DOKUMENTATION / DOCUMENTATION

Takeover Defenses in Japan: Corporate Value Reports and Guidelines

A. Introduction: Models of Takeover Regulation

Harald Baum *

Against the expectations of many observers, Japan, like Germany, has had the controversial but invigorating experience in recent years of hostile takeover bids that have gained widespread attention with the general public and sent shockwaves down the spine of corporate Japan. The courts have become busy dealing with contested defense measures of actual and potential targets of unsolicited bids.[1] These rather dramatic developments are discussed and analyzed in the contributions of Professors Sôichirô Kozuka and Curtis J. Milhaupt in this issue.[2] Also, in the fall of 2004, the Japanese government – specifically the Ministry of Economy, Trade and Industry (METI) – went into action and set up an advisory group, the so-called Corporate Value Study Group (*Kigyô Kachi Kenkyû-kai*) chaired by Professor Hideki Kanda of the University of Tokyo Graduate School for Law and Politics. The Group consisted of academics, practicing attorneys, and representatives of various industries. In the light of the significant dissolution of cross-shareholdings in Japan and the perceived corresponding (and already partly materialized) likelihood of contests for corporate control, the Group's given task was to promote the establishment of fair rules concerning takeovers in Japan. After an interim report of March 2005, the Group released its first comprehensive report in May 2005, the "Corporate Value Report" (an English abstract of the report is reprinted hereafter at II.). The report focuses on the questions of what kind of defensive measures should be allowed. In other words, it mainly deals with corporate law issues.

---

* The editors are indebted to Professor *Hideki Kanda* of the University of Tokyo Graduate School for Law and Politics and Chairperson of the Corporate Value Study Group for advising them on the publication of the materials documented here and for kindly providing them with the English translations of the Japanese originals.

1 An English translation of important recent decisions can be found with E. TAKAHASHI / T. SAKAMOTO, Japanese Corporate Law – Two Important Cases Concerning Takeovers in 2005, *infra* at 231 *et seq.*

2 Cf. S. KOZUKA, Recent Developments in Takeover Law: Changes in Business Practices Meet Decade-Old Rule, *supra* at 5 ff; C. MILHAUPT, In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan, *infra* at 199 *et seq*.

In March 2006, the Group released its second report, the "Corporate Value Report of 2006" (an English abstract of the report is reprinted *infra* at III.). The second report discusses disclosure rules for takeover defensive measures as well as how stock exchanges should handle these measures if adopted by listed companies. It also deals with other procedural questions. Thus the emphasis of the second report is on capital markets law. Most importantly, based on the recommendations of the Group's first report, METI and the Ministry of Justice issued sophisticated joint guidelines on 27 May 2005, the "Guidelines Regarding Takeover Defense for the Purpose of Protection and Enhancement of Corporate Value and Shareholders' Common Interests" (the English version of the guidelines is reprinted *infra* at IV.). For a better understanding of these activities, it may be helpful to briefly outline the regulatory setting of the Group's recommendations and the guidelines from a comparative perspective.[3]

Seen from a bird's-eye view, two fundamentally different role models of takeover regulation exist: the U.K. and the U.S. takeover regimes.[4] Both countries set the pace when choosing opposing regulatory strategies for their takeover regimes in the late 1960s. Whereas the Continental European countries, including Germany, opted somewhat later for the British approach, Japan has oriented herself – so far – on the American model. The principal differences between the two models are as follows:

The British *City Code on Takeovers and Mergers*[5] was promulgated in 1968 as a piece of self-regulation. The City Code introduced rules for fair procedure, namely

---

3 For an overview contrasting the Japanese takeover regulation with the European and German concept, *see* H. BAUM, Takeover Law in the EU and Germany: Comparative Analysis of a Regulatory Model, in: University of Tokyo Journal of Law and Politics 3 (2006) (in print); also ID., Die Neuregelung des Unternehmenserwerbs im WpÜG aus rechtsvergleichender Perspektive, in: ZJapanR / J.Japan.L. 16 (2003) 101 *et seq.*

4 For a comprehensive analysis of different takeover regimes, *see* P. DAVIES / K.J. HOPT, Control Transactions, in: Kraakman et al (ed.), The Anatomy of Corporate Law. A Comparative and Functional Approach (Oxford 2004) 157 *et seq.*; H. BAUM, Funktionale Elemente und Komplementaritäten des britischen Übernahmerechts, in: Recht der Internationalen Wirtschaft 2003, 421 *et seq.*; G. LEKKAS, L'harmonisation du droit des offres publiques et la protection de l'investisseur. Etude comparée des règles en vigueur en France, au Royaume-Uni et aux Etats-Unis d'Amérique (Paris 2001); C.M. SLAUGHTER, Rights offerings, takeovers and U.S. shareholders, in: The Company Lawyer 2002, 72 *et seq.*; G. MILLER, Political Structure and Corporate Governance: Some Points of Contrast Between the United States and England, in: Columbia Business Law Review 1998, 51 *et seq.*; R.S. KARMEL, Transnational Takeover Talk – Regulations Relating to Tender Offers and Insider Trading in the United States, the United Kingdom, Germany, and Australia, in: University of Cincinnati Law Review 1998, 1133 *et seq.*

