Corporate Value Report

May 27, 2005

Corporate Value Study Group

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Introduction

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 management are paying greater attention to their shareholders. People now have a more favorable image of hostile takeovers and foreign capital. Against this background, the conventional wisdom, that a corporate acquisition is a friendly takeover agreed upon by the management of both companies, no longer holds, creating an environment where hostile takeovers can take place.

Global trends show that an M&A market to acquire a controlling stake was first established in the United States in the 1980s and then developed in the EU in the late 1990s during integration of the EU. In the 21st century, a full-fledged M&A market is being established in Japan.

In order for the market to be economically effective, there must be a code of conduct that should be respected and observed by market players. Unlike ordinary commodity trading markets, the corporate takeover market is a market to trade the controlling stake of a corporation and involves many interested parties. Therefore, it requires fair market rules. The price of a corporation is corporate value, and the corporate value is determined by the corporation's earnings power. The earnings power of a corporation depends not only on management's ability but also on the quality of employees and other human capital, employees' commitment to their company, good relations with business partners and creditors, customers' confidence, and relations with the local community. Shareholders select management who produce higher corporate value. Management, for their part, strives to live up to the expectation of the shareholders and enhance corporate value by building favorable relationships with various stakeholders. In a hostile takeover situation we should examine whether the acquiring person or the current management can produce higher corporate value, whilst also taking into account relations with stakeholders. With regard to a controlling stake in a corporation, it is difficult for shareholders to make an informed selection unless they are provided with a far greater amount of information than is the case with ordinary commodities. Moreover, if a wrong selection is made, it could result in huge economic and social loss. It is for this reason that rules for defensive measures are hoped for; measures that would be effective against hostile takeovers that would impair corporate value but that would allow hostile takeovers that would enhance corporate value.

As a universal rule for the corporate takeover market, there is a takeover bid (TOB) rule requiring an acquiring person to offer a fair price to all shareholders. In addition to this, the United States and EU have created a rule against hostile M&As with the aim of preventing a surprise attack or excessive defense. In the U.K., total TOB is mandatory in order to control two-tiered takeovers. In Germany, in addition to total TOB requirements, defensive measures can be adopted with the approval of the board of auditors. European continental nations have adopted measures allowing the issuance of golden shares or super voting stocks with the approval of a general meeting of shareholders. The EU has decided to adopt a common intraregional rule concerning total TOB requirements in order to unify various rules now in place in European countries. In the United States, judicial decisions were made and monitoring by institutional investors increased as a result of various defensive measures devised in the 1980s. In the United States, there is now established practice by which a board of directors decides on the introduction of defensive measures and independent outside directors monitor the operation of the measures. These countries have been striving to establish rules against hostile takeovers through trial and error and a series of compromises.

Here in Japan, 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 less experience with hostile takeovers. If left as is, this absence of rules could encourage repeated surprise attacks and excessive defensive tactics, making it difficult for hostile takeovers to fully demonstrate their effectiveness as a mechanism to enhance corporate value.

Defensive measures against hostile takeovers, if they are used properly, can help enhance corporate value. But at the same time, there is a risk that defensive measures may be used to entrench corporate management. If a Corporate Law were established, it would increase the means that could be adopted as takeover defense measures. However, it would raise concerns that excessive defensive measures may be taken in an emergency and other concerns that corporations may not be able to take even reasonable takeover defense measures for fear of negative market evaluation.

Therefore, the purpose of the Corporate Value Study Group (Chairperson: Professor Hideki Kanda, The University of Tokyo) is to promote the establishment of fair rules concerning takeovers in the business community in Japan.

The Corporate Value Study Group began its activities in September 2004. The Group first studied rule establishments in the United States and European countries in order to make up for the lack of knowledge and experience concerning hostile takeovers. The study covered a variety of topics including the actual status of systems in the respective countries, corporate trends, judicial decisions, and institutional investors' judgment. In addition, the Group held a number of informal meetings to exchange views with senior corporate executives, businesspersons, institutional investors, and Western experts. Through these meetings and exchanges of views, it has been ascertained that defensive measures are business community rules and that discussion on defensive measures is inextricably linked to discussion on corporate governance.

The Group has focused on **four basic principles: (i) enhancement of corporate value, (ii) equal footing with global standards, (iii) no discrimination between foreign and domestic companies, and (iv) offering increased options for shareholders and management**. Their work was published as **"Summary Outline of Discussion Points: Proposal toward Establishment of Rules for a Fair Business Community"** on April 22, 2005. The Discussion Points makes recommendations not only on design of proper defensive measures but also on the direction of change the Japanese business community is expected to take during discussions on the advisability of introducing defensive measures.

Upon the publication of the Discussion Points, the public comment procedure was launched. To date, 69 public comments have been obtained from 19 persons, and many other comments and expectations have been received from both within Japan and the rest of the world. Some of the comments give credence to the recommendations, saying that it proposes fair and reasonable rules by taking shareholders' interests into account based on the experiences of Western countries. Some others point out that the recommendations made in the Discussion Points may not take root in Japan, as the Japanese business community lags behind Western countries in terms of corporate governance. Some expressed criticism saying that rules for corporate governance should be established before rules for defensive measures. Also, it deserves special mention that the Tokyo High Court and the Tokyo District Court expressed their expectation for the establishment of fair rules for defensive measures (those adopted before hostile approach and triggered in takeover contests) in their rulings on a case of corporate value defense.

The Corporate Value Study Group, having reviewed and revised the Discussion Points as necessary while taking all comments, criticisms, and expectations into consideration, has compiled and published the "**Corporate Value Report**." This report, which consists of more than 100 pages, describes in detail the history of M&As, M&A methods, M&A rules in Western countries, fair rules in Japan, and an ideal business community.

It also proposes that the government speed up institutional reforms, such as **formulation of Guidelines for Corporate Value** in line with the report, **establishment of a framework to revise the guidelines,** and **creation of disclosure rules for defensive measures**. The recommendations call on senior executives and institutional investors to take a proactive stance towards establishing rules for the business community. The key points of the report are introduced below.

The subject of Chapter 1 is "The Future and Problems of the M&A Market in Japan." This chapter explains the history of the M&A market formation as the corporate takeover market, the current situation of hostile takeovers, and the process of the M&A market formation in Japan, points out that there are no fair rules concerning hostile M&As in the Japanese business community and stresses the need to speed up the establishment of rules.

The subject of Chapter 2 is "Techniques and Economic Effects of Hostile M&As and Defensive Measures." After summarizing the techniques of M&As, and hostile M&As in particular, and the related legal systems, this chapter explains the requirement to set up a mechanism to overcome the lack of information, i.e., the requirement that should be in place for the economic effects of hostile takeovers and takeover defense measures to satisfy economic reasonableness.

The subject of Chapter 3 is "Rules concerning Hostile Takeovers in Europe and the United States." The experiences in advanced western nations provide a wealth of suggestions for the creation of rules on hostile M&A activity in Japan. A variety of approaches from Great Britain, Germany and various continental nations are introduced, and the attempts to unify business acquisition rules in the EU, as well as the points of compromise are presented. From a Japanese perspective, the adopted TOB rules seem strict, suggesting future issues for study.

Next, the experiences in the United States are presented. Twenty years ago surprise raids and overzealous defenses were rampant in the United States, a situation that can be claimed to be similar to the current circumstances in Japan. The points to study in the American experience are the formation of rules with enhancement of corporate value as the standard in the midst of the confusion, as a result of pressure from court decisions and institutional investors, and a weeding out of excessively defensive measures. The rights plans are the most widely utilized defensive measures in the United States. The key points to consider are how the rights plans have been developed and changed under the checks and balances provided by the courts and institutional investors, and how the methods devised have contributed to enhancing corporate value. These devices can be applied for any defensive measures, and may be used as a standard for setting the starting point in Japan.

The subject of Chapter 4 is "Establishment of 'Fair and Reasonable Rules to Enhance Corporate Value' in Japan." Measures to defend against takeovers should be, in principle, decided by shareholders, but due to time and institutional constraints, the board of directors generally has to make a decision on such measures. The decision must be secured to enhance corporate value rather than entrenching board members. In this sense, various features must be developed to reflect the best interests of shareholders as a whole in the process for the adoption and implementation of the defensive measures. Chapter 4 gives specific proposals regarding the legal framework, standards and features.

(i) Under Japanese Corporate Law, Western style defensive measures can be adopted. In this sense, rules must be developed urgently for disclosure of defensive measures.

(ii) The judgment on the reasonableness of defensive measures should be based on the corporate value standard that covers an existing threat to corporate value or appropriate decision by shareholders, the reasonableness of defensive measures, and the board's prudent and appropriate actions.

(iii) The development of defensive measures should meet one of the three features (external check by independent party, “chewable pill” and shareholder approval) to secure the adoption before hostile approaches, disclosure requirements, possible removal of defensive measures and proxy contests and eliminate the arbitrariness of managers’ decisions in takeover contests.

We call on the government to adopt these proposals as corporate value guidelines that should work as guidelines respected in the business community. We also recommend the government to consider primarily the reasonableness of regulations on hostile takeovers.

The subject of Chapter 5 is “The Infrastructure of the Business Community in Japan.” There has been an argument whether priority should be placed on the improvement of business community infrastructure or the establishment of the rules of defensive measures against takeover attempts. Along with the Corporate Value Report which was recently published, if guidelines for corporate value are established, and are shared and respected by interested parties including corporate managers, shareholders, investors, stock exchanges, lawyers, and financial advisors, 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 of external board members, active participation by institutional investors in management, and consensus-building between corporate managers and investors about the long-term enhancement of corporate values.

The mission of the Corporate Value Study Group 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, revised and developed by corporations, shareholders, investors, the administration and the courts.

Chapter 1 Future and Problems of M&A Market in Japan

Publicly-held corporations operate business efficiently by collecting funds from many people through issuance of shares and by consigning its management to professional business managers. Since shareholders can pressure professional business managers to enhance corporate value, publicly-held corporations can expect great results in management innovation compared with other types of business entities. In fact, publicly-held corporations are the most popular form of organizations among various company forms. Since publicly-held corporations are based on free transfer of shares, it is possible for a person with better management skills than the current management to replace management by acquiring stocks. For this reason, the right to control a corporation changes based on the judgment of the market. A change in the right to control a corporation is made through the acquisition of stocks. The acquisition may be friendly or hostile. The method for acquiring stocks is through mergers and acquisitions (M&As).

It can be said that the M&A market is the market for the rights to control corporations. The M&A market first developed in the United States and spread to Europe in the 1990s with the implementation of the European monetary union, and it is now being established in Japan. As for systems and practices that govern the M&A market, Japan established rules concerning friendly M&As in the second half of the 1990s, but rules concerning hostile M&As remain inadequate, causing confusion.

1. Formation of the M&A market[1] in the world ~ The United States, EU, and Japan~

The world M&A movement has always been led by the United States. The first M&A boom took place from the late 19th century to the early 20th century. There were horizontal mergers in various industries during this period and big corporations came into being one after another. Among them are U.S. Steel, AT&T, General Motors, DuPont, and General Electric. The second M&A boom took place in the 1920s and there were also many mergers of corporations in such industries as steel, oil, power, automobile, air transportation, movies, radio and electricity. The boom came to an end in 1929 due to the Wall Street Crash on Black Monday. The third M&A boom occurred in the 1960s. Many acquisitions aimed at business diversification took place, including the acquisition of Marathon Oil by U.S. Steel. As a result, many conglomerate companies came into being.

The fourth M&A boom occurred during the 1980s, when the current rules concerning hostile M&As were established. Against the background of deregulation[2] implemented by the

[1] The monetary amount of M&As quoted in this chapter are from Thomson Financial Co.
[2] Deregulation was implemented in such industries as aircraft and banking, and the public utilities.

Reagan administration and the development of financial technology, takeovers were carried out actively utilizing LBO[3]. Another characteristic of the fourth M&A boom was that many hostile takeovers took place and that various takeover defense measures, including rights plan[4], were developed to cope with coercive hostile takeovers. It triggered rampant surprise attacks[5] and excessive defense, throwing the market into confusion at one stage. However, thanks to successive court rulings on takeover defense measures and pressure from institutional investors, rules concerning hostile M&As have come to be shared by market players.

In the second half of the 1990s, the fifth M&A boom took place. It was partly triggered by the IT bubble in the United States. But it is worth noting that an M&A boom also took place in Europe in the wake of the European monetary union. Hostile M&A, which had already been popular in the United States, began to spread to Europe during this period[6].

In 2000, M&As in the world hit an all-time high of 3.5 trillion dollars, or about 350 trillion yen. It decreased in the following two years due to the collapse of the IT bubble but has been on an increasing trend since 2003, showing signs of another M&A boom.

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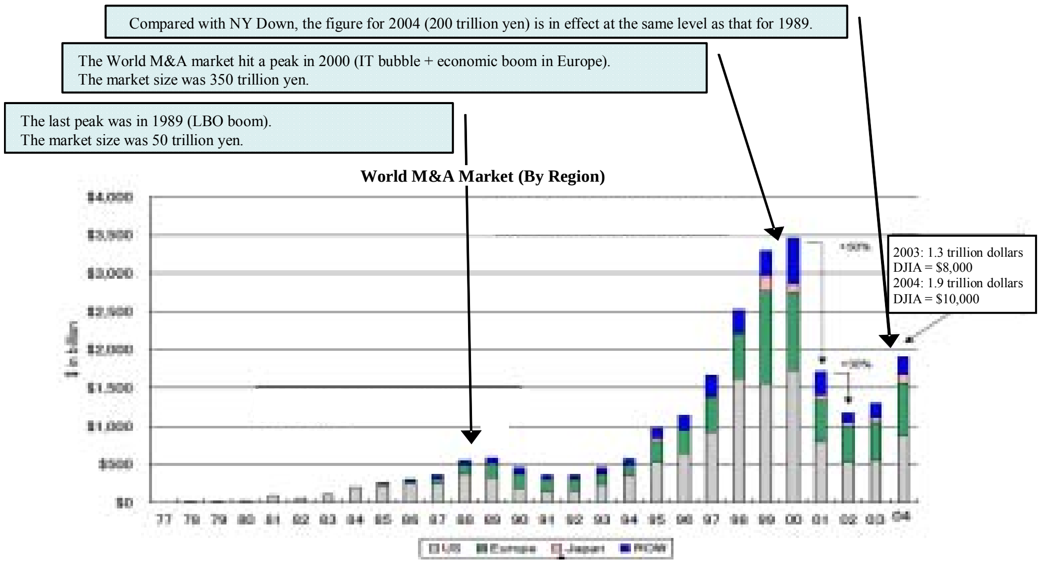
3 LBO stands for Leveraged Buyout. It is a system to raise funds on security of the asset and future cash flow of the targeted company.

4 A system under which a company distributes *Shinkabu Yoyakuken* (stock acquisition rights) to shareholders before a hostile approach. When a hostile acquiring person accumulates, for instance, 20% of the company's shares, the company issues a large amount of shares to shareholders other than the hostile acquiring person in order to drastically dilute the acquiring person's shareholding ratio.

5 For instance, Sun, in a bid to mount a takeover offensive against Benetton Dickinson, a major medical equipment manufacture, had its subsidiary propose purchase of Benetton shares secretly from 28 major shareholders (who owned 35% of the total outstanding shares) of Benetton. The shareholders were given only one night at the maximum and only 30 minutes in the minimum to consider the proposal. (Bruce Wasserstein "Big Deal" Nikkei BP, 1995, p. 255)

6 Hattori, "Practical M&A Management" (Toyo Keizai Shinposha, 2004) p.12~14

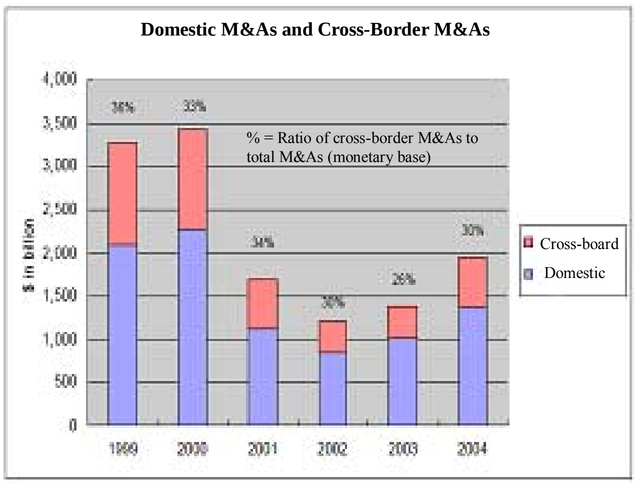
Figure 1-1 World M&A Market



Source: Hitotsubashi University, Graduate School of International Corporate Strategy

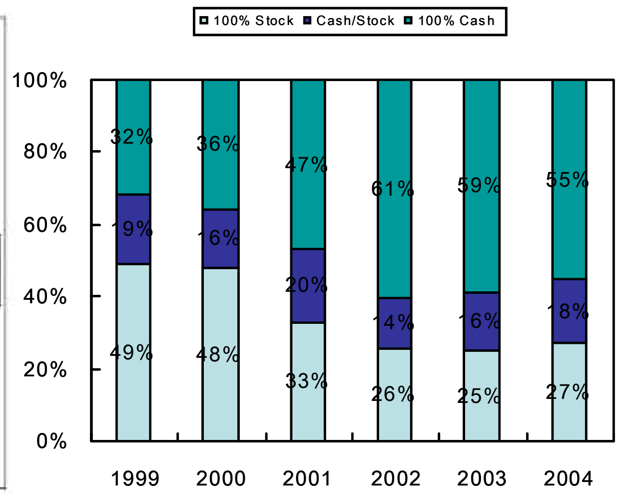
By region, the United States accounts for 40-60% of the total and Europe 30-40%. Japan has come to account for 4-6% of the world M&A market since 1999. The M&A market was formed in the United States in the 1980s and in Europe in the second half of the 1990s. But it can be said that Japan[7] is now forming an M&A market in the 21st century. Amid global expansion of the M&A market, transnational M&As[8] have increased and now account for about 30% of total M&As. Each M&A has become bigger and the currency used for takeovers is not limited to cash. Stocks (stocks of new company or acquiring company) have frequently been used. Cash is used in about 50% of takeovers, a combination of cash and stocks in 20%, and stocks in the remaining 30% of takeovers.

Figure 1-2 Domestic M&As and Cross-Border M&As



Source: Hitotsubashi University, Graduate School of International Corporate Strategy

Figure 1-3 Currency Used in M&As



Source: Hattori; Hitotsubashi University, Graduate School of International Corporate Strategy

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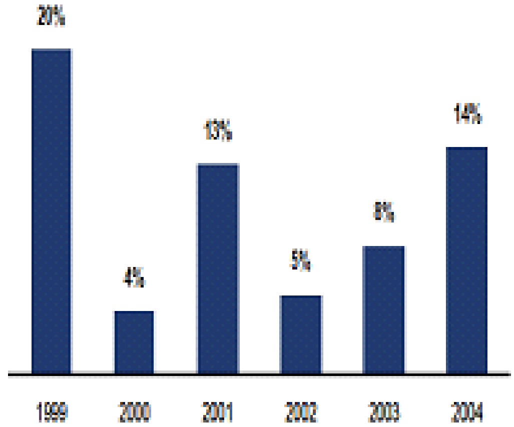
7 Average date for 1999-2004

8 They are called cross-board M&As.

2. Actual status of hostile M&As

As described earlier, there are two types of corporate takeovers; friendly takeovers, where the management of the targeted company agrees, and hostile takeovers where the ma nagement of the targeted company is opposed to the takeover. The ratio of hostile takeovers to total M&As stood at 10-20% on average in the last several years. Although it decreased after hitting a peak in 1999[9], the ratio has been experiencing a rising trend in line with an increase in the number of M&As[10].

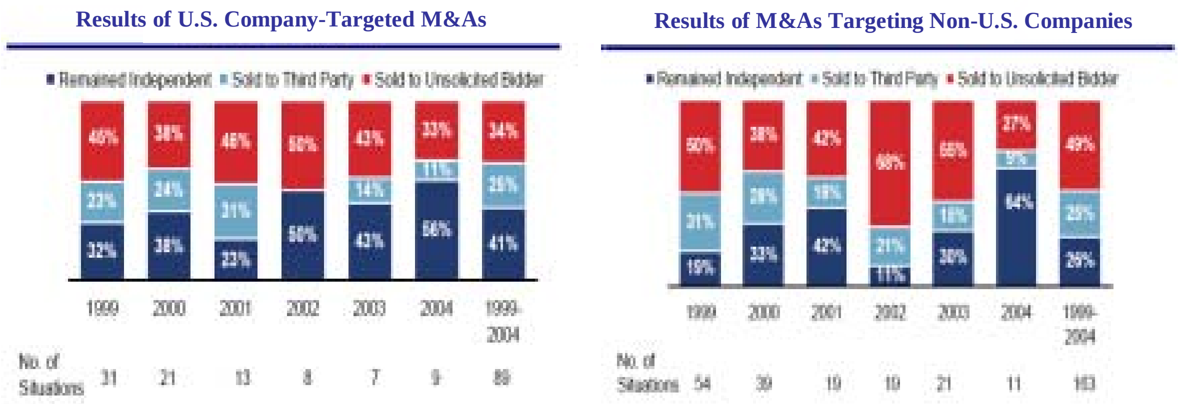
Figure 1-4 Ratio of Hostile Takeovers to Total Takeovers



Source: Hattori; Hitotsubashi University, Graduate School of International Corporate Strategy

Success rate of hostile takeovers: In the case where U.S. companies are targeted, the takeover succeeds in 35% of the cases, fails in 40% of the cases, and a third party (white knight) purchases in the remaining 25% of the cases. In the case where European companies are targeted, the comparable figures come to about 50%, 25%, and 25%, respectively. The success rate of hostile takeovers of U.S. companies is lower than that of takeovers of European companies.

Figure 1-5 Results of hostile takeovers



Source: Hattori; Hitotsubashi University, Graduate School of International Corporate Strategy

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9 There were many large hostile takeover cases in 1999. For example; British telecom company Vodafone's purchase of Mannesmann, a conglomerate of steel company and telecom company in Germany (valued 202.8 billion dollars; the largest hostile M&A on record) and U.S. pharmaceutical company Pfizer's purchase of Warner Lambert (valued 88.8 billion dollars). Hostile takeovers in 1999 came to 858 billion dollars, reaching a record high.

10 Hostile takeovers in 2004 came to 262 billion dollars (up 131% from the previous year).

3. How M&As in Japan have changed and will change

Let's look back on the history of M&As in Japan. M&A movements in Japan in the 25 years can be roughly divided into three periods: bubble years, second half of the 1990s, and the present.

(Second half of the 1980s ~Bubble and hostile cornering of stocks~)

M&As increased in Japan during the bubble economic period of the second half of the 1980s. The M&A during this period can be characterized by speculators' unfair manipulation of stock prices and sales of stocks at a profit afterwards, or so-called green mail[11].

Targeted companies, for their part, countered the hostile approach through cross-shareholdings or by issuing new shares to white knights (third-party allocation of new shares). With regard to the use of third-party allocation of new shares as a countermeasure, the Japanese courts have held that so long as the issuance of new shares is for the main purpose of raising funds it cannot be said that its main purpose is maintaining a controlling stake and therefore is not illegal. This so-called "rule of primary purpose" has been established.

(Second half of the 1990s ~Industrial reorganization of M&As~)

Although the M&A market in Japan was stagnant after the collapse of the bubble economy, many M&As began to take place in the second half of the 1990s. Behind this lies the fact that major institutional reforms concerning M&A were carried out. Among them were the lifting of a ban on holding companies[12] (1997), reform of the Corporate Law[13] (1997, 1999), establishment of a tax system for corporate reorganization[14] (2001), introduction of a consolidated tax system[15] (2002), and enforcement of the revised industrial revitalization law[16] (2003). The characteristics of the

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[11] It refers to cornering stocks of a targeted company and demanding the company buy back the stocks at higher prices. Incidentally, the word green mail was coined by associating greenback and blackmail. (Nomura Securities Co., IB Consulting Department, "Hostile M&A Defense Manual" Chuo Keizaisha, 2004, p. 20)

[12] In Japan, establishment of a pure holding company (company that control other business corporations without having a main business of its own) was prohibited under the Antimonopoly Law on the ground that business controlling power may be overconcentrated in such a company. However, the ban was lifted in 1997. The holding company system is utilized in reorganization and management integration within business groups.

[13] In 1997, a simplified merger system was introduced. In 1999, a stock swap/transfer system was introduced, establishing a system to facilitate the creation of wholly owned subsidiaries and parent companies.

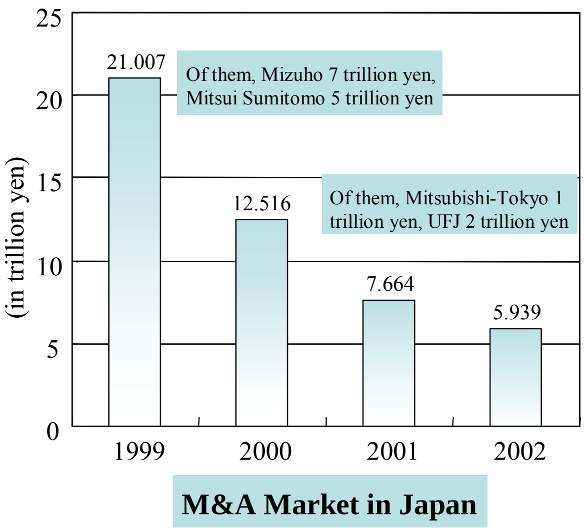
[14] Following the introduction of a corporate divestiture system in 2001, a tax relief system for organizational restructuring was established. In the case of mergers or corporate divestiture not accompanied by substantial changes in economic conditions (= continued control of assets transferred), the new system allows deferment of the shareholder tax arising from equity transfer and capital gains tax arising from asset transfer among corporations.

[15] A system to pay corporate tax on a consolidated basis after calculating income and loss of each company of a corporate group.

[16] The Industrial Revitalization Law (Industrial Revitalization Special Measure Law) was enacted in 1999 to support efforts of companies to improve overall productivity by strengthening their core businesses through corporate restructuring and capital increase. By amendment to the law in 2003, in order to cope with structural oversupply and excess debts, support measures have been increased to facilitate corporate restructuring. More specifically, support has also become available with respect to projects including "management resource reuse projects" that are aimed to improve productivity of businesses transferred from other companies, the scope of simplified corporate restructuring has been expanded, and mergers for money or other companies' stocks have become allowable.

M&As during this period were that in a broad range of industries, such as banking and industrial materials, M&As were mainly for large-scale reorganization of companies in the same trade, that there were M&As involving foreign capital, and that they were mostly friendly M&As.

Figure 1-6 M&A market in Japan



Source: Compiled by METI from Hattori, "Practical M&A Management" (Toyo Keizai Shinposha, 2004)

Figure 1-7 Major industrial reorganizations

○**Automobile industry**
Capital participation of western capital in Nissan, Mitsubishi, and Mazda in and after 1996. Incorporated into five major groups

○**Steel industry**
Incorporated into two major groups as a result of management integration of NKK and Kawasaki Steel in August 2002 and the formation of an alliance of Nippon Steel, Sumitomo Metal, and Kobe Steel in January the same year

○**Paper and Pulp industry**
Three major business reorganizations after 2001 and incorporated into two major groups

○**Cement industry**
Two major business reorganizations in the 1990s and incorporated into three major groups

○**Telecommunications industry**
Reorganization accelerated in the second half of the 1990s and incorporated into four major groups

○**Distribution industry**
Reorganization was accelerated in and after 2002, including purchase of Seiyu by Wal-Mart (2002), Management integration between Sogo and Seibu (2003), and Mycal incorporated with Aeon Group (2003).

○**Oil industry**
Reorganization accelerated in and after 1999 and incorporated into four major groups

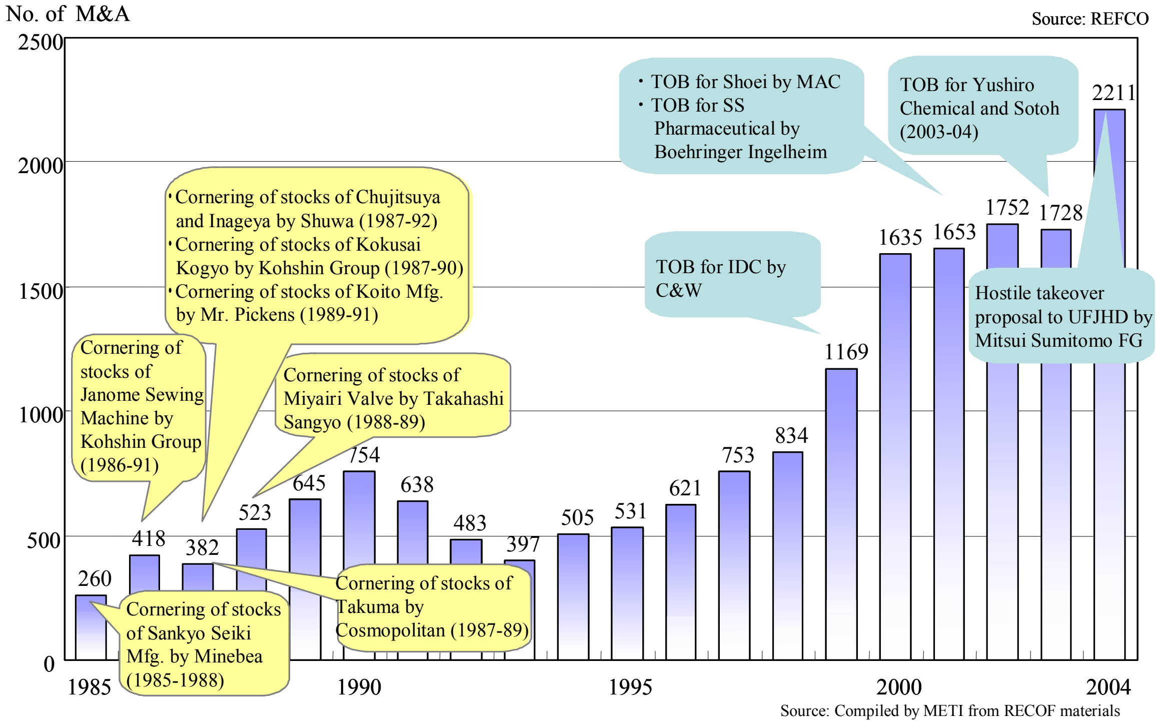
Source: Compiled by METI based on various reference materials

(After 2000 ~Chan ging Japanese business community and signs of mega-takeover era~)

The number of M&A cases, which stood at approximately 500 in the 1990s, increased sharply after 2000. They reached 2,211 in 2004, an approximate four-fold increase from 10 years earlier[17]. Though most of them are still friendly takeovers, the recent trend shows signs of an increase in hostile takeovers that had been receding since the bubble period. Among M&As that took place after 2000 there was an unfriendly takeover by a foreign capital (Boehringer Ingelheim's purchase of SS Pharmaceutical in 2001), a hostile TOB by a foreign fund (hostile TOB[18] of Steel Partners Japan for Yushiro and Sotoh in 2003), a hostile takeover proposal by a domestic corporation (Mitsui Sumitomo Financial Group's proposal to purchase UFJ Holdings in 2004), and a hostile takeover by a domestic corporation (Livedoor's hostile takeover of Nippon Broadcasting System in 2005). Defensive measures adopted or considered by target companies have diversified, such as dividend increases, different classes of stock (golden shares) and third-party allocation of stock acquisition rights.

[17] "marr February edition" RECOF p. 7
[18] Takeover bid

Figure 1-8Changes in the Number of M&A in Japan and Main Hostile Takeover Cases



4. Absence of fair rules concerning hostile M&As

(1) Structural change of the Japanese business community

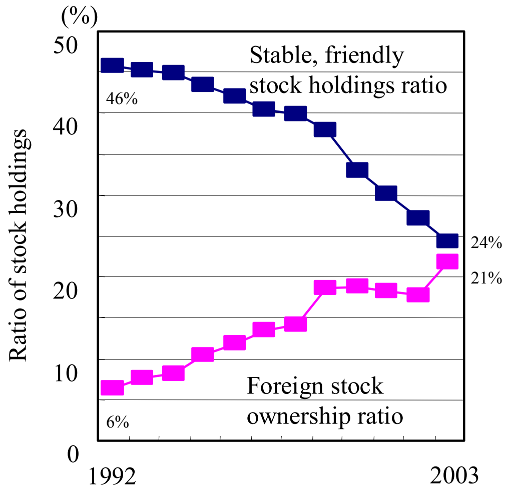
Behind the signs of an increase in hostile takeovers in Japan is the fact that the Japanese business community has undergone structural changes. There are four major changes: drastic dissolution of cross-shareholdings (the ratio of shares held by stable shareholders was reduced by half in the last 10 years), a gap in stock prices between Japan and the rest of the world (the gap in market capitalization between Japan and the United States is 1 to 4) and the gap among different lines of business (gap in market capitalization between a group of up-and-coming IT-related companies and the smokestack industry), eroding aversion to hostile takeovers and takeovers by foreign capitals, and a rising view focusing on shareholders' interests.

(Dissolution of cross-shareholdings)

The Corporate Value Study Group has received many opinions from institutional investors abroad. One of the opinions is that crossholding of shares is firmly in place in Japan and that Japan will go too far if it adopts takeover defense measures despite the fact that only a few hostile takeovers are taking place in the country. However, the reality is vastly different.

A study of the stock ownership ratio in Japan shows that the stable, friendly stock holding ratio[19], which stood at 46% in 1992, decreased dramatically over the last 10 years due to unloading of shares by financial institutions following the introduction of market-value accounting and in connection with the disposal of non-performing loans. In 2003, the ratio dropped to 24%[20]. On the other hand, the foreign stock ownership ratio, which stood at a mere 6% in 1992, increased dramatically to 21% in 2003[21].

Figure 1-9 Stable stock holding ratio and foreign stock ownership ratio



Source: Prepared by METI based on data from "Research on Cross-Shareholdings in 2003" (NLI Research Institute) and "FY2004 Share Ownership Survey" (All domestic stock exchanges)

Foreign stock ownership ratio varies from one corporation to another and from one line of business to another. In large market capitalization industries, such as chemicals, pharmaceuticals, electric equipment, precision instruments, insurance, and real estate, the foreign stock ownership ratios are higher than average. By corporation, foreign ownership ratios stand at above 50% in such corporations as Canon and Hoya.

The liquidity of stocks has increased due to the decline in the stable, friendly stock holdings ratio, resulting in an increase in the foreign stock ownership ratio and making it easy for hostile acquiring persons to corner stocks.

The defensive measure that Japanese corporations adopted before an actual threat of hostile takeover was cross-shareholding. They attached importance to long-term relationships and would not sell their stock holdings even if a hostile acquiring person offered high prices. However, the number of stable shareholders who would not sell their holdings even if a hostile acquiring person offered prices higher than market price has been decreasing.

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19 Stable, friendly stock holdings ratio is the ratio of stocks held by stable shareholders (cross-held stocks, stocks held by financial institutions, stocks of financial institutions held by business corporations, and stocks of affiliated companies held by parent companies) to total stocks surveyed. Cross-held stocks are those that are confirmed to have been mutually held between two companies.

20 "Research on Cross-Shareholdings in 2003" (NLI Research Institute)

21 "FY2004 Share Ownership Survey" (All domestic stock exchanges)

Incidentally, the United States also has a stable shareholder measure called white squire (people who hold about 15% of shares). The defensive measure is taken after concluding a status quo contract[22] and is so structured that it functions well even in an emergency.

(Gap in market capitalization)

A comparison of the market capitalization of stocks listed on the Tokyo Stock Exchange (TSE) and the market capitalization of stocks listed on the New York Stock Exchange as of August 2004 shows that there is a 1-to-4 gap between the two exchanges, with the market capitalization in Tokyo standing at 3,114.9 billion dollars[23] and that in New York at 12,317.6 billion dollars[24]. A closer look at industry-by-industry gaps shows that the gap is wider in such industries as pharmaceuticals (1 to 7.1), insurance (1 to 6.7), and food (1 to 6.2). By individual firm, while the market capitalization of Takeda Chemical is about 4 trillion yen, that of Pfizer is about 30 trillion yen, a gap of more than 1-to-7[25]. Due to these disparities, more business people express concern and anxiety about hostile takeovers by foreign firms. On the domestic front, the gap in market capitalization between up-and-coming IT-related firms and conventional firms, such as electric power and machinery, is wide. For instance, the market capitalization of Yahoo Japan is about 4.5 trillion yen, which is larger than the market capitalization of Tokyo Electric Power (about 3.5 trillion yen), the largest power company in Japan.

Figure 1-10 Gap between Market Capitalization of the U.S. and Japanese Companies

(Total market capitalization) ● U.S. companies: Japanese companies = 4:1

(Major companies)

● Pfizer	¥ 30 trillion	vs.	Takeda	¥ 4 trillion
● P&G	¥ 15 trillion	vs.	Kao	¥ 2 trillion
● Wal-Mart	¥ 24 trillion	vs.	Seven Eleven	¥ 3 trillion
● Microsoft	¥ 33 trillion	vs.	Canon	¥ 5 trillion

The factors behind the gap in market capitalization between Japan and the United States are the difference in capital productivity (while PERs[26] of both Japanese and U.S. firms are almost the same at about 20, the return on equity[27] (ROE) of Japanese firms in fiscal 2003 was 6.6% and

[22] A status-quo contract typically (i) restricts further buying of the stock, (ii) prohibits making takeover proposals, etc. without prior approval from the issuing company, (iii) restricts stock transfer, and (iv) grants priority right of purchasing the stocks to the issuer in the case when stocks are resold.
[23] Exchange rate: $1 = ¥110
[24] Needless to say, the gap fluctuates depending on exchange rate and daily stock price movements.
[25] On July 8, 2004 closing prices basis
[26] Price earnings ratio (PER) is calculated by dividing stock price by per-share net profit. PER of about 20 is considered an appropriate level.
[27] Net income divided by average shareholder’s equity of the preceding and current year. It is one of the indicators to measure the amount of profits earned by a corporation in one year by using shareholder’s equity (capital, capital reserve, profit reserve, and other reserves).

that of U.S. firms was 12.5%[28]) and the low dividend payout ratio[29] in Japan.

The dividend payout ratios of Japanese and U.S. firms both stood at 38% in fiscal 1994. However, in fiscal 2003, the ratio for the United States came to 33% and that for Japan to 21%, resulting in a gap of more than 10 percentage points[30]. Behind this lies the fact that Japanese companies did not increase dividends in proportion to the increase in net profits[31]. It is said that, in theory, stock price is neutral in its effect on dividends[32] but that an increase in dividends has a positive impact on stock prices as it reveals the company's financial strategy[33].

(Change in attitudes toward takeovers)

Since takeovers were mainly to bail out financially troubled companies in the past, many people were wary of takeovers. However, the negative image of takeovers has been lessening, partly because takeovers have become more commonplace with a sharp increase in the number of M&As in the last 10 years or so, and partly because of successful examples of corporate rehabilitation, such as Nissan Motors.

According to a survey[34] conducted by Nihon Keizai Shimbun, 78.7% of employees polled said they would not oppose a takeover if it leads to enhancing corporate value. Even employees, who would be affected most by takeovers, have become less allergic to corporate acquisitions, including those by foreign capital companies.

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[28] (Japan): Life Insurance Association's survey covering listed companies and OTC-traded companies (excluding financial companies). (U.S.): "Quarterly Financial Report" Commerce Department

[29] Per-share dividend divided by per-share net profit

[30] Life Insurance Association, "Profit Returns to Shareholders in FY2004"

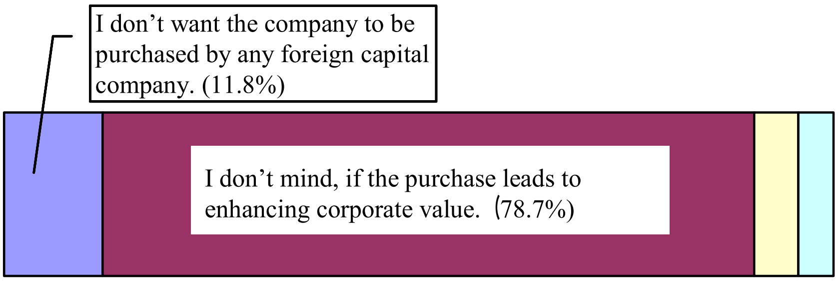
[31] The net profits of both Japanese and U.S. firms increased 2.5 times during the period from fiscal 1994 to fiscal 2003. However, while the U.S. firms doubled their total dividend, the Japanese firms increased their total dividend only by 40%. (Source: "FY2004 Reports on Return of Profits to Shareholders" Life Insurance Association of Japan.

[32] Documents prepared by Tsutomu Fujita, director at Nikko Citigroup Securities: ("In 1966, professors Miller and Modigliani, who are known for their MM Theory, presented a paper, saying that there is no relationship between dividends and stock price if certain conditions are met ((i) tax is neutral on stock dividends and stock trading profit and loss, (ii) there is no stock selling cost and liquidity is ensured, (iii) there is no stock issuing cost, (iv) dividend policy has no impact on a company's investment, operation and fund raising, and (v) management invest surplus funds reasonably and judiciously). This is called "Dividend Irrelevance Theorem." To be more precise, per-share stock value in the case of retaining earnings is equal to per-share stock value in the case of using earnings for dividends plus dividends.)

[33] Source: Documents prepared by Tsutomu Fujita, director at Nikko Citigroup Securities

[34] Oct. 18, 2004 Nihon Keizai Shimbun (morning edition) p. 13

Figure 1-11 What do you think if the company you are working for is being purchased by a foreign capital company?



Source: Oct. 18, 2004 Nihon Keizai Shimbun (morning edition) p. 13.

Then, how about hostile takeovers? As described earlier, most of the hostile takeovers in Japan until the early 1990s were aimed at gaining profits by selling stocks after raising prices through "green mail" and stock trading. Therefore, there was a strong negative image of "hostile acquiring persons = corporate raiders."

Nowadays, however, people do not necessarily have a negative image just because it is a hostile takeover. According to another survey[35] conducted by Nihon Keizai Shimbun, asked what they would do if the management of the company they work for changed as a result of a hostile takeover, nearly 40% of the respondents said they would consider responses after hearing business policy from the new management. They did not react emotionally simply because it was a hostile takeover, rather they have come to make judgments after assessing the reasonableness of the business policy.

(Change in attitudes toward "Whose company is it?")

People are critical of trading companies as if they are objects. As a result, the profound question remains of "Whose company is it?"

It goes without saying that a joint-stock company, in the legal sense of the term, belongs to its shareholders. However, it is also true that a company belongs to so-called stakeholders, such as its employees and the local community, who have already made investments in the company.

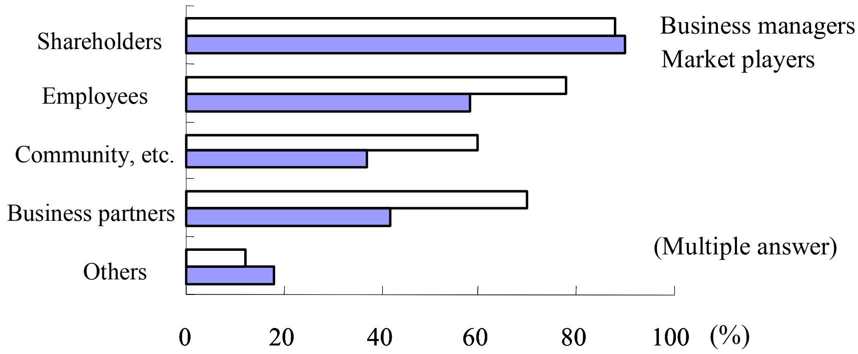
In Japan, people traditionally thought that a company belonged to its stakeholders, like employees, business partners, and the local community rather than to its shareholders.

For instance, survey results[36] announced in 1995 show that, when asked "Whose company is it?," slightly less than 80% of the respondents in the United States and about 70% in Britain said that it belonged to "shareholders." On the other hand, in countries in continental Europe like Germany and France, about 80% of the respondents said it belonged to "all stakeholders." In Japan, 97% replied that it belonged to "all stakeholders." However, 10 years after the survey, the situation

[35] March 21, 2005 Nihon Keizai Shimbun (morning edition) p. 13.
[36] Source: "Whose Company is it? The Concept of the Corporation in Japan and the West" Masaru Yoshimori (1995)

now is vastly different. In a survey[37] conducted by Nihon Keizai Shimbun on business managers and market players in March 2005, when asked "Whose company is it?" nearly 90% of the respondents said it belongs to the shareholders, indicating that the concept of "company = shareholders" has come to be valued in Japan.

Figure 1-12 Whose company is it?



Source: Prepared by METI from Nihon Keizai Shimbun (morning edition), May 13, 2005 p. 1.

