

ABHANDLUNGEN / ARTICLES

Contesting “Corporate Value” Through Takeover Bids in Japan

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I. INTRODUCTION

February 2005 marked a watershed in the history of mergers and acquisitions in Japan.¹ Livedoor Co.’s attempt to take over Nippon Broadcasting System Inc. (NBS) was certainly not the nation’s first attempted hostile takeover, but it dramatically changed the public perception of takeovers, casting wide the veil of disdain and distance which had shrouded such events in the past, and bringing them on to the public stage where, cast in the media as a contest between the new and the old, opinion was not necessarily hostile.²

The drama continued through to January 2006, when prosecutors and officials from the Securities and Exchange Commission raided Livedoor’s offices, on suspicion that the company had falsified financial reports of a subsidiary, and indeed of the parent.

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1 Support for this research from the Japanese Ministry of Education, Culture, Sports, Science and Technology (MEXT) Centre of Excellence programme, carried out at ITEC, is gratefully acknowledged.

2 Recent hostile takeover attempts include the takeover bid (TOB) by Cable and Wireless for IDC in 1999, and Boehringer Ingelheim’s attempt to take over the pharmaceutical company SSP in 2000. Examples aimed at securing assets rather than creating business synergies include Steel Partners Japan’s hostile bid for the medium-sized companies Yushiro Chemical Industry Co. and Soto Co. in 2004. In terms of impact on the judiciary, administrative agencies and corporate managers, however, the NBS case had a much greater impact.

A month later the “T-shirt president” Horie and other Livedoor executives were arrested, and before long the company was de-listed, marking an ignominious reversal of the company’s meteoric (by Japanese standards) rise.

It is tempting to see Horie as an aberration – a protruding nail that got hammered down – and his arrest as a reassertion of the status quo. The net result was not a return to business as before, however. In the interim, irreversible changes had taken place to the landscape of corporate control, both legal and institutional. The fierce debate which was generated about legitimate anti-takeover measures produced a flurry of reports, guidelines and legislation, seeking to curb management entrenchment on the one hand, and to discourage destructive corporate raiders on the other.

With little domestic case history, the courts turned to rulings abroad, particularly Delaware, resulting in a number of rulings against managers’ proposed defences. Subsequent behind-the-scene settlements, however, suggest a need for conflict resolution, perhaps in the form of a Japanese Takeover Panel, to ensure that both legal and business issues are adequately addressed. Increasing domestic and cross-border merger and acquisition activity, and the government’s goal of increasing foreign investment in Japan, further heighten this need.

The changing landscape of corporate control has considerable implications for Japanese corporate governance and the “employee-favouring firm”.³ Depending on the extent to which managers are required to adopt a passive or neutral stance, or to conduct an “auction”, takeover bids could become a trigger for re-aligning stakeholder interests, as Deakin *et al.* argue happened in the UK.⁴ We write with these implications in mind, although we cannot explore them in any detail here.

The paper is constructed as follows. After briefly setting the scene, we sketch Livedoor’s attempted takeover of NBS, the courts’ injunction preventing NBS from using a rights issue to Fuji Television to dilute Livedoor’s holding, and Livedoor’s subsequent fall from grace. We then consider the wider debates about legitimate anti-takeover measures, including the thorny concept of “corporate value” as a key criterion in determining legitimacy, as well as developments in legislation, specifically changes to the Securities and Exchange Act and company law. We then consider managers’ responses to the changed legal, judicial and business environment to suggest a departure from “business as usual”. This is shown in the (almost) carbon copy case of Rakuten’s attempted takeover of Tokyo Broadcasting System (TBS). In conclusion, 2005 marked a watershed in the history of mergers and acquisitions, but this does not necessarily herald the triumph of Anglo-Saxon corporate control and governance norms.

3 R. DORE, *Stock Market Capitalism: Welfare Capitalism: Japan and Germany versus the Anglo-Saxons* (Oxford 2000).

4 S. DEAKIN / R. HOBBS / D. NASH / G. SLINGER, *Implicit Contracts, Takeovers and Corporate Governance: In the shadow of the City Code*, Centre for Business Research Working Paper Series No. 254, University of Cambridge (2002).

II. THE DRAMATIC RISE AND FALL OF LIVEDOOR

Setting the scene: 1990 to 2004

Until the 1990s, hostile takeovers in Japan were rare, and not considered a significant issue, on account of institutions such as stable – often reciprocal – shareholding, the main bank system and relational contracting in general. When they did occur, companies responded by issuing new shares to third parties under the guise of capital procurement, thus diluting the ownership of the would-be acquirer. The courts accepted this practice, deeming that it did not contravene Art. 280 para. 10 of the former Commercial Code (Company Law Art. 210 no. 4) regarding the improper issue of shares (primary purpose theory).⁵

Mainstream academic opinion also supported this interpretation.⁶ Thus, even if shares issued to a third party diluted the holding of a would-be acquirer, if a need to raise even a small amount of capital could be demonstrated, it was not considered inappropriate. In effect, this measure could be used to thwart hostile takeovers.

