shares of the enterprise. Both are equally important to the restructuring of the enterprise. This is so because not only it is necessary for competition to be introduced, but

also that a durable transfer of control of the enterprise to private investors be fulfilled, and that the role of the state be changed.

One of the industries most significantly affected by the wave of privatization and liberalization is telecommunications. This is an economic sector universally subject to strict government regulation and, in most countries, under government ownership. On the other hand, this is a sector in which technological developments[1] have been the catalyst for changes in industry structure, but ultimately political institutions have determined the policy responses of different nations. Britain and Japan were among the first countries to undertake privatization and liberalization of their domestic telecommunications industry in 1984[2], moving British Telecom (BT) and Nippon Telegraph and Telephone Corporation (NTT) from "natural" state monopoly and control to the private sector and free market[3]. Before their privatization, both telecoms underwent almost the same interim development of being government departments and public corporations[4]. At the time of their privatization, both countries had already

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[1] Examples include satellite communications, fiber optics, and advances in microelectronics resulting in convergence between computer and telecommunications technology.

[2] Privatization of Cable and Wireless (C&W) and Kokusai Denshin Denwa (KDD), the international telecommunications providers of Britain and Japan respectively, are not within the scope of this study. The sale of shares in C&W was undertaken under the British Telecommunications Act 1981 and carried out in several tranches, the last of which was in 1985. See especially Peter J. Curwen, *Public Enterprise. A Modern Approach* (Harvester Press, 1986) at 177-78; Robert Frazer & Michael Wilson, *Privatization: The UK Experience and International Trends*, R. Frazer, ed., (Longman, Keesing's International Studies, 1988) at 23-25. The sale of all the outstanding shares in KDD was accomplished from 1953 to 1956. See especially Touyama, Yoshihiro, "Koukigyou Kaikaku to Tokushu-kaisha" (The Reform of Public Enterprises and Special Companies) (1982) 27 Kouei-hyouron 4 at 10.

[3] On the shift from state monopoly to the private sector worldwide, see the figure in *The BT/MCI Global Communications Report 1996/97, Liberalizing Telecoms*, online: BT <http://www.bt.com/global_reports/bt_mci/section4.htm> (date accessed: 5 February 2000).

[4] The difference is that before 1912 BT operated as a private company that was then nationalized, while NTT was never a private company before its privatization.

established corporate governance structures, with a leading role for institutional investors in Britain and for legal entities - "stable shareholders" through cross shareholding in Japan. Both countries had well-developed stock exchange markets, which were able to cope with large flotations on the scale of BT and NTT. Therefore attracting foreign investments, often a goal for newly developing countries, or boosting domestic stock exchanges, a goal in other developed countries, were not the main purposes of the privatizations in Britain and in Japan. This background might suggest that both governments took a similar approach to the privatization and liberalization of their telecoms. Nevertheless, although new legislation allowing the privatization of these enterprises was passed in the same year of 1984, the process developed in different ways and at a different pace, involving the use of novel corporate and regulatory techniques.

This study will examine and compare the different approaches of the British and Japanese governments to privatization and liberalization of telecommunications, the continuing role of the state in this process, and the impact that it has had on the corporate governance structure of these enterprises. It will outline as well the regulatory regime of the industry, taking the form of deregulation in Japan and regulation by a new sector-specific regulatory body in Britain.

The first Chapter will define the notions of privatization and control in order to establish the theoretical framework in which this study will be carried out. Privatization is defined as the transfer of public enterprises to the private sector, and liberalization as opening the market to new entrants and introducing

competition. Control is considered from a corporate governance point of view to be "internal control" where two elements are present, namely the power of the controlling shareholder to appoint and dismiss directors, and the power to pass important to the company resolutions. On the other hand, "external control" is related to continuous supervision by the minister or with a "regulatory control" exercised by a newly created regulatory body. In both cases it consists of constraints imposed on the "privatized" entity.

Privatization of large enterprises is a long process, usually accomplished by the sale of shares in several stages. Thus the first step toward privatization is "corporatization", *i.e.* the transformation of the public corporations into stock companies with the state as sole shareholder. The state, therefore, can exercise complete control over these one-man stock companies merely by exercising its rights as sole shareholder to appoint the directors and to take decisions on important corporate matters. The significance of this first stage is mainly in the creation of a share structure, in order to further proceed with the privatization by selling the shares on the stock market. Therefore this is usually a short period preceding the sale. However, some legal problems during this first stage cannot be ignored. They will be the focus of Chapter 2.

At the next stage, after the sale of a certain percentage of the government-owned shares, the state undertakes different measures in order to prevent a new controlling shareholder from emerging. This has the counter-effect of entrenching the controlling power of the state. In Japan, for instance, provisions regarding the continuous holding by the government of a certain percentage of all the

outstanding shares have been introduced in the special NTT Corporation Act. This is accompanied by the requirement that the Minister of Post and Telecommunications (MPT) approves certain resolutions, which otherwise are within the competence of shareholders meetings or the board of directors. In Britain, a new class of share(s) to be owned only by the government has been set out in the memorandum and articles of association of BT, giving the state the right to outvote decisions on important corporate matters and to appoint government directors. At the same time, the provided restrictions on the shareholdings, or preferences on the purchase of shares, have the effect of dispersing the shares to numerous shareholders, preventing their concentration in a small number of shareholders that might oppose or oust the state. The features of these techniques of continuous influence on the "privatized enterprise" by the state and their impact on corporate governance structure will be analyzed in Chapter 3.

One of the peculiarities that marked the development of the NTT privatization process is the recent transformation of NTT into a pure holding company without business operations, and its indirect divestiture into two regional companies and one company that is to operate internationally. From a corporate governance point of view, this has the effect of creating a new shareholder - the holding company itself - which affects the relationships between the government, current shareholders of NTT, the holding company and its subsidiaries. The related legal problems will be outlined in Part 3.3.2 of Chapter 3.

Finally, the focus in Chapter 4 will be on the "external" regulatory control by the state over the "privatized concerns" after the sale of all government-owned shares. In Japan this is exercised by the Minister of Post and Telecommunications (MPT), while in Britain by the Office of Telecommunications (OFTEL), a new regulatory body created for this purpose. This type of control was provided for by the initial acts regarding the privatization of BT and NTT and the act regarding telecommunications in Japan, but becomes very important at this stage because it remains the only means of the state to monitor the companies. In addition, in Japan the power of the MPT to approve certain decisions and to supervise NTT remains, even at this stage. This is probably one of the reasons why the Japanese government proceeded more straightforwardly with deregulation, while the British government was more concerned with creating a new form of regulation of the sector as whole.

In this study an effort will be made to examine and analyze how the role of the state has been changing during the process of privatization and liberalization of BT and NTT, and to answer the question as to whether there was in fact a withdrawal of the state from the industry. It seems at first sight that the sale of shares resulted in a radical separation between the government and the privatized concern, but in practice the role of the state was veiled by the use both of private law forms for public purposes, and of public law regulatory constraints. As a result, rather than a "rolling back [of] the frontiers of the state" occurring, there was a redefining of its role and a replacement of one form of intervention with another.

1 DEFINITION OF THE NOTIONS

1.1 Privatization

There has been no universal definition of the notion of "privatization". The term is now used in many different senses within Britain and in a large number of other countries. However, there has never been any definition by the British government itself, despite the fact that privatization as a widespread and frequent phenomenon started from Britain. Ministers, in their speeches on the subject, have used the words "returning state-owned companies to the private sector", "contracting out services to the private sector", "liberalization" and "deregulation"[5]. Some authors[6] distinguish four separate components grouped under the term of privatization: 1) privatization of financing a service that continues to be produced by the public sector; 2) franchising to private firms of the production of state financed goods and services, *i.e.* contracting out; 3) denationalization, *i.e.* the sale of publicly owned assets; 4) liberalization or deregulation. This means that the term is used to cover several distinct, and possibly alternative, means of changing the relationships between the government and the private sector, *i.e.* privatization in its broad sense. Other commentators

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[5] Kenneth Wiltshire, *Privatisation: The British Experience* (CEDA Study, Longman Cheshire, 1987) at 16.

[6] David Heald, "Privatization: Analysing its Appeal and Limitations" 5:1 Fiscal Studies at 36-46; David Steel & David Heald, "The New Agenda" in D. Steel & D. Heald, eds., *Privatizing Public Enterprises* (London: Royal Institute of Public Administration, 1984) 13 at 13; J. Shackleton, *Privatisation: The Case Examined*, at 59-60. In Japan, all but the first type are considered to be forms of privatization. Kato, Hiroshi, "Discussions on Reform of the JNR" [1987] The Annual of Japan Economic Policy Association at 35.

consider privatization not to be a policy, but an approach, and one that recognizes that "the regulation which the market imposes on economic activity is superior to any regulation which men can devise and operate by law"[7].

On the other hand, in its narrower sense privatization is used in Britain to mean denationalization, which is most commonly defined as the transfer of government-owned industries to the private sector, implying that the predominant share in ownership of assets on transfer lies with private shareholders[8]. The same definition is also used in Japan, despite the fact that NTT has never been nationalized. Privatization in this sense cannot be brought about by modification of the public corporations system and rationalization, but rather by decisive reforms in the system of public corporations itself, and changes in their management[9]. The way to achieve this is to form a company under the company law of the respective country[10] and subsequently to partially or completely sell the shares to private shareholders[11]. Thus, to privatize is to render private[12]. It is to

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[7] Madsen Pirie, *Privatization in Theory and Practice* (Aldershot, Hampshire: Wildwood House, 1988) at 2-3.

[8] D. Clementi, "The Experience of the United Kingdom" in Asian Development Bank, *Privatization* (1985) at 171.

[9] Touyama, Yoshihiro, *supra* note 2 at 4.

[10] In Japan, for instance, the concept of privatization is even sometimes narrowed to mean the process of transformation of public enterprises into private companies. This was expressed in the official reports of the Provisional Commission on Administrative Reform (Rinji Gyousei Chyosakai) cited in Tamamura, Hiromi, "Min'eika kigyou to koueki-jigyou kisei - NTT-wo chyushin-ni" (The Privatized Enterprises and Public Utilities Regulation - Focusing on NTT) 25-1-2 Ritsumeikan Keieigaku 71 at 71. But the process of privatization is not always related to "corporatization". Ishido, Masanobu, "Waga-kuni ni-okeru min'eika-kabushiki-no baikyaku joujou ni-tsuite - sono purosesu-wo rissuru-mono" (The Sale and Flotation of Privatized Shares in our Country - Legalization of the Process) 43-3 Koueiki jigyou 63 at 65.

[11] M. Beesley & S. Littlechild, "Privatisation: Principles, Problems and Priorities" in Matthew Bishop, John Kay & Colin Mayer, eds., *Privatization & Economic Performance* (Oxford University Press, 1994) 15 at 15; J. J. Richardson, "The Politics and Practice of Privatization in Britain" in Vincent Wright, ed., *Privatization in Western Europe: Pressures, Problems and Paradoxes* (Pinter Publishers, 1994) 57 at 59-60; Ian Snaith, "Grande-Bretagne: la phase de maturité" in Fabrice Dion, ed., *Les Privatisations en France, en Allemagne, en Grande-*

place the activity or the industry in the private sector or to transfer the ownership of an asset to private ownership, thereby withdrawing the state from the production of goods and services and reducing its role in making basic decisions about resource allocation[13].

To render private, however, does not mean that privatized companies operate as completely private entities. In both countries a distinction is made between "privatized" and "private" companies. In Britain, a state-owned firm is considered to be privatized if a large proportion of its equity, usually in excess of 50 per cent, is sold to private investors[14]. Therefore, even in the case of partial privatization the company is considered "privatized" in Britain. On the other hand, for a company to be considered "privatized" in Japan, it is necessary for all the government-owned shares to be transferred to private investors[15] and the special act on privatization of the company to be repealed[16]. Therefore, "privatized" in Japan is associated with "full privatization". Thus it can be said

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Bretagne et en Italie (Les Études de la Documentation Française, 1995) 139 at 140. In Japan, the notion of privatization is used to mean the partial introduction of private ownership, and/or private management, to public enterprises, and the increasing of their autonomy. Tamamura, Hiromi, *supra* note 10 at 71-72.

[12] This should not be confused with the expression "going private" for a "public company", *i.e.* a company previously trading its shares on the stock market to cease to do so. Sometimes, the term privatization is used in this meaning as well. Sir Adrian Cadbury, *The Company Chairman* (Director Books, 1990) at 190, 202.

[13] Cento Veljanovski, *Selling the State: Privatization in Britain* (London: Weidenfeld and Nicolson, 1987) at xi, 1.

[14] *Ibid.* at 1-2; Privatization in this sense is referred to as "denationalization" by Peter J. Curwen, *supra* note 2 at 163; M. Beesley, & S. Littlechild, *supra* note 11 at 15.

[15] Privatization of Kokusai Denshin Denwa Kaisha (KDD), the Japanese corporation operating international telecommunications, was achieved in a short period of three years from May 1953 to March 1956, during which period all the outstanding shares of the corporations were sold, thus its existence as a mixed enterprise with public and private ownership was short. Touyama, Yoshihiro, *supra* note 2 at 10.

[16] See *supra* note 167, below.

that privatization in Britain is related to the reduction of the state participation in the capital of the company to a certain extent, while in Japan it is related to the complete withdrawal of the state from the company's operations.

In this study the term "privatization" will be used in its narrow sense of transfer of public sector enterprises to private ownership; a transfer that involves not only transfer of the ownership, but also encompasses the transfer of "internal control" over the enterprises to private investors[17]. This is part of the fundamental process of redefinition the role of the state, another element of which is liberalization, in the sense of opening up the activities of public enterprises to competition, and relaxing arrangements that prevent private sector firms from entering markets previously exclusively supplied by the public sector. In this respect the focus in Japan has been on deregulation, which resulted in gradual relaxation of the rules governing the industry[18], while in Britain the main concern was to find a new way to regulate the industry, which resulted in replacing the monitoring by the government with monitoring by a regulatory body. Nevertheless, a degree of "external control" over the "privatized concerns" by the

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[17] Stilpon Nestor & Marie Nigon, "Les Privatisations en Europe, Asie et Amérique Latine: Quels sont les Enseignements à Tirer?" in *La Privatisation en Europe, Asie et Amérique Latine* (OCDE poche No.10, 1996) 9 at 11; Dominique Carreau, "Aspects Juridiques et Institutionnels des Privatisations" in *La Privatisation en Europe, Asie et Amérique Latine* (OCDE poche No.10) 123 at 123.

[18] Deregulation in Japan is defined in two ways: first, as deregulatory measures directed to release the market or some segments of the market; and second, as the abolition of state regulation over public enterprises or decreasing the level of regulation concerning public enterprises. Therefore, privatization and deregulation in Japan are very closely joined and even mixed. Marianna Strzyzewska-Kaminska, "The Privatization Processes in Japan in the 1980s" in V. V. Ramanadham, ed., *Privatization - A Global Perspective* (London, New York: Routledge, 1993) 491 at 491.

government in the form of regulation, although gradually diminishing, continues to exist even after a 100 per cent transfer of the shares to private investors.

Before examining the role of the state at the different stages of the transfer of internal control and the reduction of external control, it is necessary first to explain the meaning of the term "control" in relation to corporate governance, in order to complete the framework in which this study will be undertaken.

1.2 The Notion of Control

There are many different studies[19] regarding the control in a company. Usually, "control" is considered to mean the power to appoint and remove the directors of the company and the power to influence resolutions on matters fundamental to the company, such as resolutions on changes in the articles of association[20] or on dissolution of the company. All these resolutions have to be passed by the shareholders at their general meetings with a majority of the voting

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[19] Adolf A. Berle & Gardener C. Means, *The Modern Corporation and Private Property*, 5th ed. (New York, 1936) at 66; R.A. Gordon, *Business Leadership in the Large Corporation* (New York, 1945) at 36; Joe S. Bain, *Industrial Organization* (New York, 1959) at 71-77; J.E. Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Oxford: Clarendon Press, 1996) at 52; Sochi, Youji, *Waga-kuni kabushiki-kaisha ni okeru kabushiki bunsan to shihai* (The Dispersal of Shares and Control in our Corporations) (Doubunkan, 1936) at 74; Mikata, Masao, *Kaitei-kaishahou-gaku, Shin-kabushiki-kaisha-hou II* (Revised Company Law, The New Law of Corporations II) (Yubungaku, 1953) at 419; Hirose, Yuichi, *Kabushiki-kaisha shihai-no kouzou* (The Structure of Control of Corporations) (Nihon-hyouron-shinsha, 1963) at 7; Ikeda, Naomi & Nakamura, Kazuhiko, *Kabushiki-kaisha shihai-no houteki kenkyuu* (Legal Study on the Control of Corporations) (Hyouronsha, 1959) at 16; Hishida, Masahiro, *Kabunushi-no giketsuken-koushi to kaisha shihai* (The Exercise of the Shareholders' Voting Rights and the Control of the Company) (Sakai-shoten, 1960) at 25; Hirata, Mitsuhiro, *Waga-kuni kabushiki-kaisha-no shihai* (The Control of Corporations in our Country) (Chikura-shobou, 1982) at 1; Katayama, Goichi & Kondou, Taiji, *Gendai kabushiki-kaisha-no shihai kouzou* (The Structure of Control of Modern Corporations) (Minerva-shobou, 1983) at 5-7.

[20] In Japan, with respect to corporations, articles of association are referred as articles of incorporation.

shares[21]. This means that in order to control a company it is necessary for a shareholder or group of shareholders to hold more than fifty per cent of all the outstanding voting shares[22], or whatever majority is necessary if other than fifty per cent. However, the percentage of shareholding necessary to gain control is not this simple since, as the degree of dispersal increases, effective control can be exercised with a decreasing proportion of the votes, and certainly with considerably less than the majority required for a shareholder or group of shareholders to have the right to remove directors or to make decisions in key areas[23]. This is valid to the same extent with respect to large corporations, established under company law, and to large entities undergoing privatization.

The percentage of voting shareholdings has been used as a criterion for the classification of companies in numerous empirical and analytical studies[24]. The

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[21] "If we consider the shareholders rights as a variety of the property rights, it can be said that while the usus is transferred to the managers, the fructus in the form of rights in personal interest and its potestas (alienation) in the form of rights in common interest are retained by the shareholders. Therefore, the rights in common interest are the most important among other rights of shareholders because they enable them to control the managers and to protect and maximize their rights in personal interest. As the core element of the property rights the rights in common interest are called rights of control. And the most important among them are the voting rights. For this reason, it is possible to narrow the rights of control to the voting rights of the shareholders." Ikeda, Naomi & Nakamura, Kazuhiko, *supra* note 19 at 24-25.

[22] Only for reference, "control" is defined in the *Petro-Canada Public Participation Act* (P-11.1, 1991, c.10), the act respecting the privatization of the national petroleum company of Canada, in the following way. "A body corporate is deemed to be controlled by a person if (i) securities of the body corporate to which are attached more than fifty per cent of the votes that may be cast to elect directors of the body corporate are held, otherwise than by way of security only, by or for the benefit of that person, and (ii) the votes attached to those securities are sufficient, if exercised, to elect a majority of the directors of the body corporate" (s.9 (7)(a)).

[23] J.E. Parkinson, *supra* note 19 at 59.

[24] In Britain, where the matter has been less extensively researched than in the US, Florence reported in 1961, on the basis of data from more than 1,000 companies, that two thirds of the "very largest" companies were controlled by management and that the tendency towards the dispersal of shareholdings was increasing. P.S. Florence, *Ownership, Control and Success of Large Companies* (London, 1961) at 85. The approach of classifying control on the basis of fixed percentages is likely to produce misleading results in some cases. A shareholder or a group of shareholders can be regarded as having control when it is likely that they would win a

classical example is the categorization of six different types of control made by Berle and Means in "The Modern Corporation and Private Property": (1) "complete control" based on 80% or more ownership of voting shares by a group of shareholders; (2) "majority control" based on 50% or more ownership by a "controlling shareholder"; (3) "minority control" where the "controlling shareholder" owns less than 50% but more than 20% of shares; (4) "joint minority-management control" where the core shareholder or group of shareholders owns less than 20% but more than 5% of the voting shares; (5) "management control" where the shares are widely dispersed and the ownership of the core shareholder or group of shareholders is less than 5%; and (6) "control by a legal device" such as pyramidal holding by a holding company, the use of non-voting preferred stock, or proxies[25].

The same approach has been used in Japan by Professor Sochi who, in an analysis in 1934 of a number of Japanese companies, distinguishes "majority control", "minority control", "pyramidal control", along with "control by financial institutions", and "governmental control"[26]. The last category of "governmental control" is of great interest to the present study. By "governmental control", Prof.

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contested vote, but this can be determined by examining the degree of dispersal of shareholdings within the individual company concerned. J. Cubbin & D. Leech, "The Effect of Shareholder Dispersion on the Degree of Control in British Companies: Theory and Measurement" [1983] Economic Journal 355-63. Yet Nyman and Silberston, while making use of fixed percentages, also insist that the location of control can only be discovered by a case by case approach. They argue that "for many firms there is an effective locus of control connected with an identifiable group of proprietary interests", which crude statistical tests may fail to reveal. S. Nyman & A. Silberston, "The Ownership and Control of Industry" [1978] Oxford Economic Papers 80.

[25] Berle & Means, *supra* note 19 at 93. According to them the prevailing form in then (1932) American corporate society was "management control".

[26] Sochi, *supra* note 19 at 80.

Sochi means control by the government without any shareholdings in the company, but with the power, provided in a special law, to appoint and dismiss the "top managers"[27]. This definition hints that even when the state has the power to intervene - to monitor or to supervise on the basis of a special law - this does not represent control over the company unless it involves the appointment and dismissal of the top managers[28].

Thus, it can be concluded that the monitoring exercised by the state under any law on specific business activities does not necessarily mean that the state controls the company, unless it is related to the appointment and dismissal of the top managers. Furthermore, according to this definition, if the government has invested in a company, it is possible for this investment not to lead to a "governmental control". For this reason, Prof. Sochi classified almost all "public utilities", such as electricity and gas enterprises, in the category of "management controlled" enterprises[29]. In other words, "governmental control" is not necessarily related to ownership. It can be achieved by other means.

On the other hand, "constraints" are considered to be a form of control "as they shape the decisions made by limiting the scope of choice". This includes the power of veto, the power to consult, and/or the power to displace the active management. But "constraints usually involve power over only a narrow range of corporate activities, so that they amount to partial control rather than control

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[27] On the "governmental control" on private enterprises with specific business activities (such as the Bank of Japan and other specialized banks), see *ibid.*
[28] *Ibid.* at 75.
[29] *Ibid.* at 157.

over the entire spectrum of major decisions"[30]. Thus, the existence of management control subject to constraints can be accepted in appropriate cases[31].

It is generally recognized that the state has no right to intervene in the affairs of the companies in the name of public good, other than by traditional means of altering the background legal constraints within which all businesses must operate. However, it can be said that this is not absolutely valid with respect to companies undergoing privatization. Although the main objective of privatization has been to achieve the withdrawal of the state from business activities inappropriate to it, in some industries - one of which is telecommunications - even after the complete sale of government-owned ordinary shares the state still continues to exercise "control", by means of company law devices and/or different constraints, introduced by special statutes.