According to another survey[38], when asked about the Tokyo District Court's decision to bar Nippon Broadcasting from issuing stock acquisition rights, about 80% of the respondents said the decision was "appropriate." Asked about the reason for Fuji Television Network's defeat in the court battle, about 50% of the respondents said that it was because the broadcasting company "gave the impression that it was making light of the interest of shareholders." This suggests that stressing the interest of shareholders in the takeover process has become an important matter.

(2) Rising threat of hostile takeovers

Given the fact that Japan's M&A market is still at the level of 3% of its market capitalization, or about half that of the United States, the Japanese M&A market has potential to expand in the future[39]. If the liquidity of the Japanese business community continues, the move toward hostile takeovers is expected to pick up steam amid the increase cases of takeovers.

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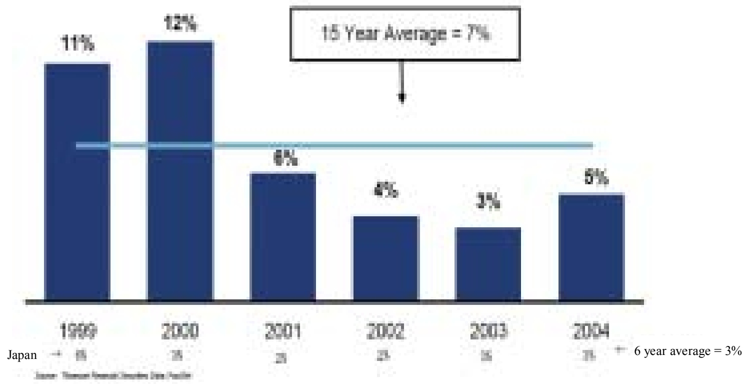
37 March 13, 2005 Nihon Keizai Shimbun (morning edition) p. 1
38 March 21, 2005 Nihon Keizai Shimbun (morning edition) p. 13
39 Thomson Financial

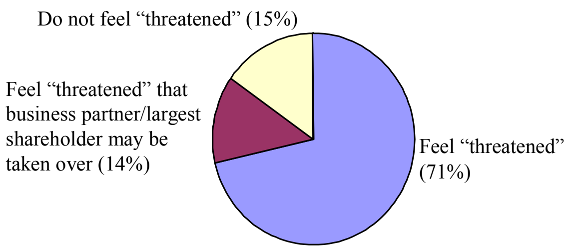
Figure 1-13 Percentage of M&A market in market capitalization (United States)



Source: Reference for the lecture by Associate Professor Nobumichi Hattori of the Graduate School of International Corporate Strategy, Hitotsubashi University

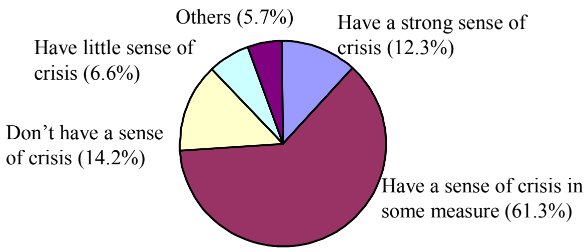
For this reason, concerns about hostile takeovers are rising in Japan and about 70% of Japanese business managers feel the threat of hostile takeovers[40]

Figure 1-14 Do you feel threatened by hostile takeovers?



September 2004 METI

Figure 1-15 Sense of crisis over hostile M&As



Source: March 6, 2005 Yomiuri Shimbun (morning edition) p. 1

The rising threat of hostile takeovers has come to function as a discipline on management. Japanese companies have come to take measures focused on return to shareholders. For instance, listed companies’ profit sharing with shareholders through dividend payouts and stock buy-back is expected to hit an all-time high of about 6 trillion yen in fiscal 2004[41].

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[40] In November 2004, Nippon Keidanren published “Opinions concerning the Establishment of Reasonable Defensive Measures against Corporate Acquisition.” In the report, the nation’s large business body says that the concerns about takeovers threatening to cause damage to corporate value are rising due to, among others, the dissolution of cross-shareholdings and a decrease in market capitalization caused by the calls for a sluggish performance of the stock market in recent years. It requires early establishment of reasonable defensive measures against corporate acquisition along with the improvement of the Corporate Law from the standpoint of curbing takeovers threatening to cause damage to corporate value and establishing an international equal footing in Japan.

[41] February 4, 2005 Nihon Keizai Shimbun (morning edition) p.1

(3) Risk of not having rules

(Lack of knowledge of and experience with hostile takeovers)

Japan lacks experience in hostile M&As. It also lacks knowledge about what would constitute legitimate and appropriate measures to enhance corporate value and protect shareholders' interest, or what would be a reasonable response to hostile takeovers. For Japanese companies, the practice of cross-shareholding was a typical example of hostile takeover defense measures (those adopted before the hostile approach and triggered in takeover contests), and a third-party allocation of new shares was a typical example of defensive measures (those adopted and triggered in takeover contests). However, as a result of progress made in the dissolution of cross-shareholding, effective defensive measures (those adopted before a hostile approach and triggered in takeover contests) are running out. As for the type of defensive measures that are adopted and triggered in takeover contests, Japanese companies at the discretion of the board of directors often resorted to massive issuance of new shares to a friendly third party in a bid to dilute the percentage of shares held by an acquiring person. However, these excessive defensive measures adopted ex-post by board directors may be ruled as "grossly unfair" in court. Moreover, from the standpoint of providing predictability to shareholders, such measures are not an appropriate action to be taken by listed companies.

Figure 1-16 Experience with hostile takeovers in Japan

[Cross shareholding]

<Takeovers failed>

Cornering of stocks of Sankyo Seiki by Minebea (1985-1988)

- Minebea, a major bearing manufacturer, acquired 19 issued shares of Sankyo Seiki Mfg., a precise equipment manufacturer, and then proposed amalgamation on an equal basis.
- Sankyo Seiki refused the proposal, and took defensive measures to maintain its trading financial institutions and companies as strong stockholders, thereby securing about 60% of shares as stable stock. Minebea, faced with the difficulty to winning over Sankyo Seiki's strong stockholders, abandoned amalgamation and sold off the shares.

Cornering of stocks of Koito Mfg. by Boone Company (Mr. Pickens) (1989-1991)

- Boone Company, having acquired 20.2% of issued shares of Koito Mfg. and become the largest shareholder, requested appointment of those from Boone as Komatsu's directors and dividend increase at the general shareholders' meeting, but all requests were rejected.
- As it was revealed that Koito shares owned by Boone had been purchased with loans from the seller Azabu Building Group, Boone abandoned acquisition of Koito.

TOB for Shoei by MAC (2001)

- For Shoei, whose cross-shareholding ratio was about 72%, MAC launched a TOB in January 2001 (buying price: 1,000 yen; premium: about 14%).
- As large shareholders did not accept the bid for the reason that the price offered by MAC did not reflect the true value of Shoei, MAC only acquired 6.5% of all shares.

<Takeover succeeded>

TOB for IDC by C&W (U. K.) (1999)

From May to June 1999, Cable & Wireless (C&W), a U.K. company, launched a TOB for International Digital Communications (IDC), where it was the largest shareholder. C&W acquired 97.69% of issued shares of IDC, thereby making IDC its subsidiary.

[Dividend increase against hostile takeover]

TOB for Yushiro and Sotoh by SPJ (2003-2004)

- In 2003, Steel Partners, a U. S. investment fund, launched TOBs for Yushio and Sotoh at the same time.
- Against the bids, Yushiro increased dividend. Sotoh initially launched a counter TOB with another domestic fund acting as a white knight, but then increased the dividend as SP raised its offering price.
- As a result of these countermeasures, the share prices of both Yushiro and Sotoh rose steeply, more than doubling compared to the level before the TOBs, few shareholders accepted the bids and therefore the bids failed.

[Allocation of new shares to third parties]

<Allocation of new shares to third parties upheld by court>

Cornering of stocks of Takuma by Cosmopolitan (1987-1989)

- Cosmopolitan, an investment group led by former organized crime group leader, acquired 36% of shares of Takuma, and exerted pressure on Takuma to hold a general shareholders' meeting to adopt measures such as the dismissal of the president.
- While ignoring Cosmopolitan's request, Takuma issued shares to third parties including Sumitomo Bank for the purpose of promoting new-product development and overseas business operation (Cosmopolitan's shareholding ratio dropped to 29%).
- Cosmopolitan brought an action for injunction of the allocation of new shares to third parties. The Osaka District Court rejected the action, ruling that there were reasonable grounds for the issue of new shares. Subsequently, Cosmopolitan fell into financial difficulties due to a stock price crash, and went bankrupt. Takuma shares owned by Cosmopolitan were sold on the market.

Cornering of stocks of Miyairi Valve by Takahashi Sangyo (1988-1989)

- Takahashi Sangyo, a medium-sized valve manufacturer, acquired 50.1% of shares of Miyairi Valve. Against this, Miyairi Valve issued shares to third parties twice.
- Takahashi Sangyo brought actions for injunction, but the court rejected the actions, ruling that there were capital needs for both issues. As a result, Takahashi Sangyo's shareholding ratio dropped to 40%, and therefore Takahashi Sangyo withdrew from the acquisition of Miyairi Valve.

< Allocation of new shares to third parties rejected by court >

Cornering of stocks of Chujitsuya and Inageya by Shuwa (1989-1991)

- Shuwa, a real estate company, purchased shares of Chujitsuya (33%) and Inageya (21%), in an attempt to reorganize the distribution industry. Against this, Chujitsuya and Inageya issued 20% shares to each other. Shuwa filed for provisional injunction to stop the issue of new shares.
- The court granted the injunction, ruling that the issue of shares by Chujitsuya and Inageya to each other was an interest-bearing issuance that failed to undergo due procedures and was an unfair measure designed only to lower a specific shareholder's stake. Finally, Shuwa sold Chujitsuya shares to Daiei and Inageya shares to Aeon.

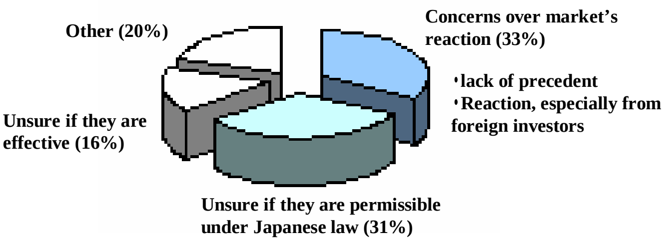
Proxy contest by Banners, etc. against Miyairi Valve (2004)

- An investment group consisting of Banners and others acquired 37% of issues of Miyairi Valve.
- Against this, Miyairi Valve issued shares to a third party. The investment group brought an action for injunction, arguing the issue of shares was an interest-bearing issuance. The court upheld this argument and granted the injunction.
- Subsequently, the investment group further acquired Miyairi Valve shares to 55% and convened an extraordinary general shareholders' meeting. At this meeting, a special resolution was passed to dismiss the president and the person designated by the investment group became the new president.

Source: Compiled by METI based on various reference materials

Meanwhile, rights plan (a defensive measure) that has been adopted by many U.S. companies is drawing attention. But, since there are no clear rules in Japan, the plan has yet to be adopted by Japanese companies. They are reluctant to adopt the plan out of fear that "adoption of the plan may not be permissible under Japanese Corporate Law" and that "adoption of the plan may cause negative share reaction." What defensive measures will enhance corporate value? What defensive measures will be used to entrench corporate management? Unless the Japanese business community establishes new realities regarding these points and designs institutional arrangements immediately, there will be repeated risks of excessive defense and excessive offense.

Figure 1-17 Reasons for not adopting defensive measures



Source: METI, September 2004

In a series of rulings[42] on Nippon Broadcasting's issuance of stock acquisition rights, the Tokyo High Court and the Tokyo District Court (hereinafter referred to as "Tokyo High Court/District Court rulings") said that defensive measures adopted after the emergence of an acquiring person (the type of measures adopted and triggered in takeover contests) are in principle illegal. But the courts left open the possibility of defensive measures adopted before hostile approach being legitimate and expressed the hope that a fair rule will be established. Many corporate managers are seeking defensive measures that would satisfy both the market and corporate acquirers.

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[42] On the issuance of stock acquisition rights by Nippon Broadcasting, the Tokyo District Court on March 11, 2005 said, "It is not in principle permissible for a board of directors to issue new shares, etc. for the main purpose of diluting the stake of a specific shareholder with whom the board is fighting over control of the company and thereby maintaining the current management's control of the company, as such acts mean that a board of directors, which is only an executing organ of a company, decides by itself who the company belongs to. The issuance of new shares, etc. should be permitted only in the cases where there is a special circumstance that would justify the issuance from the standpoint of protecting the interest of the company and all shareholders." The court said that the issuance of stock acquisition rights by Nippon Broadcasting "is aimed at maintaining the control of the company by the management belonging to the Fujisankei Communications Group and for the main purpose of maintaining the control of the company by the current management," and therefore constitutes an illegal issuance. The court thus issued an injunction to suspend the issuance. As for the type of defensive measures that are adopted before hostile approach, the district court said, "Studies are being made by experts on various occasions regarding measures that can be taken by a company beforehand, including procedures for adopting a measure, standard, involvement of outside directors and approval at shareholders' meeting. We hope that the discussions will lead to the establishment of a fair and clear rule from the standpoint of protecting the interest of the company and all shareholders."
Nippon Broadcasting filed an appeal to the Tokyo High Court, and on March 23, 2005, the Tokyo High Court said, "The main purpose of the issuance of stock acquisition rights (by Nippon Broadcasting) in the fight over control of the company was to dilute the stake of creditors (Livedoor) who are pursuing a hostile takeover to gain controlling power and to secure a controlling interest in Fuji TV, which currently controls the management and has a substantial influence over the company." The court supported the Tokyo District Court ruling and rejected the appeal. The Tokyo High Court ruling also pointed out that "the issuance of stock acquisition rights as prior countermeasures can be judged as legal depending on specific circumstances, the terms of the stock acquisition rights (whether it is shareholder allocation or not, whether it has removal provisions or not) and the procedures of issuance (whether there is approval resolution of a general meeting of shareholders or not), etc.

The mass media at home and abroad also expressed their hope that a fair rule will be established out of the hostile takeover furor[43].

To sum it up, what is needed is a defensive measure that will prompt a corporate acquirer and a corporate manager to discuss relative merits of the hostile acquirer's proposal and manager's business policy or his intended tie-up proposal and to demonstrate their skill to enhance corporate value in the presence of shareholders.

(Experience of forming rules concerning hostile M&As in the United States and Europe)

On this point, the experience of the United States and the EU are highly instructive. In the United States, when the fourth M&A boom occurred in the 1980s, there were no rules, and surprise attacks and excessive defensive measures were prevalent, producing harmful effects and confusion. In the 20 years since then, surprise attacks and excessive defensive measures were reduced thanks to legislative efforts, judicial judgments, and the rise of institutional investors. Instead reasonable rules against hostile M&As have been ingrained in the corporate community. Although the trading of companies has been liberalized in principle, a clear rule has been established in the United States after a process of trial and error. The same holds true for the EU. Toward the major goal of the integration of the EU, efforts were made to unify M&A rules and a consensus, if not ideal, is being formed.

(Establishment of comprehensive rules encompassing friendly M&A rules and hostile M&A rules)

In Japan, efforts were made to reform various M&A-related systems on the assumption that all M&As are friendly ones. The efforts resulted in large-scale industrial reorganization in the late 1990s. However, no overhaul of the system and practice was carried out with regard to hostile M&As. With the advent of an era of mega-takeovers just around the corner and in order to lead battles over hostile M&As to the enhancement of corporate value, now is the time for Japan to study in earnest rules that should be applied to the buying side and the defensive side, and defensive measures that will be accepted by shareholders and investors and are less likely to be judged illegal.

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[43] Newspapers, in their editorials, stressed the importance of establishing a fair rule concerning corporate acquisition. For instance, Asahi Shimbun says, "To what extent corporate managers are allowed to take defensive measures? What are the measures not supposed to be taken by them? It is necessary to draw a clear line of demarcation and establish procedures that should be followed. We share the same view with the Tokyo District Court, which said, 'We hope that a fair and clear rule will be established from the standpoint of protecting the interest of the company and all shareholders.'" (March 12, 2005 Asahi Shimbun (morning edition) p. 3)

Yomiuri Shimbun: "(the Tokyo High Court's statement) 'Studies are being made by experts regarding contents, standard, and procedures for adopting a measure. We hope that the discussions will lead to the establishment of a fair and clear rule.' The statement is a demand from the judicial branch of the government for resolution of inadequate law and rules concerning hostile takeovers. … Corporate defensive measures prepared beforehand on the assumption of a corporate takeover are different (from measures hastily implemented in an emergency). Preparation in peacetime is important." (March 12, 2005 Yomiuri Shimbun (morning edition) p. 3)

Overseas press: "If the guidelines (under preparation at METI) are put into force, Japanese economy will be able to take a variety of internationally-acceptable defensive measures against hostile takeovers" (March 22, 2005, *Financial Times*) p.11)

5. Problem consciousness of the Corporate Value Study Group ~Establishment of fair rules concerning hostile takeover~

The Corporate Value Study Group has been discussing ways to establish proper hostile takeover defense measures since September 2004. Its purpose is to have fair rules concerning hostile M&As take hold in the Japanese corporate community as soon as possible. It is important to realize the establishment of fair rules that meets the following basic principles: enhancement of corporate value (defensive measure is not for entrenching corporate management but for enhancing corporate value), global standard (defensive measure must be on a par with those adopted in the United States and European countries), no discrimination between foreign and domestic companies (defensive measure must give equal treatment to both domestic and foreign capitals), and increased options (offering increased options for shareholders and investors, not direct control by the government). In the following chapters, we will survey the picture of systems that need to be reviewed (Chapter 2), trace experiences in the United States and Europe (Chapter 3), and present fair rules in Japan (Chapter 4) and an ideal infrastructure of the corporate community (Chapter 5).

Chapter 2 Techniques and Economic Effects of Hostile M&As and Defensive Measures

Section 1 Techniques of hostile M&A and legal systems

As outlined in Chapter 1, the worldwide M&A market is expanding and hostile takeovers are also increasing. In Japan, where M&A is experiencing an increasing trend, hostile takeovers are also expected to increase.

In Japan, however, rules concerning friendly M&As such as mergers have been established but fair and reasonable rules concerning hostile takeovers are not available. Then, what are fair and reasonable rules concerning hostile takeovers? As an assumption to make such discussions, let's first summarize the systems that relate to M&A.

1. What is M&A?

M&A is an abbreviation of Mergers & Acquisitions, meaning that the acquirer conducts transactions for the purposes of participating in the target's management[44] or takes control of management[45]. Techniques of M&A are divided into two types, "merger" and "acquisition" like the definition.

There are two types of merger: A merger in its literal meaning in which two firms are integrated to become one, and the technique of using methods like exchange of shares and triangular merger that makes the target a subsidiary. All of these are the act accompanied by the restructuring of the corporate organization (act of organization restructuring), require the approval of a general meeting of shareholders and are performed following the regulations provided in Corporate Law. There are also techniques that do not lead to an act of organization restructuring (i.e., neither the organization of the acquirer nor that of the target changes) but enable the acquirer to take control of the target's management to a great extent. Typical examples in this respect are "subscription for new shares (capital tie-up)" and "transfer of business" through which the acquirer takes over only the related business department from the target.

On the other hand, acquisition means that the acquirer garners support from shareholders, and uses techniques such as buying up shares through TOB and replacing top management through the proxy contest.

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[44] This means to become the target's largest shareholder.

[45] Acquisition of the management right is divided into the following three stages according to the ratio of acquired shares: (1) to acquire the vetoing right regarding mergers and top management (in the case of acquiring at least one-third of the shares), (2) to make the target a subsidiary (in the case of acquiring more than 50% of the shares) and (3) to make the target a wholly owned subsidiary (in the case of acquiring all of the shares).

(1) Merger, exchange of shares and triangular merger

There are two types of organization restructuring based on Corporate Law: a merger in which two companies become one, and a transfer of shares and triangular merger in which the other party is made a wholly owned subsidiary. These are techniques used in cases of friendly M&A. Any of them can be used among Japanese companies, and the technique of triangular merger can be effectively used in mergers with foreign companies, due to the modernization of Corporate Law.

(Merger)

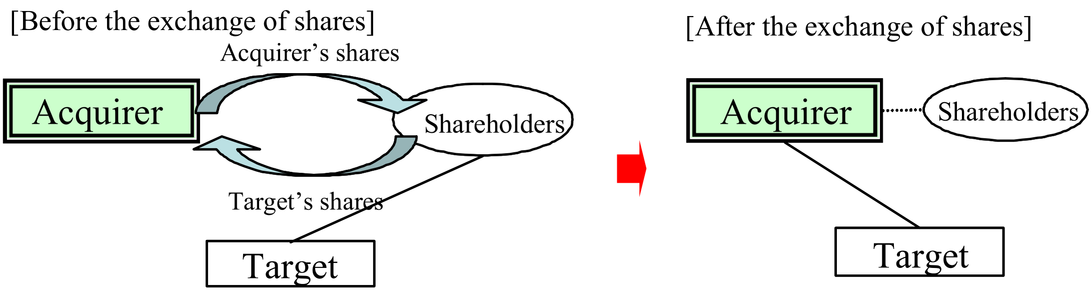
Mergers, the basic form of M&A, are where the acquirer and the target become one company using the system of merger determined by Corporate Law. Top management of the two sides conclude the merger agreement and a special resolution passed by the general meetings of shareholders of both sides (approved by at least two-thirds of the shareholders with voting rights who attend the meeting and form a majority of the total shareholders) is needed (except in those simple cases). As a result of absorbing the target through the merger, it is possible to concentrate necessary managerial resources and conduct flexible management. In addition, the treatment of tax deferral is applicable to asset transfers from the old companies to the new company and the conversion of old shares to new. On the other hand, as it takes time for the general meeting of shareholders to complete the procedures of approval, there is also the risk of being forced to take on debts hidden by the target.

(Exchange of shares)

The exchange of shares is a mechanism in which the target is made the acquirer's wholly owned subsidiary. The shareholders of the target exchange the target's shares with the acquirer's shares and become shareholders of the acquirer. As with a merger, top management of the two sides conclude the agreement on the exchange of shares and a special resolution passed by the general meeting of shareholders of the target will be needed. Incidentally, TOB in which shares are used to pay the price is also referred to as exchange of shares, but it should be noted that the mechanism involved in it is totally different.

The exchange of shares is considered a common tool when new listing of subsidiaries is reassessed in Japan, as in the case of Matsushita Electrical Industrial Co., Ltd. which made companies like Matsushita Communication Industrial Co., Ltd. its wholly owned subsidiary (2002), but besides that, the technique is also used in cases where the target wants to retain the contractual rights which can not be transferred automatically through the merger or where the acquirer wants to avoid the risk of taking on the debts hidden by the target through the merger.

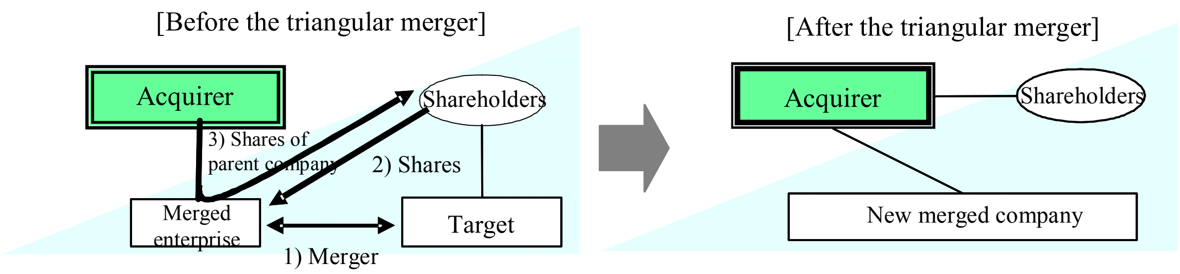
Figure 2-1 Mechanism of exchange of shares



(Triangular merger[46])

The exchange of shares is a unique system of Japan, and if an acquirer wants to make the target a wholly owned subsidiary in a foreign country, the system of a triangular merger or similar is available. The triangular merger is a mechanism in which the shareholders of the target exchange the target's shares with the acquirer's shares and become shareholders of the acquirer when the acquirer's wholly owned subsidiary merges with the target. The procedures of a triangular merger are the same as in the case of a merger: Top management of the two sides conclude the agreement of merger and a special resolution passed by the general meeting of shareholders is needed[47]. The advantage of the triangular merger is the same as in the case of exchange of shares[48] and are effectively used mainly in cases where a foreign company makes a Japanese company its wholly owned subsidiary or conversely in cases where a Japanese company makes a foreign company its wholly owned subsidiary.

Figure 2-2 Mechanism of triangular merger



(2) Subscription for new shares and transfer of business

The subscription for new shares (capital tie-up) and transfer of business are techniques

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46 Triangular merger can be performed today if certain requirements under the Industrial Revitalization Law are satisfied.

47 Under the triangular merger system to be introduced through modernization of the legal frameworks for companies, if shares with low liquidity are used for triangular merger, special resolution (approval from the majority of total shareholders and from at least two-thirds of the shareholders with voting rights) will be needed.

48 Tax deferral is applicable, if certain requirements are satisfied, to the merger and exchange of shares in the stage of shareholders but is not applicable to the triangular merger. In the case of tax transactions, the triangular merger becomes a system that cannot be used, hence an issue that will be discussed in the future.

used by the acquirer to acquire management rights of the target and the structure of the companies do not change significantly unlike in the case of mergers. Compared with the Organization Restructuring Act, the main feature is that the minority shareholders of the target still exist, and in principle, M&A through this technique is possible only if there is a decision by the board of directors and can be conducted in a flexible way.

(Subscription for new shares (Capital tie-up))

This means that the acquirer reaches an agreement with the target to subscribe for the increased capitalization implemented by the target. It can also be referred to as allocation of new shares to a third party. A special resolution passed by the general meeting of shareholders of the target is needed in the case of favorable issuance (in which the acquirer is asked to subscribe for new shares at an especially favorable price compared to the market price), but otherwise, new shares can be issued if only there is a resolution passed by the target's board of directors when the issuance is within the scope of four times of the total shares issued and does not exceed the quota determined by the articles of incorporation. As the minority shareholders of the target still exist, there is the risk that the acquirer's intention cannot be fully reflected, but this technique is suited to cases where the acquirer aims at a gradual tie-up. This technique can also be used also by foreign companies, and the capital tie-up between Nissan Motor Co., Ltd. and Renault (1999) is an example of this.

(Transfer of business)

This is a technique used by the acquirer to take over part of the target's business (business including things as a whole like company's assets, employees and business rights). If the part of business is the company's important asset, a special resolution passed by the general meeting of shareholders is needed, but in other cases, business can be transferred with only a resolution passed by the board of directors. It is effectively used when the acquirer wants to discreetly determine which part of the target's business should be taken over. In addition, foreign companies can use this technique and the transfer of leasing business from Nihon Lease to GE Capital (1999) is a typical example of this.

(3) Takeover

Buy-ins and proxy contests are takeover techniques. Unlike the Organization Restructuring Act, the acquirer is not required to reach an agreement with the target's top management regarding M&A. In addition, buy-in for the purpose of taking control of the target is normally through TOB.

(TOB)

TOB is an action whereby the acquirer buys shares of a listed target directly from its shareholders, independent of the stock market by clearly indicating the terms and conditions of purchase. TOB rules are determined by the Securities Transaction Law; if the resultant shareholding ratio exceeds one-third after purchase, this must be done through TOB and the acquirer is required to disclose information such as the period of buying, the number of shares bought and prices. The period of buying can be determined as between 20 and 60 days at the acquirer's option, three weeks at the minimum.

TOB can be used by both friendly and hostile acquirers and even foreign companies, and there are no restrictions on the means used to pay the buying price. Either cash or the company's own shares can be used[49]. The takeover of Matsushita Communication Industrial Co., Ltd. by Matsushita Electrical Industrial Co., Ltd. (2004) was a friendly TOB paid with cash, and the takeover of Germany's Mannesmann by UK's Vodafone (2000) was a TOB paid with shares.

Incidentally, compared to techniques like mergers, in the case of TOB it is not necessary to go through the procedures of approval by the general meeting of shareholders, but TOB also has its limits, such as cases where TOB alone is not enough to completely exclude minority shareholders and the fact that shareholders are subject to taxation for TOB transactions.

(Proxy contest)

As techniques to strip existing top management of management rights, in addition to buy-in, there is also the method of collecting proxies from shareholders (written documentation certifying the proxy to exercise their voting rights) and exercising the proxy voting rights so as to replace top management and acquire management rights. This is referred to as proxy contest. In Japan, the way of solicitation regarding the proxy contest is regulated by the Securities Transaction Law[50].

Incidentally, in Japan there are rarely any cases where the management rights are transferred through proxy contest, but in the United States the proxy contest is said to have been the only method before TOB was actively conducted.

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[49] Professor K. Eto, The University of Tokyo, commented: "In order to conduct TOB by paying the price with shares, either new shares should be issued or the company's own shares should be used, but under the current legal system, it is difficult in both cases. It is not that new shares cannot be issued, but, for example, if shares at a market price of 500 yen are delivered as shares at a market price of 800 yen, there is a high possibility of being sued because this is considered as issuing new shares at a favorable price." (*Economist*, temporary special number, issue of April 2005, p.15)

[50] According to the Securities Transaction Law, in the case of soliciting for proxies, it is necessary to give those solicited the paper of proxy and reference documentation (the bill to be submitted to the general meeting of shareholders, the name and address of the solicitor, and the number of voting rights) and the copies of such documentation should be submitted to the Minister of the Financial Services Agency. However, if the number of solicitors does not exceed ten or solicitation is done through newspapers or advertisement, such submission is not necessary (Article 194, the Securities Transaction Law, and No.2 of Article 36, the enforcement ordinance of the said law).

2. Techniques of hostile M&A

As has been seen so far, the techniques of M&A can be summarized as the following categories: (1) merger, exchange of shares and triangular merger, (2) subscription for new shares and transfer of business, and (3) takeover. And well, what techniques are used for hostile M&A?

(Hostile M&A starts with TOB)

Hostile M&A means that the target's top management opposes M&A proposed by the acquirer. Therefore, there arise disputes over who will take control of the target, and basically, the technique of "takeover" is used. It may as well be said that in Japan where the proxy contest has hardly been used, hostile M&As will start with TOB.

In the United States, however, the proxy contest has been used in parallel with TOB in hostile M&As since the 1990s when takeover defense measures were very popular[51]. This is because it became difficult to attain the objective of takeover if TOB alone was used. For instance, as the rights plan significantly raises takeover costs through TOB, a huge amount will be used for a takeover if TOB alone is used, but if directors can be replaced through the proxy contest, the rights plan will be removed and the target's shares can be bought up at an appropriate price. Consequently, in Japan, too, there is a high possibility to effectively use the proxy contest in hostile M&As.

(From TOB to merger)

Also, there are cases where the hostile acquirer intends to buy out the target or make it a wholly owned subsidiary. In such cases, the hostile acquirer first buys up shares through TOB (takeover) and replaces top management, and then conducts the merger, exchange of shares, triangular merger, capital tie-up or transfer of business. For instance, in the case where the hostile acquirer makes the target a wholly owned subsidiary, it conducts TOB in the first stage and after that, it uses the system of exchange of shares (for M&A among Japanese companies) or the system of triangular merger (in the case where a foreign company makes a Japanese enterprise a wholly owned subsidiary)[52][53].

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[51] For instance, there is the case where Villamet did not eliminate the stock acquisition rights regarding hostile TOB by Warehouser, and consequently Warehouser replaced one-third of Villamet's directors with those appointed by itself through the proxy contest. Incidentally, because the purchase price per share finally rose to 55.5 dollars from the initial price of 48 dollars as the result of 14-month negotiations, Villamet's board of directors agreed to the takeover and eliminated the stock acquisition rights. (Reference: *Poison Pill, Vote, and Professors: A Renewed Discussion* by Martin Lipton, and translated by Y. Tezuka, R. Nakayama and Y. Ota (Latter Part) p.24-25) (*Laws Related to Business*, No.1644, 2002)

[52] That is, after taking control of the company by acquiring more than two-thirds of the shares through TOB, the acquirer can replace directors, conclude an agreement of triangular merger with that board of directors and make the target a wholly owned subsidiary through a special resolution passed by the general meeting of shareholders.

[53] Incidentally, the system of triangular merger is introduced due to the modernization of legal systems on company, but against such two-tiered technique of takeover by the hostile acquirer, i.e., TOB in the first stage and the triangular merger in the second stage, as there is a preparation period set for Japanese companies to take effective defensive measures, it is decided that the date on which the system of triangular merger is implemented be postponed for one year.

In this way, as no agreement can be reached with the target's top management in the case of a hostile M&A, first the "takeover" is started with methods like TOB, but if top management is successfully replaced, other M&A techniques can also be effectively used.

3. Legal systems concerning hostile takeovers and defensive measures

What legal systems are related to hostile takeovers?

First, hostile takeovers start with TOB. In this sense, basically there is the Securities Transaction Law which provides the mechanism to regulate the attacker (acquirer).

On the other hand, defensive measures against hostile takeovers are an act to restrict a takeover by such a hostile acquirer as well as mergers in the second stage after a successful takeover, and effectively use means determined in the Corporate Law and the Securities Transaction Law.

For instance, there are countries like the U.K. and Germany where the acquirer is subject to the obligation to buy out all shares, i.e., the acquirer must accept all stock warrants for the TOB proposal if the acquirer wants to take control of the company (if the acquirer gains more than 30% of the voting rights). This is a measure to regulate in the initial stage the bust-up takeover for which two-tiered takeovers is used, and this can also be said as an example that rules have been formed in the direction of regulating the attacker (acquirer) mainly within the framework of the Securities Transaction Law.

By contrast, in Europe, there are countries, like France, where methods like the golden share where the different classes of stock are effectively used to cope with TOB. Also, there are other countries like the United States where TOB is restricted through the rights plan for which the stock acquisition right is effectively used. Also, each state of the United States has established the system to prohibit organization restructuring such as mergers over a few years if the hostile acquirer has acquired management rights through buying up shares and the system to restrict voting rights[54]. This can also be said as an example that rules have been formed to allow companies to take certain defensive measures in restricting hostile M&As mainly within the framework of the Corporate Law.

In this way, systems related to hostile M&As cover a wide range and are linked with each other. The effects and disadvantages of hostile M&As will be verified in the next section.

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[54] In addition, there are regulations on M&A by foreign capital. In Japan's Foreign Exchange and Foreign Trade Control Law, it is required that a foreign company should submit notification in advance if it acquires at least 10% shares regarding regulated industries such as the aviation and the weapon industries; if there are problems from the viewpoint of national security, an advisory instruction of change or suspension can be made after hearings from councils on duty and foreign exchange. Also, regarding industries such as communications, broadcasting, mining, and air transportation, the acquisition of shares by foreign capital is being regulated to some extent according to the specific laws for each industry. Besides, in the specific laws for industries like electric power, gas and railway, mergers or split-ups of the business owners who are a legal person will not come into force unless approved by the minister in charge. In addition, regulations on foreign capital and regulations through specific laws for each industry apply not only to hostile takeovers but to friendly takeovers as well.

Section 2 The effects and disadvantages of hostile takeovers and defensive measures (Economics on hostile takeovers and defensive measures)

The threat of hostile takeovers disciplines management and brings about managerial innovation. This is also shared by management executives in Japan[55]. There is no need to deny the threat of hostile takeovers. There are also cases where corporate value is enhanced through hostile takeovers and no defensive measures should be allowed to prevent this kind of takeover[56].

However, people often point out the disadvantages of hostile takeovers. Even in a court decision made by the Tokyo High Court on the case of prohibiting the issuance of the stock acquisition right by Nippon Broadcasting[57], the court indicated four types of hostile takeovers that have disadvantages and pointed out that it is possible that defensive measures to prevent such hostile takeovers may be exceptionally legitimate even if they are the ones adopted in takeover contests.

Therefore, this section tries to summarize the effects and disadvantages of hostile takeovers, and then, by taking into account concepts of "corporate value," a keyword for closely watching the effects of hostile takeovers, it explains what are reasonable defensive measures from an economic viewpoint.

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55 Mr. Okuda, Chairman of Japan Federation of Economic Organizations, said as follows: Corporate executives must remain alert, recognizing the possibility that hostile takeovers will be conducted more regularly from now on."

56 The guidelines for exercising voting rights by institutional investors in Europe and the United States clearly states to this effect (for details, refer to Chapter 3).

57 The four types of takeovers that hurt shareholders' interests (the court decision made by the Tokyo High Court on March 23, 2005)

The court decision made by the Tokyo High Court on the provisional injunction of prohibiting the issuance of stock acquisition right by Nippon Broadcasting, as was referred to in Chapter 1, pointed out that the following types of takeovers that clearly hurt shareholders' interests. There are cases where the board of directors is allowed to take takeover defense measures as a counter-measure:

(1) the case where the acquire 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 green mailer);
(2) the case where the acquire accumulates the target shares for the purpose of 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;
(3) the case where the acquire 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.
(4) the case where the acquire 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.

1. The effect of hostile takeovers to promote corporate reforms

There are cases where an acquirer more capable than the current top management conducts the acquisition of business and carries out management reforms so that corporate value is enhanced. Also, to conduct management while preparing against a hostile takeover and having feelings of tension can be considered necessary for further enhancing corporate value. It can be said that increasing concerns over hostile takeovers have in themselves the effect to promote efforts to heighten management discipline. In fact, there are many management executives who delay efforts to enhance corporate value as measures against hostile takeovers. As hostile takeovers bring about increasing threats, companies start to prepare against hostile takeovers and make managerial efforts to enhance aggregate market capitalization, such as strengthening the policy of returning profits to shareholders through dividend policy and buying the company's own shares, and reassessing business and financial strategies. It could also be beneficial for companies with publicly-held shares to be subject to pressures for management innovations under such market surveillance. In addition, there are cases where corporate value is enhanced as the result of hostile takeovers. For instance, Summers raised the takeover of Plateau Petroleum Inc. by Mr. Boone Pickens as a case where resources were more efficiently allocated as the result of the hostile takeover and society as a whole benefited[58]. It is during a hostile takeover that management resources can be boldly selected and concentrated in a way that existing top management might not do, and consequently corporate value is enhanced.

2. Types of adverse effects arising from hostile takeovers

Each company has its own corporate value created by itself and top management performs its duty by maintaining and enhancing that value. The concept of corporate value at that time is considered to be the sum of future profits the company will earn, and normally management executives make decisions by taking into account the impact of relations with a wide range of stakeholders including employees, customers, clients or the local community will have on corporate value.

By contrast, a hostile takeover tries to adopt a different strategy from the existing top management to enhance corporate value. Therefore, management executives tend to interpret hostile takeovers as a threat, but it is not that all hostile takeovers hurt corporate value. Nevertheless, it is pointed out that among techniques used by the acquirer, there are types of takeovers that structurally mislead shareholders, such as green mail and two-tired takeover. It is also true that there are some takeover proposals that hurt corporate value more than management proposals by management

[58] 10,000 employees of Plateau Petroleum Inc. were laid off but they were reemployed at the same wage level. Also, a large number of transactions were cancelled but the clients immediately found other new customers and the transaction amount remained unchanged. As a result, the company's share price is said to have risen 25%. (Source: Breach of Trust in Hostile Takeover, by Andrei Shleifer and Lawrence H. Summers (1987))

executives. For this reason, the hostile takeovers determined as a threat to corporate value in Europe and the United States are summarized below.

(1) Structurally coercive takeovers

Among hostile takeovers, there are cases where the objective and techniques structurally hurt the interests of shareholders and the company, and green mail and the two-tiered takeover are typical cases.

(Greenmail)

This is an act to buy up shares and require the company to buy them back at a higher price. The objective of a green mail is that only the acquirer (green mailer) can gain profits based on other shareholders' losses, which will obviously harm corporate value. In the takeover of oil company Gulf, people like Boone Pickens were regarded as green mailers when they made Chevron Inc., a company to which Gulf was to be sold, buy back the shares that had been bought up.

(Two-tiered takeover)

This is an act to set the terms and conditions of buy-in at a favorable price in the initial stage and at an unfavorable (or unclear) price in the second stage. In other words, this is a technique to create unfavorable conditions so that shareholders will be at a loss if they do not sell in the initial stage so are urged to sell earlier.

For instance, for the initial buy-in, shares up to one-third of the total shares are bought with cash at a price higher than the market price, and for a second-stage buy-in, that is, for the remaining two-thirds[59], unfavorable terms and conditions are presented, e.g., the price to be paid with junk bonds, the transaction not scheduled to be publicized to the public, or no clear policy to be indicated. If so, shareholders, even though believing that the share price will rise by XX% in the future and having no real intention of selling their shares at the offer price that is XX% higher, will be forced to sell in a haste amid expectations that once the hostile takeover is successful, they will be forced to accept more unfavorable terms and conditions in the second stage. In addition, the takeover proposal by Boone Pickens to Unocal Oil is a well-known case. According to that proposal, the first stage takeover would be paid in cash but the second stage buy-in would be paid with junk bonds. The court clearly identified it as a coercive technique of takeover that puts pressure on shareholders so that they will have to respond to the first-stage takeover. In Japan, too, it is pointed out that Steel Partners Japan (SPJ)'s takeover proposal to Sotoh probably falls under this category. SPJ made a TOB proposal to the shareholders of Sotoh for buying shares not exceeding one-third of the total shares at a premium price to be paid in cash but also made it clear that once the takeover was successful, there is a high possibility of running counter to the criterion for delisting. As a result, the

[59] These are bonds with a low possibility of debt-collection.

shareholders are said to have been driven into a condition of being forced to sell in haste, though unsatisfied with the offer price, in consideration of the risk that the cashability would be hurt once the shares were delisted.

(2) Lack of alternatives and shareholder fallacy

In the judicial precedents of the United States, not only the above-mentioned coercive takeovers but even the bid to all shares with the price to be paid in cash may be regarded as having adverse effects. There are two types in this respect. One is the lack of alternatives, i.e., the improper takeover proposal is made amid flagging stock prices and no room is given to present an alternative proposal, and the other is shareholder fallacy, i.e., the case where there are concerns that the hostile takeover proposal is relatively inferior to the existing management but may come into effect because shareholders do not have sufficient information. Both are considered to constitute a threat to corporate value.

(Lack-of-alternatives type (Lack-of-opportunity type))

This is the type where management is not given room to make an alternative proposal. For instance, if the takeover proposal is made amid flagging stock prices and the offer price is not appropriate but the acquirer, without holding sufficient negotiations with management executives in advance, directly launches TOB, then management executives lose the opportunity to make a better proposal and as a result, the interests of shareholders are hurt as well. Even if the acquirer's proposal is a bid to all shares with the price to be paid in cash, giving management executives enough time to present an alternative proposal is effective also for enhancing corporate value.

(Shareholder fallacy type)

This is the type of takeover where due to lack of sufficient information, shareholders have a mistaken conception of a takeover proposal that might harm corporate value, and accept the proposal. For instance, if the company's future growth potential and the results of investments in the past as well as the content of the acquirer's takeover are not clearly known, it is possible that shareholders, without having sufficient information, have to make a decision only based on how high the offer price is. A proposal that impairs corporate value may come into effect. The takeover proposal aimed at income distribution from stakeholders to shareholders enhances the value of shareholders in the short term but has a negative impact on corporate value. There are cases where shareholders mistakenly respond to the takeover proposal that hurts corporate value, if the share price fails to correctly reflect such negative impact on the corporate value.

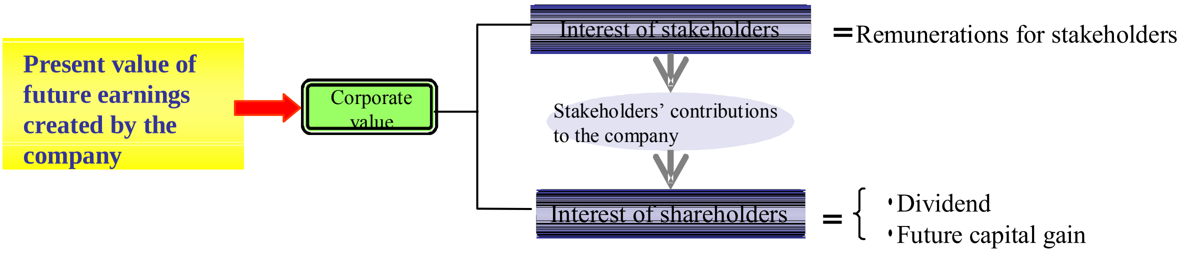
3. Hostile takeovers and corporate value

The adverse effects of hostile takeovers were summarized above. But in fact, it is difficult to discern whether a hostile takeover will enhance or impair corporate value. In the first place, what is corporate value and how we can recognize a hostile takeover that will enhance corporate value? This is an important point for understanding the reasonableness of takeover defense measures. The concepts based on such arguments are summarized below.

(What is corporate value?)

Corporate value includes the company's features that are beneficial to shareholders or the degree thereof, such as property, profitability, stability, efficiency, and growth potential. In other words, it is the sum of future earnings created by the company and falls into the value of shareholders that belongs to shareholders and the value of stakeholders that belongs to stakeholders. Corporate value is an estimated figure of future value and can easily change due to variables in the future. Therefore, it is difficult to correctly quantify the value.

