

**D. “Guidelines Regarding Takeover Defense  
for the Purposes of Protection and Enhancement  
of Corporate Value and Shareholder’s Common Interests”**

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*Ministry of Economy, Trade and Industry*

*Ministry of Justice*

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## INTRODUCTION

The Ministry of Economy, Trade and Industry (METI) and the Ministry of Justice (MOJ) have formulated “Takeover Defense Guidelines for Protecting and Enhancing Corporate Value and the Interests of Shareholders as a Whole” (hereinafter referred to as the “Guidelines”) which set forth principles that must be satisfied for defensive measures adopted in anticipation of takeovers which are detrimental to corporate value and the interests of shareholders as a whole to be considered reasonable, with the goal of preventing excessive defensive measures, enhancing the reasonableness of takeover defense measures and thereby promoting the establishment of fair rules governing corporate takeovers in the business community.

The Guidelines set forth the meaning of terms used (I. Definitions), the background (II. Background), principles concerning takeover defense measures (III. Principles), their purposes (IV. Purposes) and specific examples (V. Specific Examples).

Since the environment surrounding corporate takeovers is expected to change dramatically, METI and MOJ intend to review the Guidelines on an ongoing basis.

## I. DEFINITIONS

The terms set forth in the following subparagraphs shall have the meanings prescribed in the respective subparagraphs.

1. Takeover: The acquisition and holding of shares of a corporation in a quantity sufficient to exert influence over the corporation
2. Takeover defense measures: Measures adopted by a joint-stock corporation prior to the making of an unsolicited takeover proposal, such as the issuance of shares or stock acquisition rights (*shinkabu yoyakuken*) for purposes other than fundraising, which are intended to make it difficult to accomplish a takeover that is not approved by the board of directors
3. Adoption: Approving specific takeover defense measures, such as a plan to issue new shares or stock acquisition rights as a takeover defense measure
4. Implementation: Implementing the takeover defense measures which have previously been adopted to make it difficult to accomplish a takeover
5. Termination: Canceling adopted defensive measures, for example, by redeeming the new shares or stock acquisition rights that were issued as a takeover defense measure
6. Corporate value: Attributes of a corporation, such as assets, earnings power, financial soundness, effectiveness, and growth potential, etc., that contribute to the interests of the shareholders
7. Shareholder interests: The interests of the shareholders as a whole

## II. BACKGROUND

The structure of the Japanese business community has been undergoing dramatic changes. With the continuing unwinding of cross-shareholdings, the idea that corporations belong to their shareholders is taking hold and corporate managements are paying greater attention to their shareholders. At the same time, people now have a more favorable image of M&A transactions and foreign capital. Against this background, the conventional wisdom, that a corporate acquisition is a friendly takeover agreed to by the management of both companies, no longer holds, creating an environment where hostile takeovers can take place.

However, here in Japan, unlike the United States and EU, there is no common code of conduct in the business community with regard to what constitutes a non-abusive takeover and what constitutes a reasonable defensive measure. This is partly because Japan has had less experience with hostile takeovers. Defensive measures against hostile takeovers, if they are used properly, can help enhance corporate value and the interests of shareholders as a whole. But at the same time, there is a risk that defensive measures, if they are improperly structured, may be used to entrench corporate management, preserving intact inefficient management. If left as is, this absence of rules could encourage repeated surprise attacks and excessive defensive tactics, making it difficult for takeovers to fully demonstrate their effectiveness as a mechanism to enhance corporate value.

The purpose of the Guidelines is to promote the establishment of fair rules concerning takeovers by proposing legitimate, reasonable takeover defense measures modeled after typical defensive measures that have been developed elsewhere, based on legal precedents, doctrines concerning takeover defense measures, as well as on the Corporate Value Report (May 27, 2005) of the Corporate Value Study Group (Chairperson: Professor Hideki Kanda, The University of Tokyo).

The Guidelines are not legally binding and should not be read to require that all legitimate takeover measures must conform to the Guidelines. But, if the Guidelines are shared and respected by interested parties including corporate managers, shareholders, investors, stock exchanges, lawyers, and financial advisors,<sup>Supplement 1\*</sup> they will facilitate a major change in the Japanese business community and lead to the enhancement of corporate value. More specifically, they will lead to the establishment of corporate management focused on the interests of shareholders, active use and independence of external board members, establishment of procedures to reasonably investigate takeover proposals, improved procedures governing shareholders meetings,<sup>Supplement 2</sup> increased use of voting guidelines by institutional investors, and consensus-building between corporate managers and investors about the long-term enhancement of corporate values.

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\* (Cf. *infra* at VI.2.; the editors).

The mission of the Guidelines is to change the business community from one without rules to one governed by fair rules applicable to all. To prepare for the upcoming era of M&A activity, we expect the Guidelines to become the code of conduct for the business community in Japan by being respected and, as the need arises, revised.

### III. PRINCIPLES

Takeover defense measures should conform to the following principles in order to protect and enhance corporate value and the interests of shareholders as a whole.

1. *Principle of protecting and enhancing corporate value and the interests of shareholders as a whole*

The adoption, implementation and termination of takeover defense measures should be undertaken with the goal of protecting and enhancing corporate values and, by extension, the interests of shareholders as a whole.<sup>Supplement 3</sup>

2. *Principle of prior disclosure and shareholders' will*

When takeover defense measures are adopted, their purpose and terms should be specifically disclosed and such measures should reflect the reasonable will of the shareholders.