Keeping in mind that it is not absolutely necessary to require shareholding by the state in order to consider that it "controls" the enterprise, in this thesis the term "control" will be referred as "internal" or "external" depending on whether it is exercised from inside or from outside the company. From a corporate governance point of view, the term "internal control" is used as consisting of two elements, namely the power to appoint and dismiss the directors and the power to make decisions on issues fundamental to the company. On the other hand, the term "external control" is used to mean continuous supervision by the minister in

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[30] E.S. Herman, *Corporate Control, Corporate Power* (Cambridge, 1981) at 21.
[31] J.E. Parkinson, *supra* note 19 at 62.

charge of the industry or by a regulatory agency, resulting in state intervention and interference in the economic decisions of the companies.

In the following chapters, the novel techniques invented and implemented by the state in order to control the privatized enterprises internally and externally, the nature of these techniques, their necessity and the impact they have on corporate governance of these entities, will be examined.

2 "COMPLETE CONTROL": ONE-MAN STOCK COMPANY

2.1 Corporatization

When it is decided that the privatization of a public utility[32], considered to be a "natural monopoly"[33], is to be exercised by public offer and flotation at the

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[32] A business or service which is engaged in regularly supplying the public with some commodity or service which is of public consequence and need, such as electricity, gas, water, transportation, or telephone and telegraph service. The term implies a public use of a product or service, carrying with it the duty of the producer or supplier to serve the community at large and treat all persons alike, without discrimination. *Black's Law Dictionary*, abridged 6th ed., *s.v.* "public utility".

[33] "Natural monopolies" are the monopolies where economies of scale and barriers to entry are such that it would be artificial, wasteful, or impractical to break them up. "Natural monopolies, however, are few. Because of the integrated nature of the networks, it may make economic and business sense at present time to organize regional and national monopolies to carry out the transmission and distribution of water, gas, and electricity, to provide local district telephone services, and to carry away sewerage. But activities such as electricity generation, the production and marketing of gas, coal production and sale, *telecommunications*, bus transport, sewerage treatment and disposal are in no sense natural monopolies. The monopolies in these areas were created and it is by no means self-evident that they are necessary." [emphasis added]. John Moore, "Why Privatise" (1983) in John Kay, Colin Mayer & David Thompson, eds., *Privatization and Regulation* (Oxford: Clarendon Press, 1986) 78 at 80; John Moore, "The Success of Privatisation" (1985) in John Kay, Colin Mayer & David Thompson, eds., *ibid.* 94 at 94. "Where technology was naturally monopolistic - that is, where single firm production was the most efficient - there was a strong case for tight state control or even ownership of such a monopoly. Yet massive technological advances are weakening the extent of natural monopoly in several industries, notably in telecommunications, as well as introducing new products into the sector." Vincent Wright, "Industrial Privatization in Western Europe: Pressures, Problems and

stock market, as in the case of BT and NTT, it is necessary to be prepared in advance, and usually this is accomplished in tranches. Therefore, the long process of privatization can be divided into several stages on the basis of the percentage of voting shares owned by the state in the capital of the enterprise to be privatized. The first stage is the transformation of the public corporation into a stock company under the company law of the respective country with all the outstanding shares in the hands of the state, *i.e.* the stage of "corporatization". Second is the stage of the sale of part of the shares to private investors, resulting in a partial shareholding by the state. And the third stage is the sale of the residual shares, resulting in a situation where the state does not own any ordinary and/or special shares. It is possible to proceed with the sale of all the outstanding shares or the assets of the enterprise in one go, which is usually the case with privatization of medium and small-sized enterprises. On the other hand, the disposal of shares held in big-sized enterprises, such as BT and NTT, is accomplished in tranches, in order for the stock exchange market to be able to cope with these large disposals. No matter whether the shares are sold at once or in tranches, whenever the method of privatization is the sale of shares, the first step toward privatization is the transformation of the public enterprise into a stock company with the state being its sole shareholder. It is notable that before this stage of "corporatization", the telecommunications industry in both Britain

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Paradoxes" in Vincent Wright, ed., *Privatization in Western Europe: Pressures, Problems and Paradoxes* (London: Pinter Publishers, 1994) 1 at 3, 21.

and Japan passed through different forms of reorganization, following a similar pattern.

From 1912[34] until 1969, telecommunications in Britain were provided by a government department, part of the old General Post Office. In 1969 the government changed the status of the Post Office to that of a public corporation[35]. By the British Telecommunications Act 1981, telecommunications in Britain were separated from postal services, British Telecom was established as a public corporation and its monopoly ended. Under the Telecommunications Act 1984 (TA 1984), the government changed BT's status from that of a public corporation to that of a Companies Act public limited company, and transferred the assets from the business into this wholly government-owned company (TA 1984, s. 60), which was privatized in November of 1984[36].

The development of NTT until its corporatization differs from that of BT only in timing[37]. NTT was a state monopoly under the umbrella of the Ministry of Post and Telecommunications (MPT) until 1952, when it was separated as a public corporation, still having monopoly status. Under the NTT Corporation Act

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[34] For details on telephone services in Britain before 1912, see Newman Karin, *The Selling of British Telecom* (Holt, Rinehart and Winston, 1986) at 14-15; Robert Fraser & Michael Wilson, *supra* note 2 at 36; John Harper, *Monopoly and Competition in British Telecommunications. The Past, the Present and the Future* (London: Pinter, 1997) at 5.

[35] The post office, which retained its monopoly on telecommunications services, was still owned by the state, but instead of being headed by a minister, it had a chairman appointed by the government. Marcus Brooks, "BT's Experience of Privatization" in Daniel J. Ryan, ed., *Privatization and Competition in Telecommunications - International Developments* (Westport: Praeger, 1997) 71 at 72; Willem Hulsink, *Privatisation and Liberalisation in European Telecommunications. Comparing Britain, the Netherlands and France* (London: Routledge, 1999) at 126, 128.

[36] Newman Karin, *supra* note 34 at 15; J. Vickers & G. Yarrow, *Privatization: An Economic Analysis* (Cambridge: The MIT Press, 1988) at 197.

[37] With exception of the difference mentioned above in *supra* note 4.

(NTTCA), passed in 1984[38], NTT was transformed into a special company[39], the sale of whose shares started in 1986. Subsequently, in 1998, NTT was broken up into two regional companies: East NTT and West NTT; a new long-distance company was established; and NTT itself was transformed into a holding company, owning 100% of the shares of these three companies[40].

As mentioned above, as a first step before the sale of their shares, both the public corporations[41], BT and NTT, were transformed into companies with the state as sole shareholder[42]. This was accomplished by the enactment of new legislation, namely the Telecommunications Act 1984 in Britain[43] and the NTT

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[38] Law No.85 of December 25, 1984. This act applies only to NTT.

[39] "Special company" means a kabushiki-kaisha (corporation) established on the principle of special permission, requiring a special act to be passed. (According to Japanese law there are three different principles for incorporation of legal entities: the principle of special permission where a separate special act is necessary to be passed; the principle of permission where along with the incorporation under the current legislation it is necessary for a separate permission to be obtained from the administrative bodies; and the principle of acting upon standing rule where only registration on incorporation is required). This special act sets out a number of exceptions from the Commercial Code and provides for the protection and supervision of the activities of special companies because of their public character. As the special companies take the form of kabushiki-kaisha, the provisions of Commercial Code also apply to them. Nevertheless, the special act applies with priority. In Japan in the 1980s, separate special acts were passed for the privatization of Japan National Railways, Japan Monopoly Corporation (tobacco and salt) and NTT Public Corporation. For the advantages and disadvantages of this form of special company, see Touyama, Yoshihiro, *Gendai Koukigyou Souron* (The General Theory of the Modern Public Enterprises) (Touyo Keizai Shimpousha, 1994) at 227-230.

[40] See Part 3.3.2, below.

[41] Despite the name "public corporation", they were not corporations in the company law sense. These are legal entities, formed under a special act. They do not have a share capital, and their assets are owned by the state. They are headed by chairmen appointed by the government, and the fact that this is not the minister makes them different from their previous status of government departments. Touyama, Yoshihiro, *supra* note 39 at 158-59.

[42] The transformation of both BT and NTT into public limited company and special company respectively was accomplished following the same pattern. First, companies under the respective company law were established; second, the assets and the business of the public corporations were transferred to these new companies; and third, the public corporations were dissolved.

[43] *Telecommunications Act 1984* (c.12), [a]n Act to provide for the ... vesting of property, rights and liabilities of British Telecommunications in a company nominated by the Secretary of State and the subsequent dissolution of British Telecommunications; ...

Corporation Act in Japan, passed in the end of the same year. It is noteworthy to mention here that while in Britain only one act was passed with respect to both privatization of BT and regulation of the industry, in Japan a set of three acts was passed, one concerning only NTT, another, the Telecommunications Business Act[44], concerning the liberal regulation of the sector, and third omnibus act modifying some one hundred other laws affected by structural changes[45].

In fact, under the Britain's Companies Act (1948[46]), it is not possible for a single member public limited company to be established. Section 1 requires at least two persons to form an incorporated company. Although this provision was amended in 1992 to authorize the memorandum of association of a private company limited by shares to be signed by one subscriber (s.1 (3A))[47], at the time of BT's privatization this was not allowed.

The same is true under the Japanese Commercial Code (CC). After numerous discussions regarding whether the establishment of one-man company[48] is to be permitted or not, this became possible both with respect to kabushiki-kaisha (joint-stock companies) and yuugen-kaisha (limited liability companies) after the amendment of the CC in 1990 (CC, art. 165 amended; Limited Liability

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[44] Law No.86 of December 25, 1984.
[45] All three acts took effect on April 1, 1985.
[46] Section 60 (3) of the TA 1984 states that the company to be nominated as successor of British Telecommunications is to be "formed and registered under the Companies Act 1948".
[47] The amendment (SI 1992/1699) was made to implement the 12th Directive 89/667 of EC on single-member companies. L.S. Sealy, *Cases and Materials in Company Law*, 6th ed. (London: Butterworths, 1996) at 10.
[48] The meaning of the term "one-man company" as used in Japan and of "single member company" as used in Britain is the same, *i.e.* a company with only one member or shareholder. For uniformity the term of "one-man company" will be used in this study.

Companies Act, art. 69 (1-5) abolished). However, at the time when the privatization of NTT was decided, whilst the existence of one-man company after its establishment was thought by scholars to be possible, its establishment was rejected[49].

Thus, despite the general prohibition on the establishment of one-man companies under both British and Japanese company law at the time of privatization of BT and NTT, these two legal entities were established as wholly state-owned companies on the basis of special acts, separate for each company, namely the TA 1984 with respect to BT, and NTTCA with respect to NTT. To comply, however, with the requirements of the Companies Act 1948, two government servants agreed to act as subscribers and to take one share each in BT's capital[50]. There is no relevant information available in this respect regarding NTT, however it is not impossible that the members of the incorporation committee subscribed to a few shares so as not to breach the provisions of the Commercial Code (art. 169) as it was in the case of KDD[51]. It seems to me, however, that in these cases it is more appropriate to set out an exception from general company law, as has been done in France[52].

Because of the specificity and the importance to the public of the business to be carried on by these companies, not only the general company law, but also

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[49] Kami, Kazuteru, *Shintei Kaisha-hou* (New Revision of the Commercial Code), 2nd ed. (Keisou-shobou, 1988) at 8; Suzuki, Chiyoko, "Ichinin-kaisha to kabunushi-soukai" (One-man Company and the General Meeting of Shareholders) (1992) 65:6 Hougaku-kenkyu 45 at 46.

[50] BT, Memorandum of Association, art. 6, online: BT <http://www.bt.com/World/corpfin/frameset/index1.htm> (last modified: July 1999) [hereinafter BT, Memorandum of Association].

[51] Touyama, Yoshihiro, *supra* note 2 at 9.

[52] *Loi n° 83-675 du 26 juillet 1983 relative à la démocratisation du secteur public*, art.37.

special acts, apply to them. Although these special acts apply with priority over general company law[53], legal problems under company law cannot be avoided.

2.2 State Intervention in the Operations of One-man Companies

Broadly speaking, there are two different forms of organizational structure for stock companies[54]. One is the "neo-American" model of a unitary board structure, practiced in Britain as well as the U.S., and the other is the "Rhine" model of a two-tier structure, operated in parts of Europe and also, to some extent, in Japan. Under the two-tier system, the supervisory board is typically made up of non-executive members appointed by the shareholders, while the board of directors is an executive entity nominated by the supervisory board. The peculiarity in Japan is that the supervisors[55] and the directors are both elected by the general meeting of shareholders and they are not in a subordinate relation[56]. Wholly state-owned stock companies generally follow these main structures, with

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[53] The same is true with respect to Petro-Canada, s.2 (3) of *Petro-Canada Public Participation Act* providing that "in the event of any inconsistency between this Act and the Canada Business Corporations Act, or anything issued, made or established under that Act, this Act prevails to the extent of the inconsistency.".

[54] Despite the fact that BT was transformed into a public limited company, and NTT into a special company, in this study the term of stock company will be used to encompass the both cases in the sense of a company in which capital is limited by shares that are traded on the stock market.

[55] A board of supervisors is required only in the case of big-sized corporations.

[56] Okushima, Takayasu, "Kansa-seido to kaisha-rippou-no kokusaika" (The Internationalization of the Supervisory System and Corporate Legislation) 65:7 Houritsu-jihou 57 at 58; Kenichi, Yoshimoto, "1993 Company Law Amendment on the Supervisory System and Corporate Governance in Japan" 41:23 Osaka University Law Review 23 at 24; Kanda, Hideki, "Japan" in Arthur R. Pinto & Gustavo Visentini, eds., *The Legal Basis of Corporate Governance in Publicly Held Corporations. A Comparative Approach* (The Hague, London, Boston: Kluwer Law International, 1998) 111 at 113.

some differences, mainly with respect to the general meeting of shareholder(s). Moreover, the special acts by which these companies with the state as sole shareholder have been created, provide for some exceptions from the general company law in this relation.

2.2.1 The State as Shareholder

2.2.1.1 Liability

As a result of the transformation of the public corporations into stock companies, the state changes its status from that of owner of the corporation's assets to owner of the shares of the company. Therefore, its liability becomes limited to the investment made, without having any liability to the creditors of the company[57]. A problem then arises with respect to whether the debts of the public corporation will be inherited by the new company or not. In Britain, by virtue of s. 62 of TA 1984, outstanding debts to the National Loans Fund were cancelled and debentures issued to the Secretary of State. The reduction of some of the debt was undertaken to assist future borrowings by the company[58]. BT's balance

[57] In this relation it is noteworthy that in Italy after transformation of the enterprises to be privatized into wholly state-owned companies, despite that the state is a shareholder, thus, having limited liability, by the reason that it is the sole shareholder its liability is unlimited not only with respect to the debts of the enterprises after their transformation as provided by art. 2362 of the Italian Civil Code, but also with respect to the debts before the transformation. Thus, the so-transformed companies enjoy the unlimited guarantee of the state. Diego Corapi, "Italie: une affaire politique" in Fabrice Dion, ed., *Les privatisations en France, en Allemagne, en Grande-Bretagne et en Italie* (Paris: La documentation française, 1995) 163 at 174-75.

[58] Cosmo Graham & Tony Prosser, *Privatizing Public Enterprises: Constitutions, the State, and Regulation in Comparative Perspective* (Oxford: Clarendon Press, 1991) at 78.

sheet was restructured in order to present the company as properly capitalized[59]. With respect to NTT in Japan, re-capitalization was also undertaken by reducing the capital of the company and dividing it into capital and reserve capital, and by increasing the debts and issuing debentures (bonds)[60]. Hence, the state in both countries became not only the major shareholder but also the major creditor of the companies.

2.2.1.2 Exercising the Rights of the State as Sole Shareholder

It is obvious that the resolutions of the general meeting of shareholder(s) in a company consisting of only one shareholder cannot be anything different from the decisions of this single shareholder. When the sole shareholder is the state, its rights as shareholder are usually exercised by the government. In Japan, in this case the Minister of Finance is entrusted with the exercise of the shareholder's rights of the state. In Britain, it is the Secretary of State for Trade and Industry. In both cases, an administrative body is empowered to act as a shareholder in lieu of the state.

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[59] For details on the restructuring of BT's balance sheet, see Newman Karin, *supra* note 34 at 22.

[60] For details on the re-capitalization of NTT, see *Shin-kaisha-no Tanjou-to Kadai* (Issues on the Birth of the New Company) (NTT, 1996) at 754-55.

2.2.1.3 Necessity of General Meeting of Shareholder(s)

The issue of whether or not it is necessary for a general meeting of shareholder(s) to be called in a one-man company, does not differ in its answer when the sole shareholder is the state or a private entity. The solution seems to be different, however, with respect to BT and NTT. There is no provision in the TA 1984 regarding the general meeting of shareholder(s) during the time when BT operates as wholly government-owned company. However, some issues that are usually to be decided by resolutions of the general meeting of a company established under the Companies Act, such as the appointment of directors, raising capital by issuing new shares, voluntary winding-up, and limitations on the borrowings by the company, are vested with the Secretary of State (Part V). The consent of the Treasury is necessary in the case of issuing new shares and borrowings by the company. Thus, it can be said that it is not necessary to proceed with the formal calling of a general meeting and the issues in the scope of competence of the sole shareholder may be decided by directions or orders given by the Secretary of State.

In Japan, despite a negative response from corporate law scholars regarding the necessity of shareholder(s) meeting in one-man companies under the Commercial Code[61], backed by a number of decisions of the Supreme Court[62], in

[61] "A formal general meeting of shareholders is absolutely unnecessary. If there is consent by the sole shareholder, this can be considered to be a legal resolution of the general meeting". Ousumi, Ken'ichirou & Imai, Hiroshi, *Kaisha-houron* (The Theory of Company Law), 3rd ed. (Yubungaku, 1991) at 332.

practice after its establishment as wholly government-owned company NTT held a general meeting of shareholder(s) with the participation of the Minister of Finance only. Having in mind that the general meeting of shareholder(s) is considered to be the place to ask the accountability of the directors[63], and that in the case of state-owned one-man companies the sole shareholder does not hold the functions of the representative director as it is usually in the case of one-man companies under the CC, the calling of the meeting has some meaning. In fact, this is costly and time consuming, and so long as the directors are appointed by the sole shareholder, the issue of their accountability might be resolved by other means of communication between them and the shareholder[64].

2.2.1.4 Powers of the Sole Shareholder

The scope of the subject-matters to be decided by the sole shareholder (the state) are the same as those which are in the competence of the general meeting of shareholder(s) in a stock company under the company law.

The special NTT Corporation Act and Regulations[65] attached to it do not contain any provisions regarding the competence of the general meeting of shareholder(s). Thus, the provisions of CC in this respect shall apply as a general

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[62] The decisions of the Supreme Court of 24 June 1971 and of 20 December 1985 allow the omission of the procedures for calling general meetings of shareholder(s) in one-man companies.

[63] For example, directors and supervisors owe a duty of explanation as to the matters requested by the shareholders at the general meeting (CC, art. 237-3), at the general meeting directors may be released of their liability to the company (CC, art. 266 (5 and 6)).

[64] Making them submit business reports every three months for example.

[65] In this part, citations are from the NTT Corporation Act before its amendment in 1997.

law. Matters to be decided by the general meeting of shareholder(s), as provided by law, relate to fundamental changes in the organization or in the business operations of the company, important interests of the shareholders, appointment and removal of the company's directors and supervisors, and decisions which are too risky to be left to the discretion of the directors[66].

In contrast, in Britain, despite the short period of only few months (from 1 April to 16 November 1984[67]) for which BT existed as a wholly government-owned company, in the TA 1984 there are provisions regarding subject-matters to be decided by the Secretary of State during this period. These are the appointment of directors, raising capital by issuing new shares and voluntary winding-up.

Hence, in both countries, subject-matters with respect to the "internal control" of the company, as defined above, are in the competence of the general meeting of shareholder(s) and the state as sole shareholder has to decide them according to its own will. In this context, by exercising its rights as shareholder the state exercises its controlling power over the company. If the power of the state is limited to the exercise of its rights as a shareholder, the situation is not greatly different to that of a normal one-man company operating under company law, except for the nature of the shareholder. This is the case in Britain.

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[66] Sakamaki, Toshio & Shimura, Naomi, *Kaisha-hou* (Company Law), new ed. (Seirin-sosho, 1993) at 138-39.

[67] On 1 April 1984 a limited company was incorporated. On 6 August 1984 the business of British Telecommunications corporation was transferred to the company and shares were issued to the Secretary of State. On 16 November 1984 the Secretary of State's advisers offered 50.2% of the ordinary shares for sale on his behalf. Graham Cosmo & Prosser Tony, *supra* note 58 at 78-79.

On the other hand, in Japan, with respect to NTT, an additional guarantee to the state power is provided. This is the approval to be given by the Minister of Post and Telecommunications (MPT) to certain resolutions passed by the general meeting of shareholder(s), namely: (1) appointment and removal of directors and supervisors (NNTCA, art. 9 (2)); (2) matters related to fundamental changes in the company, such as changes in the articles of incorporation; distribution of profits; mergers; dissolution of the company (NTTCA, art. 10 (1)); and changes in the business activities (NTTCA, art. 1 (2))[68]. Financial statements of NTT, such as its balance sheet, profit and loss statement and annual business report, are to be submitted to the MPT (NNTCA, art. 12).

Bearing in mind that the powers of the general meeting of shareholder(s) in NTT as state-owned one-man company are exercised by the Minister of Finance (MF), it can be said that the omission of calling and holding the meeting would not disrupt the company's operations. Moreover, the approval by the MPT of the resolutions passed by the MF might have some meaning as a means of keeping state control after the sale of shares to the public, but at the stage of a state-owned one-man company its significance is doubtful. It is probably most appropriate that resolutions of the general meeting be passed by the MPT instead of the MF, and the consent of the MF be required only with respect to financial matters, thus making the system similar to that in Britain. Or, if the present status

[68] While under the CC (art. 166 (1-1)) the business activities are an absolutely necessary element to be set in the articles of incorporation and thus changes in them have to follow the procedure for changes of the articles, in the case of NTT this is not only an element of the articles but it is expressly provided in the special act as a matter for which the approval of MPT is absolutely requisite.

quo is to be maintained, why not consider the abolition of the provisions requiring the MPT to consult the MF regarding matters fundamental to the company[69]?

2.2.2 Board of Directors

2.2.2.1 Structure

As mentioned above, the appointment and the removal of the directors of NTT is carried out by a resolution of the general meeting of shareholder(s), subject to the approval by the MPT (NTTCA, art. 9 (2)). This requirement for approval is unique even in Japan[70]. Instead, in Britain, at the stage of wholly government-owned companies, directors are "nominated or appointed by a Minister of the Crown or by a person acting on behalf of the Crown" (TA 1984, s. 60 (6)). This is a more reasonable system, especially at this stage, because it is not time-consuming and has the same effect as the approval by the minister.

In both NTT[71] and BT[72] the directors have to be nationals of the respective country. This requirement is probably due to the specificity of the

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[69] Prior to giving approval, the MPT shall consult the MF on the following issues: change in the number of all the outstanding shares of the company, distribution of profits, mergers and dissolution of the company (NTTCA, art. 10 (1)).

[70] For example, approval regarding the appointment of the managers is not required in the case of banking and insurance businesses in Japan.

[71] NTTCA, art. 9 (1).

[72] Robert Fraser & Michael Wilson, *supra* note 2 at 37; Nakamura, Daichi, *Min'eika-no seiji-keizai-gaku – nichi-ei-no rinen to genjitsu* (The Political Economy of the Privatization – Ideology and Reality in Japan and Britain) (Nihon-keizai-hyouron-sha, 1996) at 21.

telecommunications industry[73] as related to the protection of national interests and privacy of information.