Figure 2-3 What is corporate value?



If the market is in a perfect condition, future earnings of the company under the strategy of the existing top management, which are based on the asset-liability balance sheet, indicate corporate value. If the share price is considered to correctly reflect future earnings under the existing top management, then the acquirer's proposal for buying shares at a higher price than that not only shows that the acquirer is more confident in future profits but also indicates that the takeover proposal with a higher price than the market value should not be rejected.

Also, if what belongs to stakeholders is a constant, enhancing the share value (that belongs to shareholders) is tantamount to enhancing corporate value.

However, there are cases where the share price fails to match the corporate value. Also, as the value of shareholders is not the same as the corporate value, in some cases increasing the value of shareholders does not mean enhancing the corporate value.

(Mismatch between share price and corporate value)

The share price correctly reflects corporate value only when the market is in a perfect condition. There is a possibility that valuable information that determines future earnings is not freely available in the market, and in general, corporate value does not match the share price. For instance, if unfavorable information that determines the company's future growth potential is known to the existing management executives but is not shared in the market, the share price is higher than the corporate value. Effects of practices such as window dressing settlement of accounts fall under this category. On the other hand, if favorable information that determines the company's future growth potential is known to the existing management executives but is not shared in the market, the share price is lower than the corporate value. Effects of practices such as R&D, business fixed investment and investment in human resources fall under this category. In addition, the share price generally changes more drastically than corporate value does, and even if the share price can be said to have correctly assessed the corporate value in terms of the trend, it can also be said that the share price has undervalued corporate value or overvalued it in many cases.

If the share price is undervalued, there is the possibility that one can gain the margin of profit by launching TOB at a lower price than the corporate value. In fact, it is a phenomenon often seen that the acquirer revises the offer price in the process of TOB. In the case of SPJ's hostile TOB against Sotoh, the initial offer price was 1,150 yen per share but was finally raised to 1,550 yen as the result of a counter TOB launched by the white knight. In the case of Oracle's hostile TOB against PeopleSoft, as PeopleSoft adopted the rights plan, the initial offer price of 16 dollars per share was finally raised to 26.5 dollars as the result of negotiations on the removal of the rights plan that lasted as long as a year and a half. There are cases where repeated negotiations lead to a favorable share price.

In this way, even if the offer price is higher than the share price, there is no guarantee that the corporate value aimed at by the acquirer will be higher than management executives' corporate value. If there is information asymmetry due to the imperfect market, even if the acquirer offers a price higher than the share price, there is not necessarily any guarantee that it is higher than the corporate value created by top management through their constant efforts to increase corporate value.

(Mismatch between value of shareholders and corporate value)

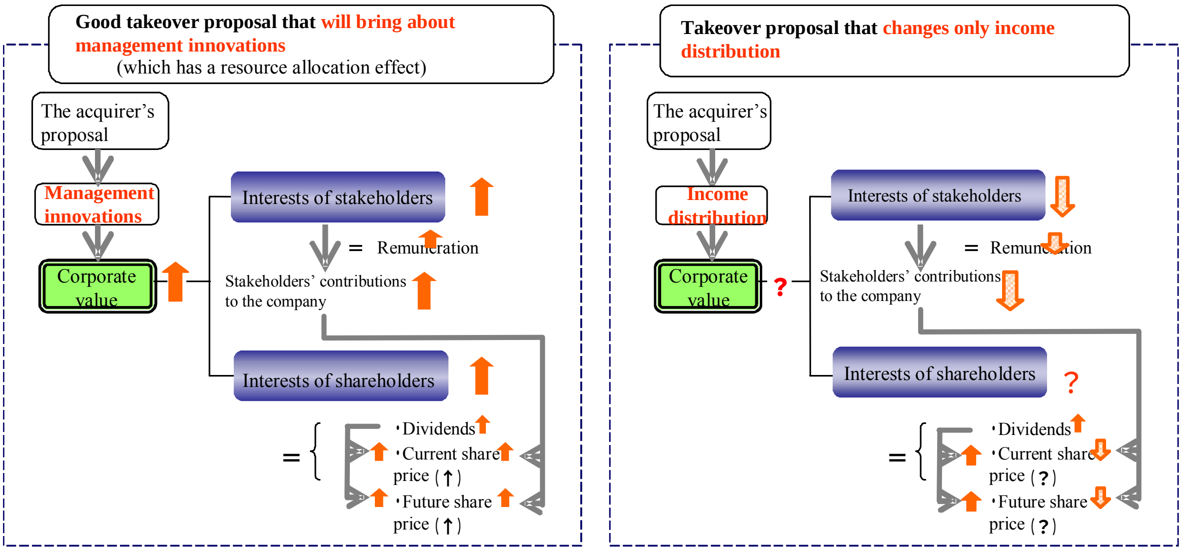
Corporate value is the sum of the value of shareholders and the value belonging to stakeholders, and the value of shareholders is not the same as corporate value. Therefore, the takeover proposal launched only for the purpose of transferring income from stakeholders to shareholders looks like a beneficial action to shareholders but is neutral with regards to corporate value and may possibly be negative in the long term. If remuneration and employment opportunities expected by employees are reduced because funds are used as income transfer to shareholders, that will lead to the inhibition of employees' motivation to make contributions to the company and the restriction on the company's inherent behavior of making investments. This is also referred to as effect of breach of trust. For instance, in case of a takeover proposal that will increase dividends merely by reducing internal reserves and employees' wages, the corporate value may possibly be hurt in the long term as that will reduce stakeholders' contribution to the company. Also, in LBO, the case of implementing management innovations and raising cash flow to repay loans after the takeover can be positively assessed as enhancing the corporate value of the target company. However the case of securing funds for repayment by laying off employees and selling assets after the takeover is highly likely to be a proposal aimed only at income distribution through the company dissolution and will resultantly hurt the corporate value. As was explained in Chapter 1, the M&A boom in the United States in the 1980s was based on LBO, and there are some people maintaining that many acquirers' profits came from laying off of employees and the selling of the company's assets[60].

(Importance of relative comparison)

For this reason, determining the corporate value only by a comparison between the one-time presented offer price and the share price entails the risk of adopting a proposal that will contrarily hurt corporate value. For instance, amid flagging share prices that have fallen below corporate value, it is also possible to buy up shares at a price lower than corporate value (but higher than the share price) and gain profits by selling the assets. Regarding takeover proposals for which such excessive price changes are exploited, we cannot rule out the possibility either that they will finally become proposals that impair corporate value. Even if the offer price is at the same level, in one takeover proposal employees will be laid off for the purpose of increasing dividends to shareholders, and in the other, on the assumption of conducting management innovations, efforts will be made to increase dividends without laying off employees. The former proposal, with income distribution alone to be changed, it is neutral to corporate value in the short term but there is a high possibility for corporate value to be hurt in the long term. This is because, as was explained above, if the distribution to stakeholders is reduced, their contributions to the company will decline and there is the possibility for future earnings to decline. Therefore, it is important that, in addition to information about how much higher the offer price is than the share price, contents of the hostile acquirer's takeover proposal and the existing management's proposal should be disclosed to shareholders. Corporate value cannot be determined only by the share price, and in the end, the judgment on whether a hostile takeover will enhance corporate value has to be made by making a relative comparison between the takeover proposal and management's proposal.

[60] According to a paper by Shleifer and Summers, in LBO and takeovers for the purpose of tax avoidance, the majority of the premium of the takeover is theoretically likely to result from transferring stakeholder profits (Breach of Trust in Hostile Takeover, by Andrei Shleifer and Lawrence H. Summers (1987)).

Figure 2-4 Corporate value should be determined by relative comparison



4. Requirements for economically reasonable takeover defense measures

What takeover defense measures can be said as economically reasonable? If a takeover defense measure is designed in such a way that a relative comparison can be made between management's proposal and the acquirer's proposal, then it is justified as a reasonable measure.

The requirements for defensive measures that have economic reasonableness are presented in the below.

(Necessary requirements for takeover defense measures to become economically reasonable)

The threat of hostile takeovers has the doubtless effect of enhancing management discipline. On the other hand, there are also cases of structural coerciveness in hostile takeovers like green mail and two-tiered takeovers and those without the possibility of enhancing corporate value. For this reason, if a defensive measure functions to rule out coercive takeover proposals and those that might hurt the corporate value more than if management is in charge, then it is a reasonable measure[61]. Also, if it is a mechanism in which information that determines the corporate value is disclosed to shareholders by both management executives and the acquirer over a reasonable period, such defensive measures may be assessed as those that enhance corporate value. For instance, TOB is a mechanism in which the judgment on the reasonableness of a takeover proposal can be made relatively quickly with the offer price being the major information. In contrast to this, if a takeover defense measure is a mechanism to give shareholders the opportunity to make a comparison between the acquirer's takeover proposal and the existing management's proposal by eliminating the

[61] Even the Tokyo High Court decision pointed out the possibility that defensive measures intended to avoid the types of hostile takeovers that have adverse effects may be legitimate even if they are adopted in takeover contests.

information asymmetry in a way better than the mechanism of TOB, this may be considered to have economic reasonableness. Such defensive measures also have the effect of excluding takeover techniques that might clearly bring about damage to corporate value, such as coercive techniques like green mail and two-tiered takeovers. Furthermore, if the defensive measure can be removed through the proxy contest, in order to use TOB along with the proxy contest and solicit support from shareholders in a limited period of a few months (in the United States the limit is one year and a few months), useful information will be disclosed by both the acquirer and management executives. As a result, uneven distribution of information can be eliminated and the corporate value can be discerned more correctly. It will also become possible for shareholders to select the superior management proposal. If such a defensive measure is available in conjunction with TOB rules, then this might be assessed as having reasonableness. On the other hand, a defensive measure that can not be removed will hurt corporate value, and as it cannot be removed even if information asymmetry is eliminated, as a result, acquisition costs will rise excessively. For that reason, the minimum necessary requirement is that it should be possible to remove the defensive measures. Further, it is recommended that defensive measures be designed in such a way that they can be removed as soon as possible if shareholders are provided with information needed to make a judgment on the corporate value.

(Necessary requirements for enhancing economic reasonableness of defensive measures)

A problem arises if it is not known whether or not management executives will use defensive measures according to the corporate value standard in a faithful way. If management executives exploit defensive measures by using the corporate value standard as a cover to maintain their own positions, then such defensive measures will hurt corporate value. This conflict of interest plagues management executives in their behaviors and various kinds of managerial decisions, and can also be said to be a problem arising from the assumption of separation of ownership from management in joint stock companies. In this sense, it can also be said that the designing of defensive measures comes down in particular to the designing of the system of corporate governance. In Europe and the United States where hostile M&As are taking place more aggressively than in Japan, management executives have developed various kinds of creative ways to defend not only themselves but corporate value as well, and it is of great significance for Japan to learn from this experience.

Chapter 3 Rules concerning Hostile Takeovers in Europe and the United States

In Chapter 2, it was pointed out that hostile takeovers have not only positive effects but also adverse effects. This chapter is going to verify the actual state of defensive measures in Europe and the United States and demonstrate that what rules have been established concerning hostile takeovers.

In Europe, there is an approach like TOB rules in the U.K. that **regulate coercive takeovers in the initial stage**. There is also the approach like golden shares in continental European countries that **allows powerful defensive measures on the precondition that there is approval of the general meeting of shareholders**. In addition, there is also an approach like that in the United States, i.e., **defensive measures can be adopted according to management executives' judgment but independent outside directors monitor top management's management**. Therefore, systems vary by country and none has established a perfect mechanism concerning the reasonableness of defensive measures, but it might be said that a sort of common sense has been established in the business community.

To learn such wisdom and experiences of Europe and the United States will give Japan suggestions for establishing its reasonable takeover rules.

Figure 3-1 Comparison of Legal Systems of Various Countries Concerning Regulation of M&A

		Japan	U.S.	EU	EU: U.K.	EU: Germany	EU: France
	Concept in each country	●Cope with coercive takeovers not through TOB regulations but through defensive measures adopted by the company.	●Cope with coercive takeovers not through TOB regulations but through defensive measures adopted by the company (mainly rights plan). ●In addition, there are laws on business joining restrictions in the laws of each state.	●Exclude coercive takeovers through strict TOB regulations. ●Defensive measures taken by the company are in principle prohibited. ●Each member country's discretion can be permitted.	●Exclude coercive takeovers through strict TOB regulations. ●Defensive measures taken by the company are in principle prohibited.	●Exclude coercive takeovers through strict TOB regulations. ●Defensives measures can be adopted if approved by the board of auditors.	●Exclude coercive takeovers through strict TOB regulations ●Companies can effectively use measures such as shares with multiple voting rights.
Regulation for acquirer	**TOB regulation** (The regulation requiring that in order to gain control of the company, the acquirer should make a bid to all shareholders at the same offer price)	Securities Transaction Law ○	Securities Transaction Law ○	Takeovers Directive (To become law in each member country by May 2006) ○ Optional for each member country	City・Code (Voluntary rule) ○	Takeovers Law (Enacted in 2002) ○	Securities Transaction Law ○
Regulation for acquirer	**Obligation to buy all shares** ●In order to gain control of the company, the acquirer should cater to all bid-respondents. ●To regulate two-stage takeovers (a takeover that offers a favorable price for the initial stage takeover and offers an unfavorable price for the second stage takeover)	×	×	○	○ 90% is pointed out to be exceptional.	○	○
Defensive measures	**Defensive measures adopted and triggered in takeover contexts** (For example: allocation of new shares to a third party)	Company Law ◌	Company Law ◌	× (Defensive measures adopted in takeover contexts are in principle prohibited. (Obligation of neutrality)) Optional for each member country	× Prohibited in principle	◎ (・Prohibited in principle ・Adoptable if approved by the board of auditors)	Company Law ―
Defensive measures	**Defensive measures adopted before hostile approach and triggered in takeover contexts** (For example: rights plan, golden shares and shares with multiple voting rights)	◌ Rights plan, golden shares, etc.	◎ (Rights plan, etc.)	× (Golden shares automatically become invalid when the acquirer has bought up at least 95% shares. (Breakthrough rule))	× Golden shares only in the case of privatized companies	Company Law × Golden shares and shares with multiple voting rights are in principle prohibited.	◎ (Effective use of shares with multiple voting rights)

Section 1 Hostile takeover defense measures in Europe

Defensive measures vary with countries in Europe. In Europe, there are countries like the Netherlands where hostile takeover defense measures are said to be allowed, and there are also countries like the U.K. where there are very strict regulations on the introduction of defensive measures. In the U.K., TOB regulations regulate the coercive takeover techniques of two-tiered takeovers. In Germany, the same approach as in the U.K. is adopted but defensive measures in takeover contests can be adopted if approved by the board of auditors. In continental European countries, different classes of shares (golden shares and super voting stocks) are adopted, and companies that comply with the principle of one voting right for one share accounts for less than 30% in France, the Netherlands and Northern Europe. The EU tried to unify rules concerning takeovers in its member countries for the purpose of forming an M&A market in the EU as a whole, but that effort finally resulted in a compromise that leaves each member country to make its own decision, due partly to conflicting opinions among its member countries.

1. Takeover rules in the U.K.

The U.K. can be regarded as a country that is very repressive towards hostile takeover defense measures. In principle, in order to adopt defensive measures, approval by the general meeting of shareholders is required[62], and this is significantly different from the United States where defensive measures can be taken with a resolution by the board of directors. But there exists the infrastructure to regulate hostile takeovers that hurt corporate value like two-tiered takeovers, e.g., the existence of regulations on the obligation to buy all shares and the prohibition of partial TOB to be mentioned below, and the flexible mechanism referred to as the Panel[63] which is a voluntary organization to deal with takeovers. In addition, **defensive measures for which alterations to the articles of incorporation are necessary, such as super voting rights and limitation on voting**

[62] Takeover techniques in Japan include mergers, company split-ups and exchange of shares, but in the U.K., techniques like mergers have rarely been used due to the problem of procedures, and among takeover techniques, transfer of shares accounts for a considerably high percentage. And because of this, the U.K. authorities, too, have made efforts to improve measures to ensure free transfer of shares (*Legal Issues on International TOB* by M. Hamada, *Securities Research* No. 102 (1992), p77). It might be judged that behind a prudent stance towards repressive measures against hostile takeovers, there are concerns that even friendly takeovers through share transactions will be regulated.

[63] In the Corporate Law of the U.K. there are various rules concerning TOB, but as there is not any special rule to regulate TOB in a comprehensive way, actual regulation is conducted mainly according to the "City-Code concerning TOB and Mergers" (City-Code) regarding the operation of "Panel on TOB and Mergers" (Panel) which is a voluntary organization. City-Code was formulated as a regulating measure to cope with coercive acts and other abusive acts in hostile takeovers that frequently occurred in the 1960s. Panel is operated under the auspices of the governor of the Bank of England and consists of 17 members, i.e., chairman, two vice-chairmen, three independent members appointed by industrial circles, and eleven members appointed respectively by the following organizations: (1) Association of British Insurers, (2) Association of Investment Trust Companies, (3) Private Investment Managers and Stock Brokers Association, (4) British Bankers Association, (5) British Industries Federation, (6) England and Welsh CPA Association, (7) Investment Advisers Association, (8) London Investment Banking Association, and (9) National Association of Pension Fund (among which (8) alone appoints three members).

rights, can be adopted if approved by a special resolution of the general meeting of shareholders (approved by 75% shareholders), but there are few cases where such measures have been actually adopted.

(Obligation to buy all shares and prohibition of partial TOB)

If the acquirer has acquired shares with at least 30% voting rights, there is an obligation to buy all shares. Moreover, the price must be paid in cash in principle. In addition, partial TOB is in principle prohibited, and if a bidder wants to gain control through partial TOB, he cannot offer to buy part of the shares but must offer to buy all of the shares.

As an effect of regulation of the City-Code which is based mainly on the above regulations, the acquirer is required to secure proof of funds, and it can be judged that two-tiered takeovers have been curtailed.

However, in cases where there is an approval by the majority of shareholders other than the acquirer and company officials concerned or where the company can be saved only by issuing new shares or through a third party (white knight), the obligation to buy all shares is exempted if Panel gives approval. On the whole, cases where the acquirer is obliged to buy all shares accounts for 10%.

(Regulation on acquirer's proof of funds)

The acquirer is required to submit proof of finance showing the ability to complete 100% buy-in. Specifically, (i) regarding the source of finance used to pay the offer price, the acquirer must receive a guarantee from a financial institution, prepare a takeout notification document and release it to the public, and (ii) the financial adviser of the applicant for buying shares must jointly undertake the responsibility for this financing.

Incidentally, according to TOB rules in Japan, the acquirer should disclose of its own accord information on proof of finance, but strict practices like guarantees from a financial institution and the joint responsibility imposed on the financial adviser in the case of U.K. are not required.

Practices in U.K. reduce the TOB requisites and regulate coercive takeovers, and as an exchange, defensive measures are restricted by Corporate Law. Such practices significantly differ from the United States where there are no strict TOB regulations but companies are allowed to take a wide range of defensive measures based on Corporate Law. It can be stated that this is the important fundamental difference in the way in which M&A rules are formed in each of the two countries[64]. As

[64] In the U.K., TOB was historically used as a method to gain control of the company because merger procedures were not in place, but triggered by rapidly increasing cases of hostile takeovers using TOB in the 1950s, legal regulations on TOB were rapidly enacted. By contrast, in the United States, as the system of mergers had been effectively utilized as a method to gain control, there was hardly any regulation on TOB, and even in the TOB regulation enacted in 1967 (Williams Act), the content was neutral to both the acquirer and management executives,

far as the U.K. is concerned, what differs is the means of TOB regulations, but the fact that discipline on hostile M&A is in place is indisputable.

2. Germany's new approach

It is said that in Germany, like Japan in the past, it was difficult for hostile takeovers to happen as traditionally banks and insurance companies were stable shareholders. On top of that, defensive measures using different classes of shares such as super voting stocks and shares with limited voting rights have functioned effectively against hostile takeovers. However, from the beginning of the 1990s, triggered by the start of discussions on the Takeovers Directive in the EU, the policy was significantly changed. In 1995, a commission of securities transaction specialists under the Ministry of Finance in Germany introduced a voluntary regulation referred to as "Rules on Gaining Control," which included rules such as the obligation to offer to buy shares from all shareholders if one has gained control, and further, in 1998, in order to form a more open capital market, Germany's Securities Law was amended and super voting stocks and shares with limited voting rights were abolished. But, as the rules on gaining control were not legally binding, companies reluctant to comply with the obligation to buy all shares continued and there were few that complied with the rules. In addition, Mannesmann, a conglomerate of steel and communications companies, was acquired[65] by Vodafone Airtouch of U.K. in a hostile takeover in 2000, and triggered by this, the German government conducted detailed discussions on rules concerning overall aspects of M&A and enacted[66] the Takeovers Law[67] with the following four features in 2002. Incidentally, even after the Takeovers Law was enacted, **super voting stocks and shares with limited voting rights were prohibited**.

(i) Introduce the British style regulation on the obligation to buy all shares[68].

(ii) For defensive measures adopted before hostile approach and triggered in takeover contests, an authorization of 18 months at maximum approved by the general meeting of shareholders is

with no effect to curtail the TOB boom. In the United States, regulations based on the laws of each state and the companies' own defensive measures became very advanced.

65 Mannesmann was a rare case among German companies. 70% of its shareholders were foreigners, and solicited by Vodafone Airtouch, the acquirer, shareholders agreed to the takeover and defense based on the counter-measure of stable shareholders is said to have failed to function. This may be considered a case where the defense against hostile takeovers based only on the counter-measure of stable shareholders, such as cross-shareholding, has its limits.

66 Super voting stocks, shares with vetoing rights and shares with limited voting rights were prohibited as a result of the amendment to laws in Germany such as the Securities Law according to "Law for Regulation and Transparency in Corporate Sector" which was passed in 1998 with a global capital market policy for expanding employment as its objective. These shares became invalid as from June 2003.

67 The official name is "Law concerning Negotiable Securities Acquisition and Takeovers."

68 According to Germany's Takeovers Law, if one has acquired at least 30% shares or if one holds at least 30% shares resultingly, a bid must be made to buy all the issued shares of the target. The price should be equal to or higher than the price paid by the acquirer in the 3-month period prior to the announcement of TOB, and if the 3-month average price is higher than the acquirer's offer price, the offer price must be equal to or higher than the said average price. In addition, this price should be paid in principle in cash or shares with liquidity, but in certain cases the price must be paid in cash.

possible (however, regarding the trigger of defensive measures in takeover contests, an approval by the board of auditors is needed).

(iii) Defensive measures adopted in takeover contests, too, can be adopted if approved by the board of auditors[69][70].

Germany can be said to have established a new system of defensive measures, such as adopting strict British style TOB regulations, allowing defensive measures to be taken with approval by the board of auditors in takeover contests, and prohibiting super voting rights. In particular, half of the members of the board of auditors are nominated by the general meeting of shareholders, one-fourth is appointed by the trade union and the remaining one-fourth is appointed by ordinary workers[71], and therefore this can be said as a mechanism in which stakeholders' interests are unmistakably reflected in defensive measures.

3. Effective use of special shares such as golden shares and super voting stocks

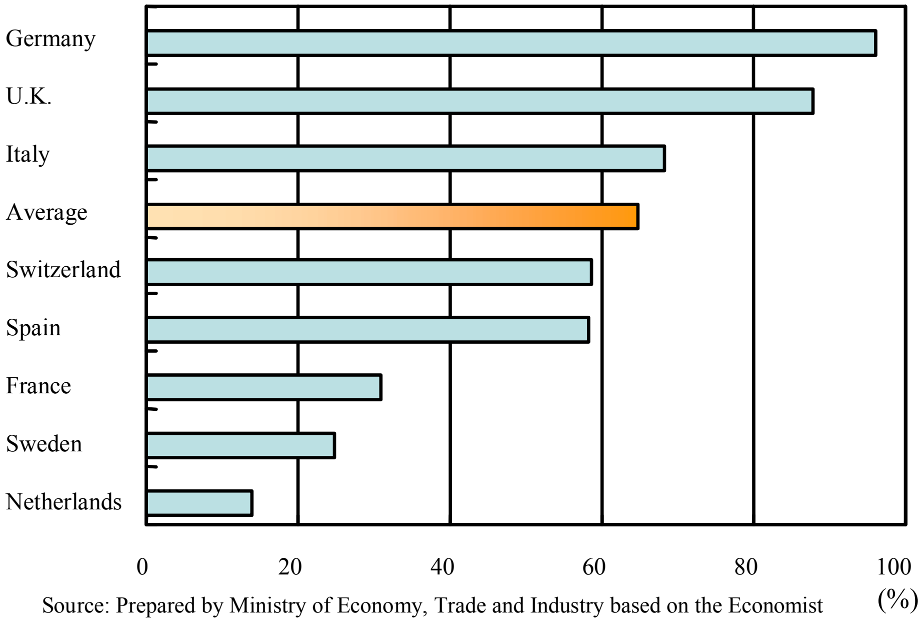
In this way, the U.K and Germany have established their M&A rules based on the above TOB regulations, but in continental European countries like France, companies have traditionally used defensive measures that exploit special shares such as golden shares and super voting stocks. **Companies complying with the principle of one voting right for one share** account for almost 100% in the U.K. and Germany but for only two-thirds in Europe as a whole, and in particular, **such companies account for less than 30% in France and Northern Europe and for less than 20% in the Netherlands**. For instance, in France, the mechanism that gives super voting rights to shareholders holding shares for a long period and the system of shares with limited voting rights that gives shareholders holding 20% or more shares only less than 15% voting rights have been introduced based on different classes of shares. Also, in the Netherlands, it is possible for the existing top management to protect the company from hostile takeovers by issuing golden shares to friendly funds.

[69] In Germany, the board of auditors is set up as an organ to appoint directors.

[70] In addition to the above, the law also approves the following as defensive measures in takeover contests: (1) the act taken by management executives as part of normal business activities and (2) the act to look for a white knight.

[71] When the number of employees ranges from 500 to 2,000, one-third of the members should be appointed by employees.

Figure 3-2 Percentage of Companies Adopting Principle of One Vote for One Share in Europe



Source: Prepared by Ministry of Economy, Trade and Industry based on the Economist (U.K.), issue of March 26, 2005 (prepared by British Insurance Alliance)

4. EU takeovers directive[72]

In this way, European countries have developed their own defensive techniques according to the legal system and social infrastructure in each country, but discussions on takeovers at the EU level started in the 1970s. Triggered by the decision that the market be integrated within the EU's borders in 1992, this move gained momentum and the first draft of EU takeover directive was formulated in 1989. However, coordination among member countries proved to be considerably difficult. The initial draft was based mainly on strict British-style TOB regulations and prohibition of defensive measures in principle, but the assertions made by continental European countries like Germany and France were accepted and in the 1996 amendment, it became an option for each member country to make a choice. This amendment was firmly opposed by the U.K. and in the 1999 amendment, it was proposed that unless there is approval by shareholders of the target company, directors should be prohibited from taking any defensive measures. However, as a result of the acquisition of Mannesmann of Germany by Vodafone of the U.K. in a hostile takeover in 2000, the situation changed once again. Councilors from Germany launched strong opposition, pointing out that "equal footing has not been established if compared to the United States where the rights plan has been adopted," and as a result, the content of defensive measures became optional, i.e., either comply with the EU principle based on the British style or adopt each member country's own system. After a period as long as fourteen years, EU Takeovers Directive finally came into effect in 2004 and

[72] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (Takeovers Directive is its popular name)

has the following features.

(1) Mandatory adoption of the obligation to buy all shares

In the case of gaining control of the company, the acquirer must make a bid to buy all shares, and the price must be equal to the highest price paid for the said share in a certain period (ranging from six to twelve months to be determined by each member country). In addition, the offer price must be paid in cash or securities with liquidity. In order to launch TOB, proof of finance showing the ability to complete 100% buy-in is needed.

(2) Prohibition of defensive measures in principle (Obligation of neutrality)

During the period of TOB, defensive measures other than looking for a white knight can not be implemented unless there is an approval from the general meeting of shareholders. Even if defensive measures were adopted before a hostile approach, an approval or confirmation by the general meeting of shareholders will be necessary in takeover contests.

(3) Defensive measures become invalid at the time of TOB (The breakthrough rule)

Shares such as those with limited voting rights and super voting stocks, and the limitations on transfer of shares lose effect at the time of TOB. If the acquirer has acquired more than 75% of shares, other defensive measures lose effect as well.

(4) The obligation of neutrality and the breakthrough rule should be adopted at each member country's discretion

The adoption of the obligation to buy all shares is compulsory, but the adoption of the above (2) the obligation of neutrality and (3) the breakthrough rule is determined by each member country on a voluntary basis.

(5) Principle of equal weaponry

Even though a member country has chosen EU Takeover Directive ((2) and (3)), if a company of that country is subject to a takeover launched by another company of a country that has not chosen EU Takeovers Directive, the said company can adopt defensive measures.

In Europe, after assiduous efforts over a long period, certain rules concerning takeovers came into effect, albeit a product of compromise. With the imposition of strict TOB regulations as the basis, each member country is allowed to decide at its discretion whether or not to adopt further defensive measures. Member countries should complete their own legal framework by May 2006, and defensive measures effectively using different classes of shares in continental European countries and defensive measures based on approval by the board of auditors in Germany are considered to remain.

Section 2 Defensive measures to prevent hostile takeovers in the United States

In the United States since the 1980s there have been many defensive measures developed to counter hostile takeover attempts. As a result of the checks and reviews by the judicial system and institutional investors over the 20 year history of these measures, the irrational measures have gradually been weeded out, and the rights plan (or "poison pill") is currently widely used as the most practical defensive measure.

In this section the variety of defensive measures developed in the United States will be presented first, followed by a discussion of how the judicial system has eliminated the excessively defensive measures, and how institutional investors lower their assessments in response to defensive measures. There is then a confirmation of the effectiveness of the rights plans and discussion of how these have been developing. This may provide some valuable insight for the construction of rules related to rational defensive measures in Japan, where there are still no established criteria for the legality or reasonableness.

1. Defensive measures developed in the active U.S. M&A Environment

In the 4th M&A boom in the 80s in the United States, a variety of offensive methods and defensive measures were developed for hostile takeover attempts. As sneak attacks and excessive defenses appeared, the court decisions accumulated and the legal range of the defensive measures was gradually clarified, while a reasonable range for defensive measures was determined under the monitoring of the institutional investors.

For the regulation of the acquiring side, there are TOB rules in the Securities Exchange Act, and these TOB rules in the United States were established on the foundation provided by the 1968 Williams Act. These rules eliminate the method of buying on a first-come, first-served basis for a purchasing period of several days and places information release regulations[73] on the buyer. In addition, the authority to oversee TOBs is granted to the US Securities Exchange Commission (SEC). The SEC makes reference to past cases when determining whether an action is considered to be a TOB, and includes active solicitation to purchase significant portions under fixed purchase terms, at a premium price, and for a limited time[74].

[73] The regulations on information release are stipulated in Section 13 (d) and Section 14(d) (1) of the US Securities Exchange Act. Section 13 (d) specifies that in cases where the buyer will acquire in excess of 5% of the shares of the target company, the buyer must inform the SEC, the securities exchange and the target company of the source of funds, the number of shares owned, and the purpose of the ownership, etc (5% Rule). Section 14 (d) (1) specifies that in the event of a TOB in excess of 5%, that the information above and the tender offer must be submitted to SEC and sent to the target company at the same time that the tender is opened.

[74] The SEC considers the following 8 factors in deciding whether an action is a TOB. (1) Is there active and widespread solicitation of shareholders, (2) Is it an attempt to purchase a substantial percentage of the issued stock, (3) Is a premium offered over the market price, (4) Are the purchase terms fixed rather than negotiable, (5) Is there a condition of a minimum number of shares and a specified maximum, (6) Is the purchase period for a limited time, (7) Are shareholders pressured to sell shares, (8) Is an acquisition plan announced in advance (is there acquisition prior to or at the same time as a rapid accumulation of shares).

The US Securities Exchange regulations have not been fundamentally revised, even with the frequent hostile takeovers in the 80s; nor have total purchase regulations, like those in U.K., been introduced. As a result, many defensive measures have been developed through the initiative of companies in order to deal with detrimental hostile takeover attempts (such as two-tiered purchases and green mail). The attacking side starts the raid with a TOB and proxy contests, and progresses through to consolidation after acquiring a controlling share. The defensive measures developed to combat such efforts can be classified into five categories: (i) Creation of stable shareholders to increase resistance to TOBs and proxy contests, (ii) Defensive measures to raise the costs to the buyer for the TOB, (iii) Defensive measures to raise the costs of a proxy contest, (iv) Defensive measures restricting business unions, such as second-step mergers and subsidiary creation, (v) Defensive measures that are urgently implemented if the event occurs.

Details of the following are presented in separate tables (Tables 3-1 and 3-2)[75].

(i) The typical forms of creating stable shareholders are "white squires" (similar to a white knight, but only owns about 15% of the shares) and ESOP (employee stock ownership plan).

(ii) Typical forms of defensive measures to increase the TOB costs are rights plans (described later), and the creation of super voting stock.

(iii) Typical forms of defensive measures to increase proxy contest costs are staggered boards (conditions specifying 3 year terms for directors, with the periods of office offset from each other) and restrictions on dismissal of directors (clauses specifying no removal during a term of office without due cause).

(iv) Typical forms of defensive measures restricting second-step mergers are super-majorities (conditions weighting the voting issues of all shareholders for business mergers performed after a hostile takeover) and fair value conditions (weighted business merger decision requirement conditions excluding business mergers at a fair price).

(v) Typical forms of defensive measures that are urgently implemented if the event occurs are white knights (a friendly buyer who provides additional capital) and crown jewel strategies (selling off the most valuable assets), which are a type of scorched earth policy if implemented on a large scale.

Items (iii) and (iv) are methods of establishing special conditions by modifying the articles of incorporation (charter), and are generically called "shark repellant". Among these various self-defense measures, items (iii) and (iv) are adopted as common rules in some state laws, and called the corporate takeover restriction laws (see Table 3-3).

The defensive measures developed in the latter half of the 1980s led to numerous lawsuits based on claims that the measures were adopted to protect top management, and the legality was questioned. As a result of the actions of institutional investors, the market did not support defensive

[75] For major defensive measures recently adopted by U.S. companies, see Reference 1 at the end of the report.

measures that were connected to the entrenchment of top management, and such measures were weeded out. Through this process of court decisions and the decision criteria of institutional investors, the more rational rights plans survived as the standard of defensive measures.

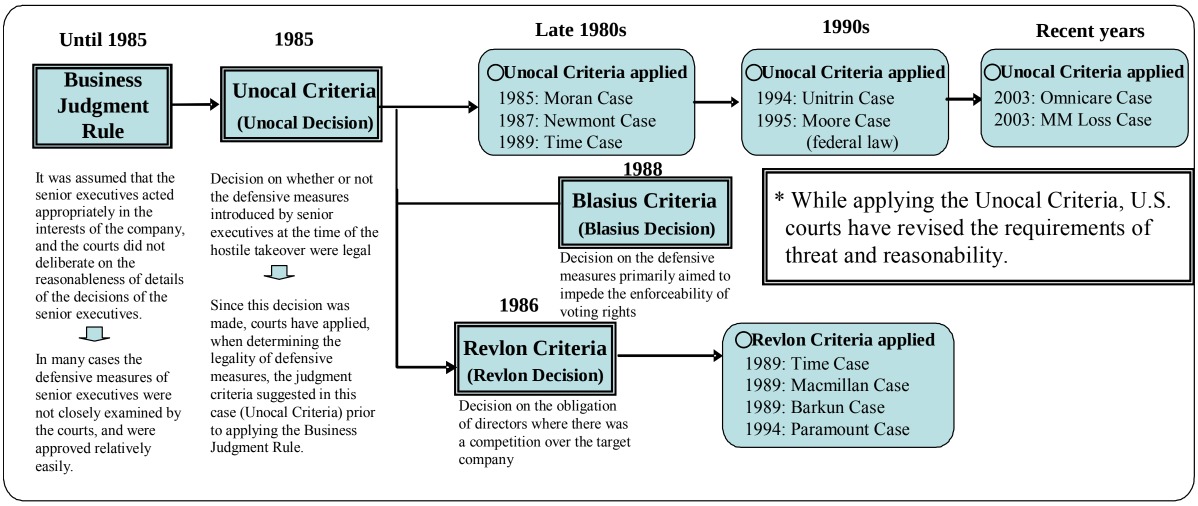
The following sections will **present the legal criteria based on U.S. court decisions (2. Court decisions eliminating excessive defensiveness), the criteria for appropriateness based on the decisions of institutional investors (3. Assessment criteria of defensive measures for institutional investors), and the search for the business society infrastructure based on the progress of the rights plans (4. Rights plans)**.

2. Court decisions eliminating excessive defensiveness

(Unocal criteria)

In the United States, the majority of U.S. companies choose to be legally based in the state of Delaware, making it the site of many precedent-setting cases on the legality of defensive measures in the latter half of the 1980s. One of these cases was the “Unocal Decision” issued by the Delaware Supreme Court in 1985. This decision has stood for 20 years, establishing the standards for the legality of defensive measures, which have come to be called the “Unocal Criteria”. Since 1985 the Unocal Criteria have been applied in 140 cases related to takeover defense measures in the state of Delaware. Of these 140 cases, 40 resulted in decisions by the State Supreme Court. Until the Unocal Criteria were established, judicial decisions on the various defensive measures used by top management to protect the business applied standards known as the “Business Judgment Rule”. The Business Judgment Rule assumed that top management acted appropriately in the interests of the company, and the courts did not deliberate on the reasonableness of details of the decisions of top management. As a result, the responsibilities of top management were not directly questioned regarding the introduction of defensive measures, even if they led to losses for the company. In many cases the defensive measures of top management were not closely examined by the courts, and were approved relatively easily. However, the defensive measures were shadowed by the possibility that they were implemented for the entrenchment of the operators of the business. In the Unocal decision it was ruled that when a threat to company control is involved, such as a hostile takeover, because there is always a possibility of director action for their own interests rather than those of the company or shareholders, and an objective decision is difficult, before applying the business judgment rule the board must (i) show that there are reasonable grounds to believe that the hostile takeover is a threat to corporate policy and effectiveness, and (ii) establish defensive measures that are reasonable in relation to the threat posed. For the top management evaluation of defensive measures, since there is a possibility they are implemented to protect the top management themselves, this decision led to top management starting to prove that there are reasonable grounds to believe that the takeover is a threat to corporate value, and that the defensive measures adopted were not excessive. The evidence analyzed by top management could include the level of the acquisition price, the quality of the acquisition compensation, the timing and nature of the acquisition, problems of illegality, and impact on stakeholders. These management executives were expected to “act in good faith and conduct reasonable investigations.” Below are explanations on the extent of a threat, the criteria for evaluating excessiveness, and on due diligence in neutral business evaluation processes.

Figure 3-3 History of court decisions on defensive measures in the United States



Source: Compiled by METI based on various reference materials

(Extent of threat to the company from a hostile takeover)

A threat means the menace to the effectiveness of the company that would arise if a hostile takeover were successful, and the extent is considered broadly. The first type is the “**structurally coercive type**”, represented by green mail and two-tiered purchases. The objective of a green mail is that only the acquirer (green mailer) can gain profits based on other shareholders’ losses, which will obviously harm corporate value. The two-tiered purchase offer has the effect of causing shareholders to sell quickly, even if the purchase price is inadequate, because the second-tiered purchase conditions may be disadvantageous or uncertain. Effectively, there is a possibility that the purchase proposal causes a loss of corporate value, so it is regarded as a type of threat. This is not the only form of threat. For example, in the case of a cash offer for all shares, although there is no structural pressure, if the purchase price is too low, or the plan of operation after the purchase is inappropriate, this is regarded as a threat to the interests of the shareholders as a whole and to effectiveness of the enterprise. An inadequate purchase price offer when there is no time for the management team to search for alternative offers is called a **lack-of-opportunity type (lack-of-alternatives type)**. Even if there is a cash offer for all shares, if the TOB is issued suddenly, with no request for negotiation of the tender offer in advance, in many cases the management has no time to make a new business proposal or search for a white knight to buy the company under more favorable conditions for the management. Shareholders are deprived of the opportunity to investigate alternative, more advantageous proposals, making it highly likely that there will be a loss of corporate value. Cases in which shareholders respond to a takeover proposal when there is a lack of information, regardless of the fact that the takeover might harm corporate value, are called the **shareholder fallacy type.** As described in the second chapter, the corporate value is the total of the future benefits generated by the company, and there are many factors that affect this. Legal precedents in the United States have taken into consideration the long-term business prospects of businesses, results of tie-ups, results of past investments, and the impact on stakeholders. This is why there is attention placed on how important factors affecting corporate value will be handled in the operation plans after acquisition.

(Criteria for evaluating excessiveness of defensive measures)

For a judicial decision on the excessiveness of defensive measures, it is necessary to determine whether the method is appropriate with respect to the threat. **For the reasonableness of a defensive measure, the focus is placed on whether the shareholders are compelled to accept resistance measures presented by the management (coerciveness of defensive measures), and whether other methods for the shareholders to accept proposals from the acquirer are also blocked (exclusion of defensive measures)**. If they are not coercive or exclusive, the defensive measures are determined to be not excessive. Furthermore, this evaluation of the reasonableness differs for each type of threat. A rough summary is given below.

First, green mail and two-tiered tender offers are considered to be structurally coercive tenders, and are absolutely problematic. As a result, a correspondingly broad range of defensive measures is permitted. In some cases, there is even leeway to allow exclusionary defensive measures, such as denial of proxy contests. In the case of the lack-of-opportunity type, the defensive measures allowed are those within the range of providing the necessary time to present alternative plans. For the shareholder fallacy type, the approval of reasonableness of the defensive measures is rigorous. Defensive measures that exclude shareholder choices, or compel the choices of shareholders are not considered reasonable. **The basic requirements for defensive measures which are not coercive or exclusionary require that shareholders other than the acquirer be treated fairly, and that the defensive measures can be removed through a proxy contest. For example, a rights plan with removal provisions is (1) not regarded as coercive because shareholders other than the acquirer are treated fairly, and (2) in principle, not regarded as excessive because the shareholders (acquirers) still have the option of the proxy fight in the removal provisions.**

In comparison, defensive measures that cannot be removed except by the managers who adopted them (dead hand provision[76] or no-hand provision[77], or in some cases, a slow hand

[76] With regard to the removal of Rights Plans, this is a condition that makes it impossible for a hostile acquirer to remove them by appointing a new board. Specifically, the provision makes it impossible for the Rights Plan to be removed by anyone other than the directors at the time the plan was adopted, or the directors appointed as their successors with their consent.

[77] This is a variation of a dead hand provision. Typically, this provision makes it impossible for any board of directors to remove the Rights Plan if the directors who adopted the Rights Plan do not account for the majority on the board.

provision[78]) are allowed some legal leeway as green mail countermeasures and partial acquisition countermeasures, but in general are illegal. In addition, **defensive measures enacted to significantly obstruct proxy contests** by acquirers (when the situation occurs, increase the number of board members, and hinder shareholder exercise of voting rights) are regarded as promotion of the entrenchment of the management, and are considered to be excessive (Blasius criteria[79])

Furthermore, if a hostile acquirer appears, while management is in the process of selling the company to a white knight, the directors are considered to have an obligation to raise the company sales price. The adoption of defensive measures that make it advantageous to establish a tie-up with the white knight are considered to be excessively defensive and are regarded as illegal (Revlon criteria[80]).

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[78] This refers to specifying limited periods in which the Rights Plan can be removed in the dead-hand and no-hand provisions. They are conditions restricting the removal of the Rights Plan by new directors to only specific periods (such as 6 months or 180 days).

[79] When a Rights Plan is used as a defensive measure, and the directors oppose an offer by an acquirer, the acquirer must try to replace the directors through proxy contests with shareholders at the shareholders general meeting once each year to overcome the opposition. In this case, if it is designed so that the Rights Plan can only be removed by the directors who adopted it, the Rights Plan cannot be removed even if the directors are replaced, becoming an obstacle to the exercise of shareholder voting rights. Shareholder voting rights are basic rights that maintain the control of the directors by the shareholders. Defensive mechanisms that restrict these rights require stricter investigation by the court, and are considered to be illegal unless the directors have strong evidence of the rationality.