3. *Principle of ensuring the necessity and reasonableness of defensive measures*

Takeover defense measures that are adopted in response to a possible takeover threat must be necessary and reasonable in relation to the threat posed.

#### IV. PURPOSES

##### 1. *Principle of protecting and enhancing corporate value and the interests of shareholders as a whole*

The adoption, implementation and termination of takeover defense measures should be undertaken with the goal of ensuring and enhancing corporate values and the interests of shareholders as a whole (hereinafter referred to as “shareholder interests”).(Note 1) (Note 2)

A joint-stock corporation aims to enhance its corporate value and ultimately shareholder interests by respecting its relationship with various stakeholders, such as its employees, suppliers and customers.

If an acquiring person becomes a majority shareholder and abuses its power by running the corporation for its own interests, it will impair the corporate value and damage shareholder interests. Moreover, depending on the manner of the takeover, shareholders may be coerced into selling, including at unfair prices not reflecting the real value of the corporation. This would harm the interests of the shareholders.

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(Note 1) The following can be cited as typical defensive measures to protect and enhance shareholder interests.

- (i) Takeover defense measures to prevent takeovers that would cause an apparent damage to shareholder interests through any of the acts listed in (a) through (d).<sup>Supplement 4</sup>
  - (a) Accumulating shares with the intent of requiring the corporation to buy them back at a higher price
  - (b) Temporarily taking control of the corporation and running the corporation in the interests of the acquirer at the expense of the corporation, such as acquiring the corporation’s important assets at low prices
  - (c) Pledging assets of the company as collateral for debts of the acquirer or its group companies or using the company’s funds to repay such debts
  - (d) Temporarily taking control of management of the company and selling valuable assets that are currently not related to the company’s businesses and declaring temporarily high dividends with profits from the disposition, or selling the shares at a higher price after the share price rose due to temporarily high dividends
- (ii) Defensive measures to prevent coercive, two-tiered takeovers (takeovers which coerce shareholders into accepting a higher priced front-end tender offer by setting unfavorable terms or not specifically indicating terms for the back end of the transaction, without offering to buy all shares at the front end).
- (iii) Defensive measures to ensure the time and negotiating power required for the target to
  - (i) obtain information from the acquirer in the case where it is difficult for shareholders to evaluate the takeover proposal, for example, where shareholders do not have sufficient information in order to decide whether to sell or keep their shares notwithstanding the fact that the takeover proposal would impair shareholder interests, or to
  - (ii) present a superior alternative to shareholders.

(Note 2) With regard to the first principle, if a competing, unsolicited proposal is received after the board has already agreed to a friendly takeover, the directors have a fiduciary duty to evaluate the competing proposal in good faith. It is not appropriate for a corporation to implement takeover defense measures that deprive shareholders of the opportunity to consider competing proposals unless there are reasonable grounds.

Therefore, it is legitimate and reasonable for a joint-stock corporation to adopt defensive measures designed to protect and enhance shareholder interests by preventing certain shareholders from acquiring a controlling stake in the corporation.

## 2. *Principle of prior disclosure and shareholders' will*

In order to ensure the legal validity and reasonableness of takeover defense measures, the purpose and terms of the defensive measure shall be disclosed in advance in specific terms to allow shareholders to make appropriate investment decisions (principle of prior disclosure) and shall reflect the reasonable will of the shareholders (principle of shareholders' will).

### (1) *Prior disclosure*

In order to enable shareholders, investors, acquirers and others to take into account the effect of defensive measures and to make appropriate investment decisions, when adopting takeover defense measures, companies should clearly disclose in detail the purpose, specific terms, and effects (both positive and negative, including impacts on the restriction or modification of voting rights and property rights) of the defensive measures.<sup>(Note 3)</sup>

### (2) *Principle of shareholders' will*

#### (i) Adoption of defensive measures upon receipt of approval at a general meeting of shareholders

As the ultimate decision making body, the shareholders, who are the real owners of a corporation, may use the general meeting of shareholders to adopt takeover defense measures involving amendments to the articles of incorporation or other methods for the purpose of protecting shareholder interests. Restricting the transfer of shares in the

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(Note 3) In order to enhance the legitimacy of takeover defense measures and promote acceptance by shareholders and market participants, it is extremely important for companies adopting defensive measures not only to comply with laws and regulations, such as Commercial Code and the Securities Exchange Law, and the minimum disclosure rules of stock exchanges but also to disclose takeover defense measures voluntarily by utilizing operating reports (*Eigyô Hôkoku-sho*) and financial reports (*Yûka Shôken Hokokusho*), etc.

