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**Fair M&A Guidelines**  
— Enhancing Corporate Value and  
Securing Shareholders' Interests —

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**June 28, 2019**

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### 1.1 Development of the Guidelines

On September 4, 2007, the Ministry of Economy, Trade and Industry (“**METI**”) issued the “Guidelines for Management Buyouts (MBO) to Enhance Corporate Value and Ensure Fair Procedures” (the “**MBO Guidelines**”). At the time, a reasonable number of MBO precedents had been accumulated and certain systemic approaches had developed, and in that context the MBO Guidelines proposed practical measures and a summary of views, including general principles, as approaches for fair rules for MBOs. The purpose of the MBO Guidelines was to establish best practices for Japanese corporate society and further the healthy development of MBOs in Japan by exploring practical approaches to fair MBOs.

More than ten years have passed since the MBO Guidelines were issued. During this ten-year period, there have been many M&A transactions in Japan, including MBOs; debate and understanding regarding fair M&A have deepened, and knowledge with respect to effective practical measures obtained through experience has been acquired. The legal system and listing rules related to M&A have been reformed and refined, and principles established by legal precedent have evolved. In addition, there have been significant social and economic changes involving listed companies in Japan, such as the advancement of corporate governance reform, exemplified by an increase in the number of outside directors, and changes in share ownership structures. Taking into account these circumstances, some observers have noted that it is time to consider revising the MBO Guidelines.

In addition, observers have called for a discussion of the significance of, and issues with respect to, M&A transactions other than MBOs, such as acquisitions of a controlled company by the controlling shareholder, where issues with respect to structural conflicts of interest exist.

In response to these views, in November 2018, METI launched the “Fair M&A Study Group” (chairperson: Hideki Kanda, professor of Law at Gakushuin University Law School; a full list of group members is set forth in Attachment 1) (the “**Study Group**”), composed of representative experts of various quarters, including corporate law scholars, institutional investors, businesspersons, and lawyers etc, to evaluate whether it was necessary to revise the MBO Guidelines and the future direction of such revisions, from the perspective of approaches to fair M&A in Japan, taking into account the actual experience of Japanese companies since the development of the MBO Guidelines, as well as changes in the Japanese business environment. The study group met on seven occasions, until April 2019, and while considering foreign legal systems and practices and the opinions and views offered by both domestic and foreign parties, deliberated with the goal to further the healthy development of M&A in Japan (the chronology of the discussions is set forth in Attachment 2).

Based on the Study Group’s discussions, METI has revised the MBO Guidelines and is issuing these Guidelines, once again presenting a summation of views (including general

principles) and practical measures based on such views, as approaches for fair M&A to be shared in Japanese corporate society, focusing particularly on MBOs and acquisitions of a controlled company by the controlling shareholder.

## **1.2 Significance of these Guidelines**

The purpose of these Guidelines is to present approaches for fair M&A in Japanese corporate society, mainly from a procedural perspective, with a focus on MBOs and acquisitions of a controlled company by the controlling shareholder.

Amidst the disruptive changes in the business environment and growing complexity of management issues encountered today by Japanese companies, it is becoming more important for each company to effectively utilize M&A, achieve sustainable growth by strengthening business models and core businesses toward optimization of business portfolios, and thereby realize the optimal allocation of management resources throughout Japan.

M&A transactions are transactions involving the control of a company which has many stakeholders. With the continuing globalization of corporate activities and capital markets in Japan, clarifying approaches to fair M&A that comply with the requirements of the Japanese legal system and social norms while also responding to the expectations of stakeholders both within and outside Japan, including international investors, and earning the understanding and trust of such stakeholders, and also aiming to form a consensus among the members of Japanese corporate society, will promote value-creating M&A by enhancing predictability in the M&A process and contribute to the sound development of M&A practices in Japan. Further, such clarification will raise confidence in the Japanese capital market, and attract mid-to-long term investment in Japanese companies in the competitive global market.

## **1.3 Position of these Guidelines**

These Guidelines have essentially the same position as the previous MBO Guidelines.

In other words, the principles and practical measures set forth in these Guidelines are proposed not for the purpose of imposing new regulations on M&A, but to identify essential points to consider in order to promote the development of M&A transactions which have economic significance, while ensuring fairness in M&A. In order to promote the healthy development of M&A in Japan, these Guidelines present approaches for fair M&A intended to establish best practices in Japanese corporate society, taking into account the actual experience of Japanese companies since the development of the MBO Guidelines.

Further, the principles and practical measures set forth in these Guidelines are not presented with the direct intention of establishing a clear position under the Companies Act; instead, they should be regarded from a broader perspective as best practices for approaches to fair M&A to

be shared in corporate society. Therefore, these Guidelines are not, for example, intended to clarify the relationship between whether to take each of the Fairness Ensuring Measures set forth in Chapter 3 and the legality of M&A transactions.<sup>1</sup>

#### **1.4 Scope of these Guidelines and Relevance to Discussions of Other Types of Transactions**

The scope of these Guidelines includes MBOs and acquisitions of a controlled company by the controlling shareholder, where issues with respect to structural conflicts of interest and information asymmetries typically exist (see Section 2.1.2 below).

In this regard, it has been observed that there may be a certain degree of structural conflicts of interest or information asymmetries even in M&A transactions that are not within the scope of either transaction type.<sup>2</sup> The scope of these Guidelines is limited fundamentally to these two types of transactions, where typically the issues of structural conflicts of interest and information asymmetries are considered to be particularly significant, and other transaction types are not the direct subject of the Guidelines; however, even with respect to M&A transactions that do not fall within either of the above transaction types, in cases where issues with respect to structural conflicts of interest or information asymmetries exist to some extent, depending on the degree of such issues, referring to these Guidelines may contribute to ensuring the fairness of such M&A transactions and be useful in fulfilling the duty to explain such fairness to general shareholders, investors and others.

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<sup>1</sup> In addition to their relationship with the legality of M&A transactions described in the main text, these Guidelines are not, for example, directly intended to reconcile the relationship between whether to take each of the Fairness Ensuring Measures set forth in Chapter 3 and (i) the interpretation of “fair price” under the Companies Act and the review by courts of “fair price,” or (ii) the duty of care and the duty of loyalty of directors of the target company. However, when the Fairness Ensuring Measures set forth in Chapter 3 are implemented effectively, the likelihood that the transaction terms agreed upon between parties are respected in the court’s decision on “fair price” will be expected to increase, and it is anticipated that breaches by the directors of the target company of their duty of care or duty of loyalty usually will not be found.

<sup>2</sup> For example, it has been observed that conflicts of interest may exist to some extent in acquisitions of substantial control of a company by a third-party allotment of shares to certain parties, including major shareholders, or by a partial tender offer by parties such as major shareholders. It has also been observed that the use of a Special Committee in connection with the adoption of measures against a hostile takeover should be discussed. It is hoped that, in the future, approaches for fair M&A of these types will be further debated.

## 1.5 Meaning of Terms Used in These Guidelines

- a) “**MBO**” (Management Buyout) means the acquisition of a target company’s shares from general shareholders that is funded in whole or in part by the current management’s investment, on the premise that the business will be continued.<sup>3</sup>

Although there are two types of MBOs, MBOs of listed companies and MBOs of non-listed companies, the scope of these Guidelines is limited to MBOs for the delisting of listed companies, in which shares are widely dispersed and held by many and unspecified investors, and issues with respect to protecting the interests of shareholders are more likely to arise.

In addition, given current practices in Japan, these Guidelines mainly cover so-called “two-step transactions,” in which, using cash as the acquisition consideration, initially a tender offer is conducted and subsequently the remaining outstanding shares of the target company are acquired through a squeeze out process. However, these Guidelines also apply to cases where a target company acquires its own shares as a first-step transaction in lieu of or in conjunction with a tender offer by an acquiring party, and to cases where all shares in a target company are acquired through a one-step transaction, such as a reverse stock split.

- b) “**Acquisition of a controlled company by the controlling shareholder**” means an acquisition by the controlling shareholder of a controlled company of all shares of the controlled company from general shareholders.

Although there are cases where a controlled company acquired by the controlling shareholder is not a listed company but a non-listed company, the scope of these Guidelines is limited to acquisitions that focus on the delisting of a listed company, in which shares are widely dispersed and held by many and unspecified investors, and issues with respect to protecting the interests of shareholders are more likely to arise.

With respect to the method of acquisition, these Guidelines are applicable to so-called “two-step transactions,” in which initially a tender offer is conducted and subsequently the remaining outstanding shares of the controlled company are acquired through squeeze out process, and to acquisitions such as corporate reorganizations, including share exchanges, and reverse stock splits, where all shares of a controlled company are acquired in one step. In addition, with respect to the types of acquisition consideration, the scope of these Guidelines includes both cases where cash is used as the acquisition consideration and cases where the controlling shareholder is a listed company and its shares are used as the acquisition consideration.

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<sup>3</sup> See Corporate Value Study Group, “The Corporate Value Report 2006: Toward the firm establishment of fair rules in the corporate community,” p. 45 (March 31, 2006).

- c) **“Controlling shareholder”** means, in principle, a controlling shareholder as defined in the Securities Listing Regulations of the Tokyo Stock Exchange, Inc.<sup>4</sup> However, the actual application of this definition is expected to be determined substantively on a case-by-case basis, taking into account the spirit of these Guidelines, and with consideration of factors such as the existence and degree of conflicts of interest and information asymmetries, and the existence of other major shareholders of the target company.
- d) **“General shareholders”** are shareholders of a target company, and exclude (i) the acquiring party and (ii) shareholders who share significant interests with the acquiring party with respect to the relevant M&A.
- e) **“Corporate value”** means a company’s assets, profitability, stability, efficiency, growth potential, and other attributes of a company, and the extent thereof, that contribute to the interests of shareholders,<sup>5</sup> and conceptually, the aggregate discounted net present value of the cash flow generated by the company.<sup>6, 7</sup>

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<sup>4</sup> “A controlling shareholder” is defined as “a parent company or an organ specified by the Enforcement Rules as organ which directly or indirectly hold a majority of the voting rights” in the Securities Listing Regulations of the Tokyo Stock Exchange, Inc. (Rule2, Item 42-2 of the Securities Listing Regulations), and specifically refers to an organ that meets one of the following requirements (Article 2, Item 2 of the Securities Listing Regulations; Article 8, Paragraph 3 of the Regulation on Terminology, Forms, and Preparation Methods of Financial Statements; Article 3-2 of the Enforcement Rules for Securities Listing Regulations; and Article 163, Paragraph 1 of the Financial Instruments and Exchange Act).

- (a) A parent company (a company, etc. that has control over the body that decides the financial and operational or business policies of another company, etc. (the body means the ensemble of shareholders at a shareholders’ meeting or any other bodies equivalent thereto))
- (b) A main shareholder (a shareholder holding 10 percent or more of the voting rights of all shareholders, in its own name or in the name of others, but excluding the parent company) who holds the majority of voting rights of a listed company after combining the voting rights held for its own account and the voting rights held by any of the entities specified in each of the following items:
  - (i) A close relative of said main shareholder (meaning a relative within the second degree of kinship); and
  - (ii) A company, etc. (meaning a company, designated corporation, partnership, or other similar entities (including foreign entities that are equivalent to these entities) whose majority voting rights are held by said main shareholder and the close relative specified in the preceding item, and a subsidiary of said company, etc.

<sup>5</sup> METI and Ministry of Justice, “Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholders’ Common Interests,” p. 2 (May 27, 2005).

<sup>6</sup> Corporate Value Study Group, “Takeover Defense Measures in Response to Recent Environmental Changes,” p. 1 (June 30, 2008).

<sup>7</sup> According to the “Corporate Value Report: Proposal toward Establishment of Rules for Fair Business Community” (May 27, 2005) by the Corporate Value Study Group, corporate value is the sum of the shareholders value that belongs to shareholders and the value that belongs to a wide range of



- f) **“Transaction terms”** are the terms of an M&A transactions, and typically include the acquisition price in an M&A transaction where the acquisition consideration is cash and the share exchange ratio in an M&A transaction where the acquisition consideration is shares.
  
- g) **“Fairness Ensuring Measures”** means practical measures that contribute to ensuring the fairness of transaction terms. Typical measures that are generally considered to be highly effective Fairness Ensuring Measures are addressed in Sections 3.2 to 3.7 below.

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stakeholders. Further, increases in contributions by stakeholders to a company can lead to long-term increases in corporate value.

## Chapter 2 Principles and Basic Perspectives

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This chapter first summarizes the significance of, and issues with respect to, MBOs and acquisitions of a controlled company by the controlling shareholder, as well as basic issues regarding acquisition consideration, in order to clarify the principles to be respected in the conduct of these types of transactions and the basic perspectives when considering practical methods to effect these principles.

### 2.1 Significance of and the Issues with Respect to MBOs and Acquisitions of a Controlled Company by the Controlling Shareholder

These Guidelines set forth approaches to fair M&A for MBOs and acquisitions of a controlled company by the controlling shareholder, since while each of these types of transactions is recognized to have economic significance, there are also distinctive issues, and it is expected that specific practical measures will be taken to ensure procedurally the realization of fair M&A.

#### 2.1.1 Significance of these Types of Transactions

MBOs and acquisitions of a controlled company by the controlling shareholder have economic significance of the kind described below.

It has been observed that these types of transactions result in changes to the shareholder composition of the target company, with equity ending up controlled by management or a controlling shareholder familiar with the target company's business. The economic significance of these transactions is that they can facilitate flexible management strategies based on long-term perspective freed from the expectations and pressure of the capital market to realize short-term profits, restructuring of business models with bold business reforms, flexible changes in business portfolios, and shareholder monitoring of the target company's management. Specifically, in the case of so-called "parent-subsidary listings," where a listed parent company converts a listed subsidiary into a wholly-owned subsidiary, it has been observed that this is an effective method to resolve the tension between the goals of total optimization of the group as a whole and partial optimization of the listed subsidiary, and thereby maximize the corporate value of the group through the implementation of dynamic, efficient group management.<sup>8</sup>

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<sup>8</sup> It is possible for acquisitions of a controlled company by the controlling shareholder to be used as a transaction that resolves structural conflicts of interest between the controlling shareholder and general shareholders. See "6. Corporate governance system of listed subsidiaries" of the "Practical Guidelines for Group Governance Systems" (June 28, 2019) issued by METI. ([https://www.meti.go.jp/policy/economy/keiei\\_innovation/keizaihousei/pdf/ggs/190628ggsguideline.pdf](https://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/ggs/190628ggsguideline.pdf))

It has also been observed that, within the lifecycle of an enterprise, when it is no longer appropriate for a company to remain listed, the delisting of the company through an MBO or an acquisition of a controlled company by the controlling shareholder enables companies to realize a capital structure appropriate for that company's particular circumstances.

Further, it has been observed that, for general shareholders of the target company, if there is an opportunity to sell the company's shares at a price that exceeds the market price, such an opportunity also has significance.