[80] The Revlon decision ('86) is a case of a hostile acquisition of Revlon (cosmetics company) by Ronald Perelman (President of the food company Pantry Pride). The acquirer was an industrialist involved in many large company acquisitions, who was very particular about business operation details, unlike other LBO specialists. This case was initially a friendly acquisition, with an offer of cash for all the stock with a condition that the Rights Plan be removed. There were issues regarding the business results of the diversified operations as well as regarding the stock price. As a measure to resist the acquisition, Revlon management concluded an agreement with a white knight including crown jewel lock-up clauses, as well as an agreement to pay a penalty if the deal was not completed. This decision sided with the acquirer, stating that once a company has decided to sell for cash, the directors must act so as to maximize the short-term price, without setting defensive measures.
It was decided that at the stage that a target company has consented to a capital tie-up with a white knight, if another interested acquirer appears and there is competition between the white knight and the acquirer for the target company, if it has been decided that the company will be sold, the directors must seek to maximize the sales price and allow the acquirer and the white knight to compete, without implementing defensive measures.
The cases in which it is decided that the company is facing sale are as follows.
(1) The management team has decided to sell the company itself or rebuild, including part of the company
For example, in the Revlon decision, the directors of the target company receiving a hostile tender from an acquirer were determined to have decided to sell the company at the point that bargaining rights for the sale of the company were granted to the white knight Forstmann & Little.
In the case of a hostile takeover attempt on Newmont Corp. by Ivanhoe Partners, the largest shareholder, Gold Fields Limited, resisted through buying more shares of Newmont Corp. Since there was a status quo agreement with Gold Fields Ltd. (specifying that Gold Fields Ltd. can only acquire up to 49.9% of Newmont Corp. stock, etc.) it was clear that there was no intent to sell the company, so it was ruled that the company was not offered for sale.
In other words, if the top mangament clearly indicate that there is no intent to sell the company, it is ruled that it is not a sale situation.
(2) There is reorganization accompanying a transfer of control, and a controlling shareholder of the company appears after the reorganization
For example, for the QVC acquisition of the movie company Paramount, Paramount, fearing acquisition by QVC, made plans to merge with the white knight Viacom. However, the controlling shareholder of Viacom became the controlling shareholder of the new company. In effect, this was the same as a sale of Paramount to the majority shareholder of Viacom. Since this also reduced the existing Paramount shareholders to minority shareholders, it was ruled that this was a sale of the company.
On the other hand, when Paramount attempted a hostile acquisition of Time Inc., Time Inc. resisted by merging with Warner Corp. Since the merger contract with Warner stipulated that the stock of the company after the merger would be distributed among many shareholders, it was not ruled to have been a sale of the company.
Therefore, if no controlling shareholders arise after reorganization, it is not considered to be a sale situation.

(Focus on due diligence and neutral business evaluation processes)

Directors who believe that acquisition is a threat, to prove that the implemented defensive measures are not excessive, **must believe there is a threat and focus on the neutrality and due diligence of the process for deciding the management evaluation implementing the defensive measures** when proving the nature of the threat and the appropriateness of the defensive measures. From the perspective of the content of the threat, if it is a structurally-coercive acquisition, the important factors for determination include the past history and reputation of the acquirer and the method of acquisition. For a shareholder fallacy type, the important considerations are the business objectives of the existing management and the business proposals of the acquirer, specifically the impact on the corporate strength that is the focus of the top management (for example, effect on the relationship of trust and accumulation of human resources that are the basis and source of the company competitive strength). For the lack-of-opportunity type, the important factors are whether there are negotiation opportunities offered to the company, and the advantages and disadvantages. In addition, for the proof of the appropriateness of the details of the defensive measures, the important factors are the planning of the defensive measures as well as the process of business evaluation of the introduction, maintenance and operation of these defensive measures. In other words, the acknowledgement of the threat to the operation and effectiveness of the target company from a hostile acquisition, and proof that the defensive measures are appropriate relative to the threat, are not arbitrary determinations by the internal executives.

The emphasis is on the due diligence and neutrality of the evaluation process, including

- **Whether adequate time and expense was spent on the investigation**
- **Whether the advice of outside experts (financial advisors, lawyers, etc.) on the analysis of the acquisition offer and defensive measure plan was conscientiously sought**
- **To what extent were there reports of neutral parties (such as outside directors) and how much time was applied for the determination of the introduction and operation of the defensive measures?**

In the Tokyo High Court decision on the recent suit to stop the issuance of stock acquisition rights by Nippon Broadcasting as well, it was determined to be difficult for the court to determine whether there was a loss in the value of the company. In the United States, as a means of practically dealing with such cases where a determination by the court is difficult, the focus is placed on the due diligence and neutrality of the actions of the board of directors. Requiring due diligence and neutrality in the actions of a board of directors effectively eliminates the entrenchment factors.

Figure 3-4 Major court decisions in the United States

[Hostile takeovers by business corporations]

Management of target company won case

<Time Case: 1989> Paramount vs. Time

Hostile takeover of Time (publisher) by Paramount (film company)
- The bidder made an all stock/cash price takeover proposal for the purpose of increasing global competitiveness.
- The management of the target company had already agreed to merger with another company prior to the bidder's proposal. As defensive measures, the management introduced an automatic share exchange article and no-shop article in the merger agreement. Upon the appearance of the bidder, the management shifted from merger to TOB.

[Decision: defensive measures upheld]
- The directors are not obliged to abandon the deliberately prepared plan for shareholders' short-term interests. The defensive measures do not prevent a takeover of the new company created after the merger.

<Unitrin Case: 1994> American General vs. Unitrin

Hostile takeover of Unitrin (insurance company) by American General (financial service company)
- The bidder, in the course of expanding its business fields through takeovers by taking advantage of its ample cash flow, made an all stock/cash price takeover proposal.
- The management of the target company introduced a rights plan and prior notice requirement for the exercise of shareholders' proposal right by revising the bylaw. Also, the management bought back up to about 20% shares from outside.

[Decision: defensive measures upheld]
- There is the possibility that shareholders might accept the inadequate proposal without knowing the true value of the company. The defensive measures are not harsh and are reasonable.

Bidder won the case

< Macmillan Case: 1989> Maxwell vs. Macmillan

Hostile takeover of U. S. publisher Macmillan by U. K. publisher Maxwell
- The bidder eagerly intended to launch business in the U.S. publishing industry by taking the advantage of the weak dollar and the maturity of European markets. The bidder made an all stock/cash price takeover proposal, while regarding the press/publishing industry as the core of the vertically integrated business process covering paper/pulp production, editing, and printing.
- The management of the target company implemented an MBO as a countermeasure, with KKR (specialized investment company) acting as its white knight. The takeover proposal offered minority shareholders payment in subordinated bonds and shares of a new company. The management also took discriminatory measures, such as notifying the white knight of the takeover price offered by the bidder.

[Decision: defensive measures rejected]
- The management's act of providing important information only for the white knight is an obvious breach of the duty of disclosure. The decision made by the directors under such circumstances cannot be upheld.

<Paramount Case:> QVC vs. Paramount

Hostile takeover of Paramount (movie company) by QVC (cable television provider)
- The bidder implemented a two-stage takeover to obtain the majority of all shares, aiming to establish a vertically integrated process covering production and distribution of video software (on the second stage, its own shares were offered for payment).
- Fearing being taken over by the bidder, the management of the target company concluded a merger agreement with another company. The agreement included a no-shop article and penalty article.

[Decision: defensive measures rejected]
- Even though it was obvious that the defensive measures would be obstacles to maximizing shareholders' interests, the directors failed to make efforts to revise them, which is breach of the duty of mandate. (is this missing a noun?)

[Hostile takeover by other bidders]

Management of target company won case

<Unocal Case: 1985> Boone Pickens (green mailer) vs. Unocal

Hostile takeover of Unocal (oil company) by Boone Pickens (president of Mesa Oil)
- Before the takeover of Unocal, the bidder implemented green mails targeting other oil companies. The bidder made a two-stage takeover proposal to Unocal (on the second stage, junk bonds were offered for payment).
- The management of the target company proposed that if the bidder bought more than half of the company's shares, the company would buy the remaining 49% shares from shareholders other than the bidder at a higher price than that offered by the bidder.

[Decision: defensive measures upheld]
- The bidder is a green mailer. The proposal made by the bidder is coercive and the offered price is insufficient. The defensive measures are reasonable.

<Newmont Case: 1987> Boon Pickens (green mailer) vs. Newmont

Hostile takeover of Newmont (mining company) by Boone Pickens (president of the investment company Ivanhoe Partners)
- The bidder had been judged to be a green mailer in the Unocal Case. Having bought the majority shares though TOB, the bidder planned to sell and reorganize most departments of the target company.
- The management of the target company paid special dividends, by which its large shareholders bought its shares.

[Decision: defensive measures upheld]
- The bidder is a green mailer. The proposal made by the bidder is coercive and the offered price is insufficient. By taking the defensive measures, the target company has successfully prevented its shareholders from accepting the two-stage takeover proposal.

Bidder won the case

<Revlon Case: 1986> Ronald Perelman vs. Revlon

Hostile takeover of Revlon (cosmetic company) by Ronald Perelman (president of the food company Pantry Pride)
- The bidder was an industrialist involved in many large company acquisitions, who was very particular about business operation details, unlike other LBO specialists. This case was initially a friendly acquisition, with an offer of cash for all the stock with a condition that the rights plan be redeemed.
- There were issues regarding the business results of the diversified operations as well as regarding the stock price. As a measure to resist the acquisition, Revlon management concluded an agreement with a white knight including crown jewel lock-up clauses, as well as an agreement to pay a penalty if the deal was not completed.

[Decision: defensive measures rejected]
- Once a company has decided to sell for cash, the directors must act so as to maximize the short-term price, without setting defensive measures.

Source: Compiled by METI based on various reference materials

(Suggestions for Japan ~ The essence of corporate value and due diligence)

In the United States, the factors that can be considered by directors for the implementation of defensive measures against hostile takeover attempts cover an extremely broad range, including the impact on stakeholders. Furthermore, it is worthwhile to pay attention to the fact that there is important consideration made of due diligence in the director actions and rational inquiries. Court decisions in the United States are technical decisions with a priority on whether the value of the enterprise is increased through the acquisition. Even if the assessments of the management are respected, since there are questions about the entrenchment aspects of their actions, the requirements for rationality and due diligence in the actions leading to the formation of the decisions of the management team are a realistic response to suppress action that is purely for entrenchment. In addition, the decisions are extremely meaningful as instructive examples to businesses planning to adopt defensive measures during peaceful times when they are not facing legal proceedings. In other words, it is required that actions related to defensive measures be performed neutrally, with due diligence and have the effect of protecting improvements in the value of the company. Specific policies to achieve this are presented in chapter 4.

Next, the assessment of defensive measures by institutional investors who provide funding to companies is considered. Descriptions of the mechanisms that facilitate the acceptance of defensive measures by the institutional investors are presented.

3. Assessment criteria of defensive measures for institutional investors

To summarize the court decisions, defensive measures are legal if they treat shareholders other than the acquirer fairly, and leave a means of conducting proxy contests. However, institutional investors place stricter standards on the types of defensive measures considered to be acceptable. In addition to being legal, defensive measures must be properly understood and approved by the shareholders and investors. In the following sections there is an analysis of the various opinions of defensive measures in general indicated by institutional investors in the U.K. and the United States. In general, institutional investors do not unconditionally approve of defensive measures. Nevertheless, if they are employed to increase the long-term stock price and corporate value, they are conditionally approved. We offer benchmarks for the introduction of defensive measures in Japan based on an analysis of conditions required by institutional investors to approve defensive measures from the perspective of long-range stock price increase.

(Characteristics of institutional investors)

In the United States, the investors that supply capital to companies can be categorized as either individual investors or institutional investors such as pension funds and life insurance companies. The stock ownership by individual investors accounts for about 40% in the United States, about twice as high as the rate in Japan. Institutional investors can be further categorized as public employee benefit pension funds, private pension funds, investment trusts and insurance companies. The most active ones to exercise voting rights are the public employee benefit pension funds. There are organizations widely known to be shareholders with strong opinions about the operations of companies, creating their own guidelines for voting rights exercise, such as CalPERS, the California Public Employees Retirement System, with total assets in excess of 10 trillion yen.

In addition there are other investing agencies[81] that create detailed guidelines for exercising voting rights, such as trust banks and investment advisors, who invest the funds received from the institutional investors, and many agencies that exercise voting rights based on these guidelines.

There are also specialty agencies, like ISS (Institutional Shareholder Services), which

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[81] Investing agencies are the agencies that apply the funds provided by investors. They can be divided into the type that selects and implements the investments, and the type that simply performs the administrative tasks of investing at the instruction of the client. In recent years, since the start of business of trust banks specializing in management in Japan, there has been a continuing reduction to 3 investment management companies (Japan Trustee Service Bank, Master Trust Bank of Japan, and Trust & Custody Services Bank). This has been a major factor making it difficult to identify the nature of shareholders from the shareholder rosters.

advise and act on behalf of institutional investors. These specialty agencies are entrusted to exercise voting rights, and there are other investing agencies and institutional investors exercising voting rights based on the guidelines of these specialty agencies.

(Institutional investor views on defensive measures based on questionnaires)

Institutional investors and investment agencies in the West are not uniformly opposed to defensive measures.

A questionnaire survey[82] on defensive measures sent to institutional investors in the West indicated that all 20 surveyed institutional investors in the United States **conditionally approve** of them, and none were opposed. Among the 20 institutional investors in the U.K., 30% were opposed, while 70% conditionally approved. The particulars of the approval conditions were most often **general shareholder agreement in advance, a specified period of validity, and possibility of removal**. Institutional investors in the U.K. showed a stronger tendency to address the issue on a case-by-case basis, as indicated by responses such as “determined separately upon consideration of dilution of shareholder value”, and “determined separately after consideration of the circumstances of the situation as a whole”.

(Institutional investor opinions based on guidelines for exercising voting rights)

There are also institutional investors in the West who have publicly announced their guidelines for exercising voting rights.

Among these guidelines there are some that clearly specify the assessment of each type of defensive measure. An analysis of these assessments indicates that defensive measures can be sorted into 3 categories: absolutely opposed defensive measures, defensive measures that are opposed in principle, and defensive measures that are conditionally approved. **Measures that provide negotiation powers to shareholders as a whole and for long-term corporate value, such as rights plans, are conditionally approved**; while defensive measures that **restrict the dismissal of top management**, such as staggered boards, or **lengthen the time required for proxy contests** are **absolutely opposed**.

(1) Absolutely-opposed defensive measures = Staggered board systems

Many investors are absolutely opposed to the introduction of staggered board systems, as indicated by comments such as “…in combination with other defensive measures, such as rights plans, are a big obstacle to a free market” (TIAA-CREF), “Annual appointment of directors improves their performance” (Florida State Board of Administrators), and “…reduces the rights of shareholders to elect directors once a year, and obstructs dealings to improve the long-term corporate value” (AFL-CIO).

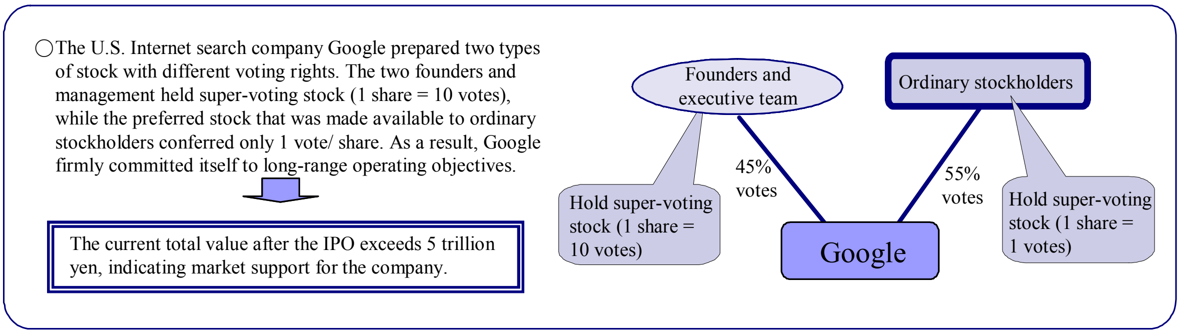
[82] This survey was not an investigation of the adoption only by Japanese businesses.

(2) Defensive measures opposed in principle = Super voting stocks, golden shares, super majority clauses

In principle, the super voting stocks are opposed, as indicated by comments such as "…because it may dilute shareholder rights" (State of Wisconsin Investment Board), as is the granting of the right to determine stock details to a board of directors (blank check stock), as indicated by comments such as "…because shareholder rights are diluted and the directors determine the shareholder rights on dividends, stock conversion, voting rights, etc." (Fidelity). Nevertheless, there are cases of approval based on conditions such as "must be for the purpose of improving long-term corporate value and benefits to shareholders."

There is opposition in principle to super majority clauses, as expressed in comments such as "shareholder rights are restricted by minority shareholders having veto rights" (Fidelity). However, there are also agencies that approve of the introduction under certain specific conditions, "in case of protection of minority shareholders when there is a shareholder with absolute controlling" (TIAA-CREF, AFL-CIO).

Figure 3-5 Super voting stocks favorably assessed by the market



Source: Compiled by METI based on various reference materials

(3) Conditionally-approved defensive measures = Rights plan, golden parachutes

With regard to rights plans, most institutional investors require general shareholder approval before they are adopted (TIAA-CREF, CalPERS, etc.), clear specification of the period of validity (typically 3 years), periodic checks (TIAA-CREF, Fidelity, etc.), periodic checks of defensive measure extension by independent outsides directors (State of Wisconsin Investment Board), and fulfillment of the duty to explain how they will improve stock value in the long term (TIAA-CREF), as some of the conditions for approval.

With regard to golden parachutes, there are institutional investors that will approve them if the approval of the general shareholders is obtained and compensation is no more than the equivalent to 2 or 3 years of the director's salary, in order to prevent complete resistance to a hostile acquisition by the executive team (State of Wisconsin Investment Board, Florida State Board of Administrators.)

Figure 3-6 Assessment by institutional investors in Europe and United States of the introduction of defensive measures

[Trends in the stance on defensive measures in guidelines for exercising voting rights]

<Major views of institutional investors and investing agencies>

Absolutely oppose

Staggered board system:
- Oppose this system because, in combination with other defensive measures such as rights plans, it is a big obstacle to a free market.
- Annual appointment of directors improves performance,
- It obstructs dealings to improve the long-term company value.

Oppose in principle

Super voting stocks:
- Oppose in principle because they may dilute shareholder rights.
- Approve if they are aimed to improve long-term benefits to shareholders.

Blank check stocks:
- Oppose in principle because they dilute shareholder rights and enabled the directors to determine the shareholder rights on dividends, stock conversion, voting rights, etc.
- Approve if approval is obtained from shareholders or they are aimed to improve long-term benefits to shareholders and corporate value and they are not super voting stocks.

Super majority clauses:
- Oppose in principle because shareholder rights are restricted by minority stockholders having veto rights.
- Approve if they are aimed to protect minority shareholders when there is a shareholder with absolute control.
- Approve with respect to a shareholder's proposal that is opposed by all directors.

Approved under conditions

Golden parachutes:

(Conditions for approval)
- Compensation is no more than the equivalent to 2 or 3 years of the director's salary.
- Approval is obtained at the general shareholders' meeting.

Rights plan:

(Conditions for approval)

<Exercise>
- If it does not include a flip-in article whereby a trigger is pulled if the acquirer obtains 20% shares or less.

<Shareholders' approval>
- Approval is obtained at the general shareholders' meeting.
- There is a sunset clause that requires periodic review (every 3 years or more frequently) of the plan.
- Support may be given on a case-by-case basis for rights plans to be revised at least every 3 years by a committee consisting of outside directors.

<Redemption>
- There are no institutional investors that uniformly set redemption conditions in decision-making guidelines.

<Others>
- Some institutional investors clearly declared opposition to acceptance of green mails.
- Some institutional investors approve fair value conditions because shareholders are equal under the conditions, whereas others oppose them because they might prevent good takeovers.
- Some institutional investors oppose the change of the company address that is aimed to limit shareholders' rights.

Source: Compiled by METI based on published decision-making guidelines of 10 institutions

[General views of agencies investing in Japan on defensive measures]

- A questionnaire survey was conducted regarding defensive measures seen in the United States and Europe, targeting agencies investing in Japan with large investment amounts (20 agencies in the United States and 20 agencies in the United Kingdom) (irrespective of adoption by Japanese companies)

•Opinion on the introduction of defensive measures

	(U.S.)	(U.K.)
Approve :	0%	6%
Approve under conditions :	100%	61%
Absolutely oppose :	0%	33%

• Among those that approve defensive measures under conditions
  - (i) 15 US agencies and 6 UK agencies require a shareholder resolution.
  - (ii) 6 US agencies and 3 UK agencies requires a clearly fixed time limit.
  - (iii) 4 US agencies and 2 UK agencies require that defensive measures can be redeemed.
  - (iv) Others
    - 4 UK agencies
      - Determination is made on a case-by-case basis while taking into consideration dilution of shareholder value.
      - Determination is made on a case-by-case basis while taking into consideration the circumstances of the situation as a whole.

Source: IR Japan; responses from 19 agencies in the United States and 18 agencies in the United Kingdom

(Suggestion for Japan ~ Important for defensive measures to be linked to long-term stock value increases)

The background of these assessments of defensive measures by the institutional investors is the recognition that the defensive measures should protect the long-term stock value and corporate value. For example, the guidelines of Hermes, an institutional investor in the U.K., state that in the event of a hostile takeover attempt, it is assumed that it is possible to believe that the existing top management and board of directors will be able to achieve long-term benefits for the shareholders of the company, and that the existing top management will continue to be supported. The guidelines of the American Federation of Labor & Congress of Industrial Organization (AFL-CIO) state that assessment of a rights plan should include consideration of whether it will contribute to improving the long-term corporate value, and that there should be a friendly response to acquisition offers for the purpose of improving the long-term benefits to shareholders. In Japan as well, the corporate governance principles of the Pension Fund Association indicate that the goal of a corporation is to obtain the maximum benefits for the shareholders over the long term. The corporate governance principles of the Pension Fund Association for Local Government Officials also state that the purpose of the association's ownership of stock is simply to increase the long-term value of the assets through the stock ownership, and contribute to the benefit of the members. It can be said that the criteria for making decisions are the improvement of the long-term value of the company. A certain consideration of stakeholders is required in order to increase the long-term value of the company. The Hermes guidelines state that for the operation of an enterprise from a long-term perspective, it is necessary to construct a smooth relationship among employees, affiliated businesses and customers, to act logically, and to respect society as a whole and the environment. This concept by an institutional investor is partially the same as concepts indicated through court decisions in the United States. The guidelines of the American Bar Association, which is composed of many well-known judges, lawyers and legal scholars present the view that there can also be consideration of the stakeholder benefits, remarking that the behaviors of a board of directors facing a hostile takeover attempt may consider the various benefits (other than for shareholders) that have a legitimate connection to the company, to the extent that there is no significant injury to the long-term profit of the shareholders. If defensive measures contribute to the long-term improvement of the value of the company, and if operations that consider all stakeholders, such as employees and transaction partners, increase corporate value and persuasively restore this to the shareholders benefit, then it is believed that it is possible to obtain the support and understanding of institutional investors who demand long-term stock price gains. The assessment criteria of the institutional investors presented here suggest that the crucial elements are business strategies that persuasively aim to improve the top management's corporate value, and an adequate duty of disclosure to ensure the reasonableness of defensive measures. American institutional investors regard rights plans as being relatively reasonable subject to the conditions that the general shareholders approve them in advance, there is a specified term of validity, and that independent outside directors perform periodic checks and reviews. The questions then become "What kind of mechanisms are these rights plans?" "What are the effects?" and "How have they developed in the United States?"

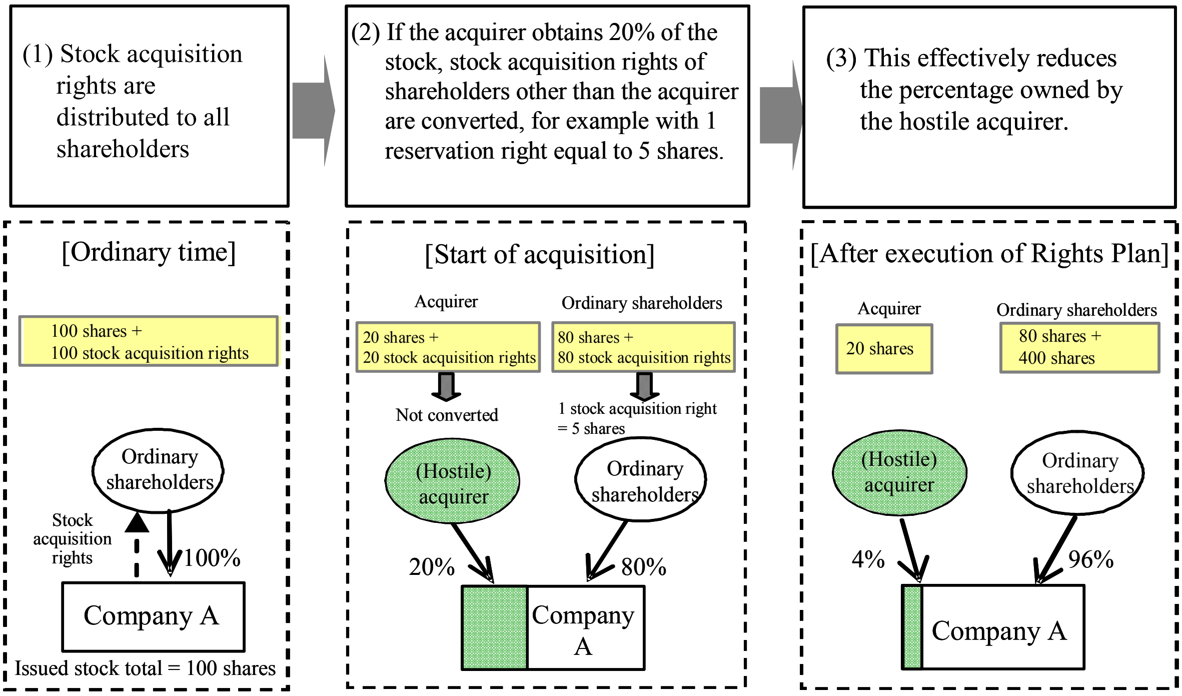
4. Rights plans

(1) What is a rights plan?

A rights plan is the authority to grant new stock to shareholders. Typically, the mechanism of a rights plan is that the company distributes stock acquisition rights to shareholders during a peaceful time, if a hostile acquirer obtains, for example, 20% of the stock, shareholders other than the acquirer are issued large quantities of stock, drastically reducing the ownership percentage of the acquirer[83].

[83] This tactic is also called a "poison pill", because the poison has an effect on the acquirer when it tries to swallow a company.

Figure 3-7 Rights plan mechanism using stock acquisition rights



(2) Operation of a rights plan in the event of a hostile takeover

The events that occur when there is a hostile takeover attempt of a company that has adopted a rights plan during a peaceful time are as follows.

(i) The acquirer stops before the trigger is pulled. (Accordingly, even if it is actually a takeover attempt, the defensive measures are not put into execution. In the United States, there is only one case of an erroneous execution of measure.)

(ii) The acquirer explains the merits of their tender offer to the board of directors, and negotiates on the removal of the rights plan.

(iii) The board of directors evaluates the tender offer of the acquirer, and decides whether to remove the rights plan.

(iv) If the board of directors decides that the existing top management's business plans can increase the corporate value, the board of directors will not remove the rights plan. In this case, if the acquirer does not withdraw, the acquirer starts a proxy contest to replace the top management and the board of directors.

(v) Through the proxy contest, the shareholders determine and decide whether the business proposal of the top management or the tender offer of the acquirer is better.

(3) Three effects of rights plans

The following three results have been indicated as the effects of rights plans.

(Do not influence stock price or corporate value during peaceful times)

Rights plans are adopted during peaceful times, and cause no change in corporate value until a hostile acquirer appears. Even if a takeover threat arises, since the existing management executives and the acquirer will inevitably discuss the removal of the rights plan, the plans are not actually executed. There is no preferential treatment for certain shareholders, as is the case with super voting stocks, golden shares, crown jewel strategies and increased third-party capital allocations. As a result, there is no effect on stock price when rights plans are adopted during a peaceful period, which has been confirmed through empirical analysis. For example, among companies that have adopted rights plans since the 1990s, investigation of the effect on stock price due to the introduction of a rights plan at 10 top companies ranked by current total valuation was made. The results showed that since the introduction of the rights plan the stock price has dropped in 4 cases, risen in 3 cases, and shown no specific trend in 3 cases, indicating that there is no general characteristic. From these results it is also possible to say that the influence of the introduction of a rights plan on the stock price depends largely on the factors for each company, and can be said to have no effect[84]. The establishment of combinations of multiple defensive measures received negative assessments from investors. There is also empirical analysis of the effects on long-range stock prices. It is necessary to pay careful attention when adopted in conjunction with staggered board systems and restrictions on director dismissal.

(Ensures time and opportunities for negotiation between acquirers and existing management executives before shareholders are approached)

By introducing a rights plan during a peaceful time, since the acquirer cannot obtain a controlling interest he is temporarily stopped, and negotiates with the board of directors to remove the rights plan. As a result, if the proposal of the existing management executives is better, the acquirer gives up on the acquisition and withdraws. It the offer from the acquirer is better, the rights plan is removed and the tender offer is accepted.

In the United States, until there were court decisions on rights plans, there were lawsuits to contest the actions. Since there have been court decisions, the lawsuits have decreased. It can be said that one of the effects of the rights plans is that the assessments of shareholders are more respected than the court decisions.

(Raises the acquisition premium, and achieves offers higher than the corporate value)

Typically, when there is a hostile TOB, shareholders are pressured to make a decision about selling their shares within about 1 month. The introduction of a rights plan causes both the existing management executives and the acquirer to solicit support from the shareholders by carefully explaining the business strategies through the process of the negotiations between the

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[84] Nomura Securities Corporate Value Research Committee materials

existing management executives and the acquirer. As a result, the better business proposal can be adopted, and corporate value increased. Therefore, it is possible to eliminate financially-motivated acquisition proposals that have no interest in the long-term operation of the company. This makes it possible to focus on the future growth potential of the company, and consider the benefits to stakeholders.

Furthermore, rights plans raise the stock price when there is acquisition activity. Empirical analysis indicates that one result of the introduction of a rights plan is "When a rights plan is adopted, the purchase premium in event of an acquisition is increased by about 10%". For example, based on studies by Georgeson Shareholders[85], between 1992 and 1996, the premium at the time of acquisition for companies with rights plans was an increase of about 8%. J.P. Morgan studies covering 1993 to 1997 indicated that the acquisition premium was 10%, and from 1997 to 2000 the acquisition premium was about 4% higher. Furthermore, a Nomura Securities study from 2001 to 2004 indicates that the acquisition premium was about 10% higher[86].

In fact, through the introduction of a rights plan, when there was a hostile takeover bid for Williamette by Weyerhaeuser in 2002, the acquisition price was increased by 16% over the course of the 14 months of negotiations. More recently, when Oracle attempted to acquire PeopleSoft in 2004, as a result of the existence of a rights plan the acquisition negotiations took about a year and a half, and the purchase price was increased by 60% over the original offer.

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[85] Major IR company in the United States.

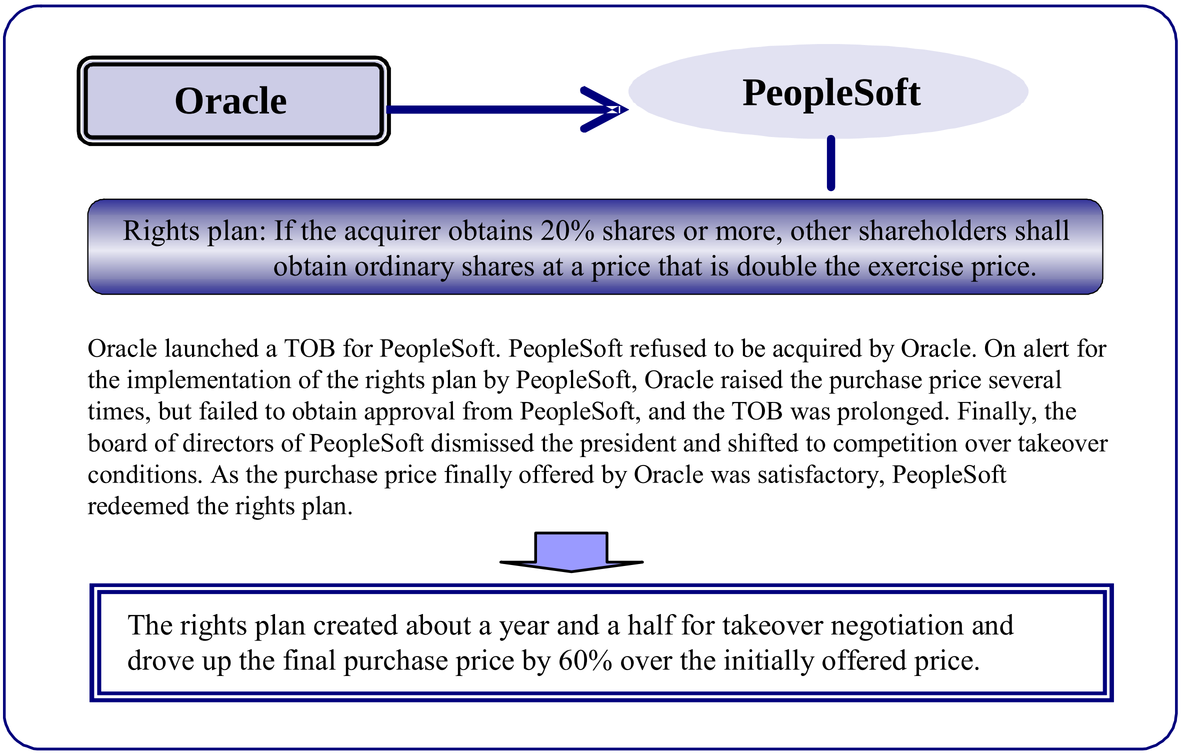
[86] (i) From 1992~1996 for acquisitions in excess of $250 million (319 cases), the premium was 8% higher at the time of acquisition (Georgeson Shareholder, Mergers & Acquisitions ： Poison Pills and Shareholder Value/1992-1996(1997))

(ii) From 1993~1997, for acquisitions in excess of $500 million in which 50% stock was obtained (300 cases), the premium was 10% higher at the time of acquisition. (J.P. Morgan＆Co, Median Control Premiums：Pill v No Pill(July 1997))

(iii) From 1997 ~ 2000, for acquisitions in excess of $1 billion the premium was 4% higher at the time of acquisition. (J.P. Morgan＆Co, Median Control Premiums：Pill v No Pill(May 2001))

(iv) Since 2001, for hostile acquisitions in excess of $200 million the premium was 10% higher at the time of acquisition (Nomura Securities "Corporate Value Research Committee" (Ministry of Economy, Trade and Industry) materials, Bloomberg records on acquisitions)

Figure 3-8 Rights plan created time for takeover negotiation and drove up the purchase price



Source: Compiled by METI based on various reference

(4) Although decreasing, the majority of U.S. companies have adopted rights plans

(Efforts to abolish rights plans)

In recent years, when a majority of individual shareholders agree to a proposal to abolish a rights plan, or among companies that have increased their total value and are at less risk of a hostile takeover, there are those who are abolishing the rights plans[87].

The numbers of S&P 500 companies that have abolished rights plans in each of the past 3 years are 7 (2002), 13 (2003) and 10 (as of August 2004). In contrast, there are still companies introducing them (9 cases (2002), 3 cases (2003), 1 case (2004)) [88].

For example, among the companies that have abolished their rights plans since 2000, there is a tendency for them to be companies with high total values. The pharmaceutical company, Pfizer, voluntarily removed the rights plan before the end of its term based on the guideline specifying the obtaining of shareholder advance approval when re-introducing a rights plan for the future. In addition, in the computer manufacturing industry, Hewlett-Packard also announced the abolition of the rights plan after the merger with Compaq at the general shareholders meeting on the merger. They voluntarily removed the rights plan before the end of the term, and stated that if a rights plan

[87] In March 2005, Cisco Systems, a large US network equipment company, abolished the rights plan that had been scheduled to remain in effect until June 2008

[88] Data by Corporate Value Research Committee (Nomura Securities)

were to be adopted in the future, the advance approval of shareholders would be obtained "removing the cases of tender offers that do not benefit shareholders". The petroleum company Chevron-Texaco also voluntarily removed their rights plan before the end of the term after receiving an abolition proposal from designated committee of independent directors considering a shareholder proposal requesting that advance approval be obtained from shareholders.

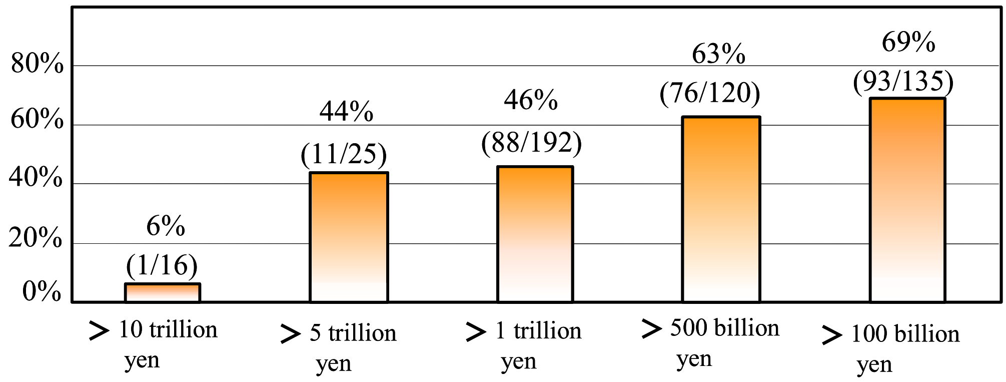
(Majority of companies still adopt rights plans)

However, over 60% of U.S. companies continue to adopt rights plans. In particular, companies with smaller total current value are more likely to actively adopt rights plans. Nearly 70% of companies with a total current value in the range from 100 billion yen ~ 500 billion yen use rights plans.

Looking at the breakdown by industry type, there are many rights plans adopted especially in the IT electronics/electrical industries and the software industry. Companies with current rights plans are Dell, Unisys, Gateway, Xerox, Oracle, and Yahoo. Many important U.S. companies are also introducing them, including Eli Lilly, Motorola, Gillette, Gap, Harley Davidson and Moodys[89].

On the other hand, even among the companies that have abolished them, there are many that have stated that if necessary the plans will be re-adopted after obtaining general shareholder approval.

Figure 3-9 Percentage of companies with rights plans (by current total value)



Created by the Ministry of Economy, Trade and Industry based on Nomura Securities materials from SharkRepellant.net data

(Data as of the end of August 2004)

[89] The reason on the company side for the introduction is generally explained as seen in a Yahoo press release, "The rights plan is adopted to prevent offers from coercive acquirers that do not offer fair and appropriate tender price and terms to all shareholders."

(5) Evolution and modification of rights plans

(Rights plans with illegal dead hand clauses)

Rights plans are effective against TOBs, but are not effective in a proxy contest. This is because through a proxy contest, an acquirer can get directors onto the board and have the rights plan removed. In the United States, some companies adopted rights plans that invalidated proxy contests by adding conditions stating that new directors had no authority to remove the rights plan (dead hand provision, no hand provision). In 1997 among the 1,600 companies that adopted rights plans, 280 of them adopted rights plans with dead hand provisions[90]. In some state regulations these are considered legal. However, since there have been court decisions determining that these dead hand provisions are illegal,[91] there are fewer companied using rights plans with dead hand provisions.

(Many companies still adopt staggered term systems)

Based on these court decisions, the **standard rights plans in the United States are designed so that the rights plan can be removed through proxy contest; but, in many cases these are in combination with staggered board systems to increase the costs of proxy contests**. Specifying a 3 year terms for directors, and restricting the mid-term dismissal of directors is a mechanism that makes it impossible to remove defensive measures without going before a general meeting of shareholders at least twice.

(Modifications due to pressure from institutional investors)

In response, the institutional investors have demanded advance approval of general shareholders, abolishment of staggered terms, and oversight of highly-independent outside directors, from the perspective of ensuring the long-term benefits of shareholders as a whole. To deal with this, although few American corporations require advance approval by general shareholders or have abolished the staggered boards, they have devised a variety of mechanisms. For example, rights plans with provisions like sunset clauses (requirement for periodic review (usually every 3 years) of the pros and cons of the rights plan details at the general meeting), and TIDE[92] provisions (requirements to check the pros and cons of extension of the defensive measures by independent outside directors), and chewable rights plans (objective removal clauses on removal based on the recommendation of independent outside directors and financial advisors in the event of an all stock / all cash tender offer) have been adopted. These modified rights plans account for more than 30% of

[90] Thomas E.L. Dewey, Loosening the Grip of the Dead Hand, Wall St. J., Aug. 24 1998

[91] In the Toll Brothers Case in 1998, the Equity Court of the State of Delaware judged the dead hand provision to be illegal, ruling that it would unreasonably restrict new directors' management control or shareholders' right to eliminate the rights plan. Also, in the Quick Turn Case in 1999, the Supreme Court of the State of Delaware even found illegality in the no hand provision of the slow-hand type that clearly fixed a period during which the rights plan could not be eliminated, thereby weakening the effect of the plan.

[92] Abbreviation for Three-year, Independent Director Evaluation

the total.

Institutional investors do not propose the abolishment of rights plans, but, there is an increasing tendency for individual shareholders to make abolishment proposals. In response, there are recently more and more companies abolishing their rights plans, but even at the companies that abolish the rights plans, there are none that disavow the adoption in the future, and most announce policies whereby introduction will be studied on the approval of the shareholders in general. This is also true at the majority of companies that currently have rights plans in place.

It has been pointed out that rights plans may be linked to entrenchment of the management executives. In the United States, there have been monitoring functions established to ensure that defensive measures do not become excessive: (i) there is clear criteria for the legality of defensive measures from the courts, (ii) institutional investors indicate the requirements of the defensive measures that are acceptable, (iii) the establishment of an independent outside director system has clarified the decision-making process for the maintenance / removal of defensive measures in the event of an acquisition attempt, and (iv) compensation for directors has been switched to a stock basis, in order to create the same viewpoint as the shareholders for business decisions. Rights plans have survived this rigorous observation, and have become rational defensive measures for improving corporate value.

(Current rights plan equilibrium points)

In this way, **the current balance for defensive measures in the United States is as follows. The institutional investors require advance approval at the general shareholders meeting, and the abolishment of staggered boards. In response, the companies commonly use a basic design of "adoption during peaceful time, with removal possible by vote at two general shareholder meetings", and a "check by independent outside directors when an acquisition attempt is made". Recently, there are beginning to be increases in the "establishment of more objective criteria for removal**".

5. Suggestions for Japan from U.S. experiences

Rights plans allow maneuverability, and can be adopted only by a board of directors (super voting stock, golden stock and large increases in capital to white knights require approval of the general shareholders). In peaceful times, they cause no loss of corporate value. When an acquisition is attempted, shareholders other than the acquirer are treated fairly (in obvious contrast to super voting stocks, golden stocks and white knight strategies). In addition, by carefully devising the execution and removal conditions, it is possible to prevent them from being used for entrenchment by management executives. Through this 20 year history, rights plans have become the most widely-used, and continue to evolve. This evolution and the standards for legality and reasonableness of defensive measures can provide valuable insights to Japan in the search for new business community awareness. Chapter 4 presents the suggestions for legal and reasonable defensive measures, and Chapter 5 presents the necessary business community infrastructure to develop the defensive measures.

Table 3-1 General Defensive Measures

Defensive measure	Summary
Rights plan (poison pill)	A mechanism to dilute a buyer's stock acquisition rate whereby if the buyer acquires more than a specified percentage of shares (typically about 20%), shareholders other than the buyer are automatically issued new shares (also called a poison pill)
Golden share	A type of share that gives veto power over important matters like mergers and changes to the board to the friendly third-party holder[93]
Super voting stock[94]	A mechanism in which the special stock of the founders has multiplied voting rights[95]
Blank check	The board is granted the authority to create stock with the terms and conditions freely devised in response to market trends[96]
Golden parachute (high value retirement/severance packages for executives)	A method of concluding contracts that grant lucrative benefits if the board and high-ranking executives lose their jobs as a result of a hostile takeover
Tin parachute (high value retirement/severance packages for employees)	A method of concluding contracts that grant lucrative benefits to ordinary employees who lose their jobs as a result of a hostile takeover.
Going private	Removing the company from the stock market[97]
White squire	Having stock held by a friendly company[98] (In the United States, typically about 15% - 20%, may also issue preferred stock that is converted to voting stock in the event of a takeover attempt)
Shark repellant[99]	Various defensive measures specified in the charter (mainly, the following 4 measures)

[93] Even if the buyer is successful in acquiring common stock, it is difficult to perform a merger or replace the board (similar to super voting stock).

[94] The internet search company Google, which went public in 2004, prepared two types of stock with different voting rights. The two founders and management executive held super voting stock (1 share = 10 votes), while the preferred stock that was made available to ordinary shareholders conferred only 1 vote/ share. As a result of a firm commitment to long-range operating objectives, the current total value after the IPO exceeds 5 trillion yen.

[95] Currently, it is generally prohibited for companies that are already public to issue new super voting stock under the uniform voting rights guidelines of the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX), and National Association of Securities Dealers (NASDAQ). (However, this does not apply to companies that introduced super voting stock prior to 1994, when the issuance was banned. In addition, there is no prohibition on the issuance of super voting stock for an initial public offering).