When adopting defensive measures, companies should proactively notify shareholders, investors, employees and other stakeholders, addressing "what is this measure intended to defend against?" and "what defensive measures are being adopted in order to accomplish that objective?" Through investor relations activities, companies should discuss the factors contributing to corporate value and specific management strategies under consideration to enhance corporate value, such as increasing dividends and implementing effective business strategies. Most institutional investors are interested in the long-term enhancement of corporate value. When adopting defensive measures in advance of an unsolicited takeover proposal, companies should spare no effort to win the understanding and confidence of shareholders and investors about long-term management strategies.

articles of incorporation is the most obvious example. Issuance of new shares or stock acquisition rights to a third party under particularly favorable conditions would also be deemed legitimate if approved by a special resolution of a general meeting of shareholders. Moreover, with regard to matters whose impact on shareholders is less significant than those matters requiring a special resolution (which requires a super-majority vote under the law), the adoption of defensive measures by an ordinary resolution of a general meeting of shareholders is permitted as a legitimate exercise of self-governance by shareholders.

(ii) Adoption of defensive measures by a resolution of the board of directors

While it is not consistent with the division of corporate authority envisioned by the laws of Japan for directors, who are elected at a general meeting of shareholders, to change the composition of shareholders by adopting a takeover defense measure, since it is difficult to convene a general meeting of shareholders in a timely manner, it is not advisable to reject outright the adoption of defensive measures by the board of directors when such measures enhance shareholder interests.

Even in the case where a takeover defense measure has been adopted by a resolution of the board of directors, if there is a mechanism that allows the shareholders to terminate the defensive measure (and their failure to do so indicates passive approval), it does not run counter to the principle of shareholders' will.

3. *Principle of ensuring the necessity and reasonableness of defensive measures*

Takeover defense measures should be designed to protect and enhance shareholder interests. If defensive measures create inequality between shareholders, they could pose a serious threat to the principles of shareholder equality and protection of property rights. Moreover, there is a risk that defensive measures may be used not to enhance shareholder interests but to entrench corporate management.

In order to ensure the legitimacy and reasonableness of takeover defense measures, it is necessary to prevent these undesirable effects. Therefore, takeover defense measures should be adopted based on the principle of necessity and reasonableness by giving due consideration to the principles of shareholder equality,<sup>(Note 4)</sup> protection of property

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(Note 4) The principle of shareholder equality is a principle that shareholders should be given proportionate treatment and rights based on the numbers of shares held. Takeover defense measures that do not treat all shareholders equally can be introduced without running counter to the principle of shareholder equality by utilizing any of the following methods (i) through (iii) specified in the Commercial Code.

(i) Issuance of stock acquisition rights on the condition that those who are able to exercise the rights are shareholders not holding shares in excess of a specified percentage (shareholders other than the acquiring person)

Since the privilege of exercising stock acquisition rights is not included in the rights of shareholders, it does not run counter to the principle of shareholder equity to attach a condition that those who can exercise the right are shareholders other than the acquiring person.



rights,<sup>(Note 5)</sup> and prevention of the abuse of defensive measures for entrenchment purposes.<sup>(Note 6)</sup>

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- (ii) Issuance of new shares or stock acquisition rights to shareholders other than the acquiring person

Since shareholders of a public corporation do not have a right to subscribe for new shares or stock acquisition rights and the allocation of new shares or stock acquisition rights is not a matter over which shareholders have any say, it does not run counter to the principle of shareholder equality to allot new shares or stock acquisition rights only to shareholders other than the acquiring person.

- (iii) Issuance of different class of shares

Since issuing different classes of shares, such as shares with certain veto powers (Article 222, Paragraph 9 of the Commercial Code), to certain persons is an exception to the principle of shareholder equality expressly set forth in the Commercial Code, it is legitimate to issue such shares as long as it is done after going through the necessary procedures, such as amendment of the articles of incorporation.

- (Note 5) Property rights are constitutional rights and the Commercial Code gives due consideration to the protection of shareholders' property rights through the principle of the free transferability of stock, the designation system for the purchasers of stock with transfer limitations, and the system allowing shareholders to request the company to buy back their shareholdings. Therefore, when adopting a takeover defense measure that may be detrimental to the financial interests of specific shareholders, such as the acquiring person, the company is required to take the following appropriate steps.

- (i) Since issuing new shares or stock acquisition rights to persons other than shareholders under particularly favorable conditions significantly reduces the value of existing stock, it requires a special resolution by a general meeting of shareholders (Article 280-2 Paragraph 2, Article 280-21 Paragraph 1 of the Commercial Code).
- (ii) It is possible to issue to shareholders stock acquisition rights that can be exercised only by shareholders other than an acquiring person if approved by a resolution of the board of directors. However, if the terms of the stock acquisition rights are likely to cause excessive damage to the financial interests of the acquiring person, there is a risk that such issuance may be determined to be illegal under the provision of Article 280-21, Paragraph 1 of the Commercial Code. Therefore, it is necessary to adopt measures to enhance the legal validity of the stock acquisition rights (see V2 (1) below).

- (Note 6) When implementing takeover defense measures, the board of directors must reasonably determine that a threat to shareholder interests exists. In addition, the board of directors must reasonably ensure that the defensive measures implemented are reasonable in relation to the threat posed and not excessive to the threat posed. The reasonable decision-making process the board of directors must engage in exercising sound judgment requires a serious review to avoid any material and careless misunderstandings of the underlying facts and should include consultation with external experts such as lawyers and financial advisors. Careful deliberations are necessary to prevent the board from making arbitrary decisions and to enhance the fairness of takeover defense measures.