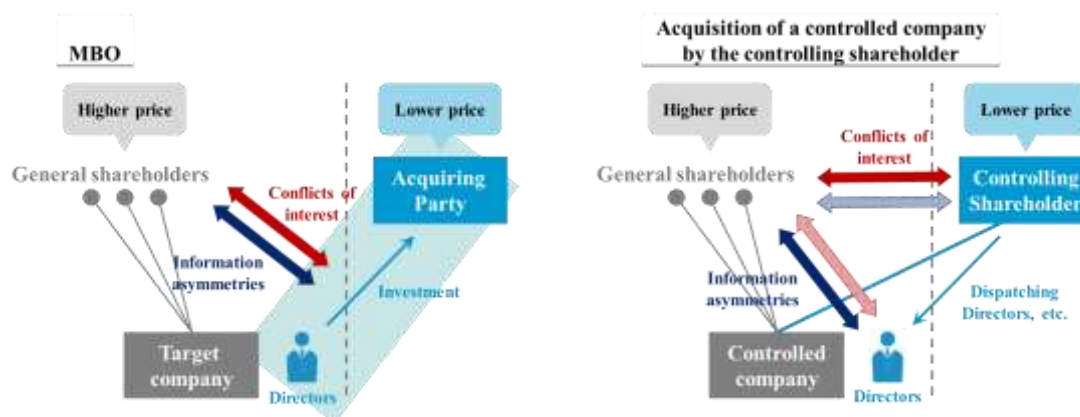
It is desirable that MBOs and acquisitions of a controlled company by the controlling shareholder that have economic significance of the type described above can be utilized effectively to increase the corporate value of the relevant companies.

### **2.1.2 Issues with Respect to the Two Types of Transactions**

On the other hand, MBOs and acquisitions of a controlled company by the controlling shareholder also present issues as described below.

Generally, in a typical M&A transaction conducted between mutually independent parties, directors of the parties are expected to act in the interests of their company and its shareholders; in other words, directors are expected to evaluate the merits of an M&A transaction from the perspective of whether the transaction will increase the company's corporate value, and to use reasonable efforts to ensure that the transaction is conducted based on the best possible transaction terms for the company and its shareholders. Accordingly, the relevant M&A transaction is expected to be conducted under transaction terms that increase the corporate value of the relevant companies and fairly distribute the increase in corporate value among the parties (hereinafter referred to as "**fair transaction terms**").

However, in the case of MBOs and acquisitions of a controlled company by the controlling shareholder, since there is a conflict of interest in the structure of each transaction, we cannot expect that the directors of the target company will, as a matter of course, act as mentioned above.



More specifically, in MBOs, one or more directors of the target company will acquire the target company’s shares from general shareholders, and since such directors, as purchasers, have a direct interest in lowering the acquisition consideration, a structural conflict of interest inevitably arises between such directors and general shareholders, as sellers of the shares.

In addition, with respect to acquisitions of a controlled company by the controlling shareholder, where there is a conflict of interest between the controlling shareholder and general shareholders who are in a buyer-seller relationship,<sup>9</sup> it has been observed that there is a risk that the directors of the controlled company will prioritize the interests of the controlling shareholder over the interests of general shareholders or that the controlling shareholder will unilaterally determine transaction terms that are advantageous to itself, since the controlling shareholder has the power to exert influence over the management of its subordinate company by exercising voting rights at a general meeting of shareholders, dispatching directors, and other actions.

In addition, since in each of these types of transactions, directors or controlling shareholders buying shares generally have a significant amount of accurate information about the target company compared to general shareholders selling the shares, there is a huge informational asymmetry between the acquiring parties and general shareholders. Moreover, it cannot be expected that the parties will voluntarily transfer information.

As described above, issues with respect to structural conflicts of interest and information asymmetries exist in these types of transactions. Therefore, general shareholders, who will lose their status as shareholders as a result of these transactions, may become concerned or suspicious that the interests of the acquiring party are being prioritized over the interests of

<sup>9</sup> According to “6.1.3 Structural Conflicts of Interest of Listed Subsidiaries” of the “Practical Guidelines for Group Governance Systems” (June 28, 2019) issued by METI, when (i) direct transactions, (ii) transfers of business departments or arrangements between related businesses, or (iii) transactions that result in an organ becoming a wholly-owned subsidiary, are conducted between a listed subsidiary and its parent company, conflicts of interest that occur between the parent company and general shareholders of the listed subsidiaries can, depending on the transaction terms, harm the interests of general shareholders. For this reason, it is necessary to implement measures to fully consider the interests of general shareholders by the establishment of an effective governance system in the listed subsidiaries. These Guidelines present approaches to fair transactions described in (iii) above, in which issues of such conflicts of interest could become very serious.

general shareholders, or that the acquiring party is using its information advantage to conduct M&A under adverse transaction terms designed to allow the acquiring party to wrongfully enjoy benefits that should accrue to general shareholders.<sup>10</sup>

In order to dispel these concerns or suspicions, in MBOs and acquisitions of a controlled company by the controlling shareholder, increases in corporate value and realization of fair transaction terms should be ensured by addressing the issues with respect to structural conflicts of interest and information asymmetries described above through the adoption of special practical measures in connection with the M&A process and provision of information to general shareholders.

### **2.1.3 Differences Between the Two Types of Transactions**

This section discusses the differences between MBOs and acquisitions of a controlled company by the controlling shareholder.

First, there are structurally important differences between the two types of transactions. Specifically, in acquisitions of a controlled company by the controlling shareholder, the acquiring party is a controlling shareholder which is already in possession of a controlling interest in the target company before the relevant M&A, whereas in MBOs, the acquiring party is one or more directors who do not necessarily have such a controlling interest.<sup>11</sup>

Further, in MBOs, as directors of the target company themselves are the acquiring party, and have a direct interest in lowering the acquisition consideration, there is a direct conflict of interest between the directors and general shareholders. In addition, the directors can freely access the internal information of the target company. In acquisitions of a controlled company by the controlling shareholder, directors of the controlled company do not have a direct interest in lowering the acquisition consideration, but only can be affected by conflicts of interest between the controlling shareholder and general shareholders through the influence of the controlling shareholder on the directors of the controlled company. Additionally, even a shareholder which holds a controlling interest does not necessarily have all of the controlled company's internal information. It has also been observed that even a controlled company is independently managed as a listed company and does not necessarily follow instructions of the

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<sup>10</sup> For example, there has been concern at times expressed by general shareholders that as a result of the information asymmetries described in the main text, directors and controlling shareholders familiar with the target company's internal information may have conducted M&A transactions at a time when the market share price of the target company was temporarily undervalued compared to its intrinsic value, for the sole purpose of pursuing their own profits, even though such transaction lacked necessity and rationality from the standpoint of increasing corporate value. In the case of MBOs in particular, it has been observed that a number of business restructuring measures that are planned after MBOs are actually feasible without delisting while continuing operations as a listed company, and that MBOs should have a positive purpose that is sufficient to dispel such concerns.

<sup>11</sup> See Note 25) for the differences in transaction types.

controlling shareholder. Thus, issues with respect to structural conflicts of interest or information asymmetries that exist in MBOs are not identical to the issues that arise with respect to acquisitions of a controlled company by the controlling shareholder.

On the other hand, it has been observed that in acquisitions of a controlled company by the controlling shareholder, since the controlling shareholder, as the acquiring party, already holds a higher percentage of voting rights before the relevant M&A, the risk that the controlling shareholder will unilaterally determine transaction terms that are advantageous to itself and the interests of general shareholders of a controlled company will be harmed is higher than with MBOs. Therefore, it is necessary to evaluate these transactions more closely than MBOs. It has also been observed that in acquisitions of a controlled company by the controlling shareholder, it cannot be assumed as a matter of course that the management of the controlled company will function independently; acquisitions of a controlled company by the controlling shareholder are final transactions that terminate the ongoing relationship where the current shareholders of the controlled company supervise its directors, as contrasted with ordinary transactions between the controlling shareholder and a controlled company, which occur in circumstances where such relationship will continue thereafter.<sup>12</sup>

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<sup>12</sup> In addition to the differences noted in the main text, it has been observed that, while the possibility of competing bidders can be expected in MBOs (where management who participate in an acquisition are not controlling shareholders), in the case of acquisitions of a controlled company by the controlling shareholder, the opportunity to reap the benefits that should be enjoyed by general shareholders of the controlled company are limited, as it is often difficult in practice to expect that competing bidders will participate. On the other hand, it has been observed that in the case of MBOs, the target company can use the existence of other possible competing bidders as a bargaining chip in negotiations with the acquiring management, but in the case of acquisitions of a controlled company by the controlling shareholder, the bargaining power of a controlled company may be weak, as the counterparty against which the controlled company negotiates is often limited to the controlling shareholder.

In addition, in the case of acquisitions of a controlled company by the controlling shareholder, it has been observed that there is a difference in the prior awareness by general shareholders of the potential risks and the necessity of protection of general shareholders, compared to MBOs in which general shareholders of the target company do not expect the target company to be acquired through an MBO, as general shareholders of a controlled company are aware when they invest of the existence of the controlling shareholder and the laws and regulations that apply in such situations, and nonetheless remain shareholders of the controlled company. Further, it has been observed that general shareholders of the controlled company may have originally acquired the shares at a depreciated share price, that the controlled company benefits from the reputation of the controlling shareholder, or that certain general shareholders of the controlled company may have acquired the shares with the expectation that the controlled company will be acquired by the controlling shareholder. On the other hand, it has been observed that rather than allowing the share price of the controlled company to be decreased reflecting the risk that the company will be acquired by the controlling shareholder under unfair transaction terms, it is desirable from the perspective of safeguarding the market capitalization of the target company, and therefore social wealth, to have a situation where the share price reverts to a price that does not incorporate such risk by protecting general shareholders from such risks. It has been further observed that it is a fundamental obligation that even in the case of controlled companies the interests of general shareholders are to be protected, given that the shares of the controlled companies are listed and general investors are allowed to freely sell and purchase their shares.

Taking into account the foregoing, while it is necessary to consider differences in transaction structure between MBOs and acquisitions of a controlled company by the controlling shareholder, and differences therein with respect to structural conflicts of interest and information asymmetries, when it comes to the need for special practical measures to ensure increases in corporate value and the realization of fair transaction terms, there is not necessarily a general, categorical difference between these two types of transactions.<sup>13</sup>

## **2.2 Basic Issues Regarding Acquisition Consideration**

As described above, in MBOs and acquisitions of a controlled company by the controlling shareholder, special practical measures should be taken to ensure corporate value increases and fair transaction terms are achieved, specifically transaction terms that fairly distribute the increase in corporate value to general shareholders. As a premise for the evaluation of such practical measures, it is useful to clarify views with respect to the value to be realized in M&A transactions and the benefits that should be enjoyed by general shareholders. The basic concepts involved in addressing these issues are set forth below.

### **2.2.1 Concepts Regarding the Value Realized in M&A**

Theoretically, the value realized in an M&A transaction can be separated into two types: (a) value that can be realized without executing the M&A transaction, and (b) value that cannot be realized without executing the M&A transaction.<sup>14</sup>

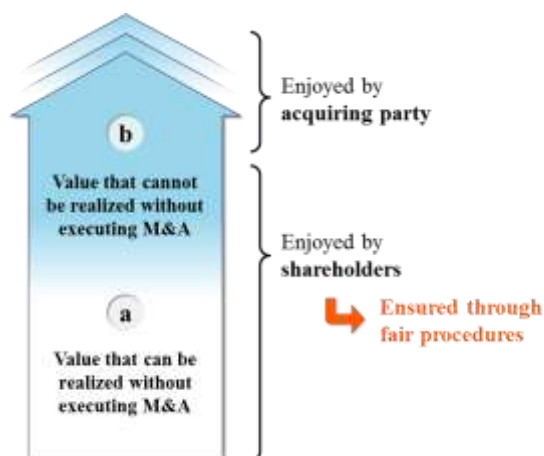
The values of (a) and (b) above should be enjoyed by all shareholders in accordance with the number of shares held by each shareholder. In cases where an M&A transaction is conducted through a squeeze out of general shareholders, theoretically and conceptually, value that can be realized without executing the transaction (case (a) above) should be enjoyed by all shareholders, including general shareholders in accordance with the number of shares held by

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<sup>13</sup> However, due to the structural differences between these types of transactions, in the case of acquisitions of a controlled company by the controlling shareholder, certain Fairness Ensuring Measures do not function effectively or are of serious concern with respect to adverse effects or other difficulties. With respect to such measures, it may be appropriate to take into account differences in transaction types. Therefore, from Section 3.2 of the main text, such measures are organized with consideration for the differences in transaction types.

<sup>14</sup> In MBOs, theoretically, synergies such as those that occur in business combinations do not occur just as the result of the MBO, but cost reduction effects resulting from the removal of general shareholders (i.e., the elimination of costs related to mediating the interests of general shareholders and disclosure costs), and value created through the efforts of management who contribute human capital in MBOs as a result of changes in incentive structures, are considered to be included in the value of (b), which cannot be realized without executing the M&A transaction. In addition, in the case of MBOs in which management jointly conduct transactions with investment funds, management efficiencies generated through the support of the investment funds and synergies generated with other operating companies under the control of the investment funds may also be included in the value of (b).

such shareholders.<sup>15</sup> On the other hand, with respect to value that cannot be realized without executing the transaction (case (b) above), although general shareholders will be squeezed out by the transaction, it is fair that general shareholders should also enjoy an appropriate portion of such value.<sup>16</sup>



## 2.2.2 Discussion of Actual Cases

As described above, although value realized in M&A transactions can be conceptualized, it is difficult in actual cases to strictly and objectively distinguish and determine the values of (a) and (b) above, as well as to determine to what extent the value of (a) is reflected in the market price before an M&A transaction is announced.<sup>17</sup> In addition, with respect to the value of (b),

<sup>15</sup> For example, profits from the sale of idle assets with large unrealized gains can be achieved without executing an M&A transaction, and should be enjoyed by all shareholders rather than monopolized by acquiring parties. In addition, value expected to be realized through business alliances with other companies after the M&A transaction can be distinguished in terms of whether such business alliance could be realized through an M&A transaction or could be formed without the M&A transaction theoretically (although it is difficult to determine in practice). In the latter case, value should not be monopolized by acquiring parties, and should be enjoyed by all shareholders.

<sup>16</sup> Under the Companies Act, the purchase price of shares in appraisal litigation (i.e., litigation with respect to the rights of dissenting shareholders to demand that a target company purchase their shares at a fair price) in connection with a corporate reorganization is determined to be a “fair price” (such as Article 785 Paragraph 1 of the Companies Act). Such price is interpreted as: (i) the price of the shares held on the record date where the corporate reorganization resulted in an increase in corporate value and, assuming the corporate reorganization was conducted under fair transaction terms, where that increase will be fairly distributed to the shareholders of the respective companies on the record date, and (ii) if the corporate reorganization did not result in an increase in corporate value, the price of shares that would have been held on the record date if there had been no resolution at the general meeting of shareholders approving the corporate reorganization. The prices to be determined by the courts in the case of a cash-out of shareholders by methods other than corporate reorganization are also similarly interpreted.