[96] If there is a hostile takeover attempt, it is possible for the board itself to create resistance measures.

[97] The most common means of doing this is the MBO (management buy out). Ordinary shareholders can obtain a premium for the sale of their stock, and the management team can continue running the business.

[98] On the NYSE companies are encouraged to obtain approval at shareholders meetings on issues related to shareholder interests. In the following cases, shareholder approval is required for the issuance of new stock (i) When the new stock issuance is greater than 1% of the stock already issued to directors, subsidiaries, affiliates, and persons with a direct of indirect interest with directors, or greater than 1% of the voting rights of the stocks prior to the issuance. (ii) When the issuance of the new stock is equivalent to 20% or more of the voting rights of the stocks prior to the issuance, or a number equivalent to 20% or more of the total number of already issued stock. (iii) When there is a shift in the control of the issuing company accompanying the new issuance. (Shareholder approval is not required for public offering in cash or the issuance of ordinary stock at a price above the book value or market price of the issuing company's ordinary stock).

[99] It refers to creation or modification of the basic charter or appended articles to maintain the independence of the company from acquisition efforts. Changes to the basic charter require a vote by shareholders, and changes to the appended articles require a vote of the board of directors.

Defensive measure	Summary
(i) Super majority	The voting requirements of the shareholders are increased for issues like mergers and replacements of board members. Even if a hostile buyer acquires a large amount of stock, this makes mergers and board reassignments difficult[100]
(ii) Staggered board (system of appointing directors with offset terms of office)[101]	The term of office of directors is staggered, so that it is difficult to replace a majority of directors. (In the United States, the term for a director is typically 3 years. If only 1/3 of the directors are up for election each year it will take a hostile buyer 2 years to replace a majority on the board.)
(iii) Setting conditions for valid reasons for dismissal of a director	If directors are dismissed in the middle of a term, it must be for a valid reason.
(iv) Fair value condition[102]	A condition requiring a hostile buyer with partial controlling interest to pay a fair price to small shareholders in the event of a planned merger as a second phase.
Change of control: capital restriction conditions	Mechanism of incorporating conditions in financial agreements requiring immediate loan repayments, or immediate release from licensing agreements in the event of major changes in shareholders or in the executive team.

Table 3-2: Immediate defensive measures

Defensive measure	Summary
White knight	Merger with a friendly company or converting to a subsidiary through an exchange of new stock
Pac-man defense	A counter takeover attempt of the acquirer. (Ex: In 1999 the French petroleum company TotalFina (#1 in the industry) attempted to acquire Elf Aquitaine (#5). Elf made a counter-bid to acquire TotalFina)
Crown jewels ↓ Done on a large scale, this is called a scorched earth strategy[103]	A business transfer of important company assets to a white knight. (One example is the loan of Fuji Television stock owned by Nippon Broadcasting to Softbank Investments)
Increase dividends	Raising the stock price by increasing dividends

100 With this it is possible to make it difficult to force a two-tiered buy-out by locking-out remaining shareholders through mergers, etc, after a majority of stock is acquired through TOB and a controlling interest is obtained. However, it can also be a barrier to friendly reorganizations

101 The system of staggered terms for directors is often introduced in conjunction with other defensive measures, such as Rights Plans. 65% of companies with Rights Plans also have a staggered board system. Since this also enables rather effective resistance against proxy fights as well, institutional investors are generally opposed to the introduction.

102 This is a type of special resolution condition. It is introduced by specifying that the special resolution requirement is lifted in the event that a fair price is paid in a second stage. This is introduced to prevent a second-stage squeeze-out merger in a forced two-tiered buyout. It is specified that the fair value must not drop below the TOB purchase price in the first stage.

103 This is a defensive measure in which the company that is the target of the takeover sells off assets to make itself less appealing when a hostile buyer appears. If the business is transferred in accordance with corporate law with

(1) Special vote of shareholders for important assets (20% or more of company's total assets)

(2) Board of director vote for other items

and for an appropriate price, since appropriate consideration is received, the value of the company does not decrease (in other words, not a scorched earth strategy)

There are the following risks if the business is handed over for a price that is not proper,

・Request for injunction on the illegal action of the board from shareholders and auditors (before the sale)

・Class action lawsuit by shareholders (after the sale)

Table 3-3 Anti-takeover laws in various states

Defensive measure	Summary
Laws on business joining restrictions —Introduced in 33 states, including Delaware and New York	An acquirer who has acquired a controlling interest in a company targeted for takeover, unless advance approval is obtained from the board of directors of the target company, is prohibited from dealings such as mergers with the target company, dissolution of the acquired company, or disposal of assets, for a specific period of time (typically 3 to 5 years). In addition to limiting second-stage transactions in a two-tiered buyout to a specified period, this regulation makes it possible to provide protection of shareholder interests from a LBO for liquidation.[104]
Fair Value laws —Introduced in 27 states, including Maryland	A mechanism that requires a special vote by shareholders if shareholders are not paid a fair price in the execution of a business combination with an interested party. However, if there is consent among a large majority of non-interested shareholders (typically about 80%), the law is not applied in many cases. Fair Value laws are also established in order to protect shareholders from two-tiered buy-outs.[105]
Laws on acquisition of a controlling stock interest —Introduced in 27 states, including Indiana and Ohio	A mechanism that requires approval of a majority of shareholders with no vested interest for acquisition of more than a specified percentage of stock (controlling shares) in the target company, or the exercise of voting rights after acquisition. This enables shareholders to be protected from being coerced into a two-tiered takeover bid.[106]
Laws on modification of fiduciary duties —Introduced in 33 states, including Pennsylvania	A mechanism that instructs and allows directors facing a purchase offer to consider not only the benefits to shareholders, but also the effects on employees, suppliers, customers and the local society.[107] In several states it is clearly stated that the board of directors is not charged with the responsibility of regarding the interests of the shareholders as superior or dominant.[108]
Laws permitting differential conditions of exercise —Introduced in 31 states, including New York	A mechanism for permitting a differential handling limiting the issue of rights only in a hostile takeover attempt (=mechanism for the purpose of supporting the legality of rights plans)[109]

[104] In New York, holders of 20% or more of the stock are not permitted to combine the business with the target company for a period of 5 years, unless they obtain the approval of the board of directors in advance. In Delaware, a similar rule restricts shareholders with 15% or more of the stock from combining business for a period of 3 years. In Delaware there are many exceptions to the business combination restriction. If approval is obtained from the board of the target company for business combination or stock acquisition before the stock is obtained, the restriction does not apply. It also does not apply in cases where 85% or more of the stock is owned (excluding stock owned by directors and officers).

[105] For example, in Maryland, in order for a company to join in business with a shareholder that owns 10% or more of the stock, special approval is required from shareholders (80% or more of the stock, and at least 2/3 of the shareholders with no vested interest). However, if there is approval by directors with no vested interest, or small shareholders will be paid a fair price (price that is no lower than the first-stage price), then special approval is not required.

[106] For example, in Ohio, it is necessary to obtain prior approval from the majority of shares of all stock and from those held by shareholders with no vested interest, in order to own 1/5, 1/3 or 1/2 of the stock. In Indiana, buyers who acquire more than 1/5 of the stock cannot exercise the voting rights for the acquires stock unless the majority of shareholders with no vested interest consent at a shareholders meeting of the target company within 50 days of the acquisition.

[107] It is claimed that many states enacted these laws after the Revlon decision in Delaware in which it was ruled that directors are not permitted to consider the interests of anyone other than shareholders in the event of a sell-off of the target company.

[108] For example, in Pennsylvania, it is stipulated that when investigating the impact caused by specific actions or maximum profit to the company, the board of directors, officers of the board and individual executives are not required to consider company benefit or benefits to specific persons as essential factors or controlling interests.

[109] Specifically, in states in which there are precedents that deny the legality of differential execution conditions, there are many examples of this kind of law being established. (New Jersey, New York, etc.). In states with precedents recognizing Rights Plans, such as Delaware, in many cases there is no such law established.

Table 3-4 Notes on defensive measures apparent in guidelines for exercising voting rights

Country	The United States	The United States
Organization	(AFL-CIO : American Federation of Labor & Congress of Industrial Organization)	(CalPERS : CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM)
Rights plan	○ Conditionally approve ・Oppose rights plans that are not submitted to the shareholders periodically (every 3 years is desired) ・Approve rights plans that require shareholder approval ・Oppose rights plans that are triggered at levels less than 20% of the issued stock ・For the evaluation of rights plans it is necessary to consider the impact of failed (hostile) acquisitions on the long-term increase in corporate value, and the fact that most (hostile) takeovers are not successful at long-term improvement in corporate value.	○ Conditionally approve ・The board of directors should not be able to adopt or modify a rights plan without the approval of the shareholders.
Term restrictions for directors, etc.	○ Oppose ・Staggered terms for directors reduces the rights of shareholders to elect directors to once a year, and suppresses dealings to improve the long-term corporate value.	○ Oppose staggered terms of office ・All directors should be elected annually for a term of one year.
Super voting stock	○Oppose in principle ・Oppose super voting stock that restricts the rights of shareholders ・Considering the corporate governance of investors in residence at the company for a long time, and the enhancement of accountability of top management, there should be favorable response to proposals to increase the long-term shareholder value.	
Absolute majority requirement	○Oppose in principle ・An absolute majority condition should consider the possibility of protection of the interests of the small shareholders.	
Fair value condition	○Approve ・Fair value conditions are a means to resist the pressure of a two-tiered buy-out. ・Should consider the potential for minimization of company liabilities, and the long-term impact on price if the shareholder does not respond to the offer.	
Other	○ Golden parachutes are approved if shareholders approve ・Golden parachutes reward poor results if there is a management change. In addition, managers who are already receiving appropriate compensation get a big retirement/severance payments. ・The payment of the Golden Parachute compensation should be subject to the completion of the takeover rather than the approval of the shareholders for the buyout. ○ Approve cumulative voting ・Cumulative voting is a means of establishing independence from the influence of the management on the board of directors, whereby small shareholders send representatives to the board. ○ For the payment of green mail, consideration should be made of the discrimination to other shareholders and the potential for lowering stock prices. Greenmail is lacking as a long-range action, so it is opposed.	○ Greenmail is opposed for all companies

Country	The United States	The United States
Organization	(CalSTRS : California State Teachers Retirement System)	(SBA -Florida State Board of Administrations)
Defensive measures in general	○ Oppose in principle ・ Approval in principle of proposal to remove all defensive measures	
Rights plan	○ Oppose in principle ・However, evaluated on a case-by-case basis	○ Conditionally approve ・ Approve if shareholder approval is obtained ・ Rights plans enable boards to reject even takeovers that are beneficial to shareholders. ・ Since courts recognize leeway in director application of rights plans even for friendly takeovers, it is important that the authority to approve a rights plan is held by shareholders
Term restrictions for directors, etc.	○ Oppose	○ Oppose staggered term systems ・ Annual appointment of directors improves performance ○ Approve granting the board of directors authority on scale of the board for (i) and (ii) below, as long as not compulsory. (i) So that a shareholder with a majority of shares cannot determine scale of the board (ii) To handle reduction in the number of directors when there is a buyout
Super voting stock		○ Handled case-by-case ・If directors introduce super voting stock, the voting rights of shareholders will be weakened.
Blank check stock	○ Oppose	○ Oppose ・ Allows the board to determine shareholder rights, such as dividends, stock conversions, voting rights, and can be used by top management to protect themselves
Absolute majority requirement		○ Conditionally approve ・ Oppose the introduction of an absolute majority requirement for approval of buyouts and other business mergers
Fair value condition		○ Handled case-by-case
Other	○ In principle, oppose the expansion of the authority to issue common stock when there is no specific reason or when the increase is not less than 15% of the already issued stock.	○ Approve Golden Parachutes that are no more than 2 or 3 years salary, and approved by shareholders. However, oppose Golden Parachutes if applied over a wide range. ○ ESOP must give rise to interest held by ordinary employees. Approval for ESOP with stock issues that do not exceed 5%. ○ Approve authority to increase issue of common stock up to a factor of 2. (Will consider proposals by the board for greater increases) ○ Approve setting internal regulations and charter articles on Greenmail, and introduction of other methods to limit payments. This is because green mail is paid to preserve the position of the board, and is only performed to evade a hostile takeover ○ Approve application of state laws on corporate takeovers

Country	The United States	The United States
Organization	(OPERS : OHIO PUBLIC EMPLOYEES RETIREMENT SYSTEM)	(SWIB : State OF Wisconsin Investment Board)
Defensive measures in general	○ Oppose (defensive measures in general) ・ Used for entrenchment by management, leads to potential acquirers negotiating directly with the board of directors, and may prevent shareholders from obtaining the maximum financial benefit (The same holds for blank check stock, staggered terms and rights plans)	○ If 3 or more defensive measures like the following are adopted, it is regarded as one condition of non-support of the board ・ Unequal voting rights ・ Super voting stock that dilutes shareholder rights ・ Absolute majority conditions ・ Consent to green mail without shareholder approval ・ Golden Parachutes with compensation in excess of a 2 year income ・ Ban on calls for a general meeting by shareholders ・ Introduction of rights plans without shareholder approval
Rights plan	○ Oppose	○ Conditionally approve ・ Oppose unless there is a sunset clause requiring review of rights plans every 3 years or less ・ Oppose rights plans that go into effect based on a trigger of stock ownership of 20% or less ・ Approve all changes that enable simple repayment of debt ・ Support on a case-by-case basis for rights plans reviewed by a panel of outside directors at least once every 3 years
Term restrictions for directors, etc.	○ Oppose staggered term systems ○ The directors are granted the authority for the scale of the board	○ Oppose staggered term systems ・ Since increases/decreases in the number of directors can obstruct proxy fights, shareholder approval is required
Super voting stock		○ Oppose in principle (with exceptions) ・ Oppose in principle because it dilutes shareholder rights ・ Case-by-case when there is a clear business reason
Blank check stock	○ Oppose	○ Oppose in principle (with exceptions) ・Oppose in principle because it dilutes shareholder rights ・Evaluated on a case-by-case basis when there is shareholder approval。
Absolute majority requirement		○ Conditionally approve ・For a proposal for which all directors have indicated opposition, it is recognized as being passed with an absolute majority of 2/3 or more. ・Oppose absolutely for director appointment and dismissal
Fair value condition		○ Oppose in principle (with exceptions) ・Since this could suppress even a good buyout, this is opposed in principle if there is an absolute majority requirement ・Evaluated on a case-by-case basis if there is consent obtained of general shareholders
Other		○ Case-by case evaluation when new issues exceed 250% of current issue (approve in principle below that level) ○ Approve cumulative voting because it protects shareholder rights ○ Approve Golden Parachutes if they do not exceed a 2 year equivalent compensation ○ Oppose acceptance of green mail without shareholder approval. However, approved if the same kind of proposal is made to all shareholders. ○ For stakeholder rights, if there is an enacted law, it should be followed. Otherwise, evaluated on a case-by-case basis

Country	The United States	The United States
Organization	(TIAA CREF : Teachers Insurance and Annuity Association - College Retirement Equities Fund)	(Hermes Pension Management Limited)
Defensive measures in general	○Conditionally approve (Defensive measures in general) ・ Must obtain approval from shareholders regarding actions related to control ・ Before introducing rights plans or other defensive measures, there should be a clear demonstration of the potential benefits to shareholders ・ Any takeover defensive measure should only be in effect for no more than 3 years ・ Strongly oppose defensive measures that restrict the freedom of the board to abolish defensive measures	○ Conditionally approve ・ Do not support defensive measures associated with irrational or unreasonable costs ○ In principle, support the current management team in the case of a hostile takeover ・ Do not support if there is loss of confidence in the current management team, or the purchase premium is clearly reasonable
Term restrictions for directors, etc.	○ Oppose staggered term systems ・ The board should be elected every year ・ Staggered terms in combination with other defensive measures, such as rights plans, are a big obstacle to a free market	
Super voting stock	○ Oppose ・Should be one vote per share	○ In principle, oppose non-voting stock and limited voting rights stock ・ Detrimental to a large number of shareholders ・ Recognize issuance in the case of a company takeover
Absolute majority requirement	○ Oppose ・Excluding cases of protection of small shareholder interests when there is one shareholder with controlling interest.	
Fair value condition	○ Approve ・ All shareholders should be treated equally	
Other	○ Should not be able to expand the authorization framework for issuing ordinary stock without shareholder approval ○ Oppose changes to the site of the company for the purpose of limiting shareholder rights. ○ In order to preserve long-term profitability, shareholders must monitor the board of directors	○ When the company plans to issue stock in quantities equal to 5% or more of existing stock issues, there should be a preferential offer to existing shareholders.

Country	The United States (Investment agency)	The United States (Investment agency)
Organization	(Fidelity Group of Mutual Funds And Corporate Governance)	(Putnam Investment)
Defensive measures in general	○ Oppose ・Defensive measures are used by management to entrench themselves	○ Oppose (defensive measures in general) ・ Defensive measures make takeovers by a third party difficult without board approval, are entrenchment for management, infringe on shareholder rights, and cause conflicts between the interests of management and shareholders (including staggered terms, blank check stocks, super voting stocks, etc.)
Rights plan	○ Conditionally approve ・If shareholder approval is not required, opposed, because the board can adopt new or stronger rights plans ・Approve if a sunset clause is included ・Oppose rights plans that are triggered by ownership of stock at 20% or less	○ Conditionally approve ・Since this is connected to improved shareholder value under specific conditions, this is evaluated on a case-by-case basis
Term restrictions for directors, etc.	○ Oppose staggered term systems ・ Takes away the right of shareholders to elect board of director members at the shareholder meetings	○ Oppose staggered term systems
Super voting stock	○ Oppose ・ Because it limits shareholder rights	○ Oppose in principle ・However, approve in cases where the rights of shareholders are improved as a result of the introduction of super voting rights
Blank check stock	○ Oppose in principle ・Because the directors determine the shareholder rights (dividend, stock conversion, voting rights, etc.) ・ However, when it is for the purpose of protecting shareholders, it is approved when the following 2 conditions are satisfied. (i) 1 stock = 1 vote, (ii) Defensive measures are not used unless prior approval is obtained from shareholders	○ Oppose ・ Oppose because is grants the board of directors the right to determine voting rights and dividend without the approval of the shareholders
Absolute majority requirement	○ Oppose ・ By granting veto power to small shareholders, shareholder rights are restricted	
Fair value condition	○ Oppose in principle ・However, approve when not in conjunction with other defensive measures, and considering only the stock prices of the past 2 years	○ Conditionally approve ・Since this is connected to improved shareholder value under specific conditions, this is evaluated on a case-by-case basis
Other	○ Golden Parachutes are opposed because they suppress buyouts that should be considered by shareholders in the future. Especially oppose when compensation exceeds 3 years of salary. ○ If shareholder approval is obtained, approve authority to issue common stock if it is not more than 3 times the current outstanding shares ○ Approve cumulative voting because it strengthens shareholder rights by changing management. However, if shareholder rights are protected by using an independently appointed committee or a board with a majority of independent directors, cumulative voting is not necessary.	○ Approval of expansion of the authority to issue common stock if there is shareholder consent, an appropriate reason given by management, and a rational system of increase. In principle, increases of 50% or more are opposed. Also opposed when the purpose of the expansion is for a defensive measure or rights plan.

Chapter 4. Establishment of "Fair and Reasonable Rules to Enhance Corporate Value" in Japan

As noted in Chapter 1, Japan lacks experiences with hostile M&As as well as knowledge about what measures are reasonable (legal and appropriate for shareholders and investors) for increasing corporate value and serving the best interests of all shareholders.

This means that there have been cases where companies hastily took defensive measures in response to surprise hostile takeover bids, led bidders to file lawsuits against the measures and received court decisions ruling the measures as illegal (adverse effects of excessive defensive measures)[110]. Attracting attention then may be new types of defensive measures (including rights plans utilizing stock acquisition rights) that are adopted before hostile approaches and triggered in takeover contests. In the absence of precedents, however, most Japanese companies hesitate to adopt such measures, fearing that "the measures may be banned under the Japanese Corporate Law framework" and that "the measures may cause a market backlash and prompt share prices to fall." Japan's TOB regulations do not require a bidder to purchase all shares of a target company. If the present situation is left untouched, companies may fail to effectively block takeover proposals that could reduce their corporate value (concerns about ineffective defensive measures).

Unless Japan urgently develops fair and reasonable rules based on logic and views expressed about what defensive measures enhance corporate value or promote entrenchment of corporate management, excessive defensive measures may be repeated or concerns may emerge about ineffective defensive measures.

While the Corporate Value Study Group published an outline of discussion points on March 7, 2005, and the summary outline of discussion points on April 22, 2005, interest has been growing in the fair development of defensive measures that are adopted before hostile approaches and triggered in takeover contests. The Tokyo High and District Courts ruled that Nippon Broadcasting's stock acquisition right issuance to Fuji Television Network as a defensive measure taken after a hostile approach (a defensive measure adopted and triggered in a takeover contest) was designed primarily to maintain the management's control and was illegal in principle. But they noted that defensive measures for adoption before hostile approaches may be legal. The Tokyo District Court decision said: "What measures should companies be allowed to adopt in preparations against

[110] Cited as a case where a defensive measure was ruled illegal is Shuwa's bid for Chujitsuya and Inageya shares (1989-91). Real estate broker Shuwa purchased a 33% stake in Chujitsuya and a 21% stake in Inageya in an attempt to reorganize the retail industry. In response, Chujitsuya and Inageya issued a 20% equity stake in each other. Shuwa filed for a court injunction to stop the new equity issuances. A decision that endorsed the injunction as requested, ruling that Chujitsuya's and Inageya's equity issuance to each other was an unfair measure that failed to undergo due procedures and was designed to lower a specific shareholder's stake. A defensive measure was ruled legal for Cosmopolitan's bid for Takuma shares (1987-89). Cosmopolitan, an investment group, acquired 36% of Takuma shares and pressed Takuma to convene a general meeting of shareholders to adopt measures such as the dismissal of the president. Takuma ignored the pressure and announced an equity issue to some parties including Sumitomo Bank for the purpose of promoting new product development and overseas business operations. (Note: Cosmopolitan's stake will be lowered to 29% if the measure is implemented). Cosmopolitan filed for a court injunction to stop the equity issue but the Osaka District Court turned down the suit, ruling that the equity issue had a reasonable objective.

future hostile takeovers? As experts at various forums are considering the details and standards as well as outside directors' involvement, shareholder approval and other procedures for their adoption, it is expected that discussions will be deepened to allow the development of fair and specific rules to protect the best interests of companies and shareholders." The ruling thus expressed hopes for the development of fair and reasonable rules in this regard. Corporate managers mostly demand that defensive measures be developed to satisfy both the market and bidders. Many media organizations at home and abroad have put forward expectations that the hostile takeover row would lead to the development of fair and reasonable rules for enhancing corporate value. Major newspaper editorials said that the Corporate Value Study Group's publication of discussion points should trigger the development of fair and reasonable rules. Overseas media reports, while appreciating the Corporate Value Study Group's publication of discussion points as fair, doubted if such rules could be rooted deep in Japan[111].

In Chapter 4, we propose fair and reasonable rules that should be established in Japan on hostile takeovers, based on economic theory-based conclusions in Chapter 2 and Western experiences introduced in Chapter 3.

First, we propose a desirable Corporate Law framework for Japan. We confirm that rights plans, golden shares and other defensive measures adopted by Western companies can be adopted under the Japanese Corporate Law framework, and propose that a system be urgently created for disclosure of defensive measures (Section 1).

Second, we propose that the "corporate value," rather than the principle of shareholder equality or the rule of primary purpose in issuing new shares, be adopted as the standard of the reasonableness of defensive measures (Section 2).

Third, we propose specific features for the development of defensive measures meeting the "corporate value standard." This idea is very simple. It is that procedures for the adoption and invocation of defensive measures should be designed to enhance corporate value and the best interests of all shareholders as much as possible (Section 3). We would like to more specifically propose the three requirements as cited in the outline of discussion points – (i) adoption and thorough disclosure of defensive measures, (ii) securing the possibility of removal and a settlement through a proxy contest and (iii) devices to eliminate the arbitrariness of board decisions in takeover contests (check by independent outside party, "chewable pill" and shareholder approval). The features would encourage both takeover bidders and management of target companies to disclose information about defensive measures linked closely to corporate value and would allow shareholders to have sufficient time for comparing and considering defensive measures.

We also propose that the "Corporate Value Defense Guidelines" based on the above proposals be worked out. At the same time, we point out that future institutional reforms should

[111] See Note 43 (Chapter 1).

focus on regulations on coercive two-tiered takeovers.

Section 1. [Legal framework] Is it possible to adopt Western style defensive measures in Japan?

Does the Japanese legal framework endorse defensive measures that prejudicially treat hostile takeover bidders? The general principle of shareholder equality[112] for Corporate Law in Japan has prompted some people to conclude that none can adopt such prejudicial defensive measures. However, the system of different classes of shares already exists to endorse inequality between shareholders. Furthermore, a senior official responsible for legislation interprets[113] conditions for exercising stock acquisition rights as including discriminatory provisions. Therefore, we cannot conclude that the adoption of defensive measures giving prejudicial treatment to hostile takeover bidders is not allowed under the principle of shareholder equality (See Section 2-1). We here would like to explain that Western style defensive measures can be adopted under Japan's present legal framework and that the modernization of the Corporate Law would widen a range of defensive measure options. Then, we would like to propose that a system for disclosure of defensive measures be created urgently under the legal framework that allows such measures to be adopted.

1. Defensive measures that can be adopted in Japan

Even under the present Japanese Commercial Code, defensive measures approved in Western countries can be adopted in Japan, if they are arranged to meet the Japanese style. Also, modernization of the Corporate Law framework will increase the variety of defensive measures.

(1) Rights plans

(Rights plan utilizing stock acquisition rights)

Rights plan utilizing stock acquisition rights means a defensive measure utilizing the stock acquisition utilizing what is called the discriminatory conditions that can be exercised only by shareholders other than an acquirer, or a defensive measure through allocation of stock acquisition rights to parties other than those who possess equity stake beyond a certain percentage level[114].

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[112] The principle of shareholder equality to be specified by Article 109 of the draft Corporate Law confirms that shareholders should be given equal treatment in accordance with numbers and other details of shareholdings. There is no change from the previous principle.

[113] In "2001 Commercial Code Amendment Q&A – Improvement of Equity System and Electronic Corporate Management" (Commercial Law, 2002), Koji Harada, Deputy Vice Minister of Justice, says, "In order to prevent third parties from taking over a company, a conceivable condition would provide that the stock acquisition right may be exercised if anyone other than A, B and C acquires more than ○○% of outstanding shares."

[114] [Legislative design of the rights plan utilizing stock acquisition rights] In the cases where an acquirer acquires equity stake beyond a certain percentage level (typically 10% to 20% in the United States), while shareholders other than the hostile takeover bidder can acquire stocks by exercising their stock acquisition rights, the hostile takeover

Under the Commercial Code of Japan, there are no specific restrictions on the conditions of exercising stock acquisition rights. Also, exercising of stock acquisition rights is neither regarded as a right nor an obligation of a shareholder. Thus, it can be regarded that it does not contradict the principle of shareholder equality.

In cases where stock acquisition rights are allocated to all shareholders, it can be issued with the resolution of the board of directors. Because there are no restrictions to the allocation of stock acquisition rights under the present law, allocation of stock acquisition rights to other than those who possess equity stake beyond a certain percentage level does not contradict the principle of shareholder equity.

Under the present Commercial Code, shareholders are left free to decide whether to exercise stock acquisition rights to acquire shares. However, the Corporate Law framework modernization will allow a company to issue stock acquisition rights with compulsory acquisition clauses (clauses to force to convert the stock acquisition rights of shareholders other than an acquirer into common shares)[115].

(Taxation related to rights plan utilizing stock acquisition rights)

In the Subcommittee on Corporate Governance of the Economic Investigation Committee of LDP, held on April 28, 2005, the National Tax Agency expressed the interpretation that there are cases where three types of rights plan utilizing stock acquisition rights presented by the Ministry of Economy, Trade and Industry, according to their contract terms, are nontaxable under usual conditions. Thus, it is possible to avoid the taxation under normal conditions by taking heed of the specific design of the plan (See References 2-① and ② at the end of report).

(Rights plan to dilute hostile takeover bidder's stocks only)

When an acquirer acquires equity stake beyond a certain percentage level, if it is available to force the acquirer's shares to be converted into those with restricted voting rights, using shares that can be converted forcibly, the mechanism will have an equal effectiveness with a rights plan utilizing stock acquisition rights. By taking defensive measures of this kind, voting rights of an acquirer will be diluted, while the payment ratio will not.

By acquiring all the outstanding common shares and issuing shares that can be converted forcibly with discriminatory conditions instead, it is possible to adopt such defensive measures. Under the current Commercial Code, a company must obtain shareholders' unanimous consent to

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bidder is restricted to exercising such rights due to discriminatory conditions and cannot acquire new stocks. Thus, the mechanism will lower the stock ownership ratio of the hostile takeover bidder. Details of stock acquisition rights with this kind of discriminatory conditions are decided in and issued by the board of directors in cases where the stocks are allocated among all the shareholders (Article 280-20 of the Commercial Code, Article 236 and 241 of the draft Corporate Law). In cases where a mechanism where SPCs and trust banks manage the stock acquisition rights until an acquirer appears, the equity issue will take form of allocation to third party. However, as long as the case does not correspond to an interest bearing issuance, it can be adopted with a decision by the board of directors.

[115] Article 236-1-7 of the draft Corporate Law

acquire common shares. However, by modernizing the Corporate Law framework, it will become possible to acquire through special resolution in the general meeting of shareholders.[116]

(2) Golden shares and super voting stocks[117]

(Golden shares)

A golden share is a special type of share that gives veto power over important matters like mergers and the election and dismissal of the board. Golden shares can be issued to certain third parties by utilizing different classes of shares[118]. A change in the articles of incorporation as well as the special resolution in the general meeting of shareholders will be required.

(Super voting stocks)

A super voting stock is a special type of stock with multiplied voting rights per stock. It can be issued to a certain third party by utilizing multiple different classes of shares with different units[119]. A change in the articles of incorporation as well as the special resolution in the general meeting of shareholders will be required.

(Golden shares and super voting stocks with restrictions on transferability)

Under the present Commercial Code, a company is prohibited from restricting the transferability of special-class shares. Thus, companies going public cannot restrict the transferability of golden shares or super voting stocks under the current legislation. However, the modernized Corporate Law framework will allow a company to restrict the transferability of some special-class shares only, so it would be able to restrict the transfer of golden shares and super voting stocks only[120].

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[116] [Legislative design of the rights plan to dilute the acquirer's stocks only] In the cases where an acquirer acquired equity stake beyond a certain percentage level (typically 10% to 20%), this mechanism forcibly converts the acquirer's share into those with restricted voting rights. A company can set out such conditions to forcibly convert shares in its articles of incorporation through the special resolution in the general meeting of shareholders (Article 222-8 of the Commercial Code, Article 108-2-6 of the draft Corporate Law), allocate such shares that can be forcibly converted to shareholders in accordance with equity stakes, and acquire all the outstanding common shares (Articles 108-1-7, 171-1 and 111 of the draft Corporate Law).

[117] Because these kinds of defensive measures have a high defensive effect, it is necessary to explain in detail including whether it has any side effect or not at the special resolution in the general meeting of shareholders, to ensure their understanding and confidence.

[118] [Legislative design of golden shares] This mechanism allows issuing special-class shares, having power to decide over important matters like mergers, to a friendly third party. The details of such special-class shares are set out in the articles of incorporation following the special resolution in the general meeting of shareholders (Article 222-9 of the Commercial Code, Article 188-1-3 of the draft Corporate Law).

[119] [Legislative design of super voting stocks] In this mechanism, different classes of shares with one voting right per one stock are allocated to a friendly third party, while stocks with one voting rights per 100 stocks are allocated to other shareholders for example. The details of such classified shares, including the units, are set out in the articles of incorporation following the special resolution in the general meeting of shareholders (Article 221-3 of the Commercial Code, Article 188-1-3 of the draft Corporate Law).

[120] [Setting restrictions on the transferability of each share] This is a mechanism to require the approval of the company for obtaining golden shares and super voting stocks held by friendly third parties. The details of such classified shares that require the approval of the company are set out in the articles of association following the

(3) Defensive measures by changing articles of incorporation[121]

(Toughening the requirements for resolution on merger approval and directors' dismissal)

Whether a company can use its articles of incorporation to toughen the requirements for a resolution on a merger approval or directors' dismissals under the present Commercial Code has so far remained unclear. The modernized Corporate Law framework will specifically allow the articles of incorporation to toughen the requirements for resolutions at general meetings of shareholders[122].

(Restrictive conditions on business joining[123], fair value condition[124] and controlling stocks condition[125])

In the cases of hostile takeovers or where the consideration of the merger is unfair, for example, it is possible to adopt provisions equivalent to restrictive conditions on business joining or fair value conditions as can be seen in the United States as shark repellents, by toughening requirements for resolutions on mergers using the company's articles of incorporation. The modernization of the Corporate Law framework will clarify the enforcement conditions of voting rights for different classes of shares, enabling the issuance of different classes of shares for which an acquirer can enforce voting rights of the number of units less than the number of shares it acquired. Through this mechanism, it will be able to adopt provisions equivalent to the controlling stocks condition that can be seen in the United States.

2. A system must be created for disclosure of defensive measures

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special resolution in the general meeting of shareholders (108-1-3 of the draft Corporate Law).

121 Because these kinds of defensive measures have a high defensive effect, and their effects are further enhanced by simultaneous use with other defensive measures such as a rights plan, it is necessary to explain in detail including whether it has any side effect or not at the special resolution in the general meeting of shareholders, to ensure their understanding and confidence.

122 [Legislative design of defensive measures using articles of incorporation] This mechanism allows the toughening of the requirement for resolutions in the general meeting of shareholders on important matters like the merger of the company. Items to be toughened and resolution requirements thereof are set out in the articles of incorporation following the special resolution in the general meeting of shareholders (Article 309-2 of the draft Corporate Law).

123 [Restrictive conditions on business joining] The mechanism is legislated in 33 states, including Delaware and New York, in the United States. An acquirer who has acquired a controlling interest in a target company, unless advance approval is obtained from the board of directors of the target company, is prohibited from dealings such as mergers with the target company, dissolution of the acquired company, or disposal of assets, for a specific period of time (typically 3 to 5 years).

124 [Fair value condition] The mechanism is legislated in 27 states in the United States, including Maryland. It is a condition that requires a special majority resolution by shareholders with no vested interest if minor shareholders are not paid a fair price in the execution of a business combination such as mergers.

125 [Controlling stocks condition] The mechanism is legislated in 27 states in the United States., including Indiana and Ohio. It is a condition that requires approval of a majority of shareholders with no vested interest for acquisition by the acquirers of more than a specified percentage of shares in the target company, or for the exercise of voting rights after acquisition.

Even under the present Corporate Law framework in Japan, Western style defensive measures can be adopted, by utilizing different classes of stocks and stock acquisition rights, or by changing a company's articles of incorporation. However, the system for disclosure of these defensive measures has not been sufficiently developed. The defensive measure disclosure system will provide infrastructure for shareholders, investors and acquirers to take appropriate actions in accordance with the presence or absence of, or details of, defensive measures. In this sense, the disclosure system must be urgently developed.

Defensive measure information for disclosure should be considered in accordance with details of such measures[126].

In this respect, information that is important for potential acquirers must be disclosed in an easy-to-understand format. Therefore, it is reasonable to provide for specific points of information for disclosure.

(1) Requiring disclosure in operating reports

Companies are required to disclose important points regarding management in annual operating reports based on Corporate Law[127]. Information is disclosed on stock acquisition rights that were issued at favorable prices to specific third parties in a relevant business year (primarily stock options). As for stock acquisition rights issued before the relevant year, a company is required to only disclose (i) the number of outstanding stock acquisition rights, (ii) the type and number of shares subject to stock acquisition rights, and (iii) issuance prices.

A company should be required to disclose stock acquisition rights (that are typically exercised in accordance with equity stakes) issued in response to hostile takeover bids since the issuance is a key point regarding management.

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[126] Three key points for disclosure as an advance warning are conceivable for a defensive measure that fixes rules for consideration and negotiation periods. The first is the definition of acquirers subject to the rules. The second is a detailed description of rules that acquirers must abide by. The third is a set of countermeasures planned against the violation of the rules (although details of securities cannot be disclosed, information should be disclosed to allow shareholders, investors and acquirers to predict the maximum effects of possible countermeasures to dilute equity stakes held by the acquirers).

[127] Article 103-2, Commercial Code Enforcement Regulations

A joint stock company with stock acquisition rights corresponding the items listed below must state the matters included in each item below in its operating reports:

1. Stock acquisition rights already issued, number of the units of stock acquisition rights, and the types, numbers and issuing prices of objective shares
2. Stock acquisition rights issued in particularly advantageous terms to those other than shareholders (excluding those listed below (excluding directors or those also holding the position of operating officer of the company preparing financial reports, hereinafter referred to as "Specified Employee.")), names of those who were allocated and the number of the units of acquisition rights allocated to them, types, numbers and issuing prices of objective shares, the reasons and conditions of the extinguishment of shares and details of the advantageous terms.

(2) Expecting stock exchanges to review disclosure rules

From the viewpoint of investor protection, it may be an effective measure for stock exchanges to expand rules for disclosure of defensive measures by publicly traded companies. In order to secure fairness and trustworthiness of the stock market, each stock exchange has established rules for timely disclosure of corporate information, requiring listed companies to immediately disclose decisions that have significant effects on investment decisions[128]. The rules require listed companies to disclose issuances of stock acquisition rights and different classes of shares. But the rules are not based on a presumption that these rights and shares would be issued to counter hostile takeover bids. Given that a rising number of companies are expected to issue stock acquisition rights and different classes of shares to counter hostile takeover bids, it may be worthy of consideration for stock exchanges to establish specific disclosure rules from the viewpoint of investor protection[129].

Section 2. [Standard for reasonableness] What is the right standard to judge the reasonableness of defensive measures?

Even if Western style defensive measures can be adopted in Japan, all such measures are not necessarily permissible. Defensive measures must be legally reasonable and satisfactory to shareholders and investors. What is the right standard to judge the reasonableness of defensive measures?

In Japan, there has been the view that defensive measures that give discriminatory treatment to acquirers may run counter to the principle of shareholder equality. The only rule based on judicial precedents about defensive measures in Japan is “the rule of primary purpose in issuing new shares” that has been established over allocations of new shares to third parties that took place during contests over control of companies. Under the rule of primary purpose, an allocation of new shares to third parties during a takeover contest is interpreted as illegal if the maintenance of control over a company is the only or primary purpose. Such share allocation is ruled legal if there is a fundraising purpose. In this respect, the Tokyo High Court decision on Nippon Broadcasting confirmed that a defensive measure adopted during a takeover contest would be illegal in principle as far as its only or primary purpose is the current management’s maintenance of control over a company. The decision also noted that defensive measures adopted before hostile approaches and

128 For example, the Tokyo Stock Exchange has introduced the “Rules for Timely Disclosure of Corporate Information by Issuers of Listed Securities.”(1999)

129 Tokyo Stock Exchange announced the “Points to Consider in Terms of Investor Protection upon the Adaptation of Defensive Measures for Hostile Takeover” on April 21, 2005. It requires disclosure to shareholders and investors of (i) the objective of adopting a defensive measure, (ii) the conditions to exercise, revoke and maintain the defensive measure and (iii) the impact on shareholders and investors upon the exertion of measures, in a sufficient and timely manner when adopting a defensive measure. At the same time, it schedules preparation rules, such as listing requirements, based on Corporate Value Defense Guidelines and discussions among parties concerned for the matters included in these points to consider. JASDAQ (April 21), Osaka Stock Exchange (April 28) and Sapporo Stock Exchange also announced points to consider similar to those announced by the Tokyo Stock Exchange.

triggered in takeover contests could be legal depending on conditions upon their adoption and their details. It left the development of fair rules as a future challenge. Given the High Court decision, the standard of the reasonableness of defensive measures adopted before hostile takeovers should be corporate value. This means that defensive measures should be endorsed as far as they are designed to block takeover proposals that impair corporate value, but not to block takeover proposals that enhance corporate value. The corporate value standard should be specified further as common knowledge to be shared in the business community.

In this respect, judicial standards developed in the United States are useful. There are three U.S. judicial standards – (i) whether there are reasonable grounds to believe that there is a threat to corporate value when a defensive measure is triggered, (ii) whether a defensive measure to eliminate the threat is excessive (the first and second standards are called ”Unocal standards”), and (iii) whether the board has made a prudent and independent decision on the reasonableness of a defensive measure.

We would like to discuss the relationship between the principle of shareholder equality and the primary purpose rule before proposing the corporate value standard specifically as the standard of the reasonableness of defensive measures.

1. Relationship between takeover defense measures and the principle of shareholder equality

The principle of shareholder equality means that shareholders should be given equal treatment regarding their legal standing in accordance with the numbers of shares they hold. Effectively, the principle is designed to protect shareholders in general from discriminatory treatments through dominant shareholders' abuse of majority decisions. In this respect, various arguments have been made over whether the principle that has failed to be specified in the Commercial Code could become an issue regarding the adoption of rights plans, or whether the principle could become an issue regarding acquirers who have realized the possible adoption of rights plans and dared to force share acquisitions. An argument says that as far as any shareholder is given prejudicial treatment by meeting certain conditions, such treatment may not be interpreted as unequal. But there has no established interpretation of the principle in this respect.

Since special-class equity shares and conditions on exercises of stock acquisition rights are endorsed, it is unreasonable to strictly and rigidly interpret the principle of shareholder equality that only means that shareholders should be given equal treatment in accordance with the number of shares they hold in respect to the same class of shares or stock acquisition rights with the same conditions on their exercises[130]. Even if the principle of shareholder equality is interpreted more widely and based on the theory of equality, any rejection of defensive measures that are used

[130] Hideki Kanda, *Corporate Law (6th Edition)* (Kobundo, 2005) p.52

reasonably to enhance the corporate value against a threat to the value may run counter to the equality theory.

2. Relationship between takeover defense measures and rule of primary purpose

If a company issues new shares in violation of law or its articles of incorporation, or in a remarkably unfair manner without violation of law or its articles of incorporation, the issuance may become subject to a suspension injunction[131]. Whether an equity issuance becomes subject to a suspension injunction may be clear, if the issuance violates law or the articles of incorporation. Whether an equity issuance is remarkably unfair depends on whether the primary purpose of the issuance is to maintain the present management team's control over the company (the so-called rule of primary purpose). Judicial precedents say that as far as the need for raising funds is proven, any equity issuance would not be remarkably unfair, or the primary purpose is not to maintain the current management's control over the company. In this respect, the need for raising funds is not necessarily required for issuance of stock acquisition rights and different classes of shares[132]. Therefore, it is unreasonable to use the presence or absence of the fund-raising purpose for deciding on the fairness or unfairness of defensive measures that use stock acquisition rights and have no direct fund-raising purpose.

The Tokyo High Court decision says that compared with the defensive measures adopted in a takeover contest that was ruled illegal for the Nippon Broadcasting case, defensive measures adopted before hostile approaches could be legal depending on conditions upon the adoption and details of the measures. This can be interpreted as expecting the development of fair rules. The time has thus come to specify the "corporate value standard" more clearly[133].

3. Developing the "corporate value standard" to prevent abuses of defensive measures and secure their reasonableness

A corporate takeover contest gives shareholders an opportunity to compare a proposal of an acquirer and a policy of the present management team and make decisions to support the acquirer or the present management team. It is desirable that a takeover proposal that can enhance the

131 Article 280-10, of the Commercial Code, Article 210 of the draft Corporate Law
132 Examples include stock options and shares with power of veto.
133 The Tokyo High Court decision on the injunction to stop Nippon Broadcasting's issuance of stock acquisition rights after the emergence of an acquirer says, "The issuance of stock acquisition rights for the primary purpose of maintaining and securing a certain shareholder's control of the company is reasonably interpreted as the stock acquisition right issuance in a 'remarkably unfair manner' as provided by Article 280-10 applied by Article 280-394 in the Commercial Code in principle." At the same time, the decision says, "If there are special conditions to justify the issuance of stock acquisition rights from the viewpoint of protecting the best interests of all shareholders, the issuance for the primary purpose of maintaining and securing a certain shareholder's control of the company may be exceptionally interpreted as not amounting to any unfair issuance." This means that even a stock acquisition right issuance for the purpose of maintaining control may not be unfair from the viewpoint of protecting the best interests of all shareholders.

corporate value of a target company is realized and that a proposal that impairs the value is not realized. Therefore, the reasonableness of a defensive measure should be judged with the standard that it is endorsed as long as it is designed to block takeover proposals that impair corporate value, but not to block takeover proposals that enhance corporate value (= corporate value standard). This standard must be further clarified and shared in the business community.

