Use of Share Options as an Anti-Takeover Defense Measure in Japan

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1. INTRODUCTION

In *Steel Partners Japan Strategic Fund (Offshore) LP* v. *Bull-Dog Sauce Co. Ltd.*,[1] the Supreme Court ruled that Art. 247 of the Companies Act (*Kaisha-hô*),[1a] which entitles shareholders to demand that the company discontinue the issue of share options for subscription (*shinkabu yoyakuken*), is applied by analogy to the allotment of share options without consideration (*shinkabu yoyakuken mushô wariate*) subject to discriminatory conditions for exercise or a discriminatory call. The court further held that a hostile takeover defense may be compatible with the principle of equal treatment of shareholders in some instances where the share options are not deemed to be effected by using a method that is extremely unfair.[2] This decision has great significance because it is the first ruling on the allotment of share options without consideration. It was introduced into the Companies Act for the first time in Japan, and it explicitly recognizes an exception to the principle of equal treatment of shareholders. Moreover, the Supreme Court seems to hold the position that it is possible to take anti-takeover measures even if the bidder is not found to be an abusive bidder.

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1 The facts are as follows (*Cf.* also the summary of and comments on the decision by E. TAKAHASHI / T. SAKAMOTO, in this issue, *infra* at p. 221, *the Editors*):
Steel Partners Japan Strategic Fund (Offshore) LP commenced a takeover bid for all of the outstanding shares of *Bull-Dog Sauce Co. Ltd.* except for those shares that Steel Partners already had owned at 1,584 yen per share. The bid would represent a 20 percent premium over Bull-Dog's share price at the close of trade on 14 May 2007. Steel Partners, along with

II. SHARE OPTIONS SUBJECT TO DISCRIMINATORY CONDITIONS FOR EXERCISE

According to Art. 2 Item 21, a "share option" means any right that entitles the holder to acquire shares in a stock company by exercising the right against the stock company. Art. 236(1) stipulates that a stock company shall prescribe the method for determining the portion of the share options to be acquired if it is arranged that a portion of the share options may be acquired by the stock company on the day the grounds arise as provided in advance (Item 7). Accordingly, it is possible to set conditions for call so that a company may treat holders of share options differently. Moreover, it is widely accepted that though a company can issue share options subject to discriminatory conditions for exercise, the Companies Act does not explicitly enable a company to do so.[3]

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its affiliates, was the largest single shareholder of Bull-Dog Sauce, having 10.15 percent of the Bull-Dog's outstanding shares when it launched the bid.

In response to the bid, Bull-Dog's board of directors requested further information from Steel Partners regarding its intentions in making the bid. Steel Partners responded that it had no intention of managing the day-to-day operations of Bull-Dog, having confidence in the present management. This made the management of Bull-Dog Sauce think that the Steel Partners' attempt was not best for the enterprise value and the interests of stakeholders, especially shareholders of Bull-Dog Sauce. Accordingly, Bull-Dog's board of directors announced its formal opposition to the takeover bid and recommended that shareholders not support the bid on June 7. The board of directors also announced that it would seek an extraordinary shareholder resolution to implement measures against a takeover attempt by Steel Partners. The plan was to issue, without consideration, three share options for each Bull-Dog share held by shareholders. As the share options could be exchanged for new shares, stockholders who before held one share in Bull-Dog Sauce would have four after the exchange. Bull-Dog would have the right to buy the options back from Steel Partners for 396 yen per share, which was equivalent to one-fourth of the initial tender offer price of 1,584 yen set by Steel Partners, instead of allowing Steel Partners to convert the share options into new shares. Under this measure, Bull-Dog shareholders would, in theory, neither profit nor suffer financial loss, while Bull-Dog would pay about 2.3 billion yen to Steel Partners. Steel Partners' stake in Bull-Dog Sauce would be diluted to 2.86 percent from 10.52 percent unless Steel Partners withdrew its takeover bid.

Steel Partners sought an injunction from the Tokyo District Court to bar Bull-Dog Sauce from implementing the measure, saying it discriminated against the fund and was financially damaging on the one hand; on the other hand, it sweetened its offer to 1,700 yen per share on June 15. However, more than 80 percent of Bull-Dog's shareholders approved the scheme at the annual general meeting held on June 24.

1a Law No. 86/2005; except otherwise indicated, all articles cited are those of the Companies Act.

2 Decision of 7 August 2007 of the Second Petty Bench of the Supreme Court, Shôji Hômu No. 1809, p. 16, which rejected Steel Partners' second appeal. In *Steel Partners* v. *Bull-Dog Sauce,* the Tokyo District Court (*infra* note 6) dismissed a claim of Steel Partners for an injunction and the Tokyo High Court upheld the decision of District Court, handing down *Steel Partners*' first appeal.

3 For example, *see* Kôji HARADA (ed.), *Heisei 13 nen shôhô kaisei, Q&A kabushiki seido no kaizen, kaisha un'ei no denshi-ka* (Shôji Hômu 2002) p. 58; KIGYÔ KACHI KENKYÛ-KAI, *Kigyô kachi hôkoku-sho – Kôseina kigyô shakai no rûru keisei ni muketa teian –* (27 May 2005), p. 77; MINISTRY OF ECONOMY AND INDUSTRY and MINISTRY OF JUSTICE, *Kigyô*

This is because the legal nature of share options is a contractual right between a company and the option holders; it might not cause problems not to recognize the principle of equal treatment of holders of share options because the holders of share options – in contrast to the shareholders – are not members of a stock company. In other words, the legal relationship relating to share options is not too complicated without the principle of equal treatment because share options – in contrast to shares – are neither proportionate rights nor rights to participate in management decisions. In addition, a holder of share options – in contrast to a shareholder – is not a residual claimant shareholder. The principle of equal treatment of share option holders is not always necessary for protecting holders of share options, because those who are going to be holders of share options may subscribe to share options knowing that discriminatory conditions for exercise or discriminatory conditions for call are set for the share options.

However, when a company allots share options without consideration to its shareholders, the provisions on "the features and number of the share options the stock company will allot to shareholders or the method for calculating such number" shall be that the share options will be allotted in proportion to the number of shares (or, for a company with class shares, the shares of the classes) held by shareholders (or, for a company with class shares, class shareholders of the classes) other than the stock company (Art. 278(2)).

Accordingly, allotting share options subject to discriminatory conditions for exercise or for call, even in proportion to the number of the shares a shareholder has, might be considered incompatible with the aim of Art. 278(2). However, aside from Art. 109(1), which provides the principle of equal treatment of shareholders in general,[4] the pro-

kachi / kabunushi kyôdô no rieki no kakuho mata wa kôjô no tame no baishû bôei-saku ni kansuru shishin (27 May 2005), p. 6 note 4.

An English translation of the Guideline of the METI and MOJ is published in: ZJapanR / J.Japan.L. No. 21 (2006) p. 143 et seq. (*the Editors*).

4 Besides, in *Steel Partners Japan Strategic Fund* v. *Bull-Dog Sauce,* the Tokyo High Court (Decision of 9 July 2007, Shôji Hômu No. 1806, p. 40) ruled as follows:

> A shareholder should, of course, exercise rights provided in the Companies Act under the fundamental legal norms such as the doctrine of good faith. Such an exercise should not amount to an abuse of rights and, in some cases, might be restricted in relation to others' rights. Accordingly, though, the principle of equal treatment of shareholders is one of the important principles stipulated in the Companies Act; a differential treatment according to the attributes of individual shareholders is not necessarily incompatible with the principle of equal treatment of shareholders in cases where the treatment is necessary, proper, and reasonable in order to prevent damages to the enterprise value of the company. The allotment of free share options was done as a so-called anti-takeover defense measure and the court found that the allotment is necessary and reasonable as an anti-takeover measure. As the allotment has been designed not to impose on Steel Partners and its affiliates excessive or unreasonable economic loss, the discriminatory treatment among shareholders is deemed as reasonable and the allotment without consideration does not conflict with the principle of equal treatment of shareholders and is not deemed illegal.

visions in the Companies Act requiring a "proportion to the number of the shares" can be classified into two types. One type of provision relates to acquisition of class shares subject to a total call by the issuing company (Art. 171(2)), allotment of shares without consideration (Art. 186(2)), dividend of surplus (Art. 454(3)), and distribution of residuum (Art. 504(3)). The other relates to the issue of new shares or the disposal of one's own shares (Art. 202(2)) and share options (Art. 241(2)), in which shareholders have entitlement to the allotment of such. Even a non-public company[5] may decide the particulars in regard to the latter, not only by a special resolution of the general meeting, but also by the board of directors or a director in cases where the articles of incorporation provide so. Therefore, the content of shares or share options, especially voting rights, should not differ among the shareholders when a company issues new shares or disposes of its own shares and share options, when shareholders have entitlement to the allotment of such. On the other hand, in regard to the former, it seems that the Companies Act requires a company to allot shares "in proportion to the number of the shares" mainly for the protection of shareholders' economic interests because the organ that decides is the same in a non-public company as in a public company. In addition, the board of directors, in principle, may decide to whom shares or share options for subscription will be allotted, and the ratio of voting rights of the existing shareholders is not protected in a public company unless the issue or disposal of shares or share options is "effected by using a method that is extremely unfair".