<sup>17</sup> Value that can be realized through the application of existing management resources held prior to the M&A transaction is included in the value of (a), which can be realized without executing the M&A transaction, even if the value is not actually realized. In this respect, it has been observed that although



there is a certain range in the value that general shareholders should enjoy, and it is difficult to create a singular and objective standard for determining what portion should be allocated to general shareholders. Therefore, it is difficult to establish directly a methodology for determining reasonable acquisition consideration in actual cases based on the theoretical concept described above, or to establish any singular or objective criteria such as, “the premium is fair if over x%” compared with the market price of the shares.

Therefore, it is not appropriate to establish any singular or objective criteria for transaction terms, including the acquisition consideration; instead, guidance should be provided with respect to procedures to ensure the fairness of transaction terms (such procedures are hereinafter referred to as “**fair procedures**”) and, by executing M&A transactions in accordance with such procedures, that general shareholders secure the fair return that they deserve (such returns are hereinafter referred to as the “**returns deserved by general shareholders**” or the “**interests of general shareholders**”).

### 2.2.3 Types of Acquisition Consideration

It has been observed that where cash is used as the acquisition consideration, a portion of the value of (b), which is to be realized after an M&A transaction, to be enjoyed by general shareholders of the target company will be cashed out at the time of the transaction and delivered to general shareholders. On the other hand, if shares of the acquiring company are used as the acquisition consideration, general shareholders of the target company will be offered an opportunity to continue holding shares as a shareholder of the acquiring company after the transaction, and can enjoy the value of (b) through their subsequent holding of such shares.

However, even if shares of the acquiring company are used as the acquisition consideration, when the transaction terms, for example, the share exchange ratio, are not fair (specifically, when the number of shares of the acquiring company that general shareholders of the target company receive is insufficient), the value of (b) which general shareholders of the target company will enjoy after the transaction through holding shares in the acquiring company will be significantly reduced; in that sense, the issues with respect to fairness of transaction terms are the same as cases where cash is used as the acquisition consideration. Therefore, the nature of the acquisition consideration does not necessarily result in a difference in the importance of

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the value of (a) is expected to be fully realized prior to the delisting of a target company through an MBO or an acquisition of a controlled company by the controlling shareholder, it is often not fully realized during the period in which the company continues as a listed company, and this situation is the basis for price formation in the stock market.

ensuring that the interests of general shareholders are protected in M&A through fair procedures.<sup>18</sup>

### 2.3 Principles to Be Respected in Conducting M&A

Taking into account the foregoing discussion, the followings are the principles to be respected in M&A transactions:

#### **Principle 1: Increase corporate value**

Whether an M&A transaction is desirable should be decided based on whether it increases corporate value.<sup>19</sup>

#### **Principle 2: Ensure the protection of the interests of general shareholders through fair procedures**

M&A transactions should be conducted through fair procedures to ensure that the interests of general shareholders are protected.

Both principles apply not only to MBOs and acquisitions of a controlled company by the controlling shareholder, but also to ordinary M&A transactions; however, Principle 2 is considered particularly important in MBOs and in acquisitions of a controlled company by the controlling shareholder.

The relationship between the two principles is that M&A should increase corporate value, fulfilling Principle 1, and with that as the premise, the interests of general shareholders should be protected by executing the M&A transaction through fair procedures in accordance with Principle 2.<sup>20</sup>

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<sup>18</sup> It has been observed that, even if shares of an acquiring company are used as the acquisition consideration, in the case where the size of the target company is smaller than the acquiring company, the value of (b) that general shareholders of the target company can enjoy by holding the shares of the acquiring company after the transaction will be significantly diluted. In addition, it has been observed that depending on differences in the characteristics of the target company and the acquiring company as investment targets and on the investment policies of general shareholders, it cannot be assumed that general shareholders of the target company will continue to hold the shares of the acquiring company after the transaction.

<sup>19</sup> In the case of acquisitions of a controlled company by the controlling shareholder, Principle 1 is likely to be considered from the perspective of whether M&A increases the corporate value of the group as a whole.

<sup>20</sup> While it is not easy in practice to decide whether an M&A transaction will increase the corporate value of a target company, if the transaction is executed through fair procedures and fulfills the requirements of Principle 2, it is unlikely that the Board of Directors and the Special Committee of the target company will agree to an M&A transaction that does not increase corporate value (as a result, value that cannot be realized without the M&A transaction is not anticipated, and such value will not be distributed to general shareholders). Therefore, such M&A transaction will increase corporate value, and it is likely that the requirements of Principle 1 will also be met.

## 2.4 Basic Perspectives on Fair Procedures

As described above, MBOs and acquisitions of a controlled company by the controlling shareholder should be conducted through fair procedures to ensure that the interests of general shareholders are protected in accordance with Principle 2. Practical measures that constitute fair procedures are referred to herein as “**Fairness Ensuring Measures.**” In MBOs and acquisitions of a controlled company by the controlling shareholder, it is advisable to adopt Fairness Ensuring Measures in accordance with the specific circumstances of each M&A transaction (such as the degree of issues with respect to structural conflicts of interest or information asymmetries in the relevant transaction, the situation of the target company, and the overall transaction structure). There are various possible Fairness Ensuring Measures, each of which can be used to realize fair transaction terms from the following perspectives.

### **Perspective 1: Ensure a situation substantially equivalent to an arm’s length transaction in the process of formulating the transaction terms**

In the negotiation and evaluation of the appropriateness of an M&A transaction and the reasonableness of transaction terms for a target company (hereinafter referred to as the “**process of formulating the transaction terms**”), ensure a situation substantially equivalent to a situation where an M&A transaction is conducted between mutually independent parties; in other words, situations where issues with respect to structural conflicts of interest or information asymmetries are properly addressed, and reasonable efforts are made to conduct the M&A transaction on the best possible transaction terms for general shareholders, while also increasing corporate value.<sup>21</sup>

### **Perspective 2: Ensure that general shareholders have an opportunity to make an appropriate decision based on sufficient information**

Taking into account the natural challenges for general shareholders to make an appropriate decision based on sufficient information (informed judgment) on the reasonableness of

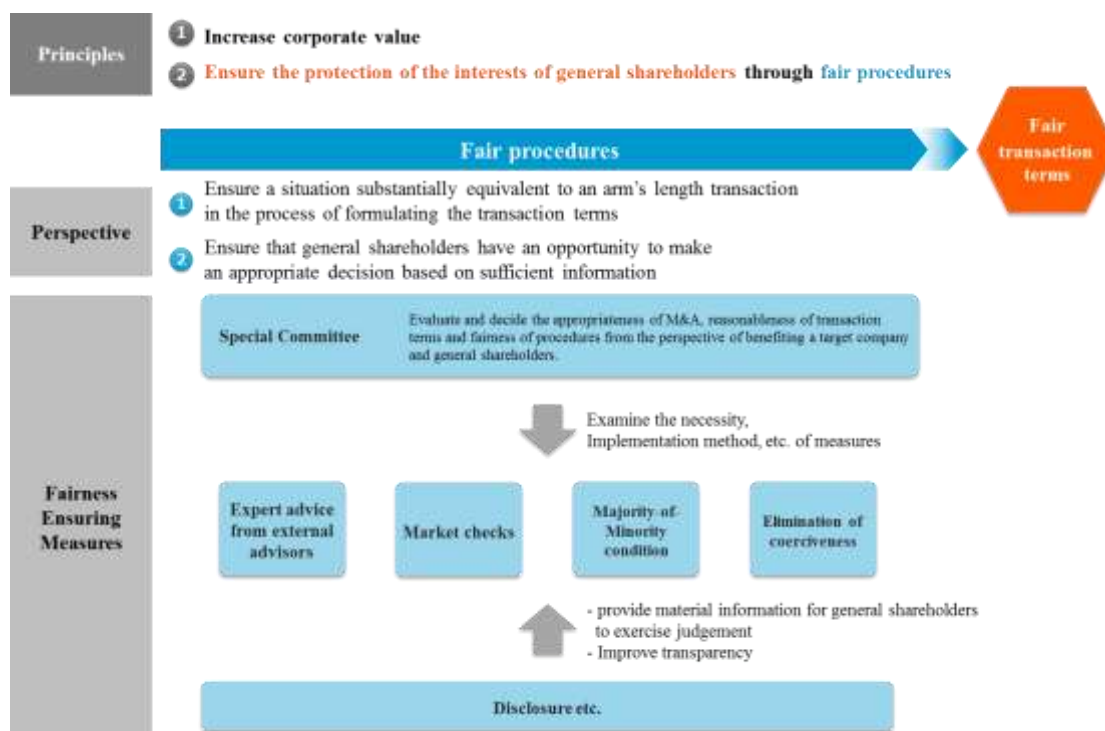
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<sup>21</sup> Perspective 1 is a perspective that is relevant when considering Fairness Ensuring Measures that will be implemented by the target company in the process of formulating the transaction terms, and is generally the perspective of the target company. In other words, during the process of formulating the transaction terms, as in an ordinary M&A transaction, reasonable efforts are made by the acquiring parties to conduct the M&A transaction on the best possible transaction terms for themselves, and Perspective 1 is not meant to deny this. Based on this assumption, Perspective 1 is intended to ensure the fairness of transaction terms by ensuring that the target company, as in the case of an ordinary M&A transaction, makes reasonable efforts to conduct the M&A transaction on the best possible transaction terms for general shareholders of the target company, while also increasing corporate value, thereby ensuring a situation which is, as a whole, substantially equivalent to one in which an M&A transaction is conducted between mutually independent parties, and negotiations and decisions on transaction terms occur in such a situation.

transaction terms due to information asymmetries between an acquiring party and general shareholders in MBOs and acquisitions of a controlled company by the controlling shareholder, provide general shareholders with necessary information to make an appropriate decision and ensure that general shareholders have an opportunity to make an appropriate decision.

## Chapter 3 Practical Specific Measures (Fairness Ensuring Measures)

With consideration for the principles and basic perspectives outlined above, Sections 3.2 to 3.7 of this chapter address certain typical Fairness Ensuring Measures that are generally considered highly effective in MBOs and acquisitions of a controlled company by the controlling shareholder, and explain their functions and advisable practices.



### 3.1 Overview

#### 3.1.1 Basic Premise of Fairness Ensuring Measures

Each Fairness Ensuring Measure set forth in this chapter is intended as a means to ensure procedurally the fairness of transaction terms for which it is difficult to establish unambiguous, objective criteria.

Therefore, the implementation of each of the Fairness Ensuring Measures is not a necessary condition to realize fair transaction terms in MBOs and acquisitions of a controlled company by the controlling shareholder; and it does not mean that if all of these measures are not always implemented, the realization of fair transaction terms cannot be ensured.<sup>22</sup>

<sup>22</sup> Further, fair transaction terms are not necessarily only realized by implementing each of the Fairness Ensuring Measures set forth in this chapter, but even in cases where such measures are not implemented there may be cases where fair transaction terms are realized and are accepted by most general shareholders.

In other words, parties should consider which, and to what extent, Fairness Ensuring Measures should be taken based on the specific circumstances of each individual M&A transaction. Further, the measures taken should be evaluated in their entirety to determine whether they are sufficient ensure the fairness of transaction terms.

### **3.1.2 Necessity of Selecting Appropriate Measures in Accordance with Individual Circumstances**

M&A transactions are diverse, highly individualized transactions. Even in cases involving MBOs or acquisitions of a controlled company by the controlling shareholder, the actual form of these M&A transactions is not uniform, and the degree of issues with respect to structural conflicts of interest or information asymmetries may differ in each transaction.<sup>23</sup> Further, in actual practice, the particular circumstances of the M&A transaction may impact the level of consideration to be given to general shareholders.<sup>24</sup>

Given the premise of Fairness Ensuring Measures described in Section 3.1.1 above, the appropriate combination of such measures may also be diverse, just as individual M&A transactions are diverse.

Therefore, in each M&A transaction, it is important to determine and implement appropriate Fairness Ensuring Measures in accordance with the specific circumstances of such transaction.<sup>25</sup>

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<sup>23</sup> In actual MBOs, current management may acquire the target company themselves or jointly with other investors (such as investment funds). For example, in cases where “shareholder/directors” such as owner-management will remain as management but sell many of the shares they own in the MBO, it may be assumed that the position of such management is similar to that of general shareholders, as their interests are similar to those of sellers of the shares. Therefore, there may be differences in the degree of economic profits that management obtain through an MBO and consequently, the degree of structural conflicts of interest, which depend on factors such as the involvement of investors other than the management, the extent of such involvement, the methods of disposal of the shares held by the management executing the MBO, and the percentage of their investment in the MBO.

In addition, in the case of acquisitions of a controlled company by the controlling shareholder, there may be differences in the degree of structural conflicts of interest and information asymmetries depending on factors such as the percentage of voting rights of the controlled company held by the controlling shareholder (which may range from less than a majority to more than two-thirds) and the relationship between the controlling shareholder and the controlled company (there may be cases where the controlled company heavily depends on the controlling shareholder, or where the controlled company is managed independently to a certain degree, depending on factors such as the personnel and business relationships between the controlling shareholder and the controlled company, differences in the fields of business, and how the controlling/controlled relationship between the two parties was formed).

<sup>24</sup> For example, in the case of an M&A transaction conducted in a turnaround situation, depending on the situation of the company, there may be cases where returns deserved by shareholders do not exist. In addition, in MBOs in which there are entities such as major shareholders or parent companies of the target companies, and the shareholders, as a group, can conclude rational negotiations with the acquiring parties, there may be cases where the acquiring management are unable in the first place to execute an unreasonable MBO, or an MBO at an unfairly low price.

<sup>25</sup> As described in Section 2.1.3 of the main text, between MBOs and acquisitions of a controlled company by the controlling shareholder, the structural conflicts of interest or information asymmetries are not identical. However, taking into account the discussions of this point, a general or categorical

If certain measures do not function effectively for a specific M&A transaction, or if concerns with respect to adverse effects or other difficulties arise with respect to certain measures, it is important that other measures be more substantially utilized in order to ensure the overall fairness of transaction terms.

Given the existence of structural conflicts of interest, it is important that an organ independent from the acquiring party, which understands the material facts regarding the conflicts of interest, be substantially involved in determining which Fairness Ensuring Measures are appropriate in the specific case.

### **3.1.3 Importance of Effective Function**

Even if the construct of Fairness Ensuring Measures is arranged, such measures will be meaningless if each measure does not function effectively. The functional effectiveness as a whole of the Fairness Ensuring Measures is thus more important than the number of such measures that have been implemented in form.

### **3.1.4 Importance of Not Impeding Desirable M&A**

When value-creating M&A transactions are conducted through fair procedures, the value realized in these M&A transactions is also enjoyed by general shareholders, which means that the interests of general shareholders are also served.

Therefore, it is not desirable for general shareholders that otherwise desirable value-creating M&A transactions be deterred, or that the parties to such transactions excessively refrain from executing such transactions.

The development of a sound capital market where value-creating M&A transactions are actively executed while also considering the interests of general shareholders requires that parties involved in M&A transactions take a balanced approach, including from the point of view of cost effectiveness, rather than being prone to risk avoidance.<sup>26</sup>

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difference between these types of transactions does not exist with respect to the appropriate Fairness Ensuring Measures that should be taken in order to address issues with respect to structural conflicts of interest and information asymmetries and to ensure fair transaction terms. Therefore, it is appropriate to consider the specific circumstances that arise from differences in transaction types in individual M&A transactions as one of the specific factors to be taken into account in determining the appropriate Fairness Ensuring Measures.

