ABHANDLUNGEN / ARTICLES

Recent Developments in Takeover Law: Changes in Business Practices Meet Decade-Old Rule

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I. INTRODUCTION

Nothing remains unchanged. And anything can come to an end all of a sudden. We now observe that corporate control in Japan, which once appeared so stable that no one predicted that the boom of hostile takeovers would ever come, was no exception. After a new IT venture led by a 32-year-old entrepreneur purchased a large portion of the shares of a thriving radio broadcasting company and challenged the friendly takeover bid being undertaken by the latter's parent company in early 2005, the hostile takeover became a fashionable topic among ordinary citizens. A year later, the young hero was arrested for allegedly having committed window dressing, but terms such as hostile takeovers, investment funds, defensive measures, and poison pills are still favorites of newspaper and television shows.

Corporate law specialists, however, have been familiar with the issue since the end of the 1980s when a series of court decisions were rendered over corporate control contests. The profound changes experienced by the Japanese economy and the fundamental reform of corporate law that followed in the meantime do not appear to have affected the legal doctrine formed in the 1980s – at least not to the extent that the general public conceived. This article compares the case law on corporate takeovers at the end of the 1980s and in the middle of the first decade of 2000. It explores, as regards the legal doctrine, what has changed and what has not. It first touches upon the backgrounds of the two surges of takeover cases briefly (II), and then examines closely the case law in the 1980s (III) and from 2005 (IV), before drawing some conclusions (V).

II. HISTORICAL BACKGROUNDS

1. Two Surges of Takeover Cases

As mentioned, the number of judicial cases on corporate takeovers is not small in Japan. However, they have not appeared constantly: rather, they form sporadic surges. The first of the surges came in the late 1980s, when important cases such as *Cosmopolitan v. Takuma,*[1] *Miyairi Valve I,*[2] *Miyairi Valve II,*[3] and *Chujitsu-ya / Inage-ya*[4] were decided. These cases established that the defensive issuance of shares by the management faced by the threat of takeover should be judged according to the "Primary Purpose Rule" (PPR).

At the end of this period, T. Boone Pickens acquired a large percentage of the standing shares of *Koito Seisaku-sho KK,* an important subcontractor of Toyota.[5] Though the dispute produced several court decisions, it did not develop into a decision directly addressing the takeovers, because the request of Pickens stopped short of acquisition of Koito; instead, it was merely to be represented on its board of directors. Then, inspired by this dispute, a new set of disclosure rules applicable to an acquirer of a large portion of shares was introduced in the Securities and Exchanges Act in 1990. At the same

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1 *Cosmopolitan KK v. KK Takuma*, Osaka District Court, 18 November 1987, in: Hanrei Jihô 1290, 144.

2 *Takahashi Sangyô KK v. KK Miyairi Valve Seisaku-sho*, Tokyo District Court, 2 December 1988, in: Hanrei Jihô 1302, 146.

3 *Takahashi Sangyô KK v. KK Miyairi Valve Seisaku-sho*, Tokyo District Court, 5 September 1989, in: Hanrei Jihô 1323, 48.

4 *Shuwa KK v. KK Chujitsu-ya*, Tokyo District Court, 25 July 1989, in: Hanrei Jihô 1317, 28; *Shuwa KK v. KK Inage-ya*, Tokyo District Court, 25 July 1989, in: Hanrei Jihô 1317, 32. The two decisions are the same except for the name of the defendant. Partial translation of the former case (*Chujitsu-ya* case) is reported at Y. YANAGIDA ET AL. (eds.), Law and Investment in Japan (2nd ed., Cambridge, Mass. 2000) 550.

5 About the attempt by T. Boone Pickens to be presented on the board of directors of Koito, see T. OKUSHIMA, The Shareholders' Right to Supervise and Correct Management of a Corporation, in: Law in Japan 27 (2001) 17 (translated by Lisa Ohno et al.); P.C. REICH, T. Boone Pickens and Corporate Governance in Japan: A Retrospective View of Three Sides of the Story and Recent Developments, in: Law in Japan 27 (2001) 27; M.E. CORCORAN, Foreign Investment and Corporate Control in Japan: T. Boone Pickens and Acquiring Control Through Share Ownership, in: Law and Policy in International Business 22 (1991) 333, 350 *et seq.*; from a German perspective: H. BAUM, Marktzugang und Unternehmenserwerb in Japan (Heidelberg 1995) 212 *et seq.*