The major concern with respect to management, however, in both Britain and Japan, was related to the improvement of management performance in order to change the corporate culture. Thus, to engage people with outstanding business knowledge and experience was the main line in the recruitment policy. As a result, in 1984 out of a main board of thirteen in BT, nine had substantial outside business experience, and the tier of senior management had also been strengthened by external recruitment[74]. And in NTT, out of a board of twenty-five members only eight were directors of the public corporation, and three were members of the incorporation committee[75]. Thus, this stage of corporatization can be characterized as "privatization of the management"[76]. But so long as the sole shareholder, having the power to appoint managers, is the state, it is difficult to imagine a management team not influenced by it.

2.2.2.2 Control of Decisions

In Japan, the state controls not only the managerial staff but also intervenes in the operations of the board of directors. Some of the matters in the

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[73] There is the same requirement also in the case of Cable & Wireless (Articles of Association, s. 119 in relation to s. 3 A- (B) (i)).
[74] Newman Karin, *supra* note 34 at 24.
[75] *NTT-no 10-nen* (The 10 years of NTT) (Tsuushi-han, 1996) at 4, 12; *Shin-kaisha-no Tanjou-to Kadai*, *supra* note 60 at 757.
[76] In Japan, for instance, there are two different words for "privatization", namely "min'eika" which focuses on the changes in the management, and "min'yuuka" which focuses on changes in the ownership.

scope of the board of directors' powers under the CC are subject to the approval by the MPT. These are decisions on the issue of new shares, of convertible bonds and bonds with preemptive rights for subscription of new shares (NTTCA, art.4 (2)); the formulation of the annual business plan (NTTCA, art.11); and the transfer of important equipment and settlement of collateral on such equipment (NTTCA, art.13). The legal nature of the approval to be given by the MPT will be discussed in detail in Part 4.1. It is sufficient here to mention that this was required in order to prevent reduction of the state holding without its consent and, therefore, to block a self-privatization of the company.

2.2.3 Supervision

In Japan, the state ensures its controlling power over the one-man companies undergoing privatization not only by its participation in the capital and exercising the shareholder's rights, and by its intervention into the decisions of the board of directors, but also by taking measures to strengthen the supervision over the company's performance.

First, the supervisors are appointed and removed by the representative of the state-shareholder. This is a matter again subject to the approval of the MPT. The number of supervisors is set at three in the special act (NTTCA, art.14 (1)).

Second, supervision is not only exercised by the appointed supervisors[77], but also a certain supervisory power is admitted by the special act to the minister

[77] Supervisors (kansayaku) in Japan are empowered by law to monitor and review the legality and performance of the directors' activities (CC, art. 274 (1)). In exercising this function,

as well. Since this is not a power of the MPT set out especially for the stage of one-man company with the state as sole shareholder its peculiarities will be outlined in details later in Part 4.1.1.

2.3 Significance of the Stage of Corporatization

This stage of transformation of the public corporations into stock companies, *i.e.* the stage of corporatization, can be considered as preparation for their privatization, making it possible to achieve this through the sale of shares. At the same time, this was preceded or immediately followed by allowing new entry into the market to encourage competition[78]. Furthermore, with respect to corporate governance, it can be said that the transformation into stock companies is significant because it ends the former uniformity in the ownership rights of the state. The owner of the assets is now the legal entity itself, and the state becomes owner merely of the shares and debentures issued by the company. Therefore, a change to a private type ownership occurs. This allows the companies to organize

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supervisors may at any time call on a director, manager or other employee for a business report, or investigate the affairs of the company and the state of its assets (CC, art. 274 (2)). The supervisors shall examine the proposals and documents which directors propose to submit to the general meeting of shareholders, and shall report their opinion thereon to such general meeting if they recognize there are matters in violation of laws, ordinances or the articles of incorporation, or seriously unreasonable ones (CC, art. 275). Supervisors also have responsibility for monitoring the auditing as well, which in large companies is entrusted to a certificated public accountant or an accounting firm. For details on the development of the supervisory system in Japan, see especially Ken-ichi, Yoshimoto, *supra* note 56.

[78] In October 1981, Mercury obtained a 25-year renewable license to operate a national and international digital network to compete against BT's trunk traffic; being the sole competitor until at least 1990. Newman Karin, *supra* note 34 at 4. On the other hand, in Japan, from June 1984 until March 1985 five newly established companies received permission from the MPT to operate Type 1 carriers (they have their own facilities and are required to obtain tariff approval). *Shin-kaisha-no Tanjou-to Kadai*, *supra* note 60 at 766.

their accounting systems in the same manner as companies established under the company law[79], to rethink their internal organization and to make some changes in it[80], and not to depend on government subsidies. The last is, however, very risky at the stage of one-man companies, because the companies still do not have access to the stock market for equity financing, and, in the case of BT, borrowings have to be approved. A listing as soon as possible and quick sale of shares is therefore indispensable.

In addition, since the sole shareholder at this stage is the state, it is difficult to think about major changes in the corporate culture. Thus, it can be said that the state still keeps its controlling power over the company merely by its participation in the capital. In addition, the interests of the state as sole shareholder are further protected by the incorporation statutes, prepared by its representatives. In the case of NTT and BT, as shown above, this protection was strengthened to a certain extent by a number of provisions, introduced in the special acts. Thinking about the importance to the public of the entities to be privatized, this can be considered as a rational policy, but if corporatization is not followed immediately by sale of shares to private investors[81], it risks altering the main purpose of privatization.

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[79] The accounting systems had to be a standard both to satisfy the relevant stock exchanges and to produce the information required to underpin the various reports and prospectuses, and the assets had to be valued realistically. C. D. Foster, *Privatization, Public Ownership and the Regulation of Natural Monopoly* (Oxford: Blackwell, 1992) at 126.

[80] Managers recognize the prospect of a clearer and cleaner operation and the opportunity to replace complex and irrational rules and procedures with those of a better design. For more on the challenges to managers of enterprises to be privatized, see *ibid.* at 127.

[81] The period of BT's existence as a wholly government-owned company was just seven and a half months (see *supra* note 67), while in the case of NTT it took more than one and a half year

3 STATE INTERVENTION AT THE STAGE OF MIXED ENTERPRISES

3.1 Mixed Enterprise

A mixed enterprise is one in which the state and private entities have participation in the capital and/or the management of the enterprise[82]. The state holds only one part of the total number of the outstanding shares, and individuals and/or companies without governmental participation hold the remaining part. There are cases where the state and private companies, investing in a joint project, establish a mixed enterprise for its realization. These enterprises are not within the scope of the present study. The focus here is on mixed enterprises formed as a result of selling the state shares in a public enterprise that has been transformed into a state-owned one-man stock company. Hence the shares owned by individuals and/or private companies are not subscribed to at the stage of establishment, but rather are a result of the sale of shares by the government in the process of privatization. Thus, after the sale, the "complete control" that state enjoyed during the stage of corporatization[83] is restricted and limited to a certain extent.

(NTT was established as a special company on April 1, 1985, and the first sale of shares took place in October 1986).

[82] Lloyd D. Musolf, *Mixed Enterprise: A Development Perspective* (Massachusetts: Lexington Books, 1972) at 3.

[83] See Chapter 2, above.

In a mixed enterprise the ownership percentage of the state varies from holding all the shares except one to holding only one share. When the state ownership is more than 50 per cent, the enterprise is considered in Britain to be in the public sector. The criterion is thus quantitative, and is equivalent to that for the "majority controlled" companies[84]. Notwithstanding this, it is possible to have a "majority controlled" company not on an ownership basis but on the basis of control of the company's management through having the majority of the votes in the board of directors.

When state ownership is reduced to less than 50 per cent, the entity is considered in Britain to be privatized, while in Japan it is necessary for the total number held by the state to be sold. Despite this difference, in both countries after the sale of some or all of the shares, the state makes use of different mechanisms in order to keep an eye on the performance of the "privatized companies"[85].

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[84] See Part 1.2, above.

[85] The term of "privatized" company will be used despite the difference that exists in both countries.

3.2 Legal Devices for Keeping the State Control

3.2.1 Measures Related to the Shareholdings of the State

3.2.1.1 Continuous Holding of a Certain Number of Shares

In Britain the first phase of privatization (1979-84) involved the sale of firms with no real characteristics that would justify their retention in public sector. The usual approach was the partial sale of shares with the government retaining ownership of just less than 50 per cent[86]. The same approach was used in the privatization of the first public utility, BT, with which began the second phase of the privatization in Britain. Its shares were sold in tranches and thus, for a certain period, the state held a percentage of shares[87]. Section 65 of the TA 1984 enables the Secretary of State to set a figure for the maximum government shareholding in the company, which may be replaced only by a new lower limit. For BT the initial limit was set at 49.803 per cent[88].

On the contrary, in Japan, NTTCA provides for a continuous holding by the state[89] of one-third and more of NTT's shares (NTTCA, art.4 (1)), and the disposal of shares is to be decided by resolution of the Diet when passing the

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[86] Cento Veljanovski, *supra* note 13 at 4.

[87] It took almost ten years to sell all the outstanding shares held by the government in BT. In 1984, 50.2% were sold, in 1992 the government reduced its holding to approximately 22% and in 1993 sold all the remaining shares. Marcus Brooks, *supra* note 35 at 73.

[88] HC 495/1984-5.

[89] With respect to companies undergoing privatization in the field of telecommunications, the same obligation of the government to hold a certain percentage of the shares is required in France and Germany. *Asahi-shimbun* (16 February 1997).

annual budget. However, at the time of establishment of the company the ownership of the state was set at one half for a period of 5 years. At present, after the fifth sale of NTT's shares, the state is still the owner of 53.30%[90] of the outstanding shares of NTT[91], sufficient to have "majority control". Therefore, NTT cannot be considered as a "privatized" entity even on the basis of the British definition. This is a critical difference between the British and Japanese approaches to the privatization of their telecoms, and is a sign of how cautious the Japanese government is with respect to the sale of its shares.

The purpose of this continuous shareholding by the state is, on the one hand, to avoid decision-making that is undesirable from a "public interest" point of view[92] and, on the other hand, to prevent the acquisition of the enterprise by foreign companies[93]. In order to keep the percentage held by the government unchanged it is provided that the disposal of shares owned by the government is to be decided by the Diet in the relevant annual budget (NTTCA, art. 5) and decisions on the issue of new shares, bonds convertible in shares and bonds with

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[90] This percentage of state-owned shares in NTT can be explained by the economic crisis in Japan after the collapse of the so-called "bubble" economy in the end of the 80's. Awaiting the stabilization of the financial market, the Japanese government postponed the sale of NTT's shares year by year to end up with a period of more than 10 years, from the third sale in 1988 to the fourth in 1999, of not selling any shares. However, as a result of two successive sales in the last two years, the state ownership was reduced from about 66% to 53.30%, which is the sign of a new wave in the development of NTT's privatization. On the "bubble economy", see especially Christopher Wood, *The Bubble Economy. The Japanese Economic Collapse* (Tokyo: Charles E. Tuttle Company, 1993). On the sales of NTT's shares and changes in its shareholders structure during the period 1985-1994, see *NTT-no 10-nen*, *supra* note 75 at 28-29.

[91] On NTT's shares and shareholders (as of March 31, 2000), see Attachment 9 to Annual Report, NTT, online: NTT <http://www.ntt.co.jp/news/news00e/0005/000526_09.html> (last modified: 26 May 2000).

[92] Such as to stop providing unprofitable services or in unprofitable areas.

[93] Inoue, Teruyuki, *NTT Kyousou-to Bunkatsu-ni Chyokumen-suru Jyouhouka-jidai-no Kyojin* (NTT, the Giant Facing Competition and Divestiture at the Time of Informatization), 2nd ed. (Otsuki Shoten, 1996) at 47-51.

preemptive right to purchase new shares, are to be approved in advance by the MPT (NTTCA, art. 4 (2)).

Keeping the position of controlling shareholder, the state can influence the decision-making on important issues at the NTT's meetings of shareholders or, even more than influence, the state can also pass the decisions that it considers to be suitable to the "continuous existence" of the company. In this respect, it is necessary to hold at least one-third of the outstanding shares, which is exactly the percentage provided in NTTCA, in order to be able to block an opposite decision proposed by other shareholders. This is because decisions regarding changes in the articles of incorporation, mergers, liquidation, dismissal of directors and supervisors, have to be passed by a special resolution[94] (CC, art. 257 (2), 280, 342 (1), 404 (2), 408 (1)).

Moreover, despite that the appointment of directors and supervisors, which is the other element of the notion of "internal control", is to be decided by an ordinary resolution (CC, art. 254 (1), 280 (1)), its quorum is the same as that required for a special resolution (CC, art. 239 (1)). There is a possibility for the quorum to be reduced in the articles of incorporation to one-third of the outstanding shares (CC, art. 256-2) but it is doubtful that in the initial articles such a provision would be stated. As for the subsequent changes in the articles, it is necessary for a special resolution to be passed (CC, art. 343). Therefore, by the

[94] For a special resolution to be passed the presence of shareholders owning more than one-half of all the outstanding shares and a majority of more than two-thirds of the votes is necessary (CC, art. 343).

requirement of a quorum for the ordinary resolution with respect to the appointment of directors and supervisors, the presence of state's nominees in the boards is guaranteed. Even in cases where the quorum has been reduced, usually the shares disposed of by the state are dispersed between numerous shareholders, and for this reason it is almost impossible for the minority shareholders to choose their own candidates as directors. Furthermore, in Japan the possibility for cumulative voting may be eliminated by a separate provision in the articles of incorporation (CC, art. 256-3), and in practice most of the corporations do so[95].

Thus, in Japan the state may easily keep its control merely by continuous holding of at least one-third of the outstanding voting shares. Needless to say, this provision for continuous holding of shares by the state is sufficient to prevent the full privatization of the concerns as understood in Japan.

In Britain, one of the ways of determining the powers of the government in the enterprises to be privatized is to properly set their content in the articles of association of the company[96]. The articles of association provide all the rights of the shareholders and the relationship between them, and the manner of pursuing the purposes of the company. In order for any or all of the provisions of the articles to be changed, a special resolution of 75% of the ordinary voting shares is

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[95] Uwayanagi, Katsurou, "Art. 256-3" in Uwayanagi, K., Otori M. & Takeuchi, T., *Shimpan Chuushaku Kaishahou (Comment on Company Law, new ed.), vol. 6, Kabushiki-kaisha-no Kikan (2) arts. 254~280 (Corporations' Bodies)* (Yuubungaku Commentaru, 1997) at 52.

[96] There are two main documents regarding the incorporation of a company in Britain. One is the Memorandum of Association and the other is the Articles of Association. Broadly speaking, by its Memorandum of Association a company proclaims to the world the external aspects of its constitution and capital structure, while the Articles of Association are concerned with matters of internal organization, which are primarily of interest to its own members and officers. L.S. Sealy, *supra* note 47 at 104.

required to be passed at the general meeting of shareholders (Companies Act 1985, ss. 9, 378). Hence, if the government does not want the content of these provisions to be altered, it must hold at least 25% of the voting shares. It is possible for a shareholding of this percentage to be maintained for a certain period in large enterprises undergoing privatization, because of the sale of shares in tranches[97]. However, the holding of such a percentage of company's shares in the long term diminishes the attractiveness of the enterprise.

In this case, when the government keeps a certain percentage of company's stock, usually it makes a promise not to use its rights as an ordinary shareholder to intervene in the business decisions of the company. This takes the form of a letter of non-interference in the normal affairs of the business, which undertaking is set out in the prospectus of BT as follows:

> HM Government does not intend to use its rights as an ordinary shareholder to intervene in the commercial decisions of British Telecom. It does not expect to vote its shareholdings on resolutions moved at General Meetings although it retains the power to do so.[98]

However, it is not to be forgotten that this promise was generously made after the government set out provisions in the articles of association giving it stronger rights and powers than those of an ordinary shareholder. These powers will be examined in the following section.

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[97] In fact, in BT a government holding of more than 25% of the ordinary shares was maintained between the first sale in 1984 and the second in 1992. See *supra* note 87, above.
[98] Newman Karin, *supra* note 34 at 23; Cento Veljanovski, *supra* note 13 at 128.

3.2.1.2 Special Shares

When the state does not maintain a certain percentage of shares in the privatized companies, there are other means to keep its controlling power. One of them is to issue shares with multiple voting rights[99] or shares with special rights, such as shares with veto rights.

In fact, when the government wants to avoid a foreign capital undesirable to the governance of the company, to prevent the privatized company from being taken over by another enterprise during the transitional period of adaptation to the new environment of operating as a private company, or to forbid the disposal of assets important to the operations of the enterprise, the government in Britain makes use of the so-called "special share". The main concern in setting this "special share" is on the future organizational and shareholders structure, management, and control of the privatized company.

The "special share" is known generally as the "golden share"[100], however, in different companies it takes different names[101]. The different names suppose

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[99] Although issue of shares with multiple voting rights is against the principle of "equal treatment of shareholders", this is used in exceptional cases as a means to keep the controlling power of certain shareholders, namely when as a result of issuing new shares if following the rule "one share one voting right" the controlling shareholder will not be able to control the resolutions on issues important to the company. The issue of shares with multiple voting rights has been used by entirely private companies, and the state can take this opportunity in order to keep its control over companies undergoing privatization or already privatized ones.

[100] On "golden share" in Britain, see Peter J. Curwen, *supra* note 2 at 216; Cento Veljanovski, *supra* note 13 at 127-28; Vincent Wright, Introduction, "Chacun privatise à sa manière" in Vincent Wright, ed., *Les Privatisations en Europe, Programmes et Problèmes* (Actes Sud, 1993) 9 at 46; Jeremy J. Richardson, "Pratique des privatisations en Grande-Bretagne" in Vincent Wright, ed., *Les Privatisations en Europe, Programmes et Problèmes* (Actes Sud, 1993) 73 at 91; Stilpon Nestor & Marie Nigon, *supra* note 17 at 18; Trésor de S.M., Londres, "La privatisation au Royaume-Uni" in *La privatisation en Asie, Europe et Amérique Latine* (Paris: OCDE, 1996) 29 at 38; Hubert de Vauplane "Les aspects juridiques des privatisations"

different special rights attached to this share. In BT this was called the "Special Rights Redeemable Share". In this study the commonly known term "golden share" will be used. The peculiarities of this "share" as set out in BT's articles of association are described and analyzed below.

(A) Shareholder

The golden share is a one pound per value share. It is held by the government and may be transferred only to the Secretary of State, a Minister of the Crown or any person acting on behalf of the Crown[102]. Thus, not only the present but also the future "special shareholder" is determined, which is in contradiction to the principle of "free transfer of the shares". However, this is an understandable provision having in mind the nature of the shareholder.

(B) Setting out in the Articles of Association

The detailed content of the rights attached to the golden share is determined in the articles of association of each company. In principle, in Britain,

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in Fabrice Dion, ed., *Les privatisations en France, Allemagne et Grande-Bretagne* (Paris: La Documentation française, 1995) 47 at 59; Ian Snaith, *supra* note 11 at 147, 150, 159-60; Nakamura, Daichi, *Gendai Igirisu Koukigyou-ron - Kokuyuuka to Min'eika no Taikou* (The Modern Theory of Public Enterprises in Britain - Nationalization versus Privatization) (Tokyo: Shiratana-shobou, 1991) at 157; Sanaka, Tadashi, "Eikoku-ni-okeru Min'eika-no Shomondai" (Problems of the Privatization in the UK) (1989) 41-1-2 Koueki-jigyou kenkyuu.

[101] In Cable & Wireless, Amersham International, Britoil and Enterprise Oil it is called "Special Rights Preference Share", in Jaguar - "Special Rights Redeemable Share" as in BT, in Sealink - "Preference Share", and in British Aerospace - "Special Share". HM's Treasury, Official Committee on Nationalised Industry Policy, *Special Rights Shares* (23 July 1985) Annex A.

[102] The wording from the Articles of Association of BT is as follows: Art. 12. (A) "The Special Share may be transferred only to the Secretary of State, a Minister of the Crown or any person acting on behalf of the Crown." All citations of the BT's Articles of Association concerning the golden share are from Kenneth Wiltshire, *supra* note 5 at 42-43.

the company limited by shares is considered to be a kind of company established on the basis of mutual agreement between the shareholders[103]. Hence, the shareholders may agree to set out certain provisions in the articles of association including the issue of shares with special rights[104]. Thus, it can be said that with the introduction of the golden share in the articles of association a new class of shares is created. The peculiarity here is that this class of shares consists only of one share and the shareholder is the government.

(C) Time of Setting out

At the time when the decision for privatization of an enterprise is made, it is not necessary for a golden share to be introduced in the articles of association. The government still holds sufficient percentage of shares to block any decision against its policy. With the progress of privatization, at the moment when the percentage of shares held by the government is about to be reduced below 50%, by a special resolution at an extraordinary general meeting of shareholders, the

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[103] Although French legal theory follows the British concept that the "société par actions" is established on the basis of a mutual agreement between the shareholders, France took a completely different position with respect to the issue of "action spécifique". In France the issue of an "action spécifique" is to be decided case by case, with a separate "décret" of the Minister of Economy after decision for the privatization of the respective enterprise has been taken. And this takes the form not of an issue of a new share, but of a conversion of an ordinary share into a special one. This conversion is allowed by art. 10 of the special to the Commercial Code *Loi relative aux modalités des privatisations* (L. n° 86-912 du 6 août 1986), modified by the *Loi de privatisation* (L. n° 93-923 du 19 juillet 1993).

[104] "[A]nd the Company shall have the power from time to time to divide the original or any increased capital into classes, and to attach thereto any preferential, deferred, qualified or other special rights, privileges, restrictions and conditions." BT, Memorandum of Association, *supra* note 50 art. 6.

memorandum of association is partially amended to issue one golden share[105]. In the case of BT the golden share was introduced by a special resolution passed on July 24, 1984 regarding the increase of the company's share capital[106]. At that time BT was still a wholly government-owned company. The first disposal of shares by the government was decided to be of 50.2% by setting the first investment limit under s. 65 of the TA 1984 at 49.8% on November 16, 1984[107]. Hence, the golden share was introduced in BT's articles of association before the first sale of company's shares. Thus, it is easy to understand why the state promised not to exercise its voting rights as ordinary shareholder.

(D) Rights Attached

The rights attached to the golden share in BT are set out in its articles of association[108] and can be summarized as follows:

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[105] This was how the golden share was created in the case of Cable & Wireless, Britoil and British Aerospace. NHK Shuzai-han, *Jouhou-ga hashiru, sekai-ga kawaru* (Special Project Group of NHK, The Information is Running, the World is Changing) (Fukumura-shuppan, 1988) at 155; Inoue, Teruyuki, "Eikoku Min'eika-kigyou-ni-okeru tokken-yuusen-kabushiki - "ougonkabu"-o C & W-sha-no jirei-ni-miru" (Special Preference Share in the Privatized Enterprises in the UK - the Example of C & W's "Golden Share") 24-1 Kawasaki Keizai Daigaku "Sangyou-Kenkyuujo Kiyou" 63 at 75; Nakamura, Daichi, *supra* note 72 at 21.

[106] "By Special resolution passed on 24 July 1984: [...] (ii) BT's share capital was increased [to...] by the creation of 1,999,800,000 Ordinary Shares of 25p each, 750,000,000 11¾ per cent Redeemable Cumulative Preference Shares of £1 each and one *Special Rights Redeemable Preference Share* of £1." [emphasis added]. BT, Memorandum of Association, *supra* note 50 art. 6, n° 2.

