

**What is Converging?**  
**Rules on Hostile Takeovers in Japan and the Convergence Debate**

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I. INTRODUCTION

The wave of hostile takeovers is spreading into countries where a hostile bid has been believed to be taboo.<sup>1</sup> In Japan, the hostile attempt by an emerging information technology company to take over a media corporation created headlines in 2005.<sup>2</sup> In the same year, two ministries jointly released an official guideline on takeovers and defensive tactics.<sup>3</sup> Based on these events, it seems as if Japan is embracing a market of corporate control.

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<sup>1</sup> See Ronald J. Gilson, *The Poison Pill in Japan: The Missing Infrastructure*, 2004 COLUM. BUS. L. REV. 21, 25 (2004) (discussing situations in France and Germany).

<sup>2</sup> Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. BUS. L. REV. 2171, 2178 (2005).

<sup>3</sup> See *infra* notes 22, 23 and accompanying text.

Does Japan's change toward corporate control favor proponents of the convergence theory? The answer depends on how converging is defined. Japan's market for corporate control appears to be converging towards the situation in the United States or the United Kingdom. The legal systems of the United States and the United Kingdom treat public company takeovers differently. On one hand, the United Kingdom strictly regulates the acquisition of large blocks of shares in a listed company. Incumbent managers of the target company are prohibited from taking countermeasures, thereby frustrating efforts to protect against takeover bids. On the other hand, the United States regulates the acquisition of large blocks of shares in a listed company far less and incumbent managers of the target company can use poison pills and other such defensive tactics to a greater extent in the United States.<sup>4</sup> Are Japan's regulations on mergers and acquisitions moving toward the American or the British system, or are Japan's regulations heading in a different direction?

This essay is organized as follows. In section II I briefly argue for a two-dimensional analysis, focusing on legal systems and policies in the convergence debate. In section III I address the particular legal systems, providing an overview of the recent changes in Japanese takeover rules and comparing them with those in the United States and United Kingdom. In section IV I explore the policy aspect, tracing the recent public backlash on takeovers and demonstrating how Japanese companies have modified the poison pill tactics used in America. In section V I conclude by suggesting that the use of bargaining between corporate managers and institutional investors plays an essential role in the transformation of mergers and acquisitions rules and practices in Japan. As a whole, I attempt to show how a naïve debate on convergence sometimes seen in the United States overlooks many aspects of law's evolution.

## II. SOME CRITICAL COMMENTS ON THE CONVERGENCE DEBATE

### A. *Convergence at Various Levels.*

Professor Ronald J. Gilson distinguishes between "formal convergence" and "functional convergence."<sup>5</sup> This dichotomy is too simplistic. There are actually many tiers to convergence.<sup>6</sup>

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<sup>4</sup> See *infra* t.2.

<sup>5</sup> Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 332 (2001) (suggesting that functional convergence, when existing governance institutions are flexible enough to respond to the demands of changed circumstances without altering the institutions' formal characteristics; formal convergence, when an effective response requires legislative action to alter the basic structure of existing governance institutions).

TABLE 1: What is Convergence?

functional convergence
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1) Fundamental policy: Shareholder supremacy versus stakeholder approach Efficiency versus public good 2) Convergence of corporate practice: Separation of the chairman and CEO etc. (Non-)existence of hostile takeovers 3) Institutional convergence: One-tier board versus two-tier board Independent director versus company auditor <sup>7</sup> 4) Statutory convergence: Soft laws: regulation by self-regulatory organizations (Non-)existence of derivative suits/shareholder class actions
↓
formal convergence

Professors Henry Hansmann and Reinier Kraakman argue that corporate law around the world will converge towards the idea that the law should maximize the long-term interests of shareholders.<sup>8</sup> This argument relates to the first tier in Table 1 above. On the other hand, “law and finance literature” posited by Professor La Porta and others<sup>9</sup> argues that Anglo-American law is superior to other models of law, such as the German and French models, in the way it protects the interests of

<sup>6</sup> See *infra* t.1.

<sup>7</sup> Company auditors audit the execution of duties by directors and are elected at a shareholders meeting. A company auditor may not act concurrently as a director and employee of the company or its subsidiary. Although the company auditor system is an unusual system rarely seen in the West, it has been in existence in Japan for over a century, from the time of enactment of the old Commercial Code. Company auditors differ from accounting advisors or accounting auditors in that no special qualifications are required. The audits performed by company auditors are broadly divided into business audits and accounting audits. Kaisha Hō [Company Act], Law No. 86 of 2005, arts. 329(1), 381(1), 335(2); see JAPAN CORPORATE AUDITORS ASS’N, THE CORPORATE AUDITOR SYSTEM, [http://www.kansa.or.jp/english/about\\_00.html](http://www.kansa.or.jp/english/about_00.html) (last visited on Oct. 7, 2007) (detailing the Corporate Auditor System).

<sup>8</sup> See Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 468 (2001) (predicting that as equity markets evolve in the developed world, the ideological and competitive attractions of the shareholder primacy model will become indisputable).