time, the rules on takeover bids were improved. The new disclosure regulation required any investor having acquired more than five percent of standing shares of a listed corporation to report the fact of such acquisition within five business days, disclosing the identity of the acquirer, the purpose of the acquisition, and the source of finance that the acquirer made use of.[6] Further disclosure was required every time such an investor acquired or released more than one percent of the shares.[7] The exemption was given to institutional investors, in which case a report was obligatory only once every three months.[8] The regulation revealed that Pickens, though having claimed much about the "unfairness" of the Japanese industry practices, was a mere puppet entirely financed by a Japanese corporate raider. After Pickens left Japan in embarrassment, this regulation effectively deterred hostile takeovers during the 1990s.

In 2005, just when the bill for the new Corporate Code which was to totally renovate corporate law in Japan was to be submitted to the Diet, the second surge of hostile takeovers came up. In two cases the validity of defensive measures against the hostile acquirer were argued before the court, while, in another, the Japanese version of the "poison pill" was successfully attacked by one of the shareholders. The takeover became an issue of such a big concern, not only to lawyers but also to the public, that semi-official "Guidelines"[9] were published by the two relevant ministries, the Ministry of Economy, Trade and Industry (METI) and the Ministry of Justice (MOJ), with regard to the extent of the permissible defenses. Hostile takeovers have kept occurring since then, but no important judicial decision has been rendered.

2. *Corporate Acquisitions in the 1980s*

The first surge of takeover cases was preceded by the gradual deregulation of the financial market in the 1980s.[10] The deregulation enhanced the availability of the bond market as well as the capital market. Some people made use of such markets to finance more money than was necessary for their business and commenced investing in other companies. The rise of the attempted hostile takeovers was the product of these changes in the Japanese market environment.

However, the old Japanese economy was also still alive in the 1980s. Cross shareholding was stable and limited the number of shares available to the acquirer. Many companies had a close tie with one or a few more banks, sometimes called "main

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6 *Shôken torihiki-hô* (Securities and Exchanges Act), Law No. 25/1948, Art. 27-23.

7 *Id.*, Art. 27-25.

8 *Id.*, Art. 27-26.

9 MINISTRY OF TRADE, INDUSTRY AND ECONOMY & MINISTRY OF JUSTICE, Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholder's Common Interests, 27 May 2005 (*hereinafter* "Guidelines"), reproduced in this volume *infra* at the 'Documentation' section.

10 As regards the liberalization of the financial regulation in the 1980s, see M. YOKOI-ARAI, Financial Stability Issues: The Case of East Asia (London 2002) 298-301.

banks."[11] Such a bank or banks tended to avoid a drastic change in the control of the company and, as a result, were not favorable to investors hostile to the incumbent management. Employees believed in their lifelong employment and did not welcome an unknown acquirer either.

Under such circumstances, the best defense against a hostile takeover was to persuade the existing stakeholders to support the current management or, at least, not to side with the acquirer. This strategy was successfully carried out when a bearing manufacturer *Sankyô Seiki KK* faced a hostile takeover by *Minebea KK*, another manufacturer of the same kind of products. After the friendly shareholders and "main banks" of Sankyô Seiki announced their support for the management and refused the takeover, the acquirer (Minebea) had few things to do but to retreat from the contest over control.

What is important with the side of the acquirer (Minebea) was that it did not consider commencing a takeover bid (TOB). All the shares of the target company were purchased through the market, though the procedure of TOB already existed in the Securities and Exchanges Act.[12] Interestingly enough, TOB has seldom been used for the purpose of hostile takeovers in Japan until very recently. Under the Japanese regulation, the acquisition of shares through the market was excluded from the mandatory requirement for the bid, however much was acquired.

3. Developments during the "Lost Decade"

Although there were rather few takeover cases during the 1990s, important developments were made during this period, which consists of the short Bubble Economy at the beginning followed by a long economic downturn named "the Lost Decade." First, the liberalization of the financial market proceeded all through this period. At the end of the decade, the regulation became as competition-oriented as its counterpart in the United States.[13] Secondly, financial engineering came to be widely known in the thus liberalized financial market and various financial products were brought in. Thirdly, the extended economic downturn, especially the sluggish stock market, forced many compa-

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11 Though the role of so-called main banks has been disputed among commentators writing about the industrial organization of Japan, this article is not going to explore this issue. For a brief and neutral description, see H. KANDA, Trends in Japanese Corporate Governance, in: Hopt/Wymeersch (eds.), Comparative Corporate Governance (Berlin et al. 1997) 190-191.