Significant changes took place from the 1990s, however, which set the scene for the drama of 2005. Facing intensified global competition, prolonged recession and declining profits, under pressure to increase asset efficiency, and cajoled by new accounting standards aimed at bringing Japan into line with “global standards”, top managers set about restructuring their business operations. A stream of legislation enabling the creation of holding companies, easing transfers of undertaking and so on, placed an array of new restructuring tools at their disposal. One result was a surge in mergers and acquisitions (M&A), which was sustained into the recovery period. Indeed, having gained a feel for rapid restructuring and M&A, and facing limited domestic growth opportunities, corporate managers were increasingly looking to expansion through M&A, sometimes on a global basis as in Toshiba’s acquisition of Westinghouse, and the Nippon Sheet Glass acquisition of Pilkington in early 2006.⁷

On the other hand, stable and mutually held shares which were sold off were bought by individual shareholders, foreign shareholders, institutional investors and investment funds. This shift also saw the decline of “silent” shareholders, and the beginnings of shareholder activism, and created the grounds for takeover bids aimed at securing

5 Niigata District Court ruling, Feb. 1967; Osaka District Court Sakai Branch, Nov. 1973; Osaka District Court, Nov. 1987 (Takuma case); Tokyo District Court, Sept. 1989 (2nd Miyairi Valve case); Tokyo District Court, July 2004 (Bell System 24 case). In August 1992 the Kyoto District Court expressed a contrary view – division of authority theory, similar to the Tokyo District Court ruling below.

6 E.g. M. YANAGA, *Rîgaru maindo kaisha-hô* [Legal Mind Company Law] (10th edn., Tokyo 2006) 349.

7 In 2004 and 2005 Japanese acquisitions of overseas firms outstripped foreign acquisitions of Japanese firms by value (Nikkei Shinbun, 30 March 2006). In 2005, 1009 M&As, almost 30 per cent of the total, took place *within* enterprise groups (Nikkei Kin’yû Shinbun, 21 February 2006).

management control. The number of takeover bids rose from close to zero in 1995 to over 40 in 2005.⁸

Still, hostile takeover attempts were generally condemned. As Jacoby concluded in his study of corporate governance and employment relations: “Normative change is proving difficult in Japan. Its institutions are more tightly linked and embedded in shared social values than are those in the United States”.⁹ Norms in which senior managers were seen as representatives of the “community firm”¹⁰ were under pressure, but still intact. This is not to say that Japan has lacked would-be norm destroyers or norm “entrepreneurs” of the ilk of James Goldsmith and others who did so much to change perceptions and behaviour towards takeovers in the USA and UK in the 1980s, but until 2005, none had made much headway.¹¹

Act 1: The Livedoor – NBS / Fuji Television struggle

Things changed with the NBS case. Let us review briefly what happened. On 17 January 2005, Fuji Television decided to launch a takeover bid to secure management control of its subsidiary NBS, which was its own biggest shareholder. NBS acquiesced. On 8 February, however, Livedoor acquired almost 30 per cent of the shares of NBS through its subsidiary Livedoor Partners in off-floor trading, giving it and its subsidiary a total of 35 per cent of outstanding NBS shares.¹² At a press conference that day, Livedoor president Horie declared his aim was a tie-up with the Fuji-Sankei group to

8 Nikkei Shinbun, 27 December 2005.

9 S. M. JACOBY, *The Embedded Corporation: corporate governance and employment relations in Japan and the United States* (Princeton, NJ 2005) 173. Similar conclusions have been reached by other studies of corporate governance in Japan, e.g. S. LEARMOUNT, *Corporate Governance: what can be learned from Japan?* (Oxford 2002); J. BUCHANAN, *Change and Continuity in Recent Japanese Corporate Governance Practice* (PhD dissertation, Judge Business School, University of Cambridge 2006).

10 T. INAGAMI / D.H. WHITTAKER, *The New Community Firm: governance, employment and management reform in Japan* (Cambridge 2005).

11 “Norm entrepreneurs” seek to change norms by public announcements and actions which defy existing norms and seek to give the impression of irreversible change (C. SUNSTEIN, *Social Norms and Social Roles*, in: *Columbia Law Review* 96 (1996) 903-968; S. JACOBY, *Business and Society in Japan and the United States*, in: *British Journal of Industrial Relations* 43 (2005) 617–634).

12 In 1996, Tokyo University student Takafumi Horie founded the Internet advertising/home page company On the Edge. The company became Cyber Click in 1998, was listed on the Mothers Exchange in 2000, and acquired the free Internet provider Livedoor in 2002. A further name change to Edge in 2003 was followed by adoption of the name Livedoor in 2004, perhaps because of the latter’s favourable name recognition. The company pursued rapid growth by a succession of acquisitions, using frequent stock splits. Effectively it became an investment company, and IT constituted a relatively small part of its business (H. IWASAKI, *Raibudoa shokku no shinjitsu* [The Truth About the Livedoor Shock] (Tokyo 2006) 25).

create business synergies. Fuji Television's board rejected this proposal on 9 February. On 23 February, the board of NBS decided to issue Fuji Television Network Inc. with 4720 new share rights, amounting to 1.44 times the existing shares. This would reduce Livedoor's stake from roughly 42 per cent to 17 per cent, while raising Fuji Television's stake to 59 per cent. On 24 February, Livedoor sought an injunction from the Tokyo District Court. The Tokyo District Court and the Tokyo High Court issued three legal rulings, each judging the new rights issue as unfair, and ordering NBS to desist.