In *Steel Partners* v. *Bull-Dog Sauce*, the Supreme Court ruled as follows:

> Since the interests of individual shareholders, in principle, depend on the existence and development of the company, the company may treat a particular shareholder discriminatorily in order to prevent the damages to the enterprise value, the interests of the company, and the common interests of shareholders in cases where the existence and development of the company are threatened by the control over the company by the shareholder. The treatment cannot be incompatible with the aim of the principle [of equal treatment of shareholders] per se unless it conflicts with the principle of equity and lacks reasonableness.

5 The Companies Act stipulates that "public company" means any stock company whose articles of incorporation do not require, as a feature of all or part of its shares, the approval of the stock company for the acquisition of such shares by transfer (Art. 2 Item 5).

III. Injunction Against Allotment of Free Share Options

While Item 2 of Art. 247 provides for an injunction against the issue of share options for subscription (Art. 238(1)), it does not explicitly provide for an injunction against the allotment of share options without consideration. Item 2 of Art. 247, however, might apply by analogy to the allotment of free share options.[6]

Though it might be possible to interpret Art. 247 as listing all cases where an injunction against the issue of share options can be sought under the Companies Act,[7] the prevailing opinion was that a shareholder could seek for an injunction against the opening of or a resolution at the general meeting even if the convener was not a director under the Commercial Code (*Shôhô*, before the 2005 amendments)[7a] because the value judgment in Art. 272 (corresponding provisions in the Companies Act are Articles 360 and 422) might apply.[8] Generally speaking, it was not the prevailing view that the provisions permitting shareholders to seek for an injunction in the Commercial Code never apply by analogy to acts of the company, its directors, or officers.

Yumeshin Co., Ltd. v. *Nihon Gijutsu Kaihatsu Co., Ltd.*,[9] which held that the provision relating to the injunction against the issue of new shares did not apply, neither directly nor by way of analogy, to share split, found that

> the Commercial Code did not provide for the shareholder's right to seek for an injunction against a share split in contrast to the issue of new shares because the shareholder would not, in ordinary cases, suffer losses, such as a decrease in the ratio of voting rights or the value of the shares he/she has. This is because a share split is a division of an existing share into more shares and does not affect the ratio of voting rights or the value of the shares a shareholder has as a whole, unless the company has issued two or more classes of shares.

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6 In *Steel Partners Japan Strategic Fund* v. *Bull-Dog Sauce,* both the decisions of the Tokyo District Court (28 June 2007, Shôji Hômu No. 1805, p. 43) and of the Tokyo High Court (*supra* note 4) are based on the premise that an allotment of free share options might be subject to an injunction order. For detail, *see* MASAO YANAGA, *Kabushiki / shinkabu yoyaku-ken no mushô wariate, kabushiki bunkatsu to sashitome*, in: Shôji Hômu No. 1751 (2005) p. 5.

7 MASAMI HADAMA, *Giketsu-ken seigen kabushiki o riyôshita baishû bôeisaku*, in: Shôji Hômu No. 1741 (2005) p. 33. *See also* TOMOTAKA FUJITA ET AL., *Shin kaisha-hô no seitei o megutte*, in: Daiichi Tokyô Bengoshi-kai Kaihô No. 390 (2005) p. 18; TSUNO ÔTORI, *Chûshaku 341 jô no 7,* in: T. Ômori / M. Yazawa (eds.), *Chûshaku kaisha-hô*, Vol. 7, p. 516 (Yûhikaku, 1971).

7a Law No. 48/1899 as amended by Law No. 154/2004. The regulations concerning company law have now been transferred to the new Company Law of 2005, cf. *supra* note 1a.

8 KEN'ICHIRÔ ÔSUMI, *Kabunushi-ken ni motozuku kari-shobun*, in: J. Nakata (ed.), *Hozen shobun no taikei*, Vol. 2, p. 661 (Hôritsu Bunkasha, 1966).

9 Decision of Tokyo District Court, 29 July 2005, Kin'yû Shôji Hanrei, No. 1222, p. 4. *See* YÔ ÔTA, *Nihon gijutsu kaihatsu no kabushiki bunkatsu sashitome kari-shobun meirei môshitate jiken*, in: Shôji Hômu, No. 1742 (2005) pp. 42-55.

Though the court ruled that Art. 280-10 Commercial Code (before the 2005 amendments) could not be applied by analogy to the share split in *that* case, we can interpret that the court was not of the view that Art. 280-10 Commercial Code (before the 2005 amendments) exclusively listed the cases where a shareholder could seek for an injunction. It denied the application by analogy on the substantial grounds that *the share split in question* was "not considered to affect the position of a shareholder substantially" (emphasis added).[10]

Moreover, even before the 1974 amendments there was an opinion that Art. 280-10 Commercial Code applied by analogy to the issue of convertible bonds in cases where conditions particularly favorable for the subscriber were provided, but there was no special resolution of the general meeting to approve the issue so that a shareholder might request an injunction against the issue.[11]

In addition, if the allotment of free share options is an "issue of share options" in Item 4 of Art. 828(1), there are no grounds to ban the injunction against the allotment of free share options since there is no difference between free share options and share options for subscription from the viewpoint of legal certainty. On the contrary, if the allotment of free share options is not deemed as an "issue of share options" in Art. 828(1), illegal or extremely unfair allotment of free share options is *per se* void and it is natural that an injunction against the allotment be ordered. While the issue of share options for subscription is a transaction between a company and a subscriber, and protection of the subscriber (or trade stability[12]) is more or less necessary, trade stability is less necessary with regard to the allotment of free share options (though trade stability should be respected with regard to the transfer of the shares a shareholder has as a result of the exercise of share options allotted to the shareholder without consideration). Because free share options are not allotted for fund raising in ordinary cases, the disadvantage for the company due to an injunction against the allotment of free share options is less than that due to an injunction against an issue of shares for subscription. It is reasonable to allow a shareholder to request an injunction in order to protect the interests of existing shareholders if a company may provide discriminatory conditions for exercise of the free share options allotted.

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10 The provision relating to an injunction against the issue of new shares might be applied by analogy to a share split in a case where the share split has a substantial effect on the position of a shareholder. In that case, the plaintiff insisted that the court should order an injunction on the grounds that the resolution of the board of directors to split shares was void; however, the court did not hold that the resolution was null and void. Accordingly, it is still open for discussion whether the court should order an injunction on the grounds of a resolution of the board of directors.

11 MAKOTO YAZAWA, *Tenkan shôken no hôritsuteki kôsei*, in: Hôgaku Kyôkai Zasshi Vol. 68, No. 6 (1950) p. 590 and p. 592, note 2.