<sup>26</sup> For example, to the extent that Special Committee members, including outside directors, perform their duties using appropriate procedures set forth in these Guidelines, and in accordance with their duty of care, in the ordinary course they should not be subject to liability for damages or otherwise.

## 3.2 Establishment of an Independent Special Committee

### 3.2.1 Function of the Special Committee

In cases where structural conflicts of interest may affect the independence of the board of directors (“**Board of Directors**”) of a target company, and there is a risk that the goals of increasing corporate value and securing the interests of general shareholders may not be properly reflected in the process of formulating transaction terms, a special committee (the “**Special Committee**”) is a deliberative body that is voluntarily established as an independent organ to supplement or substitute for the role that the Board of Directors of the target company was originally expected to perform.

The Special Committee is composed of persons who are independent. After obtaining material information, the Special Committee evaluates and decides the appropriateness of the M&A transaction, the reasonableness of transaction terms, and the fairness of proposed procedures from the perspective of increasing corporate value and benefiting general shareholders. By so doing, the function of the Special Committee is to ensure that in the process of formulating the transaction terms, issues with respect to structural conflicts of interest and information asymmetries are properly addressed, and to ensure that reasonable efforts are made to conduct such M&A transaction on the best possible transaction terms for general shareholders, while also increasing corporate value (see Perspective 1).

In this way, fundamentally, the Special Committee is expected to evaluate and decide on an M&A transaction not from the position of a neutral third party vis-à-vis the acquiring party and target company/general shareholders, but rather from a position which aims to promote the interests of both the target company and its general shareholders. If the Special Committee functions effectively in this way, it will be highly valued as a Fairness Ensuring Measure.<sup>27</sup>

### 3.2.2 Role of the Special Committee

In order to perform the functions described in Section 3.2.1 above, the Special Committee’s roles are to (1) evaluate and decide on an M&A transaction from the perspective of whether or not it increases corporate value of the target company, and (2) from the perspective of benefiting

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<sup>27</sup> The Special Committee established in MBOs or acquisitions of a controlled company by the controlling shareholder is sometimes referred to as a “third party committee.” However, as stated in the main text, it should be noted that the position of the Special Committee in such cases is different from third-party committees established in response to corporate scandals, which are required to remain neutral with respect to the company and other stakeholders, since Special Committees in the context of M&A transactions described above are not in the position of a neutral third party vis-a-vis the acquiring party and target company/general shareholders, but in a position which aims to promote the interests of both the target company and its general shareholders.



general shareholders, evaluate and decide (i) the reasonableness of transaction terms and (ii) the fairness of procedures.

Among these roles, with respect to the reasonableness of transaction terms (role (2)(i)), it is important for the Special Committee to consider the reasonableness of transaction terms by (a) ensuring that in discussions and negotiations of transaction terms with an acquiring party, reasonable efforts are made to conduct the M&A transaction on the best possible transaction terms for general shareholders, while also increasing corporate value, and (b) confirming the contents of the stock price valuation, which is an important basis for judging the reasonableness of transaction terms, and the rationality of financial forecasts,<sup>28</sup> assumptions<sup>29</sup> and other factors which are the premises for such valuation. In addition, it is important to examine not only the level of the acquisition consideration but also the reasonableness of both the acquisition method and types of acquisition consideration.

Moreover, with respect to the fairness of procedures (role (2)(ii)), the Special Committee is expected to play a role in considering which, and to what extent, Fairness Ensuring Measures should be taken in order to ensure procedurally the overall fairness of transaction terms, taking into account the practical circumstances of the relevant M&A transaction.

### **3.2.3 Significance of the Establishment of a Special Committee as a Fairness Ensuring Measure**

A Special Committee that operates properly will help to address issues with respect to structural conflicts of interest and information asymmetries, and be a highly effective Fairness Ensuring Measure while ensuring fairness in M&A.

Additionally, as described in Section 3.2.2 above, the Special Committee is expected to play a role in considering which, and to what extent, Fairness Ensuring Measures should be taken in each M&A transaction, and is positioned as a starting point for ensuring the fairness of procedures.

Taking into account the foregoing, the establishment of a Special Committee is a particularly significant measure to ensure the fairness of transaction terms in MBOs and acquisitions of a

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<sup>28</sup> In cases where the stock price valuation is conducted using the DCF method of analysis, conclusions can differ widely depending on the content of the business plan that serves as a basis for the forecast of future free cash flows. It has been observed that it is important to confirm the rationality of the business plan and its preparation process, as business plans prepared by companies vary from being optimistic to conservative depending on the purpose and the method of preparation.

<sup>29</sup> It has been observed that examples of matters for which it is advisable that the rationality be confirmed include the grounds for determining the discount rate using in the DCF analysis, and the reasons for selecting the comparable companies used in the comparable company analysis.

controlled company by the controlling shareholder, and is advisable.<sup>30</sup>

### **3.2.4 Practical Measures for the Effective Functioning of the Special Committee**

In order for a Special Committee to function effectively, and not just in form, it is advisable to implement the following practical measures.

In particular, where there are significant concerns with respect to the independence of the Board of Directors of a target company due to serious structural conflicts of interest<sup>31</sup> or other Fairness Ensuring Measures such as an active market check or a majority-of-minority condition are not implemented, it is expected that measures to enhance the effectiveness of the Special Committee will be actively implemented.

#### **3.2.4.1 Timing of Establishment**

When a target company receives an acquisition offer from an acquiring party, it is advisable to establish a Special Committee as soon as possible in order to enable the Special Committee, through involvement from an early stage, to perform the function of ensuring the fairness of transaction terms throughout the process of formulating the transaction terms as well as to avoid a situation where the purpose of establishing the Special Committee is effectively lost, which may occur, for example, in cases where the Special Committee is established after the transaction terms have been substantially determined and it is difficult to overturn the decision.<sup>32, 33</sup>

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<sup>30</sup> However, it may be difficult to establish a Special Committee in certain cases, including cases which are urgent due to the financial situation of the target company or the applicable laws and regulations, and in which prompt action is required, such as acquisitions of bankrupt companies.

<sup>31</sup> For example, there may be cases where directors who participate in an MBO or directors with a significant interest in the MBO have control over the Board of Directors based on the ratio of such directors on the board or their influence over other directors, or where there is a strong relationship between the controlling shareholder and the controlled company due to factors such as the degree of dependency of the controlled company on the controlling shareholder in terms of capital, personnel, and business relationships, differences in the business fields of the two companies, or the history of the formation of the controlling/controlled relationship between the two parties.

<sup>32</sup> For example, there may be cases where it is unavoidable that a certain amount of time is required to establish the Special Committee because a Board of Directors meeting must be held or candidates must be selected in cases where it is necessary to appoint outside experts. However, the establishment of the Special Committee should not be unnecessarily delayed, and it is advisable to exert reasonable efforts to establish the Special Committee as soon as possible.

<sup>33</sup> “When a target company receives an acquisition offer from an acquiring party” refers to cases where, objectively viewed, a bona-fide acquisition offer with a concrete and feasible intention is presented in good faith.

### 3.2.4.2 Committee Composition

#### A) Independence

The Special Committee exists for the purpose of addressing issues related to structural conflicts of interest precisely because it consists of independent members. The independence of the Special Committee members also serves as a foundation for the general shareholders' trust in the Special Committee, and it is advisable that Special Committee members have a high degree of independence.

Specifically, persons who will become Special Committee members should be required to maintain independence from (1) the acquiring party and (2) the success or failure of the M&A transaction (in other words, they should have no significant interest in the success or failure of the M&A transaction different from that of general shareholders<sup>34</sup>). This independence should be appropriately determined for each M&A transaction taking into account the specific circumstances, such as the relationship between the candidate and the acquiring party/target company and between the candidate and the M&A transaction, and from the perspective of whether such candidate generally can be expected to make an appropriate decision from the point of view of increasing corporate value and protecting the interests of general shareholders.<sup>35</sup>

With respect to independence from the acquiring party (factor (1)), in cases involving an acquisition of a controlled company by the controlling company, it is advisable that, taking into account the requirements to qualify as an outside director or outside company auditor under the Companies Act (for example, Article 2, Item 15a of the Companies Act), potential Special Committee members who are former executives or employees of the controlling company have not been either an executive or an employee of the controlling company during the period of at least 10 years prior to becoming a Special Committee member.

In addition, with respect to business relationships with an acquiring party and personal relationships other than those described above, it is beneficial to apply the independence criteria for independent officers established by the financial instruments exchanges<sup>36</sup> to relationships with the acquiring party; however, it is difficult to establish a uniform objective standard, and it is necessary to make a practical decision taking into account the specific circumstances of each

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<sup>34</sup> A typical example that raises doubts with respect to whether candidates for the Special Committee are interested in the execution of M&A is in a case where candidates receive fees that are contingent on the completion of the relevant M&A.

<sup>35</sup> Therefore, it should be noted that outside officers do not necessarily meet the standards for independence which are required of Special Committee members merely by fulfilling the requirements for outside directors and outside company auditors under the Companies Act or the independence criteria established by financial instruments exchanges, which are general and abstract standards that focus on independence from managers/officers.

<sup>36</sup> See "Guidelines Concerning Listed Company Compliance, etc." of the Tokyo Stock Exchange, Inc. III. 5. (3)-2.

M&A transaction. When the relationship existed and the importance of the relationship to the Special Committee candidate, along with other similar issues, will be important factors for consideration.

## **B) Attributes / Expertise of Special Committee Members**

It is advisable that the Special Committee be composed of outsiders, that is, outside directors, outside company auditors, and outside experts, in order to eliminate the influence of structural conflicts of interest. Persons eligible for membership on the Special Committee are described generally below.

### **a) Outside Directors**

Outside directors:<sup>37</sup> (1) are appointed at a general meeting of shareholders, have legal obligations and liability to the company, and may also be subject to liability claims from shareholders, (2) are by nature expected to participate directly in business decisions as a member of the Board of Directors, and (3) have a certain degree of knowledge of the target company's operations. Taking into account these attributes, and the role of the Special Committee, an outside director is the most suitable type of member. In principle, if independent outside directors exist, it is advisable to select members from among such directors. In addition, one practical measure to enhance the effectiveness of the Special Committee is to have an outside director act as committee chair.

### **b) Outside Company Auditors**

Outside company auditors: (1) are persons who are not by nature expected to be directly involved in business decisions, but are indirectly involved in company management in various ways, through the obligation to attend and state their opinions at meetings of the Board of Directors, through the right to request that directors cease an action<sup>38</sup>, and other roles (2) are

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<sup>37</sup> The term "outside director" includes outside directors who are audit and supervisory committee members of a company with an audit and supervisory committee as well as outside directors who are audit committee members of a company with nominating committees, etc.

<sup>38</sup> As described in Section 3.2.2 of the main text, one of the key roles of the Special Committee, which involves business judgment, is the role to ensure that in consultations and negotiations of transaction terms with an acquiring party, reasonable efforts are made to conduct an M&A transaction on the best possible transaction terms for general shareholders, while also increasing corporate value. On the other hand, outside company auditors are different from outside directors in their qualification to serve as Special Committee members in that they are by nature not expected to be directly involved in such business decisions and are only indirectly involved in management.

In connection with the foregoing, there are two theories regarding the duty of outside company auditors as Special Committee members: (i) that the duty is part of the outside company auditor's duties under the Companies Act (duty inclusion theory) and (ii) that the duty is entrusted separately from the outside company auditor's duties (separate entrustment theory). Under the duty inclusion theory, outside company auditors do not have the authority to negotiate with the acquiring party or execute

appointed at a general meeting of shareholders, have legal obligations and liability to the company, and may also be subject to liability claims from shareholders, and (3) have a certain degree of knowledge of the target company's operations. Taking into account these attributes, it is reasonable to consider outside company auditors as eligible to serve as Special Committee members to complement the outside directors since currently the number of outside directors on a typical Board of Directors is small.

### **c) Outside Experts**

In contrast to the foregoing, outside experts are not appointed at a general meeting of shareholders, their accountability to the company and shareholders is unclear compared with outside officers, and it is difficult for shareholders to hold them directly liable. However, appointing outside experts as Special Committee members, in addition to outside directors and outside company auditors, to supplement the Committee's M&A expertise (expertise on the fairness of procedures or corporate valuations) should not be denied.<sup>39</sup>

If all outside directors have issues, such as a lack of independence, that prevent them from being selected as Special Committee members, establishing a Special Committee consisting only of outside company auditors and outside experts may be considered the second-best solution.

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advisory contracts with advisors on behalf of the company due to limitations on the scope of the company auditors' authority. On the other hand, under the separate entrustment theory, outside company auditors have the authority to perform such actions. It should be noted, however, there are opinions that even under the separate entrustment theory, it is still possible to consider the duties of the Special Committee members to be within the scope of the audit duties of the company auditors, and in the case of a breach of such duties, shareholders may claim damages for the negligence of duties under Article 429 of the Companies Act. There is not necessarily a consensus on this issue, and further debate is expected to occur in the future.

Further, with respect to the foregoing issues, there is not necessarily a consensus on whether the remuneration paid separately to outside officers who serve as Special Committee members is subject to regulations regarding the remuneration of officers under the Companies Act. Nevertheless, it is advisable that the target company implement appropriate measures to provide remuneration to outside officers to compensate them for serving as Special Committee members.

<sup>39</sup> When outside experts are appointed as Special Committee members, the outside experts are considered to owe fiduciary duties to the target company as a delegate under an entrustment agreement with the target company. However, as stated in the main text, taking into account concerns that the nature of responsibility to the company and shareholders is unclear for outside experts, it is advisable that the fiduciary duties of such Special Committee members to the company be stipulated clearly in the entrustment agreement. In addition, it is advisable that, as an element of such fiduciary duties, the role of such Special Committee members to increase the corporate value of the target company and protect the interests of general shareholders be clarified in the entrustment agreement.

On the other hand, the fundamental role expected of an outside director is to manage the Special Committee appropriately and responsibly while employing the expert advice of advisors and others, based on a proper understanding of the Special Committee's role and the legal obligations and liability they have to the company. Because they are not expected to exercise expert judgment on their own, the fact that an outside director does not have expertise in M&A cannot justify a decision not to select that outside director as a Special Committee member.

The most advisable approach is that the Special Committee be composed of only outside directors, who are most suitable to serve as members, and that M&A expertise be supplemented by obtaining expert advice from advisors and others. At present, it appears that many companies may encounter difficulty in forming Special Committees with this composition due to having a small number of outside directors; however, in the future, many companies are expected to appoint multiple independent outside directors,<sup>40</sup> and it will become easier to form Special Committees with this advisable composition.

#### **3.2.4.3 Process of Establishing a Special Committee and Selecting Committee Members**

It is advisable for independent outside directors and independent outside company auditors of a target company<sup>41</sup> to be substantially involved, on an autonomous basis, in the decision to establish the Special Committee and in deciding the scope of its authority and responsibilities, selecting its members, and determining remuneration, in order to dispel, to the extent possible, concerns that they will be affected by issues of structural conflicts of interest.