Initial judgement (Tokyo District Court, 11 March 2005)

On 11 March, the Tokyo District Court ruled that:

It is inappropriate for the board of directors of a publicly listed company, during a contest for control of the company, to take such measures as the issue of new shares with the primary purpose of reducing the stake held by a particular party involved in the dispute, and hence maintain their own control. In principle the board, which is merely the executive organ of the company, should not decide who controls the company, and the issuing of new shares, etc., should only be recognized in special circumstances in which they preserve the interests of the company, or the shareholders overall.

Objection over-ruled (Tokyo District Court, 16 March 2005)

NBS objected to the ruling, but this objection was rejected by the court, which commented:

The issuing of new share rights to third parties during a contest for control, resulting in a dilution of the share ratio of one party in the dispute, and maintenance of control by the incumbent management, is in principle an extremely unfair use of a new share issue. . . . The reason new share rights cannot be issued for the primary purpose of maintenance or securing of incumbent control is that the legitimacy of the board's authority is grounded in the wishes of the shareholders who are the company's owners; they may only be issued in special circumstances from the perspective of protecting the interests of shareholders overall.

Appeal rejected (Tokyo High Court, 23 March 2005)

NBS then appealed to the Tokyo High Court, which also ruled against the new rights issue:

The issue of new shares, etc., by the directors – who are appointed by the shareholders – for the primary purpose of changing the composition of those who appoint them clearly contravenes the intent of the Commercial Code and in principle should not be allowed. The issue of new shares for the entrenchment of management control cannot be countenanced because the authority of the directors derives from trust placed in them by the owners of the company, the shareholders. The only circumstances in which a new rights issue aimed primarily at protecting management control would not be unfair is when, under special circumstances, it aims to protect the interests of shareholders overall.

The ruling went on to specify those circumstances: (1) when the hostile bidder is a greenmailer; (2) when the bidder plans crown jewel asset stripping; (3) a leveraged buyout; (4) share manipulation. When any of these circumstances can be demonstrated concretely, the directors may not be deemed to be acting inappropriately by making a new rights issue which preserves their control. Clearly the influence of the Delaware Supreme Court can be seen in this ruling, but it did not go as far as, for instance, the Unocal ruling.¹³

Blocked from making a new rights issue, NBS went on to loan its Fuji Television shares to Softbank Investment Corp. and Daiwa Securities SMBC Co., minus their voting rights. On 7 April, after weeks of acrimony, Livedoor, NBS and Fuji Television agreed on business collaborations and capital ties. As part of the deal, Livedoor would sell its NBS shares to Fuji Television, in return for which Fuji Television would purchase some 12.75 per cent of Livedoor stocks for 44 billion yen. In September NBS became a wholly-owned subsidiary of Fuji Television.

Act 2: The “Livedoor shock”

Act 2 of the Livedoor drama – the “Livedoor shock” – began on 16 January 2006, when Tokyo prosecutors and officials from the Securities and Exchange Commission launched a “surprise” raid on Livedoor’s head office in front of the nation’s media. Livedoor’s share price plummeted, as did shares listed on the TSE in general, wiping out US\$300 billion in a few days. The stock exchange was overwhelmed by the volume of trading, forcing an embarrassing closure and a subsequent reduction of trading hours.

The prosecutors were looking for evidence that Livedoor executives misled investors in 2004 in an attempt to boost the share price of subsidiary Livedoor Marketing Co. (then Value-Click Japan, Inc.) for an M&A deal. They were also looking for evidence of falsified financial reports of the parent firm, with similar motives. These offences, prosecutors suspected, were the tip of an iceberg of deceit and manipulation.

Reactions to the investigation were mixed. Young supporters vowed to stand by the “T-shirt president” Horie through thick and thin. The media was initially ambivalent, and some foreign media downright sceptical. On 18 January, the Financial Times ran an editorial titled “Japan’s old guard tastes revenge”. It argued that

Japan needs to accept that free and open financial markets, a vigorous market in corporate control and effective corporate governance are not threats to its prosperity but essential to wealth creation. Until that lesson is learned – and irrespective of the outcome of the current investigation – Japan needs more, not fewer, aggressive mould-breakers like Horie.

13 Cf. C. MILHAUPT, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, in: *Columbia Law Review* 105 (2005) 2171–2216.

The investigation led to the arrest of Horie and several other Livedoor executives on 13 February on charges of spreading false financial information and padding the accounts of affiliate Livedoor Marketing Co. New charges were brought against the defendants in March, including that of falsely declaring a consolidated pre-tax profit of 5.03 billion yen in the year to September 2004, while actually incurring a loss of 313 million yen. Delisting of Livedoor followed, with shares finishing almost 90 per cent down from the mid January figure. Fuji Television sold its Livedoor shares to another IT entrepreneur for 9.5 billion yen, incurring a loss of over 34 billion yen, but finally shaking itself free from Horie's grip. Angry Livedoor shareholders filed suit in April. The case went to court in June.