12 This is a free translation of "*torihiki no anzen*"; a literary translation of this is "security of transactions".

IV. ALLOTMENT OF SHARE OPTIONS WITHOUT CONSIDERATION

1. *Decision Made by a Resolution of the Board of Directors*

It has been widely accepted that whether a "share option issue is effected by using a method that is extremely unfair" (Art. 247 Item 2) should be judged case by case, especially when there is a battle for control.[13] In cases where the board of directors decided to issue share options in order to secure or gain the majority of voting rights in the battle for control over the company (*Livedoor Co., Ltd.* v. *Nippon Broadcasting Co., Ltd.*[14]), or where free share options that would not be transferred with the shares were allotted by a resolution of the board of directors to the shareholders of a listed company as a defense against a hostile takeover (*SFP Value Realization Master Fund* v. *Nireco Co., Ltd.*[15]) and where this would harm the shareholders the courts have held that the share option issue has been effected by using a method that is extremely unfair.[16]

2. *Mandate Made by a Special Resolution of the General Meeting*

In *Livedoor* v. *Nippon Broadcasting,*[17] the court ruled on a decision by the board of directors to issue share options in order to secure or obtain the majority of voting rights where there is a competition for control over the company. The court explained why an issue of share options is deemed as effected by using a method that is extremely unfair as follows:

> According to the Commercial Code, the general meeting is exclusively responsible for the election and dismissal of directors, and directors are executive organs elected by a decision of a capital majority of shareholders. Accordingly, it is obviously incompatible with the Commercial Code's aim to attribute authority to various organs to allow, in general, directors – who are to be elected by shareholders – to issue new shares, etc. with the primary purpose of changing the composition of shareholders, who elect the directors. This principle is similarly true even in cases where the management believes that his/her management policy, or the policy of the third party who supports and has de facto influence on the management, is better than that of the hostile acquirer. It is the shareholders who decide – through

13 *See* HIDEKI KANDA, *Kaisha-hô* (10th ed., Kôbundô, 2008) p. 145.

14 Decision of Tokyo High Court, 23 March 2005, Hanrei Jihô No. 1899, p. 56.

15 Decision of Tokyo High Court, 15 June 2005, Hanrei Jihô No. 1900, p. 156.

16 *See* KENJIRÔ EGASHIRA, *Kabushiki kaisha-hô* (Yûhikaku, 2006) p. 714.

17 The Guideline published by the Ministry of Economy and Industry and the Ministry of Justice (*supra* note 3) recommends takeover defenses, which are introduced in times of peace, to satisfy the following three principles: (a) ensuring and improving common interests of shareholders, (b) placing reliance on the reasonable will of shareholders, and (c) having need and reasonableness (p. 3). Especially, the fact that (b) placing reliance on the reasonable will of shareholders is one of the requirements seems in line with the idea of allocation of authorities among organs pointed out in the *Livedoor* v. *Nippon Broadcasting* decision, which is applied to cases where the anti-takeover measures are introduced in emergencies. Accordingly, these three principles might be true for a takeover defense introduced to respond to emergency situations.

> the election of directors by a decision of a capital majority at the general meeting – who should be the management and what should be the business policy of the company. Accordingly, it is not acceptable in principle for the management to decide to issue new shares, etc. for the primary purpose of altering the composition of shareholders in order to maintain the business policy the management believes is best.

On the other hand, if a company amends its articles of incorporation to stipulate that the general meeting decides allotment of free share options, the outline of an allotment of free share options is approved by a special resolution of the general meeting, and the board of directors decides to allot share options without consideration, the allotment of free share options is deemed as based on the reasonable will of its shareholders.[18] Thus, the allotment of free share options whose outline was decided by a special resolution of the general meeting is not an issue of "new shares, etc. for the primary purpose of altering the composition of shareholders in order to maintain the business policy the management believes is best", and it is unlikely to be deemed as "effected by using a method that is extremely unfair", at least based on the decision-making process and the logic of *Livedoor* v. *Nippon Broadcasting.*

The Tokyo District Court held in *Steel Partners Japan Strategic Fund* v. *Bull-Dog Sauce* in the same way as follows:

> The above-mentioned doctrine,[19] which may apply to the cases where the board of directors has decided to issue share options, does not apply to this case because this allotment of free share options was implemented according to the mandate by the general meeting, though it was implemented by the board of directors.

3. *Criteria for Reasonableness – Substance and Substantive Effect*

Whether an issue of share options has been "effected by using a method that is extremely unfair" is judged based on the substance and substantive effect of the issue. Because an issue of shares is not deemed to be "effected by using a method that is extremely unfair" if the company has the need to raise funds and the primary purpose of the issue is fund raising, it is consistent to consider that an allotment of share options without consideration, not done for fund raising, is "effected by using a method that is

18 Also, provided that the ideas of the Guideline are accepted, anti-takeover measures introduced by a special resolution of the general meeting are presumed to ensure and improve the common interests of shareholders without the fear of abuse of power by the board of directors, and they are necessary and proper. The presumption is, however, rebuttable.

19 If the board of directors has decided to issue shares or share options in order to secure control by the present management as a principal purpose, thus decreasing the ratio of voting rights of a particular shareholder who has competed for the control of the company by a hostile takeover in cases where control over the company has been under competition, an injunction against such an issue should be ordered in principle because the board of directors has abused the power and the issue is deemed unfair. *See Livedoor* v. *Nippon Broadcasting* (*supra* note 14).

extremely unfair" unless the allotment satisfies need and reasonableness. In *Livedoor* v. *Nippon Broadcasting,* the Tokyo High Court ruled that a takeover defense might be allowed in some cases to the extent that need and reasonableness as anti-takeover measures are satisfied. The Guideline holds the view that a "takeover defense should be designed to the extent necessary and proper to prevent a takeover".[20]

a) Discriminatory Conditions for Exercise or Call

The allotment of free share options with "discriminatory" conditions for exercise or call might be deemed as "effected by using a method that is extremely unfair" because the allotment has the effect of diluting voting rights of a particular shareholder excessively and lacks reasonableness.

Under the Companies Act, however, the board of directors may decide the details of the offer of share options in a public company as long as the amount to be paid is the fair value of the option, despite the fact that share options are not usually issued for fund raising. Therefore, this provision suggests that the Companies Act does not necessarily require a public company to keep the ratio of voting rights a shareholder has, but to refrain from impairing the financial interests of a shareholder.

Moreover, for example, the Companies Act allows a company, in accordance with a special resolution of the general meeting, to issue shares or share options whose subscribing conditions are particularly favorable to the subscriber (Articles 199(2), 201(1), 238(2) and 240(1)) though the resolution might be subject to a lawsuit to make a resolution of a general meeting void (Art. 831(1) Item 3). Thus it can be understood that the Companies Act allows a company on some occasions to treat its shareholders discriminatorily with respect to economic interests and the change in ratio of voting rights. In addition, in several circumstances majority shareholders may squeeze minority shareholders out by cash-out merger or share exchange (Art. 768(1) Item 2).

Judging from these provisions in the Companies Act, discriminatory treatment is allowed within a proper range unless, taking various factors into consideration, it amounts to "abuse of the decision by a majority". Discriminatory treatment does not necessarily make the allotment of share options without consideration "effected by using a method that is extremely unfair".[21]

Generally speaking, the reasonableness of an allotment of free share options should be judged correlatively with the need for it.

b) Decrease of Ratio of Voting Rights

In general, the allotment of free share options subject to discriminatory conditions for exercise, which decreases the ratio of voting rights of a shareholder and has a significant impact on the exercise of rights by the shareholder, is deemed as "effected by using a

20 MINISTRY OF ECONOMY AND INDUSTRY and MINISTRY OF JUSTICE, *supra* note 3, p. 3.
21 *See* KANDA, *supra* note 13, p. 141, EGASHIRA, *supra* note 16, p. 701.

method that is extremely unfair". It is likely to be thought that share options have been "effected by using a method that is extremely unfair" if the issue of the share options dilutes voting rights of an existing shareholder so much that exercise of rights by the shareholder is significantly influenced without a high degree of need for the company to do so.[22]

At the least, the influence might be significant if the ratio of voting rights of a shareholder (or a group of shareholders) has fallen from not less than two-thirds[23] to less than two-thirds, from majority[24] to not more than 50 percent, or from not less than one-third to less than one-third, due to the allotment of the share options. In a similar fashion, the influence might be significant if the ratio of voting rights of a shareholder (or a group of shareholders) has increased from less than two-thirds to two-thirds or more, from not more than 50 percent to a majority, or from less than one-third to one-third or more, due to the allotment of the share options.

c) Assumption of the Need

As mentioned above, it could be assumed that the company has the need to allot free share options subject to discriminatory conditions for exercise in cases where the majority shareholders recognize it as necessary to allot free share options, and a special resolution of the general meeting to allot free share options has been passed.[25] Even in a public company, a shareholder is legitimately concerned about who is the key share-

22 On the other hand, as in the *Bull-Dog Sauce* case, a resolution that an allotment of free share options would be made only if the hostile acquirer would not cancel the takeover bid has no effect to dilute the acquirer's share. Accordingly, it could be thought in that case that a high degree of necessity, which is required in cases where the allotment dilutes the existing shareholders' share in voting rights, is not necessarily required, but some necessity to allot share options should suffice.