<sup>9</sup> Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1151-52 (1998).

corporate shareholders and creditors. This argument has had a huge global impact. Many countries have adopted institutions and ideas on corporate law and securities regulation. The law and finance literature relates to the fourth tier in the same table.

When discussing convergence of corporate governance around the world, it is important to avoid confusing which levels we are talking about. Also, it is critical to analyze two or more levels at the same time when measuring the extent of convergence in a particular case. I discuss this multi-dimensional analysis further in Section II.D.

*B. Process of Transplanting Laws.*

There are several points to keep in mind when analyzing convergence. The first point is that the process of transplanting laws is not a natural phenomenon. Rather, it is an intentional attempt by national decision makers to selectively and strategically transplant foreign laws or systems. Sometimes decision makers transplant foreign institutions without sufficient knowledge of local rules and customs, or without due care of the locality.<sup>10</sup>

*C. The Vague Line Between Corporate Law and Securities Regulation.*

Another point to consider when analyzing convergence is that each issue must be defined adequately and narrowly. The distinction between corporate law and securities regulation is often unclear and arbitrary.

Professor Bernard Black attempted to identify whether corporate law or securities regulation are converging.<sup>11</sup> Based partly on the observation of the Russian economy's privatization, Black's argument has become a global influence. Black's argument presupposes that we are able to distinguish corporate law and securities regulation clearly. However, the spectra of corporate law and securities regulation, and the boundaries separating them differ from country to country. For instance, corporate law and securities regulation in the United Kingdom and Australia are promulgated in a single statute. In Japan, the essential components of securities regulation include investment banks, financial instruments distributors, disclosure requirements, and unfair trading. It does not appear that Black includes regulations on banks or distributors regulations when he refers to securities regulation.

Another example of regional differences is in the way audit committees are regulated. The terms of the New York Stock Exchange

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<sup>10</sup> Milhaupt, *supra* note 2, at 2213.

<sup>11</sup> Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 *UCLA L. REV.* 781, 785, 845 (2001).

(NYSE), the National Association of Securities Dealers Automated Quotations (NASDAQ) listing agreements, and the Sarbanes-Oxley Act regulate audit committees in the United States. In contrast, Japanese audit committees are regulated by the Company Act.

Consider other examples of regional differences in corporate law and securities regulation. In Japan, large corporations must provide and maintain internal control systems prescribed by the Company Act and the Securities and Exchange Act.<sup>12</sup> Finally, the law governing the relationship between an issuer of corporate bonds and its bondholders varies across different countries. In the United States, this relationship is dealt with by the Trust Indentures Act of 1939, a special statute in securities regulation. In Germany, this matter is also controlled by a special statute in the realm of contract law.<sup>13</sup> In Japan, the issue is governed by the Company Act. These examples demonstrate that distinctions between corporate law and securities regulation are not universal and may be misleading.

#### *D. The Need for Multi-Dimensional Analysis.*

A multi-dimensional analysis is essential for a comparative study of laws. Such an analysis involves both policies and legal systems. Various countries' similarities or differences in policies should be distinguished from the legal systems (regulatory strategies) in these countries. However, the analytical points of policy issues and legal framework should be combined in order to avoid misleading statements.

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<sup>12</sup> The Company Act stipulates that:

Board of directors may not delegate the decision on the execution of important operations such as the following matters to directors: (vi) The development of systems necessary to ensure that the execution of duties by directors complies with laws and regulations and the articles of incorporation, and other systems prescribed by the applicable Ordinance of the Ministry of Justice as systems necessary to ensure the properness of operations of a Stock Company [.]

Kaisha Hō art. 362(4).

Section 24-4-4 of the Financial Instruments and Exchange Act obligates each listed company to submit a certificate in each fiscal year that evaluates the accuracy of the financial information included in the financial reporting statements the company issues. See FINANCIAL SERVICES AGENCY OF JAPAN, NEW LEGISLATIVE FRAMEWORK FOR INVESTOR PROTECTION: FINANCIAL INSTRUMENTS AND EXCHANGE LAW (June 2006), <http://www.fsa.go.jp/en/policy/fiel/20060621.pdf/>. The Japanese Securities and Exchange Act is comparable to the United States Securities Act of 1933 and the Securities and Exchange Act of 1934. In 2007, the Securities and Exchange Act was thoroughly revised, then renamed the Financial Instruments and Exchange Act.

<sup>13</sup> Gesetz betreffend die gemeinsamen Rechte der Besitzer von Schuldverschreibungen [Act Regarding the Collective Rights of the Debenture Holders], available at <http://bundesrecht.juris.de/schverschrg/BJNR006910899.html>.

To understand this further, let us assume for a moment that shareholders' derivative suits in Japan function well in policing illegal or improper behaviors of corporate managers, but those in the United States do not. In addition, assume that while securities litigation in the United States play a similar policing effect on corporate managers, there is no securities litigation in Japan because of the lack of class action system.<sup>14</sup> If this is the case, is Japan's director liability rule converging with that in the United States or not?<sup>15</sup> Yes, if you set wide parameters by including both substantive and procedural rules, as well as corporate law and securities regulation. However, if you limit the scope of the parameters, the answer may be no.