With these developments, condemnation of Horie's business methods, and indeed everything he was deemed to stand for, came thick and spread fast. From mould-breaker to personification of greed, he became a symbol of Japan's emerging *kakusa shakai* (wealth-divided Japan), the opulence of his towering Roppongi Hills base contrasted with wards of Tokyo a few miles away where almost half the school children have to receive meal subsidies because their (honest and hardworking) parents cannot afford to pay for them.¹⁴ The fact that Horie had been courted by the ruling Liberal Democratic Party during the national election of 2005, and praised by the Prime Minister Koizumi as a face of the new Japan, led to a barrage of criticism of the government's liberalization programme.¹⁵

The backlash predicted by the Financial Times claimed another victim in June 2006, when Japan's most aggressive high-profile investor Yoshiaki Murakami was arrested on charges of insider trading – purchasing NBS shares in the awareness that Livedoor was going to launch a takeover bid of the company.¹⁶ The ensuing media coverage highlighted Murakami's network of affluence and influence, including cabinet ministers and

14 The Japan Times noted that “Roppongi Hills boasts apartments of ¥5 million-plus-a-month, escalators encased in glass domes, a museum stocked with masterworks and a parade of luxury stores representing half of Milan and Paris. It is also the *piece de resistance* of Mori's six ‘compact cities,’ glittering projects where some of the winners of Japan's roaring economic comeback live, work, shop, eat and play” (“Growing wealth gap shapes Tokyo skyline: Rich move into ‘compact cities’ as low income housing demand soars”, 15 March 2006). The 2006 White Paper on Labour shows the wage gap among workers increasing in recent years, especially with the rise of non-regular workers. The Gini coefficient has also risen in recent years, but at least part of the increase can be explained by changing demographics and household structure.

15 The momentum of the backlash, in turn, was dissipated when the main opposition party produced an email suggesting bribery of an LDP heavyweight by Horie, which turned out to be a fake.

16 A new editorial, entitled “Japan's watchdogs bare their teeth: But to be effective, justice must be even-handed”, argued: “[Horie and Murakami] have performed a public service in a country where companies' performance has often been handicapped by supine boards, sleepy managers and stubborn disdain for shareholders' rights” (Financial Times, 6 June 2006).

the Bank of Japan governor. That does not mean to say that the “old guard” of business leaders whose “over-riding aim in preserving the status quo is to cling to a quiet life, untroubled by shareholders’ interests in better returns”¹⁷ got its wish, however. Corporate managers could not simply return to the quiet life. Japan had entered a new era of corporate control.

III. ESTABLISHING GROUND RULES FOR CONTESTED TAKEOVERS

“Corporate value” and anti-takeover defences

The courts’ view in the NBS case was that when a takeover bid has been launched, it is unacceptable for directors to construct measures such as a new rights issue which seeks to entrench their control of the company. However, if the directors can demonstrate special circumstances in which the takeover would inflict damage on the company, the legitimacy of the measures may be recognised. Given time and information limitations following the announcement of a takeover bid, though, it may not be realistically possible for managers to demonstrate these circumstances. It is necessary, therefore, to consider alternative defence measures which may be put in place prior to the launch of a takeover bid.

In fact, these measures were already being debated by METI’s Corporate Value Committee (CVC, set up in September 2004 and chaired by Tokyo University professor Hideki Kanda) and the Ministry of Justice. On 27 May 2005, the CVC issued its “Corporate Value Report”, and METI and the Ministry of Justice jointly issued their “Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholders’ Common Interests”. The recommendations of these reports were extremely valuable for practitioners, pointing to measures which might be constructed during normal circumstances and applied in the event of a hostile takeover.

According to the Guidelines: (1) the purpose of takeover measures is “to maintain and enhance corporate value as well as the interests of shareholders as a whole” (principle of protecting and enhancing corporate value and the interests of shareholders as a whole); (2) their introduction should be accompanied by a clear indication of their purpose and contents, and should reflect the reasonable will of the shareholders (principles of prior disclosure and shareholders’ will); and (3) the defence measures should not be excessive (principles of necessity and reasonableness).¹⁸

¹⁷ *Ibid.*

¹⁸ Cf. <www.meti.go.jp/press/20050527005/2-shishinn-youyaku-set.pdf> (accessed March 2006). The implication is that measures which meet these conditions might be considered legitimate; in this the Guidelines have been influential, though they do not have the force of law (cf. H. KANDA, *Kaisha-hô* [Company Law] (8th edn., Tokyo 2006) 141).

While it is clear that corporate value does not equate with shareholder value, the Guidelines failed to pin down exactly what was meant by the term. In the introduction to the Corporate Value Report, the following explanation is offered:

The price of a company is its corporate value, and corporate value is based on the company's ability to generate profits. The ability to generate profits is based not only on managers' abilities, but is influenced by the quality of human resources of the employees, their commitment to the company, good relations with suppliers and creditors, trust of customers, relationships with the local community, etc. Shareholders select managers for their ability to generate high corporate value, and managers respond to their expectations by raising corporate value through creating good relations with various stakeholders. What is at issue in the case of a hostile takeover is which of the parties – the bidder or the incumbent management – can, through relations with stakeholders, generate higher corporate value.

It defines corporate value as

the company's assets, its ability to generate profits, stability, efficiency, growth ability etc. which contribute to profits for shareholders. In other words, it is the total future profits created by the company, which are distributed as shareholder value belonging to the shareholders, and value of the stakeholders.

The Guidelines, however, define corporate value simply as: “Attributes of a corporation, such as earnings power, financial soundness, effectiveness and growth potential, etc., that contribute to shareholder interests.”