23 A special resolution of a general meeting is made by a two-thirds majority (or another proportion in cases where a higher proportion is provided for in the articles of incorporation) or more of the votes of the shareholders present at the meeting where the shareholders holding a majority of the votes of those shareholders entitled to exercise their votes at the general meeting are present (in cases where a proportion of one-third or more is provided for in the articles of incorporation, that proportion is valid) (Art. 309 (2)).

24 Unless otherwise provided for in the articles of incorporation, an ordinary resolution of a general meeting is made by a majority of the votes of the shareholders present at the meeting where the shareholders holding a majority of the votes of the shareholders who are entitled to exercise their votes are present (Art. 309 (1)).

25 The Tokyo District Court held, in *Steel Partners* v. *Bull-Dog Sauce*, as follows:

> Even anti-takeover measures taken by a special resolution of the general meeting should not exceed the scope necessary for preventing a particular acquirer from gaining control over the company and causing damage to the interests of the acquirer or other shareholders. From this point of view, the reasonableness of the measures taken by the general meeting should be determined, considering all the factors together, including the development of the resolution of the general meeting to take the measures, the detriments from the measures suffered by the existing shareholders and their extent, and the blocking effect of the measures on the takeover.

holder or who are the majority or controlling shareholders, because the key shareholder, for example, affects the future of the company. Therefore, it might be allowable for shareholders to avoid a change of the key shareholders, etc. and maintain the value of the shares they have, deciding to allot share options subject to discriminatory conditions for call.[26]

In the first place, as a general rule, a shareholder cannot argue that an issue of share options for a fair amount to be paid in is void solely based on the decrease of the ratio of voting rights of the existing shareholders. Accordingly, it is consistent to think that a resolution to allot free share options subject to discriminatory conditions for exercise is not void or voidable, in principle, as long as the allotment is not detrimental to the financial interests of the existing shareholders.

In addition, even a non-public company may issue shares or share options by a special resolution of the general meeting as a general rule, even though the issue may affect the distribution of voting rights among the shareholders or the composition of shareholders in the company. This might be all the more true for a public company.[27]

The Supreme Court ruled as follows:

> Whether an acquisition of control over the company by a particular shareholder impairs the enterprise value of the company, the interests of the company and, consequently, common interests of shareholders should be judged ultimately by the shareholders, to whom the interests of the company are attributed. Therefore, their judgment should be respected unless there is a serious defect that leads to injustice in the judgment, such as the unfair procedure of a general meeting or the non-existence or misrepresentation of the fact which was a presupposition of the judgment.

This decision can be interpreted like this: the court showed a willingness to review the decision of the general meeting, focusing on the fairness of the process of the decision.[28]

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26 One might argue that an allotment of free share options which are subject to discriminatory conditions for exercise has a very slight bad influence on the negotiability of the shares of the company in cases where the expiration date of the share options is near to the date of the decision to allot the share options. In addition, such an allotment would be more permissible if a majority of the shareholders would like to accept the disadvantage in the negotiability. Cf. *Yumeshin Co., Ltd.* v. *Nihon Gijutsu Kaihatsu Co., Ltd.* (*supra* note 9).

27 The Guideline argues that "it does not contradict the principle of equal treatment of shareholders for a company to provide that the shareholder, excluding the bidder of a takeover bid, can exercise the share options" because holding share options is not a right as a shareholder (p. 7). Should this view be accepted, the allotment of free share options is not always "effected by using a method that is extremely unfair" on the sole ground that the conditions for exercising the share options are discriminatory conditions for exercise.

28 The Tokyo High Court in *Steel Partners* v. *Bull-Dog Sauce* acknowledged the need for takeover defense in that case, finding that Steel Partners and its affiliates were abusive acquirers. It held as follows:

> Steel Partners and its affiliates are legal persons whose structure is that of an investment fund which naturally owes a fiduciary duty to prioritizing the interests of the clients, and

V. THE GENERAL MEETING AND A DECISION TO ALLOT FREE SHARE OPTIONS

In the *Bull-Dog Sauce* case, the general meeting had amended the articles of incorporation to make the allotment of free share options subject to discriminatory conditions for exercise and discriminatory call subject to a resolution of the general meeting before the resolution to allot free share options subject to discriminatory conditions for exercise and discriminatory call.[29] This is because it is necessary for a public company to provide in the articles of incorporation that the general meeting may decide the details of an

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> which is motivated by a contingent fee and pursuing high fees as its top priority. They are neither interested in nor involved in management of the target of the takeover, but pursue their own interests exclusively and seek only to secure profits by selling companies' shares back to the company or to the third parties in the short term, in some cases with an eye to disposing of company assets after the acquisition of the shares in the target… In addition, Steel Partners and its affiliates have given Bull-Dog Sauce unnecessary cause for anxiety, announcing that they plan to acquire all shares in Bull-Dog Sauce without consideration of the management of the enterprise, for which a coordinated effort is required by the nature of things. Accordingly, the TOB, etc. carried out by Steel Partners and its affiliates with the above-mentioned development and manner are improper and conflict with the doctrine of good faith because they would impair the enterprise value and, consequently, common interests of shareholders, and thus it is proper to consider Steel Partners and its affiliates as abusive acquirers in this case.

In *Livedoor* v. *Nippon Broadcasting*, the Tokyo High Court held

> that a bidder is an abusive one if the bidder intends to make a target company or its affiliates repurchase the shares for a premium after the stock price increases (greenmailer); intends to transfer intellectual property, know-how, corporate secrets, key business transactions or customers which are vital for the operation of the company to the bidder or its affiliates ("scorched earth" policies); has acquired the target company's shares so that after acquiring control, the bidder can liquidate assets to secure or pay off bidder's debts or those of related companies (hostile LBO); or obtains temporary control of management to sell off valuable assets unrelated to the core business, such as real estate or securities, in order to pay a one-time dividend from the proceeds, or sell the shares after having driven up the stock price due to the high dividend (asset stripping).

However, the standards for determining whether a bidder is an abusive one are not fully clear despite of the rulings of the Tokyo High Court both in *Livedoor* v. *Nippon Broadcasting* and *Steel Partners* v. *Bull-Dog Sauce*.

29 *Bull-Dog Sauce* amended the articles of incorporation to provide as follows:

> The allotment of free share options of the company, particular holders of which might be treated differently from other holders in respect to the exercise or call of the share options, in order to ensure and improve the enterprise value and common interests of shareholders of the company, shall be decided by a resolution of the board of directors, a resolution of the general meeting, or a resolution of the board of directors based on a mandate by a resolution of the general meeting. (Art. 19(1))
>
> Notwithstanding the provisions of the preceding Article, the resolutions of the general meeting provided in the preceding paragraph shall be made by a majority of two-thirds of the votes of the shareholders present at the meeting where the shareholders holding a majority of the votes of the shareholders entitled to exercise their votes at such shareholders meeting are present. (Art. 19(2))

offer for subscription of share options or an allotment of free share options in order for the general meeting to resolve such matters. Unless the absence of a requirement for the payment of monies is particularly favorable to the subscriber of share options, or the amount to be paid in is particularly favorable to the subscriber, it is the general principle, in a public company, for the board of directors to decide the details of offer for subscription of share options (Art. 240(1)). Similarly, details of the allotment of free share options should be decided by a resolution of the board of directors in a company with a board of directors unless the articles of incorporation provide otherwise (Art. 278(3)).