12 Securities and Exchanges Act, Artt. 27-2 *et seq.* For further description of the TOB procedure in Japan, see H. KANDA, Comparative Corporate Governance – Country Report: Japan, in: Hopt/Kanda et al. (eds.), Comparative Corporate Governance (Oxford 1998) 934-936; from the German perspective: H. BAUM, Der Markt für Unternehmen und die Regelung von öffentlichen Übernahmeangeboten in Japan, in: Die Aktiengesellschaft 1996, 399 *et seq.*

13 S. KOZUKA, Reform of Banking Regulation in the 1990s: Has the Market Become Competitive?, in: The Japanese Economy 33 (2006) 50.

nies to sell off the shares held by cross-sharing.[14] The introduction of current value accounting of financial products was significant in this regard.

Finally, driven by all of these elements, the corporate law underwent constant reforms during this decade.[15] Beginning from the revision of the shareholder derivative suit in 1993 and a limited deregulation of the repurchase of shares in 1994, corporate law swayed between stronger corporate governance and deregulation. The incrementally developed revisions culminated in a series of revisions in 2001-2002 which marked a radical shift in the fundamental ideas of Japanese corporate law. The new idea appears to be a market-oriented one. Three of the main features are: acceptance of the modern finance theory, observed in particular about the repurchase of shares and share options; deregulation in favor of non-mandatory rules, especially with regard to the security design, venture business establishment, and close corporations; and the competitiveness in the global market of corporate governance, illustrated by the optional introduction of a U.S.-type committee system within the board.

It is easy to see that these developments prepared the new surge of hostile takeovers in 2005.[16] The finance theory shows which company's shares are undervalued, and financial engineering enables investors to have access to the financial resources necessary to purchase such shares. From the liberalized market environment emerged investors and entrepreneurs that do not hesitate to act according to the financial theory, without minding the traditional practices or understandings.

With these developments in mind, we are now ready to explore whether, and to what extent, the court decisions on hostile takeovers have changed in the meantime.

III. CASE LAW AT THE END OF THE 1980S

1. *Purchase of Shares Versus Issuance of New Shares*

In the 1980s, a popular defensive measure used by target companies was the issuance of new shares to a friendly party. When the percentage of the existing friendly shareholders was not large enough, unlike in the case of Sankyô Seiki or Koito, the management tried to increase the friendly shareholders by such issuance and dilute the shares held by the acquirer. The acquirer that encountered this defensive strategy usually applied for an injunction of the issuance by court order.

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14 See H. KANDA, Does Corporate Law Really Matter in Hostile Takeovers?: Commenting on Professor Gilson and Chancellor Chandler, in: Columbia Business Law Review 67 (2004) 70-71.

15 See T. FUJITA, Modernising Japanese Corporate Law: Ongoing Corporate Law Reform in Japan, in: Singapore Academy of Law Journal 16 (2004) 321.

16 For further analysis of the backgrounds of the second takeover surge in 2005, see C.J. MILHAUPT, In the Shadow of Delaware?: The Rise of Hostile Takeovers in Japan, in: Columbia Law Review 105 (2005) 2171, 2184 *et seq.*; an abstract of that article is reprinted *infra* at the 'Shorter Articles & Comments' section.

According to corporate law, which was codified in the Commercial Code at that time, injunction of the issuance of shares is ordered when the issuance is either (a) in breach of statutory provisions or (b) substantially unfair.[17] In the typical case of a corporate takeover, both issues are raised by the acquirer. The fairness issue concerns the fact that the issuance results in the augmentation of the shares held by friendly shareholders at the cost of the dilution of shares held by the acquirer. The statutory breach issue is raised when the shares are issued at a price below the market price without the approval by the supermajority of the shareholders' meeting, which is required by corporate law when the price is "particularly beneficial" to the subscriber.[18] The target company, faced by a hostile acquirer already possessing a large percentage of the standing shares, prefers to allege that the price is not "particularly beneficial" rather than try to ensure the supermajority by contesting with the acquirer for the support.

2. *Fairness Issue*

With regard to the fairness issue, the court decisions applied the PPR, which has been the case law since the 1970s. The PPR developed as the case law applicable to the issuance of new shares, but no prior case concerned hostile takeovers. It was, in this sense, a new development that a series of court decisions established that the management was justified in issuing new shares to friendly shareholders when the primary purpose of the issuance did not lie in the exclusion of the acquirer.