These definitions raise the thorny issue of whether the legality of anti-takeover measures should be based on a calculation of company profit or benefits for shareholders, or more broadly, encompassing the interests of diverse stakeholders. While it does not seem rational to completely ignore the interests of stakeholders other than shareholders, questions of prioritisation and scope are daunting.¹⁹ Such ambiguities in the concept of “corporate value”, and the desirability of rulings with clear criteria which offer predictability, are probably why the courts avoided the term when considering the use of anti-takeover measures by NBS.²⁰

Another problem with the Corporate Value Report is that it does not mention takeovers aimed at company break-ups in its discussion of threats to corporate value. Surely a threat to the company's continued existence is a threat to corporate value. The argument that hostile takeover bids are a matter for the bidder's and the target's share-

19 The Principles of Corporate Governance of the American Law Institute identifies circumstances in which “the board may give weight to groups or interests separate from the shareholders” which “may include groups such as employees, suppliers, and customers” as long as this does not “significantly disfavour long-term interests of shareholders” (§ 6.02 (b) (2); p. 414).

20 It is worth noting, however, that the Tokyo District Court judge responsible for the NBS case commented in relation to corporate value: “It is a mistake to think only of the interests of shareholders. Raising benefits to stakeholders such as employees, suppliers, customers and the local community accords with the overall interests of shareholders.”

holders and hence the directors should not intervene is based on the prevention of managers putting their own interests ahead of those of the company and those who appoint them. Thus directors are required to be neutral in certain jurisdictions

- such as Delaware and, under the rules of the City Code on Mergers and Takeovers, the UK
- in the sense of confining themselves to offering disinterested advice to the shareholders on the financial merits of bids. This approach is also due to influence practice in EU member states more generally, under the terms of the Thirteenth Company Law Directive, which nevertheless respects member state autonomy in a number of important respects.

Even if offeree shareholders are entitled to make an independent decision on the merits of a bid, however, it is another matter as to whether they themselves have the right to appoint the bidders to break up their company. Company law stipulates that resolutions concerning continuity of the company, including dissolution, be carried out by a general meeting of shareholders, and does not give shareholders the right to appoint people to break up the company outside those stipulations.

Company law in Japan, moreover, can be interpreted as charging directors with ensuring the continued existence of the company in order to fulfil their duties, and shareholders entrust directors with this responsibility. This can be considered to justify adopting measures beforehand which will prevent threats to the continued existence of the company. There are, of course, problems in determining whether a takeover aims at breaking up the company. That must be done in the light of individual circumstances. At this stage there are few concrete cases in Japan, and reference has to be made to the experiences of other legal jurisdictions.

In December 2005 the CVC published its proposals for rules regarding takeovers which increase corporate value, aimed at establishing a balance in the positions of the bidder and the target.²¹ Formerly, revising the terms or abandoning a takeover bid were forbidden, but the proposals envisaged protecting the bidder by allowing changes, including abandonment, in the event of deployment of anti-takeover measures. The minimum offer period of 20 days was also deemed insufficient for existing shareholders to gain enough information and question the bidder, hence an extension was proposed. The offeree would be required to give an opinion on the bid proposal. Further, with regards to fairness in management buyouts, an evaluation of the buyout price by a third party such as a certified public accountant would be required.

21 <<http://www.meti.go.jp/press/2005121510/20021215010.html>> (accessed March 2006); cf. *Nikkei Shinbun*, 15 December 2005. The proposals would necessitate substantial changes to existing regulations under the Securities and Exchange Act (SEA) (see below). A working committee of the Financial Deliberation Council (an advisory body to the Prime Minister) was concurrently considering revisions to TOB regulations, from the point of view of investor protection. Rather than various groups considering these issues separately, it would have been better to adopt a more comprehensive approach involving all the main parties.

As we shall see, many of these proposals were incorporated into the Financial Instruments and Exchange Law (FIEL, based on the SEA) passed in June 2006 and due to be implemented in 2007.²²

IV. CHANGES TO THE SECURITIES AND EXCHANGE ACT AND COMPANY LAW

Takeover bid regulations were first introduced in 1971, aimed at protecting domestic companies from foreign takeovers in the face of financial liberalisation. Tender offers could not be implemented until ten days after notification of the Minister of Finance. They were modified in the wake of the US–Japan Structural Impediments Initiative in the late 1980s.²³ According to the SEA, a tender offer is made publicly to unspecified shareholders, inviting them to sell their shares outside the securities market of the stock. In the case of NBS, Livedoor did not make a tender offer, but obtained the bulk of its shares through clandestine off-floor trading (ToST-NeT-1). Opinion is divided as to whether this and other similar cases conform with takeover bid regulations about acquisition of shares outside the stock exchange’s securities market (Article 27.2, para. 1, no. 4), and the new law seeks to remove this grey area.²⁴

The FIEL incorporates parts of several laws relating to the sale and soliciting of financial instruments, and contains new regulations on takeover bids. Investment funds will have to report the purchase of 10 per cent or more of a company’s shares within two weeks. If a party purchases 10 per cent or more of a company’s shares over a three month period, including more than 5 per cent from off-floor trading, it will be restricted to owning less than one-third of the total shares unless it makes a public tender offer. In the event of multiple bids, a party with one-third or more of issued shares will have to make a purchase of 5 per cent or more additional shares by public tender. Bidders can stipulate terms under which tender terms will be changed. The target is obliged to make a statement on the offer, and the bidder is obliged to answer questions in the statement. The target company can seek an extension of up to 30 days. A bidder acquiring two-thirds or more of a target’s shares through tender is obliged to purchase all outstanding shares.²⁵

22 As with many EU countries, rather than regulating takeover bids under this law, a special law would have been preferable given their particular nature.