Meanwhile, the articles of incorporation may provide that the details of allotment of free share options shall be decided by a resolution of the general meeting even in a company with a board of directors. This is clear because the proviso to Art. 278(3) prescribes that "this shall not apply in cases where it is otherwise provided for in the articles of incorporation".[30]

On the other hand, Art. 240(1) stipulates with respect to the decision of details of offer for subscription of share options that "except for the cases listed in each item of Art. 238(3), for the purpose of the application of the provisions of Paragraph 2 of that article to a public company, 'general meeting' in that paragraph shall be read as 'board of directors'". Therefore, it is possible to interpret that the articles of incorporation of a company with a board of directors may not provide that the details of offer for subscription of share options shall be decided by a resolution of the general meeting, but may only provide that they *may* be decided.

It is true that the details of offer for subscription of share options *may* be decided if the articles of incorporation so provide; Art. 295(2) provides that "a general meeting of a company with a board of directors may resolve only the matters provided for in this Act and the matters provided for in the articles of incorporation". But Item 1 of Art. 362(1) stipulates that the board of directors decide "business and affairs of a company with a board of directors", different from Art. 348(1)[31] concerning the power of directors in a company without a board of directors, and does not provide "unless otherwise provided in the articles of incorporation". Therefore, even if the articles of incorporation provide that the details of offer for subscription of share options be decided by a resolution of the general meeting, there is room for the interpretation that the board of directors may remain to decide the details in a public company.[32]

However, it seems that there are no substantive grounds for interpreting that the articles of incorporation may provide that the details of allotment of free share options

30 Moreover, the articles of incorporation may provide that a representative director should decide the details.

31 The directors are to perform the operations of the stock company (except for a company with a board of directors…) unless otherwise provided in the articles of incorporation.

32 TETSU AIZAWA ET AL., *Ronten kaisetsu shin-kaisha hô* (Shôji Hômu, 2006) p. 262.

shall be decided by the general meeting, but may only provide that the details of offer of share options *may* be decided by the general meeting. This idea might be persuasive if the decision on the details of the offer of share options belongs to the "business and affairs of the company" while a decision on the details of the allotment of free share options does not, but this is not necessarily true.

VI. RESOLUTION OF THE GENERAL MEETING AND "SHAREHOLDERS WHO HAVE A SPECIAL INTEREST IN THE RESOLUTION"

Art. 831(1) provides that "the shareholders…may demand, by means of a lawsuit, that a resolution of a general meeting…be voided within three months from the date of such resolution" in cases where a shareholder who has a special interest in the resolution has exercised their voting rights and the resolution is extremely unfair (Item 3 of Art. 831(1)).

1. "Persons Having Special Interests"

Watanabe Kiyomatsu v. *Futaba Yuatsu Industry Co., Ltd.* [33] gave an interpretation of Art. 239(5) of the Commercial Code (before the 1981 amendments) which stipulated that a shareholder having special interests could not exercise his/her voting rights, as follows:

> In cases where a particular shareholder has purely personal interests in a resolution, apart from his or her standing as a shareholder – for example, in cases where the company assigns its entire business or a significant part of its business to a shareholder…or the company exempts a director and shareholder from tort liability vis-à-vis the company – the shareholder should, of course, be deemed a so-called "person having a special interest in the resolution" with regard to the resolutions of the general meeting. However, it is obvious that a shareholder and director, etc. not only have personal interests but also at the same time important interests as shareholders in the resolutions which relate to the control over and participation in the management of the company, for example, in cases where the company is going to elect or dismiss the directors, etc. of the company, as discussed above. Thus, it should be interpreted differently from the above-mentioned cases where a shareholder has purely personal interests only.

In addition, *Overseas Petroleum Corporation* v. *Japan Oil Development Co., Ltd.,* [34] citing *Watanabe* v. *Futaba Yuatsu Industry*, generalized and held that a shareholder "has special interests" for the purpose of Art. 247(1) Item 3 Commercial Code [before the 2005 amendments – author added] if the particular shareholder has purely personal

33 Supreme Court, Decision of 14 March 1967, Minshû [Supreme Court Civil Cases Reporter], Vol. 21, No. 2, p. 378.

34 Tokyo District Court, Decision of 14 October 2004, Hanrei Taimuzu No. 1221, p. 294.

interests only, apart from a standing as a shareholder, and that it should be interpreted that a shareholder does not "have special interests" if the shareholder not only has personal interests in the resolution but also has interests in control over and participation in the management of the company as a shareholder. It ruled that particular shareholders who are allotted new shares are not those with "special interests" when a company whose shares are subject to restrictions on transfer issues new shares by private placement.

On the other hand, *Kashima Kôsan Co., Ltd.* v. *Neo Daikyô Jidôsha Gakuin Co., Ltd.*[35] held, without generalizing, that "a shareholder and director with regard to a resolution to exempt directors from liability" and "a shareholder who is a retired director with regard to the resolution to present retirement benefits to the retired director" are "deemed as persons who have special interests" for the purpose of Art. 247(1) Item 3 Commercial Code (before 2005 amendments).

Also, it is the prevailing view among scholars that shareholders who are in a conflict of interests with the company or with the shareholder of the company as a whole – such as the counterparty of a merger contract with regard to the resolution to approve the contract – are "shareholders who have a special interest in the resolution" for the purpose of Art. 831(1) Item 3.[36]

On the basis of the above-mentioned ideas in legal precedents and doctrines, as well as the widely accepted value judgment that "though it is inevitable that a shareholder might exercise his/her voting rights for his/her interests as he/she invests in shares, he/she is not allowed to sacrifice other shareholders' interests in order to pursue his/her personal interests",[37] a shareholder is found to have "special interests" typically in cases where the shareholder's interests conflict typologically with the interests of the company.

2. *Some Examples*

a) *Election and Dismissal of Directors*

In the light of *Watanabe* v. *Futaba Yuatsu Industry* and *Overseas Petroleum Corporation* v. *Japan Oil Development Co., Ltd.* (citing the former), no one would deny at present that a shareholder is not deemed as having special interests when he/she casts his/her votes to himself/herself in electing directors, considering himself/herself as eligible for a director.[38] *Watanabe* v. *Futaba Yuatsu Industry* held as follows:

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35 Amagasaki Branch of the Kobe District Court, Decision of 21 August 1998, Hanrei Jihô No. 1662, p. 148, *appeal dismissed* (Osaka High Court, Decision of 26 March 1999, Kin'yû Shôji Hanrei No. 1065, p. 8) and *cert. denied* (Supreme Court, Decision of 20 October 2000).

36 EGASHIRA, *supra* note 16, p. 335. *See also* SHINSAKU IWAHARA, *Chûshaku 247 jô*, in: K. Ueyanagi *et al.* (eds.), *Shinpan chûshaku kaisha-hô* (Yûhikaku, 1986) Vol. 5, pp. 323 and 325.

37 AKIO TAKEUCHI, *Kaisei kaisha-hô kaisetsu* (Yûhikaku, new edition, 1983) p. 127.

38 IWAHARA, *supra* note 36, p. 323.

> By the nature of things, a shareholder may exercise his/her voting rights in resolutions of the general meeting with respect to all the items on the agenda and look after his/her own interests, taking the interests of the company into consideration, of course, at the same time. As a result, the decisions are made in accordance with the rule of majority among shareholders with conflicting interests and different opinions. This is very natural under the system of joint-stock corporations designed to issue many shares.