[107] Cosmo Graham & Tony Prosser, *supra* note 58 at 79.

[108] In France, the rights attached to the "action spécifique" are provided in general in art. 10 of the *Loi relative aux modalités des privatisations* (L. n° 86-912 du 6 août 1986), modified by the *Loi de privatisation* (L. n° 93-923 du 19 juillet 1993) and are specified for each enterprise in the separate "décret" issued for this.

(1) The right to limit the shareholding of individuals or group of individuals[109]. The shareholdings by any individual or group of individuals in BT is restricted to 15%[110]. This means that if the holding of any individual or group of individuals is about to exceed this percentage, the government has a veto right to oppose the acquisition. By exercising this right it can avoid the holding of more than the allowed percentage of shares. Furthermore, it is not possible for this percentage to be changed without the consent of the government[111]. Since the only function of the golden share in this case is to entrench certain provisions about the limitations on shareholding, which provisions are then applied by the

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[109] There are two different types of schemes with respect to the restrictions on shareholdings. One, peculiar to Britoil and Enterprise Oil, is that if any person controls, or makes an offer for, more of 50% of the voting rights, then the special shareholder will have one more vote at the general meeting than all the other shareholders. The other is that applied in BT. For more details, see Cosmo Graham, "Privatization - the United Kingdom Experience" (1995) 21:1 Brook. J. Int'l L. 185 at 197 [hereinafter Graham, "Privatization"]; Cosmo Graham & Tony Prosser, "Golden Shares: Industrial Policy by Stealth?" [1988] Public Law 413 at 415 [hereinafter Graham & Prosser, "Golden Shares"].

[110] This percentage is usually set at 15%, but there are cases where it is higher, for example in Enterprise Oil it is set at 50%. Peter Curwen, *supra* note 2 at 216; Cento Veljanovski, *supra* note 13 at 127-28.

[111] The wording from the Memorandum and Articles of Association of BT reads as follows:

> Art.12 (B) Notwithstanding any provision in the Articles to the contrary, each of the following matters shall be deemed to be a variation of the rights attaching to the Special Share and shall accordingly be effective only with the consent in writing of the Special Shareholder.
>
> (ii) the issue of any shares in the capital of the Company with voting rights attached thereto, not being shares with rights identical with those attaching to the Ordinary Shares of the Company provided that there shall be excluded from this sub-paragraph (ii) the issue of any shares which do not constitute equity share capital and which when aggregated with all other such shares carry the right to cast less than 15 per cent of the maximum number of votes capable of being cast on a poll at any General Meeting (in whatever circumstances and for whatever purpose the same may have been convened).

directors, some authors have concluded that it is possible to have such limitations without a special preference share[112].

If we compare this limitation on shareholdings in Britain with analogous provisions in Japan, we can find some common points as well as some differences. The common point is that in the NTTCA (NTTCA, art. 4-2 (3)), for example, a limitation of 20% on shareholdings by foreigners is provided[113]. The difference is, however, in the percentage of the limitation[114], and the requirement with respect to the nationality of the holders of this percentage. While in Britain, the restriction applies to both British nationals and foreigners without distinction, in Japan it applies only to the foreign shareholdings[115].

In Britain, when the percentage of shares held in the company exceeds the provided maximum, the shareholder is compulsorily divested of them and the

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[112] Examples include British Airways and the TSB. Graham, "Privatization", *supra* note 109 at 197; Graham & Prosser, "Golden Shares", *supra* note 109 at 416.

[113] This limitation was a strengthened one in comparison to the general provision in the *Telecommunications Business Act* (art. 11) which set up a limitation of 33% to the shareholdings by foreigners with respect to any other business related to the industry. This provision was removed in 1997, except for NTT and KDD, where the 20% cap on foreign investment is still in force.

[114] In France, for instance, before the amendment of Loi n° 86-912, the approval of the Minister of Economy was necessary in cases when the shareholding of a person was going to exceed 10%. Now the Minister of Economy fixes in a "décret" several thresholds calculated as a percentage of the capital or the voting rights. When a person or group of persons is going to purchase a number of shares exceeding one of these thresholds, he/she has to take in advance the approval of the Minister (Loi n° 86-912, art. 10 (2) n°1). In Elf-Aquitaine the thresholds are fixed at 1/10, 1/5 and 1/3 (Décret n° 93-1298 du 13 décembre 1993, art. 2 (1)). In Canada, with respect to the limitation on shareholdings in Petro-Canada the articles of amendment of the company shall contain "provisions imposing constraints on the issue, transfer and ownership ... of voting shares of Petro-Canada to prevent any one person, together with the associates of that person, from holding, beneficially owning or controlling, directly or indirectly, otherwise than by way of security only, in the aggregate voting shares to which are attached more than 10% of the votes that may ordinarily be cast to elect directors of Petro-Canada, other than votes that may be so cast by or on behalf of the Minister" (s. 9 (a)). And with respect to non-residents the limitation on shareholding is 25% (s. 9 (b)).

[115] See Part 3.2.2.2, below.

shares are sold to other parties. While the procedure is being carried out, the shareholder is deprived of the voting rights[116]. In Japan, the company will not enter the name and the address of such a person in the register of shareholders, and has to take the necessary measures to ensure that the "ratio of voting rights of foreign nationals" does not reach or exceed one-fifth. The effect is the same as in Britain, *i.e.* the shares exceeding the provided percentage will not have voting rights and their owners will be obliged to dispose of them[117].

(2) The right to monitor the composition of the board of directors and right to participate in it. In the articles of association of BT it is provided that the top managers shall be British nationals[118], and that the government shall appoint a few of them[119]. This system of appointment of one or more directors by the government and of monitoring the composition of the board, is known as the "government directors" system[120]. It is stated in the articles of association[121] and

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[116] Graham, "Privatization", *supra* note 109 at 197.

[117] The same is true in France, where the holders of illegal shares are deprived of their voting rights, are made to dispose the shares in three months and if they do not obey, their shares are compulsory sold at the stock market. For details, see *Décret n° 86-1141 du 25 octobre 1986, pris pour l'application de l'article 10 de la loi n° 86-912.*

[118] Robert Fraser & Michael Wilson, *supra* note 2 at 37. The same is true in the case of C & W, Rolls-Royce, British Aerospace. Nakamura, Daichi, *supra* note 72 at 28.

[119] Peter Curwen, *supra* note 2 at 216; Cento Veljanovski, *supra* note 13 at 127-28.

[120] The same "state representative system" of appointment of one or two state representatives without voting rights at the board of directors or the board of supervisors is provided in France as well (Loi n° 86-912, art. 10 (2) n°2). For Elf-Aquitaine, the number of so-appointed directors is set at two (Décret n° 93-1298 art. 2 (2)). In Italy as well, there is a similar system of appointment of one or more directors to the board of directors of companies with state participation, which as in Britain is limited to the case when this is included in the articles of association of the company. Their removal is also the prerogative of the state (Codice Civile, art. 2458 (1)).

[121] In Britain, it is considered that a director may be made irremovable by using the technique of "weighted voting" or by providing in the articles that each class of share should carry the exclusive right to appoint one director. L.S. Sealy, *supra* note 47 at 261, notes 3. Hence, this right attached to the golden share is not a unusual practice.

cannot be changed without the consent of the government (BT's AA, art. 12 (B) (i)).

Whereas in BT two of the directors[122] are directly nominated by the government, thus imposed on the company, in Japan all the directors are elected at the general meeting of shareholders and subsequently approved by the MPT in order for the resolution to be enforced[123]. Thus, it can be said that the Japanese system seems to be more relaxed, because the shareholders and not the government elect the directors, however it clearly contains elements of both private and public law.

On the other hand, in Britain the appointment of government directors is a requisite of the golden share and therefore seems to be of a private law nature. In addition, the loyalty of the government-appointed board members is considered to be to the company, and not to the government. In most cases this has been expressed in a letter to the chairman of the new entity and outlined in the prospectus at the time of flotation[124]. Although guidelines are issued to the

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[122] Marcus Brooks, *supra* note 35 at 73; Robert Fraser & Michael Wilson, *supra* note 2 at 37; D. Clementi, supra note 8 at 171. But Kenneth Wiltshire speaks about five government-nominated directors in BT in relation to the oversight of the special share agreement. Kenneth Wiltshire, *supra* note 5 at 55. In this study the number two will be used, with the remark that no matter whether two or five of the directors are nominated by the government, the number of so-appointed directors is less than a majority in the board of directors (consisting of 13 members) in BT. Most important is the existence of this system and the impact it has on the governance of the company.

[123] In Petro-Canada, before the date on which shares of the company are first issued to persons other than the Minister, the Minister may, with the approval of the Governor in Council, appoint the chairperson, chief executive officer and other directors of Petro-Canada to hold office for a period of one year (s. 16 (2)). This option given to the Minister may be exercised at his own discretion before the privatization of Petro-Canada. After privatization the directors are to be elected pursuant to the CBCA without any intervention of the government in this respect. Thus, it can be said that regarding the management of the company the system in Canada is completely based on private law, without any remainder of public law elements.

[124] Kenneth Wiltshire, *supra* note 5 at 44.

directors on appointment, there is no requirement for reporting from them back to the minister[125], thus they are not responsible to the government or the parliament[126]. Furthermore, so-appointed directors are not to be civil servants[127] and in the case of BT two businessmen have been appointed. They were not allowed to hold executive office in the company or to be its chairman or deputy chairman. However, unlike other directors, a general meeting of shareholders could not dismiss them[128].

Despite the difference that all of the directors of NTT have to be subsequently approved by the MPT and that only two directors of BT are directly nominated by the government, and despite the fact that in Britain the government has to promise that such appointed directors will not impose the government's will while in Japan there is no such necessity, in both countries it is clear that the government continues to monitor even the daily operations of the company by ensuring that the whole or part of the board is composed of people who will pursue government policy.

In 1994, the provision for government-appointed directors was abolished[129], as the government felt that it was inappropriate as it no longer

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[125] *Ibid.* at 56.

[126] In Italy, for instance, although the rights and duties of the directors appointed by the state are the same as these of the other directors (Codice Civile, art. 2458 (3)), they are considered to be civil servants and to have responsibilities not to the company but the state. Tulio Ascarelli, "Controlli e amministratori nell'anonima di Stato" [1933] Riv. des Dir. Commerciale 284; I. Giorgio Cian & Alberto Trabucchi, *Commentario Breve al Codice Civile*, 2056-2058, 4th ed. (CEDAM, 1992).

[127] According to the rules of British public administration civil servants are appointed only when an enterprise receives government subsidies. Kenneth Wiltshire, *supra* note 5 at 56.

[128] Marcus Brooks, *supra* note 35 at 73.

[129] *Ibid.*

owned shares in the company[130] - although its other powers in connection with the golden share remained unchanged until its redemption.

(3) The right to oppose a voluntary dissolution or winding up of the company[131]. This provision in the articles of association is meant to prohibit any attempt at the dissolution of the company. In Britain it is necessary to have the written consent of the special shareholder and in Japan the approval[132] of the MPT. The rationale behind such a measure is in the importance of business operations of the privatized concerns to the public and in the "universal services"[133] that they are required to provide. As far as society as a whole is concerned, the government cannot allow these companies to be dissolved at the will of some of the investors, even if they are a majority of the shareholders. Therefore, concerns regarding social objectives in this case prevail over the economic ones.

(4) The right to oppose the disposal of all or substantial part of the company's or of its subsidiaries' assets[134]. What is "substantial" part of the assets is to be determined by the articles of association, and usually it is said to be a part

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[130] The sale of all the remaining government-owned shares was accomplished in 1993.
[131] There is no such right attached to the French "action spécifique".
[132] The form of the approval is merely a written consent.
[133] "Universal service provisions are justified by the need to provide access to public services for all groups regardless of their place in the distribution of incomes; as the European Commission put it at an early stage of preparations for liberalization of telecommunications services: Universal service obligations imposed by national legislation or authorization regimes generally oblige market participants to provide a certain basic service to customers whom they may otherwise have insufficient economic incentive to serve." Tony Prosser, *Law and the Regulators* (Oxford: Clarendon Press, 1997) at 14.
[134] The similar right to oppose, within the terms fixed by a "décret" of the "Conseil d'État", to decisions on transfer of assets or to the setting of collaterals on assets if this would abuse "national interests", can be set out as one of the requisites of the French "action spécifique". *Loi n° 86-912* (art. 10 (2) n°3); *Loi n° 96-314 du 12 avr.1996*; *Décret n° 93-1296 du 13 déc. 1993*.

having a value of more than 25% of the net capital[135]. In this case, even a substantial restructuring of the company will depend on negotiations between it and the government, rather than the free play of market forces.

This provision is similar to the requirement that approval of the MPT be granted when NTT decides to transfer or mortgage its telecommunications trunk lines or other important facilities (NTTCA, art. 13). The difference is that in the case of NTT the term "important facilities" is not defined, and this is left to the discretion of the directors[136]. The rationale in both cases, it seems, is to prevent the companies disposing of assets that might cause difficulties in pursuing their economic and social objectives.

(5) The right to oppose the issue of special shares different from the ordinary ones. In the case of BT the creation of non-equity shares is allowed under the condition that when aggregated with all other such shares, they will carry the right to cast less than 15% of the votes capable of being cast on a poll at any general meeting (BT's AA, art. 12 (B)(ii)). Hence, the issue of shares with rights identical to these attached to the ordinary voting shares is allowed, as well as the issue of non-equity shares, but in both cases the holding percentage is limited to 15%. However, the issue of any special shares not having voting rights

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[135] This type of provision has been introduced in the articles of association of Amersham International, Cable & Wireless, Jaguar and Rolls-Royce. *The Independent* (29 January 1988, 8 July 1991); Nakamura, Daichi, *supra* note 72 at 28.

[136] The articles of amendment of Petro-Canada also have to contain provisions preventing the company "from selling, transferring or otherwise disposing of [..] all or substantially all of its [...] assets to any one person or group of associated persons or to non-residents, otherwise than by way of security only in connection with the financing of Petro-Canada" (s. 9 (1)(d)). This is a general prohibition with exceptions, which is not even subject to approval by the government.

attached to them is possible only with the written consent of the government. This provision differs from the requirement that the MPT gives his approval to any decision of the board of directors to issue either ordinary voting shares or preferred shares in NTT. This gives the impression that, to some extent, the issue of new shares in BT is allowed, and hence the access to the stock market for financing the operations of the company is not limited, whereas in NTT the MPT always has the final word, and so barriers to the stock market still exist[137].

As a result, in BT's case the consent of the government is absolutely requisite for the voluntary dissolution of the company, the disposal of a "substantial" part of the assets, and the issue of special shares that can compete with the golden share.

(6) In addition, it is necessary for the consent of the special shareholder, namely the government, to be given for modification of the rights of the golden share. On the basis of the general rules of company law, in order for the rights attached to the golden share to be altered or deleted, it is necessary that a special resolution for changes to the articles of association be passed with a majority of 75% of the voting shares[138]. However, if the golden share is considered to be a separate class of shares, the special shareholder of this class has to vote separately

[137] It is noticeable that there are not any restrictions on Petro-Canada with respect to issue, sale or disposal of shares (s. 7), this making the company free to use all devices with respect of its capital provided in the Canada Business Corporations Act.

[138] The company is empowered by the statute to alter the regulations contained in its articles from time to time by special resolutions (Companies Act 1985, ss. 9, 378); and any regulation or article purporting to deprive the company of this power is invalid on the ground that it is contrary to the statute. L.S. Sealy, *supra* note 47 at 132.

when the proposed modification concerns him[139]. Thus, the necessity of consent of the special shareholder in this case does not contravene the company law provisions.

(7) Moreover, the golden share gives the special shareholder the right "to receive notice of, and to attend and speak, at any general meeting or any meeting of any class of shareholders of the company but the special share shall carry no right to vote nor any other rights at any such meeting" (BT's AA, art. 12 (C)). Hence, the special shareholder is guaranteed a right to attend all the meetings of any class of shares in the company, which allows him to have information about any resolution passed at such meetings. Although having no voting right at the meetings, the attendance right alone allows the special shareholder to take the necessary measures if a resolution not in his interests has been passed.

(8) In a distribution of capital in a winding up of the company, the special shareholder is entitled to repayment of the capital paid up on the golden share in priority to any repayment of capital to any other member. However, the golden share confers no other right to participate in the capital or profits of the company (BT's AA, art. 12 (D)). This distinguishes the golden share from the preference non-voting shares, which holders are usually entitled to a guaranteed bigger share in the profits of the company. A preference is here guaranteed only with respect to the capital to be distributed in a winding up procedure.

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[139] Section 125 (2) of CA 1985 requires the written consent of three-quarters in value of the shares of the class, or the sanction of an extraordinary resolution passed at a separate meeting of the holders of such shares, before any variation of the rights of that class can be made. *Ibid.* at 469.

(9) Furthermore, the special shareholder may require the company to redeem the golden share at par at any time, by serving written notice upon the company and delivering the relevant share certificate (BT's AA, art. 12 (E)). This is another peculiarity of the golden share, consisting in that only the special shareholder and not the company may require redemption of the share[140].

(E) Analysis

In sum, the golden share is a par value, non-voting, redeemable share, that is preferred only in winding up, and that may be held only by the government. Therefore, the golden share is neither an ordinary share, nor a preferred one in the general company law sense. Having no voting rights attached to it, it differs from the multiple voting rights shares that are usually used to entrench a controlling shareholder. The power of this share is in the special rights attached to it, consisting of the requirement that certain resolutions of the general meeting of shareholders be passed only with the consent of the special shareholder. The special shareholder, however, in this case is not an individual or a legal entity but an administrative body, namely the Secretary of State. Even though when giving consent, he is acting not as an administrative body but as a shareholder exercising his rights at his discretion, his act is not of a purely private nature. The requirement that only the government may be such a special shareholder, and the importance and the large scope of the subject-matters requiring his consent,

[140] In fact, the golden share was redeemed in 1998. For details, see (H) Temporary Measure, below.

reinforce this impression. It seems, thus, that in the privatization process private (company) law has been publicized, *i.e.* public law elements have been introduced into it.

This single share represents merely one-billionth of all the outstanding ordinary shares[141], but the power attached to it is sufficient to outvote all of the others. By holding only this share the state is able to block decisions on important issues, it may monitor the composition of the board of directors, and in fact influence the management of the company. As a result, when the state sells a large number or all of the outstanding shares, the golden share becomes the substitute to its controlling power as an ordinary shareholder. The state's control in this case consists not in an intervention in day-to-day decision-making process, but a much more sophisticated system of overlooking and monitoring through the powers attached to the golden share, and through a new regulatory framework[142]. Thus, it can be said that the government of Britain used its unlimited power to invent a new type of share so as to replace public law control by private law control.

[141] By a special resolution passed on 15 November 1984 BT's share capital was increased to £2,625,000,001 by the creation of 5,500,000,000 ordinary shares of 25p each. BT, Memorandum of Association, *supra* note 50 at 11, n° 2.
[142] See Part 4.2, below.

(F) Use

It has been argued by some authors that the golden share does not have real power, and most probably it will not be used by the state[143]. However, one must not ignore the fact that the golden share has potential power that can be used in situations when the interests of the state are threatened. Hence, even in a limited number of situations, by exercising all or any of the rights attached to it, the state will give expression to the power it still has.

In fact, there are only few cases, in which the state has made use of its golden share. It was successfully used in the case of Rolls-Royce to force the disposal of certain foreign shareholdings, in General Motors bid for Jaguar[144], and in the allocation of shares in Enterprise Oil to Rio Tinto Zinc[145]. And there are examples where despite the existence of the golden share, the government did not exercise the right to block a merger[146].

Thus, it can be said that the golden share, merely by the fact of its existence, represents a barrier to any attempt to acquire more than the permitted percentage of shares. However, the mere fact of its existence can become one of

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[143] The veto rights attached to the golden share "may prove to be more theoretical than real." Vincent Wright, *supra* note 33 at 39. "There is a little evidence that the ownership of the golden shares has been significant and it seems more of a political response to Opposition criticism than a device for facilitating the continuation of governmental "steering" of the privatized industries." Jeremy J. Richardson, *supra* note 11 at 71.

[144] For details, see Graham, "Privatization" *supra* note 109 at 197-98.

[145] For details, see Cosmo Graham & Tony Prosser, "Rolling Back the Frontiers? The Privatization of State Enterprises" in Cosmo Graham & Tony Prosser, eds., *Waiving the Rules: The Constitution Under Thatcherism* (Philadelphia: Open University Press, Milton Keynes, 1988) 73 at 85 [hereinafter Graham & Prosser, "Rolling Back the Frontiers?"]; Graham & Prosser, "Golden Shares", *supra* note 109 at 424.

[146] Examples of non-use of the golden share include the acquisition of Jaguar by Ford and the acquisition of Britoil by British Petroleum. *The Independent* (29 January 1983, 3 November 1989, 18 April 1996).

the reasons for even desirable mergers to be blocked, such as in the case of the proposed merger between BT and the American MCI a few years ago (in 1997). In this case the existence of the golden share was seen as an obstacle, making doubtful the approval of the merger by the Federal Communications Commission[147]. It was an obstacle, because it was hard to predict in what circumstances and for what reasons the government would make use of the rights included in the golden share. Furthermore, this discretion left to the government raises concerns and problems regarding the free use of the market for corporate control[148]. This considerably diminishes the capital-market pressures that are crucial to the government's market-oriented system of control[149].

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[147] "Golden Share Worry for BT/MCI Merger" *Financial Times* (16 May 1997) at 25. Finally, the merger between BT and MCI was approved by the Federal Communications Commission subject to conditions. Federal Communications Commission, News Release "Regarding BT/MCI merger" (21 August 1997), online: FCC <http://www.fcc.gov/Speeches/Chong/separate_statements/ rbcbtmci.html> (date accessed: 2 May 2000). Despite the approval the merger has not been consummated, because of the WorldCom's offer to MCI. *Les Echos* (7 October, 13 October, 13 November 1997, 13 May 1998), online: <http://rvp.tvt.fr/themes/TELECOMMUNICATIONS> (date accessed: 3 May 2000).

[148] "The central object of the "golden share" is the prevention of undesirable takeovers. However, the result was that with the introduction of "golden share" the market for corporate control has been replaced with the protective presence of the government. The logic of the corporate market arguments is that if managers are inefficient, the share price of the company will be lower than it could be with an efficient management. This provides the opportunity for an outsider to make a takeover bid. The mere threat of takeover is enough to encourage efficiency among managers. However well or badly this market may work in the ordinary case, it is simply non-existent when a "golden share" scheme is in operation." Graham & Prosser, "Rolling Back the Frontiers?", *supra* note 145 at 84-85.

[149] "It is difficult to envisage the threat of a hostile takeover bid being taken seriously by most of the [privatized] companies." Cento Veljanovski, *supra* note 13 at 128. "The golden share effectively diminishes the forces of the market-place insofar as, for example, a justifiable takeover bid for an inefficient privatised firm may be rejected out of hand by government." Peter Curwen, *supra* note 2 at 217.

(G) Purposes

These cases raise the question of what purposes the golden share serves. First, there is uncertainty about whether the government will use the golden share even in the case of a launched foreign takeover bid, thus, the purported purpose of safeguarding the enterprise from falling under foreign control is almost without grounds. Second, when used, it prevents the board from making its own decision about the future of the company, thus the aim to introduce the enterprise to a new market discipline can have only a limited success. Thus, it can be concluded that golden shares in privatized companies replace the market for corporate control with government discretion[150].

