**REFERENCE TRANSLATION**

*This English translation is a reference translation of the Japanese language original. Should there be any discrepancies, the Japanese language original shall prevail.*

# Guidelines for Corporate Takeovers

## －Enhancing Corporate Value and Securing Shareholders’ Interests－

**August 31, 2023**

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# Chapter 1 Introduction

## 1.1 Background to the Formulation of the Guidelines for Corporate Takeovers

Based on the proposition that having fair rules for engaging in M&A transactions would, among other things, encourage and promote desirable acquisitions, the Ministry of Economy, Trade and Industry ("**METI**") has been providing guidelines and issuing reports that organize principles, perspectives, and best practices regarding M&A transactions in Japan.

In 2005, the "Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholders' Common Interests" (by METI and Ministry of Justice) (the "**2005 Guidelines**") were formulated. With the aim of seeking the establishment of fair rules to guide company acquisitions and business society activities, the 2005 Guidelines present principles that reasonable takeover defense measures against acquisitions that are detrimental to corporate value and the common interest of shareholders should satisfy (such measures are referred to in the Guidelines for Corporate Takeovers as "**takeover response policies**" or simply "**response policies**"). In addition, the Corporate Value Study Group under the auspices of METI issued reports such as the "Corporate Value Report" in 2005, the "Corporate Value Report 2006" in the following year, and the "Takeover Defense Measures in Light of Recent Environmental Changes" in 2008 (the "**2008 Report**"). METI, as well, issued the "Guidelines for Management Buyouts (MBO) to Enhance Corporate Value and Ensure Fair Procedures" in 2007, which present proposals to assist development of fair market rules.

Furthermore, in 2019, the "Fair M&A Guidelines – Enhancing Corporate Value and Securing Shareholders' Interests –" (the "**Fair M&A Guidelines**") were issued, covering MBO transactions as well as acquisitions of controlled companies by controlling shareholders, seeking to address the structural conflict of interests that arise in such type of transactions, and presenting practical approaches to such issues. In addition, regarding M&As of businesses and subsidiaries within a company group, the "Practical Guidelines for Business Transformations – Toward Changes to Business Portfolios and Organizations –" were issued in 2020 demonstrating the best practices for reviewing business portfolios and carving out businesses. Very recently, METI also has presented case studies based on actual examples of innovation, management improvement and rapid growth of companies through M&A funded by foreign investors ("Case Studies Relating to the Use of Inbound M&A Transactions" as of April 2023).

Over the past nearly two decades, many changes have occurred in the environment surrounding Japanese companies and capital markets. When the 2005 Guidelines were announced, there were concerns that the flexible consideration (such as stock consideration) in the context of corporate reorganizations (such as mergers) allowed under the revised Companies Act would strengthen the "offensive power" of acquiring parties, although it later turned out that the allowance of flexible consideration did not have such an effect. In addition, the amendment of tender offer regulations in 2006 reinforced the disclosure regulations applicable to the acquiring parties.

In the early 2000s, restructuring by companies in large domestic industries was active, but in recent years, Japanese companies have been more focused on acquisitions of foreign companies rather than domestic companies. Now, we are seeing an increasing number of deals where acquisition proposals induce other options (i.e. competing proposals) from third parties, and opinions diverging over the evaluation of such multiple competing proposals. This trend is raising more complex issues that the target company's board of directors must consider and deal with. In MBO transactions and controlled company acquisitions by controlling shareholders, the "Fairness Ensuring Measures" set out in the Fair M&A Guidelines are being actively used to ensure that structural conflict of interests are taken into consideration. In turn, fairness has also become a concern in other types of acquisition transactions. During a normal phase (i.e., while a company is not subject to an acquisition attempt), the percentage of institutional investors opposed to the adoption of takeover response policies has increased significantly since 2017, and the number of companies that have adopted such measures has continued to decline especially for companies listed in the Tokyo Stock Exchange (TSE), First Section (before market restructuring of the TSE) and Prime Market (after market restructuring of the TSE). In addition, some court decisions have been handed out concerning the invocation of countermeasures based on adopted takeover response policies, including in some cases involving injunctions.

Corporate governance is closely related to the conduct of acquisitions, and, in relation to corporate governance, two codes (the Corporate Governance Code and the Stewardship Code) have been established. As a result, the ratio of outside directors has increased significantly, although continuous effort by companies to achieve effective implementation of corporate governance reform is desirable. Despite a growing awareness of the need to improve corporate

value over the medium to long-term and capital efficiency, currently there are more listed companies in Japan with price-to-book ratio below 1x compared to many other countries. More than ever before, M&A is expected to be used as a corporate strategy to tackle increasingly complex business challenges.

Taking into account these trends and with the objective of encouraging acquisitions in a healthily functioning, fair M&A market that are favorable to the economy, in November 2022, METI launched the "Fair Acquisition Study Group" (Chairperson: Hideki Kanda, Professor, Gakushuin University Law School; see **Attachment 1** for the list of group members). With the aim of improving predictability and presenting best practices both for parties involved in acquisitions and for capital market participants, the study group has been discussing how parties should behave in relation to acquisitions of Japanese companies from the perspective of further developing the conduct of M&A transactions in Japan in a sound manner, taking into account legal systems and practices of other countries and comments provided by interested parties in Japan and abroad (see **Attachment 2** for the chronology of the discussions).

METI hereby formulates the Guidelines for Corporate Takeovers (the "**Guidelines**") as fair rules regarding M&A transactions that should be shared among participants of the Japanese economy, based on the discussions by the Fair Acquisition Study Group.

### 1.2 Rationale and Meaning of the Guidelines

The purpose of the Guidelines is to present principles and best practices that should be shared among the economy to develop fair rules regarding M&A transactions, with a focus on how parties should behave in the context of acquiring corporate control of a listed company.

The development of a fair M&A market will ensure that the market functions soundly and that desirable acquisitions (acquisitions that both increase corporate value and secure the interests of shareholders) are actively conducted. This, in turn, will contribute to corporate growth through acquisitions, and also will lead to target companies' opportunities to select superior corporate strategies and to improve external discipline on management. In addition, an active market for desirable M&A transactions will optimize resource allocation, accelerate industry restructuring, and promote healthy economic metabolism of Japan's capital markets

where many participating companies currently have low capital efficiency. As a result, the entire economy and society should benefit.

To date, legal systems such as the tender offer regulation and the large shareholdings reporting regulation, as well as principles established by court precedents, have played a major role in developing fair M&A rules. The guidelines and reports established by METI have complemented these developments and contributed by providing predictability to market players. In particular, the Fair M&A Guidelines, while dealing primarily with MBO transactions and acquisition of controlled companies by controlling shareholders, at the same time provide the general principles for fair M&A transactions. The Guidelines are expected to build upon and to develop sound principles while further accelerating the establishment of a fair M&A market, thereby encouraging and promoting desirable acquisitions.

In formulating the Guidelines, we have referred the legal systems and practices in other countries, from where important suggestions were obtained. However, there are differences in legal systems, principles established by court precedents, and market conditions related to M&A transactions according to jurisdiction. The Guidelines are aimed to present a fair acquisition policy from the perspective of facilitating desirable acquisitions in Japan that is rooted in Japan's legal system, court precedents and market conditions, while at the same time meeting the expectations of domestic and foreign stakeholders including investors active in international markets, in light of the increasing globalization of capital markets, in particular the Prime Market of the TSE.

In regard to takeover response policies and countermeasures, revisions have been made based on how the 2005 Guidelines guided practice, subsequent court decisions, and changes in institutional investor behavior in exercising voting rights, among other relevant factors. Chapter 5 of the Guidelines newly explains the current view regarding takeover response policies and countermeasures.[1] The content revised from the 2005 Guidelines is supplemented by footnotes or by other means in order to facilitate the use of the Guidelines. In addition, the description in the Guidelines that follow the concept of the 2005 Guidelines, but have been simplified or

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[1] Where a provision of the Guidelines and the 2005 Guidelines is incompatible, the content of the Guidelines take precedence.

updated, are clarified by citing the relevant sections of the 2005 Guidelines in the footnotes or by other means.

In formulating the Guidelines, we have obtained the cooperation and confirmation of the Ministry of Justice, particularly with respect to matters relating to the 2005 Guidelines.

Certain detailed provisions of the Guidelines are provided in the Appendices, however, in terms of importance, no distinction should be drawn between positioning in the Appendices as opposed to the main text, and they together form a single set of guidelines. Further, the Guidelines are not presented with the direct intention to establish clear interpretations of the Companies Act or other laws and regulations.

### 1.3 Scope of the Guidelines

The Guidelines primarily address transactions in which an acquiring party acquires corporate control of a listed company by acquiring its shares.

This scope includes not only cases where an acquirer makes an acquisition proposal based on request or approach by the target company management, but also cases where an acquisition proposal is made without such a request or approach (so-called an "unsolicited offer/bid"). In the latter cases the Guidelines are conscious that conflicts may arise between the acquiring party and the target company regarding the merits of the acquisition.[2]

With respect to the structure of acquisition, in light of current practice in Japan, we are focused on cases where shares of the target company are acquired through tender offers, open-market purchases, or negotiated transactions respectively for cash consideration, although

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[2] Acquisition transactions in the form of MBO transactions and acquisition of controlled companies by the controlling shareholders were the primary focus of the Fair M&A Guidelines, and consequently the Fair M&A Guidelines focuses on how to enhance corporate value and secure the interests of shareholders in situations where the target company's board of directors might consider the interests of the acquiring party rather than the non-acquiring party shareholders with respect to an acquisition proposal. In comparison, the Guidelines are primarily concerned with acquisition proposals in the context of ordinary acquisition transactions (arms-length transactions between third parties) where the target company's board of directors and the acquiring party take different positions and have different interests. These types of acquisitions may ultimately proceed either as a friendly transaction or as a hostile transaction, although in either event such transactions may involve issues such as management's conflict of interest. The challenge will be how to materialize such acquisitions while taking these issues into consideration.

the Guidelines may also apply to cases where corporate control is acquired through stock for stock acquisitions, or through organizational restructurings such as mergers, share exchanges and share deliveries.

In addition, certain sections of the Guidelines address not only transactions taking over corporate control of listed companies through share acquisitions, but also acquisitions resulting in significant minority stake (principally in situations where takeover response policies and countermeasures are at issue), as well as taking over corporate control by replacing a majority of the directors without revealing such intention.

### 1.4 Definitions of Certain Terms Used in the Guidelines

a) "**Corporate value**" refers to a company's assets, profitability, stability, efficiency, growth potential, and other company attributes that contribute to the interests of shareholders, or the extent to which they do so. Conceptually, corporate value is the sum of the present values of discounted future cash flows generated by a company.[3]

b) An "**acquisition**" mainly refers to an act of an acquiring party gaining corporate control of a listed company by acquiring its shares (see "**1.3 Scope of the Guidelines**"). A proposal for an acquisition is referred to as an "**acquisition proposal**."

c) An "**acquisition without consent**" is an acquisition without the approval of the target company's board of directors. The term includes acquisitions referred as "hostile takeovers."

d) The "**transaction terms**" are the terms and conditions of an acquisition, typically the purchase price for an acquisition for cash consideration, or the share exchange ratio for an acquisition with stocks as the consideration.

e) The "**takeover response policies**," or "**response policy**," means a policy for dealing with acquisitions which provides that, in certain cases, the company will resist acquisition attempts against it typically by making a gratis issuance of stock acquisition rights with

[3] See page 5 of the Fair M&A Guidelines. As discussed later, from the perspective of capital financing sources, corporate value can be expressed as the sum of shareholder value (market capitalization as valued in the market) and net debt value.

unequal exercise and redemption terms, without the primary purpose of raising funds or other business purposes. Determination of the specifics of a takeover response policy is referred to as “**adoption**,” specific actions such as the gratis issuance of stock acquisition rights stipulated in the takeover response policies are referred to as “**countermeasures against acquisitions**” or simply “**countermeasures**,” and the execution of a countermeasure is referred to as “**invocation**”.

f) “**Normal phase**” refers to the time when a target company is not aware of an acquisition plan, proposal or commencement by a particular party.

g) “**Emergent phase**” refers to the time and thereafter a target company becomes aware of an acquisition plan, proposal or commencement by a particular party.

# Chapter 2 Principles and Basic Perspectives

## 2.1 Three Principles

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

**Principle 1: Principle of Corporate Value and Shareholders' Common Interests**

Whether or not an acquisition is desirable should be determined on the basis of whether it will secure or enhance corporate value and the shareholders' common interests.

**Principle 2: Principle of Shareholders' Intent**

The rational intent of shareholders should be relied upon in matters involving the corporate control of the company.

**Principle 3: Principle of Transparency**

Information useful for shareholders' decision making should be provided appropriately and proactively by the acquiring party and the target company. To this end, the acquiring party and the target company should ensure transparency regarding the acquisition through compliance of acquisition-related laws and regulations.