In addition, it pointed out that "it is one of the most important matters regarding the control over or management of a company [for shareholders – author added] to elect or dismiss a particular person as a director or statutory auditor of the company". Moreover, it argued that "it is a *natural outcome* of the fact that the control over or participation in the management of a company is ultimately in the hands of the shareholders that a particular person is elected as a director, etc. or is not dismissed as a director, etc. because he/she has a majority of the shares, while another particular person is dismissed from a director, etc. because he/she has only a minority of the shares" (emphasis added). Therefore, legal precedents have taken the position that shareholders do not have special interests in the resolution of the general meeting to elect or dismiss directors or statutory auditors.

b) Acquisition of Own Shares by the Issuing Company

Articles 140(3), 160(4) and 175(2) stipulate that, in cases where a resolution to acquire own shares from particular shareholder(s) for value is approved, the seller shareholders, in principle, may not exercise voting right at the shareholders meeting. This is because the interests of a company and the personal interests of a shareholder are in conflict when assets outflow from the company.

c) Disapproval to Transfer Shares with Restrictions on Transfers

For example, a designated purchaser has not been regarded as a shareholder who has special interests in the resolution to name a designated purchaser in a company without a board of directors in cases where the company does not grant approval to transfer shares with restrictions on transfers, in spite of the fact that the designated purchaser enjoys the increase in the share in voting rights. In addition, no shareholders have been regarded as a shareholder with special interests in the resolution of the general meeting in a company without a board of directors with respect to the approval of transfer shares with restrictions on transfers, despite the fact that the resolution affects the composition of shareholders.

d) Issue of Shares or Disposal of Own Shares

For example, the Companies Act provides that the details of an offer for the subscription of shares shall be decided by a special resolution of the general meeting in a non-public company unless entitlement to the allotment of shares is given to existing shareholders.

Even in a public company, a special resolution of the general meeting is required in cases where the amount to be paid in is particularly favorable for subscribers of shares, unless entitlement to the allotment of shares is given to existing shareholders. In either case, the person who is allotted shares for subscription is “a person having special interests” because a wealth transfer between shareholders might take place, whereas he/she is not in a conflict of interests with the company in those cases.

In addition to the discussion above, it can be said, firstly, that the shareholders whose shares are not subject to call are not in a conflict of interest with the company because they have no rights to require the company to acquire their shares at value.[39]

Second, because the future of a company depends significantly upon who the controlling shareholders or the key shareholders are, a shareholder “has interests in regarding the control and management of the company as a shareholder of the company” in respect to so-called anti-takeover defense measures. If one accepts the position of legal precedents that a shareholder is regarded as having no special interests “in cases where the shareholder not only has personal interests but also at the same time important interests as a shareholder in the resolutions which relate to the control over and participation in the management of the company”, it is not appropriate to interpret that the shareholders whose shares are not planned to call have special interests in the resolution to allot free share options subject to discretionary conditions to call.

Third, it is true that the shareholders whose share options are not subject to the call are deemed as “having special interests” if the call of share options would deprive the shareholders whose shares are subject to call of financial interests, and the former would enjoy financial interests at the loss of the latter. However, there would not be any wealth transfer between shareholders as long as the company calls the callable share options for fair and proper consideration. Under this condition, it is not persuasive that the shareholders whose share options are not subject to the call are deemed as “having special interests” in a resolution to allot free share options subject to discretionary conditions to call.

Fourth, it should be considered whether a shareholder “has special interests” in a resolution in cases where the resolution of the general meeting leads to an increase of a shareholder’s share in voting rights. Apart from the cases of significant increase, the shareholder might not be deemed to have “special interests in the resolution”, at least in a public company, because the Companies Act has adopted the so-called principle of discretionary allotment (*wariate jiyû no gensoku*), which allows the change in the ratio of voting rights by a resolution of the board of directors. Thus, it is not consistent to think that a shareholder is always regarded as having special interests in a resolution of the general meeting that leads to the increase of the share of the shareholder in voting

39 In contrast, a shareholder whose share options are subject to call might be the shareholder “having special interests” in a resolution to allot free share options subject to discretionary conditions to call.

rights. However, the change should be regarded as significant if the share of a shareholder's voting rights surpasses at least one-third – the threshold for a mandatory takeover bid under the Financial Instruments Exchange Act – due to a resolution of the general meeting (or the company's action in accordance with the resolution).

VII. ALLOTMENT OF FREE SHARE OPTIONS SUBJECT TO DISCRIMINATORY CONDITIONS

In a company with a board of directors, an allotment of share options without consideration is decided by a resolution of the board of directors unless articles of incorporation provide otherwise. Thus, even if a general meeting has made a resolution to request the board of directors to allot free share options subject to discriminatory conditions for exercise or discriminatory call, the board of directors is not legally bound to the resolution. However, in cases where the board of directors decides to allot free options in accordance with an advisory resolution (ordinary resolution) of the general meeting, it might be presumed *de facto* that directors do so out of self-protection, but based on the will of the majority of the shareholders. In other words, it should be presumed that there is a need for allotment of free share options subject to discriminatory call if a majority of the shareholders have recognized the need and a resolution of the general meeting has passed to request the board of directors to allot share options. As mentioned before, the future of a company, regardless of whether the company is a public company or not, depends on who the key shareholder, etc. is. Shareholders have a vested interest in who the key shareholder, etc. is. Thus, it might be allowable for shareholders to avoid a change in the key shareholders, etc. and maintain the value of shares they have, deciding to allot share options subject to discriminatory call.

However, there is another angle to consider in cases where an allotment is made based not on a special resolution but on an ordinary resolution of the general meeting.

First, it is problematic whether an allotment of share options subject to call is identified as an issue of share options particularly favorable for the subscriber. A special resolution of the general meeting is required for the issue of share options particularly favorable for the subscriber because existing shareholders might suffer financial disadvantage due to the issue. Thus, if an allotment of free share options subject to call is obviously designed not to inflict an economic loss on the shareholder subject to call, the allotment is not identified as an issue of share options particularly favorable for the shareholders who are not subject to call.

Second, it becomes an issue as well whether an allotment of share options subject to call is identified as an issue of class shares.[40] The Companies Act, however, positions share options quite differently from shares. That is to say, shares are proportionate

40 MISAO TATSUTA, *Kaisha-hô taiyô* (Yûhikaku, 2007) p. 310.

shares in a company, while share options are not in terms of economic value.[41] As a result, the board of directors, in a company with a board of directors, decides the contents of the share options for subscription for each issue like an issue of bonds. In addition, the contents of share options are not a matter to be included in the articles of incorporation. There are no provisions in the Companies Act that require a special resolution of the general meeting for the issue of share options subject to call to a third party. Therefore, it is not right on the mark to identify allotment of free share options subject to discriminatory call as an issue of class shares, which would require amendments to the articles of incorporation.[42]

Third, an allotment of share options subject to discriminatory call has quite a similar economic effect and effect on the ratio of voting rights to the combination of dividend of surplus and issue of callable share options to the shareholders other than those whose shares are to be called *in fact* (those whose shares are to be called *in fact* are paid in cash). However, the dividend of surplus can be decided by an ordinary resolution of the general meeting, and the issue of callable share options can be decided by a resolution of the board of directors as a general rule in a company with a board of directors. Moreover, callable share options might not be deemed as "effected by using a method that is extremely unfair" as long as the share in voting rights of a particular shareholder (ex. hostile acquirer, etc.) would fall rather slightly by the call of the share options by the issuing company. This is true even in cases where callable share options have been issued to shareholders although the company has no plan to call – except for the particular shareholder – because the principle of discretionary allotment is applied to the issue of share options more easily than to that of shares.

Therefore, it might be thought that there are no procedural defects in deciding to allot callable share options by an ordinary resolution of the general meeting and a resolution of the board of directors; these are consistent with the procedures required to decide the dividend of surplus and the issue of callable share options to the shareholders other than those whose shares are to be called *in fact* (those whose shares are to be called *in fact* are paid in cash).

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41 The Companies Act does not provide regulation on the consideration for share options equivalent to that on contribution in kind. Acquisition and disposal by the issuing company of share options are subject to a different regulation from that on acquisition and disposal by the issuing company of shares. In other words, the consideration of acquisition by the issuing company of share options is not limited to the amount of distributable surplus and can be decided by a resolution of the board of directors (in some cases, by a decision of a representative director or officer) unless the articles of incorporation provide otherwise. Moreover, the accounting treatment for acquisition and disposal by the issuing company of share options is very similar to that for acquisition and disposal by the issuing company of bonds.

42 However, share options subject to call might be allotted without consideration in order to bypass the regulation on alteration of the contents of shares. If an allotment is identified as used for alteration of the contents of shares *as a whole*, the requirements for alteration of the contents of shares, including resolutions of the general meeting, should be satisfied.