It is possible for the state to achieve the aims that it is pursuing with the golden share by continuous holding of a certain number of voting shares, but this would be against the aims it is trying to pursue by the privatization. Thus, by issuing only one golden share, it is possible both to continue with the privatization and to maintain the state's controlling power over the company. This device of the golden share, however, is not used in the privatization of all the enterprises. The state introduces it only in industries important to the public, such as telecommunications. Usually these enterprises are large, and have a monopoly position[151]. In order to avoid undesirable takeovers the state sets up limitations on the shareholdings and usually makes use of the outvoting rights in case of

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[150] Graham, "Privatization", *supra* note 109 at 201.

[151] In the case of BT with the establishment of Mercury a duopoly has been created in the telecommunications market, which continued until 1990s. However, during this period BT maintained its dominant role in the British market.

takeover bids by foreigners. Another concern of the state with respect to enterprises to be privatized is "to provide an opportunity for management to adjust to the private sector"[152].

As a result, on the one hand, the golden share accelerates the privatization of the ownership by making possible the sale of all the outstanding shares owned by the government, gives time to the privatized enterprise to adapt to the new environment and conditions of the private sector. On the other hand, it provides protection of public interests. However, as mentioned above, the rights attached to the golden share are a barrier to the completely free operation of the enterprise in the new private environment. Thus, if it is introduced as a measure to keep the state control, it is necessary to limit this to enterprises with significance to the public; to enterprises that have not only economic objectives to pursue, but also a social responsibility[153]. These could be "public utilities" or enterprises with strategic importance in the field of national security, as stated in art. 55, 56 and 223 of the Treaty of Rome[154]. However, even in these "strategic" industries, it seems preferable for a golden share to be introduced only as a temporary measure until competition arrives.

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[152] The Treasury, *Privatisations in the United Kingdom: Background Briefing* (London: HM Treasury, 1990).

[153] This is a pertinent point with respect to the ongoing privatization of public utilities in the less developed countries.

[154] The general principle in the Treaty of Rome is that "Member States shall accord nationals of the other Member States the same treatment as their own nationals as regards participation in the capital of companies" (art. 221). Exemptions from this rule include activities connected with the exercise of official authority (art. 55), special treatment of foreign nationals on grounds of public policy, public security and public health (art. 56), measures to protect essential interests of state security in connection with the production of or trade in arms, munitions and war material, are allowed (art. 223).

(H) Temporary Measure

In Britain there are two kinds of shares – those with a fixed time period[155], and those with an indefinite period[156]. It is submitted that a golden share with an indefinite period is introduced in order to avoid undesirable acquisitions by foreigners of enterprises having importance to the public interests, while a golden share with a fixed time period is introduced as a temporary measure to allow the company to adapt its operations to the market environment[157]. In the case of golden share with a fixed time period, when the period expires it is necessary to alter the articles of association by a special resolution at a general meeting of shareholders. This gives the company the opportunity to consider the possibility of extending the existence of the golden share[158].

The golden share of BT had an indefinite period and, as a redeemable share, it could be redeemed by the company upon written notice from the government (BT's AA, art. 12 (E)). In fact, in 1997 the government announced the redemption of its golden share in BT.

> This was the final step for BT in removing the traces of formal government control after thirteen years in the private sector. It

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[155] Examples of golden shares with a fixed period are as follows: in British Steel until the end of 1993, *The Independent* (14 January 1989); in the ten Water Authorities until the end of 1994, *The Independent* (19 January 1989); in the twelve Electricity Authorities 5 years until the end of March 1995, *The Independent* (29 January 1988); in British Technology Group 5 years, *The Independent* (8 July 1991); in AEA Technology 3 years, *The Independent* (3 September 1996).

[156] Examples of golden shares with an indefinite period are the cases of British Aerospace, Britoil, Sealink, Cable & Wireless, British Telecom, British Gas, Rolls-Royce, BAA. With respect to Rolls-Royce the restriction on shareholding by British citizens was with a definite period and expired in February 1988, but the restriction on shareholding by foreigners is with an indefinite period, *The Independent* (29 January 1988, 14 January 1989).

[157] *The Independent* (29 January 1989); Nakamura, Daichi, *supra* note 72 at 29.

[158] This was the case of Amersham International, which extended the period of existence of the golden share. *The Independent* (29 January 1988).

> gives clear confirmation to the outside world that BT operates in a normal, competitive environment with the same opportunities and constraints as other commercial organizations. This is important symbolically in the newly liberalizing world marketplace.[159]

For some authors, the redemption of the golden share in BT was made to smoothen the full merger with MCI[160]. Although the merger might be the catalyst for the redemption, more important is the result: as stated in the governmental announcement quoted above, the traces of formal government control were removed.

Indeed, by a special resolution passed on 15 July 1998, the £1 of BT's share capital representing the Unclassified Share arising from the redemption of the one Special Rights Redeemable Preference Share of £1, was reclassified as four Ordinary Shares of 25p each[161], and new articles of association have been adopted by a special resolution passed on 14 July 1999. This confirms the conclusion that even when necessary from the point of view of the protection of public interests, the golden share should be introduced as a temporary measure only for a limited period of time.

(I) Comparison with the Approval by the MPT in NTT

As mentioned above, the comparison between the rights attached to the golden share in BT, and the issues subject to approval by the MPT in NTT,

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[159] These are the words of chief executive Sir Peter Bonfield in BT, News Release NR9753, "BT Welcomes Redemption of Special Share" (15 July 1997), online: BT <http://www.bt.com/world/news/newsroom/document/nr9753.htm> (date accessed: 5 June 2000).

[160] Willem Hulsink, *supra* note 35 at 152.

[161] BT's Memorandum of Association, *supra* note 50 at 11.

reveals almost no differences, with the exception of the limitation on the individual shareholdings. Another common point consists of the form in which these rights are to be exercised, namely the written consent of the Secretary of State for BT, and the approval of the MPT for NTT. If the duty of continuous holding of a certain percentage of shares by the government in Japan is abolished, the exercise of the approval in Japan and the exercise of the special rights attached to the golden share in Britain would lead to the same effect. The difference is that while in Britain the state acts as a special shareholder only in emergency cases and at its own discretion, in Japan the intervention by the state takes the form of an approval, having an administrative element, and thus it is more frequent and not limited to emergency cases. The reason for this difference might be related to the more relaxed legislation regarding the different classes of shares that may be issued in Britain. The golden share arrangements are not greatly unlike similar constraints that surround other private companies floated on the stock market; thus they are in a form familiar to the British share market[162].

[162] "The marketability of British companies is affected by the tolerance of the regulatory system or of investors to the adoption of structural defences. These take the form of share structures which give voting power to "inside" shareholders disproportionate to their percentage holdings, with the effect that a bidder who obtains a majority of the shares may fail to take voting control. Measures include issuing non-voting shares or shares with enhanced voting rights, and limiting the voting rights of a member to a fixed percentage regardless of the total shares held. In Britain there are no legal barriers to issuing voteless shares or shares with weighted votes (either in regard to all matters or specifically in relation to a change in control). For example, after the battle for the control of the Savoy Hotel Ltd, its capital was reorganised in such a way as to give the holders of less than 3% of the equity the ability to outvote the rest." J.E. Parkinson, *supra* note 19 at 148-49.

A similar operation in Japanese company law can be found in the shareholders rights in common interest[163], as for example, the right to request the revocation (cancellation) of shareholders meeting resolutions (CC, art. 247 (1)) or the right to request a new issue of shares to be suspended (CC, art. 280-10). However, while these rights can be exercised by the shareholders through court intervention, the veto rights of the golden share empower the state to achieve the same effect without the need for court review. On the other hand, unlike the British system under the Japanese Commercial Code it is impossible for resolutions of shareholders meetings, such as changes in the articles of incorporation, dissolution or winding up of the company, disposal of assets, or issue of new shares, to be made conditional upon the consent of a certain shareholder. In addition, if introduced in Japan, the golden share arrangements would be in contradiction with general principles of company law, such as "one share one vote" and "equal treatment of shareholders", the principle that the directors are elected by the general meeting of shareholders, and the principle that decisions by the board of directors or the general meeting are taken by the majority prescribed in law and cannot be outvoted by a minority shareholder[164].

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[163] In Japan, the rights of shareholders are in general divided into two different types. One is rights in common interest, such as voting rights, and the other is rights in personal interest such as the right to dividends. For details, see Kanai, Masamoto, *Masta Shouhou (Master Business Law)*, (Houken Shuppan, 1992) at 88-89.

[164] This was one of the reasons for the golden share's introduction in France after a profound transformation. Jean-Luc Delahaye, "La Golden Share à la française: l'action spécifique" (1987) 13-4 D.P.C.I. 579 at 582. This transformation was to such an extent that some authors expressed the opinion that "the golden share provisions provide a much weaker form of intervention after privatization in France than in Britain; a country with a stronger concept of the state and a greater history of governmental intervention does not find these reflected in stronger powers of intervention." Graham & Prosser, "Golden Shares", *supra* note 109 at 421.

Probably so as not to contradict the principles of the company law, Japan did not introduce the golden share and chose instead the method of ministerial approval as a means of monitoring the operations of the privatized enterprises, a method in accordance with its legal practice. The "special company" system adopted on the privatization of NTT[165] is another element of this legal practice.

Thus, while in Britain the intervention of the state is achieved by a private law technique, in Japan public law elements continue to exist, interrelated with private law elements[166]. For this reason, it is said that a Japanese "special corporation" will be "entirely privatized" only when the special corporation law, providing its status, is repealed[167].

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[165] See *supra* note 39, above.

[166] It is noteworthy here that special provisions, some of them similar to the rights attached to the golden share, have been made mandatory in the articles of amendment of Petro-Canada by the *Petro-Canada Public Participation Act* (s. 9). On the other hand, the provision of s. 8 that before sending the articles of amendment to the Director the company shall submit them to the Minister for approval, makes the Canadian system one that falls between the British and Japanese ones. Another similar to the Japanese system element is that these requirements are set out in a special act. Thus, the Canadian system avoids the creation of a golden share, but makes it more difficult to change the system because of the necessity of regulatory intervention.

[167] This was a statement with respect to KDD, the Japanese provider of international telecommunications services. Although KDD was privatized in 1956 by the sale of all of its shares, the abolition of 1953 KDD Company Act in 1997 (in effect from the spring of 1998) is considered to be the point of its "full privatization". *Les Echos, L'Agefi* (12 November 1997), online:<http://rvp.tvt.fr/themes/TELECOMMUNICATIONS/art5_du_12_novembre_1997.html > (date accessed: 3 May 2000); *Report on the Japanese Telecommunications Industry*, October 1997, online: DFAIT <http://www.dfait-maeci.gc.ca/geo/html_documents/ report1-e.htm> (date accessed: 12 July 2000).

3.2.2 Measures Related to the Shareholdings of Investors

In addition to the continuous holding of a certain percentage of shares by the state, the issue of a golden share with special rights attached to it, and the approval by the minister of certain decisions of the general meeting of shareholders, all already described above, the state also takes other measures with respect to the purchase of shares. Examples include dispersing shares to numerous shareholders by providing preferences to the general public and/or employees, and limitations on shareholding by legal entities and institutional investors, nationals and foreigners.

3.2.2.1 Dispersing the Shares

(A) Preferences to the General Public

Privatization of large entities in countries with developed stock markets is usually accomplished by the sale of shares to the public. This is in compliance with one of the objectives of privatization in Britain, namely to develop a "popular capitalism" and to form a new class of shareholders[168]. To achieve this aim, there is no other means than to disperse the shares between numerous shareholders. At first glance this looks like a very democratic and liberal view.

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[168] "Real public ownership - that is ownership by the people - must be and is our ultimate goal.", Nicholas Ridley, Economic Progress Report, May 1982 cited by Peter Curwen, *supra* note 2 at 210; "[T]o promote wide share ownership; to encourage workers' share ownership in their companies" became one of the major objectives of privatization, Cento Veljanovski, *supra* note 13 at 8.

However, the effect is not only to prevent a future re-nationalization, which was one of the concerns of the government[169], but also to make it easier for the state to keep and maintain its control over the privatized concerns.

In Britain, for example, a system of setting a low purchasing price per share was introduced. This was accompanied by setting a small number for the minimum share purchase, and providing for payment of the price in two or three installments. In addition, when the shares are held for a certain period from the time of purchase, bonus shares are awarded. The detailed figures for BT are as follows: For one share of 130p payment could be in three installments of 50p, 40p and 40p over a period of 16.5 months[170]. The minimum investment was set at £250. One share was given for every ten held for three years, and the shareholders were given the option to choose to take discount coupons on telephone bills instead of the free bonus share[171]. This system of free bonus shares and discount coupons after a three year period of shareholding had the effect, on the one hand, of encouraging long term holding by individuals and, on the other hand, of avoiding the concentration of shares through their transfer to a small number of holders.

On the other hand, in Japan the main concern of the government with respect to the flotation of shares of enterprises undergoing privatization was to

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[169] Cento Veljanovski, *ibid.* at 128; Vincent Wright, *supra* note 33 at 51; Cosmo Graham & Tony Prosser, *supra* note 58 at 79.

[170] During the period when the shares remained partly paid for, individual shareholders were eligible to receive the full dividends paid by BT. BT Pathfinder Prospectus, item 5, Newman Karin, *supra* note 34 at 147.

[171] Newman Karin, *supra* note 34 at 99, 147.

maintain a fair and free market in order to protect investors. For this reason, the first sale of NTT shares in 1986 was fulfilled by a tender offer without any preferences given to the general public. However, a maximum purchase number of 20,000 shares was set up so as not to allow concentration of shares in a limited number of people. In the subsequent sales of shares, this limitation was not applied, nor were preference measures introduced[172]. Yet, in Japan there are no restrictions on transfer of purchased shares in enterprises undergoing privatization, thus, the general company law rule of "free transfer of shares" applies.

The reason why the system of preferred public participation in the privatization was not adopted in Japan as it was in Britain, can be found in the main privatization objectives of these countries. In Britain, there seems to be an inconsistency between, on the one hand, the objective of raising revenues and reducing the public sector borrowings and, on the other hand, the objective of making every citizen a shareholder by fixing a low share price and by providing the above-mentioned peculiar "sweeteners". In contrast, in Japan the privatization was a part of the administrative reform, and thus the emphasis was on increasing the revenues for the budget[173]. However, it is not without importance that in the 1980s only three large entities became privatization targets in Japan[174], and that

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[172] Ishido, Masanobu, *supra* note 10 at 68-70, 77, 82; Okitsu, Takeharu, "Nihon-denshin-denwa-kabushiki-kaisha kabushiki-no dainiji-baikyaku ni-tsuite" (The Second Sale of Shares of NTT), (December 1987) 23-9 Finance 28 at 28-29.

[173] Marianna Strzyzewska-Kaminska, *supra* note 18 at 498.

[174] The three public corporations, targets of the Japanese privatization program in 1980s are NTT Public Corporation, Japan National Railways, and Japan Monopoly Corporation (tobacco and salt).

the country did not face any financial problems in realization of the privatization[175]. Japan has a large amount of public savings, and by the average share market price the Tokyo exchange market is three times the size of the London market[176]. However, without any measure to redirect the use of the savings of individuals to the purchase of shares, the shareholders structure of NTT, except for the government holdings, followed the traditional Japanese corporate governance structure, with financial institutions and other domestic corporations being the major shareholders[177]. In order to proceed further with the privatization of NTT, it might not be meaningless to consider the introduction of some measures that are attractive to the general public, like those in Britain.

However, providing preferences to the public has its negative effects as well. As the government in Britain is pursuing a policy of maximizing small shareholdings, the ownership structure is extremely fragmented, especially if foreign holdings and employee shares are added. The "sweeteners", therefore, have the effect of dispersing the shares to numerous shareholders, whose power - from the standpoint of control - is excessively weak. The examination of the share

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[175] W. Butler, "Les dénationalisations au Japon" in C. De Croisset, ed., *Dénationalisations: les leçons de l'étranger* (Economica, 1986) at para. 1945; Tamamura, Hiromi, *Tenkanki-no min'eika seisaku. Furansu-wa seikou-shita-ka?* (The Privatization Policy in the Transitional Period. Did France succeed?) (Kyoto: Kouyo Shobou, 1997) at 95.

[176] Tamamura, Hiromi, *ibid.*

[177] The forming of "stable shareholders" through mutual exchange of stock with lenders and business partners is one of the peculiarities of the Japanese corporate governance structure. For this reason, some authors even called Japanese capitalism "Capitalism of Legal Entities". For details, see Okumura, Hiroshi, *Houjin Shihonshugi-no-kouzou, Shinpan* (The Structure of Legal Entities Capitalism, new ed.) (Shakai Shisousha, 1993); Okumura, Hiroshi, *Houjin Shihonshugi [Kaisha Hon'i]no Taikei* (Legal Entities Capitalism - Organization of the Corporation) (Asahi Bunko, 1994); Okumura, Hiroshi, *Kaisha Hon'i-shugi-wa Kuzureru-ka?* (Will the Corporatism Decline?) (Iwanami Shinsho 248, 1993); Robert A. G. Monks & Nell Minow, *Corporate Governance* (Blackwell Business, 1995) at 273.

structure of the privatized concerns reveals that the general public collectively owns only a minority of the shareholding[178], so a distortion of voting patterns is still possible. It is well known that the wider the shareholdings, the lower the percentage needed to have control of a corporation.

Another point worth making is that information flow to shareholders is deficient. With the new rule introduced by the British Companies Act of 1989 allowing listed public companies to provide shareholders with an abbreviated version of their reports and accounts (s. 251) the situation was further deteriorated. This option has been taken up by some of the privatized companies, such as BT[179]. In addition, reports of the annual general meetings of privatized industries indicate that, with the possible exception of the first BT meeting, proper scrutiny of directorial performance is non-existent[180].

The only device for the individual shareholders to have a "say" in such enterprises is to overcome their passivity, to organize in associations and to undertake common actions[181]. However, whenever shareholders have attempted

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[178] By the end of May 1985, 1.7 million individuals held only 13.7% of the ordinary shareholding in BT. Kenneth Wiltshire, *supra* note 5 at 99. In BT, the number of small shareholders dropped from 2.1 million on flotation to 1.4 million [in 1995]. Graham, "Privatization", *supra* note 109 at 193.

[179] Graham, *ibid.*

[180] "BT's attitude, sadly, is that it has a statutory obligation to hold an annual general meeting and that the shareholders are there under sufferance". "British Telecom has a Thing or Two to Learn from Ma Bell" *The Economist*, 7 September 1985, at 91.

[181] There are cases of minority shareholders organizing themselves in order to take part in the activity of the general meetings of shareholders. Usually, these organizations are consultation companies on corporate governance, investment companies or pension funds. The efficiency of their activities was recognized with the British Gas case in 1995 where minority shareholders insisted on disclosure of remunerations of the directors and proposed a remuneration committee consisting of independent directors to be formed. As a result of the activities of British shareholders, especially concerning the excessive remunerations of the directors in privatized entities, the Greenbury Committee was formed. Sophie l'Hélias, *Le retour de l'actionnaire. Pratique du corporate governance en France, aux États-Unis et en Grande-Bretagne* (Paris:

to raise controversial issues, they have easily been out-maneuvered[182]. In addition, in privatized companies the state has its own weapon to oppose common actions by minority shareholders, namely the power vested in the golden share in Britain, and the approval by the minister requirement in Japan.

(B) Preferences to the Employees

Preferences in the purchase of shares are provided not only to the general public, but also to the employees of enterprises undergoing privatization. This is because of the view that if the employees purchase shares, and as shareholders take part in the distribution of dividends, they will be more interested in the company's performance and will contribute to increase the productivity and efficiency of the company[183]. Workforces of all privatized industries in Britain were given special privileges at the time of sale. In almost all cases they were allocated free shares, and additional free shares were matched by the government for other shares purchased, although these could not be sold immediately.

Gualino éditeur, 1997) at 151. On the new standards of corporate governance introduced in British Petroleum in 1992, see Robert A. G. Monks & Nell Minow, *supra* note 177 at 304-05. Recently in Japan, although they have not been officially admitted, shareholders ombudsman groups appeared at the scene, demanding and pursuing the liability of directors in large companies.

[182] Examples of unsuccessful efforts of small shareholders to challenge either takeovers or directors include TSB, BREL, British Gas, Yorkshire Water. For details, see Graham, "Privatization", *supra* note 109 at 194-95.

[183] The policies of privatization "allow employees to take a direct stake in the companies in which they work and this leads to major change in attitude.", Cento Veljanovski, *supra* note 13 at 9.

Preferential access to buy additional shares was also given to the employees up to a given amount, although in the case of BT no limit was placed[184].

In the case of privatization of BT, 10% of all shares to be sold were reserved for purchase by the employees. In order to encourage the purchase of these reserved shares, the following preferential terms were provided: three different offers were available; firstly, the free offer was universally available on application for a free gift of 54 shares; secondly, for employees who invested their own money there was a two-for-one matching offer, *i.e.* an investment of £100.10 bought 77 shares to carry 154 free shares making a total of 231 shares, or £370 worth of shares for around £100. The third offer gave each employee the right to apply for up to 1,600 shares at a discount of 10% on the price at which the shares were to be offered to the public, and applications would be met in full. These shares, just like those bought by the public, carried a choice of telephone coupons and bonus shares[185]. As a result, some 96% of the employees accepted the free shares, almost 80% bought matching shares and over 25% bought shares under the priority offer[186].

On the other hand, in Japan, at the time of the first sale of NTT's shares, the purchase by employees was restricted because of the great demand for purchase by the public. This restriction was eliminated for the subsequent sales and the employees were allowed to purchase shares in the company where they

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[184] James Mitchell, "Britain: Privatisation as Myth?" in J. J. Richardson, ed., *Privatisation and Deregulation in Canada and Britain* (Dartmouth, 1990) 15 at 22.
[185] *Ibid.*; Newman Karin, *supra* note 34 at 150-51.
[186] James Mitchell, *ibid.* at 22.

work. Nowadays, the employee stock ownership group is listed as one of the major shareholders in NTT[187]. Nevertheless, employee privileges, similar to those in Britain are not provided. This is because in Japan, as mentioned above, the impartial and competitive purchase at a free and fair market was insisted upon.

In sum, in both countries employee purchase of shares in enterprises undergoing privatization is allowed. The preferences given to them in Britain work as a "sweetener", with the same effect as in the case of purchase of shares by the general public. Thus employees have an incentive to buy shares, which contributed to the dispersal of shareholdings. The dispersal of shares leads to an easier maintenance of control by the state. However, in contrast with the general public, it is not so difficult for the employees to organize themselves in groups, such as employee share-owning plans or pension funds[188]. The main issues raised by them in Britain are related to the remuneration of the directors on the one hand, and to plans for dismissal or a wage freeze of the employees on the other hand[189]. Promotion of non-executive directors, advisory services on proxy issues, and campaigns against anti-shareholders moves by corporate management, are

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[187] NTT Employee Share-Holding Association is the holder of 0.84% of total shares issued in NTT (as of March 31, 2000), online: NTT <http://www.ntt.co.jp> (last modified: May 26, 2000).

[188] In Japan, it is difficult to expect any activity from the employees side, because of the organization of the company itself, with the tradition of career job security (long-time employment contracts), pay and promotion systems heavily weighted toward seniority, unions that include all the employees of the company, and group approaches to decision making. James C. Abegglen & George Stalk, Jr., *Kaisha, The Japanese Corporation* (Tokyo: Charles E. Tuttle Company, 1993) at 181.