## 2.2 Basic Perspectives

### 2.2.1 Desirable Acquisitions

Realizing synergies through acquisitions and improving inefficient management are among the important ways for management to bring the corporate value closer to, or to increase, the company's intrinsic value.[4] Typically, acquisitions are made when the acquiring party is

[4] There can be various views on what the "intrinsic value" is. For example, sometimes the term "intrinsic value" is used as a term substantively equivalent to the term "corporate value" defined in the Guidelines (i.e., sum of the present values of discounted future cash flows generated by a company). In the Guidelines, the *per se* value of a company that can be realized through effective exploitation of the company's current operational resources through efficient corporate management is described as the "intrinsic value." Some advocates point out that "intrinsic value" in this sense can be objectively evaluated to a certain extent based on analysis with comparable companies.

confident that it can significantly increase company's value above the level revealed in the current stock price (the stock value as projected by the market assuming the incumbent management continues to operate the company[5]). In the event of a successful acquisition, the acquiring party enjoys the portion of increase in corporate value above the purchase price achieved by implementing its management strategy, while the former shareholders enjoy the portion of the purchase price they received in excess of the share price prior to the transaction (so-called "premium").

Thus, the acquiring party, the target company and shareholders all have reasons for pursuing acquisition transactions, and the expectation is that these parties will act rationally and, through the execution of acquisition transactions, create synergies that increase value and improve management efficiency. In addition, the possibility of an acquisition can serve as a discipline with respect to the incumbent management team.

In order for these acquisitions to fulfill their functions and for the market to be economically effective, a code of conduct is required that the parties and other participants involved in an acquisition must respect and abide by to avoid problems. Examples of problems that should be avoided are the target company's management attempting to block the acquisition at the expense of the interests of the company and its shareholders, shareholders being forced to act against their own intent in deciding whether or not to sell their shares in the acquisition, and the acquiring party obtaining excess benefits through the acquisition that it should not enjoy.

### 2.2.2 Enhancing Corporate Value and Securing Shareholder Interests

Conceptually, corporate value represents the sum of the present values of the discounted future cash flows generated by a company. This includes the value arising from quantifiable increases in future cash flows resulting from the contributions by employees, counterparties, and other stakeholders in business activities.

[5] When a potential acquisition becomes more likely, the stock price may increase in anticipation that the economic terms of the transaction will be realized, taking into account the intrinsic value of the target company.

In other words, a company management is expected to present its skills to carry out its strategy by utilizing human resources such as employees' skill, knowledge and motivation, pursuit of technology and business models, and managing assets generating cash flow among other factors, and thereby to foster expectations to future cash flow and form the market's quantitative assessment of corporate value. Particularly in recent years, non-financial information such as commitment to local communities and global environment have become increasingly important for investors and shareholders in evaluating a company's medium to long-term corporate value.[6] Shareholders select management that can achieve higher cash flow generation capability, and management responds to their expectations by making prompt and decisive decisions, establishing governance structures, and conducting sustainable business activities to enhance economic corporate value in consideration of diverse stakeholders including local community and global environment.

Looking at corporate value from source of capital, corporate value can be expressed as the sum of shareholder value (market capitalization, from the market perspective) and net debt value. Increasing corporate value through company management contributes to the interests of all shareholders (the shareholders' common interests) by increasing the current value of their shares through market valuation. "Corporate value" is a quantitative concept. The target company management should not make the concept of corporate value unclear by emphasizing qualitative value, which is difficult to measure, nor should the "corporate value" concept be used as a tool for management to defend themselves (including management referring to retention of employees as an excuse to defend themselves). To be sure, however, in the normal course of business operations, target company management should have the fundamental discretion in managing the company with the aim to improve medium to long-term corporate value by conducting business activities and securing the shareholders' common interests through such activities.

[6] When investors forecast future cash flows of portfolio companies and calculate theoretical stock prices, they elaborate on non-financial information in evaluating the corporate value, by incorporating such information into the calculation of future cash flows and by reflecting them in the discount rate used to calculate the present value of future cash flows.

In an actual acquisition, the acquiring party acquires shares from the sellers, and the shareholders who agree to sell directly benefit by receiving the acquisition consideration, rather than from the medium to long-term enhancement of the company's corporate value.

Generally, an acquisition should be materialized under transaction terms that increase the target company's corporate value and ensure that the increase in corporate value is fairly distributed among the parties.[7] Theoretically, as the benefits that should be fairly distributed to shareholders (benefits that shareholders should enjoy), "value that can be realized regardless of an acquisition" should be guaranteed as the floor, and fair allocation of a portion of the "value that cannot be realized without an acquisition" (benefits arising from the acquisition) should also be guaranteed. However, in reality, it can be difficult to objectively and rigorously distinguish and calculate these values, and to rigorously ascertain the extent to which the market share price before the acquisition became apparent actually reflects the "value that can be realized regardless of the acquisition." In addition, with respect to a portion of the "value that cannot be realized without an acquisition" that shareholders should enjoy, it is generally thought that there is a range of values that represent each portion.[8, 9]

Therefore, while the transaction terms themselves such as the price should have a certain range, especially when the board of directors decides on a direction toward reaching agreement of an acquisition (including where the board of directors is actively seeking acquisition

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[7] The Fair M&A Guidelines present "Principle 1: Increase corporate value" and "Principle 2: Ensure the protection of the interests of general shareholders through fair procedures," as principles that apply to M&A in general. These principles are the bases of the ideas described in the main text herein.

[8] For a similar argument, see Section 2.2 of the Fair M&A Guidelines.

[9] Acquisitions can include transactions in which corporate control is transferred by acquiring the controlling shareholder's shares through a discount tender offer. In such transactions, the distribution of the value of the acquisition is different: corporate control is transferred, but no premium is paid to the general shareholders. Discount tender offer is selected in situations such as when an open-market sale of shares by the controlling shareholder cause the market share price to fall, when it is necessary to avoid a particular shareholder being unable to sell all of its shares due to the proportional distribution method, or when the market share price is considerably high. For the cases in which corporate control will be transferred (and when the market price is considered appropriate), some advocates point out that essentially, the directors or the board of directors of the target company should negotiate diligently to ensure that the acquiring party allows the general shareholders with an opportunity to sell its shares and that the transaction terms include reasonable premium. However, others point out that under situations such as when an acquisition through discount tender offer is agreed between the controlling shareholder and the acquirer because prompt sale is necessary under the circumstance, it is undesirable for the target company to unreasonably interfere such transaction. In this relation, see footnote 28.

proposals; this inclusion also applicable hereinafter), the target company directors should act in the interest of the company and its shareholders. In other words, a reasonable effort should be made to ensure that the acquisition will be based on terms that will secure the interest which shareholders should enjoy, in addition to determining whether the acquisition is appropriate from the perspective of enhancing the company's corporate value. When these efforts are properly made, it is more likely that the acquisition will be based on transaction terms that will increase corporate value and such increase will be fairly allocated among the acquiring party and the target company's shareholders[10] (see "**3.2 When the Board of Directors Decides on a Direction toward Reaching Agreement of an Acquisition**"; and regarding specific actions, see "**3.2.3 Negotiations Aimed at Best Available Transaction Terms for Shareholders**").

In connection with a target company taking these actions, outside directors[11] play an important role in addressing any conflict of interest issues at the management level and improving transaction terms. In addition, depending on the degree of conflicts of interest or information asymmetry issues, as well as circumstances relating to the target company or its transaction structure, fair procedures (i.e. "Fairness Ensuring Measures"), such as establishing a special committee, or obtaining outside advisor's advice, may be taken.[12] Utilization of such

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[10] Although the Guidelines are not directly intended to clarify matters such as the duty of care and duty of loyalty of directors under the Companies Act, a "fair price," or the issue of how courts should examine a "fair price," it is expected that by referring to and acting based on the best practices presented in the Guidelines, the risk of breaching the duty of care and duty of loyalty of directors will be reduced, and the transaction terms agreed between the parties more likely will be respected.

[11] In principle, we assume an independent outside director who is registered as an independent director at a financial instruments exchange. Having this said, in the context of an acquisition, a person who lacks independence in connection with the acquisition should be excluded. Independence in connection with acquisitions means independence from the parties involved in the acquisition and from the success or failure of such acquisition (i.e., not having any material interest that differs from the shareholders), and should be substantially determined for each particular acquisition transaction, taking into account the specific circumstances such as the relationship with the acquiring party and the target company as well as the relationship with the relevant acquisition.

[12] In MBO transactions and acquisitions of controlled companies by the controlling shareholders, measures to ensure the fairness of the transaction are particularly important because of the structural conflicts of interest inherent in such transactions. On the other hand, another issue apart from structural conflicts of interest is the conflicts of interest with respect to whether incumbent management and directors can remain in office post-acquisition and the treatment of employees. In other words, there is potential threat that priority is given on the interests of management, directors, employees and others over the shareholders' common interests. However, the degree of such conflicts depends on the circumstances, so case-by-case judgment is required as to the degree of appropriate measures compared to MBOs etc. See the Fair M&A Guidelines for the concept of "Fairness Ensuring Measures" in the context of MBOs and acquisition of controlled companies by the controlling shareholders.

fair procedures usually contributes to ensure the interests that shareholders should enjoy (see "**3.3 Ensuring Fairness - Supplementary Functions and Points to Note regarding the Special Committee**").

The terms such as "shareholders' common interests," "interests of shareholders" and "interests to be received by shareholders" used in the Guidelines include only the interests to be received in their capacity as shareholders, and not the interests to be received in any other non-shareholder capacity (for example, the acquiring party, the target company's directors, and shareholders who share a significant interest with either of them have different interests in the acquisition than other shareholders).

### 2.2.3 Respecting the Intent of Shareholders and Ensuring Transparency

Although, in principle, the rational intent of shareholders should be relied upon in matters involving the corporate control of a company, there are information asymmetries between the acquiring party and the target company's board of directors on the one hand, and its shareholders on the other. Sufficient information must be provided so that the shareholders can make the correct decision regarding the merits of the acquisition and the transaction terms.

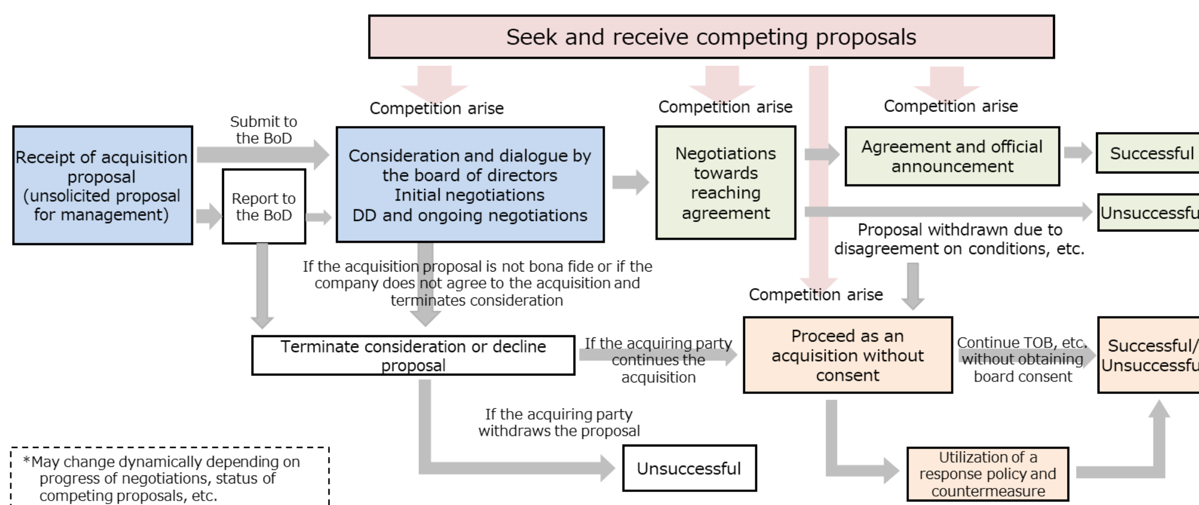
Thus, Principles 2 and 3 are required as a prerequisite for materializing Principle 1. Normally, respecting shareholders' intent in an acquisition takes the form of obtaining judgment of shareholders such as through their decision to tender shares or not. Regulatory frameworks are established to ensure that the necessary information (including a statement of opinion by the target company) is available and there is time for the shareholders' judgement. Basically, the expectation is that through compliance with these regulations by the acquiring party and the target company, transparency will be enhanced, and with the sufficient information and time, appropriate decision (informed judgment) shall be made by the shareholders. In this regard, the acquiring party should provide explanation to the target company until the acquisition is publicly announced, and after the announcement, the acquiring party should fulfill its duty to explain to the market, including shareholders, through appropriate descriptions in the tender offer registration statement and other documents. The board of directors of the target company is also required to present its own opinion to shareholders, apart from its own interests, as to

whether it believes that the proposed acquisition will contribute to enhancing corporate value and securing interests of shareholders, and whether there are other more desirable alternatives.

On the other hand, from the perspective of ensuring transparency, takeover response policies or countermeasures may be applied in response to an acquisition attempt without consent, at the initiative of the company in exceptional and limited circumstances where the regulatory frameworks as described above are not considered to be sufficient. In such event, it is fundamental to confirm what the reasonable intent of shareholders is at a shareholders’ meeting in respect of approval or rejection of takeover response policies and countermeasures in response to such an acquisition attempt.