It is, of course, difficult to show the purpose of the management directly.[19] However, the court in *Takuma v. Cosmopolitan*[20] held that the management had a justifiable primary purpose by stating that the company was in need of making investments of more than one million yen. It was followed by the court in *Miyairi Valve I,*[21] which found that the target company needed fresh capital in order to repay loans from banks. The same target company decided to issue another lot of shares within eight months, when its corporate control was threatened by the same acquirer again, but the court again accepted the allegation of the target company that the latter was in need of fresh capital of more than two billion yen in order to renovate its production facilities and computer

17 Commercial Code (prior to 2005) [*Shôhô*, Law No. 48/1957], Art. 280-10. The provision is retained without a significant change in the Corporate Code of 2005 as Art. 210.

18 Commercial Code (prior to 2005), Art. 280-2(2). The regulation is redrafted without a substantial change in the Corporate Code of 2005 as Artt. 199(2), 201(2).

19 For further analysis of the cases discussed here, see M. TOKUMOTO, The Role of the Japanese Courts in Hostile Takeovers, in: Law in Japan 27 (2001) 1; from a German perspective BAUM, *supra* note 5, 138 *et seq.*

20 *Cosmopolitan KK v. KK Takuma*, Osaka District Court 18 November 1987, in: Hanrei Jihô 1290, 144.

21 *Takahashi Sangyô KK v. KK Miyairi Valve Seisaku-sho*, Tokyo District Court, 2 December 1988, in: Hanrei Jihô 1302, 146.

system (*Miyairi Valve II* [22]). These cases showed that the PPR in effect meant that the management of the target company was permitted to issue new shares if there was a good reason for injecting fresh capital, even when the issuance would result in a dilution of the shares held by the acquirer.

The only precedent in which the defensive issuance of shares was not successful was the very exceptional case of *Chujitsu-ya / Inage-ya*. Here the acquirer, Shuwa, purchased a large amount of shares of two supermarket companies, *Chujitsu-ya KK* and *Inage-ya KK,* and proposed the merger of them and another supermarket into one in order to create an allegedly modernized retailer. Chujitsu-ya and Inage-ya did not like this idea and issued new shares to each other so that one could serve as friendly shareholder to the other in defeating Shuwa. The Tokyo District Court found that there could not be a need of fresh capital, because no fresh capital remained in the hands of Chujitsu-ya if it used up the money contributed by Inage-ya in subscribing the share of the latter, and *vice versa.*[23] Applying the PPR, the court held that the target company could not be justified as having the primary purpose of financing, rather than excluding the acquirer.

3. *Price Issue*

In contrast to the PPR, which has been much in favor of the defending management, the case law has been strict with regard to the price issue. It was already established by the time of the first takeover surge that whether the price was "substantially beneficial" to the subscriber should be determined in reference to the market price, other market and company conditions being taken into consideration. The court in *Takuma v. Cosmopolitan* [24] followed this case law and held that, in principle, the market price should be the fair price. However, the court excluded the price after the appearance of the acquirer, stating that the stock price might have soared as a result of the purchasing by the acquirer, rather than reflected the fundamentals of the target company.

In 1989, the Japan Association of Securities Dealers (JASD), faced by the increase of takeover disputes, promulgated the voluntary rule that the issuance of new shares to a particular party chosen by the management should be made at the price of ninety percent or more of the average market price for the six months prior to its issuance. After that, courts relied on this voluntary rule in deciding the price issue. The result may be different from the decision in *Takuma v. Cosmopolitan*, since the market price for the preceding six months may have already been raised as a result of the purchasing by the acquirer.

22 *Takahashi Sangyô KK v. KK Miyairi Valve Seisaku-sho*, Tokyo District Court, 5 September 1989, in: Hanrei Jihô 1323, 48.

23 *Shuwa KK v. KK Chujitsu-ya*, Tokyo District Court, 25 July 1989, in: Hanrei Jihô 1317, 28; *Shuwa KK v. KK Inage-ya*, Tokyo District Court, 25 July 1989, in: Hanrei Jihô 1317, 32.

24 *Cosmopolitan KK v. KK Takuma*, Osaka District Court, 18 November 1987, in: Hanrei Jihô 1290, 144.