23 M. TATSUTA, *Shôken torihiki-hô I* [SEA I] (Tokyo 1994).

24 I. KAWAMOTO / T. OTAKE, *Shôken torihiki-hô dokuhon* [SEA Reader] (7th edn., Tokyo 2005).

25 M. HAYAKAWA, *M&A ni okeru torishimariyaku no gimu to sekinin* [Obligations and Responsibilities of Directors in M&A], in: *Shôji Hômu* 1740 (2005); H. NAKAGAWA, *Shijô kisei no nukeana o fusagu TOB seido no seibi* [Systematizing TOBs to Prevent Loopholes in Market Regulation], in: *Bijinesu Hômu* June 2006; *Nikkei Shinbun*, 20 April 2006, 7 June 2006.

As noted above, the new law seeks to achieve a balance between the rights of the bidder and those of the target, and to clamp down on a number of grey areas which had been exploited by Horie, Murakami and others, especially in 2005.

Revision of the company law

A revamp of company law in May 2006 introduced among other things special-class stocks for start-ups to stimulate the economy. The revamp increased discretion given to corporate managers over a range of decisions, and increased their ability to construct defences against hostile takeovers. Let us consider briefly some of these potential defences.

1. *Classes of shares:* The new company law has relaxed conditions for issuing special-class shares. Issued to raise new funds, they also offer the potential for use as anti-takeover measures. For instance, shares can be issued which can be compulsorily converted into bonds, and separate from the original intent of the legislator, special-class shares can be issued under which all may be repurchased (by a special resolution at a general shareholders meeting), thus depriving the holder of voting rights.
2. *New rights plans:* It is possible to make a new rights issue which can be exercised by all but the bidder, or all those with less than a certain proportion of shares. (As the latter is not actually restricted by law, it is presumably not deemed to infringe on the principle of shareholder equality.) Shares stipulating compulsory conversion to shares with restricted voting rights can also be issued, achieving the same effect as a rights plan. Such measures restrict voting rights, but do not dilute the dividend ratio.
3. *Golden shares:* A potentially powerful defence measure is special-class shares which give the holder certain rights, such as appointing directors and auditors or restraining voting rights. Under the new company law a company's charter can be amended by a two-thirds majority to allow this. And whereas it was formerly considered that transfer restrictions could not be applied to one class of share, this has now become possible. There have been fierce debates about the legality and desirability of golden shares, however, and their use will not be sanctioned easily.²⁶

26 METI's CVC favoured recognising golden shares under certain conditions such as limited duration, while the Tokyo Stock Exchange banned their issue in guidelines it published on anti-takeover mechanisms in November 2005. The Financial Services Agency director declared they were legal under company law and, pointing out that Nasdaq recognised them under certain circumstances, argued that refusing to newly list companies that issued them was problematic. The peak business organisation Nippon Keidanren also argued that a blanket ban was excessive. The Tokyo Stock Exchange yielded to such pressure and recognised them conditionally in its revised guidelines of March 2006. The Financial Services Agency director's comments point to the need for further debate over the compatibility of laws which serve different purposes. Cf. M. HAMADA, *Ôgon kabu* [Golden Shares], in: *Hôgaku Kyôshitsu* 306 (2006).

As this brief account shows, new legislation has sought to eliminate grey areas thrown up by recent takeover bids, including the Livedoor drama, and balance the interests of bidders and targets. New company law gives greater discretion to corporate managers to shape their company's corporate governance, and with it the potential to construct a variety of anti-takeover measures. At the same time, they are required to state their "basic policy regarding control of decision making over policies of finance and business" in their annual report. This is supposed to indicate policies towards those deemed inappropriate to exercise control, reasons for them and assurances that defence measures will not be used against shareholder interests or to entrench incumbent management.

V. MANAGEMENT RESPONSES

With the Livedoor drama unfolding before them, the debates about "corporate value" and new legislation, corporate managers have found themselves in a rapidly changing environment as far as corporate control is concerned. How have they responded?

In a Nikkei survey of corporate executives carried out in March 2006, 70 per cent reported that they were introducing or weighing up defences against hostile takeovers. The most popular measure listed was increasing cross shareholdings (34.8 per cent).²⁷ In March 2006, for instance, the Toyota group increased its share ownership of the original group company Toyota Industries to over 50 per cent. Toyota Industries held a 5.5 per cent stake in Toyota Motor Co., a 7.8 per cent stake in Denso and a 6.7 per cent stake in Aisin Seiki, making it somewhat analogous to NBS in the Fuji-Sankei group, and its shares were seen as undervalued, making it a potential takeover target.

Mindful of Mittal's hostile bid for Arcelor SA, and fearing they could also be targeted, Japan's major steel companies Nippon Steel, Sumitomo Metal Industries and Kobe Steel also announced in March 2006 that they would act in mutual defence in the event of a hostile takeover bid.²⁸ Japan's Antimonopoly Law prevented these companies from merging – a Nippon Steel–Sumitomo Metal Industries merger would create a giant with 49 per cent of the market, far above the 35 per cent limit (which METI is seeking to raise to 50 per cent) – but there is little doubt that some of the increasing M&A activity, both within enterprise groups and between them, is at least partially intended to thwart hostile takeover attempts.²⁹

The second most popular measure in the Nikkei survey was increasing the limit of authorised capital (26.1 per cent), to give directors greater discretion over capital in-

27 Nikkei Weekly, 27 March 2006.

28 Nikkei Shinbun, 29, 30 March 2006.

29 The new company law allows for M&A using a combination of cash and parent company shares. Implementation of this provision, which is believed – feared – will increase acquisitions of Japanese by foreign companies, has been delayed until 2007.

creases. This has not been without its problems or controversies, however. In the June 2005 round of annual general meetings, Fanuc, Tokyo Electron and Yokogawa Electric Corp. had proposals to increase authorised stock voted down by shareholders, who deemed there was no need for an increase.