# Chapter 3 Code of Conduct for Directors and Board of Directors regarding Acquisition Proposals

This chapter guides a phase-based approach to the code of conduct for each director and the board of directors regarding acquisition proposals to acquire corporate control. An example of the flow of issues to be considered in connection with an acquisition proposal is illustrated below.




Essentially, each director and the board of directors are expected to increase corporate value by exerting management efforts during the normal phase, and to take steps to ensure that such increase of corporate value is reflected in market capitalization.

From this perspective, it is important that the composition of the board of directors is highly independent (for example, by increasing the ratio of outside directors to majority), and that such a board of directors examines the company's business plan (business strategy and financing plans) and capital structure, periodical review of the business portfolio[13], dialogue with investors and enhancement of information disclosure, promotion of the increase of stock liquidity, management succession and enhancement, M&A and other subjects. In particular, companies whose shares are objectively undervalued in the market are expected to be more proactive in such efforts.

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[13] See the "Practical Guidelines for Business Transformations" (METI, formulated on July 31, 2020) which demonstrates the best practices for reviewing business portfolios.

Such efforts to enhance corporate value during the normal phase will also enable the board of directors, upon receiving an acquisition proposal, to promptly compare the details of the proposed acquisition with the measures to enhance corporate value if the incumbent management team continues to manage the company. Realizing synergies through acquisitions and improving inefficient management are among the important ways for management to bring corporate value closer to, or to increase, its intrinsic value.

## 3.1 Upon Receipt of an Acquisition Proposal

### 3.1.1 Submitting and Reporting the Proposal to the Board of Directors

In principle, upon receipt of an acquisition proposal to acquire corporate control, management or directors should promptly submit or report such matter to the board of directors.[14]

If an acquisition proposal has a certain degree of credibility in addition to its specifics, the potential opportunity for a desirable acquisition to materialize should not be lost by not submitting the matter to the board of directors. Even if an acquisition proposal is not submitted to the board of directors, it should be promptly reported so that the board of directors can exercise its supervisory function over management.[15]

Whether an acquisition proposal should be submitted to the board of directors shall be judged formally and objectively, and one of the important factors in judging it is whether the proposal is specific, such as being in written form rather than oral, identifying the acquiring party rather than anonymous, and inclusion of the purchase price and timing of the acquisition.[16] In

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[14] The term "submit" herein refers to the submission of an acquisition proposal to the board of directors for substantive deliberation and consideration (the intent here is not to limit the categories of agenda items for board meetings in companies to specific categories, such as resolution matters or deliberation matters). In some cases, the proposal can be first reported and subsequently submitted for discussion and consideration at a later board of directors meeting.

[15] If a person who may have conflicts of interest is a member of the board of directors, such as a person affiliated with the acquiring party, a person from a competitor of the acquiring party, and a person from a controlling shareholder, it is necessary to consider appropriate measures such as comprehensive management and control of information and exclusion of the relevant director from the board's deliberations and resolutions, taking into account the significance of the relationship between such director and the acquiring party, the competitor or the controlling shareholder, among other specific factors.

[16] As an acquiring party, in order to proceed with the transaction on the basis of a friendly proposal, there may be circumstances where a dialogue is initiated without specifying the terms and conditions at the

determining how to handle the proposal at the board of directors' meeting (e.g., whether to submit or merely to report), in addition to the specifics of the acquisition proposal, credibility of the acquiring party, for example its track record[17] as an acquiring party and the probability of its financial strength,[18] may also be considered.

#### 3.1.2 Consideration by the Board of Directors

The board of directors to which the matter is submitted shall in general give "sincere consideration" to a "bona fide offer."[19] Whether an acquisition proposal corresponds to a "bona fide offer" (an acquisition proposal that is specific, rationale of purpose, and feasible) is one

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initial stage, or where a proposal does not take a written form. This section does not deny the submission or reporting of such proposals to the board of directors.

[17] For example, track records can include previous acquisitions successfully closed, or increased corporate value of an acquired company. In some cases, it may be better not to make a mechanical judgment merely based on whether the acquiring party has sufficient track record, since there are circumstances where a strategic acquirer acquires another company in the same industry where restructuring was uncommon within such industry in the past, or where the acquiring party includes an individual with extensive experience and proven track record.

[18] Since it is normal that a written statement of financial resources for the acquisition is not presented at the initial stage of the proposal, the probability of the acquiring party having sufficient financial resources can be considered by referring to publicly available information such as financial information and past track record.

[19] With respect to the factors that can be considered in light of the stage and perspectives regarding the board of directors' consideration, Sections 3.1.1 and 3.1.2 provides as follows at each stage of the process:
(1) At the stage of determining whether the management or director who received the acquisition proposal should submit or report (as at the point in time) to the board of directors: the concreteness and credibility of the proposal that can be judged formally and objectively;
(2) At the stage of determining whether the proposal is worth further consideration by the board of directors: the concreteness, rationale of purpose, and feasibility of the proposal, taking into account the time and cost that will be involved in the consideration; and
(3) At the stage of considering the appropriateness of the acquisition from the perspective of whether it will contribute to the enhancement of corporate value: the management strategy after the acquisition, the appropriateness of the purchase price and other transaction terms, the acquiring party's financial resources, track record and management capabilities, and the feasibility of the acquisition, among other factors.
Having this said, in practice, it is expected that some of the considerations during stages (1) through (3) may overlap, so all of these factors should be continuously regarded in order to determine whether the proposal is ultimately capable of enhancing corporate value, and are not always clearly distinguishable. Based on the above, it is expected that the board of directors' awareness of each of the factors to be considered in steps (1) to (3) can serve as steppingstones for an effective consideration of acquisition proposals from a multifaceted approach.

indicator that the board of directors should consider in determining whether it is worth spending the cost and time to give "sincere consideration" to such proposal. These criteria are intended to be used not only at the initial stage of consideration, but also when deciding whether to continue or terminate the consideration at a later stage.[20]

For example, by comprehensively considering the factors set forth below, a determination could be made that an acquisition proposal does not constitute a "bona fide offer" if the concreteness, rationale of purpose, or feasibility of the proposal is reasonably doubtful. However, it is important to take care not to arbitrarily interpret the meaning of a "bona fide offer" and simply reject a proposal that may increase corporate value. If there is hesitation over whether an acquisition proposal constitutes a "bona fide offer" or if the outside directors lack expertise in M&A matters, the board of directors should consider obtaining outside advisor's advice based on appropriate management and control of non-public information.

(a) Specifics may be reasonably doubtful if:
- Acquisition proposal does not specify the details of the purchase price and key transaction terms

(b) Rationale of the purpose may be reasonably doubtful if:
- Acquisition proposal does not indicate the management strategy after acquiring corporate control[21]
- Acquisition proposal is made for the purpose of raising the purchase price of other parties (in situations where there are other competing bidders)
- Acquisition proposal is made by competitors for a purpose such as gaining confidential information

(c) Feasibility may be reasonably doubtful if:
- Acquisition proposal without appropriate financing of the transaction[22]

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[20] As described in 2. of "**Appendix 1: Specific Actions of Directors and the Board of Directors**," these factors can be considered when deciding whether to allow due diligence for the potential acquirer and its scope.

[21] If the acquiring party indicates a specific management strategy, it is easier for the target company to understand that the rationale purpose of acquiring corporate control is to execute the management strategy, but if no management strategy is indicated at all, there may be reasonable doubt on the rationale of the purpose.

- Acquisition proposal is objectively unlikely to succeed due to the low probability of satisfying the conditions for acquisition, such as regulatory permits and approvals[23]
- Acquisition proposal aims to obtain controlling interest in situations where the controlling shareholder is known to have no intent of selling its controlling shares to a third party[24]

The board of directors, in proceeding with its "sincere consideration" of an acquisition proposal that is a "bona fide offer," is expected to obtain additional information from the acquiring party about the acquisition proposal, and should consider the appropriateness of the acquisition from the perspective of whether the acquisition will contribute to enhancing corporate value, with a focus on the post-acquisition management strategy, the appropriateness of the purchase price and other transaction terms, the acquiring party's financial resources, track record and management capabilities, and the feasibility of successful completion of the acquisition. If the company's stock price is significantly below the proposed price, that may provide an opportunity for the board of directors (especially outside directors) and the management team to recognize the issue of why such a discrepancy occurs, and to consider and analyze the situation.

In doing so, the purchase price and other transaction terms should be seriously examined. If an increase in corporate value can be reasonably expected from the acquisition proposal, as

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[22] In addition to balance certificates, loan certificates and commitment letters, a letter issued by a financial institution identifying the target company and indicating a high degree of certainty of financing (a "highly confident letter") is also considered to demonstrate the acquisition financing to a certain degree. However, at the initial stage of a proposal (prior to conducting due diligence), it should not be decided that the acquisition proposal is not feasible solely because such a document has not been presented. The probability of the acquiring party's financial resources should be considered by referring to the acquiring party's financial information, past track record, and other publicly available information.

[23] However, if it is reasonably possible to obtain the necessary permits and approvals under the competition laws and foreign direct investment laws by taking the necessary procedures and measures to resolve the issues (remedies), the probability of obtaining such permits and approvals (and in turn the feasibility of the acquisition proposal) should not be judged as low at the initial stage.

[24] At initial stage, even if a controlling shareholder is known to have no intent of selling its controlling shares to a third party, it may be inappropriate to decide solely from such circumstance that the feasibility is doubtful. Although a sale of controlling shares held by a controlling shareholder to a third party is primarily a matter to be decided through negotiations between the acquiring party and the controlling shareholder, the target company may be able to approach the controlling shareholder to sell its shares if it desires, or the controlling shareholder may be willing to sell the controlling shares if the purchase price is attractive.

suggested by a purchase price that is considerably higher than the historical stock price level,[25] each director and the board of directors should give the proposal due consideration.

In addition, it is advisable for the board of directors to thoroughly compare, from a quantitative perspective, the differences between the purchase price and measures to enhance corporate value through acquisitions proposed by the acquirer, and the measures to enhance corporate value if the incumbent management team were to continue to manage the company.[26]

Furthermore, the board of directors should act in a manner that allows it to be responsible for explaining (afterward) the rationale behind its reactions to acquisition proposals and their decisions on whether to accept acquisition proposals.[27] Often, the proposed purchase price can be higher than the immediately preceding stock price (which is formed on the basis of the market's evaluation of the incumbent management team and its management strategy). If the board of directors decides not to support such acquisition proposal, one approach is, prior to making such decision, to compare the alternatives on the assumption that a post-decision explanation may be required in this regard.

In addition to the foregoing, a confidentiality agreement and due diligence cooperation should be considered by the company if they are necessary for the acquiring party or target company to disclose the information necessary to continue the consideration and discussion of the

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[25] Medium to long-term values, such as values related to environmental and social responsibility and human resource, are now being increasingly reflected in market stock prices. If the company's market stock price continues to remain at a level considered to be significantly below the intrinsic value of the stock, efforts should be made by the company to ensure that the medium to long-term value of the stock is reflected in the stock price as described above.

[26] As a prerequisite for a sufficient comparison between the alternatives, it should be remembered that sufficient information disclosure by the target company is important, while in determining whether and to what extent a target company should respond to due diligence requests, the target company should comprehensively consider various factors (see 2. of "**Appendix 1: Specific Actions of Directors and the Board of Directors**"). On the other hand, it is not ideal to require an acquiring party to disclose and provide unreasonably detailed information at a stage where the acquiring party has not been given or only had a limited opportunity to conduct due diligence.

[27] The accountability here means the duty to explain upon a public announcement of an acquisition or when the directors' duty of care or loyalty is scrutinized later. As described in b) of "**4.2 Information Disclosure by Target Company**," it is worth noting that making disclosures about the acquisition proposal without media coverage or rumors, at the stage when the acquisition is still under consideration, could lead to a significantly negative situation. For example, it may cause various speculations, and the market reaction to such speculation may force the acquisition to be terminated.

acquisition proposal. For a summary of basic perspectives on these matters, see 1. and 2. of "**Appendix 1: Specific Actions of Directors and the Board of Directors**."

## 3.2 When the Board of Directors Decides on a Direction toward Reaching Agreement of an Acquisition

### 3.2.1 Possible Scenarios

As stated in "**2.2.2 Enhancing Corporate Value and Securing Shareholder Interests**" above, especially when deciding on a direction toward reaching agreement of an acquisition, the directors and board of directors of the target company (including the special committee if it is established; this inclusion shall apply hereinafter) should make reasonable efforts to ensure that the acquisition will be based on terms that will secure the interest which shareholders should enjoy, in addition to determining whether the acquisition is appropriate from the perspective of enhancing the company's corporate value (see "**3.2.3 Negotiations Aimed at Best Available Transaction Terms for Shareholders**"). Where these efforts are properly made, it is more likely that the acquisition will increase corporate value and the transaction terms will enable the increase in corporate value to be fairly distributed among the acquiring party and the target company's shareholders.

When the board of directors has examined and decided on a direction toward reaching agreement of an acquisition aiming to acquire corporate control, more careful consideration of the interests of shareholders becomes necessary. The company is expected to be more responsible for explaining its actions, since the probability that an acquisition will have impact on the interests of shareholders increases and thereafter the main issue will be the price and other transaction terms.