The voluntary rule was modified in 2003 to the extent that the price is now required to be ninety percent or more of the market price of the day preceding the decision of issuance. Consideration of the market price of a preceding period (maximum six months) is permitted only where it is found appropriate. The Tokyo District Court followed this stricter rule in its decision *Miyairi Valve III* [25] which it decided the next year.

4. *Meanings of the Rule*

Taking court decisions on the fairness issue and price issue together, the case law prior to the second surge of takeovers in 2005 can be summarized as follows: on the one hand, the management of the target company had wide latitude in choosing a friendly shareholder to step in, while on the other hand the latter was required to contribute money equivalent to the price in the stock market at the time of stepping in. In other words, courts have permitted the target company to seek the white knight as long as the premium paid by the acquirer is not disregarded. As the premium paid by the acquirer reflects the difference in the evaluation of the target company by the acquirer and that realized by the incumbent management, it can be said that the market for corporate control was working under this case law.

It may be noted that this case law does not leave any room for the acquirer to offer a second bid: there is no chance for the acquirer to continue contesting by raising its offer in response to the stepping in of the white knight. It is the cost of not choosing the TOB procedure under the Securities and Exchanges Act. The TOB procedure is always open to an acquirer, though the total cost of acquisition will probably be higher as compared with purchasing in the market, assuming that the Japanese stock market is not fully efficient (in the sense of information efficiency). It is left to the acquirer whether or not to make use of it.

IV. TAKEOVER RUSH FROM 2005 AND NEW COURT DECISIONS

1. *Livedoor / Nippon Broadcasting Case*

In January 2005, Fuji Television Co. was trying to acquire all the shares of its parent, Nippon Broadcasting Co. *[Nippon Hôsô KK]*, through a friendly TOB in order to make the latter its subsidiary. Both companies belong to the same media conglomerate. Nippon Broadcasting is a radio broadcaster that founded Fuji Television as its subsidiary decades ago, but as time has passed, the corporate value of the subsidiary in television business has far exceeded that of the parent. The friendly TOB was commenced to correct this twisted corporate group structure.

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25 *KK Matsuka v. KK Miyairi Valve Seisaku-sho* (Miyairi Valve III), Tokyo District Court, 1 June 2004, in: Hanrei Jihô 1873, 159.

While this friendly TOB was being processed, the acquirer, Livedoor KK, purchased the shares of Nippon Broadcasting through the trading system operated by the Tokyo Stock Exchange (ToSTNeT). The amount of shares so acquired reached as much as one-third of the standing shares, apparently frustrating the intent of Fuji Television. As a means of excluding the unwelcome acquirer, the target company issued a great number of share options to Fuji Television. If all of these options were exercised, Fuji Television would have acquired an additional 59% of the shares of the target company, while the shares held by Livedoor would have been diluted to 17%.

This measure of defense was different from those used in the precedents in two respects. First, share options, rather than the shares, were issued, with the same purpose of ensuring a majority of friendly shareholders. In the case of share options, no share is issued and no cash flows in until the holder exercises the option. If the acquirer sells off the shares it has acquired, finding little chance for dominating over the contest for control, no option will actually be exercised, which means that the holder of the options can save much money. Secondly, the target company, Nippon Broadcasting, candidly announced in its press release that the aim of the issuance of options was to thrust the restructuring of the corporate group as planned, defeating Livedoor which "would not be compatible with the public mission of the media company."[26]

Enjoining the issuance of the options at the application of Livedoor, the Tokyo District Court[27] held that the PPR was applicable also to the issuance of share options when corporate control was already under contest.[28] It held that the issuance of share options was "substantially unfair" and subject to an injunction, as long as the primary purpose was to dilute the share of a certain shareholder and maintain the control of the incumbent management. Then it added that the issuance would be justified in an exceptional case where "the corporate value and the interests of the shareholders as a whole" would be harmed by the takeover. Livedoor, however, was not found to be such an exceptional acquirer.

This idea of maintaining the PPR with the addition of some exceptions was followed by the review decisions of the Tokyo District Court (another chamber)[29] as well as the

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26 For facts of the Livedoor case, see also MILHAUPT, *supra* note 16, 2178-2180.

27 *KK Livedoor v. KK Nippon Hôsô*, Tokyo District Court, 11 March 2005, in: Hanrei Taimuzu 1173, 143; for an English translation and brief comment, see E. TAKAHASHI / T. SAKAMOTO *infra* at the 'Case Law' section.