[189] Sophie l'Hélias, *supra* note 181 at 172. It is notable that these issues, traditionally the main concern of trade unions, now became the concern of institutional investors.

provided by groups organized at a national level[190]. Although they are common to all companies, these issues are thornier in privatized entities undergoing a difficult period of initial encounter with the market forces. It is to be noted that the issue of employee participation in the board has not been as significant in Britain as in France and Germany despite the "Fifth Company Law Directive" of the EC[191].

3.2.2.2 Limitations on Purchase of Shares

(A) By Nationals

Dispersal of shares can be of importance to everyone, individual or legal entity, local or foreign, who aims at having control over an enterprise. Dispersal makes it easier to achieve "minority control", by holding a percentage of shares less than the 50% of all the outstanding shares necessary for "majority control". The concentration of shares can be achieved by their purchase not only in the primary market but also in the secondary one. For example, the number of shareholders in BT had fallen from 2,051,373 to 1,236,870 by 1990, demonstrating that a process of concentration of privatized shares in the key City institutions had taken place[192]. To avoid further increases in institutional

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[190] At national level groups dedicated to improving the accountability of corporations to their owners include PRO NED, National Association of Pension Funds, Pension and Investment Research Consultants. For details see Robert A. G. Monks & Nell Minow, *supra* note 177 at 305.

[191] On the development of European and British company law with respect to this issue, see L. S. Sealy, *supra* note 47 at 221-22.

[192] J. J. Richardson, *supra* note 100 at 75; see also Graham, "Privatization", *supra* note 109 at 193; Kenneth Wiltshire, *supra* note 5 at 99.

investors' shareholding[193], the state provided limits of 15% on individual shareholding as one of the elements of the golden share. Since this limitation does not apply only to undesirable acquisitions of shares, it can be said that its aim is to prevent any concentration of shares, and thus any attempt to achieve control over the privatized concern.

Another factor reinforcing this conclusion is the recognized passivity of the institutional investors. Empirical evidence shows that they rarely intervene in management matters, and that they will not do so in the public forum of the general meeting[194]. Instead, they prefer to take part in the activities of the company through negotiations and "behind-the-scenes" discussions with management[195]. The passivity of institutional investors became the subject of criticism, with proposals for reform obliging institutions to exercise their voting rights at general meetings[196]. This problem, however, is not peculiar to privatized industries, and so it will not be reviewed in detail. Nevertheless, the passivity of institutional investors is another factor increasing the role of the state in privatized concerns, and making it easier for the government to impose restraints on the market for corporate control.

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[193] In Britain, 67% of domestic equities is held by institutional investors, a stake larger than this of their US counterparts (the comparable figure for the US is 46.8%). Monks & Minow, *supra* note 177 at 303.

[194] Hamish McRae, "Annual Meetings Do Not Work - We Need Another Way" *Guardian*, 17 August 1988, at 7.

[195] Robert A.G. Monks & Nell Minow, *supra* note 177 at 303; Sophie L'Hélias, *supra* note 181 at 163, 166.

[196] Sophie L'Hélias, *ibid.* at 155-56; Revue Governance 30 (November 1995).

On the other hand, in Japan, where the golden share system was not introduced, there are no special provisions in the NTTCA regarding limitations on shareholdings by nationals. Therefore, the general provisions of the Commercial Code[197] and the Anti-Monopoly Act[198] apply. Nevertheless, while they respect these limitations on shareholdings, through the system of cross-shareholding, Japanese financial institutions are often the controlling shareholder in enterprises. Their shareholding of 10.50% in NTT is also significant, making them the second largest shareholder after the government (currently holding 53.30%[199]). Given the dispersal of shares, this percentage alone is enough to make them controlling shareholder if the government proceeds further with the privatization. However, it is not to be forgotten that they have to act in concert, and that the provision for continuous holding of one-third of all shares by the government is still in force.

(B) By Foreigners

In the process of privatization of "natural monopolies" or enterprises with strategic importance, the state is concerned about foreign ownership and usually

[197] For example the ban on exercise of voting rights provided in art. 241 (3): "In the case where a company, a parent company and affiliated company, or an affiliated company in possession of shares exceeding one-fourth of the total number of the outstanding shares of another kabushiki-kaisha ..., the said kabushiki-kaisha ... does not have the voting right in respect of the shares of the company or the parent company thus in possession."

[198] The Law Relating to Prohibition of Private Monopoly and Methods of Preserving Fair Trade, No. 54, 14 April, 1947 (Anti-Monopoly Act) provides limits on shareholding that exceeds a basic amount (art. 9-2), limit of 5% on shareholding by financial institutions (art. 11), limit on shareholding by individuals or not incorporated entities (art. 14).

[199] As of March 31, 2000.

places restrictions on it[200]. Thus, in Japan foreigners were prohibited from taking part in the initial sale of shares of NTT. In 1992, as a result of amendment to NTTCA, the ban was lifted but a limitation of 20% was imposed on total combined foreign ownership (NTTCA, art. 4-2). Necessary measures have to be undertaken by the corporation in order to prevent foreign shareholdings from exceeding this limit: annual reports on foreign shareholdings are compulsory (art. 4-2 (4)), and if the limit is exceeded, the foreign shareholder is not registered in the list of shareholders.

On the other hand, in Britain there is no special limitation on foreign shareholdings, although the 15% limit, provided with the golden share, applies to them as well[201].

In addition, as mentioned above, in both countries top manager positions are reserved for nationals, and thus control of the majority of the board by foreigners is excluded.

As a result, by setting out restrictions on foreign ownership as well as on national ownership, the state prevents the concentration of shares and the

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[200] In the field of telecommunications almost all countries have set out limitations on foreign ownership. For example, in the US and France the direct investment by foreigners in wireless stations is limited to 20%, in Canada the limitation on foreign investment is 20%, in Mexico and South Korea 49%. *Asahi-shimbun* (16 February 1997); APEC, online: APEC <http://www.apecsec.org.sg/guidebook.html> (date accessed: 12 July 2000). In Canada the 20% restriction is with respect to establishment and operation of common carriers (33 1/3 % in the case of holding companies). There are no ownership restrictions for companies which provide telecommunications services on a resale basis.

[201] There are only two cases in Britain where, with the golden share, more strict restrictions on foreign ownership than on national ownership were set out, namely the cases of Rolls-Royce and British Aerospace. Trésor de S.M., *supra* note 100 at 38. *The Independent*, 29 January 1988.

emergence of a "controlling shareholder" in the privatized concerns[202], which has the counter-effect of making the state's intervention easier.

Then, if we follow the classification of different types of control outlined in Part 1.2, companies with no "controlling shareholder" and a dispersal of shares among numerous shareholders should be classified as "management controlled" companies. However, in the case of BT, the rights attached to the golden share held by the government are enough to distort the market for corporate control and to be an obstacle to the restructuring of the company. They work as constraints on the decision-making process, limiting the choice available to directors. Therefore BT can be considered to be "management controlled" subject to governmental constraints. Even after the redemption of the golden share, the

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[202] In contrast, in France, at the time of privatization, the problem arose of to whom the state would transfer control of privatized concerns. This led to the creation of small groups of stable shareholders, the so-called "noyaux durs", which is considered to be a more significant phenomenon than the golden share with respect to corporate governance of French privatized companies. In practice, the Minister of the Economy has used this structure when the company is privatized by private sales to ensure that a controlling block of the capital (and voting rights) of a privatized company are put in the hands of a relatively small group of other companies, particularly financial institutions. A contract is concluded with each of the chosen stable shareholders, providing the terms of purchasing shares in the privatized enterprise with restrictions on their disposal for a certain period of time. It is not clear, however, whether or not the state can maintain indirectly its controlling power over such privatized companies by setting out different terms in the contract to be concluded between it and each member of the group. This technique is considered to be a substitute for the golden share or a management entrenchment device. On "noyeux durs", see James A. Fanto, "The Transformation of French Corporate Governance and United States Institutional Investors" (1995) 21:1 Brook. J. Int'l L. 1 at 59-67; Frank Bancel, "Le processus de privatisation: la spécifité française" in Fabrice Dion, ed., *Les privatisations en France, en Allemagne, en Grande-Bretagne et en Italie* (Paris: La documentation Française, 1995) 17 at 30; Tamamura, Hiromi, *supra* note 175 at 63-65; Monique Caverivière & Marc Debène, "Sociétés privatisées et stratégies actionnariales (Dès lois de l'été 1986 aux lois de l'été 1989)" (1989) 589 Revue des Sociétés 203 at 207; Sophie l'Hélias, *supra* note 181 at 54-55; Hervé Dumez & Alain Jeunemaitre, "Privatization in France: 1983-1993 in Vincent Wright, ed., *Privatization in Western Europe,: Pressures, Problems and Paradoxes* (London: Pinter Publishers, 1994) 83 at 97-101; Claude Merkin, "Le contrôle de l'actionnariat des sociétés privatisées" (1987) 13-4 D.P.C.I. 589 at 589-602; Cosmo Graham & Tony Prosser, *supra* note 58 at 154-60.

regulatory control over the company is stringent enough to prevent BT from being a completely "management-controlled" company.

On the other hand, in Japan only the existence of the requirement for "approval" of certain decisions by the MPT is absolute enough to classify NTT as a mixture between management- and an indirectly government-controlled company. In this case, however, government control is indirect, because it does not take the form of direct appointment of the directors.

3.3 Form of Organization of the Privatized Concerns

3.3.1 Privatizing BT as an Intact Unit

With respect to the form of privatization of BT and NTT, two options were available - on the one hand, to sell them as single integrated organizations, and on the other hand, to follow the example of the American Telephone and Telegraph Company which had been broken up into separate companies.

The original intention with the telecommunications body in Britain was to break it into small parts to be sold so that competition would prevail after privatization[203]. Despite this government intention, the telecommunications industry was privatized without being restructured. The reason for this was a combination of pressures from management, and the difficulties of a successful flotation. For management it was essential to retain as much monopoly as possible

[203] There were also attempts to subject the privatized body to competition, by creating Mercury's competition for some business with BT using BT's own physical network, and by increasing competition for suppliers of equipment. Kenneth Wiltshire, *supra* note 5 at 47.

after privatization,[204]. At the same time, the initial flotation was risky, the sell-off was critical to the government's financial needs, and thus increasing competition in the industry could have jeopardized its success[205].

After a series of discussions, the break-up was also judged impractical because of the difficulty in finding buyers for BT's unprofitable parts, and because it would diminish BT's ability to compete in foreign markets.

> [Britain] needed a large company to face a liberalized home market and to defend it against foreign competitors. The convergence of computing and telecommunications required companies with strong financial and technological resources, and since the government and BT's managers agreed that BT's role in the future lay as the "flagship" for Britain's information technology industry, keeping BT together was the means to an end[206].

As a result the government went for limited competition and selling BT without breaking it up[207].

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[204] For details, see Newman Karin, *supra* note 34 at 11-13; Douglas Pitt, "An Essentially Contestable Organisation: British Telecom and the Privatisation Debate" in J. J. Richardson, ed., *Privatisation and Deregulation in Canada and Britain* (Dartmouth, 1990) 55 at 55; Jeremy Moon et al., "The Privatization of British Telecom: A Case Study of the Extended Process of Legislation" (1986) 14 Eur. J. Pol. Res. 339, 351.

[205] The initial sale of 51% of BT's shares in November 1984 raised a total of 3.9 billion, six times larger than any previous issue on the UK stock exchange. Matthew Bishop & John Kay, *Does Privatization Work?: Lessons from the UK* (London: Centre for Business Strategy, London Business School, 1988) at 4.

[206] Newman Karin, supra note 34 at 12; Douglas Pitt, *supra* note 204 at 60.

[207] It is notable that no one had studied the real problems of interconnection that would have followed from a break-up and more competition. C. D. Foster, *supra* note 79 at 129.

3.3.2 Divestiture of NTT

In Japan, divestiture of NTT[208] was one of the main issues debated at the time of privatization. Divestiture was recommended several times by the MPT and each time opposed by the government[209]. Finally in 1997, the Law for Amendment of NTT Corporation Act[210] was passed in June, by which two regional companies, East NTT and West NTT, along with one long-distance company, were established as wholly-owned subsidiaries of NTT[211], and NTT itself was transformed into a pure holding company without being engaged in any business operations[212]. This divestiture and transformation took place in July 1999.

The objective of the amendment was to encourage fair and effective competition in the telecommunications market, to allow NTT to engage in international operations through its newly-established long-distance subsidiary, and to concentrate on fundamental research and development in order to be able

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[208] Divestiture is used in the sense of separation of long-distance operations of NTT from its local network.

[209] On different projects for divestiture of NTT, see Inoue, Teruyuki, *NTT (Nihon-no Big Business 01)*, 2nd ed. (Tokyo: Otsuki Shoten, 1996) at 190-218; Daniel J. Ryan, *Privatization and Competition in Telecommunications - International Developments* (Westport: Praeger, 1997) at 21, 26; "NTT to Introduce Pure Holding Company Structure", NTT News Release (Dec. 6, 1996), online: NTT, <http://pr.info.ntt.co.jp/news96e/961206.html>; Bistra Stoytcheva, "Holding Company System in the Privatization of NTT" (1999) 18 Waseda Bulletin of Comparative Law 23 at 26.

[210] Promulgated as Law No.98 on June 20, 1997.

[211] On the way of establishment of these companies and the transformation of NTT into holding one, see Bistra Stoytcheva, *supra* note 209 at 27-29.

[212] This structure became possible because at the same time the Anti-Monopoly Act was amended in June 1997 in order to partially allow the establishment of holding companies, which was banned after the World War II as a measure to dismantle zaibatsu (the mammoth Japanese combines). Article 9 (1) defines holding company as a company where the purchasing amount of stocks in subsidiaries exceeds 50% of its total assets.

to respond to the ongoing globalization associated with the development of information technology[213].

Although with respect to competition this method of reorganization or divestiture of NTT might have some effect, it can be said that with respect to the relationships between the government, the holding company and its subsidiaries no substantial changes are expected to occur. The only difference from the previous situation is that now the government is the major shareholder of the holding company, and the holding company has to have the approval of the MPT if the company intends to dispose of shares held in the long-distance subsidiary (supplementary provisions art. 13, art. 16 (2))[214]. Indeed, the power of the government seems to be strengthened because of the approval that is required for the issue of new shares by the regional companies (NTT Companies Act[215], art. 5, art. 6), their annual business plans (art. 12), changes of articles of incorporation, mergers and dissolutions (art. 11), and appointment and dismissal of their directors and supervisors (art. 10).

After NTT's divestiture and transformation into a holding company, the only shareholder of its subsidiaries is the holding company itself. Therefore, the general meetings of the subsidiaries consist of the representative(s) of the holding

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[213] Tanaka, Ei'ichi, "NTT saihen kanren sanhou-no seiritsu-ni-tsuite - NTT saihensei-to chyokuzoku mondai-wo chyushin-ni" (On the Three Acts Related to Reorganization of NTT - Focusing on the NTT Reorganization and the Directly Related Problems) (15 September 1997) 1119 Juristo 66 at 66.

[214] There is no provision concerning disposal of shares owned in regional companies, but from the imperative character of the provision on the ownership of NTT in regional companies, it can be concluded that this is not allowed at present.

[215] The name of the act was changed from NTT Corporation Act to NTT Companies Act.

company, *i.e.* the general meeting of the subsidiaries will in practice be transformed into a board of directors meeting, because representatives of the holding company are its directors. Hence, the most important issues with respect to the activities of the subsidiaries, along with decisions on the appointment and dismissal of directors and supervisors, are to be decided by the holding company's directors and not by the shareholders. In such a situation, it seems appropriate for the rights of the shareholders of the holding company to be strengthened to a certain extent in order to exercise effective supervision over the decision-making process in the subsidiaries as well. This is true for the NTT holding company both before and after its full privatization, *i.e.* after the sale of all of the holding company's outstanding shares held by the government.

Shareholders of the holding company have voting and monitoring rights in the holding company itself, but they have no rights in its subsidiaries. They cannot vote at the general meetings of the subsidiaries, they cannot elect or dismiss subsidiaries' directors and supervisors, and they cannot challenge illegal acts of directors or take legal actions against them. Meanwhile, on the one hand the source of their dividends is profits from the activity of the subsidiaries, and on the other hand their investments are at risk only in relation to the subsidiaries' performance[216]. In short, despite the lack of a direct relation between the holding company's shareholders and its subsidiaries[217], their investments and dividends

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[216] Ousumi, Ken'ichiro, *Shimpan kabushiki-kaishahou hensenron* (The Development of the Company Law, new ed.) (1987) at 182; Maeda, Masahiro, "Motikabukaisha" (Holding Company) 1466 Shouji-houmu 23 at 23, 25.

[217] Between the holding company's shareholders and the subsidiaries is the holding company itself as a shareholder of the subsidiaries.

depend on the activity of the subsidiaries[218]. Therefore, problems related to the protection of holding company's shareholders, especially of the minority shareholders, may arise.

Although the holding company's directors have the duty to exercise the shareholder's rights of the holding company in subsidiaries in the holding company's best interest, there could be cases of insufficient supervision of the subsidiaries by the directors, and as a result damages could arise for the subsidiaries, and thus for the holding company's shareholders. In theory, in such cases the holding company's shareholders have the right to sue the holding company's directors (CC, art. 266). However in practice it is almost impossible to do so. The problem is that they do not have sufficient information about the situation in the subsidiaries, and proving damages becomes extremely difficult[219]. This means that their rights as the holding company's shareholders are limited and, by extension, the power of the holding company's directors is increased.

One of the solutions to the problem of how to exercise control over the holding company's directors[220] could be supervision by outside supervisors[221]. In the case of NTT, in addition to the general election of supervisors, the possibility

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[218] The reason is that NTT itself is a pure holding company without any business operations.
[219] Maeda, Masahiro, *supra* note 216 at 26.
[220] This is a general issue in all companies but it becomes more important with respect to holding companies because of the increased power of the directors.
[221] In Japan, discussions on improving the monitoring system of directors performance in large corporations are focused not on the introduction of committees consisting of outside directors, but on the supervisory board (some authors call it audit committee), one of the members of which must be from outside the corporation, defined as a person who has had no relationship or affiliation with the company for at least 5 years (including suppliers, creditors, and so forth). This structure was introduced with the 1993 amendment to the Commercial Code and the Law for Special Exceptions to Commercial Code concerning Audit of Kabushiki-Kaisha (Law No. 22, 2 April 1974) (art. 18(1)).

for appointment of outside supervisors exists. The MPT may issue an order and appoint supervisors to verify specific items (NTTCA, art. 15). It can be said that by protecting its own interests as a majority shareholder in this way, the government protects the interests of minority shareholders as well. The problem for minority shareholders is that they cannot appoint their own supervisors and always depend on the discretion of the minister.

Another way of solving the above-mentioned problem is to require information about financial statements of subsidiaries to be provided to the holding company's shareholders as well, *i.e.* by way of disclosure by the subsidiaries[222]. In the case of NTT, this is again guaranteed to the government (NTTCA, art. 13) but not to all shareholders.

The same can be said about decisions on important issues related to transfer of operations, transformation, mergers, changes in the articles of incorporation, appointment and dismissal of directors, and business plans of subsidiaries. All these issues are discussed and voted on at the general meetings of subsidiaries, in practice at a kind of enlarged board of directors meeting, about which the holding company's shareholders do not have information. Thus they do not have any influence on the decisions taken at the general meetings of subsidiaries. Again, the government is an exception, because in order to take effect, all these decisions have to be approved by the MPT.

[222] Maeda, Masahiro, *supra* note 216 at 27.

Thus, it can be concluded that in a situation of a holding company undergoing privatization, such as NTT, even if the interests of the minority shareholders are not protected at all, at least the interests of the major shareholder, the government, are entirely protected. The means of this protection is the approval that must be obtained from the MPT of decisions important to the company and to its subsidiaries, along with the MPT's strengthened control over the companies' activities.

4 STATE INTERVENTION AFTER THE SALE OF ALL GOVERNMENT-OWNED SHARES (EXTERNAL CONTROL)

Usually, after the sale of all government-owned shares, including the redemption of the golden share in Britain, the directors of the privatized companies should be accountable only to the shareholders. The shareholders and the board of directors in the case of one-tier system and additionally the board of supervisors in the case of two-tier system, are the constituencies monitoring directors. Monitoring by shareholders can be achieved by their exercise of rights to appoint and dismiss directors and/ or supervisors, to request information, or by the use of the remedies related to directors' liability. Monitoring by the board of directors in Britain is exercised by reporting systems, setting up of audit committees, including non-executive outside directors, and separating chairman

and chief executive officer's functions[223]. In Japan, there is a sophisticated system of monitoring by the supervisory board, one of whose members must be from outside the company, by the authorized accountants, by the other members of the board of directors and by the representative director. This is the system of so-called "internal control" of directors' decision-making, although some of the members of the boards are called "outside", "independent" or "non-executive".

In addition, with respect to the companies undergoing privatization and already privatized ones, another "external control" is exercised by the respective minister and/or by regulatory bodies. Since "internal control" does not differ in companies undergoing privatization from that in companies formed under the company law of the respective country, the focus in this chapter will be on "external control". This type of control is available and is exercised at all stages of the privatization of enterprises, but it becomes more important at this stage, after the sale of all government-owned shares, because it remains the last weapon of the state to oversee and interfere in companies considered "private" from an ownership point of view. While in the case of BT, with the sale of all government-owned ordinary shares and the redemption of the golden share, this stage is already a reality, it is fair to assume that the provision on continuous holding of shares by the Japanese government in NTT will also be abolished and that subsequently all shares will be sold. What remains is the system of approval of

[223] See especially "The Report of the Cadbury Committee on The Financial Aspects of Corporate Governance: The Code of Best Practice" in Robert I. Tricker, *International Corporate Governance. Text, Readings and Cases* (Singapore: Prentice Hall, 1994) 576 at 576-580.

certain shareholders meeting's resolutions and board of directors' decisions and regulatory control by the MPT in Japan, and regulatory control by the OFTEL in Britain.

4.1 External Control by the Minister

4.1.1 Approval and Supervision

4.1.1.1 Approval of Resolutions and Decisions

As mentioned above, along with other already outlined devices, one of the means for the state to interfere in companies undergoing privatization in Japan is the requirement set out in the special act on privatization of the company that the minister in charge of the respective industry, in the case of NTT the MPT, must approve a number of resolutions adopted at shareholders meetings and decisions of the board of directors. This approval is required at all stages of privatization of NTT, from the transformation of the public corporation into a "special company", to the sale of all state-owned shares. The approval requirement will be removed only with the repeal of the special act, as was the case with KDD. In addition, the minister is vested with strong supervision rights, which he can exercise at his own discretion.

Approval by the MPT is to be given to the following resolutions passed by the general meeting of shareholders: (1) appointment and removal of directors and supervisors (NNTCA, art.9 (2)); (2) matters related to fundamental changes

in the company, such as changes in the articles of incorporation; distribution of profits; mergers; dissolution of the company (NTTCA, art.10 (1)); and changes in the business activities (NTTCA, art.1 (2)). Financial statements of NTT, such as its balance sheet, profit and loss statement and annual business report, are to be submitted to the MPT (NNTCA, art.12).