VIII. "EXTREMELY UNFAIR RESOLUTIONS" OF THE GENERAL MEETING

If a shareholder whose allotted share options are not subject to call by the issuing company is considered a "shareholder having special interests in the resolution" of the general meeting to allot the share options, it becomes a issue whether or not the resolution is "extremely unfair".

Legal precedents and former doctrines have not necessarily given general or abstract criteria for "extremely unfair resolution" in cases where a shareholder having special interests exercises his/her voting rights. However, in light of the accepted interpretation of "abuse of decision by a majority" for the purpose of the Commercial Code (before the 1981 amendments), a resolution to pay inadequate high remuneration, a resolution to approve restructuring activities with unfair conditions or consideration, a resolution to issue shares or dispose own shares to particular shareholder(s) with the amount to be paid being particularly favorable for subscribers, and a resolution to consolidate shares which originates unnecessarily many fractions in order to squeeze minority shareholders out, is deemed as "extremely unfair".[43]

On a resolution to exempt a director from liability, the Osaka High Court ruled as follows in *Kashima Kôsan Co., Ltd.* v. *Neo Daikyô Jidôsha Gakuin* in judging whether a resolution was "extremely unfair" for the purpose of Art. 247 (1) Item 3 Commercial Code (before the 2005 amendments):

> It is proper to judge whether it was generally reasonable to exempt the director from liability by taking these circumstances into consideration: the status and authority of the director at the company, the presence/absence and extent of the director's involvement in day-to-day operation of the company, the role of the director in the transaction, the development and purpose of the transaction, and the director's knowledge of the transaction's effect on the company.

Taking these court precedents and doctrines into consideration, a resolution will be regarded as "extremely unfair" mainly in cases where there is a conflict of interests between the company and a shareholder and the resolution is favorable for the shareholder, or in cases where a wealth transfer between shareholders has taken place and the resolution is not reasonable in light of the company's operation.[44]

Therefore, a resolution to allot free callable share options subject to discriminatory call might not be regarded as "extremely unfair" as long as the share options allotted are designed not to economically damage the shareholder subject to call by the company[45]

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43 IWAHARA, *supra* note 36, pp. 324-325; MISAO TATSUTA, *Kabunushi sôkai ni okeru giketsuken naishi tasû-ketsu no ran'yô,* in: Suekawa Sensei Koki Kinen Ronbun-shû Kankô Iinkai (ed.), *Kenri no ran'yô* (Yûhikaku, 1962) Vol. 2, p. 136.

44 *See* TSUNEO ÔTORI ET AL., *Kaisei kaisha-hô seminâ* (Yûhikaku, 1984) Vol. 2 (General Meeting) pp. 219-235.

45 Under this condition, no transfer of wealth between shareholders occurs.

and the extent that the decrease of shares in voting rights of the shareholder is not more than the extent allowed under the Companies Act due to the principle of discretionary allotment for issues of shares or share options for subscription. In other words, the criteria for judging whether an issue of shares has been "effected by using a method that is extremely unfair" (application by analogy of Art. 247 Item 2) are true as well for the allotment of free callable share options subject to discriminatory call.

IX. BAN ON GRANTING PROPRIETARY BENEFITS

Art. 120(1) stipulates that a stock company may not grant proprietary benefits to any person relating to the exercise of shareholders' rights for the accounts of the company or its subsidiaries.[46]

1. Giving "Proprietary Benefits"

"Proprietary benefits" include cash, goods, debt relief, and credit facility as well as an offer of benefits, services, and wining and dining for free or at discount.[47]

While it seems that "proprietary benefits" are not recognized in transactions with proper consideration,[48] some influential scholars are of the opinion that "proprietary benefits" are given even in transactions with proper consideration.[49]

The opinion that "proprietary benefits" are offered even in transactions with proper consideration, however, is thought to be based on the premise that a normal margin is included in the "proper consideration".[50] Accordingly, a case where the consideration of share options is calculated based on the market price of the shares and no margin is envisaged might be out of the range of view. Moreover, while the purchase of share options by the company issuing share options from a particular holder of share options might fall under giving "proprietary benefits" when it is difficult to realize the share

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46 Art. 120 Companies Act prohibits a company and its subsidiaries from giving proprietary benefits "relating to (*kanshite*)", the exercise of shareholders' rights. Because the expression *kanshite* is often used to cover pretty broad territory (contrary to *kakaru*), transactions between a company and its shareholders might always be deemed as "relating to the exercise of shareholders' rights" if interpreted in the broadest way. *See* ÔTORI ET AL., *supra* note 44, pp. 288-298; TOSHIHIKO SEKI, *Chûshaku 294 jô no 2*, in: K. Ueyanagi *et al.* (eds.), *Shinpan chûshaku kaisha-hô* (Yûhikaku, 1986) Vol. 9, p. 256.

47 *See* TAKEUCHI, *supra* note 37, p. 127; SEKI, *supra* note 46, p. 239.

48 SHIGERU MORIMOTO, *Ihôna rieki kyôyo no han'i*, in: Kansayaku No. 167 (1982) p. 7; SHÔSAKU MASAI, *Kabunushi no kenri kôshi ni kansuru rieki kyôyo no kinshi*", in: H. Imai *et al.* (eds.), *Kaisei kaisha-hô no kenkyû* (Hôritsu Bunka-sha, 1984) p. 586.

49 SHIN MOTOKI, *Kaisei shôhô chikujô kaisetsu* (Shôji Hômu Kenkyû-kai, revised and enlarged edition, 1983) p. 222; TAKEO INABA, *Kaisei kaisha-hô* (Kin'yû Zaisei Jijô Kenkyû-kai, 1982) p. 185. *See also* AKIO TAKEUCHI, *Kaisha-hô no riron* (Yûhikaku, 1984) Vol. 2, p. 58; EGASHIRA, *supra* note 16, p. 321, note 20.

50 *See* ÔTORI ET AL., *supra* note 44, pp. 302-304.

options by transfer to a third party,[51] it is not necessarily true that the issuing company is "granting proprietary benefits" to purchase from a particular shareholder, by itself, if the share options have sufficient negotiability because the underlying asset of the share options (that is, the shares of the issuing company) is at least listed.

2. Dividend of Surplus and Art. 120

The decision of the board of directors on the dividend of surplus might have much influence on shareholders' decisions to appoint directors. Accordingly, it might be reasonable to think that the dividend of surplus is paid "relating to the exercise of shareholders' rights", after all, in a company the board of directors decides on the dividend of surplus. However, there is no agreement that the duly paid dividend of surplus falls under the granting of "proprietary benefits" for the purpose of Art. 120. This interpretation might be justified because the dividend of surplus leads to a decrease in the value of shares and a shareholder does not enjoy proprietary benefits at net base, or because the dividend of surplus itself is exempted from the ban provided in Art. 120 since the Companies Act explicitly allows a company to pay dividend of surplus.

Therefore, it might be possible to interpret that the acquisition by the issuing company of share options is exempted from the ban provided in Art. 120 because the Companies Act explicitly allows an issuing company to acquire its share options. It is consistent to think that a shareholder and holder of share options does not receive proprietary benefits whenever the company calls the share options at fair price.

3. Acquisition of Own Shares and Share Options by the Issuing Company

The Companies Act strictly regulates the acquisition of own shares from a particular shareholder for value. This is partly because a company might acquire from a particular shareholder at the price that is particularly favorable for the shareholder, and partly because the acquisition from a particular shareholder might be equitable for other shareholders in cases where the opportunity to sell out the share is limited for the shareholders (e.g. in cases where the shares are not publicly traded) even if the price is not favorable for the seller.

The provisions of Art. 160 and the following articles of the Companies Act, however, assume that it does not fall within the granting of "proprietary benefits" (Art. 120) to the seller-shareholder to acquire own shares in accordance with the provisions of Art. 160 and the following articles of the Companies Act. In other words, it might be widely accepted that acquisition by the issuing company of shares in accordance with the provisions of Art. 160 and the following articles of the Companies Act is not deemed as giving "proprietary benefits" to the seller-shareholder by the issuing company of shares

51 *See* ÔTORI ET AL., *supra* note 44, p. 299.