Accordingly, in order to conduct a comparative legal analysis properly, we need to consider the above-mentioned cases, which will help to avoid misunderstandings as well as acquire greater insight into the relationship between policies and regulatory strategies.

### III. THE DEVELOPMENT OF A LEGAL FRAMEWORK: WANDERING BETWEEN THE UNITED STATES AND THE UNITED KINGDOM

In this section, I focus on the legal framework of our comparative study. More precisely, I present a brief history of Japanese corporate law and securities regulation that govern hostile takeover issues<sup>16</sup> and compare

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<sup>14</sup> Although this hypothesis is an oversimplification, it appears to be partially true. Class action litigation were introduced to Japan in the spring of 2007, but are limited to plaintiffs who represent accredited consumer organizations. At present, class actions can be used only for injunctive relief, and thus, cannot necessarily be employed in exactly the same way they are for securities litigation in the United States. In shareholders' derivative suits, courts in Japan often mention the business judgment rule. However, they tend to review the reasonableness of the business judgment at issue even if there is no conflict of interests between the defendant director and the corporation. Cf. Bruce E. Aronson, *Reconsidering the Importance of Law in Japanese Corporate Governance: Evidence from the Daiwa Bank Shareholder Derivative Case*, 36 CORNELL INT'L L.J. 11, 12 (2003) (explaining the Daiwa Bank case); *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959, 970 (Del. Ch. 1996) (holding that a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may render a director liable for losses caused by non-compliance with applicable legal standards). Because of this difference, derivative suits in Japan could be a larger threat on corporate managers than those in the United States.

<sup>15</sup> See generally Tomotaka Fujita, *Transformation of the Management Liability Regime in Japan: In the wake of the 1993 Revision* 3-23 (Draft for the East Asian Corporate Governance Authors Workshop Sept. 30 and Oct. 1, 2006) (providing details of the director liability rules in Japan), available at: <http://www.ju-tokyo.ac.jp/coelaw/COESOFTLAW-2005-12.pdf>.

<sup>16</sup> See, e.g., Hideki Kanda, *Comparative Corporate Governance Country Report: Japan*, in *COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART*

these rules with those in the American and British systems. Table 2 presents a rough sketch of the American and British rules that deal with takeovers and defensive activities from approximately 1985 to the present.

TABLE 2: American and British Takeover Rules, 1985-Present

	Acquisition of shares	Defensive measures by the target board	Investors' influence on the result
United States	Regulation is not strict	Possible; however, they undergo a judicial review	Indirect
United Kingdom	Strictly regulated and supervised by the Takeover Panel	Prohibited	Direct

#### A. *The Rules Before 1990.*

Japanese companies were not able to rely on golden shares until the Diet passed the 2001 Commercial Code Amendment. By contrast, many public companies in Europe have made use of golden shares to fend off hostile takeovers.<sup>17</sup>

Even with or without golden shares, corporate managers can devise an ownership structure to their favor. Ownership structure is a tactic that enables the founding family of an enterprise to maintain corporate control while raising large capital via the stock market. In fact, such pyramidal structures in group companies and a vertical share ownership among them were adopted by many U.S. companies in the 1920s and is still being

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AND EMERGING RESEARCH 934–936 (Klaus J. Hopt et al. eds., Oxford 1998); Sōichirō Kozuka, *Recent Developments in Takeover Law: Changes in Business Practices Meet Decade-Old Rule*, 21 ZEITSCHRIFT FÜR JAPANISCHES RECHT [JAPANESE LAW JOURNAL] 5, 9 (2006); Kenichi Osugi, *Transplanting Poison Pills to a Foreign Land: Japan's Experiment*, Part II and III (unpublished manuscript, on file with author); Kenichi Osugi, *Companies Act – Overview*, <http://corporation.rikkyo.ac.jp/en/overview.html> (offering a general guide to corporate law in Japan).

<sup>17</sup> Until the 2001 revision of the Commercial Code, the predecessor of the Company Act that was legislated in July 2005, golden shares were not legally available. The revision came into effect on April 1, 2002, but the Tokyo Stock Exchange (TSE) and other exchanges revised the listing standard in March 2006 so as to impose an almost total ban on golden shares in listed companies.

adopted by many European companies. In Japan, however, *zaibatsu* (vertically formed corporate groups) were dismantled by General Headquarters as a key occupation policy after World War II. Instead, large companies in Japan developed a horizontal ownership structure or interlocking share holding schemes. Until recently, this horizontal scheme, coupled with a social norm that favored long-term relationships, effectively prevented hostile takeovers of listed companies.<sup>18</sup>

Nevertheless, several takeover attempts were made during the era of the bubble economy in the late 1980s. During that time the regulation regarding the acquisition of a block of shares was not strict. The Securities and Exchange Act had rules on tender offers but an acquirer could circumvent these rules by buying shares in a stock market or a block of shares directly from large shareholders. Target boards were able to issue new shares and place them in friendly hands. In addition, an authorized capital rule enabled (and still enables) the board to issue up to three times as many shares as the outstanding shares. However, shareholders of the issuing company could (and still can) file a motion in a court seeking temporary injunctive relief if such an issuance is deemed unfair. Around 1990, the courts in Japan flexibly settled these disputes. In some cases private placement was enjoined, in other cases such motions were dismissed.<sup>19</sup> Broadly speaking, Japan's rules on hostile takeovers in this period resembled those of the United States in the early 1980s.