A number of companies have also attempted to introduce early warning measures, calling for those acquiring shares above a specified threshold – 20 per cent for Matsushita/Panasonic, for instance, and 15 per cent for Eisai and Nippon Steel – to declare their intentions and offer other information, and desist from buying more shares for a specified period, failure to do which would trigger the use of equity warrants. Here, too, there has been controversy, with close scrutiny of the length of the specified period, independence of the committees tasked with considering the impact on corporate value and shareholder interests, impact of warrant issues on shareholder interests, etc.

In April 2006 the Tokyo District Court ordered Nireco Corp. to abandon its poison pill, central to which was an equity warrant plan, ruling that it was unclear that Nireco's management would respect the recommendations of its independent committee, and that the criteria for triggering the equity warrant issue – undermining the interests of customers and employees – were too broad and lacked clarity.³⁰ The ruling set three conditions for the legitimate use of equity warrants: approval by shareholders in principle, defence for shareholders against unacceptable decisions by the board, and no unpredictable damage to existing shareholders.

The Tokyo Stock Exchange, too, weighed in with new rules in March 2006 requiring prior consultation and publication of defence measures, sanctioned by the threat of naming and shaming transgressors. It climbed down on its blanket opposition to golden shares, legalised under the new company law, but threatened to de-list those companies whose provisions were considered inappropriate or could not be overturned at shareholder meetings.³¹

Investor organisations have also established guidelines, intending to apply them to voting in the June 2006 shareholder meeting season, in which a rush of defence proposals was expected. The Pension Fund Association, for instance, with some four trillion yen invested in the shares of domestic firms, objected to measures which did not require the regular approval of shareholders.³²

Managers have therefore come up against constraints from various directions which effectively limit their options. In some cases they have abandoned defence measures as

30 Nikkei Shinbun (2 June 2006) commented: "This ruling effectively means that companies are not allowed to take the interests of customers and employees into consideration when deciding whether an unsolicited takeover would damage their corporate value (T)his severely limits the conditions under which defensive measures can be adopted, experts say."

31 Nikkei Weekly, 3 April 2006.

32 In the June annual general meeting season, it turned out, the issue of defence measures was overshadowed by that of control over dividend decisions, sparked by the new company law.

a result (e.g. Uniden, and Tsugami, prior to their 2006 annual general meeting), or decided not to deploy them. At the very least, they have had to acquire a deeper knowledge of the issues at stake, and what might pass the scrutiny of shareholders, courts and stock exchanges as legitimate defence measures. As leading US shareholder advocacy companies have rushed into the Japanese market, so too have IR service companies mushroomed, spurring not just friction but professionalisation of the corporate-shareholder interface, which is unlikely to be reversed.

In seeking to defend themselves against possible takeovers, moreover, managers often have to adopt shareholder-friendly measures, in effect aping behaviour advocated by those who would take them over. Dividends exemplify this. When Sotoh Co. and Yushiro Chemical Co. were targeted by Steel Partners in December 2003, largely because of their amassed internal reserves, they were forced to raise their dividends by a factor of 14-15 times. Fuji Television raised its dividends five-fold in the year to March 2005, bringing its payout ratio to 50 per cent. And if one company in an industry does this, competitors often feel obliged to follow. Dividend payments by listed companies as a whole increased 19 per cent in the year to March 2006 over the previous year (although the payout ratio remained largely unchanged at just under 25 per cent).³³

Thus, it is possible to argue that the ground has shifted for corporate managers, who must now be much more concerned about shareholder interests. This shift is neatly captured by Buchanan's small-scale survey³⁴, asking senior executives about changes in time allocated to stakeholders between 1984 and 2000. Employees still commanded the most time, and indeed time allocated to them had risen, but there was a much larger increase in time allocated to shareholders. This does not necessarily equate with alignment to shareholder interests, but it does suggest a shifting balance of stakeholder interests in the "employee-favouring firm".³⁵

VI. CONCLUDING COMMENTS

Many of the changes we have been describing are encapsulated in Internet company Rakuten's attempted takeover of the Tokyo Broadcasting System in October 2005. In some respects, this was a carbon copy of Livedoor's attempted takeover of NBS. After acquiring a large volume of its shares, Rakuten announced it was seeking to create a new media company with TBS. Eight months had made a lot of difference, however, and TBS had prepared defences. In addition to boosting stable shareholding, in June it had issued 80 billion yen in new rights to an investment company, for exercise in the event that a hostile bidder acquire 20 per cent or more of the company's shares.

33 Nikkei Shinbun, 8 March 2006.

34 BUCHANAN, *supra* note 9, appendix.

35 DORE, *supra* note 3.

Rakuten stopped after acquiring 19.09 per cent of TBS's shares, thus avoiding exercise of the rights, or possible court intervention. On 30 November, after mediation by Mizuho Corporate Bank, both parties agreed in principle to enter into negotiations aimed at amicable resolution. Rakuten would withdraw its demand for integration, refrain from acquiring significant new TBS shares, and entrust shares in excess of 10 per cent to a financial institution. In return TBS would explore business collaboration opportunities.

