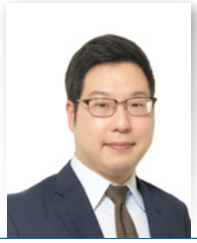
[To be published in two parts]

Overview of Guidelines for Corporate Takeovers: Enhancing Corporate Value and Securing Shareholders' Interests – Part I



Yuzo Ogata
yuzo.ogata@ohebashi.com

I. Introduction

On August 31, 2023, the Ministry of Economy, Trade and Industry formulated and announced the Guidelines for Corporate Takeovers (the "**Guidelines**").[1] The Guidelines clearly state that the economy of Japan is aiming to have a soundly functioning market in acquisitions involving the transfer of corporate control and welcomes active acquisitions that contribute both in enhancing corporate value and securing the interests of shareholders. The Guidelines also aim to meet the expectations of domestic and foreign stakeholders, including investors active in international markets. The purpose of the Guidelines is to present principles and best practices that should be shared in the economy to develop fair rules for acquisitions, with a focus on how parties should behave in the context of acquiring corporate control of a listed company. While the Guidelines are not legally binding, referring to and taking action based on the best practices presented therein would likely reduce the risk of directors breaching their duties of care and loyalty, and courts will likely respect the transaction terms agreed upon between the parties more.

This article has been divided into two parts. Part I discusses the scope, basic principles, and perspectives of the Guidelines as well as the code of conduct that directors and the board of directors must observe concerning acquisitions. Part II in the next newsletter will cover increased transparency of acquisitions and takeover response policies and countermeasures.

II. Scope of the Guidelines

The Guidelines primarily address transactions where the purchaser obtains corporate control of a listed company by acquiring its shares, regardless of whether the offer or bid is solicited or unsolicited. Concerning the structure of the acquisition, the Guidelines focus on cases where the shares of the target company are acquired through tender offers, open-market purchases, or negotiated transactions, in each case, for cash consideration. However, the Guidelines may also apply to cases where corporate control is acquired through stock for stock acquisitions or through organizational restructurings, such as mergers, share exchanges, and share deliveries.

1. Available at https://www.meti.go.jp/shingikai/economy/kosei_baishu/pdf/20230831_3.pdf.

III. Principles and Basic Perspectives

The Guidelines present the following three principles that should generally be respected in acquisitions of corporate control of listed companies:

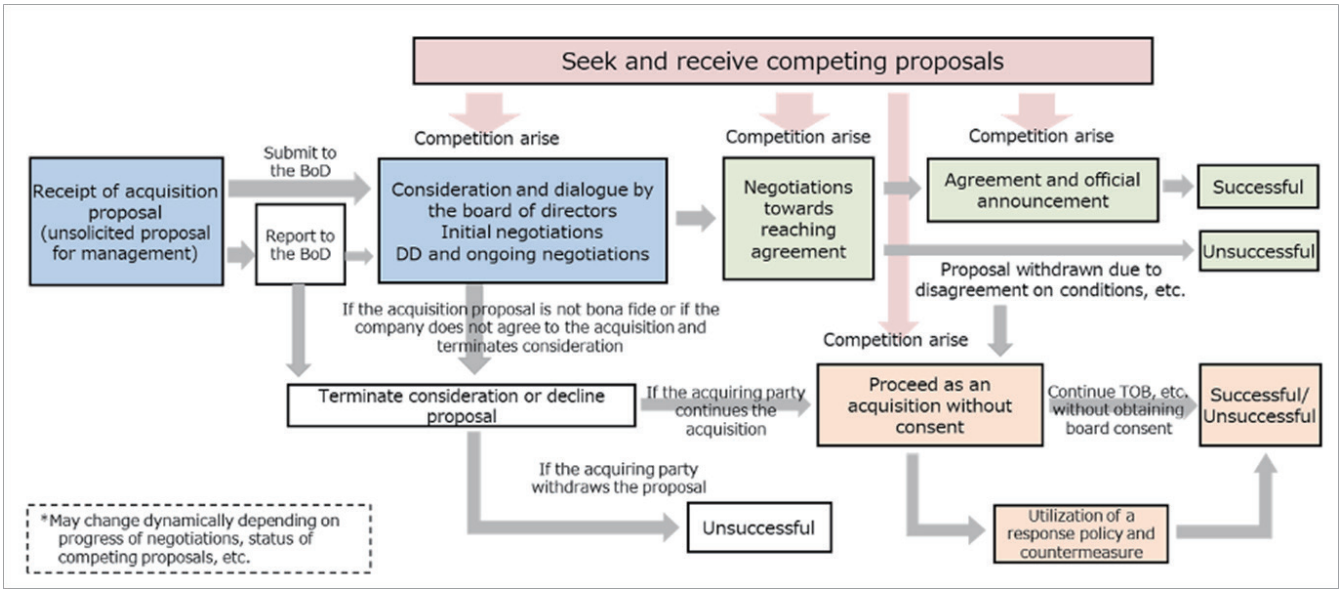
Principle 1: Principle of Corporate Value and Shareholders' Common Interests
Whether or not an acquisition is desirable should be determined on the basis of whether it will secure or enhance corporate value and the shareholders' common interests.
Principle 2: Principle of Shareholders' Intent
The rational intent of shareholders should be relied upon in matters involving the corporate control of the company.
Principle 3: Principle of Transparency
Information that is useful in the decision-making of the shareholders should be provided appropriately and proactively by the acquiring party and the target company. To this end, the acquiring party and the target company should ensure transparency in the acquisition through compliance with acquisition-related laws and regulations.