## V. SPECIFIC EXAMPLES: FOCUSING ON STANDARD FOR REASONABLENESS AND THE INTERPRETATION OF THE GROSSLY UNFAIR ISSUANCE STANDARD

There are a variety of takeover defense measures, and the most typical ones in use are stock acquisition rights and different classes of stock. It would be useful to establish criteria on the legality (see 1 (1) and 2 (1) below) and the reasonableness (see 1 (2) and 2 (2) below) of these types of takeover defense measures for the business community.

Some specific examples of takeover defenses which utilize stock acquisition rights and different classes of stock (hereafter called “stock acquisition rights, etc.”) are presented below, along with steps that should be taken to promote the acceptance of such measures by interested parties (such as stockholders and the market) while ensuring reasonableness and eliminating the risk of injunction,<sup>(Note 7)</sup> these steps are also in keeping with the three principles of the Guidelines.

### 1. *When stock acquisition rights, etc. are issued based on approval at a general meeting of stockholders*

#### *(1) Methods for avoiding an injunction on the issuance of stock acquisition rights, etc.*

Under the Commercial Code, the issuance of stock acquisition rights, etc., is, in principle, subject to a board resolution (Article 280-20, Paragraph 2, Article 280-2, Paragraph 1), and for joint stock companies, except where transfer of their shares is restricted, approval at a general meeting of stockholders on the issuance of stock acquisition rights, etc. is only required if:

- 1) The issuance is to someone other than a stockholder on especially favorable terms (Article 280-2, Paragraph 2, Article 280-21, Paragraph 1); or
- 2) The articles of incorporation specify that the issuance of stock acquisition rights, etc. requires approval at the general meeting of stockholders (Article 280-2, Paragraph 1, Article 280-20, Paragraph 2)

With respect to the use of different classes of stock, a prerequisite for the issuance of such stock is that the terms of such shares must be fully set out in the articles of incorporation (Article 222, Paragraph 2). When stock acquisition rights, etc. are issued as a takeover defense measure based on approval at the general meeting of stockholders, it is generally assumed that (i) shareholder interests will be protected and enhanced, (ii) the

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(Note 7) It is important to discuss the possibility of an injunction being granted with respect to the issuance of stock acquisition rights, etc. (Articles 280-10 and 280-39 of the Commercial Code) because: (i) practically, the legal introduction of takeover defense measures is of the utmost importance and (ii) while the issue of whether there have been violations of legal ordinances or the articles of incorporation which might give rise to an injunction is relatively straightforward, the question of whether such an issuance might constitute a grossly unfair method is far more difficult. Therefore, the presentation of objective and specific criteria which should eliminate the risk of injunction based on the three principles of the Guidelines is very important.

will of the shareholders has been followed, and (iii) the defensive measures will be used according to necessary and reasonable methods without a risk of abuse of power by the board of directors. Therefore, there is a high probability that such measures will be considered in compliance with the three principles of the Guidelines, and thus constitute a fair issuance.

*(2) Methods to ensure the reasonableness of takeover defense measures and promote the acceptance by shareholders, investors and other interested parties*

In order to promote the acceptance of shareholders, investors and other interested parties, it is also necessary to increase the reasonableness of takeover defense measures in accordance with the three principles indicated in the Guidelines.

Taking into account the principle of protection and enhancement of corporate value and shareholder interests, even if the issuance of stock acquisition rights, etc. as a takeover defense measure is approved at the general meeting of stockholders, in the event of a takeover bid that is in the shareholders' best interests, it is necessary to have a mechanism that makes it possible to remove the takeover defense measure, such as stock acquisition rights, etc. Accordingly, to improve reasonableness, shareholders should be able to terminate the stock acquisition rights, etc. by replacing the board at one general shareholders meeting.<sup>Supplement 5, 6</sup>

Taking into account the principle of prior disclosure and shareholders' will, reasonableness is increased by, for example, requiring the periodic approval of the stock acquisition rights, etc. at general shareholders meetings after the issuance.<sup>Supplement 7</sup>

Taking into account the principle of ensuring necessity and reasonableness, it is necessary to consider fair treatment of shareholders, especially since the introduction of different classes of stock, such as golden shares, may discriminate against shareholders other than the acquiring person. In particular, a publicly traded company should be cautious about issuing non-redeemable golden shares.

*2. When stock acquisition rights, etc. are issued based on a resolution of the board of directors*

*(1) Method for avoiding an injunction on the issuance of stock acquisition rights, etc.*

Any issuance of stock acquisition rights, etc., except in the instances mentioned in 1 (1) above, does not require approval of the general shareholders meeting.<sup>Supplement 8</sup>

Accordingly, in such cases, the issuance of stock acquisition rights based solely on a resolution of the board of directors is not a violation of law or articles of incorporation. However, there is a possibility that such issuance will be considered an issuance by a grossly unfair method and thus will be enjoined.

The question of whether the issuance of stock acquisition rights, etc. as a takeover defense is a grossly unfair method is ultimately for the courts to decide. Clarifying the details based on legislative intent and judicial precedents, however, would be helpful in

establishing the standards as to whether the method conforms to (i) the principle of protecting and enhancing corporate value and stockholder interests, (ii) the principle of prior disclosure and shareholders' will, and (iii) the principle of necessity and reasonableness.