28 Before the developments in 2005, the author was rather skeptical about the possibility that the PPR would be maintained as regards share options used as defensive measure (S. KOZUKA, The Use of Stock Options as Defensive Measures: The Impact of 2001 Amendments to the Corporate Law on Corporate Governance in Japan, in: ZJapanR/J.Japan.L. 15 (2003) 135, 138), but the court preferred to stick to the established rule.

29 *KK Livedoor v. KK Nippon Hôsô*, Tokyo District Court, 16 March 2005, in: Hanrei Taimuzu 1173, 140.

Tokyo High Court.[30] The former, stressing that the board of directors should be elected by the shareholders but never *vice versa*, held that exceptional situations in which defensive measures would be justified were to be found when the acquirer was a green mailer or going to harm the target company irrevocably. The latter decision elaborated on the exceptions as (1) the case of greenmailing, (2) when the acquirer intended to deprive the target company of the assets of the latter, (3) the diversion of the assets of the target company was foreseen, or (4) the acquirer would bust up the target company with the purpose of selling the shares at a good price. Though these types of exceptions were a mere *obiter*, they attracted people's attention because it was the first time that a Japanese court had explicitly held the possibility for defensive measures to be justified.

It will not be easy to show before the court that the acquirer will harm the target company irrevocably. This means that, according to the series of court decisions in the *Livedoor* case, the defensive measures will likely be enjoined as their primary purpose is lying in the defense. It was against these developments that the introduction of a Japanese version of poison pills became the next focus.

2. *Poison Pills and Nireko Case*

One such poison pill introduced by a manufacturer, Nireko KK, was challenged by an institutional investor before court. It was a share option that entitled each holder to subscribe to one share for only one yen. The condition for the exercise of the option was the acquisition by a certain shareholder of twenty percent or more of the standing shares. The board of directors was given the authority to cancel the option at any time before the condition for the exercise was fulfilled. A special committee consisting of two independent members and the CEO was set up in order to give advisory opinions to the board on whether or not to cancel the options.

The options were issued to the current shareholders, two for a share. It was provided that the options were not transferable. Apparently the management was satisfied with the current shareholders but feared that an acquirer might be attracted by the relatively low share price. One of the shareholders, a fund located in the Cayman Islands, raised suit for injunction of the issuance of the options, alleging that it infringed upon the Commercial Code (corporate law at that time), besides being “substantially unfair.”

The Tokyo District Court[31] distinguished the case at hand from the *Livedoor* case by pointing out that the control of the target company was not in actual contest in this case. Based on this distinction, the court stated a three-prong test of proportionality of the defensive device and held that the issuance of share options satisfying this test cannot be enjoined, even if the primary purpose of the management lay in diluting the shares of

30 *KK Livedoor v. KK Nippon Hôsô*, Tokyo High Court, 23 March 2005, in: Hanrei Taimuzu 1173, 140.

31 *The SFP Value Realization Master Fund Ltd. v. KK Nireko*, Tokyo District Court, 1 June 2005, in: Hanrei Taimuzu 1186, 274.

a future hostile acquirer. The test consisted of (1) whether the will of the shareholders' meeting was reflected, (2) whether the exercise of the option was limited to the case where the acquirer would give irreparable harm to the company, and (3) whether shareholders other than the acquirer would not incur unexpected damages. The court found that the defensive device in the Nireko case failed to satisfy any of these tests. The decision was reviewed and approved by the Tokyo District Court (another chamber)[32] and then by the Tokyo High Court.[33] The latter decision focused on the fact that, given the non-transferability of the option, the value of the shares of Nireko would inevitably fall in the market due to the possibility of dilution by the exercise of the options. The court, holding this fact as failing to satisfy test (3) above, concluded that the option in this case was substantially unfair and, therefore, should be subject to injunction.

3. METI / MOJ Guidelines

It was obvious that the three-prong test of the Tokyo District Court, which was basically supported by the reviewing courts, was in line with the "Guidelines"[34] published by METI and MOJ a few days before the first District Court decision. Though not at all binding, the Guidelines aimed at providing safe harbors about the defensive measures against hostile takeovers.[35] It provided that any defensive measure must protect and enhance corporate value and the interests of the shareholders as a whole and, for this purpose, conform to three principles, namely: it shall contribute to protect and enhance corporate value and the interests of the shareholders as a whole; it shall be sufficiently disclosed in advance and reflect the will of the shareholders; and it shall not be more than necessary and reasonable as against the threat posed by possible hostile takeovers.

