Submission Form

Corporate System Division, Economic and Industrial Policy Bureau, METI

Comments on the Draft of the Guidelines for Corporate Takeovers

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[Opinion]	

The American Chamber of Commerce in Japan (ACCJ) welcomes the continued efforts by the Ministry of Economy, Trade and Industry ("METI") to promote fair rules for engaging in M&A transactions to encourage and promote desirable acquisitions.

We continue to support the efforts to revitalize the market for corporate control in Japan. In the "Strategy for Promoting Foreign Direct Investment in Japan," published on June 2, 2021, the Council for Promotion of Foreign Direct Investment in Japan set a policy target of doubling the inward foreign direct investment stocks to 80 trillion yen, or 12% of GDP, by 2030. For developed countries such as Japan, the most significant source of inward foreign direct investment is through M&A rather than greenfield investment. A robust domestic M&A market will not only increase inbound M&A, but is also essential for Japan to re-allocate resources to more productive uses that create shareholder and societal value and drive economic growth.

To that end, we respectfully submit the following comments to the Draft of the Guidelines for Corporate Takeovers (the "Guidelines") for your consideration.

1. Corporate Value

We support the clarifications by METI to discourage an abuse of the concept of “corporate value”. For instance, we agree that corporate value “is a quantitative concept” and that “target company management should not make the concept of corporate value unclear by emphasizing qualitative value.” (See p.12 of the Guidelines.)[1]

On the other hand, the connection between “corporate value” and the price to be received by the shareholders of the target company is not always clear in the Guidelines.[2] For instance, the Guidelines state that “a reasonable effort should be made to ensure that the acquisition will be based on terms that will secure the interest which shareholders should enjoy.” (See p.14 of the Guidelines.) This does not seem to be a sufficiently high standard of efforts that should be made by the board of directors of the target company to obtain the best price reasonably available when negotiating an M&A transaction, especially in the case of an all-cash transaction for the entire company. As noted by the Guidelines, in such a transaction, “the appropriateness of the transaction terms in terms of price will be particularly important to shareholders because it is the last opportunity for shareholders to gain benefit (including a control premium) from their investment in the target company’s stock.” (See p.24 of the Guidelines.)

For a listed target company, its shareholders are generally not involved in the negotiation of the transaction, and are relying on the board of directors to represent their interests. If the board of directors of the target company does not obtain the best price reasonably available for the shareholders, we believe that there is a real question as to whether corporate value has been “fairly distributed” among the parties, or whether benefits that should be fairly distributed to the shareholders have been appropriated by other parties, such as the target company management and the acquiror. We believe that public shareholders, who are not directly seated at the negotiating table, are uniquely vulnerable to being exploited by the other parties. Furthermore, even when the shareholders object to the price being received, if the shareholder base is dispersed (i.e. a large number of shareholders hold small amounts of shares), such shareholders may face various difficulties in pursuing other possible remedies available to them (such as appraisal rights) due to the potential costs and other challenges of such remedies, as compared to the value of their individual holdings in the target company.

Therefore, we urge METI to increase the Guidelines’ emphasis on the link between “corporate value” and the price to be received by shareholders of the target company, particularly as it

[1] Unless otherwise noted, our citations are to page numbers in the English reference translation of the Guidelines.

[2] We would like to note that “price” may not always mean the highest price, but should take into account the probability that the price will be received, for instance where the acquiror may have difficulties obtaining sufficient financing or regulatory approvals. Therefore, we believe that “expected value” to be received by the shareholders may, strictly speaking, be a more appropriate concept.

relates to an all-cash transaction for the entire company. We believe that protection and fair treatment of public shareholders will not only promote beneficial M&A, but also serve the central goal of promoting inward investment into Japan.

2. Board Recommendation to Shareholders

We agree with METI that when the board of directors decides to "endorse a proposal that is considered to be conducive to enhancing corporate value but is not sufficiently priced," that should be an "exceptional decision." (See p.26 of the Guidelines.)

The Guidelines state that in such case, the board of directors should "fully explain the reasonableness of its decision." (See p.26 of the Guidelines.) However, in our view, where the board of directors of the target company approves a transaction from the perspective of corporate value, but does not recommend that the shareholders tender their shares from the perspective of shareholder interest, that raises the question of whether the board failed to diligently negotiate a transaction that was in the best interests of the shareholders and whether value that should have been "fairly distributed" to the shareholders is being appropriated by another party. We believe that, in principle, the board of directors of the target company should be required to diligently negotiate a transaction that is not only fair in terms of corporate value, but that is fair to its shareholders, and which can therefore be recommended to the shareholders by the board of directors.