1) Principle of protecting and enhancing corporate value and shareholder interests

If the issuance of stock acquisition rights, etc. is solely for the purpose of entrenching the board, it is likely that it will be regarded as a grossly unfair method. On the other hand, if the issuance is intended to protect or enhance shareholder interests (see Note 1), there is little risk that it will be considered a grossly unfair method, even if there is no business purpose, such as the procurement of capital.

2) Principle of prior disclosure and shareholders' will

The fairness of an issuance of stock acquisition rights is enhanced if (1) there is public disclosure of the purpose and specific terms prior to the issuance of the stock acquisition rights, etc., and (2) the issuance reflects the reasonable will of the shareholders

*(The purpose of the issuance of stock acquisition rights, etc. must be disclosed)*

The issuance of stock acquisition rights, etc. as a takeover defense measure will affect shareholders with respect to future changes in the control of the company. Since it is possible that the issuance will be judged to be a grossly unfair method, the company is required to provide the necessary information to shareholders so that they can decide whether to seek an injunction or act to cause the termination of the stock acquisition rights, etc. based on the general consensus of the shareholders after being informed of the purpose.

Accordingly, the fairness of the issuance of stock acquisition rights, etc. as a takeover defense can be increased by disclosing to shareholders that the main purpose of the rights is as a takeover defense method, along with disclosure of the potential disadvantages to the shareholders.

*(Must reflect the reasonable will of the shareholders)*

An issuance of stock acquisition rights, etc. cannot be considered to be based on the reasonable will of the shareholders if there is no mechanism whereby the shareholders can cause the termination of the stock acquisition rights, etc. (in which case their failure to do so would constitute passive approval). In such a case, it is likely that such issuance will be considered an unfair issuance and thus will be enjoined.<sup>Supplement 9</sup>

Accordingly, for stock acquisition rights to be used as a takeover defense, it is necessary to provide a mechanism to allow shareholders to cause the termination of such rights based on the general opinion of the shareholders.

### 3) Principle of necessity and reasonableness

The fairness of the issuance of stock acquisition rights, etc. can be enhanced by providing measures like those described below and using the necessary and appropriate methods to prevent a takeover.

*(Ensuring no discrimination among shareholders other than the acquiring person)*

Unfavorable treatment of shareholders other than the acquiring person or the failure to grant advantages to all shareholders other than the acquiring person in order to prevent a takeover is generally not reasonable. Therefore, unless there is a reasonable basis for the issuance, it is likely that stock acquisition rights, etc. will be considered to have been issued by a “grossly unfair method,” if their terms include a provision which allows discriminatory treatment among shareholders (other than the acquiring person),<sup>Supplement 10</sup> or if such rights have been issued on favorable terms only to certain shareholders (other than the acquiring person).<sup>(Note 8)</sup> <sup>(Note 9)</sup>

Accordingly, the fairness of the issue of new stock acquisition rights, etc. as a takeover defense can be enhanced by designing the measure so that there is no unreasonably unequal treatment of shareholders other than the acquiring person.

*(There should be no excessive financial loss to shareholders as a result of the issuance)*

Takeover defense measures will be implemented after a takeover is initiated. If they are implemented and the takeover is thereby prevented, the purpose is achieved. In the event of an issuance of stock acquisition rights, etc. in the absence of an actual takeover threat, if such issuance results in an excessive financial loss to shareholders at the time of the issuance,<sup>(Note 10)</sup> there is a high probability that the issuance will be considered as a grossly unfair method.

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(Note 8) In the case of stock acquisition rights, etc. being issued to a specified third party for the purpose of procuring capital or establishing a business tie-up, the prohibition on discrimination discussed above will not apply, since such issuance is not a takeover defense measure.

(Note 9) Unlike the stock acquisition rights, etc., the details of different classes of stock are defined in the articles of incorporation, and thus, shareholder approval is obtained for the differential treatment of the shareholders of the different classes of stock. Therefore, this is generally considered to be legal, even when the different classes of stock are only issued to specific shareholders.

(Note 10) This means, for example, a case where stock acquisition rights, etc. with the exercise conditioned on the initiation of a takeover are actually allocated to all shareholders before the start of a takeover, with a specific day prior to the start of the takeover as the record date for allocation (except where resolved or disclosed prior to the commencement of a takeover that stock acquisition rights will be allotted on condition that a takeover is commenced). In such cases, it is likely that all shareholders acquiring stock after the record date, including those who are not the acquiring person, will incur unexpected losses. In addition, the value of the stock owned by shareholders as of the record date may also drop significantly. If the stock acquisition rights are subject to transfer restrictions, it is also possible that the shareholders cannot recover the portion of their investments corresponding to such drop in value. In this way the takeover causes unforeseen losses for shareholders who are not acquiring persons.

Accordingly, the fairness of the issuance of stock acquisition rights, etc. as a takeover defense can be enhanced by designing the measure so that this type of excessive financial loss created for shareholders at the time of the issuance does not occur.

*(There should be measures to prevent the abuse of power by the board of directors)*

There are also cases in which it is necessary for the board of directors to be given the discretion to redeem or terminate the stock acquisition rights, etc. in order to enable them to negotiate with the acquiring person regarding the terms of the acquisition. Therefore, granting the board of directors this discretion cannot be considered to constitute a grossly unfair method.