#### **3.2.4.4 Involvement in Negotiations of Transaction Terms with an Acquiring Party**

As described in Section 3.2.2 above, in discussions and negotiations of transaction terms with an acquiring party, the Special Committee performs the role of ensuring that reasonable efforts are made to conduct an M&A transaction on the best possible transaction terms for general shareholders, while also increasing corporate value. In order for the Special Committee to

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<sup>40</sup> “6. Corporate governance system of listed subsidiaries” of the “Practical Guidelines for Group Governance Systems” (June 28, 2019) issued by METI states that since the Board of Directors bears primary responsibility for implementing effective governance mechanisms to mitigate risks caused by conflicts of interest in listed subsidiaries and to protect the interests of general shareholders, it is fundamental to aim to increase the ratio of independent outside directors (to at least one-third, or a majority).

<sup>41</sup> In principle, this category applies to outside directors and outside company auditors who have been identified as independent officers in notices to the financial instruments exchanges (other than those who clearly lack independence with respect to an M&A transaction from the perspective of Section 3.2.4.2 A) of the main text).

perform this role, it is advisable for the Special Committee to be substantially involved in negotiations between the target company and the acquiring party with respect to the transaction terms, including the acquisition consideration.

For example, the Board of Directors can decide in advance that it will not agree to an M&A transaction if the Special Committee determines that the transaction terms are not appropriate,<sup>42</sup> and, based on such decision: (1) the Board of Directors can delegate to the Special Committee the authority to directly negotiate the transaction terms of the M&A transaction based on such negotiating authority, or (2) while the negotiation itself may be handled by in-house persons at the target company, such as officers in charge, members of the project team, and advisors, the Special Committee can, for example, confirm the negotiation strategy in advance, obtain timely reports on the negotiation status, and at important junctures render opinions, instructions, or requests, and thereby ensure that the Special Committee is substantially affecting the negotiation process with respect to the transaction terms. It is advisable that the Special Committee be involved in negotiations between the target company and the acquiring party with respect to the transaction terms, in an appropriate manner and way depending on the specific circumstances of each M&A transaction, such as the degree of structural conflicts of interest and the composition of the Special Committee members.

#### 3.2.4.5 Advisors

In order for the Special Committee to properly understand and perform its role, it is necessary for members to evaluate and decide on the proposed transaction based on expert knowledge regarding the fairness of procedures and corporate valuations. In more than a few cases, the Special Committee members themselves may not have such expertise, and in such cases, it is advisable to have trustworthy financial advisors / third party valuation advisors and legal advisors (collectively referred to as “**advisors**”) from whom the Special Committee can seek professional advice.

It is advisable to consider appropriate approaches based on the specific circumstances of each M&A transaction, such as whether the Special Committee or in-house persons at a company should be tasked with discussing and negotiating with an acquiring party. Specifically, (1) it is useful for the Special Committee to appoint its own advisors,<sup>43, 44</sup> but (2) the Special

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<sup>42</sup> This guarantees that a situation where the Board of Directors of the target company agrees to M&A despite the Special Committee’s decision that the transaction terms are inappropriate will not occur, thereby ensuring a situation substantially equivalent to a situation where the Special Committee has authority to oppose the deal. Further, even if such decisions are made, it is assumed that the Board of Directors of the target company will make a final decision based on an understanding of the decisions of the Special Committee.

<sup>43</sup> In cases where the Special Committee appoints its own advisors, there are both cases where the Board of Directors of the target company appoints its own advisors separately and where it does not do

Committee should not be denied an opportunity to make use of advisors appointed by the Board of Directors of the target company if the Special Committee decides that it can trust the relevant advisors and seek their expert advice, for example, in cases where such advisors have high levels of expertise and there are no issues with respect to their independence. However, in case (2), there may be concerns that, due to a structural conflict of interest, advisors appointed by the Board of Directors of the target company may provide advice or information that prioritizes the interests of the acquiring party or the success of the M&A transaction over the interests of general shareholders. Therefore, it is advisable to take measures to ensure the reliability of expert advice provided by advisors appointed by the Board of Directors of the target company, as such advice is an important basis on which the Special Committee will conduct its examination and make its decision. For example, such measures may include giving the Special Committee authority to name the advisors to the Board of Directors of the target company or to approve (including retroactive approval)<sup>45</sup> such advisors.

#### **3.2.4.6 Procurement of Information**

In MBOs and acquisitions of a controlled company by the controlling shareholder, the issue of information asymmetries has created concerns that M&A transactions may be conducted on transaction terms that are unfavorable to general shareholders due to imbalances in the distribution of information to the acquiring party. However, it is difficult to address issues with respect to information asymmetries solely by making direct disclosures of information to general shareholders, as certain information, such as confidential information, is unsuitable to be made public and there are limits on the information that can be disclosed to general shareholders.

Therefore, based on the premise that each member of the Special Committee has an obligation of confidentiality to the target company, it is advisable that the Special Committee,

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so; in the latter case, the Board of Directors may receive expert advice from the advisors appointed by the Special Committee as necessary.

<sup>44</sup> Even if the Special Committee is planning to appoint its own advisors, there may be cases in which advisors are involved in the M&A transaction prior to the establishment of the Special Committee (see Section 3.3.1 of the main text with respect to legal advisors). In such cases, the Special Committee, once established, can confirm the independence of the advisors, and if there are no problems, the advisors can be re-appointed as the Special Committee's own advisors.

<sup>45</sup> For example, if there are problems with the independence of existing advisors to the Board of Directors of the target company, the Special Committee may not approve such advisors. If the Special Committee does not approve the existing advisors to the Board of Directors of the target company, it is possible to resolve the issue by changing the existing advisors, by having the Board of Directors appoint additional advisors named or approved by the Special Committee, or by having the Special Committee appoint its own advisors.



on behalf of general shareholders, obtain material information, including non-public information, and use such information to evaluate and decide on the transaction, thereby ensuring that the Special Committee examines and decides the appropriateness of the M&A transaction and the reasonableness of its transaction terms as a whole based on such material information.

Accordingly, it is advisable that the Special Committee make efforts to procure information necessary for its evaluation and decision, for example, by seeking and obtaining such information from executive officers and engaging fully in discussions with the acquiring party.

#### **3.2.4.7 Remuneration**

In order for the Special Committee to properly perform its role, it is advisable that the content and level of the remuneration paid to Special Committee members correspond appropriately to their responsibilities.

In addition, as described in Section 3.2.4.2.B) above, outside officers are expected to perform the duties of Special Committee members as part of their responsibilities as outside officers. However, compared with an outside officer's regular duties, the duties of a Special Committee member may require a considerable commitment of additional time and effort, and there may be cases where the officer's remuneration originally expected to be paid does not include remuneration for such member's duties as a Special Committee member. Therefore, in such cases, consideration should be given to separate remuneration to Special Committee members for their duties on the Special Committee.

#### **3.2.5 Methods Used by the Board of Directors of the Target Company to Handle Special Committee Decisions**

The Special Committee is a voluntary organ that is not an organ contemplated by the Companies Act. Therefore, even in cases where a Special Committee is established at the time of an M&A transaction, the Board of Directors will generally make the final decision regarding the approval or rejection of the transaction.<sup>46</sup>

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<sup>46</sup> The unanimous consent of all directors, and an opinion of all company auditors that there are no objections to an M&A transaction, excluding those who have significant interests in the transaction, in the board resolution with respect to the approval of an M&A transaction are considered to be an indication that Fairness Ensuring Measures have functioned effectively. On the other hand, if there are directors or company auditors who objected to the M&A transaction, in addition to describing the persons who opposed and the reason for the opposition in the minutes of meetings of the Board of Directors, it is important to disclose this to shareholders, from the perspective of ensuring an opportunity for informed judgment by general shareholders (Perspective 2) (See Section 3.6.2.3 f) below).

In such cases, given the intent in establishing the Special Committee, it is advisable that the Board of Directors appropriately understand and grasp the Special Committee's decision and then make its own decision in a manner that respects, to the maximum extent possible, the decision of the Special Committee (in cases where a decision described in Section 3.2.4.4 above is made in advance by the Board of Directors, if the Special Committee decides that the transaction terms are not appropriate, the Board of Directors should not agree to an M&A transaction based on those transaction terms).

Although a decision of the Board of Directors cannot be automatically justified for the sole reason that a Special Committee has been established and the Board's decision is based on the decision of the Special Committee, in principle, if an independent Special Committee is established and functions effectively, the Board of Directors can satisfy its duty of explanation by making a decision based on the decision of the Special Committee.

Based on the foregoing, only in exceptional cases will it be appropriate for the Board of Directors to make a decision different from that of the Special Committee. However, if such a case occurs, given the intent in establishing the Special Committee, it is advisable that the Board of Directors duly satisfy its duty of explanation by providing the reasons for its decision.

### **3.2.6 In-house Examination System for the Target Company**

Even in cases where a Special Committee is established in MBOs or acquisitions of a controlled company by the controlling shareholder, it is expected that in many cases the Board of Directors of the target company, the officers in charge, and the project teams established under them will, in the first instance, consider matters such as the merits of the M&A transaction, the reasonableness of transaction terms and the fairness of procedures, and conduct discussions and negotiations with the acquiring party.

With respect to the resolution of the Board of Directors of the target company to approve or reject the M&A transaction, the Companies Act prohibits "directors with a special interest" from participating in the decision.<sup>47</sup> A system in the target company that enables, to the extent possible, an evaluation and negotiation of the proposed transaction independent from the acquiring party should be established in order to eliminate the influence of structural conflicts of interest in the process of formulating the transaction terms. For example, this should be a

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<sup>47</sup> Article 369, Paragraph 2 of the Companies Act. Although the scope of "directors with a special interest" in MBOs and acquisitions of a controlled company by the controlling shareholder poses an issue of interpretation, it has been observed that a broader interpretation of "special interests" should be considered from the perspective of enhancing the fairness of procedures in the process of formulating transaction terms. For example, it has been observed that, not only directors who conduct MBOs, but also directors who have already agreed to invest or participate in the management of the acquiring party should be excluded. On the other hand, it has been observed that even directors other than such directors may attempt to protect themselves, and expanding such interpretations does not necessarily increase the fairness of these procedures.

system that excludes directors with certain interests, including “directors with a special interest,” from evaluating and negotiating the transaction on behalf of the target company not only at the stage of the resolutions by the Board of Directors described above but also, depending on the specific circumstances of such M&A transaction, at the preceding stages of evaluation and negotiation.

In such cases, with respect to the scope of directors excluded from the evaluation and negotiation, if an independent Special Committee has been established and functions effectively, it may not be necessary to exclude all former executives or employees of the acquiring party. For example, if it is assured that there are directors who are able to conduct appropriate evaluations and negotiations, it may be sufficient to exclude directors who at the time of the relevant M&A transaction concurrently serve as executives and employees of the acquiring party.

### **3.3 Independent Expert Advice from External Advisors**

It is advisable to obtain the independent<sup>48</sup> expert advice described below from external advisors in order to carefully evaluate and decide the fairness of procedures and the reasonableness of transaction terms.

#### **3.3.1 Advice from Legal Advisors**

Legal advisors play an important role in determining and implementing appropriate Fairness Ensuring Measures within the target company and in ensuring the fairness of procedures (Perspective 1, Perspective 2).

Legal advisors assist the target company to fully understand the significance of Fairness Ensuring Measures, and play an important role on matters such as establishing a Special Committee and selecting Special Committee members<sup>49</sup>, analyzing which directors have or may have special interests (and who should therefore be excluded from the evaluation and negotiation of a transaction), and examining the independence of financial advisors and third party valuation advisors. Considering this role, it is advisable to involve independent<sup>50</sup> legal advisors from the initial stage and to obtain their independent professional advice.

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<sup>48</sup> With respect to the independence of external advisors, similar to the independence of Special Committee members in Section 3.2.4.2A of the main text, there are issues with (i) independence from the acquiring party and (ii) independence from the success or failure of the M&A transaction. However, the degree and significance of the independence may differ.

<sup>49</sup> See Section 3.2.4.3 of the main text with respect to the process of establishing a Special Committee and selecting Special Committee members.

<sup>50</sup> Specifically, it is important that the legal advisors involved in the establishment of a Special Committee and the legal advisors to the Special Committee be independent. For example, from the perspective of maintaining independence from the acquiring party, it is not advisable to appoint as the

### **3.3.2 Obtaining Valuation Reports or Fairness Opinions from Third Party Valuation Advisors**

In order to address issues with respect to structural conflicts of interest and information asymmetries in the process of formulating transaction terms, it is advisable that the Board of Directors of a target company or the Special Committee obtain a valuation report, etc. from an independent third party valuation advisor with expertise and use this report, etc. as the basis for their judgment (Perspective 1).

In addition, in connection with making reasonable efforts to conduct the M&A transaction on the best possible transaction terms for general shareholders while also increasing corporate value, it is also effective to obtain advice and assistance, as needed, from experienced financial advisors in the process of formulating transaction terms, particularly with respect to evaluations of M&A transaction schemes and alternative methods, alternative transactions, and price negotiations<sup>51</sup> (Perspective 1).

Based particularly on the perspectives stated in the first paragraph, a discussion of the significance of obtaining valuation reports or fairness opinions from independent third party valuation advisors is set forth below.

#### **3.3.2.1 Valuations by Third Party Valuation Advisors**

##### **A) Function**

By clarifying the range of a target company's share value, a valuation by an independent third party valuation advisor with expertise allows the Board of Directors of a target company and the Special Committee to obtain important reference information for the purposes of evaluating, negotiating, and judging transaction terms. In addition, because the Board of Directors of a target company and the Special Committee will have difficulty agreeing to an M&A transaction conducted on transaction term levels that cannot be explained from the valuation results, such valuations mitigate the risk that transaction terms unfair to general shareholders will be

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legal advisor an attorney highly dependent on the acquiring party due to an advisory agreement executed between the attorney and the acquiring party and who regularly consults with the acquiring company's management regarding legal matters.

<sup>51</sup> Financial advisors which provide advice and support to a target company, including in price negotiations, also often serve as a third party valuation advisor and provide a valuation report or fairness opinion as part of their services.

implemented as a result of structural conflicts of interest or information asymmetries (Perspective 1).

Further, disclosure of valuations to general shareholders of the target company provides general shareholders with an important resource to judge the reasonableness of transaction terms (Perspective 2).

## **B) Position Relative to Other Factors**

While keeping the concept regarding the interests of general shareholders in mind as referenced in Section 2.2 above, in many cases, valuations are based on financial forecasts that do not assume an M&A transaction will be carried out, and are not based on the sum of the value of each element such as (a) value that can be realized without the M&A transaction and (b) value that cannot be realized without the M&A transaction.<sup>52</sup> With respect to the concept described in Section 2.2 above, returns deserved by general shareholders, including a portion of the value of (b), can be realized effectively through the process of evaluating and negotiating transaction terms taking into account the valuation results and seeking to obtain the best possible transaction terms for general shareholders while also increasing corporate value.