Although shareholders as a general rule should decide whether a takeover proposal can impair corporate value, or whether to revoke defensive measures or not, since there are limitations in terms of both time and system to the company being able to hold a general meeting of shareholders in a prompt manner, the decision should be primarily entrusted to the management team who were approved in the general meeting of shareholders to be in charge of the management of the company. On the other hand, there is always the problem that the management team can make a decision on defensive measures so as to entrench itself.

The U.S. Unocal standard says that since the current managers' decision on defensive measures can be designed to entrench themselves, the defensive measures should become legal only if the managers prove that there are reasonable grounds to believe that a takeover threatens to impair corporate value and that the defensive measures they take are not excessive. The managers' proof and analysis can cover "the takeover price, the quality of the consideration for the takeover, the characteristics and timing of the takeover, illegality problems and the effect on stakeholders" and can be accepted as far as they "act in good faith and conduct a reasonable survey."

Based on the U.S. standard, we here would like to propose (i) the scope of threats, (ii) the standard of excessiveness and (iii) the process of the managers' prudent and adequate decisions regarding details of the "corporate value standard" in Japan.

(1) Scope of threats posed by hostile takeover bids to companies[134]

(Basic ideas)

The threats are those that will be posed to corporate value, including those posed to the efficiency of the takeover target company when the takeover is successful, and those posed to adequate decision of shareholders. Maintenance and exertion of defensive measures without these threats cannot be accepted. Typical threats and factors to verify such threats are given below.

[Structurally coercive takeover type]

This is a type of takeover represented by green mailing and two-tiered takeovers. Greenmailing is designed to benefit the acquirer only in exchange for the damage imposed on other shareholders and clearly impairs corporate value. The two-tiered takeover proposal can prompt even shareholders seeing a takeover price as insufficient to hastily sell shares, by making conditions for

[134] Types of harmful effects of threats posed by hostile takeover bids are also explained in Section 2, Chapter 2.

the second-stage takeover unfavorable or uncertain. These takeover proposals, even though impairing corporate value, may become successful and bring about threats.

[Lack-of-alternative type]

This is a type of takeover that does not allow the target company's present management team enough time to consider alternative plans. In this pattern of takeover bids including a fully financed cash offer for all outstanding shares, an acquirer may launch a TOB without any prior offer of negotiations on a takeover proposal and refuse to give the target's present management team enough time to look for a white knight offering more favorable acquisition conditions or to make new management proposals.

[Shareholder fallacy type]

This type of takeover leads shareholders to accept the proposal based on insufficient information even though the takeover proposal impairs corporate value. As noted earlier, corporate value is the total future value that a company will produce. There are many factors affecting corporate value. In respect to the long-term corporate value, how key factors affecting corporate value would be treated in a business proposal after the takeover may attract attention along with the treatment of stakeholders and corporate assets, and methods for raising funds for the takeover.

(Verification factors)

Key factors for verifying the existence of a threat include acquirers' histories and reputations, and takeover methods for the structurally coercive takeover type; the unreasonableness of takeover prices, the presence and length of negotiation time given by acquirers to targets for the lack-of-alternative type; and business proposals by acquirers and target companies' managers, particularly effects on strengths of companies emphasized by managers (including effects on human capital accumulation and confidential relations as the source or base of corporate competitiveness), for the shareholder fallacy type.

(2) Standard of excessive defensive measures

(Basic ideas)

Defensive measures should not be excessive but proportional to threats. As a general rule, defensive measures should not treat general shareholders other than the acquirer discriminately (no coerciveness), and should ensure that they do not take away shareholders' fundamental right to choose (no exclusion).

(No coerciveness -- Equal treatment of shareholders other than the acquirer)

Defensive measures should not be coercive as a general rule.

This means that, while defensive measures treating some shareholders favorably or those buying back shares from certain shareholders to their advantage may not be considered excessive against structurally coercive takeovers, it is highly likely that they would be regarded as excessive measures in general cases unless there are rational reasons[135]. On the other hand, defensive measures treating ordinary shareholders other than the acquirer equally, such as the case of a rights plan, are not regarded as coercive.

(No exclusion -- Ensuring shareholders' choices such as proxy contest)

Defensive measures should not be exclusive as a general rule.

This means that defensive measures that do not present an alternative way such as proxy contest to an acquirer to revoke the defensive measures, which is the case of dead hand defensive measures, are regarded as excessive against acquirers other than structurally coercive takeovers, since it completely excludes the shareholders' rights to choose. On the other hand, cases where shareholders are able to eliminate and revoke the defensive measure through procedures such as proxy contest are not exclusive, thus not regarded as excessive, because it gives the opportunity for shareholders to decide the reasonableness of the defensive measure. It is particularly reasonable if the reasonableness of the defensive measure can be decided in a single general meeting of shareholders.

(Handling at the stage where it is already decided to sell the company)

If an acquirer appears while the board of directors had already decided to sell the company to a different entity and is in the process of negotiation with it, the directors should also consider the takeover proposal from the said acquirer as a general rule. Measures to completely deprive of the opportunity to consider such competitive proposals are inappropriate unless there are specific rational reasons[136] not to consider such proposals.

(3) Managers' prudent and independent decision-making process

(Basic ideas)

In order to prove that the decision by the board of directors to adopt, maintain or revoke defensive measures is made to enhance corporate value and not to entrench directors themselves, prudent and adequate actions are required concerning the adoption, maintenance and revocation of the defensive measures. In specific, it will be necessary to allocate sufficient time for consideration,

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135 For example, cases such as where there is a necessity to treat odd shares and it is regarded as reasonable to handle separately according to perspectives of industry law and other legislations.

136 For example, cases such as where the corporate value may be impaired because sales are highly urgent and the sales itself may become difficult while the directors are considering a competitive proposal.

to seek analysis of outside experts, and to ensure the involvement of third parties.

(Allocation of sufficient time for consideration)

Upon making decisions related to the adoption, maintenance and revoke of defensive measures, the board of directors should take as much time as possible for consideration. The consideration must set a focus on finding out a measure that most enhances corporate value, taking account on the aspects of takeover that impair corporate value, analysis on takeover proposals, comparison of the proposal and management policy of the present management team, and effects of alternative measures such as selling to a friendly third party.

(Analysis of outside experts)

Upon making decisions related to the adoption, maintenance and revocation of defensive measures, the board of directors should carefully seek advice from outside experts (including lawyers and financial advisors) on the analysis of takeover proposals and designing of defensive measures, based on their sufficient analysis.

(Involvement of third parties)

Upon making decisions related to the adoption, maintenance and revocation of defensive measures, it must be ensured that third parties with relatively small conflicts of interest, such as outside directors and auditors, have been given sufficient information and are involved in the decision-making process.

Figure 4-1 Standard to judge the reasonableness of defensive measures

[Standard 1] Existence of a threat ~There exists a threat of hostile takeover that may impair corporate value

1. Structurally Coercive Hostile Takeover (Structurally Coercive Takeover Type)
- Case 1: Shareholders are coerced to sell hastily; if shareholders don't sell, they will suffer unreasonable loss
- Case 2: The bidder is a "green mailer"
[Key factors for consideration] - Bid structure (e.g. partial TOB without any terms for back-end offer)
- Bidder's history (green mailer, etc.)

2. Acquisition proposal which does not allow the target's board enough time to consider alternative plans (Lack-of-Alternative Type)
- Case 1: A bidder launches a TOB without any prior notice and the target's management does not have enough time to consider alternative plans
[Key factors for consideration] - Whether or not the bidder allowed enough opportunity and time to the target's management to evaluate its offer

3. Practically Coercive Hostile Takeover (Shareholder Fallacy Type)
- Case 1: Offer price does not reflect the full and fair corporate value and shareholders who do not have enough information would sell their shares; thus, corporate value would be impaired
- Case 2: Shareholders who do not have enough information accept the underpriced offer; thus, the opportunity to receive the company's long-term value will be lost
[Key factors for consideration] - Whether the long-term stand-alone corporate value higher than the offer price
  Whether there are realistic and objective grounds
  Whether there are ways to fill the difference between the long-term standalone corporate value and the current share price
- Whether the management have a valid business plan that enhances corporate value
  Evaluation towards the capability of management
  Faith in management by shareholders, stakeholders and experts
  Possibility that management's historical efforts be reflected in future company performance
  Whether there is a specific long-term strategy and eternal evaluation thereof
- Whether the bidder presents a specific plan and the plan's effects on corporate value
  The bidder's management capability and historical performance
  Impact on long-term corporate value for accepting the bid (for example, whether or not the bidder is intending to transfer the benefit of stakeholders such as employees and contractors to him/herself, resulting in the competitiveness of the company or the accumulation of human resources and relationships that form the basis of the company being damaged)
  Financing of the bid (whether the bidder is using target's assets as collateral to obtain financing, etc.)

[Standard 2] Proportionality of defensive measures ~Defensive measures taken are not excessive

1. Shareholders should not be coerced to take the defensive measures presented by the management team
[Key factors for consideration] - Whether the defensive measures discriminate not only against the hostile takeover bidder but also against the general shareholders and whether they treat certain shareholders favorably

2. The measures should ensure not to exclude any other alternatives for the shareholders to accepting the bidder's plan
[Key factors for consideration] - Whether an alternative way such as proxy contest to revoke the defensive measures is presented to the bidder, and whether the shareholders' rights to choose is ensured
(Handling at the stage where it has already been decided to sell the company)
If a hostile takeover bidder appears while the board of directors had already decided to sell the company to a different entity and is in the process of negotiation with it, the directors should also consider the takeover proposal from the said hostile takeover bidder as a general rule. Measures to completely deprive of the opportunity to consider such competitive proposals are inappropriate unless there are specific rational reasons not to consider such proposals.

[Standard 3] Prudent and independent decision-making process ~The decision-making process to prove the details of threat and the legality of the defensive measures should be prudent and adequate

[Key factors for consideration]
- Whether enough time was allocated for the comparative analysis of the hostile bid relative to the stand-alone strategy upon identifying the threat (whether the board was allowed to take sufficient time for deliberation, and the hostile bid was analyzed objectively)
- Whether advice from outside experts (including lawyers and investment banks) on the analysis of takeover proposals and designing of defensive measures was sought
- Whether third parties with relatively small conflicts of interest (such as external directors and auditors) have been given sufficient information and are involved in the decision-making process
- Prior shareholder approval could enhance the reasonableness of the decision making process

Section 3. [Features] Features to enhance the reasonableness of defensive measures and obtain market support

What features are required for defensive measures to meet the "corporate value standard?" In order to enhance the reasonableness of anti-takeover defense measures, the process for adopting and triggering defensive measures should be designed to reflect the enhancement of corporate value and the best interests of all shareholders. If defensive measures are designed to provide shareholders with sufficient information and time, the acquirer and the existing managers of the target company may have a contest over strategies to enhance the corporate value. In this case, a proposal that enhances corporate value more than others will be more likely to be realized.

In Japan, the following three requirements should be developed:

First, defensive measures should be adopted before a hostile approach. The managers should make prudent decisions on the design of defensive measures and disclose their details to fulfill the accountability to shareholders and investors.

Second, defensive measures should be removable. If directors are replaced through a

proxy contest, the defensive measures may be removed. If defensive measures are adopted, it is imperative to create opportunities for shareholders to directly choose to maintain or remove defensive measures at annual general meetings of shareholders, without any staggered board being adopted. This is the minimum requirement for securing the legal reasonableness of defensive measures.

Third, mechanisms should be developed to prevent directors from making arbitrary decisions in takeover contests. Companies should adopt external checks by independent parties including independent outside directors and auditors, objective criteria to remove defensive measures, or shareholder approval on contents of defensive measures.

Defensive measures that meet the above three requirements may be a key factor for a court to decide whether defensive measures are fair or whether the board's decisions to adopt relevant defensive measures and trigger them in takeover contests have run counter to directors' duty of care and loyalty.

1. Defensive measures should be adopted and disclosed before hostile approaches to fulfill accountability

(Adoption before hostile approaches gives predictability to shareholders, investors and potential acquirers)

For the purpose of increasing predictability for shareholders and investors and enabling them to make appropriate investment decisions, when adopting takeover defense measure, companies should adopt the defensive measures before hostile approaches[137] [138], and 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.

[137] Defensive measures such as issuance of new shares and subscription rights in takeover contests can also be regarded as measures before hostile approaches if, before hostile approaches, an alert has been issued to notify that new shares or stock acquisition rights may be issued in takeover contests or the board of directors has made a resolution of conditional issuance. The Tokyo High Court decision on an injunction to stop Nippon Broadcasting's issuance of stock acquisition rights does not deny defensive measures adopted before hostile approaches for the sake of protection of all shareholders' best interests even under the theory of the division of corporate authority. It says, "Even in the absence of new legislation, the issuance of stock acquisition rights adopted as a measure to counter a future hostile approach may be ruled legal depending on specific conditions upon the adoption of the measure, details of the rights (whether the rights are allocated to shareholders and whether any removal provision is attached), issuance procedures (whether a resolution approving the issuance has been adopted at a general meeting of shareholders), and other case-by-case situations."

[138] Exceptions to the principle include cases where the company looks for a white knight and where the directors exercise their authority under the Corporate Law for purposes other than maintaining management control (e.g. issue new shares to third parties for the purpose of raising fund, purchase the company's own shares as part of justifiable capital policy, and exercise the authority in the course of ordinary business operations that have been decided prior to the takeover).

The adoption of defensive measures before hostile approaches allows such measures to be designed more prudently to enhance the interests of all shareholders and the corporate value. Unlike defensive measures adopted after hostile approaches, the measures adopted before such approaches do not discriminate against any specific shareholders. It may be easier to describe the objective of such measures to block hostile takeovers that impair corporate value. The possibility declines of such measures being interpreted as designed to entrench present managers.

Compared with defensive measures adopted in takeover contests, the adoption of defensive measures before hostile approaches may allow investors and potential acquirers to make more prudent investment decisions after analyzing such measures and develop better takeover methods.

(Comply with corporate law and information disclosure rules of stock exchanges)

Companies should disclose details of defensive measures widely to stakeholders in compliance with the business report system under the Corporate Law to be developed and information disclosure systems of stock exchanges. Until these disclosure rules are developed, companies that intend to adopt defensive measures should make efforts to voluntarily disclose their defensive measures on their operating reports and financial reports.

(Revitalize corporate strategies and investor relations activities with the aim of enhancing corporate value)

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 strategic 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. While adopting defensive measures in advance of an unsolicited takeover proposal, companies should spare no effort to win the understanding and confidence about long-term management strategies of shareholders and institutional investors who are interested in long-term enhancement of corporate value[139].

For example, U.S. Internet search engine provider Google Corp. has disclosed "what is this measure intended to defend against?" and "what defensive measures are being adopted in order to accomplish that objective?" and then announced a powerful defensive measure (super voting stock) for its two founders and its management team to develop businesses from a long-term point of view. Such measures are favorably accepted on the market to some extent, with its market capitalization reaching ¥5 trillion.

[139] According to the "IR Activities Survey" by the Japan Investor Relations Association (June 2004, 1,307 publicly traded companies as respondents), only 50% of Japanese companies hold briefings for investors, 80% accept interviews with investors, and only 15% conduct shareholder verification surveys as a precondition for IR activities.

(Adoption of defensive measures before hostile approaches is neutral to stock prices and causes less confusion)

Among defensive measures adopted before hostile approaches, conventional rights plans and others that equally treat all shareholders before such approaches and discriminate acquirers in takeover contests are neutral to stock prices and more desirable.

2. Defensive measures should be removed depending on decisions at a general meeting of shareholders

(Removal provisions should be added to defensive measures to allow removal of defensive measures through a proxy contest)

Defensive measures should be removable so as to eliminate their excessiveness. Therefore, defensive measures should have removal provisions (including those allowing the board to remove the measures through resolutions before acquirers begin to acquire shares).

Dead hand defensive measures, which an acquirer cannot remove even by controlling a majority of the board members through a proxy contest before the measures are triggered, have legal problems. They are also inappropriate as they deprive shareholders of their decision-making opportunities, and therefore, in principle, they should not be adopted. Defensive measures without removal provisions are unreasonable. So are defensive measures that have a dead hand provision (to make the measures un-removable if any one of the board members adopting the measures is replaced), a no hand provision (to keep the measures un-removable unless a majority of the board members adopting the measures are replaced) or a slow hand provision (to keep the measures un-removable for a specified amount of time after a majority of the board members adopting the measures are replaced).

(Defensive measures should be allowed to be removed through a general meeting of shareholders)

U.S. rights plans are basically designed to secure avenues for their removal through proxy contests. U.S. companies fix a term of office for a director at three years, stagger the board and restrict mid-term dismissal of directors by requiring more than a majority of votes to pass resolutions for mid-term dismissal or justifiable reasons as well as resolutions for mid-term dismissal. The result is that it may take up to two years (two annual general meetings of shareholders) to take control of the board. Such measures are criticized by institutional investors as prolonging proxy contests and impeding shareholders' intentions from being reflected in decisions on defensive measures (see Chapter 3 "Institutional investors opinions based on guidelines for exercising voting rights").

In Japan, a term of office is fixed at one year or two,[140] making it difficult to adopt

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[140] Article 256(1) of the Commercial Code: "The term of office of directors shall not exceed two years." In companies with a committee-style corporate governance system, the term of office of directors shall be one year

staggered board. For mid-term dismissal of directors, the modernized Corporate Law would shift from a special resolution to an ordinary resolution[141] and would not endorse any requirement for justifiable reasons[142]. As a result, Japan has paved the way for someone to take control of the board through a general meeting of shareholders. In order to ensure that shareholders' intentions will be reflected more speedily in decisions on maintenance or removal of defensive measures, companies that intend to adopt defensive measures need to design measures that can be removed through a general shareholders' meeting[143].

(Removal provisions should be required for golden shares and super voting stock)

The legality of defensive measures (rights plans, golden shares and super voting stock) approved at general meetings of shareholders may not be questioned. Among them, golden shares, super voting stock and other measures that discriminate not only acquirers but also other shareholders could be excessively defensive without removal. In particular, careful consideration is required when publicly-traded companies issue new golden shares that cannot be removed.

In this respect, the New York Stock Exchange prohibits listed companies, other than IPO companies, from issuing super voting or golden shares. With a view to enhancing the reasonableness of defensive measures for better understanding by shareholders and investors, Japan may have to give further consideration to companies that issue super voting or golden shares for defensive purposes without removal.

(Considering a more flexible TOB system to allow a TOB and a proxy contest to be utilized together)

A proxy contest may be utilized along with a TOB to enhance the practicability of the contest. This means that an acquirer may emphasize a share acquisition price in a TOB and propose a new management team in a proxy contest. A combination of a TOB and a proxy contest can be expected to reduce any additional cost for the contest[144]. Under the Japanese TOB system, however, conditions for withdrawing a TOB are rigid and it is difficult to combine a TOB with a proxy contest

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(Article 21(61): "The term of office of directors shall expire at the end of the regular general meeting for the final fiscal term within one year from the appointment.")

141 Article 341 of the draft Corporate Law: "Notwithstanding the provisions of Article 309(1) (Ordinary resolution of general shareholders' meeting), a resolution of a general shareholders' meeting to appoint or dismiss directors shall be adopted by majority (or larger share as provided by the articles of incorporation) of votes held by the shareholders present who hold majority (or one-third or a larger share as provided by the articles of incorporation) of votes held by all shareholders with voting rights."

142 Article 339(2) of the draft Corporate Law: "A director and an auditor may be dismissed from office any time by a resolution of a general shareholders' meeting." A similar provision is seen in Article 257 of the Commercial Code.

143 Possible means to reflect shareholders' intentions in decisions include adopting resolutions of general shareholders' meetings as well as giving notice to shareholders to provide them with the opportunity to express their intentions.

144 The proxy contest in Japan is structurally similar to the U.S. one, but it has not been utilized so frequently. In order to allow a proxy contest to be exploited appropriately and effectively in regard to key matters like decisions on hostile takeover proposals, Japan should consider a more desirable proxy contest system and methods for its utilization.

for a company that has adopted defensive measures. In this respect, it is appropriate to consider a more flexible TOB system while giving due consideration to possible influence on share price of easy withdrawal of a TOB.

3. Developing mechanisms to prevent board decisions in takeover contests as much as possible from entrenching the board

In takeover contests, decisions as to whether or not to maintain or trigger defensive measures shall be made by directors due to time constraints. Such decisions may always be suspected of being intended to entrench the board members rather than enhancing the interests of all shareholders and corporate value. The board is required to maintain defensive measures against takeover proposals that impair the corporate value and to remove defensive measures in response to proposals that enhance the value. The board must act prudently to meet this requirement. It is desirable for the board to promptly remove defensive measures in response to takeover proposals that are significant to the company and its shareholders. If the board alone makes easy decisions to wage a proxy contest, it may be difficult for the board to get understanding and support from the market.

Based on Western experiences, we here would like to propose objective mechanisms to eliminate the board's entrenchment.

The first is an "independent party checks" **mechanism under which the board of directors makes decisions on defensive measures while taking into consideration judgments by independent outside directors and auditors regarding the maintenance or removal of defensive measures in takeover contests**, particularly those adopted through the board's resolutions.

The second is a "chewable pill" **mechanism under which criteria for removal of defensive measures in takeover contests (including negotiation time and qualified decision makers) are developed beforehand as objectively as possible and the final decision of whether or not to accept a takeover proposal is left to shareholders through TOB, thereby weakening resistance to takeover proposals that are likely to enhance corporate value.** (A chewable pill means a defensive measure that is easy to remove.) This mechanism is growing popular in the United States.

The third is **a mechanism for a general meeting of shareholders to approve the adoption of defensive measures before hostile approaches and authorize the board's decision-making process in takeover contests.** This requires the board to comply with requirements specified in the articles of incorporation for triggering or removing defensive measures so as to prevent the board from making arbitrary decisions in takeover contests. Regular checks (for example, checks done every three years) can enhance the reasonableness of defensive measures. This mechanism has not been introduced in the United States but has been sought by institutional investors.

Each mechanism **is designed to eliminate arbitrary decisions by internal board members. If any of the mechanisms is introduced, it may enhance the reasonableness of defensive measures. If the board were to make decisions to adopt defensive measures before hostile approaches, it should choose either the independent party check mechanism or chewable pill mechanism. The shareholder approval mechanism is fundamentally different from these approaches depending only on board decisions for adopting defensive measures. Standards for decisions made by the board on defensive measures in takeover contests are subject to approval by shareholders at their general meeting, allowing shareholders to accurately reflect their intentions in defensive measures and secure defensive measures meeting the extent of their confidence in the board.**

These mechanisms do not exclude each other. The three mechanisms can be combined to enhance the reasonableness of defensive measures. Various combinations may be developed depending on the extent of shareholders' confidence in the board.

When adopting any of the three mechanisms, it is necessary to clearly set the term of defensive measures as two or three years rather than making them effective infinitely.

(1) Independent party checks mechanism – Dominant in the United States

This mechanism utilizes external checks by independent parties to secure careful and appropriate decisions by internal board members in takeover contests on whether to maintain defensive measures adopted by the board alone. The U.S. companies adopt rights plans only with board decisions before hostile takeovers and ask independent outside directors as third parties to check board decisions in takeover contests. The independent party checks mechanism is dominant for rights plans.

In order to ensure the reasonableness of takeover defense measures, the necessity to check the entrenchment behavior of internal board members differs depending on the objectivity of criteria for removal of defensive measures. In particular, independent parties are indispensable for ensuring the reasonableness of takeover defense measures without any objective termination criteria.

(Giving priority to decisions by outside directors and auditors having legal responsibility and power)

If third parties have greater responsibility and power for the company (shareholders), defensive measures may become more reasonable and easier to get support from shareholders[145]. Outside directors, like other directors, are elected at a general meeting of shareholders and required to carry out the duty of care and loyalty for the company. They take part in the board authorized to make executive decisions[146].

Outside auditors are elected at a general meeting of shareholders and required to carry out the duty of care for the company. They are also required to make comments if the board is to adopt resolutions that are illegal or remarkably unreasonable. If directors' actions running counter to laws, ordinances or the articles of incorporation are likely to significantly hurt the company, auditors may demand the suspension of such actions[147]. The term of office for auditors is fixed at four years and opinions of the board of auditors are reflected in their election and dismissal. Their full independence from operating officers is legally secured by Commercial Code provisions. Furthermore, auditors are authorized to represent the company when it sues directors[148] and give consent to reduction or elimination of responsibility for directors and out-of-court settlements to class action suits. They thus mediate between shareholders and directors when they have conflicts of interest.

In this sense, it is reasonable for outside directors and auditors to make decisions on the maintenance or removal of defensive measures in takeover contests. Therefore, the mechanism should be introduced for the board to give priority to judgments by outside directors and auditors when making decisions to maintain or remove defensive measures.

(Developing rules to secure third parties' independence from the company)

"Independence" is a concept required in order for outside directors and outside auditors who review the takeover defensive measures to be able to strictly check the entrenchment behavior of inside directors, and means substantial independence from the company. For example, with respect to whether or not the company's major trading partners, advisors, creditors including main financing banks, relatives of the company managers, and former employees are eligible as "independent outside parties" in charge of monitoring defensive measures, careful examination should be conducted and shareholders' understanding should be obtained[149].

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[145] In order to allow independent party checks to work well, Japan should consider in what manner independent parties should be involved in checks and what kind of parties can be deemed to be independent.

[146] Articles 254 (appointment at general shareholders' meeting), 254(2) and 254-3 (director's duty of care and duty of loyalty), and Article 260(1) (authority of the board of directors), Commercial Code

[147] Articles 280 (appointment at general shareholders' meeting and auditor's duty of care), 275 (duty to report), and 275-2 (request to stop unlawful acts of directors), Commercial Code

[148] Article 275-4, Commercial Code

[149] According to a questionnaire survey (fiscal 2004, 593 respondents allowed to choose plural answers for each question) by the Life Insurance Association of Japan, directors or former employees of relevant companies' parents or affiliates accounted for the largest portion (38%) of outside directors, followed by directors or former employees of relevant companies' trading partners (27%) and directors or former employees of firms having no trading relations with relevant companies (about 21%). The survey (fiscal 2004, 94 respondents allowed to choose plural answers for each question) also found that directors or former employees of firms having no trading relations with relevant companies accounted for the largest portion (76%) of outside directors viewed by investors as desirable, followed by business management consultants (39%) and commentators and analysts well versed in relevant industries (30%).

Arguments about independence have continued through trial and error. The bottom line is that independent outside directors at one company must be prepared to strictly monitor entrenchment behavior of the company's internal directors. Their effective independence from the company is most important.[150] As for third parties to check the reasonableness of defensive measures, each company should voluntarily develop mechanisms to secure independence of outside directors and auditors. If the outside directors' ratio of the board is small at a company, for example, the company should organize a corporate governance committee in which opinions of independent outside directors and auditors can be sufficiently reflected, and respect recommendations made by the committee on whether or not to trigger defensive measures in takeover contests.

In addition to companies' voluntary mechanism development, common rules should be urgently considered about qualifications for third parties.

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[150] According to the Commercial Code, outside directors must not be those who are or have ever been directors, operating officers or employees working for the company or its subsidiaries (Article 188(2) (vii)-2 of the Commercial Code). Outside auditors must not be those who have been directors, operating officers or employees before their appointment (or for five years under provisions lasting until the end of April 2005) (Article 18(1) of the Special Commercial Law.

The concept of independence in the United States is provided in the 2002 Corporate Governance Act (Sarbanes-Oxley Act), the Securities and Exchange Commission regulations and the New York Stock Exchange's listing regulations. Basically, the U.S. concept is narrower than the Japanese concept in that trading partners, outside advisers and relatives are not considered independent. But it is wider than the Japanese in that former employees of a company who left the company three or more years ago and receive no remuneration from the company are considered independent.

At the California Public Employees' Retirement System (CalPERS) and TIAA-CREF among U.S. institutional investors, guidelines for exercising voting rights for investment targets are stricter than the Japanese concept in that former employees, trading partners, outside advisers and relatives are not considered independent (The CalPERS guidelines require outside directors of a company to exclude those who have been employed by the company for the past five years. The TIAA-CREF guidelines require outside directors to exclude those who have ever been employed by the company).

Figure 4-2 Outside directors and auditors in Japan and the United States and requirements for their independence

<table>
<tr><th rowspan="2"></th><th>United State</th><th colspan="2">Japan</th></tr>
<tr><th>Outside (independent) directors</th><th>Outside directors</th><th>Outside auditors</th></tr>
<tr><td>Percentage of outside directors (auditors)</td><td>○About 80% for large companies
- Average number of board members: 12
Internal directors: 2
(usually CEO or CFO)
Outside directors: 10
(including 8 or 9 independent directors)

Note: In companies listed on the NYSE or NASDAQ, the majority of the board members must be independent directors, and all members of the audit committee must be independent directors.</td><td>○About 40% for companies with a committee-style corporate governance system
- Average number of board members: 10.3
Outside directors: 4.5
Note: Such companies must have at least two outside directors.
- The majority of board members are outside directors in two companies (15.4% of 13 respondent companies)
○About 20% for companies with auditors (large companies)
- Average number of board members: 9.8
Outside directors: 2.4
- The majority of the board members are outside directors in 118 companies including those other than large companies (5.9% of 2003 respondent companies)
Source: Japan Corporate Auditors Association, survey conducted in July 2004</td><td>[Reference] Companies with a committee-style corporate governance system under which the audit committee consists of directors instead of auditors)
- Average number of audit committee members: 3.4
Outside directors: 2.7
Note: In companies with a committee-style corporate governance system, the majority of the audit committee members must be outside directors.
○About 60% for companies with auditors (large companies)
- Average number of auditors: 3.7
Outside directors: 2.2
Note: In large companies, the majority of the audit committee members must be outside directors.
Source: Japan Corporate Auditors Association, survey conducted in July 2004</td></tr>
<tr><td>Requirements for independence (neutrality)</td><td>[Requirements for independent directors of companies listed on the NYSE]
- They are not employed or have not been employed for the past three years by the company.
- They or their family do not receive or have not received for the past three years, payment of $100,000 or more from the company.
- They or their family are not related to the company's auditors.
- They are not employed by the company's major trading partner which brings 2% of the company's total sales or at least $1 million.
Note: Companies must submit reasons for judging the directors to be independent from them.</td><td>[Requirements for outside directors under the Commercial Code]
(Article 188)
- They are not or have not been directors, operating officers, managers or employees working for the company or its subsidiaries.

Note 1: Those related to the parent company or consolidated subsidiaries or their relatives, or those related to trading partners (including lawyers and consultants) may become outside directors.
Note 2: The requirements in Japan are stricter than those in the United States in that those with any employment relationship with the company in the past are excluded in Japan.
Note 3: Some companies set their own requirements for outside directors.</td><td>[Requirements for outside auditors under the Special Commercial Law]
(Article 18)
- They have not been directors, operating officers or employees working for the company or its subsidiaries before their appointment.</td></tr>
</table>

Source: Compiled by METI based on various reference materials

(Necessity of experts' advice to support independent outside judgment)

When using independent outside directors and auditors, the board of directors should hear opinions from outside experts such as financial advisors and lawyers on maintenance and removal of defensive measures and provide such information for independent outside directors and auditors, so as to ensure a deliberate judgment process.

(2) "Chewable pill" mechanism to develop objective criteria for removal

The mechanism is called "chewable pill" or "permitted offer exception (qualified offer)" in the United States. Under this mechanism, the board of directors shall make a decision on the adoption of defensive measures. If importance is not placed on judgments made by independent outsiders on how to handle defensive measures in takeover contests, criteria (including negotiation time and qualified decision makers) for removal of defensive measures in takeover contests are developed beforehand as objectively as possible and the final decision of whether or not to accept a takeover proposal is left to shareholders through TOB, thereby weakening resistance to takeover proposals that are likely to enhance corporate value.

In order to make defensive measures more reasonable, it is necessary to secure objectiveness of criteria depending on the degree to prevent directors from making arbitrary decisions on the occasion of triggering defensive measures. In particular, where a decision on whether or not to trigger defensive measures is made only by internal directors without the approval of outside directors, objective rules will be needed to prevent internal directors from making arbitrary decisions, such as defensive measures being automatically removed if adequate information is provided and a specified assessment or negotiation period expires.

(Securing time for negotiation with the acquirer)

For example, a mechanism is provided for the board to remove defensive measures and shift to a TOB, if an acquirer specifies details of a takeover proposal[151], gives the board the time required for their negotiations or the development of an alternative proposal and provides shareholders with sufficient information[152].

The time for negotiations and the development of an alternative proposal will be adjusted depending on the details of the takeover proposal, such as whether the proposal seeks a total takeover or a partial one or whether the acquirer offers cash for shares. In response to a fully financed cash offer for all outstanding shares that is not coercive, the negotiation period may be limited to one month or a few months. After such a period, the board may remove defensive measures and shift to a TOB. In response to a partial takeover offer, a longer negotiation period may be set (in this case, the period may be prolonged to allow a conclusion through a proxy contest at the next general meeting of shareholders). These criteria are reasonable. These objective criteria secure a TOB avenue for all takeover proposals in principle and may be different from other defensive measures and sufficiently reasonable even if internal board members alone make a decision to maintain or remove defensive measures.

(Removing defensive measures with respect for outside advice in response to a fully financed cash offer for all outstanding shares)

If the proposal seeks a partial takeover, defense measures are not removed. If specifics of a takeover proposal are disclosed including a fully financed cash offer for all outstanding shares, outside experts such as financial advisors and lawyers may analyze the acquisition price and other details. If outside directors check the analysis and realize the takeover proposal as one likely to enhance corporate value, the board may remove defensive measures.

In the United States, some 30% of companies adopting rights plans have established such

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[151] The details are sufficient information for the board and shareholders of the target company to consider the takeover proposal, including the takeover purpose, acquisition price and treatments of stakeholders.

[152] Specifically, a mechanism may be designed for the board to remove defensive measures and shift to a TOB "at the end of a certain period of time that is sufficient for the board to make an alternative proposal after essential takeover proposal information (including a management policy and a business plan after the proposed takeover) is given to the board."

permitted offer exception (qualified offer) mechanisms. Oracle Corporation's rights plan contains a permitted offer exception provision that says "the rights plan will be removed if a total takeover proposal complying with the TOB rules is judged by a majority of the board members as bringing about sufficient and maximum benefits to the company and shareholders." At Yahoo! Inc., Xerox Corporation and Marriott International, the permitted offer exception provisions say: "The rights plan may be removed if outside directors, based on advice from plural investment banks, accept a takeover proposal as offering a reasonable price for all outstanding shares and a reasonable acquisition period. Investment banks shall give advice on the acquisition price and period from the standpoint of whether the acquisition price is fair and not insufficient to the company and its shareholders or whether the proposal would bring about sufficient benefits to the company and its shareholders." At Thermo Electron Corporation, the permitted offer exception provision says: "The rights plan may be removed if 75% or more of the board members, based on advice from plural investment banks, accept a takeover proposal. Investment banks shall give advices on the acquisition price and period from the viewpoint of whether the acquisition price is fair and not insufficient to the company and its shareholders or whether the proposal would bring about sufficient benefits to the company and its shareholders." Independent decisions are required on whether a fully financed cash offer for all outstanding shares meets certain conditions.

Some 2% of U.S. companies adopting rights plans have set numerical criteria such as "the rights plan may be removed if the acquisition price is larger than the market price for the target company's stock by a premium." For instance, in 1998, Pennzoil Corporation adopted a provision that "the rights plan shall be terminated in the case of an all stock/cash TOB with at least 35% premium for the market price of the company's stock." Also, Adaptive Broadband Corp. and Footstar Inc. have recently adopted similar provisions. However, a dominant view is that if a uniform acquisition price is set, the company is likely to accept a takeover proposal that does not maximize corporate value. No institutional investor has set any uniform numerical threshold for removal of defensive measures in respect to takeover proposals.

(3) Shareholder approval mechanism as recommended by institutional investors

The mechanism is for a general meeting of shareholders to authorize the board's decision-making process when adopting defensive measures. The board will comply with the process for deciding to remove or maintain defensive measures in takeover contests. In this case, the board cannot ignore a majority of shareholders in adopting defensive measures.

Specifically, the adoption of defensive measures and other amendments to the articles of incorporation may be approved at a general meeting of shareholders before hostile approaches. The board is required to comply with the removal process (including decision-making standards and process) specified in the articles of incorporation so as to prevent the board from making arbitrary decisions in takeover contests.

Defensive measures to be approved at a general meeting of shareholders may focus on criteria for triggering or removing such measures. The criteria are required to be as specific as understood and accepted by shareholders. In order to enhance the reasonableness of defensive measures, a general meeting of shareholders should be planned to regularly (for example, every three years) decide to approve or remove defensive measures (sunset clause).

As one of the first sunset clauses introduced in the United States, a clause requiring the board to submit a resolution on the maintenance or removal of a rights plan at a regular general meeting of shareholders every three years was attached by National Intergroup Inc. to its rights plan in 1989. In 2001, Bell Industries reportedly adopted a sunset clause requiring its rights plan to be approved at a general meeting of shareholders every two years[153].

The shareholder approval mechanism allows shareholders to decide on the reasonableness and details of defensive measures in accordance with the company's past performances and future management policy, as well as the extent of their confidence in the board. For example, the board may be authorized at a general meeting of shareholders to request advice on the maintenance or removal of defensive measures in takeover contests from a management advisory committee consisting of outside experts. As far as the board acts under the authorization, its actions may be sufficiently reasonable. The shareholder approval mechanism is legally the most stable since shareholders approve the board's decision-making process in takeover contests. Many Western institutional investors have called for adoption of defensive measures to be approved by shareholders. In this sense, the shareholder approval mechanism is the most reasonable mechanism for getting shareholders' understanding.

Section 4. Development of Corporate Value Defense Guidelines and institutional reforms left for future

(Developing Corporate Value Defense Guidelines and accelerating infrastructure formation for business community)

It is pointed out that independent outside directors have diffused in Japan less than in the United States and that Japan lacks infrastructure for adopting takeover defense measures. Is it true?

As noted earlier, Japan's Corporate Law allows various defensive measures to be adopted. It may be noted that as no consensus is formed on fair defensive measures at present, the risk exists of excessive defensive measures being adopted. In the absence of TOB rules to regulate partial takeovers, there is a strong need for adoption of reasonable defensive measures. Therefore, **specific rules are required for promoting adequate operations of defensive measures and preventing their abuse. Individual companies may incorporate the three mechanisms, as proposed here, into their defensive measures to promote the formation of business community infrastructure**

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[153] Kazuhiro Takei, Hiroshi Ota, Ryutaro Nakayama, *Corporate Takeover Defense Strategy* (Commercial Law, 2004) p. 128

including utilization of independent outsiders and the emphasis on shareholders.

We here would like to introduce two defensive measures as proposed by the Corporate Value Study Group. The trust-utilizing defensive measure[154] is an integration of the three mechanisms (independent party checks, "chewable pill" and shareholder approval). The advanced countermeasure warning defensive measure[155] amounts to the second mechanism ("chewable pill"). Criteria for removal may be configured to develop reasonable defensive measures in Japan.

As for the trust-utilizing defensive measure:

(i) A resolution for its adoption at a general meeting of shareholders authorizes qualified decision makers, items for decisions, standards for decisions, a decision-making process, etc.

(ii) Conditions for triggering the measures should be objective, including:

(a) No reasonable period of time exists for the board to propose an alternative to a takeover proposal.

(b) A trading mechanism in a takeover proposal forces shareholders to accept the takeover.

(c) Takeover conditions (including the price, timing, quality of consideration, illegality, and probability of transactions being exercised) are insufficient or inappropriate for the essential value of the target company.

(iii) For third party checks, outside directors independent of the board are appointed or experts free of the influence of the board are allowed to make effective decisions (qualifications of experts and details of contracts with them are proposed and approved at a general meeting of shareholders as the preconditions for issuance of stock acquisition rights). Furthermore, board members, outside directors or experts are allowed to seek opinions or advice from professionals such as financial advisors, accountants and lawyers at the company's cost so as to secure the objectiveness, legality and reasonableness of their decisions. Use of trust allows rights plans to have contingency.

As for the advanced countermeasure warning defensive measure, the criteria for removal have an enhanced objectivity, saying that defensive measure may not be exercised in principle (i) if the acquirer gives necessary information (necessary and sufficient information on the acquirer's identity, the objective of the takeover proposal, details of the proposal, the grounds for the takeover price and the corroboration of takeover funds, the management policy and business plan after the takeover, etc.) and (ii) if the acquirer offers a period of time for assessment, consideration and negotiations meeting the takeover method. This defensive measure amounts to the second mechanism and is designed to allow a shift to a TOB. Therefore, the measure, even if adopted

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[154] Manabu Ishiwata, *Legal Framework for Defensive Measures against Hostile Takeovers (I) (II) (III) – Preemptive Trust Rights Plan* (Commercial Law Nos. 1716,1717,1721, 2004-2005); Ishiwata's paper submitted at the 5th meeting of Corporate Value Study Group; Kazuhiro Takei, Hiroshi Ota, Ryutaro Nakayama, *Anti-Takeover Defense Strategy* (Commercial Law, 2004) p.61; Ryutaro Nakayama, *Legal Problems with Introduction of Japanese-Style Rights Plans* (an article commemorating the 70th birthday of Ochiai, Commercial Law, 2004) p.416

[155] See Fujinawa's paper submitted at the 6th meeting of the Corporate Value Study Group

through a decision by internal directors alone, can be sufficiently reasonable.

However, the Corporate Value Study Group's publication of the Corporate Value Report alone has no effective power to bring about the implementation of the recommendations. **The Corporate Value Study Group would like to ask the government to develop the "Corporate Value Defense Guidelines" that reflect the message of the Corporate Value Report.** Companies have various individual characteristics. Their relations with their shareholders are diversified. Therefore, rules for takeover defense measures should not be rigid. As individual companies develop better mechanisms through consultation with their shareholders, flexibility and discipline may emerge.

The Guidelines, if based on the Corporate Value Report as published, would allow Japanese companies to adopt defensive measures that are more reasonable than Western ones. Standard rights plans in the United States must undergo two proxy contests before their removal. The shareholder approval mechanism is effectively absent in the United States. But the three mechanisms, as proposed in the Corporate Value Report, are based on defensive measures that can be removed through only one proxy contest, and call for independent outside checks, objective criteria for removal and shareholder approval. This indicates that Japanese companies could adopt more reasonable defensive measures than U.S. ones.

The Guidelines, if respected by relevant parties just as the British City-Code is, would work to prevent abuses of defensive measures. Business community players may be allowed to participate in amending the Guidelines so as to develop a common ground for the business community based on the Guidelines. In order to encourage business community players to participate in amending the Guidelines, we would like to **propose a forum based on the Corporate Value Study Group to review the Guidelines.**

(Institutional reforms left for future)

The Corporate Value Report proposes fair rules regarding defensive measures against hostile takeovers and asks the government to develop the Corporate Value Defense Guidelines. Modernization of the Corporate Law, amendment of the Securities and Exchange Law regarding off-hours transactions and the development of the Corporate Value Defense Guidelines will complete the first step in the development of rules regarding hostile M&As in Japan.

But discussion points that must be considered are not limited to those as published here.

Discussion points left for the future include the reasonableness of the total takeover requirement adopted by an EU Takeover Directive to regulate two-tiered takeovers, the treatment of business integration regulations introduced through state laws to suppress two-tiered takeovers in the United States, the concept of independence and other corporate governance problems regarding effective monitoring on defensive measures, and TOB rules anticipating adoption of rights plans and other defensive measures.

These discussion points have been put forward by a Corporate Governance Committee at the Liberal Democratic Party and the Financial System Council as well. Following the development of the Corporate Value Defense Guidelines, the Corporate Value Study Group would like to further deepen consideration of these discussion points.

Chapter 5. The Infrastructure of the Business Community in Japan

The Corporate Value Study Group indicated in the previous chapter the reasonable defensive measures that should be implemented in Japan considering the rules concerning hostile takeovers in Western countries. The Study Group also recommended that the government should clearly develop the Guidelines (Corporate Value Defense Guidelines) based on the Corporate Value Report on defensive measures. If the contents of the Guidelines are worked out based on the Discussion Points, they must be in accordance with the American rules which have been developed through a series of revisions over 20 years and also with the British rules which require special resolutions at general shareholders' meeting for the adoption of defensive measures. These Guidelines should also comply with global standards. If market participants such as companies, institutional investors and shareholders follow the Guidelines, fair defensive measures against hostile takeovers could be adopted from an international viewpoint, and confusion resulting from a lack of rules or from excessively aggressive or less aggressive defenses against hostile takeover attempts would be avoided

On the other hand, in Japan some people are critical of the adoption of defensive measures in Japanese companies because of the difference in corporate culture in Japan and the United States. As the concept of focusing on shareholders' interests and the system of independent outside board members is not well established and institutional investors cannot fully function monitoring the management of companies in Japan, they are concerned that management might abuse defensive measures for entrenchment. However, it is more urgent to establish fair rules concerning hostile takeovers rather than to improve the infrastructure of business community in Japan. As Corporate Law allows companies to adopt defensive measures against hostile takeovers, rules are indispensable to prevent abuse of defensive measures by management of companies. In contrast, if people concerned respect and adhere to the Corporate Value Defense Guidelines, a new awareness about the need to enhance corporate value will gradually permeate the Japanese business community. And a new corporate culture will offer additional encouragement for companies to use defensive measures properly and prevent the abuse of them.