Following the announcement, Rakuten transferred 9 per cent of TBS shares to Mizuho Trust and Banking Co. at the last minute before the end of March 2006 deadline, after a wrangle over the shares' voting rights. The committee to discuss the alliance met only once during this time (although two working groups met more often), and the deadline for talks was put back by three months, and then a further month. The outcome was still unclear at the point of writing.

Unlike the Livedoor and NBS/Fuji Television dispute, on the one hand Rakuten and TBS deployed their tactics in private, while at the same time exchanging questions and answers. TBS took advice from a special committee ("corporate value evaluation special committee") set up under its defence measures, and discussions were held between practitioners from both companies. Whether shareholders were given sufficient information and transparency from the time of the proposed business integration on 13 October until the settlement on 30 November is arguable. The TBS labour union expressed its opposition to the integration proposal early on, but it is unclear as to what kind of information and from what perspective this was based on. It does suggest a strong relationship of trust between TBS and its employees, which was a potent weapon in TBS's defence.

Finally, TBS defence measures were not subject to judicial scrutiny, unfortunately in the view of some. A ruling, however, would only have been on the concrete defence measures adopted by TBS, and not on the case overall. For this kind of assessment, recourse to the accumulated knowledge and wisdom of practitioners may well become important. This knowledge suggests that it is difficult to separate takeovers which increase corporate value and other kinds of takeovers. It is difficult for judges to delve deeply into the management of the companies in question. If a means can be made for a third party consisting of managers, scholars and lawyers to advise judges, it might be possible for judges to make quicker and more persuasive decisions.³⁶ The composition of such bodies and qualifications of their members would need careful consideration, and in order for them to make quick, informed decisions, they would need to be given certain legal powers. The time might be ripe for Japan to create its own Takeover Panel to give meaningful expression to the concept of "corporate value".

36 Cf. keynote address by Shin'etsu Chemical president C. Kanagawa to "What is a Company? Company Law and M&A" symposium in December 2005 (Nikkei Shinbun, 15 December 2005).

ZUSAMMENFASSUNG

Die versuchte Übernahme von Nippon Broadcasting System Inc. durch Livedoor Co. im Februar 2005 markiert einen Wendepunkt in der Geschichte der Unternehmensübernahmen in Japan. Das Drama spielte sich vor den Augen der Öffentlichkeit ab und führte zu einem Wandel in der öffentlichen Wahrnehmung und zu einer heftigen Debatte über die Zulässigkeit von Abwehrmaßnahmen. Dies mündete schließlich in eine Reihe von Berichten, Empfehlungen und Regulierungen, durch die einerseits die Möglichkeit der Unternehmensleitung, im eigenen Interesse zu handeln, eingeschränkt und andererseits das Eingreifen von „corporate raiders“ verhindert werden sollte. Der Schlüssel zu diesem Balanceakt lag im Begriff der Steigerung des Unternehmenswertes – einem Begriff, der in der Praxis schwer festzumachen ist.

Um den Schutz der Aktionäre zu gewährleisten und um zu verhindern, daß die Unternehmensleitung im eigenen Interesse handelte, untersagte in dem geschilderten Fall das Distriktgericht Tokyo Nippon Broadcasting System die Ausgabe neuer Aktien an Fuji Television zum Zwecke der Abwehr des Übernahmeangebotes. Das Obergericht Tokyo wies die Berufung von NBS ab. Nach einigen Wochen heftigen Ringens, das die Medien als einen Wettstreit zwischen alten und neuen „corporate practices“ darstellten, kam es zu einem Vergleich. In der Folge wurde jedoch – manche würden sagen, als Reaktion der „alten Garde“, – die Unternehmensführung von Livedoor wegen Verbreitung falscher Finanzinformationen verhaftet und aus Livedoors rasantem Aufstieg wurde mit dem Ausschluß von der Börse ein ebenso rasanter Abstieg.

Livedoors Sturz hat die Spannungen im Bereich des Anlegerschutzes nicht entschärft. Das neue Gesetz zum Handel mit Finanzprodukten soll Grauzonen, die der Livedoor-NBS-Fall zu Tage gebracht hat, beseitigen und einen Ausgleich zwischen den Rechten des Bieters und des Zielunternehmens schaffen. Änderungen im Gesellschaftsrecht schaffen neue Möglichkeiten für Abwehrmaßnahmen gegen Übernahmen, aber die Börsen, Investorengruppen und besonders die Gerichte zögern noch, sie anzuwenden.

Anhand eines Vergleichs des Livedoor-NBS-Falles mit dem Übernahmever such von Tokyo Broadcasting System, den Rakuten später im gleichen Jahr unternahm, werden die Veränderungen in der Unternehmenskontrolle in Japan untersucht. Von einigen wird bedauert, daß der Fall Rakuten-TBS nicht einer gerichtlichen Prüfung unterlag. Eine solche Überprüfung hätte sich jedoch auf die von TBS eingesetzten Abwehrmaßnahmen beschränkt, nicht aber die Hauptsachfragen im Hinblick auf die Steigerung des Unternehmenswertes geklärt. Dazu sind die Erkenntnisse der Praktiker vonnöten: Vielleicht ist die Zeit reif für die Schaffung einer japanischen Übernahmekommission.

(Übersetzung durch d. Red.)