For example, if the target company actively seeks acquisition proposals for the transfer of corporate control and enters into negotiations to select a proposal and to fix the terms and conditions, or enters into negotiations to reach an agreement to accept a proposal from an acquiring party to acquire corporate control, such cases are likely to be considered as "when the board of directors decides on a direction toward reaching agreement of an acquisition."

In addition, if a competing proposal is made during such a case, and multiple proposals with different transaction terms are presented and become publicly known, the issue of whether the interests of shareholders are being considered (i.e., whether the best choice is being made regarding the price and other transaction terms) is particularly likely to be focused on, and the importance of the responsibility for explaining to the market likely will increase.

### 3.2.2 Differences in Acquisition Ratio and Acquisition Consideration

When the board of directors decides on a direction toward reaching agreement of an acquisition, especially if the proposal is for an all-cash, full acquisition (an acquisition which the acquiring party is committed to ultimately acquire 100% of the shares), the appropriateness of the transaction terms in terms of price will be particularly important to shareholders because it is the last opportunity for shareholders to gain benefit (including a control premium) from their investment in the target company's stock. In such type of transaction, if the second-step squeeze-out as part of the acquisition structure guarantees the exit opportunity at the same price, the coercion issue is diminished, and the transaction terms are particularly important in terms of price, since the acquiring party is usually confident with its management strategy to increase value as it will be assuming all the risks borne as a shareholder (unless the acquiring party is planning dissolution of the company or discontinuance of the business).

By contrast, if the proposal is for a partial acquisition, a principal factor in the shareholder's decision-making is that, even if the transaction terms of the deal are good in terms of price, shareholders may not be able to sell all of their shares at that price. Therefore, if the problems caused by a partial acquisition are significant, a possible approach is to negotiate to change the acquisition to a full acquisition, thus eliminating such problems. In addition, since some shareholders will remain as minority shareholders after the acquisition, not only the appropriateness of the transaction terms in terms of price, but also whether the corporate value after the acquisition will increase over the medium to long-term will be a particularly important decision factor for shareholders compared to a full acquisition. Therefore, it is particularly important to provide information regarding post-acquisition measures to enhance corporate value, among other matters, which are necessary for shareholders to make its decisions.

If all or part of the consideration for the acquisition is shares, shareholders who accept the offer will retain the shares received as consideration post-acquisition, so not only the appropriateness of the transaction terms in terms of price (e.g. exchange ratio) but also whether the value of the corporate group after the acquisition (value of the shares received as consideration) will increase over the medium to long-term will be an important decision factor for such shareholders. Therefore, it is particularly important to provide information regarding the corporate value enhancement measures and the appropriateness of the consideration (information on shares to be used as consideration and whether the market valuation thereto is appropriate), which are necessary for shareholders to make their decisions, and appropriate explanation of such matters is required for this purpose.

#### 3.2.3 Negotiations Aimed at Best Available Transaction Terms for Shareholders

When the board of directors decides on a direction toward reaching agreement of an acquisition, the board of directors should negotiate diligently with the acquiring party with the aim of improving the transaction terms (including the purchase ratio and purchase consideration, in addition to the price; the probability of a transaction occurring is also an important factor) so that the acquisition is conducted on the best available transaction terms for the shareholders.

Specifically, each director and the board of directors should make all reasonable efforts not only to enhance corporate value but also to secure interests of shareholders. An example of such reasonable effort is to extensively negotiate with the acquiring party to raise the purchase price to a level commensurate with the corporate value, taking advantage of the existence of competing proposals if any to seek a price increase to a level comparable to such competing proposals, and, if each director and the board of directors consider the problems caused by a partial acquisition to be significant, to negotiate with the acquiring party to change the structure to a full acquisition.[28]

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[28] When corporate control will be transferred by selling the controlling shareholder’s interest to the acquiring party, many matters will be agreed between the acquiring party and the controlling shareholder, so there may be certain restrictions on the scope of negotiation the target company’s board of directors may be involved. The target company’s board of directors should use its reasonable efforts within such restrictions.

It is also reasonable to aim to improve the terms of an acquisition, by publicly announcing facts concerning the acquisition to create an environment where other potential acquiring parties can make competing proposals after the announcement (indirect market check), or by seeking out potential acquisitions that will benefit the shareholders (proactive market check).[29]

Normally, these types of diligent negotiations and the search for potential acquisitions are expected to result in the best available transaction terms for shareholders, while enhancing corporate value.

Notwithstanding such efforts being carried out, if the board of directors still makes an exceptional decision to endorse a proposal that is considered to be conducive to enhancing corporate value but is not sufficiently priced,[30] the board of directors should fully explain the reasonableness of its decision.[31] It should be noted that, in practice, even if the board of directors accepts such a proposal, there is the possibility that shareholders will not fully tender their shares for the tender offer or will not vote in favor of the proposed acquisition at the shareholders' meeting, resulting in non-consummation of the acquisition.

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[29] Proactive market checks include (1) bidding procedures (auctions) or individual approaches to multiple potential candidate acquirers, before an agreement is reached with a specific acquiring party to execute the M&A and announced, and (2) active solicitation for counter-proposals by the target company, for a certain period after agreement with a specific acquiring party and announcement (so-called "go-shop"). Having this said, active market checks may have disincentive effect on acquisitions in general by reducing the incentive for potential acquiring parties to prepare acquisition proposals at its cost, or raising concerns from the perspective of controlling and managing non-public information, among other issues. Furthermore, proactive market check may increase competition among multiple potential acquiring parties and cause a potential acquiring party to leave negotiations, which should be considered especially if closing of the transaction is imperative. See Section 3.4 of the Fair M&A Guidelines for further details of the market check concept.

[30] When the company's board of directors makes such an exceptional decision, in practice, when expressing its opinion to a tender offer launched by the acquiring party, there are cases where the board of directors approves the acquisition from the corporate value perspective, but not approving a recommendation to shareholders to tender their shares from the shareholders interest perspective (for example, resolving an opinion to leave the decision whether to tender the shares to the judgement of each shareholder). Having this said, if the transaction terms are unreasonably outside of the appropriate range for the interests of shareholders, in many cases, the rationale of the decision that the acquisition contributes to the enhancement of corporate value itself may be questionable, and in turn the company should not have approved the tender offer.

[31] A high degree of explanation is required especially in the case of a full acquisition.

In addition to the foregoing, please refer to 3. of "**Appendix 1: Specific Actions of Directors and the Board of Directors**" for perspectives on considerations and negotiations.

### 3.3 Ensuring Fairness - Supplementary Functions of the Special Committee and Matters to be Noted

As described in "**2.2.2 Enhancing Corporate Value and Securing Shareholder Interests**" above, fair procedures (i.e., "Fairness Ensuring Measures") such as the establishment of a special committee or seeking advice from outside advisors may be implemented depending on the degree of conflict of interests, the degree of information asymmetry issues, the circumstance surrounding the target company and the transaction structure. Utilization of such fair procedures usually contribute to ensure the interests of shareholders.

Particularly in companies where the majority of the board of directors is not constituted by outside directors, to establish an independent special committee and to respect its judgment may be beneficial to supplement the independence of the board of directors and to ensure the fairness of the transaction.

On the other hand, in ordinary acquisitions between third parties other than MBOs and acquisitions of controlled companies by controlling shareholders (transactions where structural conflicts of interest exists), at the initial stages after receiving an acquisition proposal, there are cases where the probability of an acquisition occurring is low. Always requiring a special committee from such an initial stage may impose excessive burden on the company. In addition, even in the case where a special committee is considered effective, the benefit of establishing a separate special committee may be relatively limited for a company with majority of its board of directors constituted by outside directors.

Therefore, the necessity of establishing a special committee should be considered on a case-by-case basis, depending on the degree of conflicts of interest, the need to supplement the independence of the board of directors, and the need to provide explanation to the market. For example, a special committee is useful in the following context:

- When the appropriateness of the transaction terms is considered particularly important to the interests of shareholders because the proposal includes cash-out[32]
- When considering takeover response policies or countermeasures[33]
- Other cases where accountability to the market is considered high (e.g., when there are multiple publicly known acquisition proposals)[34]

* In addition to the types of transactions discussed above, it is advisable to establish a special committee when structural conflict of interests issues exist in connection with the transaction, such as an MBO or acquisition of controlled companies by controlling shareholders (see Fair M&A Guidelines).

In these cases, in connection with the board of directors making a decision on whether to approve or reject an acquisition proposal, it is advisable for the board of directors to make its decision with the utmost respect for the independent special committee's judgement, based on an appropriate understanding and appreciation of such judgment.

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[32] In addition, in a cash-out proposal, taking measures to ensure the fairness of the transaction terms and other aspects is highly significant, since a dispute may arise during the court review of the share purchase price (whether the price was fair) during the share purchase demand procedure (appraisal right) at the court. Note that the "Code of Corporate Conduct for Matters to be Observed Pertaining to Significant Transactions, etc. with Controlling Shareholders" (issued by the financial instruments exchanges) requires to obtain an opinion from a person without interest in the controlling shareholder (such as a special committee) that the squeeze-out procedures subsequent to the tender offer are not disadvantageous to minority shareholders. Therefore, in practice, often a special committee is established from the initial stage of a tender offer process.

[33] It is worth noting that if a special committee is established only in name and without substance, respecting its recommendations does not mean that the board of directors' decision is justified. The board of directors should be responsible for determining whether it is necessary to establish a special committee, as well as its composition, and should be responsible for explaining to shareholders that its decision is reasonable. See the 2008 Report which discusses the same.

[34] If more than one acquisition proposal is publicly known, explanation is required regarding how the different transaction terms, corporate value enhancement measures and other factors were compared and considered. In addition, depending on the circumstance, the company's duty to explain the corporate value enhancement measures and the appropriateness of the acquisition consideration (i.e., information on shares to be used as consideration and whether the market valuation thereto is appropriate) may become particularly important in the case of a share-consideration acquisition proposal. Other circumstances where establishment of a special committee is worth considering include when the company's duty to explain is considered to be particularly heightened due to the size and development of a particular deal.

In addition, the special committee should basically consist of outside directors, given that outside directors: (1) have legal duties and responsibilities to the company, (2) are expected to be directly involved in management decisions as members of the board of directors, and (3) have a certain level of knowledge of the target company's business.[35] Note that an independent outside director who is registered as an independent director at the financial instruments exchange may not always be recognized as being independent from the parties involved in an acquisition, or as being independent from the success or failure of an acquisition (i.e., certain outside directors may have a material interest that differs from that of the shareholders).[36]

In cases where outside directors lack expertise in M&A, in addition to trying to improve the M&A literacy of the outside directors, one approach is to retain advisors to seek for professional advice. If it is not appropriate to have only outside directors as members of the special committee from the perspectives such as lack of independence and other factors, the next best approach may be to have outside auditors or external experts as members of the special committee as necessary.

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[35] There are arguments that it may be useful to include internal directors who are familiar with the business as members of the special committee, while at the same time ensuring the high degree of independence by comprising the majority of the special committee with outside directors (at least from outside of the company).

[36] See footnote 11.

# Chapter 4 Increased Transparency Regarding Acquisitions

This chapter presents how transparency in acquisitions should be improved from the perspective of both the acquiring party and the target company in order to realize Principles 2 and 3 (Principle of Shareholders' Intent and Principle of Transparency) regarding acquisitions that aim to acquire corporate control of listed companies.

## 4.1 Information Disclosure and Provision of Time by the Acquiring Party

### 4.1.1 Acquisition of Shares and Disclosure of Information by an Acquiring Party

When an acquiring party proceeds with the acquisition of shares, the nature of the investment, its impact on the market, and the required level of transparency differ depending on the stage – the stage at which it acquires 5% of the shares or less (the initial stage), the stage after it acquires more than 5% of the shares and files a large shareholding report (the stage of over 5%), and the stage at which it acquires corporate control by acquiring shares in the market or by launching a tender offer (the stage at acquisition), as an example.

At each stage, it is expected that the acquiring party will comply with the large shareholdings reporting regulation and the tender offer regulation to increase transparency and provide shareholders with sufficient information and time allowing to make an appropriate decision (informed judgment). Specifically, the following information should be considered to be disclosed and provided to shareholders.

#### 4.1.1.1 Disclosure and Provision of Information at the Time of Acquisition

It is advisable for persons intending to file a large shareholding report or tender offer registration statement to make full disclosure of the purpose of the acquisition in accordance with these regulations.

In the case of an open-market purchase, the information disclosure regulations under the tender offer regulation do not apply. However, in a situation such as an acquirer attempts to

acquire corporate control in a short period of time through open-market purchase, it is advisable for the acquirer to provide at least the same level of appropriate information to the capital markets and the target company as in the tender offer registration statement in a timely manner and an appropriate form, such as the purpose of the purchase, the number of shares to be purchased, summary of the acquiring party, and the basic management strategy after the acquisition, so that shareholders can decide whether to accept the acquisition proposal after understanding the impact of the acquisition on the company's corporate value.[37, 38]

In addition, if significant changes in relationships with stakeholders (such as employees and major business partners) are envisioned after the acquisition, it would be beneficial for shareholders and investors to disclose and provide information regarding the contemplated strategies, given the importance of such information.[39]

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[37] It should be noted that for information requests from the target company to the acquiring party, asking overly detailed questions to an acquiring party should not be used as a tactic to effectively prevent potential acquisition of management control, and outside directors should provide appropriate supervision from this perspective.