In this chapter we will explain how Japan is expected to change through the establishment of fair rules concerning hostile takeovers.

1. Expected changes in the business community in Japan

(Expected changes with respect to the Corporate Value Defense Guidelines)

During the discussion process at the Study Group meetings, some members expressed concern that it would be premature for Japan to adopt American-style defensive measures without due consideration and that these defensive measures might be abused under the current situation because the Japanese business community is different from that of the United States. But as the results of the questionnaire show, there are a considerable number of corporate managers who do not adopt defensive measures because of their fear that they would lose trust in the market if they did so[156]. At the same time there is strong demand among them that the fair Corporate Value Defense Guidelines should be established as soon as possible. It is expected that once the Guidelines are established, many companies will consider the adoption of reasonable defensive measures, which are in conformity with the Guidelines. If the Guidelines are respected as the code of conduct by companies as mentioned above, the abuse of defensive measures will be avoided preemptively and a fear of market participants will be erased.

(Expected changes in the business community in Japan with respect to the Guidelines)

Moreover, in designing defensive measures in accordance with the Guidelines, inevitably communication between corporate managers and shareholders is expected to improve, which would lead to the progress of reforms related to corporate governance. In the previous chapter, the Study Group indicated that companies should comply with three necessary conditions to enhance the reasonableness of defensive measures. Firstly, companies should assume the responsibility for accountability for shareholders and investors by disclosing the contents of defensive measures under ordinary situations. Secondly, defensive measures should be removed by a decision of a general shareholders' meeting. Thirdly, a company has to devise several ways to exclude arbitrary judgments by board members in takeover contests, either by outside checks by independent party, or by the establishment of objective criteria for removal, or by the requirement of the approval by a general shareholders' meeting. If a company adopts defensive measures in accordance with the above-mentioned conditions, top management would intend to share strategies to enhance long-term corporate value with investors and shareholders through the enrichment of IR activities and continuous efforts to communicate with major shareholders. And in order to exclude arbitrary judgments, management should actively use independent outside board members and auditors, and should empower them to focus on shareholders' interests in order to obtain the approval from a general shareholders' meeting. And when institutional investors begin to use the Guidelines as their benchmark to establish concrete checks about defensive measures, such a move would work to deter the adoption of excessive defensive measures and to encourage companies to focus on shareholders' interests and to use outsiders.

(Establishment of management that focuses on shareholders' interests and conducts fully-fledged communication with shareholders)

At the time of the adoption of defensive measures against hostile takeovers, the process begins for companies to win the understanding of market participants such as shareholders about the

[156] 33% of responding companies answered that they are reluctant to adopt rights plans because of worries about the response from the market (the survey was conducted by METI in September 2004)

criteria and process of judgments in regard to removal and maintenance of them and about the management to enhance corporate value. Therefore, IR activities should be regarded as part of a strategic plan to gain the trust of shareholders and to enhance corporate value. The importance of IR activities is also expected to increase in corporate management[157]. Many companies which want to avoid legal and market risks would consider first and foremost defensive measures based on the shareholder approval. At the same time, some institutional investors have pointed out the need to address problems of procedure and function with regard to general shareholder meetings, including the fact that shareholder meetings of most companies are held at the same time[158], the delayed delivery of notices of holding shareholder meetings[159], the lack of adequate disclosure[160], and insufficient IR activities[161][162]. If companies want to adopt reasonable defensive measures corresponding to their own situations, it will become necessary for them to make efforts to solve these problems related general shareholder meetings.

(Fully-fledged use of external parties and development of the concept of independence)

When defensive measures based on the first type (independent party checks) are adopted,

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157 Professor Kunio Ito of Hitotsubashi University said, "By using IR activities effectively, companies can reduce capital costs and increase corporate value." (Source: *Nippon Keizai Shinbun* article, March 31, 2005)

158 In Japan about 80% of companies listed on the Tokyo Stock Exchange usually hold general shareholders meetings in June every year. For FY2004, about 80% of the listed companies held general shareholders meetings on the 25th and 29th of June (see the research result about the holding date of shareholders meetings by the Tokyo Stock Exchange)

Therefore institutional investors could not thoroughly analyze and examine proposals for general shareholders meetings as the presentations were concentrated in June. And because of the overlapping of shareholders meetings, institutional investors cannot attend all of the shareholders meetings. (See Wakasugi, Takaaki edited "The Day Shareholders Awaken" p.203 to p.205, *Commercial Law*, 2004)

159 Notice of a general shareholders meeting with proposals is usually sent by companies to trust banks, who are nominal shareholders on the list of shareholders, at least two weeks prior to the meeting. Then, trust banks notify institutional investors. After deciding whether or not they agree to proposals, institutional investors return the notice to trust banks. Trust banks collate votes and make the final tally. The final result is reported to the companies. Therefore institutional investors have in fact only two or three days to examine proposals. It is actually impossible for them to make thorough analysis and examination of proposals in such a short time, which prevents the effective and smooth exercise of voting rights by institutional investors. Moreover if institutional investors are foreign entities, it would take much longer considering the delivery time and the fact that most proposals are written in Japanese, and the exercise of the voting rights would become more difficult. (ibid. p.203 to p.205. Also see the Request Letter titled "About the Measures to Improve the Infrastructure for Exercising the Voting Rights," which was sent jointly by Japan Securities Investment Advisers Association and Pension Fund Association to the stock exchange in February 2005)

160 Documents of general shareholders meetings in Japan often lack real substance. There is no clear mention about the policy of management reform, numerical targets of business, the policy of dividends, the basic formula regarding compensation for board members or neutrality and independence of outside directors and auditors. In many cases, documents contain only debrief reports and conclusions of a general shareholders meeting. Therefore it is often noted that these documents are not useful in making proper judgments about management. (ibid. p.203-p.205. Also "About the Measures to Improve the Infrastructure for Exercising the Voting Rights")

161 According to research by Zenkoku Kabu Kon Rengokai, about 27% of public companies held a company information session for domestic investors as part of IR activities. Only 10% of them held them for foreign investors (but the Japan Investor Relations Association reported that more than 50% of public companies held a company information session for domestic investors and more than 80% of them held individual meetings with investors). And according to the Japan Investor Relations Association, less than 15% of public companies conducted investigations to identify shareholders. These facts identify the reason companies lack direct communication with shareholders.

162 The request letter sent jointly by the Japan Securities Investment Advisers Association and Pension Fund Association to the stock exchange on February 14, 2005.

judgments and prudence of managers should be shown in a more objective way. Therefore, the use of outside directors and auditors would be promoted in earnest. But there is a criticism that, as outside directors and auditors under the current system in Japan tend to align with a company, their function to check top management has not been fully accomplished. But from now on, through communication between companies and shareholders, the argument about the independence of outside parties will proceed, and outside directors and auditors are requested to shoulder much heavier responsibility and authority than now. As to the necessary conditions for their independence, both Japan and the United States are still experimenting with trial and error. But as Japanese companies have adopted the first type of defensive measures, it is important that each company should make the effort to work out the criteria of their independence. With collective efforts by companies, companies and market participants are expected to quickly reach a consensus about the idealistic structure of corporate governance including independence of outside directors and auditors.

(Establishment of practice to make a prudent investigation about the takeover proposal)

There is an observation that there is no common practice in the Japanese business community for the target company to fully examine the contents of a takeover proposal and judge the benefit of that proposal for shareholders and corporate value. In the future, such a practice is expected to permeate the business community. Companies which have adopted defensive measures will be required to negotiate seriously with an acquirer, to take advantage of outside professional advisors, and to make a full examination about the impact of a hostile takeover proposal on corporate value and shareholders' interests as a whole.

(Diffusion of stock-price linked compensation and restraints on the conflict of interest for top management)

The accumulation of judicial judgments and pressure from institutional investors is often cited as one of the major reasons that rights plans were adopted in the United States as a means to enhance corporate value. There is another explanation which emphasizes the increased compensation to directors based on the performance of stock prices[163]. Though there is a criticism that the more closely related directors' compensation and stock prices are, the more top management is inclined to maximize profits over a short time, this system is also expected to work to restrict the conflict of interests affecting top management. Though it is dubious whether the golden parachute, which

[163] Marcel Kahan and Edward B. Rock, "How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law" (2002)
The ratio of American major companies that provided stock options to CEOs increased from 30% in 1980 to 70% in 1994. The ratio of stock compensation to total compensation for top executives increased from 41% in 1992 to 55% in 1996 and 75% in 2000. (Source: "The System of Compensation for Managers and Corporate Governance" in the December 2003 issue of *Financial Review* by the Ministry of Finance Financial Research Institute)
The ratios of stock compensation to total compensation for executives in Japan and the United States are 23% and 73%, respectively (Source: "Guidelines for Compensation for Managers" issued in February 16, 2005 by the Committee on Infrastructure and Transparency of the System, Japan Director Association)

guarantees managers a lump sum of money in a retirement and severance package, will be accepted as the norm in Japan, the system to link managers' compensation to the performance of stock prices is expected to become more common in the business world in the future[164].

(Responsible behavior by institutional investors)

It is well known that one of driving forces to develop and revise defensive measures from the viewpoint of corporate value enhancement is the pressure from institutional investors (refer to Chapter 3). American institutional investors make it a rule to establish detailed guidelines for various types of defensive measures from the standpoint of long-term interests for shareholders and to make their own judgments on a case-by-case basis whether or not to accept defensive measures adopted by individual companies. On the other hand, the number of Japan's institutional investors which establish their own guidelines and aggressively exercise their voting rights at a general shareholder meeting based on their guidelines has been rising. In the future, the number of companies which would adopt reasonable defensive measures is expected to increase as they establish guidelines. At the same time, they are expected to clarify what kind of attitudes toward acquirers they would take and to consider how to take defensive measures, including the establishment of voting rights guidelines.[165] Properly-structured defensive measures would work both to protect management and to increase corporate value. According to empirical studies, a well-designed rights plan has the effect of increasing the premium for acquisition in takeover contests. The defensive measures explained in the Corporate Value Report, which are adopted and disclosed before a hostile takeover approach, ensuring the possibility of removal and a proxy contest, with devices to exclude arbitrary judgments by management in takeover contests (such as independent party checks, chewable pills, shareholder approval) are criteria that institutional investors will use to exercise their voting rights on a case-by-case basis, depending on the degree of trust in companies. In the process of a hostile takeover, not only the acquirer and top management but also shareholders become main players. Ultimately it is shareholders in the market who will make final judgments whether or not defensive measures are appropriate. Responsible behavior by institutional investors would play an important role to reject excessive defensive measures in the market. Their actions are expected to become a driving force for changes in the business community in Japan.

[164] The Japan Director Association announced the guidelines to increase the ratio of stock compensation to total compensation for CEOs to more than 30% within two to four years in order to improve the accountability of companies to investors (ibid)

[165] Some institutional investors are working on new decision-making guidelines for defensive measures against takeovers. For instance, the Pension Fund Association published the "Assessment Criteria for the Exercise of Shareholders' Voting Rights on Defensive Measures against Corporate Takeovers" on April 28, 2005.

2. Formation of consensus to increase long-term corporate value

Actions taken by concerned parties, along with the Corporate Value Defense Guidelines which are explained in the Corporate Value Report, should bring about changes of the business community in Japan so that managers who increase corporate value would be supported and those who fail would be forced to resign. Many shareholders, including institutional investors, aim at an increase of stock prices over a long period of time. Many management executives of blue-chip companies in Japan are focusing on shareholders' interests on one hand, but are displaying their strength by implementing long-term corporate strategies on the other hand. It is possible that management executives of Japanese-style blue-chip companies and institutional investors with a long-term investment perspective can establish a new type of coalition through relationship investment. In the past, in order to make a long-term corporate strategy possible, the corporate model in which profits are retained as internal reserve for future capital investment and shareholders benefit by capital gains rather than increase of dividends has been recommended. But from now on, in response to the increasing pressure from shareholders, companies will have to review the balance between the increase in internal reserve and the payout of dividends to shareholders. On the other hand, in order to differentiate themselves from competitors, a corporate strategy with long-term perspectives continues to be needed to train employees, to establish a favorable relationship with trading partners, and to gain the trust of clients and the regional business community. Using the arguments about defensive measures, we can expect a tense coalition between shareholders who seek to increase long-term profits and corporate managers who seek to increase long-term corporate value, due to arguments about the strength of companies to increase long-term corporate value, what kinds of business and financial strategies are needed to increase corporate strength, how to increase shareholders' interests over the long term by strengthening incentives for stakeholders.

In order to prepare for the coming age of M&A, we have to change the situation having no rules regarding hostile takeovers to those with shared fair rules. If concerned parties such as companies, shareholders, investors, employees, the government, and the courts comply with and, as the need arises, revise these rules, they would become the code of conduct for Japanese companies and at the same time would motivate the Japanese business community to change. We expect the Corporate Value Report to trigger these changes.

We expect that defensive measures considered for adoption by companies in the future will not only protect corporate value from hostile takeovers but also increase corporate value through dialogue and mutual understanding between management and shareholders, and will play a role in stimulating the business community.

Concluding remarks

In the process of working out the Corporate Value Report, we received lots of advice and cooperation from many people.

Director Yukio Takaoka of Sotoh Corporation, Representative Director Yasuyo Hatakeyama of Lazard Freres and Associate Professor Akira Toda of the Law Department of Kyoto University kindly participated in the Study Group and made presentations to the members of the Study Group.

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Lazard Freres and the Sullivan and Cromwell Law Office gave us advice about overseas public relations strategy regarding the Corporate Value Study Group. Their advice assisted the Study Group in receiving a favorable response from the foreign press.

Mr. Robert Alan Feldman, Director of the Japan Research Department at Morgan Stanley Securities (Japan), Mr. Tsutomu Fujita, Director of Research Department, Nikko City Group Securities Co., took the trouble to act as the liaison with a many different people.

I would like to express my gratitude on behalf of the Study Group to the many people who provided their kind cooperation.

May 27, 2005
Hideki Kanda
Chairman
The Corporate Value Study Group

Appendix 1: Roster of Corporate Value Study Group

Chairman	Hideki KANDA	Professor, University of Tokyo Graduate Schools for Law and Politics
	Toshio ADACHI	Corporate Director, Group General Manager, Tokyo Branch, Sharp Corporation
	Gaku ISHIWATA	Attorney at Law, Mori Hamada & Matsumoto
	Takeki UMEMOTO	Executive Officer, Director, Information Planning Department, RECOF Corporation
	Toshio OSAWA	Corporate Officer, Corporate Administration Division Head, Astellas Pharma Inc.
	Kenichi OSUGI	Professor, Chuo Law School
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	Shirou TERASHITA	Executive Officer, IR Japan, Inc.
	Motoyoshi NISHIKAWA	Chief Legal Counsel, Nippon Steel Corporation
	Takashi HATA	Managing Officer, Finance & Accounting Group, Toyota Motor Corporation
	Nobuo HATTA	Member of the Board, Director, Administrative Headquarters, ROHM Co. Ltd.
	Takashi HATCHOJI	Senior Vice President and Executive Officer, Hitachi, Ltd.
	Kenichi FUJINAWA	Attorney at Law, Nagashima, Ohno & Tsunematsu
	Keisuke HORII	Senior Vice President, Global Hub Compliance Office, Sony Corporation
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	Noriyuki YANAGAWA	Associate Professor, Graduate School of Economics, Faculty of Economics, The University of Tokyo
(Observer)		
	Tetsu AIZAWA	Secretary, Civil Affairs Bureau, Ministry of Justice

Appendix 2: Matters Investigated by the Corporate Value Study Group

1. Current status of defensive measures in the United States and Europe: What measures are being taken in the Western world?
> Analysis of defensive measures in the United States
- Analysis of the actual situation of adoption of defensive measures by S&P 500 companies and the impact of the defensive measures on the acquisition premium, acquisition activities, and share price
> Analysis of defensive measures in Europe
- Analysis of the attitude about and the actual situation of hostile takeover defense measures in the United Kingdom, Germany, and the EU

2. Attitude of institutional investors: What kinds of defensive measures are supported by institutional investors?
> Attitude of major Western institutional investors
- Analysis of the standards set by the guidelines for exercising voting rights (analysis of the voting rights exercise guidelines of ten major institutional investors)
- Interview survey (about 40 institutions including U.K. and U.S. pension funds, U.K. and U.S. investment institutions, U.S. trade union investment companies, and the Council of Institutional Investors)

3. Judicial decisions: What kind of case law is established in the United States?
> Analysis of major U.S. court decisions related to defensive measures
- Analysis of about 40 Supreme Court decisions (extracted from about 140 court decisions related to takeover defense measures rendered in Delaware State since 1985) as to the claims by the acquirers, claims by the target companies, and what kinds of defensive measures would be judged to be legal

4. Actual conditions in Japan: What kinds of measures could be adopted in Japan?
> Survey on the actual situation of Japanese companies concerning hostile takeovers
- Survey of about 60 Japanese companies regarding their measures and ideas on hostile takeovers
> Practical strategies in Japan
- Analysis of practical strategies that can be introduced in Japan
> Survey on the actual situation of proxy contests in Japan and the United States
- Analysis of the differences between the proxy contests in Japan and the United States and the potential for proxy contests in Japan

5. Economic theory on acquisitions
- Theoretical analysis of the economic rationality of hostile takeovers

Appendix 3: Progress of Discussions by the Corporate Value Study Group

First Session (September 16, 2004)

Method of conducting the study group meetings

Ideal corporate value protection measures

Measures against hostile TOB

Second Session (September 28, 2004)

Current status of Japanese companies (report of the results of the survey on actual conditions)

Problem awareness of Japanese companies (explanations by industrial sector members)

Third Session (October 20, 2004)

Conditions for reasonable defensive measures indicated in major court decisions

Actual situation of adoption of defensive measures in the United States and their effects

Voting rights exercise guidelines of major Western institutional investors against companies' defensive measures

Fourth Session (November 25, 2004)

Actual situation of defensive measures in Europe

Economic theory on acquisitions

Fifth Session (December 22, 2004)

Key issues and concept of adopting defensive measures

Practical strategies against hostile takeovers

Sixth Session (January 19, 2005)

Sorting out discussion points

Practical strategies against hostile takeovers

Seventh Session (February 9, 2005)

Sorting out discussion points

Actual situation of proxy contests

Eighth Session (March 7, 2005)

Outline of discussion points

Ninth Session (May 13, 2005)

Summary of public comments on the Discussion Points

Draft of the Corporate Value Report

Recent trends and future schedule

Reference 1 Adoption of Defensive Measures in the United States

Adoption of defensive measures in 488 of the S&P500 companies (at the end of September 2004; aggregate market value for Japanese companies is as of November 5.)

Major defensive measures
A: Blank check; B: Appointment to fill vacancies; C: Rights plan; D: Staggered board; E: Requiring reason for dismissal of directors; F: Requiring special resolution for dismissal of directors; G: Super voting stock

[Explanation of terms]
A: Authorizing the board to create stock with the terms and conditions freely devised in response to market trends
B: Authorizing the board to appoint directors to fill vacancies
C: A mechanism to dilute an acquirer's stock acquisition rate whereby, if the acquirer acquires more than a specified percentage of shares (typically about 20%), stockholders other than the acquirer are automatically issued new shares
D: System for appointing directors with offset terms of office
E: Requiring a reason in the event of dismissal of a director in the middle of the term of office
F: Requiring special resolution of the general shareholders' assembly in the event of dismissal of a director in the middle of the term of office*
G: A mechanism in which specified shareholders such as the founders of the company have multiple voting rights
* In the United States, dismissal of a director may be generally decided by an ordinary resolution.

○ Aggregate market value: 50 billion dollars or over

<U.S. companies>

Rank	(		A	B	C	D	E	F	G
1	General Electric Company	347	○			○	○		
2	Exxon Mobil Corporation	317	○	○					
3	Microsoft Corporation	300	○	○					
4	Wal-Mart Stores, Inc	221	○						
5	Citigroup Inc	200	○	○					
6	Pfizer, Inc	209	○	○					
7	Bank of America Corporation	177	○	○					
8	Johnson & Johnson	169	○	○			○		
9	IBM	148	○	○			○		
10	AIG	146	○						
11	Intel Corporation	136	○	○					
12	P&G	133	○	○		○	○	○	
13	JPMorgan Chase & Co.	131	○	○					
14	Cisco Systems, Inc	120	○		○				
15	ChevronTexaco Corporation	133	○	○					
16	Verizon Communications Inc	107	○	○					
17	Wells Fargo & Company	97	○	○					
18	Altria Group Inc.	94	○	○					
19	The Coca-Cola Company	93	○	○					
20	Dell Inc.	86	○	○	○		○		
21	The Home Depot, Inc.	84		○					
22	SBC Communications Inc.	82	○	○					
23	PepsiCo, Inc.	81							
24	Time Warner Inc.	74	○	○					
25	Merck & Co., Inc.	67	○	○			○	○	
26	Amgen Inc.	67	○	○	○	○	○		
27	QUALCOMM Incorporated	66	○		○	○		○	
28	American Express Company	64	○	○					
29	Abbott Laboratories	63	○		○				
30	eBay Inc.	63	○	○		○	○		
31	Oracle Corporation	62	○		○				
32	Wachovia Corporation	61	○		○	○	○		
33	Medtronic, Inc.	59	○	○	○	○		○	
34	3M Company	58	○	○		○	○		
35	ConocoPhillips	58	○		○	○	○		
36	Eli Lilly and Company	57	○	○	○	○	○	○	
37	Hewlett-Packard Company	54	○						
38	Viacom Inc.	53	○	○					○
39	Morgan Stanley	52	○	○	○	○	○	○	
40	U.S. Bancorp	52	○	○	○	○	○		
41	The Walt Disney Company	50	○	○					

< Japanese companies >

← Toyota Motor Corporation (142)

← NTT DoCoMo, Inc. (89)

← Nippon Telegraph and Telephone Corporation (67)

← Mitsubishi Tokyo Financial Group, Inc. (58)

ars or over

Rank	(		A	B	C	D	E	F	G
42	Wyeth	49	○	○			○	○	
43	Merrill Lynch & Co., Inc.	48	○	○	○	○	○	○	
44	BellSouth Corporation	48	○		○		○	○	
45	Yahoo! Inc.	47	○		○				
46	United Technologies Corporation	46	○						
47	United Health Group Incorporated	45	○	○		○		○	
48	United Parcel Service, Inc.	45	○						○
49	The Goldman Sachs Group, Inc.	44	○	○	○	○	○	○	○
50	Bristol-Myers Squibb Company	44	○	○				○	
51	Target Corporation	43	○	○	○	○		○	
52	E.I. DuPont de Nemours and Company	42	○	○					
53	Lowe"s Companies, Inc.	41	○	○		○		○	
54	The Dow Chemical Company	41	○	○				○	
55	The Boeing Company	41	○			○	○		
56	AT&T Wireless Services, Inc.	40	○	○	○	○	○		
57	Anheuser-Busch Companies, Inc.	40	○	○	○	○	○		
58	Motorola, Inc.	39	○	○	○				
59	The Gillette Company	39	○	○	○	○	○		
60	Texas Instruments Incorporated	38	○	○	○				
61	Walgreen Co.	36	○		○				
62	McDonald"s Corporation	35	○	○		○	○	○	
63	First Data Corporation	33	○	○		○	○		
64	Washington Mutual, Inc.	33	○	○	○	○	○		
65	The Allstate Corporation	32	○	○				○	
66	MBNA Corporation	31	○	○					
67	EMC Corporation	29	○	○		○	○		
68	Kimberly-Clark Corporation	29	○	○	○	○	○	○	
69	Boston Scientific Corporation	29	○	○		○		○	
70	Sprint Corporation	28	○	○	○		○		○
71	Nextel Communications, Inc	28	○	○		○	○		○
72	Alcoa Inc.	27	○			○		○	
73	Honeywell International Inc.	27	○	○		○	○	○	
74	Illinois Tool Works Inc	26	○	○					
75	Applied Materials, Inc.	26	○		○				
76	Caterpillar Inc.	26	○	○	○	○		○	
77	Fifth Third Bancorp	26	○			○	○		
78	MetLife, Inc.	26	○		○	○	○		
79	Emerson Electric Co.	26	○	○	○	○		○	
80	FedEx Corporation	26	○	○		○	○		
81	Exelon Corporation	25	○			○	○		
82	Schering-Plough Corporation	25	○	○	○	○	○	○	
83	Automatic Data Processing, Inc.	25	○						
84	National City Corporation	24	○	○					
85	Comcast Corporation	24	○	○	○		○		○
86	The Bank of New York Company, Inc.	24	○	○	○		○		

Nissan Motor Co., Ltd. (49)
Mizuho Financial Group, Inc. (48)
Honda Motor Co., Ltd. (47)
Canon In
Takeda Pharmaceutical Company Limited (44)
Sumitomo Mitsui Banking Corporation (41)
Matsushita Electric Industrial Co., Ltd. (36)
Yahoo Japan Corporation (34)
Sony Corporation (33)
The Tokyo Electric Power Company, Inc. (TEPCO) (31)
Millea Holdings, Inc. (25)
Nomura Holdings, Inc. (25), Seven-Eleven Japan Co., Ltd. (25)
UFJ Holdings, Inc. (25)

Note: Aggregate market value for Japanese companies is calculated on the basis of an exchange rate of 105 yen to the dollar.
Source: Compiled by METI based on data from Nomura Securities Co. Ltd.

ars or over

Rank	(		A	B	C	D	E	F	G
87	Colgate-Palmolive Company	23	○	○	○				
88	Lockheed Martin Corporation	23	○				○	○	
89	The Southern Company	23		○					
90	Ford Motor Company	23	○	○					○
91	Prudential Financial, Inc.	23	○	○	○	○	○		
92	Occidental Petroleum Corporation	22	○	○					
93	Duke Energy Corporation	22	○	○	○	○	○		
94	BB&T Corporation	22	○						
95	Gannett Co., Inc.	21	○	○	○	○		○	
96	Lehman Brothers Holdings Inc.	21	○	○		○	○		
97	Costco Wholesale Corporation	21	○	○		○	○		
98	NIKE, Inc.	20		○					
99	Dominion Resources, Inc.	20	○	○			○	○	
100	General Motors Corporation	20	○	○					
101	The St. Paul Travelers Companies, Inc	20	○	○					
102	Cendant Corporation	20	○	○					
103	.Guidant Corporation	20	○	○		○		○	

Hitachi Ltd. (21)
KDDI Corporation (20)

Note: Aggregate market value for Japanese companies is calculated on the basis of an exchange rate of 105 yen to the dollar.
Source: Compiled by METI based on data from Nomura Securities Co. Ltd.

ars or over

Rank	(	(t	A	B	C	D	E	F	G
104	General Dynamics Corporation	19	○	○					
105	Starbucks Corporation	19	○	○		○			
106	The Progressive Corporation	19	○	○		○	○	○	
107	SYSCO Corporation	19	○		○	○	○		
108	Avon Products, Inc.	19	○	○	○	○	○	○	
109	Newmont Mining Corporation	19	○	○	○				
110	AFLAC Incorporated	19							○
111	SunTrust Banks, Inc.	19	○	○		○		○	
112	Biogen Idec Inc.	18	○	○	○	○	○		
113	International Paper Company	18	○	○		○	○	○	
114	SLM Corporation	18	○						
115	Best Buy Co, Inc.	18	○	○		○		○	
116	Devon Energy Corporation	18	○	○	○	○	○		
117	Apple Computer, Inc.	18	○						
118	Symantec Corporation	18	○		○				
119	Baxter International Inc.	18	○	○	○	○	○		
120	TXU Corp.	18	○		○				
121	Clear Channel Communications, Inc.	17	○					○	
122	Northrop Grumman Corporation	17	○	○		○	○	○	
123	Kellogg Company	17				○	○	○	
124	The Gap, Inc.	17	○	○					○
125	Sara Lee Corporation	17	○	○	○			○	
126	Countrywide Financial Corporation	17	○	○	○	○	○	○	
127	Anadarko Petroleum Corporation	17	○	○	○	○	○		
128	Kohl"s Corporation	17	○	○		○	○		
129	HCA Inc.	17	○	○					○
130	Apache Corporation	17	○	○	○	○	○		
131	Golden West Financial Corporation	17	○	○		○	○		
132	Capital One Financial Corporation	17	○	○	○	○	○	○	
133	CVS Corporation	16	○	○					
134	Burlington Resources Inc.	16	○	○	○		○		
135	Stryker Corporation	16	○						
136	Danaher Corporation	16	○	○		○	○		
137	Cardinal Health, Inc.	16	○			○	○	○	○
138	ALLTEL Corporation	16	○	○	○	○	○		
139	Zimmer Holdings, Inc.	16	○	○		○	○	○	
140	Harley-Davidson, Inc.	16	○	○	○	○	○		
141	General Mills, Inc.	16	○		○				
142	The Hartford Financial Services Group, Inc.	16	○	○	○				
143	Forest Laboratories, Inc.	16	○	○				○	
144	The McGraw-Hill Companies, Inc	15	○	○	○	○	○	○	
145	Union Pacific Corporation	15	○	○				○	
146	Raytheon Company	15	○	○		○	○		
147	Computer Associates International, Inc	15	○		○				

Note: Aggregate market value for Japanese companies is calculated on the basis of an exchange rate of 105 yen to the dollar.
Source: Compiled by METI based on data from Nomura Securities Co. Ltd.

← Resona Holdings, Inc. (19)

← Mitsubishi Corporation (18), Japan Tabacco Inc. (18)

← Central Japan Railway Company (18),
← The Kansai Electric Power Co., Ltd. (18)
Fuji Photo Film Co., Ltd. (18)

← Shin-Etsu Chemical Co., Ltd. (17)

← Nintendo Co., Ltd. (16)

← Chubu Electric Power Co., Ltd. (16)

← Nippon Stee

← Sharp Corporation (16), JFE Holdings, Inc. (16),
Softbank Corp.(16)

← Bridgestone Corporation (16)

← Ito-Yokado Co., Ltd. (15)

's or over

			A	B	C	D	E	F	G
148	Regions Financial Corporation	15	○	○		○	○	○	
149	Waste Management, Inc.	15	○	○				○	
150	Burlington Northern Santa Fe Corporation	15	○						
151	Halliburton Company	15	○	○	○				
152	Corning Incorporated	15	○	○	○	○	○		
153	Lucent Technologies Inc.	14	○	○	○		○		
154	Analog Devices, Inc.	14	○	○	○	○			
155	Deere & Company	14	○	○	○	○	○		
156	Weyerhaeuser Company	14	○	○		○		○	
157	Entergy Corporation	14							
158	Masco Corporation	14	○	○	○	○	○		
159	The PNC Financial Services Group, Inc.	14	○	○	○				
160	State Street Corporation	14	○	○	○	○	○		
161	Baker Hughes Incorporated	14	○	○		○	○		
162	Franklin Resources, Inc.	14	○						
163	Gilead Sciences, Inc.	14	○		○			○	
164	Maxim Integrated Products, Inc.	14	○	○					
165	Staples, Inc.	14	○	○		○	○		
166	Marathon Oil Corporation	13	○	○		○	○		
167	Sun Microsystems, Inc.	13	○	○	○				
168	WellPoint Health Networks Inc.	13	○	○		○			
169	SouthTrust Corporation	13	○	○	○	○	○	○	
170	Marsh & McLennan Companies, Inc	13	○	○	○	○	○		
171	Omnicom Group Inc.	13	○				○	○	
172	Praxair, Inc.	13	○		○	○	○		
173	FirstEnergy Corp.	13	○					○	
174	Electronic Arts Inc.	13	○	○					○
175	KeyCorp	13	○		○	○	○	○	
176	Tribune Company	13	○	○	○	○	○		
177	Caremark Rx, Inc.	13	○	○	○	○	○		
178	ConAgra Foods, Inc.	13	○	○		○	○		
179	Aetna Inc.	13	○	○					
180	Norfolk Southern Corporation	12	○			○			
181	St. Jude Medical, Inc.	12	○	○	○	○	○	○	
182	Adobe Systems Incorporated	12	○	○	○	○			
183	AT&T Corp.	12	○	○			○		
184	American Electric Power Company, Inc.	12		○			○		
185	FPL Group, Inc.	12	○	○	○		○	○	
186	PG&E Corporation	12	○						
187	Hershey Foods Corporation	12	○	○	○				○
188	The Chubb Corporation	12	○	○	○				
189	YUM! Brands, Inc.	12	○	○	○	○	○		
190	Apollo Group, Inc.	12	○	○		○	○	○	○

Yamanouchi Pharmaceutical Co., Ltd. (13)

›., Ltd. (12)

③ Aggregate market value: 10 billion dollars or over

<U.S. companies>

Rank	Companies	Aggregate market value (billion dollars)

< Japanese companies >

.td. (12)

HOYA Corporation (11)

Murata Manufacturing Co., Ltd. (11)

Asahi Glass Co., Ltd. (11)

T&D Holdings, Inc. (11)

Tokyo Gas Co., Ltd. (10)

›rporation (10)

ACOM Co., Ltd. (10)

td. (10)

0)

ORIX Corporation (10)

Note: Aggregate market value for Japanese companies is calculated on the basis of an exchange rate of 105 yen to the dollar.
Source: Compiled by METI based on data from Nomura Securities Co. Ltd.

③時価総額１００億ドル以上（その３）

＜米国企業＞ ＜日本企業＞

順位	企 業 名	時価総額（１０億ドル）	A	B	C	D	E	F	G	日本企業
191	Becton, Dickinson and Company	１２	○	○	○	○	○			ローム（１２）、イオン（１２）
192	H.J. Heinz Company	１２	○	○						
193	Xerox Corporation	１２	○		○		○			
194	Paychex, Inc.	１２								
195	Air Products and Chemicals, Inc.	１２	○	○	○	○	○			
196	The Charles Schwab Corporation	１１	○	○		○	○	○		
197	Marriott International, Inc.	１１	○	○	○	○	○	○		
198	Wm. Wrigley Jr. Company	１１	○	○	○	○	○		○	
199	Simon Property Group, Inc.	１１	○							ＨＯＹＡ（１１）
200	The Clorox Company	１１	○	○						
201	Agilent Technologies, Inc.	１１	○	○	○	○	○			
202	Bed Bath & Beyond Inc.	１１	○	○		○	○			村田製作所（１１）
203	Mellon Financial Corporation	１１	○		○	○		○		
204	Genzyme Corporation	１１	○	○	○	○	○			
205	M&T Bank Corporation	１１	○							
206	Southwest Airlines Co.	１１				○	○			
207	PACCAR Inc.	１１	○	○	○	○		○		
208	The TJX Companies, Inc.	１１	○	○		○		○		
209	Principal Financial Group, Inc	１１	○	○	○	○	○			旭硝子（１１）
210	Biomet, Inc.	１１	○	○	○	○		○		
211	Linear Technology Corporation	１１	○	○						
212	Equity Office Properties Trust	１１	○	○			○			
213	Limited Brands, Inc.	１１	○	○		○	○	○		Ｔ＆Ｄホールディングス（１１）
214	Unocal Corporation	１１	○	○	○	○	○			
215	Archer-Daniels-Midland Company	１１	○	○						
216	International Game Technology	１１		○				○		
217	The Kroger Co.	１０	○	○	○	○	○	○		
218	Valero Energy Corporation	１０	○	○	○	○	○	○		東京ガス（１０）
219	Moody''s Corporation	１０	○	○	○	○	○	○		
220	J.C. Penney Company, Inc.	１０	○	○	○	○				キーエンス（１０）、NEC（１０）
221	Loews Corporation	１０	○	○					○	アコム（１０）
222	Campbell Soup Company	１０	○							
223	Consolidated Edison, Inc.	１０	○	○			○			住友信託銀行（１０）
224	Monsanto Company	１０	○	○		○	○	○		
225	PPG Industries, Inc.	１０	○		○	○		○		三菱電機（１０）
226	Johnson Controls, Inc.	１０	○			○	○	○		
227	Fortune Brands, Inc.	１０	○	○	○	○	○	○		
228	Lexmark International, Inc.	１０	○		○	○	○		○	
229	Progress Energy, Inc.	１０	○	○		○				
230	Electronic Data Systems Corporation	１０	○	○	○	○	○			
231	Anthem, Inc.	１０	○	○		○		○		
232	Comerica Incorporated	１０	○	○	○	○	○			
233	Xilinx, Inc.	１０	○							オリックス（１０）

注：日本企業のドルベースの時価総額は、１ドル１０５円で計算した。
出所：野村證券資料より経済産業省作成

③ 時価総額50億ドル以上（その1） Aggregate market value: 5 billion dollars or over

<U.S. companies> ＜米国企業＞

Rank	Companies	Aggregate market value (billion dollars)	A	B	C	D	E	F	G
234	Starwood Hotels & Resorts Worldwide, Inc.	9	○	○	○		○	○	
235	Public Service Enterprise Group Incorporated	9	○	○		○		○	
236	Pitney Bowes Inc.	9	○	○		○		○	
237	PPL Corporation	9	○	○		○	○	○	
238	Edison International	9	○		○				
239	Univision Communications Inc.	9	○						○
240	The Bear Stearns Companies Inc.	9	○	○					
241	Eaton Corporation	9	○		○	○	○	○	
242	Textron Inc.	9	○	○	○	○	○		
243	Ameren Corporation	9	○	○	○				
244	Equity Residential	9	○	○			○	○	
245	Rohm and Haas Company	9	○		○				
246	Marshall & Ilsley Corporation	9	○	○		○	○	○	
247	Computer Sciences Corporation	9	○	○	○			○	
248	AmSouth Bancorporation	9	○	○	○	○	○	○	
249	VERITAS Software Corporation	8	○	○	○	○	○	○	
250	Kerr-McGee Corporation	8	○	○	○	○	○	○	
251	Allergan, Inc.	8	○	○	○	○	○	○	
252	Medco Health Solutions, Inc.	8	○	○		○	○	○	
253	Coca-Cola Enterprises Inc.	8	○	○		○	○		
254	Northern Trust Corporation	8	○	○	○				
255	KLA-Tencor Corporation	8	○		○	○	○		
256	Quest Diagnostics Incorporated	8	○	○	○	○	○		
257	Eastman Kodak Company	8	○	○		○	○		
258	Network Appliance, Inc.	8	○	○					
259	BJ Services Company	8	○	○	○	○	○		
260	Georgia-Pacific Corporation	8	○	○	○	○		○	
261	Ecolab Inc.	8	○	○	○	○	○		
262	Intuit Inc.	8	○	○	○				
263	Albertson"s Inc.	8	○	○	○	○	○		
264	CIGNA Corporation	8	○	○	○	○	○		
265	Synovus Financial Corp.	8			○	○		○	○
266	Parker-Hannifin Corporation	8	○	○	○	○	○		
267	Altera Corporation	8		○					
268	AMBAC Financial Group, Inc.	8	○		○				
269	EOG Resources, Inc.	8	○	○	○				
270	Federated Department Stores, Inc.	8	○	○	○	○	○	○	
271	Amerada Hess Corporation	8	○	○		○		○	
272	Sempra Energy	7	○	○	○	○			
273	Phelps Dodge Corporation	7	○	○	○	○	○		
274	MBIA Inc.	7	○	○					
275	Coach, Inc.	7	○	○	○			○	
276	Kinder Morgan, Inc.	7	○	○	○	○	○		
277	Safeway Inc.	7	○	○					
278	H&R Block, Inc.	7	○	○	○	○		○	

< Japanese companies > ＜日本企業＞

- Nippon Oil Corporation (9)
- Sumco Corporation (9), Tokyo Electron Limited (9)
- Aiful Corporation (9)
- Mitsubishi Heavy Industries, Ltd. (9)
- TDK Corporation (9), Takefuji Corporation, (9), Kyushu Electric Power Co., Ltd. (9), Kyushu Electric Power Co., Ltd. (9)
- Kirin Brewery Co., Ltd. (9)
- Sompo Japan Insurance Inc. (9), Mitsui Fudosan Co., Ltd. (9)
- Sankyo Co., Ltd. (9)
- Promise Co., Ltd. (9)
- Eisai Co., Ltd. (8)
- Nikko Cordial Corporation (8), Fujisawa Pharmaceutical Co., Ltd. (8), Shinsei Bank, Limited (8)
- SECOM Co., Ltd. (8), Tohoku-Electric Power Co., Ltd. (8), The Bank of Yokohama, Ltd. (8)
- Rakuten, Ltd. (8)
- Daiwa Securities Co., Ltd. (8)
- NIDEC Corporation (8)
- Nitto Denko Corporation (8)
- West Japan Railway Company (8)
- Seiko Epson Corporation (8)
- Sumitomo Chemical Co., Ltd. (7), NTT Data Corporation (7)

注：日本企業のドルベースの時価総額は、1ドル105円で計算した。
出所：野村證券資料より経済産業省作成

Note: Aggregate market value for Japanese companies is calculated on the basis of an exchange rate of 105 yen to the dollar.
Source: Compiled by METI based on data from Nomura Securities Co. Ltd.

④ Aggregate market value: 5 billion dollars or over

<U.S. companies>

Rank	Companies	Aggregate market value (billion dollars)

< Japanese companies >

- Sumitomo Electric Industries, Ltd. (7), Dentsu Inc. (7)
- Ajinomoto Co., Ltd. (7)
- Fast Retailing Co., Ltd. (7)
- Mitsui O.S.K Lines (7)
- ITOCHU Corporation (7), Advantest Corporation (7), Toppan Printing Co., Ltd. (7), Komatsu, Ltd. (7)
- Osaka Gas Co., Ltd. (6), Konica Minolta Holdings, Inc. (6)
- Aisin Seiki Co., Ltd. (6)
- Daikin Industries, Ltd. (6), Toray Industries, Inc. (6)
- Yamato Transport Co., Ltd. (6), The Chugoku Electric Power Co., Inc. (6), Asahi Kasei Corporation (6)
- Mitsubishi Chemical Corporation (6)
- Taisho Pharmaceutical Co., Ltd. (6)
- Oriental Land Co., Ltd. (6)
- NYK Line (6), JS Group Corporation (6), Matsushita Electric Works, Ltd. (6)

Note: Aggregate market value for Japanese companies is calculated on the basis of an exchange rate of 105 yen to the dollar.
Source: Compiled by METI based on data from Nomura Securities Co. Ltd.

