

Designing a New Framework to Regulate Hostile Takeovers in Japan

Implications of the Australian Takeovers Panel

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Time to Reconsider Hostile Takeover Regulation in Japan (1): Background

- Japan does not fit easily into the existing theoretical “US vs. UK” framework. Japan’s system of regulation remains fragmented and undeveloped
- Improvements in corporate governance may provide stronger institutional “players” who can assume larger roles
- New urgency for reform:
- (1) new hostile M&A cases and METI guidelines highlight both increasing activity and uncertainty in dispute resolution, and
- (2) there is a need to continue corporate governance and other reforms to create efficient capital markets and attract global investors

Time to Reconsider Hostile Takeover Regulation in Japan (2): Research Goals

- (1) Make a theoretical contribution to the framework for takeover regulation by adding Australia as a new point of reference (“in-between” the US and the UK),
 - (2) Apply this revised framework to Japan to highlight weaknesses and institutional players who might assume greater roles, and
 - (3) Evaluate the potential for adaptation of an Australian-style, limited takeover panel into the Japanese system.
- What models should Japan consider while pursuing reform?

Revision of Simplified Regulatory Frameworks for Hostile Takeovers (adding Australia)

Country	Bid Decision-maker	Main “Subordinate Lawmaker” (rules and adjudication)	Comments
UK	Shareholders	Takeover panel	Strong influence of Institutional Investors
US	Board of directors (IDs)	State courts (Delaware)	No strong I.I.; rise of IDs; tradition of state court decisions in corporate cases (Delaware)
Japan	Mixture of shareholders and board? Moving toward shareholders?	Mixture of courts, government agencies (METI), and TSE?	No strong I.I., no strong IDs, and no tradition of court decisions in corporate cases
Australia	Shareholders	Legislature makes rules; takeover panel adjudicates	Separates “Subordinate Lawmaker” and has a limited panel; “UK-lite?”

Sources: Compiled from Armour, Jacobs and Milhaupt (2011) and Armson (2018)

Why Study Australia's Takeovers Panel?

1. Takeover Market—After the US and UK, Australia arguably has the only other active takeover market
2. The Australian panel has a limited role and may be a good model for Japan—less authority, independence, budget, staff, and cases than the UK panel
3. Australia has no dominant subordinate lawmaker, as different institutional players act as the rule-maker (the legislature) and adjudicator (the takeovers panel) in hostile takeover bids
4. The Australian panel is also judged to function effectively and be a “success”

Australian Regulatory Framework

Features: Function of Subordinate lawmaker is divided;
General principles are applied by a specialized takeover panel

(1): Rule-maker is Legislature through Corporations Act 2001 - §602 (general purposes re takeover bids) and other policies

(2): Bid Decision-maker is Shareholders (through voting)

Like the UK, the board of directors must maintain neutrality and cannot adopt takeover defenses; its role is to make recommendation to shareholders

(3): Adjudicator is Takeovers Panel through limited power to sanction violations of general purposes in §602 (declaration of unacceptable circumstances) and issue related orders

Our Framework: Reconsidering the Institutional Roles (Players) Needed for a Regulatory System

All legal systems for hostile takeovers have three main roles:

1. **“Rule-maker”** who decides the legal principles/rules for making decisions on takeover bids and defenses
2. **“Bid Decision-maker”** who makes the initial decision about the value of a hostile M&A bid and decides on whether to support or oppose it, and
3. **“Umpire”** (adjudicator) who can review this decision (or problems in the process of making the decision) from a broader social perspective

Japan's Regulatory Framework in the 2000s

- No strong institutional players (institutional investors, independent directors, courts, etc.)
- Combination of courts using “primary purpose” rule and METI 2005 Guidelines.
- Who is the Bid-decision-maker? “Shareholders’ will” under METI 2005 Guidelines. Courts tended to prohibit defensive measures without shareholder approval (Livedoor case) and permit those with shareholder approval (Bulldog Sauce case). But rules are vague.
- Bulldog Sauce case permits greenmail and leads to impression that hostile takeovers (at least by foreigners) are not welcome

General Changes in Japan (1)

2000s—Hostility to Hostile Takeovers

- Mistrust of “corporate raiders” and “vulture funds”
- Japanese view that corporations are “people” and not “assets”—“lifetime employment”
- Media and the public generally support management
- Activists not welcome and can go to jail (Murakami, Horie)
- Cross-ownership of shares and stable shareholders
- Institutional investors are passive and support management
- No independent directors (“IDs”) to protect shareholder interests

General Changes in Japan (2)