– regardless of whether the price is objectively fair or not[52] – unless the resolution of the general meeting is void or annulled.[53]

Otherwise, acquisition by the issuing company of shares from a particular shareholder always violates the provision of Art. 120 because it should be interpreted that acquisition by the issuing company of shares from a particular shareholder "relating to the exercise of shareholders' rights" as the acquisition leads to a decrease of the share of the shareholder in voting rights.[54]

Therefore, the discussion above is true for acquisition by the issuing company of share options (even in cases of acquisition other than acquisition in accordance with conditions for call (*infra.* (4))), and it should be interpreted that "proprietary benefits" (Art. 120) are not granted in cases of acquisition at fair price. Finally, acquisitions of share options made in accordance with a special resolution of the general meeting should not be interpreted as giving "proprietary benefits" because the same procedures are carried out as those for the acquisition of own shares from a particular shareholder .

4. Acquisition of Share Options by the Issuing Company in Accordance with the Predetermined Conditions

The Companies Act assumes that a company does not give "proprietary benefits" to shareholders of shares with a put option or callable shares with a put option by the acquisition of the shares in exchange for the predetermined consideration. This can be applied to cases where a company calls callable share options in accordance with the pre-determined conditions for call.

Accordingly, it is inconsistent with the accepted interpretation regarding the acquisition of callable share options to think of acquiring share options in accordance with the

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52 The resolution could be voidable if the determined acquisition price is more than the objectively fair price because the resolution is "extremely unfair" (Art. 831(1) Item 3, Companies Act).

53 *See* ZEN'ICHI SHISHIDO, *Shitesuji kara no kyôhaku ni ôjite kyogaku no kin'in o kôfu suru koto to shita torishimari-yaku no sekinin*, in: *Heisei 18 nendo jûyô hanrei kaisetsu*, (Yûhikaku, 2007) p. 106.

54 Above all, acquisition by the issuing company in case of disapproval of the acquisition of shares with restriction on transfer (Art. 140 Companies Act), acquisition by the issuing company from heirs, etc. of the shareholders (Art. 162 Companies Act), and acquisition by the issuing company due to the demand for sale against heirs, etc. of the shareholders (Artt. 175 and 176 Companies Act) are based on the judgment that the acquirer or the heir, etc. is a *persona non grata* and, then, the acquisition is usually deemed to be made "relating to the exercise of shareholders' rights". If one could think that Art. 120 Companies Act would not apply to those transactions, the conclusion will most naturally be explained that the procedures provided in the Companies Act (special resolution of the general meeting) have been carried out before the transactions. Moreover, a similar reasoning might be necessary to legitimize the interpretation that an acquisition by the issuing company of class shares subject to total call (Art. 171 Companies Act) never infringes on Art. 120 Companies Act.

pre-determined conditions for call as giving "proprietary benefits", though allotment of callable share options without consideration itself might be thought of as an offer of "proprietary benefits".[55]

Meanwhile, in *Steel Partners* v. *Bull-Dog Sauce*, Tokyo High Court held as follows:

> Bull-Dog Sauce pays 396 yen for 1 unit Steel Partners and its affiliates when it acquires the share options according to the conditions to call. This payment is not made as an offer "relating to the exercise of shareholders' rights" but as a pre-determined consideration of acquisition of the share options to Steel Partners and its affiliates. In the same way, the cash paid by Bull-Dog Sauce in cases where Bull-Dog Sauce would not exercise the option to call but buy the share options from Steel Partners and its affiliates is not deemed as an offer "relating to the exercise of shareholders' rights" because Bull-Dog Sauce pays the same amount as in the case where it exercises the option to call and the payment is substantively the same as the pre-determined consideration of acquisition of the share options to be called.

ZUSAMMENFASSUNG

*Die Entscheidung vom 7. August 2007 (*Steel Partners *v.* Bull-Dog Sauce*) ist die erste publizierte Entscheidung des Obersten Gerichtshofes, die sich mit der Zulässigkeit von Abwehrmaßnahmen gegen feindliche Übernahmeversuche befaßt. Sie hat zudem besonders große Bedeutung, weil es sich um die erste Entscheidung handelt, in der es um die Zulässigkeit der Ausgabe von kostenlosen Bezugsrechten geht, die für Japan in dem neuen Gesellschaftsgesetz von 2005 eingeführt wurde, und weil das Urteil ausdrücklich eine Ausnahme von dem Gleichbehandlungsgrundsatz der Aktionäre zuläßt. Ferner kommt der Entscheidung auch deswegen Bedeutung zu, weil sie klarstellt, daß Abwehrmaßnahmen prinzipiell auch dann zulässig sind, wenn es sich bei dem Bieter nicht um einen sogenannten „mißbräuchlichen" Bieter handelt.*

55 If the allotment of share options without consideration amounts to granting "proprietary benefits", a share split, for example, would amount to this as well. It would also be a case for the issue of shares or share options, granting entitlement to subscribe. Accordingly, it is not appropriate to consider an allotment of free options as "proprietary benefits" for the purpose of Art. 120 Companies Act.

Im übrigen ist der von den Gerichten in den Entscheidungen Steel Partners *v.* Bull-Dog Sauce *gewählte Ansatz zwar geringfügig verschieden, überwiegend aber ähnlich mit dem, den das Obergericht Tokyo in der Entscheidung* Lifedoor *v.* Nippon Broadcasting *gewählt hat. In jener Entscheidung war die Leitlinie für die Instanzgerichte bezüglich der Ausgabe neuer Aktien im Rahmen einer Privatplazierung. Während die Instanzgerichte bei früheren Entscheidungen über die Zulässigkeit von Abwehrmaßnahmen abgewogen haben zwischen dem Ziel der amtierenden Verwaltung, „die Kontrolle zu behalten", und der Notwendigkeit einer Kapitalaufnahme (sog.* „primary purpose"*) haben die Gerichte in den Entscheidungen* Steel Partners *v.* Bull-Dog Sauce *sich auf die Frage konzentriert, ob die Abwehrmaßnahmen vernünftig und angemessen waren, auch wenn sie im Ergebnis dazu führen, daß die amtierende Verwaltung die Kontrolle über die Gesellschaft behält. Ferner haben die Gerichte klargestellt, daß sie bereit sind, eine grundsätzliche Notwendigkeit für den Erlaß von Abwehrmaßnahmen anzunehmen, wenn die Hauptversammlung einer entsprechenden Entscheidung zugestimmt hat.*

Darüber hinaus scheinen die Gerichte nicht der Auffassung zu sein, daß Aktionäre, die für das Ergreifen von Abwehrmaßnahmen gegen ein (feindliches) Übernahmeangebot stimmen, als Aktionäre mit „besonderen Interessen" an dieser Entscheidung zu qualifizieren sind. Die mit der Sache befaßten Gerichte haben zudem übereinstimmend festgestellt, daß der Beschluß der Hauptversammlung nicht als „außergewöhnlich unfair" zu qualifizieren sei, weil die ergriffenen Abwehrmaßnahmen der Zielgesellschaft Bull-Dog Sauce *nicht unvernünftig waren.*

Schließlich hat das Obergericht Tokyo festgestellt, daß die an den Bieter gezahlte Gegenleistung für den Ausschluß von den Bezugsrechten, wodurch dieser anders als die anderen Aktionäre behandelt wird, mit Blick auf Art. 120 Gesellschaftsgesetz nicht notwendigerweise als eine „ausschließliche" Begünstigung anzusehen ist.

Trotz der umfassenden Entscheidungen der beteiligten Gerichts sind nach wie vor einige Fragen offen: beispielsweise ist es nach wie vor unklar, unter welchen Umständen die finanziellen Interessen eines Bieters verletzt werden dürfen, oder ob die Gerichte künftig eine Notwendigkeit anerkennen, Abwehrmaßnahmen zu ergreifen, wenn diese im Zuge einer normalen Abstimmung auf einer ordentlichen Hauptversammlung beschlossen wurden.

(dt. Übers. durch die Red.)