5 The City Code on Takeovers and Mergers. Rules, Appendices and Notes, 7th edition of 1 May 2002 as amended on 7 November 2005; for a short but profound overview, *see* DAVIES, Gower's Principles of Modern Company Law (6th ed., London 1997) 772-816; a comprehensive commentary can be found with M. BUTTON (ed.), A Practitioner's Guide to the City Code on Takeovers and Mergers (Old Woking, Surrey, 2003); M.A. WEINBERG / M.V. BLANK / L. RABINOWITZ, Weinberg and Blank on Takeovers and Mergers (5th ed., London 2002).

transparency rules, and the so-called "mandatory bid rule" that became its centerpiece. Roughly speaking, the latter imposes the obligation to acquire all shares offered if a person or a company acquires one-third of the voting rights in public companies, and to pay the same price to all shareholders willing to sell. The aim is to guarantee an exit route for minority shareholders in case of a change of control, and to secure equal treatment of all shareholders in substance – i.e., financially – in the case of the takeover. These measures were of some help to the incumbent management of a target company confronted with a hostile takeover because, in effect, transparency rules and especially the mandatory bid rule make takeovers more costly. However, these "advantages" were at least partly offset by the introduction of a strict neutrality principle that essentially binds the hand of managers. According to the "non-frustration" rule laid down in the Code's General Principle 7 and supplemented by Rule 21 and Rule 37, the management of a target company may not take any action that might frustrate a bid without express up-to-date consent of the company's shareholders. Thus the decision in the U.K. about a change in control has rested since then firmly with the shareholders as the residual risk takers. By and large, the British concept has become the European one that has been, at least in principle, adopted by all member states of the EU.

The United States adopted a takeover regulation in the same year as the U.K., in 1968. However, interestingly, the chosen regulatory approach laid down in the Williams Act [6] differed substantially from the British, notwithstanding the fact that a predominance of public companies with widely spread shareholdings was (and still is) characteristic for both countries, along with a market- and outsider-oriented corporate governance model. The Williams Act has no self-regulatory basis; it is a piece of state legislation on the federal level. Nevertheless, it can be characterized as a light regulation of purely procedural nature, which focuses on disclosure. It applies if and when a bidder makes a tender offer to purchase shares regardless of whether this leads to a change of control.[7] The latter has no regulatory consequences under the Williams Act, as that does not provide for a mandatory bid rule. The aim of the Act is to protect and to guarantee an equal treatment of all shareholders with respect to information and procedure so as to prevent a premature and under-priced selling of shares. Thus, in effect, rather than facilitating the exit of shareholders as in the British takeover regime, the U.S. regulation seems to encourage shareholders to stay invested in the target com-

6 Law of 29 July 1968, codified as part of the Securities and Exchange Act of 1934; 15 U.S.C. §§78m(d)-(e), 78n(d)-(f).

7 For a short overview, *see* H.S. BLOOMENTHAL / S. WOLFF, Securities and Federal Corporate Law (2nd ed., St. Paul, Minn. 2000) Chap. 25; L. LOSS / J. SELIGMAN, Securities Regulation (3rd ed. 1990, Supplement 2004, Boston u.a.) Chap. 6; a comprehensive commentary of the U.S. takeover regulation is R. GILSON / B. BLACK, The Law and Finance of Corporate Acquisitions, (2nd ed., Westbury 1995).

pany.[8] Furthermore, the Williams Act differs from the City Code in its silence about management's role in the acquisition process. Only some ten years later, in the wake of a wave of hostile takeovers in the late 1970s and early 1980s and after corporate management cried foul, did numerous states start to grant them protection in the form of so-called anti-takeover statutes.[9] Also, court decisions allowed bid-frustrating defensive actions, especially in Delaware.[10] This approach is more or less the opposite of the British approach; as a consequence, the decision in the U.S. about the change of control rests to a large extent with management and *not* with the shareholders as in the U.K.