To facilitate desirable acquisitions that enhance corporate value and secure the shareholders' common interests, a code of conduct is required, and the parties and other participants involved in an acquisition must respect and abide by it. Although, in principle, the rational intent of the shareholders should be relied upon in matters involving the corporate control of a company, there are often information asymmetries between the acquiring party and the target company's board of directors on the one hand, and its shareholders on the other. Sufficient information must therefore be provided so that the shareholders can make a correct decision on the merits of the acquisition and the transaction terms (informed judgment).

IV. Code of Conduct for the Directors and Board of Directors on Acquisition Proposals

The Guidelines provide a phase-based approach to the code of conduct for each director and the board of directors for proposals that seek to acquire corporate control.

An example of the flow of issues to be considered in connection with an acquisition proposal is illustrated below:



Source: The Guidelines, p. 17.

1. Reporting upon Receipt of an Acquisition Proposal

In principle, upon receipt of an acquisition proposal to acquire corporate control, the management or directors should promptly submit or report this to the board of directors.

Whether or not an acquisition proposal should be submitted to the board of directors should be judged formally and objectively, and one of the important factors in determining this is whether the proposal is sufficiently specific, such as when the proposal is in written rather than in oral form, identifies the acquiring party rather than being anonymous, and includes the purchase price and timing of the acquisition.

The board of directors to which the matter is submitted shall in general give "sincere consideration" to a "bona fide offer" – an acquisition proposal that is specific, has a rationale purpose, and is feasible. The board of directors should consider the appropriateness of the acquisition from the perspective of whether the acquisition will contribute to enhancing the corporate value, with a focus on the post-acquisition management strategy; the appropriateness of the purchase price and other transaction terms; the acquiring party's financial resources, track record and management capabilities; and the feasibility of successful completion of the acquisition.

2. When the Board of Directors Decides on a Direction toward Reaching an Agreement on an Acquisition

What is important for shareholders in terms of differences in the acquisition ratio and acquisition consideration?

(a) In case of an all-cash, full acquisition: the appropriateness of the transaction terms in terms of the price;

(b) In case of a partial acquisition: information on post-acquisition measures to enhance corporate value; and

(c) In cases where all or part of the consideration for the acquisition is shares: information on the corporate value enhancement measures and the appropriateness of the consideration (information on shares to be used as consideration and whether the market valuation thereof is appropriate).

When the board of directors decides on a direction toward reaching an agreement on an acquisition, it should negotiate diligently with the acquiring party with the aim of improving the transaction terms so that the acquisition is conducted on the best available transaction terms for the shareholders.

3. Ensuring Fairness – Supplementary Functions of the Special Committee and Matters to be Noted

The necessity of establishing a special committee should be considered on a case-by-case basis, depending on the degree of conflict of interest, the need to supplement the independence of the board of directors, and the need to provide an explanation to the market. Particularly in companies where the majority of the board of directors is not composed of outside directors, establishing a special committee and respecting its judgment may be beneficial. For example, a special committee is useful in the following scenarios:

(a) When the appropriateness of the transaction terms is considered particularly important to the interest of the shareholders because the proposal includes a cash-out;

(b) When considering takeover response policies or countermeasures; and

(c) Other cases where accountability to the market is considered important (e.g., when there are multiple publicly known acquisition proposals).

The special committee should basically be composed of outside directors, given that outside directors: (a) have legal duties and responsibilities to the company, (b) are expected to be directly involved in management decisions as members of the board of directors, and (c) have a certain level of knowledge of the target company's business. In cases where the outside directors lack expertise in acquisitions, one approach is to retain advisors that will provide professional advice to the outside directors, as well as try to improve their familiarity with acquisitions.

V. Conclusion

The Guidelines present three principles and basic perspectives and state that, through the reasonable actions of acquirers, target companies and shareholders in acquisition transactions, and to generate value through synergy, improve management efficiency, and function as a discipline for the management team, it is necessary to adhere to a code of conduct. Under such framework, the code of conduct for directors and boards of directors for proposals to acquire corporate control outlined in the Guidelines responds to a recognition that legal precedent may not be entirely clear, and there may not necessarily be a sufficient shared understanding in practice about the actions to be taken. Nevertheless, the code of conduct is expected to be refined and clarified through future practice.