In this case, approval can be defined as an administrative act, supplementary to the general meeting of shareholders' resolutions, with the effect of allowing the enforcement of the resolutions. If the resolutions have not been approved, they are invalid (null and void). Therefore, when resolutions of the general meeting are approved problems do not arise, but when they are not approved, it is necessary for the shareholders meeting to discuss the issues again and to pass new resolutions. Needless to say, this is a costly and time-consuming procedure, which may have a negative effect on the company's relations with third parties. In order not to give rise to repetitive consideration, the shareholders meeting is obliged to pass resolutions consistent with government approval.

Having in mind that another administrative body, namely the Minister of Finance as state representative, has the final word at the shareholders meeting because of the number of shares held by him and the dispersed shareholder structure, this approval by the MPT seems to be a double protection for the government – in effect one roof built upon another. But while its necessity is doubtful in the case of a company the majority of whose shares are owned by the state, once the state has no shares and therefore no means to influence shareholder decisions, the approval of the minister will gain great importance.

However, it is necessary to point out that there are no reported cases of refusal of MPT's approval. Therefore, it can be said that the requirement for an approval to be given works more as a means to prevent the company passing decisions which might be not in accordance to the government policy, than as a means to intervene in the decision-making process of the company.

Naturally questions arise as to the reasons why MPT approval is required. One reason might be the significance of the matters subject to approval for the company's existence and the importance of the business activities to the public. Another reason might be the necessity to avoid abuse of authority by the Minister of Finance at the stage of partial privatization, and by the management[224] at the stage of full privatization. Looking retrospectively, at the time when NTT was a public corporation all these matters were to be decided by the Diet (Japanese Parliament)[225]. After its establishment as a special corporation, Diet approval was abolished as inappropriate to the main power of the legislative body. In this sense, providing approval by the MPT can be considered to be a loosening of the rules, *i.e.* deregulation. However, retaining the approval by the MPT shows that the state was still cautious about the impact of the transfer of an important business to the private sector. Considering the gigantic technological and financial power of this special company, and the the difficulties to which privatization might give

[224] The shareholders meetings of Japanese private listed corporations with widely dispersed shareholdings are largely influenced by the directors, and are usually held at the same day for numerous corporations to avoid shareholder participation, and take less than one hour. For details, see Toriyama, Kyoichi, "Les groupements dans la vie des affaires. Rapport japonais" in Association Henri Capitant Des Amis de la Culture Juridique Française, *Journées japonaises, 22-25 mai 1994*, Proceedings at para. 23, 24, note 7.

[225] Under the NTT Public Corporation Law.

rise, it was provided that changes in business activities were to be allowed only with the approval of the MPT[226].

Decisions within the scope of the board of directors' power, for enforcement of which it is necessary that the approval of the MPT be given, include decisions on the issue of new shares and of convertible bonds and bonds with preemptive rights for subscription of new shares (NTTCA, art. 4 (2)); formulation of the annual business plan (NTTCA, art. 11); and transfer of important equipment and settlement of collateral on such equipment (NTTCA, art. 13).

The approval by the MPT of the annual business plan can be seen as a residue from the public corporation period[227], but the difference is that only the business plan, and not the financial plan or the budget of the company, is subject to approval. Such approval involves a preliminary consultation with the MF.

As for the other issues, during the public corporation period, all matters were to be decided by the Diet. With the establishment of the new company, MPT approval was stipulated for the issue of new shares, since if they were not allocated to the state, this would lead to a reduction in its share in the capital and would be equivalent to a partial privatization without its consent. However, justification will become irrelevant after the sale of all state-owned shares. On the

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[226] Takechi, Kenji, "Denki-tsuushin shin-jidai ni taiou shita denden-saikaku-sanhou" (The Three Reforming Acts as a Response to the New Era in the Telecommunications) (1985) 1244 Toki-no Hourei 5 at 8-9.

[227] At the time when NTT was a public corporation, it had to submit its annual budget, business and financial plan, and all the supportive budget documents to the MPT. After consultation with the MF, it was necessary for a decision of the government to be obtained. Finally the government submitted the budget of the company to the Diet together with the country's budget.

other hand, it can be said that despite the fact that the state is no longer owner of either the assets of the company or of its shares, the requirement for approval by the MPT of transfer of important equipment remained in place because of the importance of the business to the public. Needless to say, this requirement distorts free decision-making about the restructuring of the company.

Although the subject matter about which approval must be given, the body to give it, and the way to give it, are similar to the requisites of the golden share, the British government, as has been noted, set the consent requirement out as a private law device in the articles of association of the company, while the Japanese government retained it as a public law device set out in the special statute. This overlap between a system of private law (resolutions passed by the general meeting of shareholders under the Commercial Code) and a system of public law (approval by the minister under administrative law) is a peculiar phenomenon in Japan, pointing to the difference between "special companies" undergoing privatization and purely private companies established under the Commercial Code.

4.1.1.2 Supervision

In Japan, the powers of the minister with respect to the supervision of the company undergoing privatization are set out in the special act concerning the company. NTTCA, for example, contains provisions that the financial statements and reports of the company and its subsidiaries (NTT group) are to be sent to the

MPT. Hence, the MPT, and not the Minister of Finance, receives information about the financial results of NTT group, and thus exercises a form of audit control.

In addition, the MPT has the option to exercise, at his own discretion, certain supervisory powers set out in the special act. In particular, when it is especially necessary, the MPT has the power to issue orders to the company regarding the supervision of its business activities (NTTCA, art. 15). The minister may, to the extent necessary to enforce the act, require the company to submit reports related to its business activities (NTTCA, art. 16). Yet, the minister may appoint auditors and make them check specific matters and report to him the audit results (NTTCA, art. 14 (2)). As mentioned above, all these powers have been extended to apply to the holding company and its subsidiaries after the transformation of NTT. The supervisory powers of the minister are similar to the monitoring rights of the supervisors or the shareholders under the Commercial Code[228], but in this case they are not vested in the MF as representative of the state-shareholder at the stage of state shareholding, but in another administrative body, the MPT. Probably they will remain so even after the sale of all state-owned shares, as was the case for KDD.

One could argue that this strengthened supervisory power is related to the importance of the business to the public, but nevertheless the possibility of

[228] For example, the power of the supervisors to monitor the performance of the directors (CC, art. 274), the right of the shareholders to verify the accounting books (CC, art. 293-6), the right of the shareholders holders of more than 10% of all the outstanding shares to ask the court to appoint an inspector (CC, art. 294) etc.

disruption to the day-to-day business operations of the company should not be ignored.

4.1.2 Regulatory Control

Regulatory control of the telecommunications industry in Japan is also vested in the MPT. In this respect, it is noteworthy to mention that the MPT implemented tighter control on NTT than on the newcomers. First, since NTT was expected to be the only carrier providing local service nation-wide for some considerable time, it has been placed under certain special obligations, including the provision of universal service[229]. To ensure that NTT lives up to these special obligations, it is required to submit its annual business plan for approval by MPT, and the minister has the above-mentioned power to order NTT to fulfill its statutory duties[230].

Second, as NTT must provide universal service, while competitors have no such obligation, this seems to necessitate either rate rebalancing or an access charge for new carriers which seek interconnection of their networks with the NTT local network[231]. However the tariff and access policy of MPT were

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[229] Article 1 of the NTT Corporation Act prescribed that NTT "shall be a company whose purpose is to operate a domestic telecommunications business." Despite this purpose being shifted to the regional companies with the NTT Companies Act, it is still an obligation of the NTT holding company "to give the regional companies the necessary advices, good offices and other assistance in order to ensure the appropriate and stable provision of telephone and telegraph services by them" (art. 1 (2)).

[230] Makoto, Kojo & H.N. Janish, "Japanese Telecommunications after the 1985 Regulatory Reforms" (1992) 1 M.C.L.R. 308 at 318-19.

[231] *Ibid.* at 319.

favorable to the entry of new common carriers. MPT maintained a sizeable difference between NTT and new common carriers rates[232] to give the latter a competitive advantage. NTT was not allowed to de-average its long-distance rates nor raise its local rates. It was considered that selective entry by new competitors would put pressure on NTT to be more efficient[233]. In this way, MPT has used its regulatory power to protect new common carriers by strictly regulating NTT. Hence, even as a "private company", NTT remained under special common carrier obligations and regulation consisting of interfering with business decisions on price and service.

Recently, however, it was realized that these kinds of regulations designed to protect Japanese telecommunications firms were in fact adversely affecting competition. Under the pressure from corporate users dissatisfied with rate levels and the international movement toward liberalization of the telecommunications market, namely the WTO Agreement on Telecommunications[234], in 1997 the government of Japan took a series of deregulation and liberalization measures. Most significant was the lifting of the regulations separating domestic and international telecommunications businesses, which allowed international service

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[232] Initially this was 25%, later 20%. See Marianna Strzyzewska-Kaminska, *supra* note 18 at 506.

[233] Makoto, Kojo & H.N. Janish, *supra* note 230 at 319.

[234] On 15 February 1997, 69 members of the WTO entered into agreement to open their basic telecoms markets to competition, which marked the successful end of negotiations to extend the General Agreement for Trade in Services to basic telecommunication services. The agreement, in force since 5 February 1998, not only provided a framework for the gradual liberalization of the market access but also established a framework of basic regulatory principles to which the majority of countries also committed themselves. "International Liberalisation", online: DTI <http://www.dti. gov.uk/cii/t3/doc7.htm> (last modified: 26 March 1999).

telecommunications companies to merge or link with domestic service firms[235]. Also of great importance are the elimination of bureaucratic controls on phone rates and the removal of restrictions on connecting international private leased circuits with public networks, the removal of the 20% foreign investment cap, except for NTT and KDD[236], and the abolition of the government approval system for telephone charges, the abolition of the KDD law and the divestiture of NTT[237]. In this way, Japan not only increased domestic competition, but also opened its doors to foreign competition. In these circumstances, what remains to be done in order to completely liberalize the Japanese telecommunications market is a complete privatization of NTT by further sale of government-owned shares, and the repeal of the NTT Companies Act. While the former may be carried out, realization of the latter will probably still take many years[238]. However, it is notable that Japan went through liberalization and deregulation of its telecommunications market without the need to have recourse to regulatory bodies, as Britain did. As C.D. Foster notes: "it was a political decision that BT

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[235] Examples include the merger between International Telecom Japan (ITJ) with Japan Telecom, the alliance of KDD with Telway Japan and TTNet and its merger with DDI, joint services offered by International Digital Communications and Telway Japan. *Report on the Japanese Telecommunications Industry, October 1997*, online: DFAIT <http://www.dfait-maeci.gc.ca/geo/html_documents/report1-e.htm> (date accessed: 12 July 2000).

[236] The Ministry of Foreign Affairs of Japan, Japan's Individual Action Plan for Implementing Osaka Action Agenda <Summary Sheet>, online: The Ministry of Foreign Affairs of Japan http://www.mofa.go.jp/policy/economy/apec/1997/plan.html (last modified: November, 1997); Communication from Japan, Draft Schedule of Specific Commitments on Basic Telecommunications (1997), WTO Doc. S/GBT/W/1/Add.29/Rev.1, online: WTO <http://www.wto.org> (last modified: 14 February 1997).

[237] *Report on the Japanese Telecommunications Industry, October 1997, supra* note 235.

[238] In the case of KDD it took more than 40 years.

should not be regulated by ministers."[239]. Perhaps the British government wanted to reaffirm its decision to break forever with the former methods of supervision and monitoring of public utilities.

4.2 External Control by the Regulatory Body (OFTEL)

4.2.1 The Necessity of Regulation

The transformation of BT's status and share flotation was meant to have the effect of subjecting it to the disciplines of the marketplace, the judgment of its shareholders and the demands of its customers. However, as has been shown above, the market for corporate control has been replaced by the necessity for each shareholding in excess of the percentage set out by the golden share to have the government's written consent; and the role of the shareholders at the general meetings has been diminished by the dispersed structure of shareholdings.

On the other hand, the government of Britain "recognized that simply transferring the company to the private sector, while an important first step, would not sufficiently secure a competitive market. While private ownership did introduce discipline via capital markets, it did no more."[240] It was realized that, despite the liberalization of the market since 1981, the plan to float BT as one

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[239] "Instead, analogy suggested that the job should be done by the Director General of Fair Trading, who was in fact pressed to take it on. However, he decided that he had enough to do, so a specialist look-alike was invented, the Director General of Telecommunications." C.D. Foster, *supra* note 79 at 125.
[240] Marcus Brooks, *supra* note 35 at 74.

entity rather than splitting it up into smaller units meant that BT would continue to dominate the British market and that competition would take time to develop.

Therefore, "[w]hen privatization is extended to "natural monopolies" where competition is either unworkable or very limited in scope, regulatory arrangements take the place of the market in holding down prices and ensuring good services for the customer."[241]. For this reason, the privatized concern was not left to implement its objectives free from scrutiny[242], and in addition to the existing legislation in the Fair Trading and Competition Acts, and the competition rules in articles 85 and 86 of the Treaty of Rome, the government created a regulatory system especially for telecommunications[243]. With the TA 1984 a regulatory body, the Office of Telecommunications (OFTEL) was established to keep check on the extent to which BT complies with its license conditions.

This was a novel technique for Britain, and developed to ensure that vital national and public interests could be reconciled with private ownership. "[W]here competition is impracticable, ... regulated private ownership of natural monopolies is preferable to nationalisation"[244]. Some authors, however, evaluate it as a "rather simple exchange of one form of government operation for another: public ownership = private ownership + regulation"[245].

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[241] HM's Treasury, *supra* note 152 at 1.
[242] British government was heavily influenced in its thinking by the American models of regulation of private enterprise.
[243] Newman Karin, *supra* note 34 at 17-18.
[244] John Moore, "The Success of Privatisation", *supra* note 33 at 95.
[245] Kenneth Wiltshire, *supra* note 5 at 40. By regulation the author means more than just the operation of a regulatory body. He includes the range of procedures: the introduction of social objectives into the new legal mandate of the privatized company; special arrangements in the voting structure for decision-making, including the golden share; occasional reporting mechanisms to the minister concerned; creation of some kind of a new competitive framework

Changes in ownership have been already discussed above, therefore here the focus will be on regulation in the sense of "controlling, directing, or governing according to a rule, principle, or system"[246]. In the case of BT, regulation is achieved by means of license arrangements and monitoring by the regulatory body.

4.2.2. BT's License

While in Japan the regulatory framework is set out in the Telecommunications Business Act, in Britain it is based on a system of licenses, including conditions set out in detail in s. 8 of TA 1984. Most innovative of all was the introduction of a scheme known as the RPI-X formula, placing a ceiling on tariffs in the non-competitive areas[247].

BT was issued a license in 1984, to which are attached more than 60 conditions. They principally serve to place obligations on, and control, BT's exercise of market power. The most important issues covered by the BT's license are the following: those which impose service obligations on BT; those which assist competitors; and those which control BT's principal prices[248].

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in which the new body will operate; sunset clause arrangements for various aspects of the operation of the body concerned, usually built into the licensing arrangements. *Ibid.*

[246] Tony Prosser, *Law and the Regulators*, *supra* note 133 at 4.

[247] The RPI-X regulatory scheme originally covered about 55% of BT's activities. Willem Hulsink, *supra* note 35 at 164.

[248] Marcus Brooks, *supra* note 35 at 75.

4.2.2.1 BT's Service Obligations (Social Regulation)

The main obligations introduced into BT's original license were to provide the universal service, free directory services to the disabled, emergency service dialing facilities, rural and maritime services, and to maintain the number of its public phone boxes. Even though they are not as detailed, the social obligations of NTT are virtually the same. Most of these are loss-making services, thus it is difficult to determine the balance between BT's reasonable desire not to run too many of them, and certain small communities' reasonable desire not to be left without a public phone box, for example[249]. The role of the regulatory body in this case is to pass judgment upon whether the licensee is behaving reasonably. The fairness of the judgment, however, is doubtful, because the regulatory body has to rely predominantly upon information supplied by the licensee. The monitoring of BT's compliance with these conditions of license is called "social regulation"[250].

4.2.2.2 Fair Trading and Competitor Assistance (Regulation for Competition)

The license forces BT to allow competitors to interconnect with its network, and where commercial terms cannot be agreed upon, OFTEL is

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[249] *Ibid.*; Kenneth Wiltshire, *supra* note 5 at 56.
[250] Tony Prosser, *Law and the Regulators*, *supra* note 133 at 7; C.D. Foster, *supra* note 79, at 291.

empowered to determine the terms on which interconnection takes place[251]. This condition in the license contrasts with the free-of-charge system in Japan described above. Moreover, the license prohibits sales linked to other conditions, prohibits certain exclusive dealing arrangements and cross-subsidy[252] and establishes an obligation to supply information[253]. This is known as "regulation for competition"[254].

4.2.2.3 Pricing (Regulating Monopoly)

Before the TA 1984, prices for BT's services were set in the light of financial targets agreed with the government and following consultation with the Post Office User's National Council. After 1984, in the license issued to BT a control over the prices charged to regulate monopoly was included[255]. The debate about the form that such control should take ended by accepting the price control proposed by Professor Littlechild[256]. The license requires BT to ensure that certain prices do not rise faster than X% less than the Retail Price Index (RPI). This RPI-X formula is to be revised every 5 years and the first one was set out as

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[251] In 1993, OFTEL made few proposals on interconnection and accounting separation, which led to the amendment of BT's license in 1995. For details, see Marcus Brooks, *supra* note 35 at 76; Tony Prosser, *ibid.* at 75-76.

[252] The rules on cross-subsidy are designed to prevent BT from using profits from the exercise of market power in one area to cross-subsidize its activities in others, where competition maybe stronger. Marcus Brooks, *ibid.*

[253] Information obtained as part of BT's monopoly activities may not be used to benefit BT's operations in competitive markets. *Ibid.*

[254] Tony Prosser, *Law and the Regulators*, *supra* note 133 at 6-7.

[255] *"[R]egulating monopoly,* mimicking the effect of market forces through implementing controls on prices and on quality of service." [emphasis in original]. *Ibid.* at 6.

[256] The concept is that control should lie not with profits but with tariffs.

RPI-3 for the period beginning 1 August 1984[257]. After having set "X" OFTEL only checks to ensure that the pricing decisions made by BT are within the prescribed ceilings. In this role OFTEL is passive, and indeed it is hard to foresee a situation in which OFTEL could become "proactive", that is, "initiating rather than reacting"[258].

Actually, as the number of non-competitive areas covered by the price formula diminish[259], the need for OFTEL to become "proactive" is declining. Even though it leaves the regulator free to exercise its discretion in setting up price caps, this system seems to reflect costs better than the Japanese approval of tariffs by the MPT.

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[257] Newman Karin, *supra* note 34 at 20. Since the first price cap there has been a tightening and expansion of the cap. The cap became 4.45% less in 1988, then 6.25% in 1991, 7.5% in 1993, and 4.25% in 1997. The last applies only to around a quarter of BT's revenues, low- to medium-spending residential consumers. The other markets served by BT are now considered competitive. Marcus Brooks, *supra* note 35 at 78. See also Table 7.1 Changes on the Price Control Mechanism (1984-1993) *ibid.* at 79; Tony Prosser, *Law and the Regulators*, *supra* note 133 at 66-71; Peter Curwen, *Restructuring Telecommunications. A study of Europe in a Global Context* (MacMillan Press Ltd., 1997) at 146-47; Willem Hulsink, *supra* note 35, at 164; Stephen Martin & David Parker, *The Impact of Privatisation. Ownership and Corporate Performance in the UK* (London: Routledge, 1997) at 45.

[258] Newman Karin, *supra* note 34 at 18.

[259] In *Pricing of Telecommunications Services From 1997*, OFTEL proposed that price cap regulation should apply only to residential and smaller business users, while prices for larger users would be left to be determined by competition. It is noticeable, however, that initially there was no price control on BT's international services or on apparatus supply but later, in 1991, international services were included in the basket of prices to which the formula applies. Peter Curwen, *supra* note 257 at 146-47; Willem Hulsink, *supra* note 35 at 164.

4.2.3 Regulatory Body's Role

4.2.3.1 Duties

OFTEL was established as a non-ministerial government department, modeled on the Office of Fair Trading, to regulate telecommunications in Britain following the sale of BT. The Office is headed by a Director General.

Appointed by the Secretary of State for Industry, the Director General operates within guidelines and criteria defined by s. 3 of the TA 1984[260]. His main duties are:

> (a) to secure that there are provided throughout the UK, [...,] such telecommunication services as satisfy all reasonable demands for them including, in particular, emergency services, public call box services, directory information services, maritime services and services in rural areas; and
> (b) [...] to secure that any person by whom any such services fall to be provided is able to finance the provision of these services.

As some authors comment, these two primary duties reflect two principles which are in tension: the financing of investment, which would clearly make it unacceptable for a regulator to impose a set of social obligations that threaten the financial viability of the company or its ability to raise capital, and the concept of maximizing a universal right of access, including access where this might not be justified on straightforward commercial grounds[261].

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[260] The Director General also has certain powers under general competition law in respect to telecommunications.
[261] Tony Prosser, *Law and the Regulators, supra* note 133 at 23.

As supplementary and secondary to the above-mentioned duties, in subsection 2 are enumerated a number of duties, among which are the following:

> (a) to promote the interests of consumers, purchasers and other users in the UK in respect of the prices charged for, and the quality and variety of, telecommunication services provided and telecommunication apparatus supplied;
> (b) to maintain and promote effective competition between persons engaged in commercial activities connected with telecommunications in the UK.

Thus the legislative mandate for telecommunications regulation appears to place the highest priority on social regulation and regulating monopoly rather than on regulation for competition[262]. Problems in consumer protection led to the necessity in 1992 for new legislation to be passed, namely the Competition and Service (Utilities) Act 1992[263], and to proposals in the Utilities Review of 1998 to make consumer protection a primary duty of utility regulators[264].

The secondary place of the responsibilities of OFTEL with respect to competition, can be explained by the existence of primary control of competition exercised by the main competitive authorities, the Office of Fair Trading and the Monopolies and Mergers Commission, and by the initial intention that the regulator be a temporary institution "until competition arrives"[265]. Currently, however, increased competition has not led to discharging the regulatory body of

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[262] The TA 1984 extended consumer protection powers of regulators, especially in relation to the setting of standards of performance, the collection of information on performance, the establishment of complaints procedures. Tony Prosser, *ibid.* at 18.
[263] *Ibid.* at 50.
[264] On key proposals affecting regulation of converging industries, see Department of Trade and Industry, Regulating Communications: The Way Ahead, Results of the Consultation on the Convergence Green Paper, online: DTI <http://www.dti.gov.uk/cii/convergence-statement.htm> (last modified: 15 June 1999) [hereinafter DTI, Regulating Communications].
[265] S. Littlechild, *Regulation of British Telecommunications' Profitability* (London: Department of Trade and Industry, 1984) para. 4.11.

these functions. It led rather to gradual replacement of regulation of monopoly by regulation for competition[266].

4.2.3.2 Operating Method

OFTEL has the obligation to regulate the behavior of BT and its smaller competitor Mercury. The role of the Director General is to issue certain licenses to BT subject to the approval of the Secretary of State[267]; to enforce license conditions and modify licenses should it prove necessary; to rule on fair trading; to handle consumer representations and complaints; and to publish such information as he considers to be expedient[268]. OFTEL also has a relationship with the Secretary of State and his department, and with other regulatory bodies such as the Monopolies and Mergers Commission (MMC)[269].

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[266] "The regulator is to take much wider powers to root out what he considers unfair competitive practices by BT." John Harper, *supra* note 34 at 182; "Oftel is adopting a tough approach to outlawing anti-competitive behaviour by BT." Stephen Martin & David Parker, *supra* note 257.