*B. Before the Dawn: 1990-2004.*

In 1990, the Securities and Exchange Act was revised. The new law adopted some of the tender offer rules utilized in the European countries, like the rule that an acquirer could not buy one-third or more of the outstanding shares of a listed company by direct purchase. Under this law, in order to purchase one-third or more of the outstanding shares the acquirer was required to launch a tender offer and follow stringent regulation. Nevertheless, transactions within a stock exchange were not banned even if they resulted in an acquisition of a one-third ownership. In fact, even after the revision, hostile acquirers continued using market transactions instead of tender offers. In 2004, a group of hostile shareholders succeeded in taking over Miyairi Valve Manufacturing Company (listed on the Tokyo Stock Exchange) via market transactions of

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<sup>18</sup> See Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions*, 25 DEL. J. CORP. L. 189, 209-217 (2000) (discussing how cross-shareholding in Japan is an efficient mechanism of coordinating money capital and human capital within a company).

<sup>19</sup> Kozuka, *supra* note 16, at 6.



shares in it. However, the Securities and Exchange Act reform remained a half measure.

In comparison, England's Takeover Panel, a supervisory institution, reviewed the appropriateness of the disclosure of information by an acquirer and monitored both the acquirer and the target board to see if either of them were non-compliant. In Japan, there was no real supervisory institution. The Financial Services Agency oversaw disclosure statements issued by both tender offerors and the target companies, and engaged in corrective activities when it discovered a misstatement. However, the Financial Services Agency was inflexible and lacked discretionary power. Thus, it is safe to argue that Japan had no supervisory panel like England.

Another important reform was the liberalization of share options in 2001, which went into effect in 2002. Before this reform, a stock corporation could issue share options only when they were coupled with corporate bonds or were placed in the hands of directors or executives as incentive compensation. Thanks to the reform, corporations can now issue share options without any restriction on the purpose of the issuance. It was argued that this liberalization could lead to new sorts of defensive measures, such as issuing options in friendly hands or structuring options in a manner similar to the poison plan in the United States. However, as shown in the next section, no company in Japan adopted such defensive tactics until 2005.

Overall, these revisions of the Commercial Code or the Securities and Exchange Act did not dramatically change the legal framework that regulates mergers and acquisitions in Japan. Thus, the system was more similar to the US system than the UK system.

### *C. 2005: Tentative Solution.*

In 2005, both rules and practices with regard to hostile takeovers underwent significant changes. First, the Japanese government promulgated an official guideline that endorsed poison pill measures on a relatively strict condition. Second, large law firms in Japan developed several new forms of defensive measures. A dozen listed companies adopted these new measures. Some measures were disputed in the courtroom, which subsequently led to the development of case law.

The guideline was promulgated via a somewhat abnormal procedure as below. The Commercial Code, the predecessor of the Company Act, was handled by the Ministry of Justice, while the Securities and Exchange Act was handled by the Financial Services Agency. However, it was the Ministry of Economy, Trade and Industry (METI) that swung into action in anticipation of the surge of hostile takeovers. In the fall of 2004, METI set up a group named the Corporate Value Study

Group. The chair was Hideki Kanda, a professor of commercial law at the University of Tokyo. The study group was comprised of business lawyers, business world representatives, institutional investors, several law professors, and a professor of economics.<sup>20</sup> In addition, some civil officials from the Ministry of Justice and the Financial Services Agency attended the meetings as observers. This group researched legal systems and practices concerning hostile acquisitions in the United States, United Kingdom, and other European countries. An agreement occurred between METI, MOJ, and FSA, and the METI's stance of introducing a poison pill through an interpretation of the existing Commercial Code was shared by the other two bodies. The group released a tentative report in March 2005. This report proposed that poison pill measures could be legally structured in Japan without a revision of the Commercial Code, and that poison pill measures should not be abused. The report was finalized and published in May.<sup>21</sup> As a result, Japan chose to structure poison pill measures within the existing Commercial Code rather than enacting a separate statute.

To ensure that practitioners would properly employ poison pill measures, METI believed that it needed to involve the Ministry of Justice in publishing an official guideline. On May 27, 2005, METI and MOJ finally released an official guideline.<sup>22</sup> However, the Ministry of Justice ratified the measure with reluctance, imposing strict conditions on companies that wanted to adopt the pill.

The Livedoor case occurred while METI was in the process of drafting its tentative report. In this case, Livedoor bought shares of Nippon Broadcasting Systems (NBS). Although the purchase method did not violate the Securities and Exchange Act literally, it was questionable given the spirit of the regulation.<sup>23</sup> NBS granted share options to Fuji Television Network (Fuji), an affiliated corporation in order to block the

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<sup>20</sup> I was also a member of the group.