Therefore, valuation results do not directly make clear the value of (b) in Section 2.2 above or the respective portions of that value that general shareholders and the acquiring party should enjoy; and accordingly, in actual M&A transactions, the transaction terms to which a target company should agree cannot be mechanically determined based solely on valuation results.

Therefore, it is advisable that the Board of Directors of a target company and the Special Committee evaluate, negotiate, and decide on transaction terms taking into account a variety of factors in addition to valuation results, including the positioning and feasibility of the business plan on which the valuation was based, the characteristics of the valuation methodologies used, the level of premiums (the difference between the acquisition price and the prior market price of the shares) generally paid in similar M&A transactions, the value that can be realized without such M&A transaction, the expected increase in corporate value created by such M&A transaction<sup>53</sup>, and the existence and nature of alternative transactions.

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<sup>52</sup> The background to this relates to the fact that there is uncertainty in post-M&A business plans, that a target company does not have sufficient information with respect to the business plans and future possibilities assumed by the acquiring party, and that in many cases it is difficult to reasonably estimate financial forecasts based on these assumptions. In addition, from the perspective of takeover strategies, there are limits to the detail that an acquiring party can disclose to a target company with respect to the above-mentioned information because the acquiring party must reveal its strategies through this disclosure. Nevertheless, valuations may be conducted by preparing financial forecasts that take into account, to a certain extent, the effects of various measures based on the M&A transaction, such as reducing costs for the maintenance of the listing status by delisting.

<sup>53</sup> Such expected increase in corporate value created by M&A is not necessarily limited to a quantitative estimate of a specific increase in corporate value.

### 3.3.2.2 Fairness Opinions

#### A) Function

A fairness opinion is generally an opinion delivered by an independent third party valuation advisor with expertise to companies involved in an M&A transaction with respect to the fairness<sup>54</sup> from a financial point of view of the proposed transaction terms to the companies involved or their general shareholders.

In other words, when a target company obtains a fairness opinion, it means that a third party valuation advisor with financial expertise has, after a careful evaluation from a perspective independent of the target company, determined that the proposed terms of the M&A transaction between the parties are, from a financial point of view, fair to the general shareholders of the target company, and expressed an opinion to such effect. Thus, fairness opinions differ from valuation reports in that in fairness opinions, the third party valuation advisor forms and expresses an opinion with the objective of evaluating the fairness of the proposed transaction terms between the parties, specifically with respect to the interests of general shareholders of the target company. Accordingly, compared with valuation reports, fairness opinions are reference information that can relate more directly, and be of greater significance, to the value of the target company, and therefore can be more useful to address issues with respect to structural conflicts of interest and information asymmetries in the process of formulating transaction terms (Perspective 1).

It has been observed that, in the United States and Europe, it is common practice to obtain fairness opinions as important reference information related to the reasonableness of transaction terms in M&A transactions where structural conflicts of interest exist, and that it is useful to obtain fairness opinions to ensure accountability to general shareholders, including international investors (Perspective 2).

#### B) Significance as a Fairness Ensuring Measure

As described above, while fairness opinions can be effectively utilized as a Fairness Ensuring Measure, taking into account factors such as the relationship of fairness opinions to the concept of the returns deserved by general shareholders<sup>55</sup> described in Section 2.2 above and the present

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<sup>54</sup> Certain third party valuation advisors make the “reasonableness” of the transaction terms the subject of their opinion.

<sup>55</sup> As described in Section 3.3.2.1 B) of the main text, valuations used by third party valuation advisors as a basis for issuing a fairness opinion are, in most cases, not based on the sum of the value of each element such as (a) value that can be realized without an M&A transaction and (b) value that cannot be realized without the M&A transaction. Rather, the valuation used by third party valuation advisors is usually determined based on financial forecasts that do not assume the M&A transaction has been conducted, and the “fairness” of transaction terms in fairness opinions is also understood to be assessed through comparison with the results of this valuation. In addition, since fairness opinions state opinions from a financial point of view, it is generally understood that the fairness of procedures and the existence

environment in Japan,<sup>56</sup> the effectiveness of fairness opinions may vary depending on the particular case. Therefore, it is appropriate that the Board of Directors of a target company or the Special Committee consider whether to obtain a fairness opinion based on the specific circumstances of each M&A transaction.

In addition, since the effectiveness of fairness opinions as a Fairness Ensuring Measure is based on the reliability of the third party valuation advisor issuing the opinion, fairness opinions should be positively evaluated as a Fairness Ensuring Measure if the third party valuation advisor issues a fairness opinion with elements that include: (i) independence and neutrality, (ii) a rigorous issuance process<sup>57</sup>, (iii) advanced expertise and performance, and (iv) a positive reputation.<sup>58</sup>

Therefore, it is advisable that the Board of Directors of a target company and the Special Committee consider these characteristics in selecting third party valuation advisors.

### **3.3.2.3 Independence of Third Party Valuation Advisors**

In order to ensure that valuations and fairness opinions have the functions described above, it is critical that third party valuation advisors appointed by the Special Committee (or, in cases where a Special Committee does not appoint its own advisor and uses a third party valuation advisor appointed by the Board of Directors of the target company, such advisor) be independent. In cases where such third party valuation advisor has a significant interest in the success or failure of an M&A transaction, it is advisable to disclose information regarding the

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of alternative transactions are not directly subject to consideration when a third party valuation advisor issues its fairness opinion.

<sup>56</sup> In Japan, unlike in certain other countries, since there are no particular regulations or rules applicable to issuing entities or the fairness opinion issuance process, and since it cannot be said that there is a satisfactory, prevailing understanding with respect to the definition of “fairness” of transaction terms in fairness opinions or issuance procedures required for these opinions, it has been observed that decisions regarding these matters are left to each third party valuation advisor, and that there are circumstances in which there may be differences in such decision-making depending on the third party valuation advisor. Further, it has also been observed that it cannot be said that there is a satisfactory environment in which the legal responsibilities of third party valuation advisors which have issued inappropriate fairness opinions can be pursued.

<sup>57</sup> In the issuance of fairness opinions, there are third party valuation advisors which carefully adhere to an issuance process that emphasizes objectivity and independence, including practices such as additional interviews with the target company and others and a multi-layered review by independent review committees within the third party valuation advisor which are composed of experienced members.

<sup>58</sup> As described in Note 56), in Japan, where it cannot be said that the legal responsibilities of third party valuation advisors which have issued fairness opinions can be adequately pursued, the advisor’s reputation becomes an important factor, since the proper functioning of fairness opinions is considered to be protected to a certain extent by the reputation risks borne by the third party valuation advisor.

valuation advisor's independence and the nature of the valuation advisor's interest to enable general shareholders to appropriately judge the advisor's independence.

For example, if such third party valuation advisor has a serious interest in the success or failure of an M&A transaction<sup>59</sup>, such as cases where the third party valuation advisor also provides funding, including financing for the acquisition, to the acquiring party, there will be a considerable degree of concern with respect to the advisor's independence and it will generally be considered undesirable to have the advisor perform the functions described above. However, if this type of case arises due to reasonable necessity, accountability about the details of its independence and the nature of its interests should be fulfilled by the valuation advisor through the disclosure of details regarding the economic benefits that the third party valuation advisor will receive from the relevant M&A transaction etc.<sup>60</sup>

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<sup>59</sup> However, in cases where a third party valuation advisor to a Special Committee (in cases where a Special Committee does not appoint its own third party valuation advisor but instead uses a third party valuation advisor appointed by the Board of Directors of the target company, such third party valuation advisor) provides financing or other funding to the acquiring party for the acquisition, the degree of interest of the third party valuation advisor will differ depending on the specific circumstances, including the importance of the loan or other funding to the third party valuation advisor concerned (for example, the loan amount provided by the third party valuation advisor compared to the scale of the third party valuation advisor's business), the role of the third party valuation advisor in the loan or other funding (for example, in the case of a syndicated loan with more than one lender, whether the third party valuation advisor plays a central role as an arranger or only participates in the syndicate), and the terms and conditions of the loan or other funding. There may be cases where a third party valuation advisor may not be deemed to have a significant interest.

It has been observed that, depending on the relationship between the third party valuation advisor and its group companies, substantially the same concerns with respect to the independence of a third party valuation advisor may exist, in addition to cases where such third party valuation advisor has a serious interest, in cases where group companies of the third party valuation advisor have an interest. On the other hand, it has been observed that even in these cases, when financial institutions such as banks and securities firms serve as a third party valuation advisor, concerns with respect to their independence have been mitigated, since they are required under the Banking Act and the Financial Instruments and Exchange Act to establish management policies for conflicts of interest, and management policies for conflicts of interest have actually been established between the third party valuation advisor and its group companies, in addition to measures to protect against the exchange of information between the third party valuation advisor and its group companies that have also been taken through the application of prophylactic measures set forth in the Financial Instruments and Exchange Act (firewall regulations).

<sup>60</sup> For example, if a third party valuation advisor to a Special Committee (in cases where a Special Committee does not appoint its own third party valuation advisor but instead uses a third party valuation advisor appointed by the Board of Directors of a target company, such third party valuation advisor) provides financing or other funding for the acquisition to the acquiring party, the Special Committee may confirm, as a matter related to the independence of the third party valuation advisor and the nature of its interests, in addition to information with respect to the compensation to be received by the third party valuation advisor in connection with its valuation work, information with respect to the economic benefits to be received in connection with the financing.



### 3.4 Ensuring Opportunities for Other Acquiring Parties to Make Proposals (Market Checks)

#### 3.4.1 Function

Ensuring opportunities for competing proposals by other prospective acquiring parties (hereinafter referred to as “**competing proposals**”); and parties making a competing proposal are hereinafter referred to as “**competing counterbidders**”) in M&A transactions (hereinafter referred to as “**market checks**”) enhances the bargaining power of a target company in the process of formulating transaction terms and contributes to the conduct of the M&A transaction on the best possible transaction terms for general shareholders, while also increasing corporate value (Perspective 1), since these opportunities provide important reference information with respect to the value of the target company and the reasonableness of transaction terms. These opportunities for competing proposals confirm whether competing counterbidders who may offer terms better than the original proposal exist, and also encourage the initial bidder to propose transaction terms better than those anticipated in a competing counterbidder’s proposal.

#### 3.4.2 Implementation

Market checks include so-called “active market checks”<sup>61</sup> to investigate and evaluate prospective acquiring parties in the market, and so-called “indirect market checks” where an M&A transaction is executed in a manner that allows other prospective acquiring parties to make competing proposals after the proposed M&A transaction is announced .

With respect to indirect market checks, for example, in executing an M&A transaction the parties can : (i) ensure that there is a relatively long period of time after the announcement of the proposed M&A transaction<sup>62</sup> in which competing proposal can be made, as well as (ii) refrain from actions such as entering into agreements that will excessively restrict the target company

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<sup>61</sup> Active market checks include (i) bid processes (auctions) and individual approaches to multiple prospective acquiring parties before an agreement is reached or an announcement is made with respect to an M&A transaction with a particular acquiring party, and (ii) methods adopted by a target company to actively solicit competing proposals for a certain period after the agreement or announcement of an M&A transaction is reached or announced (so-called “go shops”). Where active market checks are conducted, it is reasonable for parties to the M&A transaction to agree to appropriate deal protection provisions.

<sup>62</sup> With regard to the issue of how long the period of time should be, it should at least be long enough to allow for indirect market checks to function effectively. However, it is difficult to standardize the length of this time period since it may vary depending on the size of the target company and the specific circumstances of the case (for example, in a corporate turnaround situation, the transaction must be executed in a particularly rapid manner). The longer the time period is, the more effective indirect market checks are expected to be. However, it should also be noted that if the period of time is too long, employees, business partners and others may be put in an unstable position, which in turn may adversely affect the business of the target company.

from communicating with competing counterbidders in cases where a competing counterbidder actually appears with a competing proposal.<sup>63</sup>

### **3.4.3 Significance as a Fairness Ensuring Measure**

Different circumstances exist with respect to whether market checks function effectively as a Fairness Ensuring Measure depending on whether the acquiring party is a controlling shareholder or not. The effectiveness of market checks in each case is discussed below.

#### **3.4.3.1 Cases Where the Acquiring Party is Not a Controlling Shareholder**

In cases where the acquiring party is not a controlling shareholder (in other words, the management conducting the MBO is not a controlling shareholder), market checks will likely be effective.

Taking into account the observation that limitations on the time and information required to evaluate a transaction often make competing proposals difficult to obtain, active market checks tend to function more effectively than indirect market checks. Further, if active market checks are conducted, they will be evaluated more positively as a Fairness Ensuring Measure than indirect market checks.

On the other hand, there are concerns that active market checks can be a the deterrence to M&A transactions and that there are practical issues with respect to information control<sup>64</sup> in the case of active market checks; therefore, it cannot be said that it is always advisable to conduct active market checks in cases where the acquiring party is not a controlling shareholder.

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<sup>63</sup> For example, an acquiring party agreeing with a target company on a deal protection provision that entirely prohibits the target company from communicating with any party making a competing proposal is considered an excessive restriction. On the other hand, using a breakup fee (termination fee) provision as a deal protection provision is permissible if it is within a reasonable scope (for example, if the amount is not so excessively high that the provision in practice has the effect of coercing the target company shareholders to approve the M&A transaction).

<sup>64</sup> With respect to active market checks, it has been observed that (i) in the most common type of MBO where management and investment funds jointly execute the transaction, the implementation of an active market check may not be compatible, since it is important for both parties to jointly manage the target company after the MBO based on strong relationships of trust for the purpose of increasing the corporate value of the target company, and management often decide to implement the MBO only after spending a significant period of time building such relationships of trust with the investment fund; (ii) prior market checks may involve risks that confidential information will be leaked to competitors through the related process, which may have adverse effects on the business and share price of the target company; (iii) it is possible that indirect market checks conducted in a situation where the acquiring party and the target company have not agreed to deal protection provisions can function effectively; and (iv) unlike in certain other countries, because there are no strict regulations in Japan with respect to expressions of intent of a person or organ to acquire a company, there are concerns that persons or entities may for other purposes express an intent to acquire a company, such as simply acquiring the target company's information, despite having no true intent to acquire the company itself.

For this reason, it is advisable that the Board of Directors of the target company and the Special Committee consider the effectiveness and possible harmful effects of active and indirect market checks based on the specific circumstances of the particular M&A transaction and then implement an appropriate market check.

### **3.4.3.2 Cases Where the Acquiring Party is a Controlling Shareholder**

In contrast, in cases where the acquiring party is a controlling shareholder (in other words, cases where the management conducting the MBO is a controlling shareholder and cases where a controlling shareholder acquires a controlled company), the controlling shareholder seeking to acquire the target company already has a controlling interest in the target company, and it is unlikely that a serious competing proposal will be made in cases where the controlling shareholder is unwilling to sell to a third party. For this reason, in cases where the acquiring party is a controlling shareholder, there are only a limited number of cases where a market check will function as a Fairness Ensuring Measure, and in most cases there will be scant meaning to implementing a market check.<sup>65</sup>

However, even in cases where the acquiring party is a controlling shareholder, there may be exceptional cases in which a market check can function properly.<sup>66</sup> Therefore, it is advisable for the Board of Directors of the target company and the Special Committee to confirm that these exceptional circumstances do not exist.