[38] In relation hereto, there is another issue regarding transparency in cases of corporate control acquisition, where a shareholder proposing an election or dismissal of directors acquires a significant amount of shares in concert with other shareholders, without disclosing its intention to acquire corporate control, and subsequently requests a convocation of the shareholders' meeting to resolve its proposal to replace the directors with those whom it can influence. Such a situation involves the possibility that a specific party may acquire corporate control without the shareholders deciding on the pros and cons of the acquisition (as a result of the dispersion of shareholdings among multiple parties, there also may be a risk of violating or circumventing large-shareholding reporting regulations). In addition, when a request to convene a shareholders' meeting is made, the issue of insufficient information is likely to arise because relevant information is not disclosed in the reference documents for the shareholders' meeting, in contrast to a tender offer. For these reasons, when making a request to convene a shareholders meeting to replace a number of directors for the purpose of acquiring corporate control, it is advisable for the acquirer requesting for the meeting to furnish shareholders with a summary of the purpose of the request, the person requesting the meeting (and the persons, if any, who have agreed with the person requesting for the meeting on the acquisition or disposal of shares, or the exercise of rights as shareholders), the basic management strategy after the proposal is approved, and other appropriate information at least to the same extent as that contained in the tender offer registration statement.

[39] The "Guidance for Integrated Corporate Disclosure and Company-Investor Dialogue for Collaborative Value Creation 2.0" (METI, revised on August 30, 2022), in "2-2.2.2. Relationships with Stakeholders to Support Competitive Advantage," describes the importance of information regarding relationships with stakeholders when making investment decisions.

#### 4.1.1.2 Toehold and Disclosure of Intent of Acquisition

When considering an acquisition, an acquiring party's strategy may be to establish a small capital relationship with the target company through a pre-acquisition purchase (toehold) in order to gain an understanding of the company's status, and then decide whether to proceed with an acquisition proposal. Acquiring shares in advance also has the effect of increasing the likelihood of a successful tender offer for the acquisition. Thus, pre-acquisition purchases have significance in advancing acquisitions and should not be negatively regarded.

However, if a party has a clear intent of acquisition but advances to buy shares without revealing this intention, other shareholders may sell their shares at a lower price (which does not reflect a control premium).

Therefore, it is advisable for a party intending to make an acquisition, if the party is definite about its intention to make a subsequent tender offer, to provide information to the capital markets and the target company when advancing to purchase the company's shares in the market prior to its tender offer[40].

#### 4.1.1.3 Information Disclosure concerning Advanced Notice of Planned Tender Offer

In Japan, there are no strict regulations on declaring an intention of an acquisition. In practice, there are examples of so-called "advance notice of planned tender offer," in which an acquirer announces its intention to launch a tender offer prior to the public notice of the commencement of the tender offer.

Such advance notice of planned tender offer is considered highly necessary from a practical viewpoint in some cases, such as when it is necessary to announce the planned acquisition prior to the stage of commencing the acquisition process to counter a tender offer by another potential acquiring party and to obtain support from the target company's shareholders for the acquisition it contemplates, or when the acquisition needs to be announced at a planned stage for obtaining

[40] It should be noted that, if the party is definite about its intention to make a subsequent tender offer and provide such information to the capital markets, the same issues as stated in "**4.1.1.3 Information Disclosure concerning Advanced Notice of Planned Tender Offer**" may arise.

permits and approvals (such as clearance under competition laws) in connection with the acquisition.

By contrast, in such practice, there is an aspect of destabilizing the market and the position of the target company in cases, for example, where there is no rational basis for an actual launch of a tender offer which could amount to spreading false information or market manipulation,[41] or where the conditions for launching a tender offer and the scheduled commencement date of the process are not clearly stated and the tender offer is not commenced nor the acquisition offer is withdrawn for a long period of time.

In light of these competing perspectives, when announcing an advanced notice of a planned tender offer, it is advisable for the potential acquirer to have a reasonable basis for actually commencing the tender offer, such as having the financial resources required for the acquisition, and to disclose specific information that contributes to market understanding, such as the conditions under which the tender offer will be launched and the scheduled commencement date.

In the event that an advance notice of a planned tender offer is announced, but the tender offer cannot be commenced within a reasonable period of time,[42] from the viewpoint of market stability, it is in principle advisable to withdraw the notice.

#### 4.1.1.4 Information Provision and Disclosure of Substantial Shareholders

Although there are certain disclosure requirements for so-called "substantial shareholders" (beneficial shareholders) under the large shareholdings reporting regulation,[43] there are cases in

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[41] According to the answer to Q48 of "Q&A on Tender Offers for Share Certificates, etc." by the Policy and Markets Bureau of the Financial Services Agency, while the legitimacy must be judged on a case-by-case basis, for example, if a company announces that it may commence a tender offer even though there is no reasonable basis to actually commence a tender offer, this may be considered as spreading false information (Article 158 of the Financial Instruments and Exchange Act) or market manipulation (Article 159, Paragraph 2, Item 2 of the Financial Instruments and Exchange Act).

[42] If an announcement of a planned acquisition is necessary for the purpose such as obtaining permits and approvals (e.g., clearance under competition laws), even if it takes a considerable period of time (including extensions) until launching a tender offer, it should be considered to be "within a reasonable period of time."

which “substantial shareholders” are not identified at a stage not subject to such regulations (e.g., holding 5% or less of the total shares).[44]

Therefore, if a person making an acquisition proposal is a “substantial shareholder,” it is necessary to provide the target company with information regarding the fact that the acquirer is a substantial shareholder and the relationship between such substantial shareholder and the nominee shareholder. In order to foster a relationship of trust with the target company, it is advisable for the acquirer to respond in good faith when asked by the target company about the extent to which there are any joint holders, and if there are circumstances which can be inferred that a person is a joint holder,[45] it is advisable for the acquirer to provide relevant information.

Even at a time where no formal acquisition proposal has been made, if a target company recognizes based on objective facts the possibility of an acquisition by a specific entity or person, and seeks to confirm certain facts in order to engage in a dialogue with that entity or person, it is advisable for the entity or person in question to confirm facts such as regarding whether such entity or person is a substantial shareholder and regarding any joint holder relationships. In addition, it is advisable for custodians who are nominee shareholders for such entities or persons to cooperate in confirming facts regarding the “substantial shareholders” for which they hold shares after confirming intention of such entities or persons.[46, 47]

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[43] Large volume holders include not only persons who hold share certificates, etc. under its own name or under the name of others, but also persons who is authorized to invest in share certificates, etc. based on discretionary investment contracts or other contracts or legal provisions (Article 27-23 and subsequent provisions of the Financial Instruments and Exchange Act), and therefore institutional investors and other substantial shareholders who do not appear on the shareholders registry are also subject to reporting obligations.

[44] Japan does not have regulations for identifying substantial shareholders, comparable to the U.S. regulation for disclosure of ownership report by institutional investors (Form 13F) or the U.K. regulation for disclosure request.

[45] Example of such circumstance is when there are multiple parties with an appearance of acting in concert to acquire corporate control, and there are reasonable grounds to suspect the existence of an agreement for joint acquisition or to jointly exercise the statutory rights as shareholders.

[46] However, confirmation of such fact may be constrained by the agreement between the substantial shareholder and the custodian.

[47] Relatedly, from the perspectives such as economic security, some advocates argue that disclosure of the beneficial owner (UBO) (controlling shareholder who directly or indirectly holds more than a certain percentage (e.g., a majority) of the voting rights of a large shareholding reporter) should be obligated under the regulations, referring to the regulations in the U.K. and certain other countries. Some advocates also argue that in friendly acquisitions, the acquiring party may inform the target company about the UBO, so it is desired to have similar practices to inform the target company about the UBO for acquisitions in

#### 4.1.2 Provision of Time to Consider the Acquisition Proposal

For the target company's shareholders to have the opportunity to make an informed judgement, it is important that the shareholders and the board of directors are provided not only with information, but also given sufficient time to consider.

If a tender offer is launched without negotiations with the target company, there may be insufficient time for the target company's shareholders and board of directors to consider and prepare for the acquisition. Under the tender offer regulation, a target company may extend the tender offer period for up to 30 business days, but if such time period is objectively considered insufficient,[48] it is advisable for the acquiring party to set a longer tender offer period than originally proposed, or extend the period for a reasonable time period, taking into account the needs of the target company and its shareholders.

If the target company's shares are acquired through a rapid open-market purchase rather than by way of a tender offer, the target company's shareholders and the board of directors may not have sufficient time to make a decision. Generally speaking, it is advisable for the acquiring party to design a process and time schedule that allows sufficient time for shareholders and others to make its decisions.

If a confidentiality agreement is to be entered into between an acquiring party and a target company, a standstill clause or similar provision that sets forth a certain reasonable time period can be used to ensure appropriate negotiation period and opportunities (see 1. of "**Appendix 1: Specific Actions of Directors and the Board of Directors**"). From an acquiring party's perspective of fostering a relationship of trust with the target company, it is reasonable to enter into a confidentiality agreement with such provisions and to allow sufficient time when advancing with the matter.

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general. Mandatory disclosure of UBOs is not a subject of the Guidelines, since it is an issue that should be resolved in a cross-sectional manner regardless of whether a company is listed or not, from the perspective such as economic security and anti-money laundering under the Foreign Exchange and Foreign Trade Act and the Act on Prevention of Transfer of Criminal Proceeds, etc. Development of future discussion on this issue will be noted.

[48] Article 27-10, Paragraph 2, Item 2 and Article 27-10, Paragraph 3 of the Financial Instruments and Exchange Act.

## 4.2 Information Disclosure by Target Company

At the time an acquiring party commences to acquire corporate control, informed judgment by shareholders will be possible through substantial information disclosure by the target company and through providing important decision-making materials that contribute to the judgment on the appropriateness of the transaction terms. In addition, after the announcement, disclosure of information regarding how the target company reacted to the acquisition proposal and how the acquisition was consummated, and improvement of transparency in relation to the process of how the transaction terms were agreed, can lead to more careful consideration and negotiation with an awareness of the views of general shareholders and other stakeholders.

**a) Disclosure at the Acquisition Implementation Stage**

In acquisitions, it is advisable for the target company not only to comply with the disclosure requirements under the timely disclosure regulations of the financial instruments exchanges, but also to voluntarily disclose information regarding the board of directors or the special committee (if a special committee is established) on the process in relation to how it considered the proposal, and its involvement in the negotiation process with the acquiring party in relation to the transaction terms, in a full and complete manner. It is advisable for members of the board of directors and special committees to engage in discussions to unify the opinions of the respective bodies they belong to, but since there may be cases where opinions differ even after substantial discussions, it is worth considering disclosure of information on how each outside director fulfilled their supervisory functions, so as to contribute to decisions on the subsequent director selection and dismissal at shareholders' meetings.

In addition, as described in "**3.2 When the Board of Directors Decides on a Direction toward Reaching Agreement of an Acquisition**" above, if a competing proposal is made, and different transaction terms are simultaneously offered through multiple proposals and become publicly known, the question of whether the interests of shareholders are being considered (whether the best choice is being made regarding price and other transaction terms) is likely to become apparent. After the announcement of the acquisition offer that the target company supported, the target company should disclose, in the explanation of the reasons for supporting

the offer, that there were other competing proposals, but that the target company decided that the supported offer was more desirable than others together with the reasons for such decision.[49]

**b) Disclosure on Media Reports while Acquisition Proposal is Still Under Consideration**

It should be noted that if media reports or rumors are spread during the stage while an acquisition proposal is under consideration, it may be necessary to disclose the authenticity of the reported information as well as other facts. As described in 1. of "**Appendix 1: Specific Actions of Directors and the Board of Directors**," it should be noted that disclosure may be required in such cases, and consequently it is worth considering to devise appropriate measures such as by having an exception clause in the confidentiality agreement.

Disclosing an acquisition proposal at the premature stage of consideration without public reports by media may result in significant negative impact, such as various types of speculations arising, and the market reaction to such speculation causing the possible acquisition to be abandoned. Careful consideration will be required when deciding whether to maintain strict information control, or instead to disclose the information about the proposal.

### 4.3 Preventing Acts that Distort Shareholder Decision-Making

When shareholders make decisions on acquisitions, it is important to ensure that they are provided with the necessary information and are not prevented from making rational decisions.

From this perspective, it is not advisable for the acquiring party to take the following actions (if it constitutes a violation of any law or regulation, such action should not be taken):

- Engaging in aggressive coercive acquisition techniques, such as coercive two-step acquisition (see "**Appendix 2: Assessment of Coercion**")

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[49] Even when a competing proposal is not publicly known, the facts concerning a competing proposal have a certain degree of importance in the judgment of shareholders. Therefore, it is advisable for the company to disclose in the explanation of the reasons for supporting the acquisition offer the fact that a competing proposal had been made, and whether the company considered the proposal, while maintaining confidentiality of the identity of the party that made the competing proposal and the details of the proposal.