Japan's sophisticated takeover regulations can be found in the Securities and Exchange Act[11] and accompanying ordinances that are – after a major amendment in 1990 – actually much more refined than those of the Williams Act on which they were initially modeled.[12] As with the Williams Act, the Japanese regulations are focused on procedural issues and only at the margin on a change of control. So far, there is no mandatory bid rule like that of the British City Code and other EU takeover regimes. However, the pending reform of the Securities and Exchange Act may lead to the introduction of such a rule in Japan as well.[13] If so, Japan is in danger of falling into the same regulatory trap as Germany by combining elements of different takeover regimes in a dysfunctional manner: a mandatory bid without a strict neutrality rule.[14] The procedural rules in the Securities and Exchange Act are in line with their focus on disclosure and silent on defense measures. The Guidelines of 2005 fill this gap by clarifying what kinds of defensive measures are acceptable in certain circumstances. As before, the U.S. regulation has been the model, though this time it was not the Williams Act but rather the rules on defensive measures developed by the courts in Delaware – the major incorporation state in the U.S. In effect, management has been given wide discretion in implementing defensive measures. Now Japanese managers have bid-frustrating powers similar to their American counterparts, and possibly even more so because there might be some leeway in interpreting the rather vague standards differently from U.S. courts.[15] Seen from a comparative perspective, it is safe to say that Japan oriented herself both in the 1990 and in the 2005 reforms in form and substance – at least in principle – on the U.S. model rather than on the European one.

---

8 *Cf.* R.H. SCHMIDT, in: Boettcher et al. (eds.), Jahrbuch für Neue Politische Ökonomie, Vol. 6 (Tübingen 1987) 180 *et seq.*

9 *Cf.* R. ROMANO, The Political Economy of Takeover Statutes, in: 73 Virginia Law Review (1987) 111 *et seq.*

10 A discussion can be found with GILSON / BLACK, *supra* note 7, at 801 *et seq.,* 1317 *et seq.*

11 *Shôken torihiki-hô*; Law No. 25/1948 as amended.

12 For an analysis, *see* H. BAUM, Der Markt für Unternehmen und die Regelung von öffentlichen Übernahmeangeboten in Japan, in: Die Aktiengesellschaft 1996, 399 *et seq.*

13 *Cf.* the report of H. ODA, Comprehensive Overhaul of the Securities and Exchange Act, *infra* at 225 et seq.

14 For a critic of the German takeover law *see* BAUM, *supra* note 4.

15 See the contribution by C. MILHAUPT, *infra* at 199 *et seq.*

ZUSAMMENFASSUNG

In jüngster Vergangenheit ist es in Japan zu einer Reihe feindlicher Übernahmen bzw. Übernahmeversuche gekommen, die viele Beobachter überrascht und für erhebliche Aufregung im Lande gesorgt haben. Im Mittelpunkt der dadurch angestoßenen juristischen Diskussion steht die Frage, unter welchen Voraussetzungen und in welchem Umfang Abwehrmaßnahmen der angegriffenen Unternehmen zulässig sind, die von diesen als unerwünscht eingestuft werden. Die Frage hat auch bereits die japanischen Gerichte beschäftigt. Die Beiträge von Sôichirô Kozuka, Curtis J. Milhaupt *und* Eiji Takahashi / Tatsuya Sakamoto *sind diesem Thema gewidmet.*

Im Herbst 2004 hat das japanische Wirtschaftsministerium eine Arbeitsgruppe unter Vorsitz von Prof. Hideki Kanda *von der University of Tokyo Graduate School for Law and Politics ins Leben gerufen, die* Kigyô Kachi Kenkyû-kai *(Corporate Value Study Group). Deren wichtigste Aufgabe war, Vorschläge zur Regelung von Abwehrmaßnahmen zu entwickeln. Die Gruppe hat einen ersten Bericht im Mai 2005 und einen zweiten im März 2006 vorgelegt. Englische Zusammenfassungen beider Berichte sind nachfolgend abgedruckt (II., III.). Auf der Grundlage des ersten Berichtes haben das Wirtschaftsministerium und das Justizministerium am 27. Mai 2005 Empfehlungen publiziert, die Regeln für die Ausgestaltung zulässiger Abwehrmaßnahmen enthalten. Eine englische Übersetzung ist im Folgenden unter IV. abgedruckt.*

Die Empfehlungen orientieren sich am U.S.-amerikanischen Recht, konkret an der Rechtsprechung der Gerichte des dortigen Bundesstaates Delaware, die für die Praxis in den USA von maßgeblicher Bedeutung ist. Die bisherige gesetzliche Regelung von Übernahmen ist in Japan, wie in den auch dafür als Vorbild dienenden USA, rein kapitalmarktrechtlich ausgerichtet und betrifft im wesentlichen nur verfahrensrechtliche Fragen, namentlich Informationspflichten, nicht aber Abwehrmaßnahmen. Weltweit gibt es – vereinfacht ausgedrückt – seit rund vier Jahrzehnten zwei mehr oder weniger gegensätzliche Modelle der Regulierung von Übernahmen, das britische und das U.S.-amerikanische. Japan hat sich bislang durchgängig an letzterem orientiert; für Deutschland gilt das Umgekehrte.