<sup>21</sup> Corporate Value Study Group, *Corporate Value Report 2005*, 21 ZEITSCHRIFT FÜR JAPANISCHES RECHT [JAPANESE LAW JOURNAL] 137, 137-9 (2006) (containing an English abstract of the Corporate Value Report 2005).

<sup>22</sup> Ministry of Economy, Trade and Industry, Ministry of Justice, *Kigyō Kachi, Kabunushi Kyōdō no Rieki no Kakuho mata ha Kōjō no tamenō Baishū Bōeisaku ni kansuru Shishin* [Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholder's Common Interests], 21 ZEITSCHRIFT FÜR JAPANISCHES RECHT [JAPANESE LAW JOURNAL] 143, 143-61 (2006) [hereinafter *METI Guidelines*] (providing an English translation of the guidelines).

<sup>23</sup> The technique used in the acquisition of shares was after-hours trading, a loophole in the then existing STA. After the transaction began, professors of commercial laws in Japan, while interpreting the tender offer regulation, were divided in their opinion regarding the pros and cons of the transaction.

takeover attempt. This was the first time share options were used as a defensive measure in Japan.

In March, another corporation, Nireco, announced its intentions to adopt a defensive plan utilizing share options. Although Nireco's tactic relied on share options as a defensive measure, the use was novel because Nireco granted share options to all existing shareholders. In addition, Nireco announced its plans before any takeover attempts. Nireco's plan was an imitation of the American poison pill.

The courts subsequently enjoined both NBS<sup>24</sup> and Nireco's plans.<sup>25</sup> Nevertheless, the courts did not put a total ban on the use of poison pills. Both decisions based their argument on the interpretation of the Commercial Code that the use of defensive measures would be enjoined when its use is deemed as unfair. After those decisions were made, more attorneys started to believe that adequately structured defensive tactics that were compatible with the METI guidelines would not be enjoined, even if a target board triggered the pill during a control test. Consequently, approximately twenty companies listed on the Tokyo Stock Exchange adopted poison pills in May and June of 2005.

Corporate lawyers in Japan, most graduates of U.S. law schools, brought expertise in structuring poison pill measures to Japan. These lawyers were young and had practiced in large U.S. law firms for about a year. However, these young and bright lawyers often avoided mentioning the disciplinary role of the Delaware judiciary, one of the most essential components of the Delaware system. The METI report referred to Delaware cases such as *Unocal* and *Revlon*, but neither the *Corporate Value Report* nor the *METI Guidelines* made any reference to whether courts in Japan would enjoin a defensive measure that is triggered by the target board during a control test. Neither the *Corporate Value Report* nor the *METI Guidelines* argue by what standard courts in Japan would determine whether the defensive measure at stake shall be enjoined or not. There were no traces of *Unocal* or *Revlon* in those judgments. Instead, they applied and extended the existing legal doctrine in Japan. Nevertheless, by ordering the injunctions the judges played similar roles to the judges in *Unocal* and *Revlon*. Thus, the role of the judge as a gatekeeper was recognized by the public.

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<sup>24</sup> See Kozuka, *supra* note 16, at 12 (discussing the Livedoor case); Eiji Takahashi & Tatsuya Sakamoto, *Japanese Corporate Law: Two Important Cases Concerning Takeovers in 2005*, 21 ZEITSCHRIFT FÜR JAPANISCHES RECHT [JAPANESE LAW JOURNAL] 231, 232 (2006); Osugi, *supra* note 16, at Part V-1.

<sup>25</sup> See Kozuka, *supra* note 16, at 14 (discussing Nireco); Takahashi & Sakamoto, *supra* note 25, at 236; Osugi, *supra* note 16, at Part V-2.

In sum, the development of a takeover law in 2005 was initiated, mainly by the public officials of the METI, as an intentional and selective attempt to transplant the U.S. model.

Unlike the *Unocal* decision, neither the METI guidelines nor the Livedoor case analyzed whether the board of directors exercised its power appropriately. Instead, both the guidelines and the cases emphasized whether the defense was based on the will of shareholders. There are two possible reasons for this. This can be explained by two reasons. First, the traditional theory of corporate law, shareholders, not the board, are entitled to decide who should enjoy control rights in the corporation. Second, most directors of Japanese companies are also officers of the same company, which is quite different from American and British companies. Independent, non-executive directors are uncommon, although Japanese company auditors could be seen as a type of non-executive director.<sup>26</sup> Nearly a half of listed companies adopt outside directors, but most of them still come from another company in the same corporate group. Such outside directors are not considered independent enough from the executives of the company to make fair judgment when a control contest occurs. Because of the difference in board composition, shareholder decisions are held in higher esteem than decisions made by the directors. This difference has led to the Japanization of poison pills, as is shown in the next section.

*D. 2006: A Turning Point?*

While the series of events in 2005 can be summarized as a convergence with the American model, the events in 2006 were of a mixed nature. In 2005, the Japanese Commercial Code was completely revised and the law on corporate matters was reorganized as the new Company Act. The Company Act went into effect on May 1, 2006, but the reorganization had only a modest impact on the introduction and structure of poison pill measures.