- Disclosing inaccurate information or providing or disclosing misleading information to shareholders
- Notwithstanding an intention to make an acquisition proposal, to conceal such intent and advance to make share purchases
- Announcing advance notice of a planned tender offer without a reasonable basis for actually commencing the tender offer, such as by lacking the financial resources required for the acquisition (see "**4.1.1.3 Information Disclosure concerning Advanced Notice of Planned Tender Offer**").
- Leveraging the acquiring party's dominant position, such as to approach the acquiring party's business partners who are also shareholders of the target company
- Providing money or goods when soliciting votes and proxies

From the same perspective, it is not advisable for the target company to take the following actions (if it constitutes a violation of any law or regulation, such action should not be taken):

- Disclosing inaccurate information or providing or disclosing misleading information to shareholders
- Leveraging the target company's dominant position, such as to approach the target company's business partners who are also its shareholders
- Providing money or goods when soliciting votes and proxies[50]

[50] Profit sharing with shareholders is prohibited (Article 120, Paragraph 1 of the Companies Act) and is not appropriate from this perspective as well.

# Chapter 5 Takeover Response Policies and Countermeasures

## 5.1 Approach on Takeover Response Policies and Countermeasures

Proper behavior of the parties involved in an acquisition should result in sincere consideration and negotiation, supply of necessary information by both the target company and the acquiring party, and after ensuring transparency and fairness, an informed judgment by shareholders as to whether or not to accept the acquisition of shares by the acquiring party (Principles 2 and 3).

In this regard, there is a possibility that corporate value and the shareholders' common interests may be harmed, if the acquisition is made without providing the target company and its shareholders the necessary time and information, or if the acquiring party acquires corporate control for the purpose of obtaining unjustified profits at the expense of the target company and its general shareholders. Currently, companies do not deal with such situations only through legal processes such as the tender offer regulation. Rather, depending on the circumstance, they may adopt a response policy including possible countermeasures against acquisitions typically using gratis issue of stock acquisition rights with unequal terms (takeover response policies), and invoke the countermeasure based on this policy, which has been recognized by court decisions as lawful in some cases.[51] If used appropriately, such takeover response policies may enable the shareholders to be furnished with sufficient information and time to consider, equip the board of directors with negotiating power in relation with the acquiring party, and contribute to ensure shareholders' common interests and transparency by extracting more favorable acquisition terms from the acquiring party or other third parties.

However, the potential use of such a response policy should not result in hesitation of a potential acquirer to make a desirable acquisition proposal, reduction of management discipline that is maintained by being a potential acquisition target, or impede sincere consideration of acquisition proposals. Moreover, the takeover response policies should not be intended to protect or entrench the incumbent management from "parties who are undesirable to the

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[51] As a background to the utilization of takeover defense measures, there are arguments that the Japanese tender offer regulation differs from foreign regulations (e.g., the U.K.) in terms of how open-market purchases are regarded. There also are arguments that, compared to the poison pill in the U.S., takeover defense measures in Japan are easier to abolish by replacing directors.

incumbent management."[52] Furthermore, since an acquisition can be an appropriate opportunity for shareholders to sell their shares, countermeasures should not be used to unreasonably frustrate the shareholders' right to dispose their shares by applying to a tender offer or similar offer.[53]

In particular, unlike regulatory frameworks, takeover response policies are used selectively at the initiative of the company (only in the context of acquisition attempts without company consent) and are characterized by the fact that the company is the designer. Therefore, structurally, there is an inherent risk that takeover response policies may be used by companies which have considerable room for management improvement where the economic significance of an acquisition can be easily demonstrated, or a risk that it may be designed and operated in a manner preventing an acquisition to materialize. Even when the purpose of the takeover defense measure is to confirm the shareholders' intent, or to ensure the time and information disclosure to consider and the opportunity to negotiate, depending on the operation of such measure by the company, it may not function as a neutral procedural rule for the parties concerned, so efforts should be made to dispel such concerns.

With regard to the response policies, some advocates argue that establishing and disclosing the rules before a specific acquiring party appears (i.e. during normal phase) enhances the predictability that acquiring parties, shareholders, and other interested parties will anticipate that a response policy may be utilized in the event certain number of shares are acquired.[54] However, especially for this type of response policy (i.e. adopted during normal phase), there are circumstances where the assessment of the response policy differs between the company adopting the response policy and institutional investors, and even when the company believes the response policy is reasonable, it is practically difficult to utilize it without obtaining the

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[52] The 2008 Report also stated that "Takeover defense measures that are, contrary to these desired objectives, exploited for the purpose of managerial entrenchment should not be allowed, and the Corporate Value Study Group cannot support such takeover defense measures." "The Board of Directors must not obscure the interests to be protected by takeover defense measures by referring to the interests of stakeholders other than shareholders in cases that does not protect or enhance the shareholder interests, or must not broadly interpret implementation terms for the purpose of managerial entrenchment."

[53] Corporate Governance Code, Supplementary Principle 1.5.1 states that "In case of a tender offer, companies should clearly explain the position of the board, including any counteroffers, and should not take measures that would frustrate shareholder rights to sell their shares in response to the tender offer."

[54] From these perspectives, the 2005 Guidelines cover only the response policies that are adopted during normal phase.

understanding and consent of shareholders and institutional investors. In reality, the number of companies that have adopted a response policy has continued to decline since 2008, especially in the TSE First Section (before TSE market restructuring) and Prime Market (after TSE market restructuring).

By contrast, under an emergent phase, there are events where making case-specific decisions is appropriate, since there can be various forms of acquisitions. In addition, when seeking approval at a general shareholders' meeting, it may be easier for shareholders and investors to make their decisions regarding the response policy if the acquiring party and its method of acquisition which the response policy specifically focuses on are identified. In these respects, adopting a response policy after an acquiring party appears (i.e. in emergent phases) can be an option for the company, although such approach will have less predictability from the aforementioned perspective. In any event, the rational intent of shareholders should be relied upon.

Based on the foregoing explanation and points to keep in mind, and taking into account previous court decisions, this chapter discusses the overview of takeover response policies and countermeasures from the perspective of respecting the shareholders' intent, ensuring necessity and proportionality, prior disclosure, and dialogue with the capital market. For details of each factor, please refer to "**Appendix 3: Takeover Response Policies and Countermeasures (Particulars)**".

### 5.2 Respecting Shareholders' Intent

The invocation of countermeasures based on the response policy should rely on the rational intent of shareholders, since it concerns the corporate control of the company.[55] In addition, obtaining approval at a shareholders' meeting at the stage of adopting a response policy or at the stage of invoking countermeasures based on the response policy can be regarded as a way to demonstrate that the company is taking the action pursuant to the rational intent of

[55] The 2005 Guidelines also state that "In order to ensure the legal validity and reasonableness of takeover defense measures, [...] the defensive measure [...] shall reflect the reasonable will of the shareholders (principle of shareholders' intent)." In addition, Japanese courts' decisions have long been dependent on a similar concept (the so-called "order theory of allocation of authority") in many instances.

shareholders.[56] Based on court decisions to date, the legitimacy of invoking countermeasures is considered relatively easier to be recognized if it is resolved at a shareholders' meeting.

It is worth noting that even after such resolution is made at a shareholders' meeting, the board of directors still should not just defer as a formality to the decision of a shareholders' meeting, but should carefully consider the substantial necessity of the countermeasures and how to ensure fairness (e.g., involving a highly independent board of directors or special committee), and sufficiently fulfill its duty to explain.

### 5.3 Ensuring Necessity and Proportionality

The invocation of countermeasures based on the response policy should be carried out in a manner based on necessity and proportionality, taking into consideration the principle of shareholder equality, protection of property rights, and prevention of abuse by management to protect its own interests, among other factors.[57] The grounds for an injunction against invocation of a countermeasure are the "issuance of share options effected by using an extremely unfair method" (unfair issuance) and the "violation of laws and regulations" (violation of the principle of shareholder equality) (analogous application of Article 247, Item 1 and Item 2 of the Companies Act[58]). Japanese courts have long been understood to examine

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[56] The Nippo Sangyo case (Nagoya High Court decision, April 22, 2021), the Fuji Kosan case (Tokyo High Court decision, August 10, 2021), the Tokyo Kikai Seisakusho case (Supreme Court decision, November 18, 2021), and the Mitsuboshi case (Supreme Court decision, July 28, 2022) among other cases are considered to have been decided on the assumption that advisory resolution by an ordinary resolution is sufficient.

[57] The 2005 Guidelines also mentions that "although takeover defense measures should be designed to protect and enhance shareholder interests, if defensive measures create inequality between shareholders, they could pose a serious threat to the principles of shareholder equality and protection of property rights. Moreover, there is a risk that defensive measures may be used not to enhance shareholder interests but to entrench corporate management. In order to ensure the legitimacy and reasonableness of takeover defense measures, it is necessary to prevent these undesirable effects. Therefore, takeover defense measures should, by necessary and appropriate means, give due consideration to the principles of shareholder equality, protection of property rights, and prevention of the abuse of defensive measures for entrenchment purposes."

[58] The 2005 Guidelines mentions that "Since the privilege of exercising stock acquisition rights is not included in the rights of shareholders, it does not run counter to the principle of shareholder equality," (Note 4 of the 2005 Guidelines), but in the Bull-dog Sauce case (Supreme Court decision, August 7,

whether an issuance constitutes an "unfair issuance" or "violation of the principle of shareholders equality" from the perspective of necessity and proportionality.

### 5.4 Prior Disclosure[59]

By adopting and disclosing the response policy during a normal phase, the predictability of acquiring parties, shareholders and other stakeholders anticipating the possibility of countermeasures being utilized in the event of an acquisition of more than a certain number of shares can be relatively enhanced. They may be able to take actions such as making careful investment decisions based on the details of the response policy, or devise the structure of acquisition when attempting to make acquisitions.

On the other hand, advocates have pointed out that prior disclosure may result in the adopting company not being considered as a potential acquisition target (including as a target of a desirable acquisition), thus external discipline on management may be lost.[60]

### 5.5 Dialogue with Capital Market

It should be noted that in Japan, until now, response policies have tended to be adopted by companies with considerable room for management improvement, such as those with sluggish performance, and where the economic significance of an acquisition can be easily demonstrated. If takeover response policies are adopted by these companies, and if they are designed and operated to protect incumbent management, this may lead to hesitation of potential acquirers to make desirable acquisition proposals, reduction in management discipline otherwise imposed by being a potential acquisition target, or a disincentive to sincerely consider acquisition proposals.

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2007), Article 247, Item 1 and Item 2 of the Companies Act were applied by analogy to the gratis issue of stock acquisition rights.

[59] While the 2005 Guidelines establishes the "principle of prior disclosure," the Guidelines cover cases where a response policy is adopted in an emergent phase, so we have not classified prior disclosure as a general rule.

[60] Nonetheless, since there have been cases in which response policies adopted in an emergent phase have been invoked, from an acquiring party's perspective, they may act under the assumption that a response policy may potentially be adopted. If so, the difference depending on whether a response policy is adopted in normal phase or emergent phase could be relatively mitigated to a certain extent.

Therefore, if a company is considering to adopt a response policy, it is first and foremost required to make reasonable efforts to enhance corporate value at a normal phase, and to take steps to ensure that such increase is reflected in market capitalization (see the opening statement of "**Chapter 3 Code of Conduct for Directors and Board of Directors regarding Acquisition Proposals**").

While making such efforts, it is possible that the company may determine in a normal phase that it is necessary to adopt a response policy. Nonetheless, when a response policy is adopted during a normal phase and disclosed, the shareholders' intent will be reflected through the shareholders' meeting resolution, or otherwise through the election or dismissal of the directors. Therefore, even if the response policy is legitimate, practically it will be difficult to adopt a response policy unless it is understood and accepted by institutional investors and other parties in the capital market.

Since the necessity of a response policy and the particulars of required features may differ depending on the size and situation of each company, a constructive dialogue between the target company and institutional investors from the perspective of improving corporate value over the medium to long-term is advisable. If the target company believes that the adoption of a response policy is necessary as part of its management strategies, it should communicate and disclose information in detail regarding its reasons for adoption of such a response policy, ensure fairness by enhancing the independence of the composition of its board of directors (for example, by increasing the ratio of outside directors to majority), and respect to the maximum extent possible the judgment of the special committee consisting mainly of outside directors. Given that the response policy may increase transparency regarding acquisitions in such a circumstance, it is advisable for institutional investors and voting advisory companies to consider the cost-effectiveness[61] and other perspectives, and make their decisions either for or against the adoption of the response policy or the invocation of countermeasures based on the prevailing circumstance of the target company, dialogues with the company concerned, and the terms of the response policy, rather than making decisions simply relying on generalized criteria

[61] The reference made here to cost-effectiveness is based on the fact that response policies, especially those adopted and renewed during a normal phase, are often on the agenda of the annual general shareholders' meeting, which most companies hold in June.

applied in a formal way (this applies also when the response policy is being utilized in emergent phases)

Below are examples of possible features to align the target company with institutional investors when engaging in dialogue and information disclosures.[62, 63]

- To design the response policy to always require a shareholders' meeting when invoking countermeasures
- To design the response policy so that the requirements to permit invocation are strict[64]
- To design the response policy as a temporary measure to be utilized under special circumstances[65]

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[62] In addition, in the "V. Specific Examples:" of the 2005 Guidelines also provides examples of "methods to ensure the reasonableness of takeover defense measures and promote the acceptance by shareholders, investors and other interested parties."