However, if the structure of the stock acquisition rights, etc. issued as a takeover defense is such that such rights cannot be redeemed and the discretion granted to the board of directors is overbroad, allowing the board of directors to entrench themselves in office<sup>Supplement 9</sup> despite the fact that the takeover proposal is in the shareholders' best interests, it is possible that they will be considered to be grossly unfair methods.

Accordingly, the fairness of the issuance of stock acquisition rights, etc. as a takeover defense can be enhanced by providing a mechanism to prevent the abuse of power by the board of directors.

*(2) Methods to ensure the reasonableness of takeover defense measures and promote acceptance by shareholders, investors and other interested parties*

In order to promote acceptance by shareholders, investors and other interested parties, it is crucial to increase the reasonableness of takeover defense measures in accordance with the three principles presented in the Guidelines. In particular, in the case of a takeover bid that would protect and increase corporate value and shareholder interests, there should be a mechanism in place that enables the board of directors to act as promptly as possible to terminate defensive measures, without waiting for the judgment of the shareholders.

To achieve this, in order to prevent the abuse of discretion by the board of directors, there must be a mechanism whereby shareholders can express their own will regarding the takeover defense measures at the annual general meeting of stockholders,<sup>Supplement 5, 6</sup> defensive measures should include provisions establishing objective criteria for the conditions on which the defensive measures would be terminated by the board of directors, or, importance should be placed on the judgments of independent outsiders.

*(Establishment of objective criteria for transitions to takeover bids)*

Ensuring opportunities for an acquiring person to make a takeover bid (TOB) is an effective means of reflecting shareholder opinions by allowing them to respond to the TOB based on their own decisions.

Therefore, if the defensive measures are designed so that the stock acquisition rights, etc. are terminated<sup>(Note 11)</sup> in the event that the evaluation period and negotiation period for the TOB, details of the offer and related matters satisfy certain objective criteria, it will be easier to promote the acceptance of shareholders, investors and other interested parties.<sup>Supplement 11</sup>

In addition, if inside directors alone are allowed to decide whether to implement defensive measures without obtaining the consent of the independent outsiders, it is necessary to establish these objective criteria that preclude arbitrary judgments by inside directors. An example would be the automatic termination of stock acquisition rights, etc. in the event that the predetermined objective criteria, such as but not limited to, the provision of certain information, and the passage of specific evaluation and negotiation periods, are fulfilled.

*(Consideration of the judgments of independent outsiders)*

The decision on whether to eliminate stock acquisition rights, etc. as a takeover defense after a takeover bid has been initiated may require consideration of complicated business issues, but the decision also can be influenced by the entrenchment behavior of inside directors. Therefore, it is reasonable for an outsider who can understand the operations of the company to evaluate a takeover bid after being given access to confidential company information that is difficult for shareholders to obtain. If provisions are included that give weight to the judgments of independent outside directors and auditors (independent outsiders) who are capable of closely monitoring any entrenchment behavior of inside directors, this should be effective in creating confidence among shareholders that the decisions of the board of directors are fair.<sup>Supplement 12</sup> The greater the degree of independence that the company outsiders have from the company, the greater this effect.<sup>Supplement 13</sup>

Therefore, takeover defense measures require careful thought and planning to correlate the objective termination provisions with the independence and power of the independent outsiders.

In particular, if there are no objective termination criteria, in principle, some means is necessary to seriously consider the judgments of independent outsiders in order to eliminate arbitrary decisions by the board of directors.

## VI. COMMENTARY

### 1. *Diagram*

The appended diagram provides an overview of the concepts of the guidelines.

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(Note 11) In the event that stock acquisition rights, etc. have not yet been issued, this would mean stopping the issuance.

## Takeover Defense Guidelines for Protecting and Enhancing Corporate Value and the Interests of Shareholders as a Whole

- Concept of takeover defensive measures to be adopted before an unsolicited takeover proposal is made –

[The purpose of takeover defensive measures is to protect and enhance corporate value and the interests of shareholders as a whole]

### [Principle 1] Protecting and enhancing corporate value and the interests of shareholders as a whole

#### – Examples

- 1) Defensive measures against certain types of takeovers that are clearly detrimental to the interests of shareholders as a whole (Green mail, Bust-up acquisitions, etc.)
- 2) Defensive measures against coercive, two-tiered takeovers
- 3) Defensive measures to ensure that shareholders receive adequate information to make a decision on an informed basis, and to provide the target an opportunity to pursue alternatives