### **3.4.4 Responses to Competing Proposals**

If a competing counterbidder emerges, and if the competing proposal is a serious, concrete and feasible acquisition proposal<sup>67</sup>, it is necessary for the Board of Directors of the target

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<sup>65</sup> Even if a market check is considered ineffective, ensuring a relatively long period of time after the announcement of an M&A transaction, including a tender offer period, can serve as a period for general shareholders to consider the appropriateness of the M&A transaction and reasonableness of the transaction terms and make appropriate decisions, which is considered to give this market check significance (Perspective 2).

<sup>66</sup> For example, such cases have been observed to include cases where the percentage of voting rights held by the controlling shareholder is low, cases where there is a possibility that if a highly attractive competing proposal is made the controlling shareholder may decide to sell, and cases where the controlling shareholder intends to acquire the controlled company initially, and then eventually dispose of all or part of the controlled company.

<sup>67</sup> A careful evaluation should be conducted to decide whether a competing proposal is a serious, concrete, and feasible acquisition proposal, and the Special Committee should be substantially involved in the decision. Normally competing proposals in cases where the acquiring party is the controlling shareholder are unlikely to be considered feasible or serious, because in such transactions, the controlling shareholder (which already has a controlling interest in the company) is trying to acquire the target company and thus is unwilling to sell the company to a third party. That being said, the feasibility and seriousness of the competing proposal should be considered, including with respect to this point, in the same way as discussed in Section 3.4.3.2 of the main text.

company and the Special Committee to seriously evaluate its content, and it is inappropriate to reject the proposal without reasonable grounds.

In addition, an acquisition proposal that will more substantially increase the corporate value of the target company will normally result in greater benefit (acquisition consideration) to general shareholders. However, in the exceptional case where those circumstances are not aligned<sup>68</sup> and the Board of Directors of the target company and the Special Committee agree to accept an acquisition proposal that more substantially increases the corporate value of the target company, and not another proposal that would result in greater benefit to general shareholders<sup>69</sup>, it is advisable that the Board of Directors of the target company and the Special Committee fully satisfy their duty of explanation with respect to the reasonableness of their judgments.<sup>70</sup>

### **3.4.5 Provision of Information to Competing Counterbidders**

It has been observed that it may be difficult for a competing counterbidder to make a serious, concrete and feasible acquisition proposal if the target company does not provide the competing counterbidder with sufficient information. Further, once a competing counterbidder emerges, a level playing field between the parties making acquisition proposals should be ensured and it is not advisable to treat one party more favorably than other parties.

On the other hand, it has been observed that: listed companies have already made public information necessary for investing in their shares, and competing proposals may be feasible even without necessarily providing an opportunity to conduct due diligence; there are certain limitations on information that can be provided due to the risk of leaks of confidential

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<sup>68</sup> For example, it has been observed that this lack of alignment can occur in cases such as (i) an acquisition proposal that has significant benefits to general shareholders reduces the benefits to other stakeholders (for example, employees) at the expense of increases to the benefits to shareholders, (ii) an acquisition would be conducted by an acquiring party overconfident in its management ability, which consequently undermines corporate value, and (iii) the shares of an acquiring company that have been temporarily overvalued in the market are used as the acquisition consideration. In these types of cases, there may be differences between an acquisition proposal that more substantially increases the corporate value of the target company and an acquisition proposal that will result in greater benefit to general shareholders.

<sup>69</sup> As described in Perspective 1 of Section 2.4 of the main text, it is assumed that the target company will make reasonable efforts to conduct M&A transactions on the best possible transaction terms for general shareholders, while also increasing corporate value in the process of formulating the transaction terms. As described in the main text, as a result of these reasonable efforts, an acquisition proposal that more substantially increases the corporate value of the target company normally results in a greater benefit to general shareholders. However, the main text is intended to address cases where these reasonable efforts have been made but the conditions are not aligned. Even in these cases, such reasonable efforts should be made to realize transaction terms that fairly distribute the increase in corporate value to general shareholders, and the interests of general shareholders should not be unduly harmed solely for the purpose of increasing corporate value.

<sup>70</sup> It is necessary to make a careful determination regarding which acquisition proposal more substantially increases the corporate value of the target company, and it is not advisable to make this decision unclear by arbitrarily expanding the concept of corporate value.

information to competitors, or the risk of adverse effects on the target company's business and share price due to leaks regarding the transaction; and unlike in certain other countries, because there are no strict regulations in Japan with respect to expressions of intent of a person or organ to acquire a company, there are concerns that persons or entities may for other purposes express an intent to acquire the company, such as simply acquiring the target company's information, despite having no true intent to acquire the company itself.

Therefore, for example, depending on factors such as the specificity, feasibility, and degree of good faith which can be confirmed with respect to the acquisition proposal, it is reasonable to evaluate the necessity of providing information and the scope of information to be provided (for example, by providing limited information at the outset and gradually expanding the scope of information provided in accordance with the degree of confirmation mentioned above).

### **3.5 Establishment of a Majority-of-Minority Condition**

#### **3.5.1 Function**

A majority-of-minority condition means, in cases where shareholders are asked to express their position whether or not to support an M&A transaction, either by exercising their voting rights at a general meeting of shareholders or deciding whether or not to tender their shares in response to a tender offer, a condition to the consummation of the M&A transaction that it receive support from a majority of the shares held by general shareholders (in other words, shareholders that do not share significant interests with the acquiring party<sup>71</sup>), and the prior public announcement of such condition.<sup>72, 73</sup>

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<sup>71</sup> The scope of general shareholders who do not share significant interests with an acquiring party described in the main text should be determined practically based on the specific circumstances of each M&A transaction.

In this connection, under current tender offer practices, shareholders that have entered into agreements with an acquiring party to tender their shares in a tender offer are uniformly excluded from the scope of general shareholders (the denominator, "minority"), when calculating the number of general shareholders to be confirmed support the M&A transaction under a majority-of-minority condition. However, shareholders that have entered into agreements with an acquiring party to tender their shares in a tender offer may or may not share significant interests with the acquiring party. Where they do not share such interests, the fact that the tender offer agreement was executed pursuant to serious negotiations with shareholders which have the interest of a seller of shares may in fact be considered to be a factor that supports the fairness of the transaction terms. Therefore, it is not necessary to uniformly exclude these shareholders from the scope of general shareholders to be confirmed support the M&A transaction solely for the reason that the tender offer agreement was executed.

<sup>72</sup> A majority-of-minority condition may be established (i) in cases where an M&A transaction is executed in a two-step acquisition, by setting a certain number of shares as the minimum number of shares to be purchased in the first-step tender offer, or (ii) in cases where an M&A transaction is executed in a one-step acquisition, including a corporate reorganization, for example, by establishing a condition subsequent where the agreement for the corporate reorganization will be terminated in the event of the failure to obtain a certain number of favorable votes at the general meeting of shareholders (without the need for amending the articles of incorporation to raise the approval threshold for the special resolution of the general meeting of shareholders).

Establishing a majority-of-minority condition will lead to a greater emphasis on ensuring opportunities for general shareholders to exercise judgment by directly confirming that a majority of general shareholders are satisfied with the transaction terms (Perspective 2).

In addition, in cases where a majority-of-minority condition is established, in order to complete the M&A transaction the transaction terms will need to be at a level that is expected to satisfy the majority of general shareholders. Therefore, this condition will also have the function of strengthening the target company's bargaining power in the process of formulating the transaction terms and thereby contributing to the execution of M&A transactions on transaction terms favorable to general shareholders (Perspective 1).

### **3.5.2 Significance as a Fairness Ensuring Measure**

A majority-of-minority condition is considered a Fairness Ensuring Measure in cases where the additional support of a considerable number of general shareholders is needed to complete the M&A transaction; in these cases, the majority-of-minority condition is highly effective in ensuring fairness in the transaction terms of an M&A transaction.

On the other hand, taking into account concerns about the possible deterrence of value-creating M&A transactions in cases where an acquiring party holds a large number of shares of the target company<sup>74</sup>, such as an acquisition of a controlled company by the controlling shareholder, it is difficult to go so far as to say that it is advisable to impose a majority-of-minority condition at all times. It is advisable that the Board of Directors of a

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<sup>73</sup> In a tender offer, where the offer does not require a minimum number of shares to be purchased (as described in Note 72), but a majority of shareholders end up tendering their shares in response to the tender offer, the majority-of-minority condition described in these Guidelines will not be deemed to have been established. Further, as a prerequisite for a majority-of-minority condition to function properly, the information necessary to make an appropriate decision must be provided to general shareholders.

<sup>74</sup> With regard to the majority-of-minority condition, it has been observed that: (i) the higher the ownership ratio of an acquiring party in a target company's shares, the easier it will be to obstruct the M&A transaction by acquiring only a small number of shares, such as by acquiring the target company shares to take advantage of the M&A opportunity, which increases the concern that these circumstances can become a deterrent to value-creating M&A transactions, (ii) as the scale of passive index funds has increased in recent years as a trend in the Japanese capital markets, some of these investors refrain, as a matter of policy, from tendering their shares in response to a tender offer regardless of the appropriateness of the transaction terms, which undermines the inherent function of the majority-of-minority condition and increases the foregoing deterrent effect, and (iii) since the "fair price" that is offered as the purchase price of shares in an appraisal litigation in connection with a corporate reorganization under the Companies Act, and the price for a "cash-out" which is determined by the court, are prices which include the fair distribution of corporate value that has increased due to the corporate reorganization, there are factors that create an incentive to vote against a transaction at a general meeting of shareholders or to refrain from tendering shares in response to a tender offer in order to secure the shareholder's position to exercise their appraisal rights, regardless of the transaction terms.

target company and the Special Committee comprehensively evaluate the effectiveness and possible adverse effects of a majority-of-minority condition based on the specific circumstances of the relevant M&A transaction, and then decide whether such condition should be imposed.<sup>75</sup>

In addition, if a majority-of-minority condition is not established, it is important to compensate by enhancing other Fairness Ensuring Measures so that, overall, the fairness of the transaction terms are secured.

### **3.6 Enhancement of the Provision of Information to General Shareholders and Improvement of Process Transparency**

#### **3.6.1 Function**

Due to the significant information asymmetries between an acquiring party and general shareholders in MBOs and acquisitions of a controlled company by the controlling shareholder, it cannot be assumed that, as matter of course, general shareholders will appropriately decide the reasonableness of transaction terms based on sufficient information (informed judgment). Enhancing disclosure at the time of an M&A transaction enables informed judgment by addressing issues of information asymmetries and providing material information for general shareholders to decide the reasonableness of transaction terms<sup>76</sup> (Perspective 2).

In addition, it is expected that the transparency of the process of formulating transaction terms will be improved, and evaluations, negotiations, and valuations will be carried out more carefully with general shareholders in mind, if matters such as the evaluation and negotiation process conducted by the Board of Directors of a target company and the Special Committee, the grounds for their decisions, and the content and process of valuations by third party valuation advisors are subject to disclosure ex-post facto and the scrutiny of general shareholders and the public at large. This will help to address issues with respect to structural conflicts of interest and information asymmetries (Perspective 1).

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<sup>75</sup> In determining whether to establish a majority-of-minority condition, considering that this condition can strengthen the bargaining power of the target company, it has been observed that certain factors should be taken into account, such as the percentage of voting rights held by the acquiring party in the target company prior to the execution of the M&A transaction, the relationship between the acquiring party and the target company prior to the execution of the M&A transaction (such as the degree of independence of the target company), and the position of the acquiring party in the negotiation of the M&A transaction.

<sup>76</sup> Information that is useful for shareholders to make informed judgments with respect to the reasonableness of the transaction terms at the time of an M&A transaction includes information with respect to (i) the valuation results, (ii) the valuation determination process and the third party valuation advisors, and (iii) other information with respect to the process of formulating transaction terms. (i) is considered to be directly useful to determine the reasonableness of the transaction terms, (ii) is useful to determine the reasonableness of the transaction terms by verifying and evaluating the rationality and reliability of the information set forth in (i), and (iii) is useful to determine the reasonableness of the transaction terms by confirming whether the transaction terms have been determined through fair procedures.

Particularly in connection with the latter function of addressing information asymmetries, in addition to direct disclosure to general shareholders in disclosure documents at the time of an M&A transaction, submission as evidence in court proceedings<sup>77</sup> and other ex-post facto disclosures also have significant import.

### **3.6.2 Information Expected to be Substantially Disclosed**

In MBOs and acquisitions of a controlled company by the controlling shareholder, it is advisable not only to comply with the timely disclosure rules of laws and regulations and financial instruments exchanges<sup>78</sup>, but also to utilize disclosure such as the Tender Offer Registration Statement, the Tender Offer Opinion Statement, and timely disclosure to voluntarily disclose, in an easily comprehensible manner, enhanced information that will contribute to an appropriate judgment by general shareholders, with consideration for the composition of shareholders, and their background and attributes.<sup>79</sup>

Specifically, enhanced disclosure of the following information is expected.

#### **3.6.2.1 Information with Respect to the Special Committee**

Enhancing the disclosure of information with respect to the Special Committee will help general shareholders of the target company decide whether the Special Committee has effectively performed its function. As described in Section 3.2.4.6 above, it is difficult to resolve concerns arising from information asymmetries only by the direct disclosure of disclosure documents to general shareholders at the time of an M&A transaction. It is important to ensure a situation which can, as a whole, address concerns by properly combining the Special Committee's approach with others to evaluate and decide the appropriateness of transaction terms and whether to approve the M&A transaction after the Special Committee obtains material information, including non-public information, on behalf of general shareholders. In order to ensure the credibility of this approach, it is important to enable

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<sup>77</sup> From this point of view, it is not desirable for third party valuation advisors that have provided valuation reports or fairness opinions to the target company or the Special Committee to be reluctant to provide information regarding their valuation reports and fairness opinions in subsequent court proceedings for reasons such as the existence of confidentiality clauses.

<sup>78</sup> The information that must be disclosed under the timely disclosure rules of laws and regulations and financial instruments exchanges in MBOs and acquisitions of a controlled company by the controlling shareholder is set forth in the Cabinet Office Order on Disclosure Required for Tender Offers for Shares by Persons Other Than Issuers, the Forms of the Cabinet Office Order, and the guidebook for timely disclosure of company information issued by the Tokyo Stock Exchange, Inc. The main text below summarizes information that it is desirable to disclose on a voluntary basis, with these timely disclosure rules of laws and regulations and financial instruments exchanges, as a premise.

<sup>79</sup> For example, in addition to considering institutional investors, it is necessary to provide a thorough and satisfactory explanation that considers individual shareholders.



general shareholders to decide whether the Special Committee has functioned effectively by enhancing disclosure with respect to the Special Committee.