[63] Satisfying several or all of these features should not immediately be interpreted as the response policy being highly reasonable, and conversely, a combination of several or all of these features may not always be required.

[64] For example, the requirements permitting invocation of countermeasures may vary from company to company, such as limiting the invocation of countermeasures appliable only to cases where the acquiring party fails to comply with the procedural rules, or even if the acquiring party complies with the procedural rules, limiting the permissible requirements only to cases where there is a clear infringement of corporate value and the shareholders' common interests or where coercion is particularly strong. Another example is to generally exclude from the permissible requirements "all or nothing" tender offers (a two-step acquisition, without setting an upper limit for the number of shares to be acquired while setting a lower limit so that the tender offeror's shareholding ratio after a successful tender offer reaches the level enabling subsequent cash-out actions such as reverse stock split (i.e. two-thirds or more of the voting rights), and with an advance notice to conduct the cash-out at the same price as the tender offer price after a successful tender offer). It is also advisable to authorize the board of directors to decide on invocation of the countermeasure only when the majority consists of outside directors, or only when the board of directors respect to the maximum extent possible the decisions of a special committee consisting solely of outside directors.

[65] For example, the response policy can be designed to be adopted on a temporary basis as an exceptional measure (e.g., set forth a short effective period and terminate the measure when the market crisis is over) when stock prices in the entire market temporarily shows a sharp drop due to a financial crisis or equivalent reasons.

# Chapter 6 Conclusion

Japan's economy, as expected to accelerate optimization of resource allocation, industry restructuring and healthy economic metabolism of capital markets through M&A transactions, is aiming to have a market functioning soundly in acquisition transactions involving transfer of corporate control, and welcoming active acquisitions that contribute both to enhance corporate value and secure the interests of shareholders.

For the principles and best practices set forth in the Guidelines to be firmly established in Japan's economy, thereby contributing to the development of a fair and high-quality M&A market that is regarded trustworthy by domestic and international players, it is necessary for companies and capital market participants involved in acquisition transactions to understand the intent of the Guidelines and appropriately fulfill their respective roles toward materialization of the principles and best practices recommended herein. We hope that the Guidelines will be respected by the management of target companies and acquiring parties, directors, shareholders and investors, advisors and other relevant parties, and that the Guidelines serve as a code of conduct for Japan's economy and provide the opportunity to promote evolution in this regard.

In addition, the M&A market by nature is subject to constant changes and development, as legal systems, court precedents and practices evolve. Going forward, we expect the Guidelines to be updated in a timely manner in response to such evolution, thereby serving as a catalyst for further development of fair M&A rules.

End

# Appendix 1: Specific Actions of Directors and the Board of Directors

**1. Confidentiality agreements**

Confidentiality agreements may be required when a target company provides an acquiring party with information necessary to further formulate an acquisition offer, or when an acquiring party provides a target company with information necessary to consider or evaluate its proposal.

In order to foster mutual trust, it may be reasonable to consider ensuring adequate time and opportunity to negotiate an acquisition proposal through negotiations of certain clauses in a confidentiality agreement between the target company and the acquiring party, such as prohibiting the acquiring party from publicly disclosing the acquisition proposal, commencing a tender offer, and purchasing additional shares (a standstill), respectively during a specified reasonable time without consent of the target company. Although these clauses may not be a strong deterrent as takeover response policies, by agreeing to these types of provisions in a confidentiality agreement, if an acquiring party is in pursuit of a sincere acquisition attempt, to a certain extent, the time and information necessary for negotiation can be secured without adopting a response policy or invocating countermeasures.

Having this said, in case that both the target company and the acquiring party are listed companies, as the parties need to fulfil their duty to explain to their own shareholders, unnecessarily broad obligation in a confidentiality agreement is not advisable. Especially, if there are media reports or rumors spreading about the acquisition, the target company may be required to disclose relevant information. Bearing in mind that disclosure may be required in such circumstances, certain measures such as including exception clauses in the confidentiality agreement permitting such disclosure by the target company should be considered.

**2. Cooperation to due diligence**

Since due diligence usually requires a target company to provide internal, non-public information to an acquiring party, the due diligence process should be conducted when the company regards a proposal as worth considering and negotiating, due to the risks of leakage to competitors or use for an unintended purpose.

Therefore, in determining whether and to what extent a target company should respond to due diligence requests, the target company should consider, not only the factors in determining whether an acquisition proposal constitutes a "bona fide offer" (see (a) through (c) of "**3.1.2**

**Consideration by the Board of Directors**”), but also the factors such as specific details of the proposal identified through consideration and negotiation, the acquiring party’s business environment and track record, the reliability of information control and management, and the feasibility of the proposal in a comprehensive manner.

It is also reasonable for the target company to provide information to acquiring parties in stages, after carefully considering the impact of engaging in the due diligence process.

If there are multiple proposals, the target company should also consider fair treatment of acquirers as well as effective comparisons of multiple proposals.

However, limiting an acquiring party’s opportunities for due diligence or asking overly detailed questions to an acquiring party as a precondition for engaging in the due diligence process should not be used as a tactic to effectively prevent potential acquisition of management control, and outside directors should provide appropriate supervision from this perspective.

**3. Consideration and Negotiation in Pursuit of Transaction Terms to Ensure the Interest Shareholders should Enjoy**

The board of directors, either by itself or through a special committee, should play a supervisory role by effectively participating in the analysis and evaluation of acquisition proposals and in negotiations with acquiring parties, by receiving reports from management and persons involved in the negotiations at an appropriate timing, and by considering and providing instructions. The board of directors should also ensure that a fair review process is in place that addresses potential conflict of interests.

While negotiation of commercial matters is often led by management, it is advisable for outside directors and special committees to be substantively involved in the review and negotiation process with respect to the transaction terms, including the purchase price and the shareholding ratio to be acquired, depending on the degree of conflict of interests among other factors. In situations where conflict of interests between the company and its management or controlling shareholders may arise, outside directors are expected to be actively involved from an independent standpoint in order to determine whether such consideration and negotiation were conducted in an appropriate manner. Especially for companies without a board of directors

of which majority are outside directors, it is advisable to place more importance on the involvement of outside directors.[66]

Post-acquisition ownership ratio (the strength of the acquiring party's influence on corporate control after the acquisition), whether existing shareholders will remain as shareholders after the acquisition (whether the company will go private or remain listed), and the type of consideration (cash or stock) impacts the potential enhancement of corporate value and the interests shareholders should enjoy as a result of the acquisition. Therefore, these factors should be considered when analyzing and evaluating acquisition proposals and when comparing multiple acquisition proposals. In addition to price and other transaction terms, the probability of successful closing also should be considered as an important factor.

In selecting a proposal to keep the target company listed from among multiple proposals, through the company's business performance and market evaluation after the transaction, it is considered possible to verify whether the value that had been explained by the board of directors has realized, although such post-transaction value also may have been impacted by other various external factors. It is advisable for the board of directors to keep this in mind when fulfilling its own accountability to shareholders.

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[66] In cases where the extent of involvement of outside directors may result in the loss of outsider status (non-executive requirement), it is worth considering a board resolution based on the so-called "safe harbor rule" under the Companies Act (Article 348-2), which allows a company to entrust the execution of duties to outside directors by a resolution of the board of directors if there are conflict of interests between the company and the directors/executive officers or if there are any other risk that the interest of shareholders may be impaired.

## Appendix 2: Assessment of Coercion

Coercion is an issue whereby shareholders of the target company are pressured to accept an acquisition against their will, where they anticipate disadvantages if an acquisition is completed while they do not accept, as compared to when they do accept the offer. When coercion exists, even if many shareholders believe that the purchase price is lower than the objective value of the shares, they feel forced to accept the offer.

Hereunder, we will present certain theoretical discussions which are intended to be referred to in the relevant sections of the Guidelines.

### 1. Coercion in Tender Offers

Coercion in tender offers can be broadly categorized as follows: a) coercive two-step transactions; b) tender offers in which minority shareholders may remain; and c) tender offers that are designed to eliminate coercion.[67]

#### a) Coercive Two-Step Transactions

An acquisition where the first-step purchase terms are set favorably but the second-step purchase terms are unfavorable or unclear (coercive two-step transaction) are understood to have a strong coercive effect.[68]

#### b) Tender Offers in which Minority Shareholders Remain

When an upper limit of shares sought to be acquired is set forth (a partial tender offer), certain existing shareholders will remain as minority shareholders as a result of an acquisition. Thus, it is pointed out that a partial tender offer may consummate acquisitions that potentially

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[67] In addition, advocates point out that in two-step transactions, if there is a time gap between the completion of the first step of the acquisition and the squeeze-out of minority shareholders in the second step, there is a certain degree of coercion as a result of, for example, the fluctuation of the stock price and the unavailability of funds in the minority shareholders' hands that can otherwise be appropriated to other investments. Coercion resulting from this time gap is believed to be significantly reduceable by promptly conducting the second squeeze-out step.

[68] In the 2005 Guidelines, "Defensive measures to prevent coercive, two-tiered takeovers (takeovers which coerce shareholders into accepting a higher priced front-end tender offer by setting unfavorable terms or not specifically indicating terms for the back end of the transaction, without offering to buy all shares at the front end," is considered as a typical defense measure to ensure and enhance shareholders' common interests.

reduce corporate value, because of its nature that the remaining minority shareholders will experience reduction of corporate value. Another issue pointed out in this scenario, apart from coercion, is that shareholders who wish to sell their shares may not have the opportunity to sell all of their shares through the tender offer, even if the acquiring party will obtain management control of the company through the transaction.

In contrast, if no upper limit of shares to be acquired is set forth (a tender for all shares), the risk of an exploitative acquisition may be relatively small. However, if no lower limit is set, or if the lower limit is set very low, even if the tender offer is successful, the second cash-out step is not guaranteed (e.g., the tender offeror may not be able to acquire enough ownership ratio necessary to complete the second cash-out step), raising the possibility that minority shareholders will remain. Therefore, it is believed that in these cases, the same coercion issue as with partial tender offers may arise.

Having this said, the extent to which coercion may become an issue cannot be assessed solely based on the possibility that minority shareholders will remain, and in order to consider the degree of coercion that may actually occur, as described in 2.(1) b) of "**Appendix 3: Takeover Response Policies and Countermeasures (Particulars)**," it will be necessary to assess each case based on the specific facts.

**c) Tender Offers Designed to Eliminate Coercion**

The problem of coercion is considered eliminated in an "all or nothing" offer, i.e., a two-step transaction in which no upper limit is set (a tender for all shares); a lower limit is set so that, if the tender offer is successful, the post-purchase ownership ratio by the acquiring party is at a level that would permit a reverse stock split or other structure (i.e. two-thirds or more of the voting rights) such that non-tendering shareholders will be cashed out at a price equal to the tender offer price; and an announcement of such structure is made at the time of the tender offer.

**2. Coercion in Open-Market Purchases**

Although, unlike tender offers, it is not easy to determine in a formulaic or typological manner whether coercion exists and the degree thereof in the context of open-market purchases, it is pointed out that open-market purchases that potentially reduce corporate value may have an

effect of facilitating a successful acquisition, due to its nature of reducing future corporate value.

Furthermore, unlike a partial tender offer where purchases are made on a pro rata basis, shares in the open market are purchased on a "first come, first served" basis from the selling shareholders. Because there may exist huge information asymmetries between buyers and sellers in these transactions, some advocates argue that coercion is more likely to occur than in a tender offer.

There are court decisions upholding that open-market purchases in certain cases may be considered as an incentive to place pressure (coercion) on shareholders to sell their shares.[69]

However, other advocates have pointed out that, in the context of open-market purchases, a "late winner" may be observed (i.e., rather than rushing to sell in response to market purchase orders, some shareholders try to sell as late as possible, waiting for the market price to rise sufficiently). Therefore, it is necessary to consider the situation in each particular case when assessing the degree of coercion that may actually occur, as described in 2. (1) b) of "**Appendix 3: Takeover Response Policies and Countermeasures (Particulars)**."

[69] See Tokyo Kikai Seisakusho case (Supreme Court decision, November 18, 2021).