The Guidelines and the court decisions in the *Nireko* case attempted to provide rules about the permissibility of defensive measures (poison pills) when there is no actual contest for control yet, an issue not fully explored before. The newly formulated rule does not prohibit introducing measures with the apparent intent of defending against hostile takeovers entirely, but requires such measures to contribute to "the corporate value and the interests of the shareholders as a whole," not just benefiting the incumbent management. Comparing this rule with the *Livedoor* decisions, it is easy to see that the new rule is based on the latter so that the rules on defensive measures are consistent both before and after the corporate control is cast in actual contest.

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32 *The SFP Value Realization Master Fund Ltd. v. KK Nireko*, Tokyo District Court, 9 June 2005, in: Hanrei Taimuzu 1186, 265.

33 *KK Nireko v. The SFP Value Realization Master Fund Ltd.*, Tokyo High Court, 15 June 2005, in: Hanrei Jihô 1900, 156; for an English translation and brief comment, see E. TAKAHASHI / T. SAKAMOTO *infra* at the 'Case Law' section.

34 Guidelines, *supra* note 9.

35 It was necessary at this stage to calm down the industry – people panicked at the Livedoor's attack on Nippon Broadcasting Co. – in order to have the new Corporate Code approved by the Diet as scheduled.

4. *Yumeshin Case*

The third case of hostile takeover took place in July 2005, when *KK Yumeshin Holdings* announced a public bid (TOB pursuant to the Securities and Exchanges Act) against *Nippon Gijutsu Kaihatsu KK.* Both the acquiring and the target companies were engaged in construction-related business. The target company, accusing the acquiring company for not sufficiently disclosing its intent, announced that it was going to split each of its shares into five. As it was probable that such a share split would diminish the value of a share of the target company to one-fifth of what it was before the share split, this was expected to frustrate the bid to be undertaken by the acquirer.

Unlike the case of the issuance of shares or options, a statutory provision for enjoining a share split was lacking in the Commercial Code.[36] Therefore, the acquirer requested the court to either enjoin the share split by "the application *mutatis mutandis* of the injunction against the issuance of new shares" or declare the decision of the board of directors to split the shares as illegal and invalid.

The Tokyo District Court[37] rejected the claim of Yumeshin, not only by relying on the lack of a statutory provision authorizing the court to issue an injunction order, but by holding that the share split did not in fact frustrate the takeover bid because the announcement of the share split was made before the commencement of TOB process so that the acquirer had the opportunity of adjusting the price of the bid, which was actually done. As a result, the only effect of the share split was limited to preventing the exercise of the voting rights for shares acquired by Yumeshin through the takeover bid, by setting the effective date of the share split at the day two months after the TOB period. The court found this latter effect to be not decisive, however, as only "halting" and not totally frustrating the bid process. Having lost the case before the courts, Yumeshin proceeded with the TOB that turned out to be unsuccessful.

5. *What Has Changed?*

After several court decisions on three cases, rules regarding hostile takeover have become increasingly clear. Contrary to the large repercussions that these incidents raised among the public, the legal rules have not greatly changed compared to the old case law of the late 1980s, but only evolved to some degree.

First of all, it is noteworthy that the PPR has not lost its relevance: it is applicable even in the case of share options. This means that a defense by issuing share options will very likely be enjoined by a court because the primary purpose, by definition, lies in defeating the takeover. Secondly, the *Yumeshin* case revealed that the management is allowed to halt the attack by the acquirer for some time. This will enable the manage-

36 Such a provision does not exist in the Corporate Code of 2005 either.

37 *KK Yumeshin Holdings v. Gijutsu Kaihatsu KK*, Tokyo District Court, 29 July 2005, in: Hanrei Jihô 1909, 87.

ment to seek a white knight, just as under the case law in the 1980s. Thirdly, it is to be noted that the price issue was not argued much in the *Livedoor* case because the price of the option was worked out according to the finance model. Considering this fact, together with the reasoning of the *Yumeshin* decision that mentioned the (absence of) damage to the acquirer, it is reasonable to make an inference that the white knight, when called in by the incumbent management, will be required to contribute the same or more of the amount as compared with the market price in the stock market, which reflects the bid offered by the acquirer. Thus the market for corporate control is still workable in Japan, at least as much as it was in the late 1980s.