In 2006, the Securities and Exchange Act was thoroughly revamped and reorganized as the Financial Instruments and Exchange Act (FIEA).<sup>27</sup> The FIEA revised tender offer rules. Prior to the revision, a hostile acquirer could purchase a block of shares in listed a company in the public market and, in practice, most acquirers used this mode of purchase. The FIEA was made into effect with three phases. When the new tender offer rules in FIEA came into effect in December 2006 it restrained the use of market transactions to buy blocks of shares. Under the FIEA, an acquisition of more than one-third of the outstanding shares

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<sup>26</sup> See *supra* note 7 and accompanying text.

<sup>27</sup> See *supra* note 12 and accompanying text.

in a listed company by a single acquirer must be made in principle through a mandatory tender offer. It is difficult to predict the impact of the revision.

The Financial Services Agency consulted a group which proposed the reform of tender offer rules. Due to time constraints, the consulted group was not able to discuss the choice of basic policy between the American and British models. Instead, the consulted group proposed plugging several loopholes.

The FIEA has no provisions that ban poison pills. Most scholars do not interpret the act as prohibiting poison pills or other defensive measures, because of the following reason. Because Japan does not have a supervisory body like the United Kingdom's Takeover Panel, a target board is still deemed to have discretion to judge whether the information that the acquirer furnished to target shareholders is true and appropriate, and whether the time range set by the acquirer is sufficient for the target board to negotiate with the acquirer and for target shareholders to decide on selling or holding their shares. In this manner, poison pill measures empower the target board to obtain the leverage necessary to make those judgments. Moreover, the new Financial Instruments and Exchange Act allows defensive measures like the poison pill<sup>28</sup>.

Table 3 summarizes a comparison of the United States, the United Kingdom, and Japan hostile takeover models. The Japanese legal system concerning hostile takeovers lies somewhere between the American and British but probably closer to the American model.

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<sup>28</sup> The FIEA allows a bidder that announced a tender offer to rescind the offer or to change the conditions of the offer only in circumstances that are stipulated in the statute, and some of those circumstances refer to an invocation of a poison pill or other defensive tactics.

TABLE 3: Comparison of U.S., U.K., and Japan Hostile Takeover Models

	Acquisition of shares	Defensive measures by the target board	Investors' influence on the result
United States	Regulation is not strict	Possible However, they undergo a judicial review.	Indirect
United Kingdom	Strictly regulated and supervised by the Takeover Panel	Prohibited	Direct
Japan	Regulations exist but without any supervisory body	Private placement of securities in friendly hands is strictly regulated by the FIEA. A poison pill is available to a target board, but adopting and/or triggering it can be challenged in a judicial procedure.	(Not yet clear).

#### IV. THE PROCESS OF JAPANIZATION

In the previous section I focused on various legal models of Corporate Takeovers and discussed how the system in Japan at first closely resembled the American model, but later adopted several element of the British model. In section IV I concentrated on policy issues in the debate between the shareholder-oriented model and the stakeholder-oriented model, and analyze which model Japan is moving toward.

##### A. *The 2006 Backlash.*

Among the changes to mergers and acquisitions in 2006, the changes in public sentiment about hostile takeovers was more significant than the changes in law discussed in Section V.

In 2005, Takafumi Horie, the CEO of Livedoor, was perceived by a wide range of citizens as a man of creative destruction. His actions were perceived as renewing Japan's economy and culture as well as enhancing the shareholders' interest. In January 2006, he was arrested and indicted on allegations of accounting fraud and stock market manipulation. On

March 16, 2007, the Tokyo District Court sentenced Horie to two and a half years imprisonment.

In another example Yoshiaki Murakami, the CEO of the so-called Murakami Fund, an investment fund known for its activism and confrontational approach with corporate managers. On June 2006, Murakami was arrested on allegations of a series of insider trading scandals. On July 19, 2007, the Tokyo District Court fined Murakami three million yen, sentenced him to two years of imprisonment, and collected an additional 1.15 billion yen. These scandals generated public skepticism in information technology companies, investment funds, and corporation takeovers. Thus, the shareholder-oriented model of corporate economy in the Anglo-American manner attracted criticism, and the belief that hostile bids could develop a national economy waned.

Another important event was the unsuccessful attempt by Oji Papers to acquire Hokuetsu Paper Mills in 2006. Oji's management communicated its acquisition and its post-merger integration plan to Hokuetsu management. But, Hokuetsu management vehemently resisted the offer by relying on a placement of new shares in the friendly hands of Mitsubishi Corporation as well as adopting poison pill measures. Meanwhile, Oji commenced a tender offer. Although the pill was not triggered, few shareholders of Hokuetsu respond to the offer. Large-block shareholders, especially banks and local companies who enjoyed business relationships with Hokuetsu, showed no interest in selling their shares even if Oji's offer price for Hokuetsu shares was considerably higher than the market price. The tender offer failed in part because Oji hesitated to file with the court for an injunction on the issuance of new shares and the adoption of poison pill measures.