Overview of Guidelines for Corporate Takeovers: Enhancing Corporate Value and Securing Shareholders' Interests – Part II

Yuzo Ogata
yuzo.ogata@ohebashi.com

This article has been divided into two parts. Part I[1] covered the scope, basic principles and perspectives of the Guidelines for Corporate Takeovers (the "**Guidelines**")[2] as well as the code of conduct that directors and the board of directors must observe concerning acquisitions. This Part II discusses increased transparency of acquisitions and takeover response policies and countermeasures.

I. Greater Transparency of Acquisitions

1. Disclosure of Information and Provision of Time by the Acquiring Party

At each stage of its progress in acquiring the shares of a target company, the acquiring party is expected to comply with the large shareholding reporting rule, the tender offer rule, and other regulations to increase transparency. Based on such rules and regulations, it would be ideal for the acquiring party to provide shareholders not only sufficient information but also enough time to make an informed decision.

(a) Disclosure of Information at the Time of Acquisition

The acquiring party should aim to provide the capital markets and the target company with at least the same level of appropriate information as contained in the tender offer registration statement and in a timely manner and in an appropriate form. Such minimum information includes the purpose of the purchase, number of shares to be purchased, summary of the acquiring party, and basic management strategy after the acquisition.

(b) Disclosure of Intent to Acquire

If the party intending to make an acquisition is definite about its intention to make a subsequent tender offer, then prior to such tender offer, it would be ideal for it to provide information to the capital markets and the target company when it is moving ahead with its plan to purchase the target company's shares in the market.

(c) Information Disclosure of Advance Notice of Planned Tender Offer

When announcing an advance notice of a planned tender offer, the potential acquirer should aim to have a reasonable basis for actually commencing such tender offer, such as having the financial resources needed for the acquisition, and disclosing specific

1. Available at https://www.ohebashi.com/jp/newsletter/NL_en_2023winter_all.pdf.
2. Available at https://www.meti.go.jp/shingikai/economy/kosei_baishu/pdf/20230831_3.pdf.

information that can contribute to market understanding, such as the conditions for the launch of the tender offer and the scheduled commencement date thereof.

If an advance notice of a planned tender offer is announced, but such tender offer cannot be commenced within a reasonable period of time in light of market stability, then in principle, it is advisable to withdraw the notice.

(d) Information Provision and Disclosure of Substantial Shareholders

If the person making the acquisition proposal is a "substantial shareholder," then the target company must be provided with information regarding the fact that the acquirer is a substantial shareholder as well as its relationship with the nominee shareholder(s).

The acquirer should respond in good faith when asked by the target company about the extent to which there are any joint holders.

If a target company recognizes based on objective facts the possibility of an acquisition by a specific entity or person, and seeks to confirm certain facts to engage in a dialogue with that entity or person, then such entity or person should confirm certain facts such as whether it is a substantial shareholder as well as the existence of any joint holder relationships.

As to custodians who are nominee shareholders for such entities or persons, they should cooperate in confirming certain facts regarding the "substantial shareholders" for which they hold shares after confirming the intention of such entities or persons.

(e) Provision of Time for an Acquisition Proposal to be Considered

The acquiring party should ideally set a longer tender offer period than originally proposed or extend the period for a reasonable time, taking into account the needs of the target company and its shareholders.

2. Information Disclosure by the Target Company

An informed decision by the shareholders will be possible through substantial information disclosure by the target company.

(a) Disclosure at the Implementation Stage of an Acquisition

Ideally, the target company should voluntarily disclose in a full and complete manner information regarding the process of how the board of directors or the special committee considered the acquisition proposal and its involvement in the negotiation process with the acquiring party with respect to the transaction terms.

If any competing proposal is made, then the target company should disclose in the explanation of the reasons for supporting the offer that there was such other competing proposal, but that the target company decided that the offer being supported was more desirable together with the reasons for such decision.

(b) Disclosure of Information regarding Media Reports while Acquisition Proposal is Still Under Consideration

It should be noted that if media reports or rumors spread during the stage an acquisition proposal is being considered, then it may be necessary to disclose information regarding the accuracy of the information reported as well as other facts.

Careful consideration will be required in deciding whether to maintain strict information control, or instead disclose information about the acquisition proposal.