[267] OFTEL has limited powers with respect to the license. The right to license operators was retained by the Secretary of State (s. 7). However when granting licenses, the Secretary of State is required to consult the Director General of OFTEL. On the other hand, although the Director General may grant licenses with the consent of or following a general authorization given by the Secretary of State (s. 7 (b)), by now no such consent or authorization has been given. Department of Trade and Industry, Background Paper on Telecommunications, online: DTI <http://www.dti.gov.uk/cii/c16/tactsum.htm> (last modified: 26 February 1997). The concept of license removal, should the licensee transgress, is barely addressed in the Act.

[268] It is noteworthy that the Director General of telecommunications has made a public commitment to openness, and his advice and opinions are regularly published. However, it is his discretion to publish information about his operations (s. 48). In contrast, under the Competition Act 1998 regulators have the obligation to publish their decisions and reasons for making them. DTI, Regulating Communications, *supra* note 264.

[269] Kenneth Wiltshire, *supra* note 5 at 55; Peter Curwen, *supra* note 2 at 254.

The principal way by which the Director General exercises his authority is through his duty to enforce telecommunications licenses, and also his ability to amend them in certain circumstances.

The Director General has in principle considerable powers to remedy breaches of license conditions, including failure to comply with pricing rules. He is empowered, for example, to order a licensee who has breached a license condition to take "such steps as appear to the Director to be requisite for the purpose of securing compliance". Such orders can be made when the Director thinks there is a breach, without his needing to establish the facts; the order can require remedial action; and failure to obey an order can result in court action leading to fines[270]. It is also within the powers of the Director General to refer BT to the MMC, and to ask it to investigate and report on issues relating to telecommunications which raise either competition or other public interest issues (s. 13). He did so in 1995, referring BT to the MMC regarding the "number portability" issue[271]. On the basis of the MMC report, the Director General amended the BT license with effect from 1999[272]. However, it is notable that "OFTEL, BT and the Department of Trade and Industry, have a preference for informal controls rather than specific punitive measures for breaches of license agreements, because of their suitability to British practices and greater efficiency in the long run"[273].

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[270] Peter Curwen, *ibid.* at 255-56.
[271] For details on the number portability issue, see Peter Curwen, *supra* note 257 at 148-49.
[272] Tim Clarke, "Privatisation and Competition Policy" [December 1988] Int'l Bus. Lawyer 508 at 509-10.
[273] Kenneth Wiltshire, *supra* note 5 at 82.

To amend a license, the Director General may require the agreement of the licensee or failing this he may make a reference to the MMC. The latter is used when the licensee does not agree with the proposed amendment. If the MMC concludes that the proposed amendment is in the public interest, the Director General may amend the license accordingly (s. 12-15)[274]. On the other hand, where a licensee wishes to introduce a change in a license, the Director General can ask the MMC to investigate the issue.

It should be noted that in this case the customers are kept at a distance from the licensee[275]. Using the formal procedure for license modification can result in substantial difficulties, and thus some authors see negotiated agreement between the regulatory body and the company as a better way of proceeding with license modification[276]. However, recent practice reveals a different approach. The introduction by OFTEL of a new condition in BT's license, consisting of a general duty to refrain from engaging in anti-competitive conduct, was referred to the High Court by BT at the end of 1996[277].

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[274] Marcus Brooks, *supra* note 35 at 74.
[275] Peter Curwen, *supra* note 2 at 255.
[276] When the formal procedure was invoked, in the case of telephone chatlines and information services, the Director General of Telecommunications discovered that the MMC took a more relaxed view of the problem than he did and OFTEL, was also threatened with a judicial review action. Cosmo Graham, "The Regulation of Privatised Enterprises" [1991] Public Law 15 at 17 [hereinafter Graham, "The Regulation"].
[277] Tim Clarke, *supra* note 272 at 509; Peter Curwen, *supra* note 257 at 148.

4.2.3.3 Activities

A threshold question regarding OFTEL was how active it would be in using its powers[278]. OFTEL's first test occurred when, in October 1984, it was asked for advice on a proposed joint venture between IBM and BT to form a data network system in the UK. The Director General's view was that such a venture would pose a threat to competition in the fledgling value-added network services market, and the venture was accordingly vetoed[279]. Another test occurred when BT wanted to buy MITEL, the Canadian manufacturer of telephone exchanges. The Secretary of State decided to refer the issue to the MMC on the advice of OFTEL and the Office of Fair Trading, although OFTEL has no direct power in the area of mergers[280]. The MMC recommended that the acquisition should take place subject to safeguards. Another important action of OFTEL was the so-called "interconnection decision", on the issue of the price that BT would be allowed to charge for the use of its own networks as a common carrier for the customers of Mercury[281].

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[278] Some authors think that with no powers to quicken the pace of competition by creating new licenses, it is difficult to envisage OFTEL attaining a "proactive" role. Newman Karin, *supra* note 34 at 19.

[279] Peter Curwen, *supra* note 2 at 256; Cento Veljanovski, *supra* note 13 at 184; Douglas Pitt, *supra* note 204 at 71.

[280] Kenneth Wiltshire, *supra* note 5 at 82; Cento Veljanovski, *supra* note 13 at 184; Douglas Pitt, *ibid.* at 68, 71; John Vickers & George Yarrow, "Regulation and Privatised Firms in Britain" in J. J. Richardson, ed., *Privatisation and Deregulation in Canada and Britain* (Dartmouth, 1990) 221 at 227.

[281] OFTEL decided that BT should connect Mercury's system at local exchanges and at trunk exchanges for use without limits, except those necessary to ensure that the quality of messages was good, and that the access be established at prices which gave Mercury a reasonable incentive to extend its system. For details, see Cento Veljanovski, *supra* note 13 at 185; Newman Karin, *supra* note 34 at 21; John Vickers & George Yarrow, *ibid.* at 226-27.

4.2.3.4 Independence

Another question was how independent OFTEL would be from interference by both the government and the industry itself, and to what extent it would be subject to any control.

It is the Secretary of State who appoints the Director General of OFTEL, and it is also that Minister who tables the annual report of OFTEL in the House[282]. Therefore, it can be said that OFTEL is not directly accountable to parliament. However, as some authors argue, there is no reason why departmental select committees, as well as the Public Accounts Committee, should not scrutinize the work of the Director General[283].

The decisions of OFTEL are made by the one man Director alone, and not by a board[284]. The Director must exercise his duties in a manner which he considers is best to ensure the provision of an efficient telecommunications service. There is no quasi-judicial process, and no avenue of appeal on most

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[282] "The Secretary of State does not receive questions in the House of Commons relating to BT because it will not accept them, on the grounds that BT's operations are not its responsibility. The House of Lords is a little more liberal because there is one spokesman for all of the government in that chamber. For the most part, however, there is a standard reply to questions about BT. Thus, despite the fact that the government is still actively participating in the affairs of the new enterprises, the ministerial accountability to the parliament in the post-privatization phase is missing. Despite the continuing government involvement, there is no parliamentary involvement, and the wording of enabling legislation ensures that this situation prevails. Thus, the parliament has information about the performance of the company only by means of company law, *i.e.* annual and semi-annual reports, statements to stock exchanges, and any data offered by the company." Kenneth Wiltshire, *supra* note 5 at 80-81.

[283] Graham, "The Regulation", *supra* note 276 at 19.

[284] It has been proposed, however that individual regulators be replaced by regulatory boards in the Utilities Review. See DTI, Regulating Communications, *supra* note 264.

matters[285]. The power of the Director, however, is restricted to enforcing the terms and conditions of the licenses granted to the companies, these terms having been decided by the Secretary of State[286]. Controls over his activities depend on the powers of the Secretary of State given to him by the TA 1984, namely the power to give general and special directions[287]. There is no requirement as to any publicity to be given to such directions, and in practice it might be difficult to ascertain whether a particular direction was given, or indeed was complied with[288]. Thus, the problem is to make the central government accountable for the exercise of its powers.

As the basis of its actions, OFTEL relies heavily on complaints[289]. The complaints from business are mostly to do with fair trading practices, and those from individuals are mainly to do with telephone bills[290]. OFTEL can issue an order against BT if it believes BT is breaching its license, but if the order is not complied with, it is the complainant who must take the matter to the courts for

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[285] J. F. Garner, "After Privatisation: Quis Custodiet Ipsos Custodes?" [1990] Public Law 329 at 330.

[286] The issue of licenses by the Secretary of State is one example of the continuing power of the government after privatization of the telecommunications. Another example is that the review of the duopoly policy was entirely in the Secretary of State's hands.

[287] General directions can only be given indicating considerations to which the Director should have particular regard in determining priorities with respect to the statutory duties and in the exercise of any of his functions. He may also be required by the Secretary of State or the Director General of Fair Trading to give information, advice and assistance as to any of his functions (s. 47 (4)). Specific directions can be given only in limited circumstances, most notably where national security is involved (s. 94), although the Secretary of State can direct the MMC not to proceed with a reference in telecommunications (s. 15 (5)).

[288] J. F. Garner, *supra* note 285 at 331.

[289] In telecommunications, there are a variety of advisory committees which undertake some complaint-handling functions, as well as advising the Director on specific policy issues (s. 27 and 54).

[290] Kenneth Wiltshire, *supra* note 5 at 81.

redress. Therefore, the privatized industries are beyond the jurisdiction of an ombudsman[291].

Most commentators are pessimistic about the role of judicial review respecting the operations of the regulatory body[292]. In fact, "the decision to keep the courts out of the regulatory process was made not because of a wish to avoid legalistic procedures of American legislation, but because ... the Cabinet ... was persuaded of the harm past increases in the regulatory role of the courts had done"[293]. Some authors even recommend that the regulators themselves adopt defensive procedures that keep the courts out, and that the appeal should lie to the MMC[294].

In sum, the new regulatory body, OFTEL, seems to be subject only to the "remote control" of the Secretary of State. Therefore, it can be said that the regulatory body is immune from external control[295], which raises problems as to its efficiency and need to exist at all.

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[291] Britain does not have other forms of quasi-judicial administrative appeals, such as those that exist in Australia for instance. *Ibid.* at 100.

[292] If the Director General detects a breach of license conditions and wants to take enforcement action, then the companies are granted certain procedural protection giving them a right to state their case as well as a right of appeal to the High Court within certain time limits (s.16-18). J. F. Garner, *supra* note 285 at 335-36; There is no reported case of application for judicial review against the Director General of Telecommunications. One case of such successful application against the Director General of Gas Supply is reported by Graham, "The Regulation", *supra* note 276 at 19.

[293] C.D. Foster, *supra* note 79 at 125.

[294] *Ibid.* at 395-96.

[295] J. F. Garner, *supra* note 285 at 337.

4.2.3.5 The Future of the Regulator

As competition develops, the need for sector-specific regulation is likely to reduce, as greater reliance is placed on the operation of general competition law. This is recognized by OFTEL itself, stating that "[c]ompetition, rather than OFTEL, would increasingly become the industry regulator"[296] and corresponds to the initial intention of the government to set out a regulation framework "until competition arrives".

However, nowadays, it seems unlikely that the regulatory control will be completely removed. First, under the new Competition Act of 1998[297], the regulators have concurrent powers with the general competition authorities in Britain to enforce, under domestic law, the prohibitions against abuse of dominant position and against agreements and concerted practices restraining competition. Second, although the government did not introduce as a statutory duty the existing arrangements between the regulators for coordination and cooperation in regulation, it welcomed them. Third, the proposals in the Utilities Review of 1998 introduce a number of important changes in the way in which utilities are regulated and their introduction as legislation is pending. Finally, the government is currently consulting about revised Telecommunications Act licensing arrangements for access control services. These are designed to ensure that OFTEL will have "tools available to tackle any anti-competitive practices which

[296] OFTEL, *supra* note 259.
[297] In force from March 1, 2000.

cannot be addressed through Competition Act powers"[298]. This approach is consistent with the view of most of the commentators that each sector is unique, and its particular features and problems have to be specifically addressed[299], and that the regulators are in a sense "governments in miniature" and their tasks cannot be reduced to any single logic[300]. It is argued that if a single agency were to replace either the Office of Fair Trading and the natural-monopoly regulators, or the natural-monopoly regulators alone, this would abandon the advantage of concentrated expertise and would be more likely to lead to inconsistency[301]. Different alternatives to regulation, such as nationalization, non-regulation or self-regulation, or leaving regulation to domestic or European competition law, were analyzed[302]. It was concluded that public ownership does not itself in any way create public accountability or responsiveness to consumers; that the common law courts are the least suitable place for issues such as those concerning interconnection, for instance, to be determined; that competition policy does not in practice operate in a way which provides a predictable environment for enterprises; and that extended deregulation will not happen in the field of telecommunications[303]. Propositions were made to reinforce the independence of the industry-specific regulators[304] or to deregulate private services and facilities, to open retailing and service creation to unregulated competition, and to have one

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[298] DTI, Regulating Communications, *supra* note 263.
[299] Tim Clarke, *supra* note 271 at 508.
[300] Tony Prosser, *Law and the Regulators*, *supra* note 133 at 305.
[301] C.D. Foster, *supra* note 79 at 404, notes 123.
[302] For details, see Tony Prosser, *Law and the Regulators*, *supra* note 133 at 168-77.
[303] Tony Prosser, *ibid.*
[304] C.D. Foster, *supra* note 79 at 395-99.

single organization to control and manage the unified public network infrastructure[305]. Therefore, despite there being some calls for total deregulation, the case for regulation of "natural monopoly" remains strong. However, it seems to me that although regulation may be better than ministerial control, and better than leaving the industry completely to competition, at the present stage of liberalization of the industry these are not sufficiently persuasive rationales for retaining the regulator. It is true that there is no way back, but it is also true that because of the existence of this external constraint on the market, "there is a real danger that regulated privatised businesses may be subject to more state interference than they were as nationalised industries"[306].

CONCLUSIONS

Nowadays, most countries are undertaking a process in which they adjust their national public monopoly to the new technological, economic and institutional conditions of international telecommunications. Although the degree of implementation differs from country to country, the institutional framework seems to be characterized by privatization of ownership and management, liberalization of the market, and some degree of regulation to guarantee universal service provision, reasonable tariffs and fair competition.

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[305] John Harper, *supra* note 34 at 208-10.

[306] Chairman's address at the Annual General Meeting of BT in 1992, quoted in Cento Veljanovski, *The Future of Industry Regulation in the UK* (London: European Policy Forum, 1993) at 23.

Britain and Japan, having the largest public telecommunications operators in the world, were among the first countries to start their privatization and liberalization programs. These programs are further advanced in these countries than elsewhere in the world, and lessons can accordingly be learned from the experience there.

This study was mainly concerned with the issue of the control and constraints imposed by the state on the privatized enterprises. It was asserted that, even though they are gradually loosening, close links between the state and private industry were maintained at all stages of the privatization process. Efforts were made to explain the legal grounds and rationales for this.

Privatization of telecommunications in both Britain and Japan was allowed by passing special legislation for the industry. However, while in Britain the special Telecommunications Act 1984 encompasses both liberalization of the industry and privatization of BT, in Japan two separate acts were passed, namely the NTT Corporation Act with respect to privatization of NTT, and the Telecommunications Business Act with respect to liberalization and deregulation of the industry. In both countries the statutes provide for corporatization and the sale of shares as a method of privatization. But while the act in Britain takes the form of a broad delegation of power to the Secretary of State, the legislation involved in Japan contains detailed provisions on the design of the "privatized company". In Britain even the most important of such provisions are left to the company's articles of association, including those setting out the relations with the government after privatization through such devices as the "golden share". On

the other hand, in Japan, the relations between the government and the privatization target are outlined in the statute, thus the methods of intervention are more transparent and readily identifiable in advance. This difference comes from the different legal classification of the state intervention (private or public law) during and after privatization. Therefore, the first lesson to be learned is that telecommunications is a specific sector, for which privatization and liberalization require special legislation. And because this legislation reflects the different means of state intervention during and after privatization, it is necessary for a clear governmental policy in this regard to be developed.

Second, the large size of telecommunications operators and the universal services that they provide determines the method of privatization. In countries like Japan and Britain, their privatization is neither possible nor suitable to accomplishment by the sale of assets to a core investor. The only possible method is to sell shares through the stock market, attracting numerous investors. Usually this is accomplished in tranches, gradually diminishing the percentage held by the government. Therefore, the stage of corporatization, *i.e.* the stage of transformation of the public corporations into stock companies with the state as their sole shareholder, is indispensable only if a public offer is the chosen method of privatization. And to avoid some legal problems, such as the need to call the general meeting of shareholder(s), and the need for a "golden share" or an approval of decisions by the minister while the "complete control" remains with the state, this stage should be as short as possible, but long enough to prepare for

successful flotation of the companies. In any case, it would be useful to have provisions that specially provide for this stage of the privatization.

Privatization policies have spawned widespread concern about how the public interest will be protected, given that public enterprises were established with social objectives in mind, and these enterprises had almost always had a monopoly in the telecommunications sector. The protection of public interests has, however, the side-effect of entrenching the state's participation. This was achieved by means of a private law form, namely the golden share, in Britain, and a public law form, namely the approval by the MPT, in Japan. Both of them have the effect that some resolutions or decisions can be enforced only with the written consent of the government. Those are decisions on changes of the articles of association, mergers and dissolution, and issue of new shares (having special rights attached to them in Britain), all matters of importance to the company's existence, which is one of the elements of the notion of "internal control". Although these measures are provided in the name of protecting public interests, they are enough to immunize the companies from both desirable and undesirable takeovers and, therefore, to distort the market for corporate control.

At the same time, in Britain the government set out limits on shareholdings and provided some preferential terms for buying shares to the general public and employees, while in Japan limits were only placed with respect to foreigners and preferential terms were not provided. In this way the government monitors the shareholding structure, not allowing a new "controlling shareholder" to arise. This produces a dispersal of the shares to numerous

shareholders, and the emergence of "management-controlled" companies subject to government supervision and constraints.

Yet the British government reserved the right to nominate two directors in BT, and the election of all directors and supervisors in NTT is subject to approval by the MPT. Thus, the management structure, the second element of "internal control", is monitored as well.

Moreover, while in Japan approval will be given as long as the special act exists, *i.e.* even after the sale of all government-owned shares, in Britain the golden share was a temporary measure (however, it is again for the government and not the shareholders to decide when to redeem the golden share).

Furthermore, after privatization substantial shareholdings were retained by the government. The scheme in BT's sale of shares was to sell at once just a little more than 50% of all outstanding shares, leaving the government with a shareholding percentage large enough if not to pass a special resolution, at least to block the adoption of one. As a result, according to British definitions BT was transferred to the private sector with the effect of excluding it from the public borrowings. Financial markets became freely accessible, but the full disciplines of the marketplace were missing because of the golden share.

The second and third (final) sales of shares in BT were realized in 1992 and 1993 respectively, *i.e.* after lifting the duopoly and opening the market to more competition. Gradually the terms of the golden share were relaxed. First, the system of government-nominated directors was abolished in 1994, and second, the share itself was redeemed in 1998. More competition allowed the

government to proceed with the sale of shares, and selling the shares allowed it to release the terms of government control. However in Britain, the government itself put up barriers to competition, privatizing BT as an intact entity without divesting it and allowing only one competitor for a period of ten years, thus entrenching itself for this period. As a result, at present BT is 100% private owned and without any private law-type intervention from the government, but strictly regulated by the regulatory body and through license arrangements.

On the other hand, the substantial amount of equity of NTT on offer caused the Japanese government to proceed very cautiously with the sale. The collapse of the "bubble economy" at the end of the 80's, and the resulting financial crisis, delayed the sale of shares of NTT further. At present, after 15 years from the start of the privatization of NTT, the government is still owner of more than 50% of the shares, thus exercising "internal control" merely as an ordinary shareholder. In addition, the necessity of approval by the MPT of shareholders meetings' resolutions and board of directors' decisions, and the potential for strengthened auditing supervision, makes NTT subject to "external" constraints and control. Even if the provision for continuous holding by the government were abolished and all shares sold, "external control" would most probably remain. The purpose is again to build a company strong enough to resist any attempt of takeover and to meet its social responsibilities.

Thus, it can be concluded that the issue of public interests and social objectives must be addressed in any privatization of telecommunications. This is a particularly pertinent point for smaller, developing countries. The need for foreign

capital there should be accompanied by setting out safeguards in the form of a golden share or ministerial approval, and licensing arrangements enforced by a sector-specific regulatory agency or by the minister. It is for the government in question to decide which techniques to use – private or public law ones or a combination of both. Regardless the techniques used, if the continuous intervention by the government is occasional rather than day-to-day, the company will be freer than previously to restructure its manner of operations. However, this will not make it completely "private". It takes considerable time to sell all state-owned shares, to deregulate the market and to introduce competition. Therefore, it can be said that to hurry the privatization of telecommunications, and probably also of other public utilities, when competition is not available, is foolhardy.

Another aspect of the privatization programs is the resulting regulation of the industry. This again takes a different form in Britain and Japan. In Japan, social objectives are imposed by legislation, tariffs are approved by the MPT, and monitoring of fair trading and abuse of monopoly position is left to the Fair Trading Commission under the general Anti-Monopoly Act. The government gradually deregulated the telecommunications industry with the effect of increased competition and product market pressure on NTT. This pressure will increase further as a result of the recently undertaken moves, under the WTO agreement, to open the Japanese telecommunications market to foreign competition.

On the other hand, in Britain the system of issuing licenses by the Secretary of State, and their enforcement by the regulatory body, coexists with the possibility of breaches and amendments of licenses along with fair trading and competition issues to be referred to the MMC. The responsibilities of OFTEL, the regulatory body, are outlined in the legislation and detailed in the license. These responsibilities evolved over time from monitoring whether the company is self-financing and whether it is complying with its social objectives, to promoting competition and protecting consumers. Although the role of OFTEL as a mediator between the industry on one hand, and the MMC and the Office of Fair Trading on the other, might be of some importance, it must be noted that it raises accountability problems and imposes stronger constraints on the telecommunications operators than those imposed on any other corporation. For this reason, some authors argue that there is no great difference between a publicly owned enterprise and a publicly regulated one.

Despite the differences in regulation methods, it is noteworthy that both the British and Japanese governments accepted a phased-in solution to the monopoly problem in the process of privatization, gradually opening up their industries to competition. This is realistic, since perfect competition cannot be attained overnight.

Finally, it is to each country to decide whether, and how, to privatize and liberalize its telecommunications industry, but the growing globalization of this market, its convergence with other industries and the trend of establishing of

international strategic alliances, inevitably call for a deregulated sector consisting of companies more similar to private than to public ones.

CHRONOLOGY

Major Developments in Telecommunications in Britain and Japan

	Britain	Japan
Private Company	By 1912	
Government Department	By 1969	By 1952
Public Corporation	From 1969 to 1984 Separated from the Post Office - 1981 (1981 TA)	From 1952 to 1984
Statute	Telecommunications Act 1984 – 12 April 1984	NTT Corporation Act - 2 December 1984
Stock Company	Private Limited Company Established - 1 April 1984	Special Corporation Established – 1 April 1985
First Sale of Shares	November 1984	October 1986
Major Changes	Special Resolution Re Golden Share – 24 July 1984	
	Last Sale of Shares – 1993	NTTCA Amended Foreign Shareholdings by 20 % Allowed – 1992
	Government-Nominated Directors Requirement Abolished - 1994	
	Special Resolution Re Redemption of Golden Share – 15 July 1998	NTT Companies Act – Promulgated 20 June 1998
	New Articles of Association – 14 July 1999	Transformation into Holding Company – July 1999

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