Reform and Potential New Players

- Greater acceptance that activism/hostile takeovers can create value
- “Lifetime employment” has weakened
- Shareholder activism has increased and so has investment in Japan
- Improvement in corporate governance and disclosure (Codes)
- Cross-ownership has declined (and foreign ownership increased)
- The number of IDs increased (and board size shrunk)
- Institutional investors are more active and independent
- Companies are abolishing takeover defenses
- New hostile bids and court cases (domestic parties only)

Recent Changes in Hostile Takeovers (1)

New Court Decisions

New takeover cases since 2021 focused on whether takeover defenses are permissible and if shareholder approval is required

- Defenses adopted by the board without shareholder approval have been carefully scrutinized and denied (Nihon Asia Group Case)
- Defenses adopted with approval by a majority of shareholders have been upheld (Nippon Sangyo Case and Fuji Kosan case)
- Defenses adopted with approval by a “majority-of-minority” shareholders were also upheld (Tokyo Kikai case)
- But a defensive measure approved by a majority of shareholders may be deemed unfair if it is disproportionate to the threat (Mitsuboshi case)

Since courts have ruled only on issues related directly to the particular disputes, directors’ overall duties in hostile bid situations remain unclear

Recent Changes in Hostile Takeovers (2)

Revised METI Takeover Guidelines (2023), etc.

Purpose of 2023 Guidelines: “to develop sound principles,...[and] a fair M&A market, **thereby encouraging and promoting desirable acquisitions**”

Specific Changes

- I. Not legally binding, but should be “shared among participants of the Japanese economy”
 - II. “Corporate value” defined quantitatively to favor shareholders (as suggested in the 2008 guidelines)
 - III. Pivot away from pre-bid “warning” defenses to post-bid defenses
 - IV. Tightening acceptable circumstances for defense measures (transparency)
 - V. Further emphasis on intent of shareholders
- The TSE sent a request to listed companies to improve capital efficiency and share price (March 31, 2023)
 - The FSA also reviewed regulations on large share purchases and tender offers, but proposed only minor gap-filling changes for now (Dec. 2023)

Applying the Revised Framework to Japan: Considering New Institutional Roles

- All players may have strengthened their capabilities since the 2000s
- Increasing importance of institutional investors and shareholder activists may be the biggest change in Japanese corporate governance
- Relatively speaking, shareholders have strengthened more than independent directors/courts
- New shareholders' strength due to increasing ownership by trust banks and foreigners, proxy voting, rise of activists, etc.
- More independent directors, but role is uncertain and their judgment is not respected by institutional investors and courts.
- Courts have not increased their capabilities

Example of A New Takeover Regime for Japan

1. **Rule-maker:** General principles or METI guidelines

Either 1. A broad purpose clause in corporate law, but legislation is always difficult to enact. Broad purpose clause in a soft law code (no legal force)?

Or 2. METI guidelines, if they are seen as being neutral and reasonable (no legal force).

2. **Bid Decision-maker:** shareholders (but some role for board)

Either 1. The board must be neutral and cannot take defensive measures, but must analyze any bid and make a recommendation to shareholders,

Or 2. Board may propose defensive measures to shareholders for approval

3. **Umpire:** Australian-style takeovers panel

Any administrative agency would likely not be seen as sufficiently neutral. Courts are neutral, but they lack expertise and are inconsistent. An Australian-style panel could be a significant improvement.

Major Obstacles to Adapting an Australian-style Takeover Panel in Japan

Although not an issue in the UK or Australia, in Japan:

1. Where are the “neutral experts” who could serve on the panel?
 - Will lawyers, investment bankers who are active in M&A be seen as neutral? Who would nominate panel members and through what process?
 - Can a panel practice be developed that is based on commercial norms and does not involve lawyers?
 2. What would be the relationship between the new panel and courts?
 - In the UK and Australia, courts themselves have decided to generally defer to panel decisions. This may not be the case in Japan (JFTC cases, etc.)
 - Can courts be “forced” to defer? Persuaded to defer?
- ❖ Would a “voluntary panel” be worth considering as an initial measure?

Conclusion

- Japan's regulatory system for hostile takeovers remains incomplete
- There is a new urgency due to recent court cases, guidelines and the necessity of further corporate governance reforms to attract foreign investors
- The roles of I.I.s, IDs and courts have all increased, but still no dominant "subordinate lawmaker," but shareholders have strengthened more than IDs and courts
- An Australian-style, limited takeover panel is a promising approach to achieve credibility in Japan's regulation of takeovers through a neutral, expert, independent, and predictable Umpire