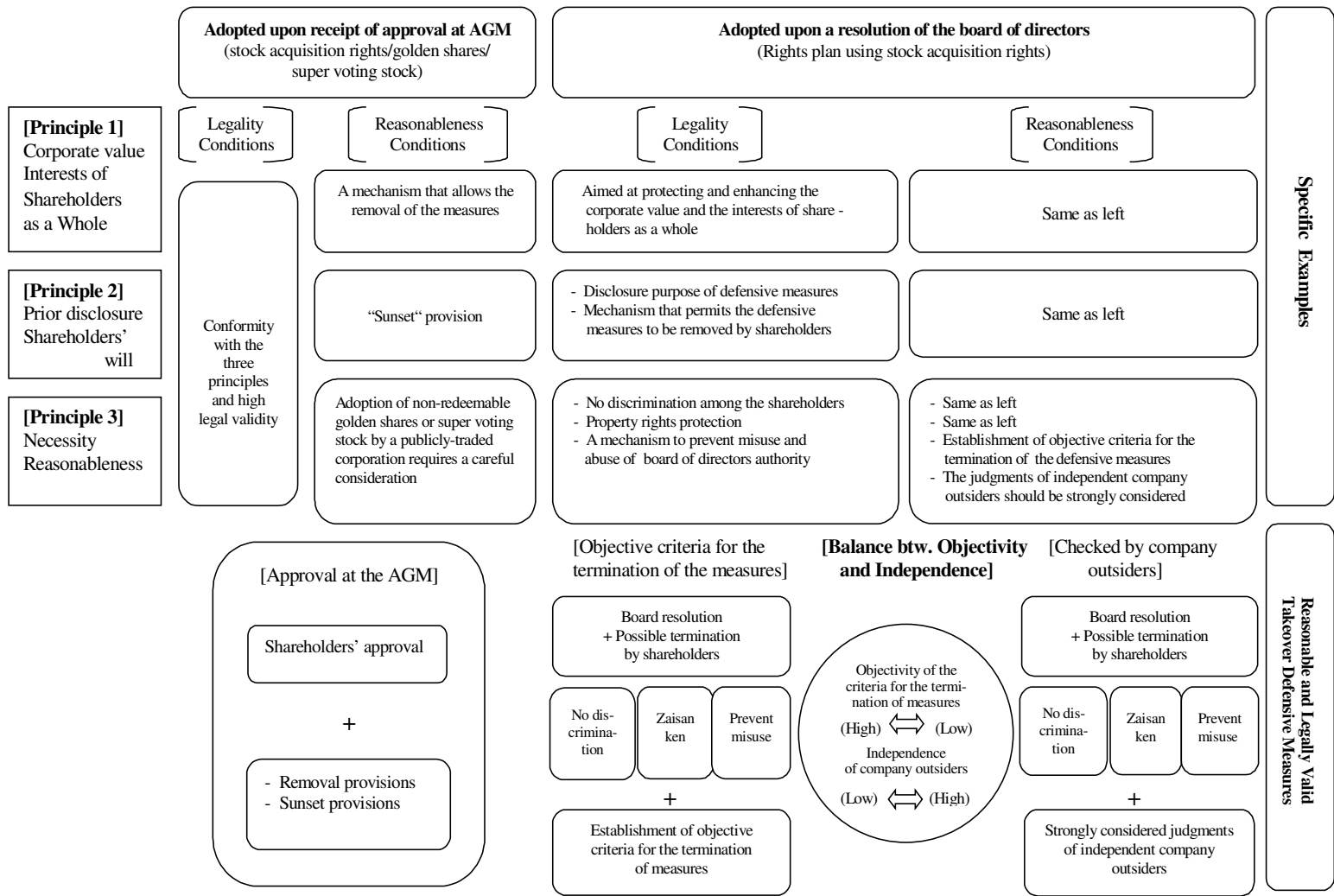
### [Principle 2] Prior disclosure and shareholders' will

- **Prior disclosure:** Details (purpose, details, effect, etc.) of defensive measures must be disclosed in advance so shareholders can make appropriate investment decisions
- **Shareholders' will:**
  - 1) Adopted upon receipt of approval at the general shareholders' meeting → Shareholders' will
  - 2) Adopted by a resolution of the board of directors → Must be a mechanism so the shareholders can remove such measures

### [Principle 3] Necessity and reasonableness

- **Shareholder equality principle** Even for defensive measures that discriminate against the acquiror, if the procedure is proper based on Commercial Law, it can be adopted
- **Property rights protection** Even for defensive measures that may cause financial losses to the acquiror, if the procedure is proper based on Commercial Law, it can be adopted
- **A mechanism to prevent misuse by management** When the board reasonably determines the existence of threat, there should be appropriate, non excessive implementation of defensive measures to counter that threat





## 2. *Supplemental Explanation*

(1) (Page 146) The Tokyo Stock Exchange has announced that it will develop listing standards and a disclosure system based on the Guidelines. The Pension Fund Association has published guidelines for exercising voting rights concerning takeover defense measures, which is based on the Summary Outline of Discussion Points released by the Corporate Value Study Group. Many Japanese corporations have stated that they will refer to the Guidelines in considering adopting takeover defense measures.

(2) (Page 146) With regard to general meetings of shareholders in Japan, institutional investors have pointed out the need to address problems of procedure and function, including the fact that shareholder meetings of most companies are held at the same time, the lack of adequate disclosure, and insufficient IR activities. If companies want to introduce reasonable defensive measures corresponding to their own situations, it will become necessary for them to make efforts to solve these problems related to general shareholder meetings.

(3) (Page 147) In the cases where directors exercise their authority granted in accordance with corporate law for a primary purpose other than maintaining and securing the control of the company (for instance, issuing shares to a third party for the purpose of raising funds, buying back shares as part of the legitimate capital policy, or taking actions as part of business activities that had been determined before a contest for control of the company arises), they are outside the scope of the principle of protecting shareholder interests, even if such actions result in changes to the ownership structure.