Notwithstanding the above observations, there have been some changes brought about in 2005 to takeover law in Japan. Most importantly, it is now admitted by the courts that the management of the target company can take defensive measures, though only in exceptional cases where the acquirer is likely to harm the corporate value. Under the PPR, the target company had to allege that the action taken was not a defensive measure; after the court decisions of 2005, the issue will be more focused on whether or not the acquirer is in fact a corporate raider that is harmful to the target company.

Another significant point is that courts as well as the Guidelines have taken a very fundamentalist position that the interests of the shareholders shall be the standard. Apparently, the court decisions equate "corporate value" with "the interests of shareholders as a whole." The Guidelines, while referring to the interests of various stakeholders, also state that the ultimate goal of a stock corporation is to maximize the interests of the shareholders. This may be very interesting, given that Japanese companies have been considered to be putting more weight on the interest of employees than that of shareholders.

V. Conclusion

The year 2005 marked a significant step forward in the law of takeovers in Japan. A hostile takeover and a defensive measure against it are no longer a hypothetical case in the classroom, but an actual issue argued before the courts. Case law is being formed, supplemented by the Guidelines published by two governmental agencies.

It is noteworthy that the law on takeovers thus being revealed is very much in favor of the market for corporate control. While the management is not prohibited from seeking the white knight, it is probably required that the offer by the white knight be as competitive as that of the acquirer, reflected in the market price at the time of stepping in. Besides, the management, when taking any action that will affect the control of the company, whether before or after an acquirer appears, has to be mindful of the "corporate value" or "the interests of the shareholders as a whole." Interestingly enough, these rules have not vacated the existing case law on the issue, formulated during the first surge of takeovers at the end of the 1980s, but have rather retained and extended the latter.

It is indeed impossible for anything to last eternally. However, it is also common knowledge that no change can take place abruptly. Human beings cannot produce something from nothing. The new developments in takeover law in Japan are no exception: they are based on the existing law, being adapted to the changes in the environment.

ZUSAMMENFASSUNG

Die Diskussion über feindliche Übernahmen hat in Japan neuerdings eine bedeutsame Wendung genommen. Der Versuch eines jungen IT-Unternehmens, Anfang 2005 eine etablierte Rundfunkgesellschaft, die zu einem der größten japanischen Medienkonglomerate gehört, zu übernehmen, und andere ähnliche Fälle führten zu einer Reihe von Gerichtsentscheidungen und waren Anlaß für die vom Ministerium für Wirtschaft, Handel und Industrie und vom Justizministerium gemeinsam formulierten Richtlinien zu Abwehrmaßnahmen. Diese Entscheidungen und Richtlinien bilden den rechtlichen Rahmen für die Beurteilung der Zulässigkeit solcher Maßnahmen. Die im Zuge dieser Aktivitäten entwickelten Regeln knüpfen an bestehende Rechtsprechung an und haben diese ausgebaut.

Schon zuvor hatten die Gerichte die einzige Abwehrmaßnahme, die japanischen Gesellschaften bis vor kurzem zur Verfügung stand – die Ausgabe von Aktien an freundliche Aktionäre – einer zweifachen Prüfung unterworfen. Sie prüfen zum einen, ob nicht der Hauptzweck der Aktienausgabe in einer Verwässerung der Anteile des Erwerbers bestand und somit unzulässig war, und zum anderen ob der Ausgabekurs in etwa dem Marktwert entsprach. Im Ergebnis durfte nach dieser Rechtsprechung ein sog. „weißer Ritter“ intervenieren; Voraussetzung hierfür war jedoch, daß sein Angebot dem feindlichen gleichwertig war.

Die neueren Entscheidungen lassen nunmehr Abwehrmaßnahmen per se ausdrücklich zu, wenn und soweit diese den Wert des Unternehmens sichern und die Aktionärsinteressen insgesamt wahren. Sie halten jedoch gleichzeitig im Kern an der früheren Rechtsprechung, insbesondere an der Überprüfung des Ausgabepreises fest. Man kann sagen, daß das gegenwärtige japanische Übernahmerecht den Markt für Unternehmenskontrolle grundsätzlich fördert, da den Aktionären der von einer Übernahme bedrohten Gesellschaft die Entscheidungsbefugnis über den Kontrollwechsel eingeräumt wird, wobei sich ihre Entscheidung im Marktpreis der Aktie widerspiegelt.

(Übersetzung durch d. Red.)