④時価総額５０億ドル以上（その２）

＜米国企業＞　　＜日本企業＞

順位	企 業 名	時価総額（１０億ドル）	A	B	C	D	E	F	G	日本企業
279	American Standard Companies Inc.	7	○		○	○				住友電気工業(7)、電通(7)
280	Hilton Hotels Corporation	7	○	○	○	○		○		
281	CSX Corporation	7	○							
282	Dover Corporation	7	○	○	○					
283	Rockwell Automation, Inc.	7	○	○	○	○	○	○	○	
284	SunGard Data Systems Inc.	7	○		○					味の素(7)
285	Lincoln National Corporation	7	○	○	○	○		○		
286	North Fork Bancorporation, Inc.	7	○			○	○			ファーストリテイリング(7)
287	DTE Energy Company	7	○	○	○	○				
288	ITT Industries, Inc	7	○	○	○					
289	McKesson Corporation	7	○		○	○	○			
290	Sovereign Bancorp, Inc.	7	○	○	○	○				
291	PeopleSoft, Inc.	7	○	○	○	○	○	○		
292	The May Department Stores Company	7	○	○	○	○	○			
293	Micron Technology, Inc.	7		○						
294	Constellation Energy Group, Inc.	7	○	○		○	○			
295	The AES Corporation	7	○	○			○			
296	Cintas Corporation	7	○	○			○	○		商船三井(7)
297	Cinergy Corp.	7	○			○		○		
298	Mattel, Inc.	7	○	○						伊藤忠商事(7)、アドバンテスト(7)、凸版印刷(7)、コマツ(7) 大阪ガス(6)、コニカミノルタ(6)
299	The Pepsi Bottling Group, Inc.	6	○	○					○	
300	Broadcom Corporation	6	○						○	
301	Xcel Energy Inc.	6	○	○	○					アイシン精機(6)
302	R.R. Donnelley & Sons Company	6	○	○	○	○	○			
303	Genuine Parts Company	6	○		○	○	○	○		
304	Affiliated Computer Services, Inc.	6	○		○			○	○	
305	Fiserv, Inc.	6	○		○	○	○	○		
306	UST Inc.	6	○	○		○	○			
307	Sears, Roebuck and Co.	6	○	○		○	○	○		
308	Cincinnati Financial Corporation	6		○		○	○			
309	The Williams Companies, Inc.	6	○	○	○	○	○	○		
310	AutoZone, Inc.	6	○	○				○		ダイキン工業(6)、東レ(6)
311	ProLogis	6	○			○	○	○		
312	Nucor Corporation	6	○	○	○	○	○			ヤマト運輸(6)、中国電力(6)、旭化成(6)
313	MedImmune, Inc.	6	○		○					
314	Pulte Homes, Inc.	6	○	○		○				
315	Harrah"s Entertainment, Inc.	6	○	○	○	○				
316	T. Rowe Price Group, Inc.	6	○							
317	Jefferson-Pilot Corporation	6	○	○	○	○		○		三菱化学(6)
318	Freeport-McMoRan Copper & Gold Inc.	6	○		○		○			大正製薬(6)
319	The Black & Decker Corporation	6	○							オリエンタルランド(6)
320	Plum Creek Timber Company, Inc.	6	○	○			○	○		日本郵船(6)、住生活グループ(6)、松下電工(6)
321	Rockwell Collins, Inc.	6	○	○	○	○	○	○		

注：日本企業のドルベースの時価総額は、１ドル１０５円で計算した。
出所：野村證券資料より経済産業省作成

④ Aggregate market value: 5 billion dollars or over

<U.S. co＜米国企> < Jap＜日本companies >

Rank	(	(l	A	B	C	D	E	F	G	Japanese companies
322	KeySpan Corporation	6	○	○			○			
323	Aon Corporation	6	○	○						Kubota Corporation (6), Shizuoka Bank, Limited (6), SANYO Electric Co., Ltd. (6), Oji paper Co., Ltd. (6)
324	MeadWestvaco Corporation	6	○	○	○	○	○	○		
325	Dollar General Corporation	6	○	○	○		○			
326	Qwest Communications International Inc	6	○	○				○		
327	Centex Corporation	6	○	○	○	○		○		Mitsui Trust Holdings, Inc. (6), Sumitomo Metal Industries, Ltd. (6)
328	Avaya Inc.	5	○	○	○	○	○			
329	MGIC Investment Corporation	5	○	○	○	○				
330	The Sherwin-Williams Compan	5	○	○						
331	SAFECO Corporation	5	○	○		○				
332	V. F. Corporatio	5	○	○	○	○	○	○		
333	Avery Dennison Corporatio	5	○	○	○	○	○			Daiwa House Industry Co., Ltd. (5), OMRON Corporation (5)
334	National Semiconductor Corporatio	5	○	○	○		○			Shionogi & Co., Ltd. (5), Ono Pharmaceutical Co., Ltd. (5)
335	Zions Bancorporation	5	○		○	○		○		Japan Airlines Corporation (5)
336	Chiron Corporation	5	○	○		○				
337	Autodesk, Inc.	5	○		○					
338	Nordstrom, Inc.	5		○						
339	AmeriSourceBergen Corporation	5	○	○	○	○	○	○		
340	C.R. Bard, Inc	5	○	○	○	○				Daito Trust Construction Co., Ltd. (5), Credit Saison Co., Ltd. (5), Daiichi Pharmaceutical Co., Ltd. (5)
341	Reynolds American Inc.	5	○	○	○	○	○			
342	The New York Times Company	5	○	○			○		○	Shiseido Co., Ltd. (5)
343	Sunoco, Inc.	5	○	○	○					
344	El Paso Corporation	5	○							Asahi Breweries, Ltd. (5), The Chiba Bank, Ltd. (5)
345	Torchmark Corporation	5	○	○		○	○	○		Kintetsu Corporation (5), Fuji Television Network, Inc. (5), Sumitomo Realty & Development Co., Ltd. (5)
346	NiSource Inc.	5	○	○	○	○	○	○		
347	Advanced Micro Devices, Inc.	5	○	○						NOK Corporation (5), Nippon Express Co., Ltd. (5)
348	Huntington Bancshares Incorporated	5	○		○	○	○	○		Terumo Corporation (5), Tokyu Corporation (5)
349	Newell Rubbermaid Inc.	5	○	○	○	○	○			
350	Knight-Ridder, Inc.	5	○	○	○	○	○	○		
351	W.W. Grainger, Inc.	5	○		○					
352	Leggett & Platt, Incorporated	5	○	○	○		○			
353	First Horizon National Corporation	5	○		○	○	○			All Nippon Airways Co., Ltd. (5)

Note: Aggregate market value for Japanese companies is calculated on the basis of an exchange rate of 105 yen to the dollar.
Source: Compiled by METI based on data from Nomura Securities Co. Ltd.

③ Aggregate market value: 3 billion dollars or over

<U.S. companies>

	(	Aggregate market value (billion dollars)	A	B	C	D	E	F	G
354	NCR Corporation	4	○		○	○	○	○	
355	IMS Health Incorporated	4	○	○	○	○	○	○	
356	JDS Uniphase Corporation	4	○	○	○	○			
357	Vulcan Materials Company	4	○	○	○	○	○		
358	The Interpublic Group of Companies, Inc.	4	○						
359	Office Depot, Inc.	4	○	○	○				
360	Solectron Corporation	4	○	○	○				
361	Tenet Healthcare Corporation	4	○					○	
362	Hospira, Inc.	4	○	○	○	○	○	○	
363	Jabil Circuit, Inc.	4	○		○				
364	Waters Corporation	4	○		○				
365	Express Scripts, Inc.	4	○	○	○				
366	Delphi Corporation	4	○	○	○	○	○		
367	Health Management Associates, Inc.	4	○	○					
368	RadioShack Corporation	4	○		○				
369	Siebel Systems, Inc.	4	○	○	○	○	○		
370	Family Dollar Stores, Inc.	4	○	○					
371	Robert Half International Inc.	4	○						
372	CenturyTel, Inc	4	○		○	○	○		○
373	Mylan Laboratories Inc.	4	○	○	○				
374	E*TRADE Financial Corporation	4	○		○	○		○	
375	Brunswick Corporation	4	○	○	○	○	○		
376	AutoNation, Inc.	4	○	○					
377	Providian Financial Corporation	4	○	○	○	○	○	○	
378	Thermo Electron Corporation	4	○	○	○	○	○		
379	Jones Apparel Group, Inc.	4	○	○					
380	Liz Claiborne, Inc.	4	○	○	○	○	○	○	
381	Ball Corporation	4	○	○	○	○	○	○	
382	McCormick & Company, Incorporated	4	○						○
383	Tiffany & Co.	4	○	○	○				
384	Scientific-Atlanta, Inc	4	○	○	○	○	○	○	
385	United States Steel Corporatio	4	○	○	○	○	○		
386	BMC Software, Inc.	3	○	○	○				
387	Comverse Technology, Inc.	3	○						
388	Ashland Inc.	3	○	○	○	○		○	
389	Citizens Communications Company	3	○		○				
390	Citrix Systems, Inc.	3	○			○		○	
391	Pinnacle West Capital Corporation	3	○	○	○	○			
392	Sealed Air Corporation	3	○	○					
393	UNUMProvident Corporation	3	○	○		○	○	○	
394	Alberto-Culver Company	3		○		○	○		
395	SUPERVALU Inc.	3	○	○	○	○	○		

< Japanese companies >

Nippon Paper Group, Inc. (4)

Nippon ... Insurance Co., Ltd. (4)

OLYMPUS Corporation (4)

Mitsui & Co., Ltd. (4), The Chugoku Electric Power Co., Inc. (4)

JSR Corporation (4), Funai Electric Co., Ltd. (4)

Yamaha Motor Co., Ltd. (4)

Kobe Steel, Ltd. (4)

Kajima Corporation (4)

Nippon Mining Holdings., Inc. (4)

Marubeni Corporation (4)

Hokkaido Electric Power Co., Ltd. (4), Obayashi Corporation (4), Toyota Tsusho Corporation (4)

Odakyu Electric Railway Co., Ltd. (4), Hirose Electric Co., Ltd. (4)

The Joyo Bank, Ltd. (3), Kaneka Corporation (3), Fuji Heavy Industries Ltd. (3)

Mitsui Chemicals, Inc. (3)

Nomura Research Institute, Ltd. (3), Kawasaki Kisen Kaisha, Ltd. (3)

Nippon Television Network Corporation (3), Teijin Limited (3)

Hokuriku Electric Power Company (3)

⑤ 時価総額30億ドル以上（その2） Aggregate market value: 3 billion dollars or over

<U.S. companies> ＜米国企業＞

順位	企業名 Companies	時価総額 market value (10億ドル) (billion dollars)	A	B	C	D	E	F	G
396	Toys "R" Us, Inc.	3			○				
397	Sanmina-SCI Corporation	3	○	○	○				
398	Mercury Interactive Corporation	3	○	○	○		○	○	
399	Sigma-Aldrich Corporation	3		○	○				
400	Fluor Corporation	3	○	○		○	○		
401	Applera Corporation - Applied Biosystems	3	○		○				○
402	Darden Restaurants, Inc.	3	○	○	○		○	○	
403	Tellabs, Inc.	3	○	○		○	○	○	
404	KB Home	3	○	○	○	○	○		○
405	Wendy''s International, Inc.	3	○	○	○	○	○		
406	Whirlpool Corporation	3	○	○	○	○	○		
407	Novellus Systems, Inc.	3	○						
408	The Stanley Works	3	○	○	○	○	○		
409	International Flavors & Fragrances Inc.	3			○				
410	Janus Capital Group Inc.	3	○	○	○	○	○		
411	Fisher Scientific International Inc.	3	○	○		○	○	○	
412	Goodrich Corporation	3	○	○	○		○		
413	Eastman Chemical Company	3	○	○	○	○	○	○	
414	Dow Jones & Company, Inc.	3		○					○
415	Unisys Corporation	3	○	○	○	○	○	○	
416	Pactiv Corporation	3	○	○	○				
417	Engelhard Corporation	3	○		○	○	○		
418	Temple-Inland Inc.	3	○	○	○	○	○		
419	Apartment Investment and Management Company	3	○	○			○	○	
420	Equifax Inc.	3	○	○	○	○	○		
421	Symbol Technologies, Inc.	3	○	○	○				
422	Monster Worldwide, Inc.	3	○						○
423	American Power Conversion Corporation	3			○			○	
424	SABRE Holdings Corporation	3	○	○		○	○	○	
425	CenterPoint Energy, Inc.	3	○		○	○	○		
426	Teradyne, Inc.	3	○	○	○	○	○		
427	Bausch & Lomb Incorporated	3	○	○		○	○	○	
428	Pall Corporation	3		○	○	○	○		
429	Ryder System, Inc.	3	○	○		○		○	
430	Hasbro, Inc.	3	○	○	○		○		
431	Circuit City Stores, Inc.	3	○		○	○			
354	NCR Corporation	4	○		○	○	○	○	

< Japanese companies > ＜日本企業＞

Mazda Motor Corporation (3),

Nippon Electric Glass Co., Ltd. (3), Taisei Corporation (3)

Sekisui Chemical Co., Ltd. (3), Nikon Corporation (3), The Bank of Fukuoka, Ltd. (3), Shimizu Corporation (3)

The Hachijuni Bank, Ltd. (3)

Toyo Seikan Kaisha, Ltd. (3), Keio Electric Railway Co., Ltd. (3)

Hankyu Corporation (3)

TOTO Ltd. (3)

Casio Computer Co., Ltd. (3), Pioneer Corporation (3), Mabuchi Motor Co., Ltd. (3), Yokogawa Electric Corporation (3)

CSK Corporation (3)

Yamada-Denki Co., Ltd. (3), Tobu Railway Co., Ltd. (3), Nissin Food Product Co., Ltd. (3)

Aioi Insurance Co., Ltd. (3), Keihin Electric Express Railway Co., Ltd. (3)

YAMAHA Corporation (3)

Tokyo Broadcasting System, Inc. (3), Nippon Meat Packers, Inc. (3)

ıted on the basis of an exchange rate of 105 yen to the dollar.
ties Co. Ltd.

⑥ Aggregate market value: 1 billion dollars or over

<U.S. companies>

Rank	Companies	Aggregate market value (billion dollars)

< Japanese companies >

The Hiroshima Bank, Ltd. (2)
The Nishi-Nippon City Bank, Ltd. (2)
Leopalace 21 Corporation (2)
Nagoya Railroad Co., Ltd. (2)
Stanley Electric Co., Ltd. (2)
Showa Denko K.K. (2)
Mitsubishi Motors Corporation (2)
Takashimaya Co., Ltd. (2)
Isuzu Motors Limited (2)
The Gunma Bank, Ltd. (2)
Tosoh Corporation (2)
Bank of Kyoto, Ltd. (2)
ISETAN Co., Ltd. (2)
Sapporo Hokuyo Holdings, Inc. (2)
NSK Ltd. (2)
Toyoda Gosei Co., Ltd. (2)
The Chugoku Bank, Ltd. (2)
Brother Industries, Ltd. (2)
Mitsukoshi Ltd. (2)
Shinko Securities Co., Ltd. (2)
The 77 Bank, Ltd. (2)
Oki Electric Industry Co., Ltd. (2)
Mitsubishi Materials Corporation (2)
The Iyo Bank, Ltd. (2)
Kawasaki Heavy Industries, Ltd. (2)
Alps Electric Co., Ltd. (2)
Taiheiyo Cement Corporation (2)
Diamond Lease Co., Ltd. (2)
The Daimaru, Inc. (2)
Suzuken Co., Ltd. (2)
Suruga Bank Ltd. (2)
The Yamaguchi Bank, Ltd. (2)
Nisshin Steel Co., Ltd (2)
UNY Co., Ltd. (2)
Yamazaki Baking Co., Ltd. (1)
Fuji Electric Holdings Co., Ltd. (1)
Nissay Dowa General Ins. (1)
The Hyakujushi Bank, Ltd. (1)
Sankyo Seiki Mfg. Co., Ltd. (1)
MEDICEO Holdings Co., Ltd. (1)
Dainippon Ink and Chemicals, Incorporated (1)
Cosmo Oil Co., Ltd. (1)
Seino Transportation Co., Ltd. (1)
Sumitomo Heavy Industries, Ltd. (1)
Ishikawajima-Harima Heavy Industries Co., Ltd (1)
Meiji Dairies Corporation (1)
Orient Corporation (1)

Note: Aggregate market value for Japanese companies is calculated on the basis of an exchange rate of 105 yen to the dollar.
Source: Compiled by METI based on data from Nomura Securities Co. Ltd.

⑥時価総額10億ドル以上（その1）

<米国企業>

順位	企業名	時価総額（10億ドル）	A	B	C	D	E	F	G
432	Cummins Inc.	2	○	○	○				
433	Federated Investors, Inc.	2	○	○					○
434	Humana Inc.	2	○	○	○				
435	Brown-Forman Corporation	2		○					○
436	Molex Incorporated	2	○	○		○	○		○
437	TECO Energy, Inc.	2	○	○	○	○		○	
438	Rowan Companies, Inc.	2	○	○	○	○	○		
439	King Pharmaceuticals, Inc.	2	○	○	○	○			
440	QLogic Corporation	2	○	○	○				
441	Watson Pharmaceuticals, Inc.	2	○	○		○		○	
442	Manor Care, Inc.	2	○	○	○		○		
443	Bemis Company, Inc.	2	○	○	○	○			
444	Louisiana-Pacific Corporation	2	○		○	○	○	○	
445	Novell, Inc.	2		○	○				
446	Allied Waste Industries, Inc.	2	○	○			○		
447	Boise Cascade Corporation	2	○	○	○	○	○	○	
448	Meredith Corporation	2	○	○		○	○	○	○
449	Adolph Coors Company	2	○						○
450	Tektronix, Inc.	2	○		○	○			
451	Convergys Corporation	2	○	○	○	○	○	○	
452	Allegheny Energy, Inc.	2	○	○	○				
453	PerkinElmer, Inc.	2	○		○			○	
454	NVIDIA Corporation	2	○	○		○		○	
455	The Millipore Corporation	2		○	○	○	○		
456	Reebok International Ltd.	2			○				
457	Dana Corporation	2	○	○	○				
458	Andrew Corporation	2		○	○				
459	Compuware Corporation	2	○	○	○				
460	Navistar International Corporation	2	○	○		○	○		
461	Deluxe Corporation	1		○	○				
462	Gateway, Inc.	1	○	○	○	○	○		○
463	Dynegy Inc.	1	○						○
464	LSI Logic Corporation	1	○	○	○				
465	ADC Telecommunications, Inc	1	○	○	○	○		○	
466	Worthington Industries, Inc.	1	○	○		○	○	○	
467	Crane Co.	1	○	○	○	○	○	○	
468	PMC-Sierra, Inc.	1	○		○				
469	The Goodyear Tire & Rubber Company	1	○	○		○	○	○	
470	Allegheny Technologies Incorporated	1	○	○	○	○	○	○	
471	Snap-On Incorporated	1	○	○	○	○	○		
472	Dillard"s, Inc.	1	○	○	○		○	○	
473	Nicor Inc.	1	○	○	○				
473	Nicor Inc.	1	○	○	○				
474	Peoples Energy Corporation	1	○		○				
475	Hercules Incorporated	1	○	○		○	○	○	

注：日本企業のドルベースの時価総額は、1ドル105円で計算した。

出所：野村證券資料より経済産業省作成

<日本企業>

広島銀行 (2)
西日本シティー銀行 (2)
レオパレス21 (2)
名古屋鉄道 (2)
スタンレー電気 (2)
昭和電工 (2)
三菱自動車 (2)
高島屋 (2)
いすゞ自動車 (2)
群馬銀行 (2)
東ソー (2)
京都銀行 (2)
伊勢丹 (2)
札幌北洋ホールディングス (2)
日本精工 (2)
豊田合成 (2)
中国銀行 (2)
ブラザー工業 (2)
三越 (2)
新光証券 (2)
七十七銀行 (2)
沖電気工業 (2)
三菱マテリアル (2)
伊予銀行 (2)
川崎重工業 (2)
アルプス電気 (2)
太平洋セメント (2)
ダイヤモンドリース (2)
大丸 (2)
スズケン (2)
スルガ銀行 (2)
山口銀行 (2)
日新製鋼 (2)
ユニー (2)
山崎製パン (1)
富士電機ホールディングス (1)
ニッセイ同和損害保険 (1)
百十四銀行 (1)
三協精機 (1)
メディセオホールディングス (1)
大日本インキ化学工業 (1)
コスモ石油 (1)
西濃運輸 (1)
住友重機械工業 (1)
石川島播磨重工業 (1)
明治乳業 (1)
オリエントコーポレーション (1)

⑥ Aggregate market value: 1 billion dollars or over

<U.S. companies>

Rank	(		A	B	C	D	E	F	G
476	CMS Energy Corporation	1	○	○			○		
477	Cooper Tire & Rubber Company	1	○	○	○	○	○	○	
478	CIENA Corporation	1	○	○	○	○			
479	Big Lots, Inc.	1	○						
480	Maytag Corporation	1	○	○	○	○	○		
481	Parametric Technology Corporation	1	○	○	○	○	○		
482	Great Lakes Chemical Corporation	1		○			○		
483	Applied Micro Circuits Corporation	1	○	○					
484	Calpine Corporation	1	○	○	○	○		○	

Note: Aggregate market value for Japanese companies is calculated on the basis of an exchange rate of 105 yen to the dollar.

Source: Compiled by METI based on data from Nomura Securities Co. Ltd.

< Japanese companies >

Sumisho Lease Co., Ltd. (1)
Sumitomo Forestry Co., Ltd. (1)
The Hokkoku Bank, Limited (1)
The Fuji Fire and Marine Insurance Company, Limited (1)
The Seiyu, Ltd. (1)
The Juroku Bank, Ltd. (1)
The Awa Bank, Limited (1)
The Higo Bank, Ltd. (1)
Ogaki Kyoritsu Bank, Ltd. (1)
The Hyakugo Bank, Ltd. (1)
Ebara Corporation (1)
Tokyu Land Corporation (1)
Mitsui Engineering & Shipping Co., Ltd. (1)
The Shiga Bank, Ltd. (1)
The Daishi Bank, Ltd. (1)
Ube Industries, Ltd. (1)
Toda Corporation (1)
San-In Godo Bank, Ltd. (1)
Nanto Bank, Ltd. (1)
The Kagoshima Bank, Ltd. (1)
Shikoku Bank, Ltd. (1)
The Musashino Bank, Ltd. (1)
Daio Paper Corporation (1)
Tomen Corporation (1)
The Bank of Nagoya, Ltd. (1)
The Yamanashi Chuo Bank, Ltd. (1)
The Bank of Ikeda., Ltd. (1)
The Fukui Bank, Ltd. (1)

⑥ Aggregate market value: 1 billion dollars or less

<U.S. companies>

Rank	(	(l	A	B	C	D	E	F	G
485	Visteon Corporation	0.8	○	○		○	○		
486	Power-One, Inc.	0.5	○	○	○	○	○	○	
487	Delta Air Lines, Inc	0.4	○	○	○				
488	Winn-Dixie Stores, Inc.	0.4				○	○	○	

Note: Aggregate market value for Japanese companies is calculated on the basis of an exchange rate of 105 yen to the dollar.

Source: Compiled by METI based on data from Nomura Securities Co. Ltd.

< Japanese companies >

The Keiyo Bank, Ltd. (0.9)
Nippon Shinpan Co., Ltd. (0.9)
Sojitz Holdings Corporation (0.9)
The Bank of Iwate, Limited (0.9)
Nishimatsu Construction Co., Ltd. (0.9)
HASEKO Corporation, Inc. (0.8)
Hanwa Co., Ltd. (0.8)
The Daiei, Inc. (0.8)
The Aichi Bank, Ltd. (0.8)
The Tokyo Tomin Bank, Limited (0.8)
Maeda Corporation (0.8)
The Yamagata Bank, Ltd. (0.8)
Tokyo Leasing Corporation (0.8)
The Toho Bank, Ltd. (0.8)
The Chukyo Bank, Ltd. (0.7)
The Kiyo Bank, Ltd. (0.7)
Akita Bank Co., Ltd. (0.7)
JACCS Co., Ltd. (0.7)
The Eighteenth Bank, Limited (0.7)
The Aomori Bank, Ltd. (0.7)
The Michinoku Bank, Ltd. (0.7)
The Daisan Bank, Ltd. (0.7)
The Oita Bank, Ltd. (0.7)
Snow Brand Milk Products Co., Ltd. (0.6)
Central Finance Co., Ltd. (0.6)
The Bank of Saga, Ltd. (0.6)
The Tochigi Bank, Ltd. (0.6)
Kanematsu Corporation (0.6)
Maruha Group Inc. (0.6)
Kanebo Ltd. (0.5)
The Miyazaki Bank, Ltd. (0.5)
The Towa Bank, Ltd. (0.5)
Kyushu-Shinwa Financial Group. (0.5)
Bank of Ryukyus, Limited (0.4)
Higashi-Nippon Bank, Ltd. (0.4)
Ehime Bank, Ltd. (0.4)

Reference 2-1

Types of Rights Plans

April 28, 2005

Ministry of Economy, Trade and Industry

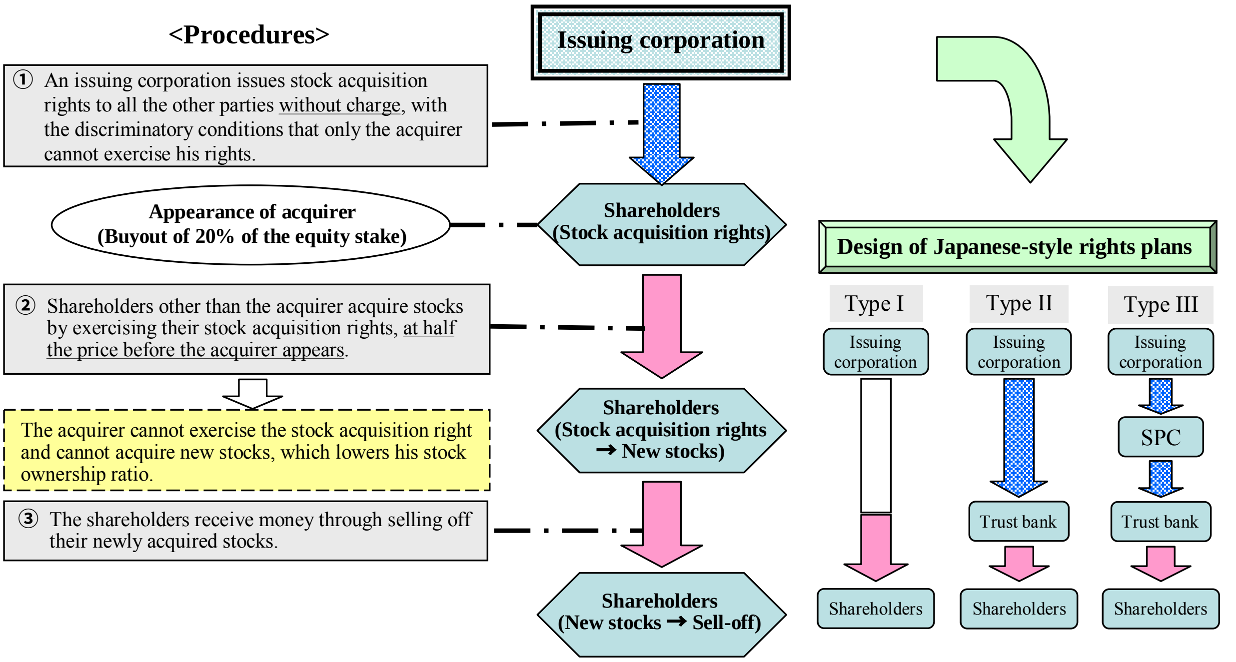
Rights Plans

[What is a rights plan?]

○ A rights plan is a defensive measure mechanism utilizing stock acquisition rights.

○ The mechanism will lower the stock ownership ratio of an acquirer through allocating stock acquisition rights to all other parties without charge, with the discriminatory conditions that only the acquirer (typically those who take up 20% of the equity stake) cannot exercise his rights, and allowing the other parties to acquire several stocks at half the price before the acquirer appears.

○ As the acquirer will negotiate with the company for the removal of the stock acquisition rights, this mechanism is not supposed to be put into execution (Even in the United States, where rights plans originated, the measure has never been executed).



[Points to remember in introducing a rights plan]

○ Under current Japanese rules, distribution of stock acquisition rights combined with stocks is not permitted (having no contingency). If stock acquisition rights are issued under usual conditions, an acquirer can collect only stock acquisition rights, which may weaken the plan's function as a defensive measure.

○ Considering the drawback mentioned above, possible types of rights plans in Japan are as follows (see the above-right flow-chart).

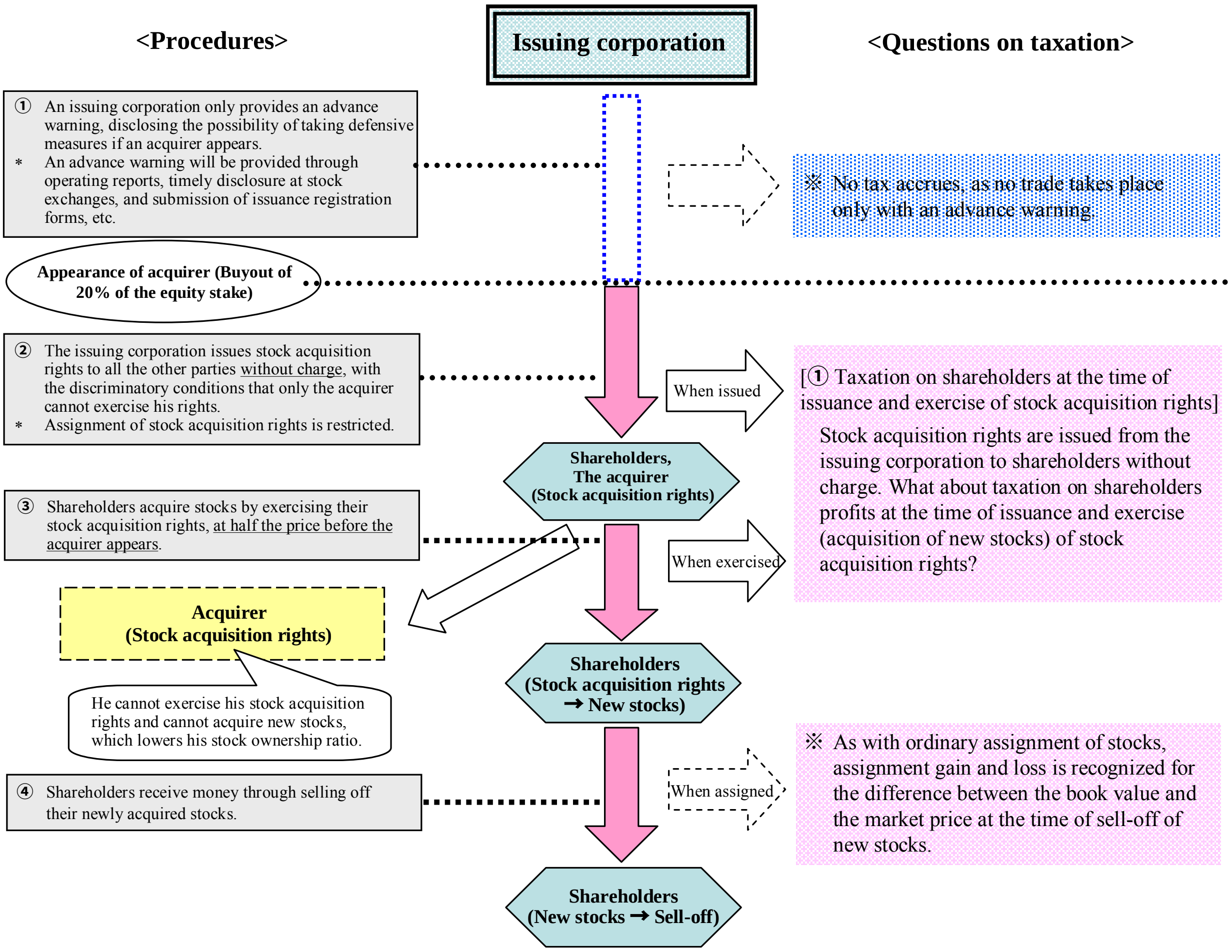
- [Type I] Only advance warning of a rights plan is provided under usual conditions, and stock acquisition rights are issued in a takeover contest.
- [Type II] Stock acquisition rights are lodged in trust accounts in a trust bank under usual conditions, and are issued to shareholders by the trust bank in a takeover contest.
- [Type III] Stock acquisition rights are issued to a Special Purpose Company (SPC), lodged in trust accounts in a trust bank by a SPC under usual conditions, and are issued to shareholders by the trust bank in a takeover contest.

○ Corporations introducing a rights plan are concerned especially about whether it is taxable under the usual conditions (before an acquirer appears). The taxation in a takeover contest (after an acquirer appears) is not recognized as an issue, because (1) rights plans are not supposed to be put into execution, and (2) even if executed, shareholders have already gained profits.

Concrete steps Type I Advance Warning Style Rights Plans

[Outline of defensive measure]

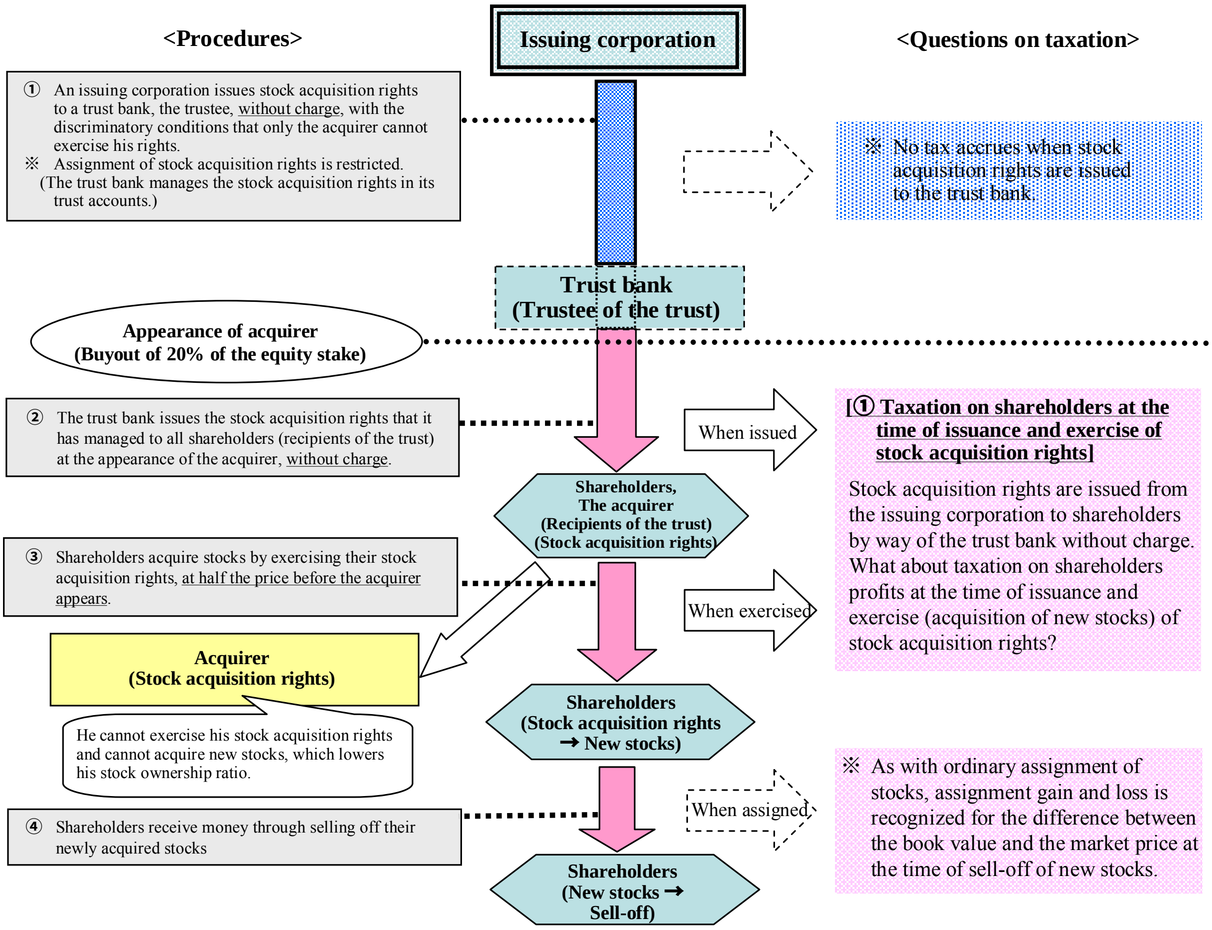
Defensive measures to be taken when an acquirer appears are disclosed, and an advanced warning is provided under the usual conditions. After an acquirer appears, according to the advanced warning, stock acquisition rights are allocated to all shareholders without charge, with the discriminatory conditions that only the acquirer cannot exercise his rights. Shareholders other than the acquirer are allowed to acquire new stocks at half the price before the acquirer appears, which as a result lowers the stock ownership ratio of the acquirer.



Concrete steps Type II Trust Style Rights Plans (Direct Style)

[Outline of a defensive measure]

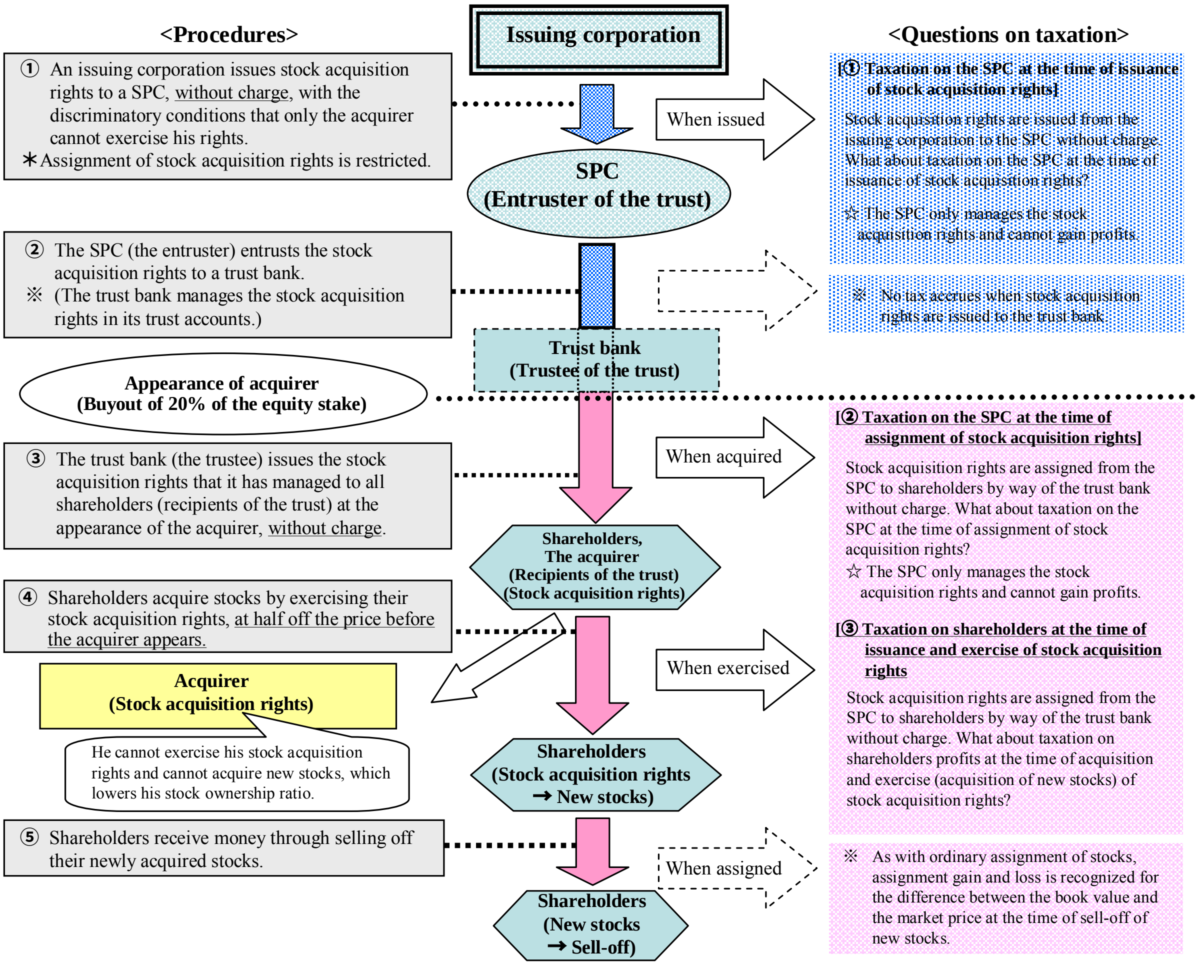
Under usual conditions, stock acquisition rights are issued to a trust bank without charge, with the discriminatory conditions that only the acquirer cannot exercise his rights. The trust bank manages the stock acquisition rights in its trust accounts for shareholders (recipients) in case of a takeover contest. After an acquirer appears (recipients are identified), the trust bank issues the stock acquisition rights to all shareholders (recipients) without charge, and allows the other parties except the acquirer to acquire stocks at half the price before the acquirer appears. As a result, the stock ownership ratio of the acquirer is lowered.



Concrete steps Type III Trust Style Rights Plans (SPC Style)

Outline of a defensive measure

Under usual conditions, stock acquisition rights are issued to a SPC without charge, with the discriminatory conditions that only the acquirer cannot exercise his rights. The SPC entrusts the stock acquisition rights to a trust bank. The trust bank manages the stock acquisition rights in its trust accounts for shareholders (recipients) in the case of a takeover contest. After an acquirer appears (recipients are identified), the trust bank issues the stock acquisition rights to all shareholders (recipients) without charge, and allows the other parties except the acquirer to acquire stocks at half off the price before the acquirer appears. As a result, the stock ownership ratio of the acquirer is lowered.

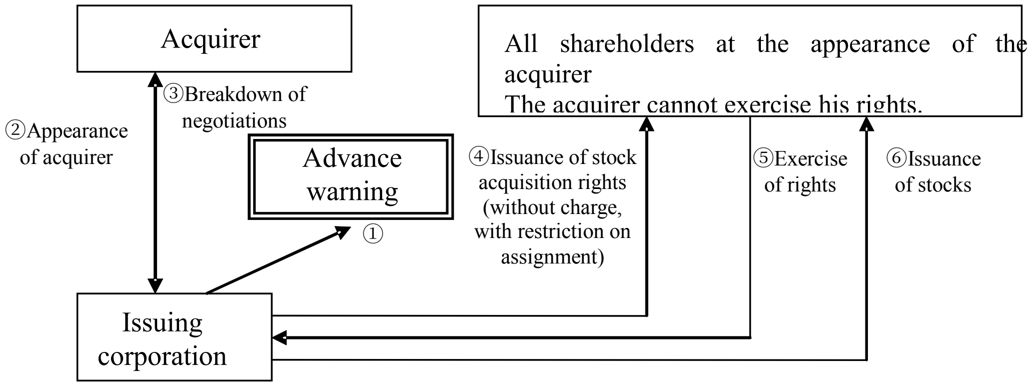


Reference 2-2		April 28, 2005 National Tax Agency

Principle Taxation with regard to Hostile Takeover Defense Measures utilizing Stock Acquisition Rights

(Related to Corporation Tax, Income Tax)

Tax Treatment for Advance Warning Style Rights Plans (Type I)

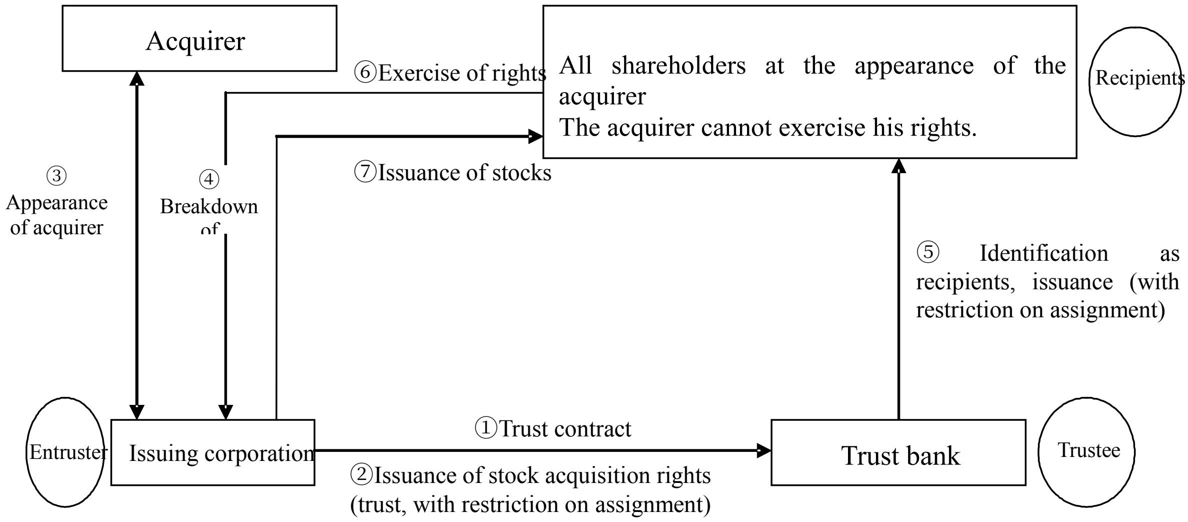


○ Principle taxation

Classification	Issuing corporation	Corporate shareholders that received issuance	Individual shareholders that received issuance
At the time of [Advance Warning]	—	—	—
At the time of ② and ③ (Appearance of acquirer, breakdown of negotiations)	—	—	—
At the time of ④ (Issuance of stock acquisition rights)	—	Issuance creates donated profits equivalent to the market price of stock acquisition rights	(Income Tax Law Enforcement Ordinance,
At the time of ⑤ and (Exercise of stock acquisition rights)	—	—	Tax is imposed to the difference between the market price and the exercise price (the amount paid at the exercise of stock acquisition

Note: If extinguishment, etc. of stocks occurs while holding stock acquisition rights, the corporate shareholders will have miscellaneous losses equivalent to the book value. If such extinguishment, etc. occurs in the same business year as the donated profits are created, tax is not imposed.

Tax Treatment for Trust Style Rights Plans (Direct Style) (Type II)



○ Principle taxation

Classification	Issuing	Trust bank	Corporate shareholders that received issuance	Individual shareholders that received issuance
At the time of ① and ② (Trust contract, Issuance of stock acquisition rights)	—	—	—	—
At the time of ③ and ④ (Appearance of acquirer, breakdown of negotiations)	—	—	—	—
At the time of ⑤ (Issuance of stock acquisition rights)	—	—	Issuance creates donated profits equivalent to the market price of stock acquisition rights	(Income Tax Law Enforcement Ordinance,
At the time of ⑥ and ⑦ (Exercise of stock acquisition	—	—	—	Tax is imposed to the difference between the market price and the exercise price (the amount paid at the exercise of stock acquisition

Note: If extinguishment, etc. of stocks occurs while holding stock acquisition rights, the corporate shareholders will have miscellaneous losses equivalent to the book value. If such extinguishment, etc. occurs in the same business year as the donated profits are created, tax is not imposed.