3. Preventing Acts that Distort Decision-Making by the Shareholders

It is important to ensure that shareholders are provided with the necessary information and are not prevented from making an informed decision. From

this perspective, the following actions by either the acquiring party or the target company are not advisable (and any action that would constitute a violation of any law or regulation should not be taken):

The Acquiring Party	The Target Company
Engaging in aggressive coercive acquisition techniques, such as a coercive two-step acquisition	N/A
Disclosing inaccurate information or misleading information to shareholders	Same
Notwithstanding an intention to make an acquisition proposal, to conceal such intent and advance in making share purchases	N/A
Announcing an advance notice of a planned tender offer without a reasonable basis for actually commencing the tender offer, such as lacking the financial resources required for the acquisition	N/A
Leveraging its superior position, such as approaching its business partners who are also shareholders of the target company	Same
Providing money or goods in soliciting votes and proxies	Same

II. Takeover Response Policies and Countermeasures

Regarding takeover response policies, establishing and disclosing the rules before a specific acquiring party appears (i.e., the normal phase) would enhance predictability among the stakeholders, such as acquirers and shareholders. However, there are circumstances where the assessment of the response policy differs between the company adopting it and institutional investors, and it is practically difficult to utilize it without obtaining the understanding and consent of the shareholders and institutional investors.

On the other hand, during an emergent phase, case-specific decisions may be suitable. Adopting a response policy after an acquiring party emerges (i.e., the emergent phase) is an option, though less predictable. In any event, reliance on the rational intent of the shareholders is crucial.[3]

1. Respecting the Intent of the Shareholders

Invoking a countermeasure based on a response policy should be based on the rational intent of the shareholders since it concerns corporate control of the target company. The legitimacy of invoking a countermeasure will be much more likely to be acknowledged if approval at a shareholders' meeting is obtained at the stage of either adopting the response policy or of invoking the countermeasure based on such response policy.

It must be noted that invoking a countermeasure based on a resolution passed at a shareholders' meeting which excluded the voting rights of the acquiring party, the target company's directors and their related parties from being counted must not be abused and may only be permitted in very exceptional and limited cases, taking into consideration the special circumstances of the case concerning the mode of acquisition, among other factors (such as coercion arising from the acquisition method, legality, and period for confirmation of the shareholders' intentions).

Invoking a countermeasure based on the judgment of the board of directors can be permitted only when the need for such action is high under specific circumstances, such as an acquisition by criminal elements or one where there is a high probability that the acquiring party will gain an unfair advantage at the expense of the target company and its general shareholders. In addition, it should be taken into account that there is an increased risk that such

3. For the details of each factor, please refer to "Appendix 3: Takeover Response Policies and Countermeasures (Particulars)" of the Guidelines.

invocation of a countermeasure will be enjoined by a court if a resolution approving the same has not been passed at the shareholders' meeting.

2. Ensuring Necessity and Proportionality

The invocation of a countermeasure based on the response policy should be carried out in a manner that is based on necessity and proportionality, taking into consideration, among other factors, the principle of shareholder equality, protection of property rights, and prevention of abuse by management to protect its own interests.

3. Prior Disclosure

By adopting and disclosing the response policy during the normal phase, predictability can be enhanced among the acquiring parties, shareholders and other stakeholders anticipating the possibility of a countermeasure being utilized in the event of an acquisition of more than a certain number of shares. In addition, just because it is predictable that a countermeasure may be used, it does not necessarily mean that there is a possibility of avoiding the invocation of such countermeasure, and thus, it is considered important to have a high degree of predictability as to "in what circumstances the countermeasure will be used."

4. Communication with the Capital Market

If a target company is considering adopting a response policy, it must first make reasonable efforts to enhance corporate value during the normal phase, and then take steps to ensure that such increase in its corporate value is reflected in its market capitalization.

If the target company believes that the adoption of a response policy is necessary as part of its management strategy, then it should communicate and disclose information in detail regarding its reasons for adopting such response policy, ensure fairness by enhancing the independence of the composition of its board of directors (for example, by increasing the ratio of outside directors to at least majority of the members of the board), and respect, to the maximum extent possible, the judgment of a special committee consisting mainly of outside directors.

Below are examples of possible features that would make it somewhat easier to gain the understanding of institutional investors when engaging in dialogue and information disclosure activities with them:

(a) Design the response policy to always require a resolution passed at a shareholders' meeting when a countermeasure is being invoked;

(b) Design the response policy so that the requirements to trigger an invocation of a countermeasure are strict; and

(c) Design the response policy as a temporary measure to be used under special circumstances.

III. Concluding Remarks

As mentioned in the introduction of Part I, the Guidelines clearly state that the economy of Japan is aiming to have a soundly functioning market in acquisitions involving the transfer of corporate control and welcomes active acquisitions that contribute both in enhancing corporate value and securing the interests of shareholders.

While the Guidelines are not legally binding, they outline the principles and best practices, and serve as a code of conduct for target companies, acquiring parties, directors, shareholders, investors, advisors, and other relevant parties at each stage of an acquisition in which an acquiring party wishes to acquire corporate control of a listed company by acquiring its shares. Therefore, it is anticipated that the Guidelines will have a significant impact on the practice of M&A in Japan.