Specifically, it is advisable to enhance the disclosure of the following information:

- a) Information regarding the independence and qualifications of members of the Special Committee  
(for example, information regarding the independence of members, their attributes and reasons for appointment, and the selection process)
- b) Information regarding the scope of the authority granted to the Special Committee  
(for example, information regarding whether the decisions described in Section 3.2.4.4 above have been made in advance by the Board of Directors, and whether the authority of the Special Committee to appoint its own advisor, and the authority of the Special Committee to name and approve advisors to the Board of Directors of the target company)
- c) Information regarding the chronology of Special Committee deliberations and the status of its involvement in negotiating transaction terms with the acquiring party  
(for example, information regarding the timing of the establishment of the Special Committee, matters reviewed by the Special Committee, the types of information received by the Special Committee and the number and duration of Special Committee meetings)
- d) Information regarding the rationale and basis for decisions by the Special Committee on the appropriateness of the relevant M&A, the reasonableness of transaction terms and the fairness of procedures (such as the status of implementation of Fairness Ensuring Measures), and the content of the Special Committee's report<sup>80</sup>  
(for example, in a case where there were principal matters evaluated in connection with the relevant M&A transaction, information regarding the results of those evaluations, and the rationale and basis therefor)
- e) Information regarding the structure of remuneration for members

### **3.6.2.2 Information with Respect to Valuation Reports and Fairness Opinions**

Enhancing the disclosure of information with respect to the valuation reports and fairness opinions obtained by the Board of Directors of a target company or the Special Committee will enable general shareholders of the target company to more practically verify and assess the rationality and reliability of the valuation results and fairness opinions, thereby improving the

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<sup>80</sup> In addition to the approach of disclosing the Special Committee report itself, another approach is to include in disclosure documents a summary of the report that focuses on the matters set forth in the main text.

utility of these as evaluation materials in judgments by general shareholders of the reasonableness of transaction terms.

From this perspective, as a matter of general principle, it is advisable to disclose information to an extent that allows general shareholders of the target company to verify the rationality and reliability of the valuation results and fairness opinions. Specifically, it is advisable to enhance disclosure of the following information with respect to the valuation reports and fairness opinions obtained by the Board of Directors of the target company and the Special Committee:

- a) Information regarding the process for making the valuation based on the specific valuation methodologies  
(for example, information regarding (1) in cases where the valuation is conducted using the DCF analysis, (i) free cash flow forecasts for the target company used as a basis for the valuation, and whether the forecasts assume the relevant M&A transaction will be carried out; (ii) the chronology of the preparation of the financial forecasts used as a basis for the valuation (whether the rationality of the business plans was confirmed by the Special Committee; whether the financial forecasts were reviewed by third party valuation advisors; and, in cases where the financial forecasts used substantially differ from those announced prior to the relevant M&A transaction, the reasons for using these forecasts); (iii) the type of discount rate (for example, cost of shareholders' equity or weighted average cost of capital), as well as the grounds for the calculation; and (iv) perspectives on the period used for the free cash flow forecast and perspectives on the perpetual value such as the growth rate assumed for after the forecast period,<sup>8182</sup> and (2) in cases where the valuation is conducted using the comparable company analysis, the reasons for selecting comparable companies)

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<sup>81</sup> In the notice issued by the Tokyo Stock Exchange, Inc. on July 8, 2013 titled "Enhancement of Timely Disclosure Concerning MBO, etc." (TSE No. 752), with respect to MBOs and tender offers by the controlling shareholder, the actual amounts for financial forecasts which serve as assumptions for the calculation of the DCF analysis must be disclosed. By contrast, with respect to a corporate reorganization with the controlling shareholder in which listed shares that are listed on a domestic financial instruments exchange are used as the acquisition consideration, the actual amounts of the financial forecasts are not required to be disclosed unless the allotment of consideration is significantly disadvantageous to shareholders of the controlled company compared to the market share price. Item (a)(1)(i) of the main text is based on the assumption that the free cash flow forecasts of the target company will be voluntarily disclosed in cases where M&A transactions are carried out in corporate reorganizations that are not subject to the requirement of disclosure of the actual amounts of financial forecasts pursuant to the timely disclosure regulations of the Tokyo Stock Exchange, Inc.

With respect to this point, it has been observed that in cases where the valuation has been conducted using the DCF analysis in connection with the acquisition of a controlled company by the controlling company where shares are used as the acquisition consideration, careful evaluation should be conducted regarding the disclosure of the information in items (i) to (iv) of item (a)(1) in the main text, which is not required under the timely disclosure rules of current laws and regulations and the disclosure regulations of financial instruments transactions, as well as to disclosure similar to that in M&A transactions where cash is used as the acquisition consideration, as such disclosure may raise concerns

- b) Information regarding fairness opinions  
(for example, information regarding the issuance process and views on “fairness”)
- c) Information regarding significant interests of third party valuation advisors  
(for example, information regarding the third party valuation advisor’s fee structure (such as whether it is a contingency fee paid based on factors such as the completion of the relevant M&A transaction, or a fixed fee paid regardless of the success of the relevant M&A transaction))

### **3.6.2.3 Other Information**

In addition to the information above, it is advisable, for example, to enhance the disclosure of the following information:

- a) Information regarding the process leading up to the execution of the M&A transaction
- b) Information regarding the background and purpose of the decision to carry out the M&A transaction at that time<sup>83</sup>
- c) Information regarding the specific content of the interests of the directors of the target company with respect to the relevant M&A transaction (for example, the final shareholding ratio of directors and other investors (such as investment funds) in an MBO, and any agreement to guarantee the position of directors after an MBO), and whether the directors were involved in the process of formulating the transaction terms and the nature of this involvement
- d) Information regarding the details of discussions and negotiations between the target company and the acquiring party on matters such as the transaction terms

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about the deterrence of acquisitions of controlled companies by the controlling shareholder using shares as the acquisition consideration; for example, the share value based on the DCF analysis of a controlling company that will continue to remain listed may, to a certain extent, be inferred by the public. Due to these concerns, it has been observed that in cases where some of the information described in items (i) to (iv) of item (a)(1) is not voluntarily disclosed, it is advisable that the Special Committee specifically evaluate the scope of the undisclosed information, the rationality of the reasons for this non-disclosure, and the appropriateness of the controlled company’s share value, and disclose the results of its evaluation.

<sup>82</sup> As corporate value also includes the value of non-business assets, it has been observed that it is advisable to provide an explanation with respect to the approach to non-business assets in cases where those are significant to the valuation.

<sup>83</sup> It is advisable to provide an especially complete explanation in cases where concerns may arise over whether the company has intentionally lowered its share price in the stock market to facilitate the M&A transaction, for example, where an M&A transaction is carried out after a downward adjustment of the target company’s financial forecast.

- e) Information regarding whether alternative acquisition methods or competing proposals were considered
- f) In cases where there were opposing directors or objecting company auditors to an M&A transaction in connection with the resolution of the Board of Directors to approve or reject the transaction, the names of such directors or auditors and the grounds for their opposition or objections

### **3.7 Elimination of Coerciveness**

Where MBOs or acquisitions of a controlled company by the controlling shareholder are conducted by way of a tender offer, coercion<sup>84</sup> should be avoided to ensure that general shareholders have an opportunity to appropriately decide whether to tender their shares in response to the tender offer (Perspective 2).<sup>85</sup> Specifically, it is advisable that the following practical measures be taken to address cases where general shareholders opposed (did not tender their shares in response to) a tender offer.

- a) Refrain from adopting a scheme that does not ensure that in a squeeze-out process after the tender offer, dissenting shareholders have appraisal rights or a right to request a determination of price.
- b) In cases where the large majority of the shares are acquired through a tender offer, unless special circumstances exist, a squeeze-out process shall be conducted as soon as possible. In addition, unless special circumstances exist, the purchase price in a squeeze-out process after the tender offer shall be based on the tender offer price, and a statement to that effect shall be made in the disclosure documents.

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<sup>84</sup> The issue of the coerciveness in tender offers arises in cases where a tender offer is successful and shareholders who do not tender their shares in response to the tender offer are expected to be treated less favorably than if they tendered their shares in response to the tender offer, which will unreasonably impact their decision whether to tender their shares, and shareholders which are dissatisfied with the offer price will in effect be pressured to tender their shares.

<sup>85</sup> Coercion should be avoided not only in MBOs and acquisitions of a controlled company by the controlling shareholder, but also in ordinary M&A transactions.

## Chapter 4 Conclusion

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The fair conduct of MBOs and acquisitions of a controlled company by the controlling shareholder is crucial for raising confidence in Japanese capital markets, both in Japan and abroad.

It is essential that relevant parties in the corporate community appropriately perform their respective roles with consideration for the purpose of these Guidelines so that these Guidelines become rooted as best practices in Japanese corporate society and contribute to the realization of fair M&A that both increases corporate value and protects shareholder interests.

Outside officers, beginning with outside directors, who serve as Special Committee members play a particularly important role. Outside officers are asked to fully understand their roles in these situations, meet the expectations of stakeholders (beginning with general shareholders), and properly perform their roles so that value-creating M&A transactions can be executed fairly and smoothly.

Management and other business practitioners who play central parts in the planning and execution of M&A transactions, as well as M&A market participants who support these business practitioners, are also expected to play important roles. Each of these stakeholders is expected to recognize its part in achieving the development of a sound capital market, and they are expected to take initiative in understanding and realizing the purpose of these Guidelines. Shareholders and investors are also expected to make appropriate judgments based on the information they are provided.

We hope that these Guidelines will be respected by the parties involved in M&A in corporate society and that they will further develop sound M&A practices in Japan in a manner that is open both domestically and abroad.

## Attachment 1: List of Members of Fair M&A Study Group

(without honorifics / Japanese alphabetical order)

Chairman	: Hideki Kanda	Professor, Gakushuin University Law School
Vice chairman	: Tomotaka Fujita	Professor, The University of Tokyo Graduate Schools for Law and Politics
	Katsumi Ao	Executive Officer, Tokyo Stock Exchange, Inc.
	Gaku Ishiwata	Partner, Lawyer, Mori Hamada & Matsumoto
	Kotaro Inoue	Professor, Tokyo Institute of Technology, School of Engineering, Department of Industrial Engineering and Economics
	Takashi Inoue	Managing Director, KEIDANREN (Japan Business Federation)
	Akitsu Era	Head of Investment Stewardship, BlackRock Japan Co., Ltd.
	Takahito Kato	Professor, The University of Tokyo Graduate Schools for Law and Politics
	Hiroyuki Kansaku	Professor, The University of Tokyo Graduate Schools for Law and Politics
	Kohei Kodama	Vice President and Executive Officer, General Counsel, Hitachi, Ltd.
	Hiroki Sampei	Head of Engagement, Fidelity International, Japan
	Kazuhiro Takei	Partner, Lawyer, Nishimura & Asahi
	Wataru Tanaka	Professor, The University of Tokyo Institute of Social Science
	Yuko Tamai	Partner, Lawyer, Nagashima Ohno & Tsunematsu
	Shinsuke Tsunoda	Principal Managing Director, Global Head of Mergers & Acquisitions, Nomura Securities Co., Ltd.
	David A. Sneider	Registered Foreign Lawyer, Simpson, Thacher & Bartlett LLP
	Shinichi Baba	General Manager, Corporate Credit Group, Credit Department, The Dai-ichi Life Insurance Company, Limited
	Kazuhiro Fukushima	CEO, Deloitte Tohmatsu Financial Advisory LLC
	Shozo Furumoto	Managing Executive Officer, NIPPON STEEL CORPORATION
	Kensaku Bessho	Managing Director, Head of M&A Advisory Group, Investment Banking Business Unit, Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.
	Ken Hokugo	Director, Head of Corporate Governance, Head of Hedge Fund Investments, Pension Fund Association
	Noriyuki Yanagawa	Professor, The University of Tokyo Graduate School of Economics
	Kazuhiro Yamada	Chairman, The Japan Private Equity Association Managing Director, Representative in Japan, Carlyle Japan, L.L.C.
Observers	Toshitake Inoue	Director, Corporate Accounting and Disclosure Division, Policy and Markets Bureau, Financial Services Agency, The Japanese Government
	Toshikazu Takebayashi	Counsellor, Minister's Secretariat, Ministry of Justice, The Japanese Government

## **Attachment 2: Chronology of Discussions of Fair M&A Study Group**

### **1. Study Group**

First Study Group Meeting (November 9, 2018)

- Purpose of the Meeting and Items for Evaluation

Second Study Group Meeting (December 7, 2018)

- Differences in transaction types and the Special Committee
- Presentation by Mr. Ishiwata, Study Group Member (Implementation of Fairness Ensuring Measures in recent M&A with conflicts of interest)
- Presentation by Mr. Bessho, Study Group Member (Analysis of M&A with conflicts of interest)

Third Study Group Meeting (January 10, 2019)

- Market Check and Majority-of-Minority Condition
- Presentation by White & Case LLP (Overseas legislative investigation on M&A with conflicts of interest (interim report))
- Presentation by Mr. Kato, Study Group Member (Significance of “generally accepted procedures as fairness” in principles established by legal precedent)

Fourth Study Group Meeting (February 1, 2019)

- Valuation, Fairness Opinions and Disclosures
- Presentation by White & Case LLP (Disclosure in M&A with conflicts of interest in the United States and the United Kingdom)

Fifth Study Group Meeting (February 22, 2019)

- Public Consultation Summary Report, Secretariat Hearing Summary Report, Discussion Points Summary

Sixth Study Group Meeting (April 5, 2019)

- Fair M&A Guidelines: Enhancing Corporate Value and Ensuring Fair Procedures (Draft)

Seventh Study Group Meeting (April 19, 2019)

- Fair M&A Guidelines: Enhancing Corporate Value and Securing Shareholders’ Interests (Draft)

## **2. Survey of Overseas Legal System, etc.**

- Period: October 15, 2018 to February 28, 2019
- Contractor: White & Case LLP
- Surveyed countries: United States, United Kingdom, France, Germany
- See the materials of the third Study Group on the website below for an overview of the survey results.

[https://www.meti.go.jp/shingikai/economy/fair\\_ma/003.html](https://www.meti.go.jp/shingikai/economy/fair_ma/003.html)

## **3. Public consultation**

- Period: December 28, 2018 to February 5, 2019
- See the website below for the implementation guidelines for public consultations.  
<https://www.meti.go.jp/press/2018/12/20181228003/20181228003.html>
- See the materials of the fifth Study Group on the website below for a summary of the results of the public consultation and the main opinions received.

[https://www.meti.go.jp/shingikai/economy/fair\\_ma/005.html](https://www.meti.go.jp/shingikai/economy/fair_ma/005.html)

## **4. Secretariat Hearing**

- Hearing Date: January 25, 2019
- See the materials of the fifth Study Group on the website below for an overview of the hearings held by the secretariat.

[https://www.meti.go.jp/shingikai/economy/fair\\_ma/005.html](https://www.meti.go.jp/shingikai/economy/fair_ma/005.html)

## **5. Public comments**

- Period: May 14, 2019 to June 12, 2019
- See the website below for a summary of the public comments received and the Ministry of Economy, Trade and Industry's approach to comments.

[https://www.meti.go.jp/policy/economy/keiei\\_innovation/keizaihousei/pdf/fairmaguidelines\\_publiccomment.pdf](https://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/fairmaguidelines_publiccomment.pdf)