We agree that even if the board of directors approves such a transaction, "there is the possibility that shareholders will not fully tender their shares for the tender offer or will not vote in favor of the proposed acquisition at the shareholders' meeting, resulting in non-consummation of the acquisition." (See p.26 of the Guidelines.) However, we believe that is a separate issue from whether the board of directors of the target company has sufficiently performed its responsibilities to the target company and its shareholders. In particular, public shareholders are unable to negotiate directly with the acquirer and are relying on the board of directors to negotiate on their behalf and, as noted above, may face difficulties in pursuing other potential remedies, especially given the absence of a mechanism for collective or class actions and an active and sophisticated plaintiffs' bar to police the board's fulfillment of its duties in the sale context, as may be available under other major legal systems such as the United States. Furthermore, the board of directors is likely to have much more information, including advice from financial, legal and other advisors, about the desirability of a transaction from the shareholders' perspective, as it relates to both the business and future prospects of the target company but also as it relates to the acquiror and the proposed transaction. In our view, a board's decision to endorse a takeover proposal while not recommending that shareholders tender their shares is an abdication of the board of directors' fiduciary duties to the public shareholders at the moment in a company's life that is most critical to the public shareholders.

We urge METI to more strongly recommend that the board of directors of a target company be required to diligently negotiate a transaction that can be recommended to the shareholders, and to discourage boards of directors from agreeing to transactions that they are unable to recommend. We believe that strengthening the accountability of boards of directors of listed companies to their shareholders will also help promote beneficial M&A and further promote inward investment into Japan.

3. Anti-Takeover Measures Adopted by a Shareholder Vote Excluding Interested Parties

We are supportive of METI's view that "the invocation of countermeasures based on a resolution of a shareholders' meeting when certain shareholders' voting rights have been excluded . . . must not be abused, and that such invocation may be permitted only in very exceptional and limited cases." (See p.56 of the Guidelines.)

We are aware that there have been recent court decisions in Japan upholding the validity of such resolutions, in particular the Tokyo Kikai Seisakusho case where the Supreme Court found that the acquisition of shares exceeding one-third ownership in a short period of time through open-market transactions with inadequate disclosure in contravention of Japanese legal requirements was coercive to ordinary shareholders. (See pp.56-57 of the Guidelines.) Another recent example which has been reported in the media is a similar shareholder resolution with respect to the adoption of anti-takeover measures relating to the accumulation of shares in Cosmo Energy by entities controlled by Yoshiaki Murakami.

Further, we remain concerned about actions to selectively prevent certain shareholders from voting, and whether cases such as Tokyo Kikai Seisakusho establish a rule that enables boards to disenfranchise whichever shareholders they disagree with at the time using the behavior of certain exceptional actors as a justification. This goes against the fundamental principles of shareholder democracy and the fundamental Japanese law concept of equal treatment of all shareholders of a specific class. This is especially the case with respect to actions that are not directly related to the adoption of an anti-takeover measure, such as the election of directors.

In the United States, if the directors of a Delaware corporation take an action with the primary purpose of disenfranchising a shareholder, such action would require a "compelling justification." Delaware law imposes this very high standard because the shareholders' right to vote is deemed to be the ideological underpinning on which the legitimacy of the directors' managerial power rests—keeping proper balance in the allocation of power between the shareholders and the board of directors is dependent upon the shareholders' unimpeded right to vote effectively in an election of directors. Therefore, we would urge METI to recommend that a resolution that is adopted by excluding the voting rights of an acquiring party should be prohibited unless Japan's courts will be able to independently evaluate and establish on a facts-and-circumstances basis that there is a genuine threat posed to the value of company from the point of view of the shareholders as a whole and that the response is narrowly tailored to such threat (that is, judged objectively, including based on expert reports from both sides where appropriate, rather than by the subjective preferences of the board or management).

We are also aware that the Financial Services Agency has established a Working Group on Tender Offer Rule and Large Shareholding Reporting Rule in order to consider potential revisions to such rules, and that such rules may be another method for addressing the concerns posed by a coercive acquirer seeking control.

We believe that ensuring that there is no improper infringement on the franchise of the shareholders of Japanese corporations is critical to promoting beneficial M&A and further promoting inward investment into Japan.

4. Continued Adoption into "Hard" Law

Finally, even as we continue to support METI's efforts, we recognize that there are limits on what can be achieved by METI through "soft" law measures such as the Guidelines. For instance, the Guidelines state that "it is expected that by referring to and acting based on the best practices presented in the Guidelines, the risk of breaching the duty of care and duty of loyalty of directors will be reduced," however, "the Guidelines are not directly intended to clarify matters such as the duty of care and duty of loyalty of directors under the Companies Act." (See p.14 of the Guidelines.)

Furthermore, while the Guidelines contain many prescriptions regarding actions that should be subject to greater scrutiny, they do not prohibit such actions outright and recognize that there may be exceptional cases (such as the "exceptional decision" discussed above). Therefore, motivated directors or company management may be able to take, and may be able to pressure their advisors to endorse, various undesirable actions by creating sufficient justifications.

In order to continue the progress made so far to promote fair rules for engaging in M&A transactions, we encourage other relevant bodies in Japan, such as the courts, the Diet and other government agencies, to continue to codify the recommended practices embedded in the Guidelines into "hard" law through the use of judicial decisions, laws and regulations, particularly by clearly specifying prohibited actions from the perspective of protecting the interests of shareholders.