(4) (Page 148) The Tokyo High Court in its ruling on the Nippon Broadcasting System case on March 23, 2005 pointed out that the following four types of takeovers are “cases of exploiting a company”:

(i) The case where the acquirer accumulates the target shares for the purpose of making the concerned parties of the company buy back the shares at a higher price by driving up share prices, though there exists no true intention of participating in management of the company (the case of the so-called greenmailer);

(ii) The case where the acquirer accumulates the target shares for the purpose of an abusive acquisition, such as temporarily taking control of management of the company and transferring assets necessary for business operations of the target, such as intellectual property, know-how, confidential business information, and information as for major clients and customers, to the said acquirer or its group companies;

(iii) The case where the acquirer accumulates the target shares in order to pledge the target’s assets as collateral for debts of the acquirer or its group companies or as funds for repaying such debts, after taking control of the company; or

(iv) The case where the acquirer accumulates the target shares for the purpose of temporarily taking control of management of the company so as to dispose of high-value assets such as real estate and negotiable securities that are currently not related to

the company's businesses and pay temporarily high dividends out of proceeds from the disposition, or sell the shares at a higher price because share prices have risen rapidly due to temporarily high dividends

(5) (Page 153 and page 156) A proxy contest, i.e., a mechanism to allow shareholders to decide whether to terminate takeover defense measures through the exercise of voting rights in the election of directors will be used more efficiently if combined with a takeover bid (TOB). The acquirer tries to appeal to shareholders with the offer price, and with a new management team by means of the proxy contest. In addition, the additional expense needed for a proxy contest can be effectively limited if it is combined with a TOB. With regard to this point, it has been pointed out that it is difficult to conduct a TOB in parallel with a proxy battle at companies that have introduced takeover defense measures, since the conditions of withdrawal of TOBs are inflexible under TOB regulations in Japan.

(6) (Page 153 and page 156) An example of a scheme in which shareholders are able to terminate the defensive measures at one general shareholders meeting by replacing directors is a scheme in which the defensive measure is terminable by the board of directors and the term of office for directors is set at one year.

(7) (Page 153) This is the so-called sunset provision.

(8) (Page 153) For example, the board may, upon its resolution, issue and allot to all shareholders stock acquisition rights, etc. with discriminatory exercise conditions, for example, rights which are not exercisable by shareholders who own more than a certain percentage of the stock. The issuance may be conditioned in accordance with a board resolution.

(9) (Page 154 and page 156) A defensive measure would be considered unfair, if it (i) becomes non-terminable in the event that any of the directors in office at the time of adoption is replaced, (ii) is non-terminable if a majority of the directors in office at the time of adoption are replaced, or (iii) is non-terminable for a certain period of time after a majority of the directors are replaced. In contrast, for example, if stock acquisition rights have a redemption provision under which the term of the rights will be periodically extended with approval at shareholders' meetings or consent of a certain percentage of shareholders but will be redeemed if such approval or consent is not obtained, such rights will be viewed as more fair, since it shows that such defensive measure reflects shareholders' will.

(10) (Page 155) If there are shareholders who already own more than the specified percentage of stock, such as 20%, at the time that takeover defense measures are introduced, excluding such ownership from causing the defensive measure to be triggered does not constitute "differential treatment among shareholders other than the acquiring person".

(11) (Page 157) For example, this is a mechanism through which the board of directors will terminate defensive measures and move toward the TOB if the acquiring person presents definitive information on the acquisition offer, the time necessary for the board of directors to negotiate with the acquiring person and pursue alternatives is ensured, and shareholders are provided with adequate information. It is reasonable to specify the conditions according to the situation. For example, in the case of a cash offer for all shares, since this is not inherently coercive, it is reasonable to limit the negotiation period to between one and several months, after which the takeover defense measures are removed and a transition is made to the TOB. In the case of a proposed partial acquisition, or where securities are proposed to be used for the consideration, a longer negotiation period is reasonable. These kinds of objective termination criteria are superior in ensuring the path of TOB in all acquisitions, in principle. Unlike other takeover defense measures, these are sufficiently reasonable, even if it is only the inside directors who make the decisions about the takeover defense measures.

(12) (Page 157) In the case where termination provisions provide that the takeover defenses will not be terminated in the event of a partial offer, but will be terminated and a TOB will be commenced only in the event of all cash for all shares offer, an outsider's participation is presumably necessary, such as an analysis by outside experts (lawyers and financial advisors for example) on the appropriateness of the acquisition price and other terms, and consent of outside directors and outside auditors.

(13) (Page 157) "Independence" is a concept required in order for outside directors and outside auditors who review the takeover defense measures to be able to strictly check the entrenchment behavior of inside directors, and means substantial independence from the company. To be fair and proper as an "independent outsider" who is overseeing takeover defense measures demands that the actual situation be closely examined, and that acceptance of the shareholders be obtained depending on the details of the defensive measures. If there is a low percentage of independent outside directors and outside auditors, it is necessary to come up with ways to overcome this, such as making efforts to increase their numbers, organizing an corporate governance committee composed of independent outside directors and independent outside auditors, and the board of directors obtaining advice from such committee on the implementation of takeover defenses when the need arises.