In Japan a company is deemed to not only stands for its shareholders but also for its employees, business partners, the relationship with the local community, and so on. Thus, cases like Livedoor, Murakami, and Oji revived this traditional stakeholder-oriented model of corporations.

#### *B. The Japanization of Poison Pill Measures.*

In the United States, poison pills are used to set the table for negotiations between the acquirer and target management. In Japan, however, corporate managers do not like to negotiate with unsolicited acquirers. So, Japanese corporate managers asked corporate lawyers to devise a mechanism to definitively defeat an unsolicited offer. As explained in Section III, the *METI Guidelines* and case law in Japan emphasize the shareholders' will in evaluating the legitimacy of defensive measures. As a result, corporate lawyers have attempted to minimize the risk of injunction by involving shareholders in the adoption of a pill or in

the activation of poison pill measures. In fact, more Japanese companies obtain shareholder approval before they introduce a poison pill provision than in any other country. Nippon Steel Corporation and some others went even further: they have structured a poison pill that can be triggered by a resolution of the shareholders' meeting.

There are a little less than 4,000 companies listed on stock exchanges in Japan. Among them, 381 have introduced poison pills as of the end of July 2007. Of the 381 companies that have introduced the pill, 218 have obtained shareholders' approval for such introduction. Thirty-one companies' provisions stipulate that the poison pill may only be triggered by the resolution of a shareholders' meeting. Another eighteen companies introduced poison pills that can be triggered by shareholders or other internal bodies, such as a board of directors or an independent committee for anti-takeover defense.

There are other defensive tactics companies can rely on to minimize the legal risk of an injunction. For example, companies can increase the numbers of independent directors. However, there have been few companies that have increased independent directors. Furthermore, only 327 companies have set up independent committees focused on anti-takeover defense, such committees are comprised of independent members are often outside company auditors and professionals, such as lawyers and certified public accountants. Japanese corporate managers have opted for shareholder involvement rather than appointing independent directors.

Then came the Bulldog case, which was covered by media around the globe. Steel Partners, an active hedge fund, acquired and held 10 percent of the shares in the Bulldog Company, a company listed on the Tokyo Stock Exchange. On May 16, 2007, Steel Partners launched a tender offer for Bulldog at JPY (Japanese Yen) 1,584 per share, approximately 15 percent higher than the market price at the time. On June 7, 2007, Bulldog's board of directors announced a plan to issue share warrants and to allocate them to all of its shareholders, including Steel Partners, on record as of July 10. According to the plan, each shareholder would receive three warrants per share. The plan was conditioned on the approval of a special resolution at the annual shareholders' June 24 meeting. Under the plan, warrant-holders were eligible to exercise their warrant at one yen per share. However, Steel Partners were to exercise their warrants in the same way (unequal provision). Instead, Bulldog had the right to purchase Steel Partners' warrants at JPY 396 per share (1,584 divided by 4). This scheme prevented Steel Partners from buying shares in Bulldog from 10 percent to 3 percent. On June 24, a majority of the shareholders (89 percent of those who attended, 83 percent of the entire shareholders, as of the voting rights) approved the plan. Steel filed a motion for a preliminary injunction with the Tokyo District Court.



On June 28, the court denied the motion. The decision based its argument on the following reasons<sup>29</sup>. The unequal provision did not violate the principle of equality among shareholders since Steel Partners had not shown its proposed management program or its prospective exit strategy. Since the defensive plan was authorized by the majority of shareholders, the plan was deemed to have a legitimate purpose. The effect of the plan was not draconian since Bulldog made a legitimate offer to sell warrants to the hostile acquirer. Judging from the above factors, the measure taken in the case was not unfair.

Steel Partners appealed to the Tokyo High Court. On July 9, the court affirmed the District Court's decision, but it developed a different approach in ruling the case as the following<sup>30</sup>. The unequal provision did not conflict with the equality principle. The High Court considered the fact that Steel Partners was a hedge fund with no real intent to manage Bulldog after acquisition but rather planning to sell off its equity stake for profit, and labeled Steel Partners an "abusive acquirer." Thus, the defensive tactics by Bulldog were deemed to have had a legitimate purpose. Also, the effect of the plan was found within the range of fairness because it was approved by majority of shareholders.

The Supreme Court denied Steel's appeal and affirmed the High Court's decision. The rationale that the Supreme Court gave was much closer to that of the District Court than to that of the High Court<sup>31</sup>.

### C. *Search For A New Equilibrium?*

At a first glance, the Japanese practice of empowering shareholders to decide on issues of corporate control seems similar to Anglo-American practice. In the American system during the 1980s, the Chancery Court in Delaware repeatedly reviewed matters on anti-takeover measures. But since the 1990s, most contests for corporate control have been fought and settled outside the courtroom—typically via a proxy fight at a shareholders' meeting. Some American companies have come to consult with shareholders before adopting poison pill measures. While the evolution process in the United States took a long time and went down a winding road, the process in Japan is taking a straighter course.

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<sup>29</sup> Steel Partners Japan Strategic Fund (Offshore), L.P. v. Bulldog Sauce Co. Ltd., 1805 SHÖJI-HÖMU 43, 1270 KINYŪ-SHÖJI-HANREI 12 (Tokyo D. Ct., June 28, 2007).

<sup>30</sup> Steel Partners Japan Strategic Fund (Offshore), L.P. v. Bulldog Sauce Co. Ltd., 1806 SHÖJI-HÖMU 40, 1271 KINYŪ-SHÖJI-HANREI 17 (Tokyo High Ct., July 9, 2007).

<sup>31</sup> Steel Partners Japan Strategic Fund (Offshore), L.P. v. Bulldog Sauce Co. Ltd., 1809 SHÖJI-HÖMU 16, 1273 KINYŪ-SHÖJI-HANREI 2 (Sup. Ct., Aug. 7, 2007).

Looking at the convergence of the legal systems on mergers and acquisitions from a functional viewpoint rather than a formal viewpoint, one can argue that merger and acquisition law in Japan is converging with that of the United Kingdom. The City Code stipulates that a company can install a defensive measure against a takeover if it obtains the shareholders' approval at the shareholders' meeting.<sup>32</sup> This view probably deems the formal difference between the American and British laws as insignificant, emphasizes the fact that the shareholders' will is considered primary in deciding control contests in both laws is considered primary, and concludes that the law in Japan is going the same direction.

But why do institutional investors vote in favor of the adoption, and even the triggering, of poison pill measures? Under what circumstances do they vote in favor of these? A possible explanation is that the promotion of stakeholders' interests would lead to maximizing the shareholders' wealth in the end. If a majority of investors in Japan share this belief, the policy with regard to company takeovers is different from that of the United States and the United Kingdom, as illustrated in Table 4.<sup>33</sup> One thing is certain. In the wake of hostile takeovers and discussions for and against poison pills, communications between company managers and institutional investors become frequent and substantial. This may promote the synthesis of the stakeholder model and the shareholder model of public companies.

TABLE 4: Takeover Policy Comparison

	Shareholder oriented	Stakeholder oriented
Tender offer regulation & neutrality rule	U.K.	Continental countries in Europe
Defensive tactics & judicial review	U.S.	Japan

If that is the case, there is still room for inquiries. In Japan, listed companies have four kinds of shareholders within each company, and roughly speaking, each of four has a share of a quarter. The first type of shareholder is the individual investor. They rarely have a strong say or

<sup>32</sup> See PANEL ON TAKEOVERS AND MERGERS, THE CITY CODE ON TAKEOVERS AND MERGERS, R. 21.1 (May 20, 2001), available at <http://www.thetakeoverpanel.org.uk/new/codesars/DATA/code.pdf>.

<sup>33</sup> See *infra* t.4.

interest in takeover issues. The second type is the hedge fund, both foreign and domestic. Hedge funds tend to be critical of defensive measures and eager to make money from short-term investments. The third type is the institutional investor, which is interested in long-term performance of their portfolios and take a case-by-case basis approach to defensive tactics, especially domestic pension funds and life insurance companies. The final type of shareholder is the business corporation. Business corporations are still block holders in other companies, but sometimes they give priority to the benefits from business relationships rather than the interests of shareholders. Thus, they are assumed to have an implicit lead role in defeating any hostile deals.

Recently, the rate of cross-shareholding has been slightly increasing. One possible result of this increase is that cross-shareholding can successfully deter the shortsighted behavior of hedge funds. As a result, a reasonable balance of interests between shareholders and other stakeholders is created. It is also possible that cross-shareholders are less likely attracted to tender offers because they are mutually bound by their cross holding to support each other's defensive measures. It is not clear which outcome will prevail.

## V. CONCLUSION

The recent events in Japan should not be considered managerial triumphs or shareholders' defeats. The Delaware court allowed corporate managers to interfere with hostile takeover attempts to a limited extent. The economic environment, however, has changed in favor of a more shareholder-oriented model, which was exemplified in the activism of institutional investors.<sup>34</sup> In fact, shareholders in Japanese companies have a greater say in the company matters than shareholders in American companies: The Company Act gives more power to shareholders through charter amendments.<sup>35</sup> In addition, a shareholder who owns one percent or 300 shares in a company may propose to the company to remove its directors from office.<sup>36</sup> Further, the shareholders may resolve to remove a director by majority vote without cause.<sup>37</sup>

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<sup>34</sup> William T. Allen & Leo E. Strine, Jr., *When the Existing Economic Order Deserves a Champion: The Enduring Relevance of Martin Lipton's Vision of the Corporate Law*, 60 BUS. LAW. 1383, 1392 (2005).

<sup>35</sup> Del. Code Ann. tit. 8, § 109(a), 211(b) (2007). Only the election of directors and amending the bylaws do not require board approval before shareholder action is possible in Delaware corporations. On the other hand, Section 295 of the Company Act in Japan allows the articles of incorporation of stock companies to stipulate a provision that empowers a shareholders' meeting to resolve a particular matter.

<sup>36</sup> Kaisha Hō art. 305(2).

<sup>37</sup> Kaisha Hō arts. 339, 309(1).

Shareholder behavior, not legal reforms, is the predominant factor in corporate defensive measure in Japan. Convergence is of less importance.