# Appendix 3: Takeover Response Policies and Countermeasures (Particulars)

## 1. Respecting Shareholders' Intent

### (1) Significance of a Shareholders' Meeting Resolution regarding the Invocation of Countermeasures

In cases where the approval of a shareholders' meeting is obtained to invoke countermeasures (including cases where the ratification by a shareholders' meeting is obtained after the board of directors approved the gratis issue of stock acquisition rights), the necessity of countermeasures is considered to be inferred, in principle.[70]

Specifically, necessity is considered to be inferred when the following circumstances are identified:

- Approval of the shareholders' meeting can be one of the factors that demonstrate the need of the countermeasure from a perspective of ensuring the time and information necessary to confirm the shareholders' intentions regarding the acquisition proposal at the shareholders' meeting. In addition, it can be one of the factors that demonstrate the need of the countermeasure from a perspective of ensuring that shareholders have an opportunity to make their decision in a non-coercive manner when coercive acquisition tactics are used, by providing shareholders with an opportunity to decide whether to approve or reject an acquisition proposal separately from the decision to sell their shares.[71]
- The fact that shareholders, after comprehensively considering various factors[72] related to the acquisition proposal, approve the invocation of countermeasures because they

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[70] See Bull-dog Sauce case (Supreme Court decision, August 7, 2007), Fuji Kosan case (Tokyo High Court decision, August 10, 2021), Tokyo Kikai Seisakusho case (Supreme Court decision, November 18, 2021), and Mitsuboshi case (Supreme Court decision, July 28, 2022). To supplement, the idea that the necessity is inferred by obtaining shareholders' meeting resolution when invoking the countermeasure against a specific acquirer applies similarly regardless of whether the response policy was adopted during normal phase or at an emergent phase.

[71] However, since coercion requires case specific consideration as described in "**Appendix 2: Assessment of Coercion**," it is not advisable to emphasize the necessity of countermeasures merely based on the fact that coercion may arise as a result of open-market purchases or partial tenders offers.

[72] For example, the following factors may be considered: whether there is a necessity to secure time and information or the necessity to remove coercion; whether there is a risk of apparent infringement on corporate value and shareholders' common interests; whether the terms of the acquisition proposal are

believe that the acquisition if consummated will harm corporate value and the shareholders' common interests, can be one of the factors that indicate the necessity, in the sense that the invocation of countermeasures is dependent on the rational intention of the shareholders, i.e. those who the company's interests are attributed to.

**(2) Significance of Adopting the Response Policy through a Shareholders' Meeting Resolution**

When the board of directors invoke countermeasures based on a response policy adopted by a resolution of the shareholders' meeting,[73] there is a court decision in which the content of a response policy itself and the legality of the invocation of countermeasures have been upheld based on relatively lenient examination, rather than within the framework of the so-called "main purpose rule."[74, 75]

The following circumstances are considered to have been taken into account (and with no clear line being drawn as to whether the measures were adopted during normal phase or with respect to an emergent phase), although there are not many court decisions under similar circumstances.

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insufficient compared to the intrinsic value of the company; whether there is a high risk of infringing corporate value and the common interests of shareholders due to changes in relationships with employees, business partners, and other stakeholders; and whether the purchase is inappropriate from the perspective of public order and morals, including participation by or involvement of anti-social forces.

[73] The 2005 Guidelines state that, "As the ultimate decision making body, the shareholders, who are the real owners of a corporation, may use the general meeting of shareholders to adopt takeover defense measures involving amendments to the articles of incorporation or other methods for the purpose of protecting shareholder interests. Restricting the transfer of shares in the articles of incorporation is the most obvious example. Issuance of new shares or stock acquisition rights to a third party under particularly favorable conditions would also be deemed legitimate if approved by a special resolution of a general meeting of shareholders. Moreover, with regard to matters whose impact on shareholders is less significant than those matters requiring a special resolution (which requires a super-majority vote under the law), the adoption of defensive measures by an ordinary resolution of a general meeting of shareholders is permitted as a legitimate exercise of self-governance by shareholders," and this concept generally can be maintained.

[74] These are principles established by legal precedents which state that if stock acquisition rights are issued for the purpose of maintaining or securing corporate control in a situation where there is a dispute over corporate control, a request for an injunction should, in principle, be granted as an unfair issuance of stock acquisition rights.

[75] See Nippo Sangyo case (Nagoya High Court decision, April 22, 2021). In this case, the acquiring party violated the procedural rules of the response policy in a material respect.

- Approval of the shareholders' meeting demonstrates that the content of the response policy relies on the rational intention of the shareholders, i.e. those who the company's interests are attributed to.
- If the board of directors invokes countermeasures based on a response policy decided by the shareholders' meeting at the time of adoption, where arbitrariness and discretion of the board are restricted, it is more likely to find that invocation by the board is within the reasonable intention of the shareholders.

In practice, most companies that have adopted a response policy during normal phase have obtained approval for its adoption or continuation at a shareholders' meeting. The referenced case demonstrates that adoption of countermeasures based on such a response policy can be legitimate.

In addition, in an emergent phase, there are practical examples of adopting a response policy at the discretion of the board of directors due to time constraints, but if the effective period of the policy is repeatedly extended or continued at the discretion of the board of directors, that policy may effectively deter acquisitions unless the acquiring party withdraws the acquisition proposal or takes comparable actions. Consequently, it is advisable for the target company to take measures to avoid arbitrary operation of their response policy, such as to obtain approval at a shareholders' meeting for the extension or continuation of the effective period in order to confirm that the policy reflects the shareholders intention, or otherwise to terminate their response policy once a certain period of negotiation with the acquiring party had taken place.

### (3) Exceptional Measures for Confirming the Intention of Shareholders

#### a) Resolutions Requiring a Majority of Votes Among Non-Interested Parties[76]

There has been a court decision where a resolution at a shareholders' meeting on the invocation of countermeasures was adopted, which excluded the voting rights of the acquiring party, the target company's directors and their related parties from being counted.[77]

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[76] Although sometimes referred to as "majority-of-minority (MoM) resolution," the term "MoM resolution" is not used here because shareholders with voting rights (other than interested shareholders) are usually not minorities.

[77] See Tokyo Kikai Seisakusho case (Supreme Court decision, November 18, 2021).

If countermeasures based on such a resolution are easily allowed to be invoked, it could lead to a situation where even desirable acquisitions are discouraged. In addition, given that it is the target company that sets the resolution threshold requirements, there is a risk that the target company may arbitrarily set the resolution requirements at thresholds for which it considers easier to obtain approval.[78]

Therefore, it must be noted that the invocation of countermeasures based on a resolution of a shareholders' meeting when certain shareholders' voting rights have been excluded as above must not be abused, and that such invocation may be permitted only in very exceptional and limited cases, taking into consideration the special circumstances of the case with respect to the mode of acquisition among other factors (such as coercion arising from the acquisition method, legality, time margin for confirmation of shareholders' intentions).[79]

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[78] The majority-of-minority condition used in MBO transactions or acquisitions by a controlled company by the controlling shareholder reduces the ratio of shareholders in favor of the target company's proposal (e.g., implementation of the MBO). In contrast, in the context of takeover response policies, the requirement for a resolution by a majority of shareholders other than interested parties increases the ratio of shareholders in favor of the target company's proposal (such as invocation of countermeasures), so the target company has an incentive to use this special resolution requirement to obtain shareholder approval of its own proposal.

[79] In general, it is not always clear on what basis or to what extent a resolution by a majority of non-interested parties may be permissible. In the discussions of the study group, the following opinions were raised.

(1) Opinion focusing on problems over rapid open-market purchases: when an acquiring party makes rapid open-market purchases, the decision of shareholders in the market may be affected by problems in information disclosure (the level of information is not disclosed to them in accordance with tender offer regulations), time (rapid purchases do not allow sufficient time for review), and rush to sell (in a situation where a controlling interest is acquired in a short period of time through open-market purchases, shareholders will be rushed to sell), among other problems, and that because the voting rights of the relevant shares sold and purchased under such problematic conditions should not count, it may be possible for a company to adopt a resolution excluding the voting rights (of said portion) of the acquiring party and its related parties;

(2) Opinion focusing on problems over open-market purchases and on the nature of related parties: because in respect of open-market purchases, unlike tender offers, the issues may exist that (i) information disclosure regulations do not apply and sufficient information may not be disclosed, and (ii) shareholders have the motive to sell their shares if the acquirer takes exploiting actions after acquiring control (issue of coercion), and under such circumstance, considering that the acquirer and its related parties have an interest in whether or not the acquisition is approved, it may be possible for a company to adopt a resolution which excludes all of the voting rights of the acquirer and its related parties; and

(3) Opinion focusing on violation of laws and regulations by an acquirer: when an acquiring party materially violates laws and regulations related to acquisitions such as the large shareholdings reporting regulation (e.g., if the acquiring party intentionally delays reporting large holdings), it may be possible for

[Reference]

In the Tokyo Kikai Seisakusho case (Supreme Court decision, November 18, 2021), the court held that regarding resolution requiring a majority of non-interested parties to affirmatively vote, the acquisition of shares exceeding one-third ownership in a short period of time was advanced through open-market transactions, which are not subject to the tender offer regulations, is coercive to general shareholders (i.e., non-interested parties). The court also found that confirming the intention of only the general shareholders at a shareholders' meeting regarding whether or not the inability of such general shareholders to secure sufficient information and time to make an appropriate decision would harm the corporate value of the company and the common interests of its shareholders, and whether or not it is necessary to invoke countermeasures to prevent such harm, is not immediately deemed as unreasonable.

**b) Adoption and Invocation based on Judgment by the Board of Directors**

Although the invocation of countermeasures based on a response policy should rely on the reasonable intent of shareholders, it is possible that, in certain exceptional cases, an adoption of the response policy and invocation of countermeasures based solely on the judgment of the board of directors is not entirely denied.

It is considered, however, that the countermeasure must also be deemed to be necessary and proportional,[80] even if the adoption and invocation of such measures are based solely on the judgment of the board of directors.

In addition, there is a question of on what basis an adoption and invocation of measures based solely on the judgment of the board of directors may be justified in relation with the principle of respecting the intent of shareholders (Principle 2) as set forth in the Guidelines. The answer is,

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a company to adopt a resolution excluding the voting rights of the acquiring party if it believes that the acquiring party is problematic.

[80] In this regard, referring to the proviso of Paragraph 4 of Article 206-2 of the Companies Act (special provision regarding allotment of offered shares, etc. in public companies), the argument exists that the legitimacy in invocation of countermeasures by the board of directors may be recognized in cases, where the necessity of the countermeasure is high because it is obvious that the corporate value and the shareholders' common interests would be damaged, and where the urgency is high in light of the purchase method and other factors. There are other arguments, however, that limiting the scope to cases where it is "obvious" that the corporate value and the shareholders' common interests would be harmed, or to cases with "urgency," is excessive and inappropriate in light of past court decisions.

in certain exceptional cases, such as acquisitions by antisocial forces or acquisitions where there is a high probability that the acquiring party will gain an unfair advantage at the expense of the target company and general shareholders, it may be possible for the board of directors to conclude that reasonable shareholders would naturally approve the countermeasure, and so even without an explicit shareholder approval having been received, there may be justification for the board to take this type of action as an emergency action.

However, in light of recent court decisions, it is permissible to hold a shareholders' meeting after the fact (and, although exceptional and limited, a meeting resolution that requires a majority of votes cast by only the non-interested parties can be permissible). In such cases, where there will be the time to hold a shareholders' meeting, it is considered that in reality, invocation of countermeasures based on the judgment of the board of directors can be permitted only when the need for such action is high under the specific circumstances.[81] In addition, it is necessary to take into account the increased risk that the invocation of countermeasures will be enjoined by a court if a resolution of the shareholders' meeting is not taken.

[Reference]

In contrast to the response policy using the gratis issue of stock acquisition rights covered by the Guidelines, some court decisions to date have shown that it is possible for the board of directors to exercise its own judgment to invoke countermeasures against an abusive acquisition that is clearly detrimental to corporate value and the common interests of shareholders, when

[81] The 2005 Guidelines state that, "While it is not consistent with the division of corporate authority envisioned by the laws of Japan for directors, who are elected at a general meeting of shareholders, to change the composition of shareholders by adopting a takeover defense measure, since it is difficult to convene a general meeting of shareholders in a timely manner, it is not appropriate to reject outright the adoption of defensive measures by the board of directors when such measures enhance shareholder interests. Even in the case where a takeover defense measure has been adopted by a resolution of the board of directors, if there is a mechanism that allows the shareholders to terminate the defensive measure (and their failure to do so indicates passive approval), it does not run counter to the principle of shareholders' will." On the other hand, in light of the description in the main text and court decisions to date, it is considered that there will be only limited cases in which the invocation of countermeasures is permitted in a state of only passive approval without ex-post facto confirmation of shareholders' intentions for a response policy adopted solely based on the judgment of the board of directors.

the board makes a substantive judgment in view of the details of the proposed acquisition (Nippon Broadcasting System case (Tokyo High Court decision, March 23, 2005)).[82] Although this court decision suggests that such countermeasure could be appropriate, what was used in this case in question was a powerful countermeasure called a "third-party allotment type" in which the controlling ownership will be attributed to a fixed third party. The court in this case did not permit the use of such particular countermeasure, as a result.[83]

## 2. Ensuring Necessity and Proportionality

### (1) Ensuring Necessity

#### a) Securing Time, Information and Negotiation Opportunities

Depending on the transaction form of the acquisition, corporate value and interests of shareholders may be harmed if, for example, the acquisition is made without the necessary time or information being provided to the target company and its shareholders. In such limited circumstance, when the company believes that the possible remedies afforded by the legal

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[82] In the Nippon Broadcasting System case (Tokyo High Court decision, March 23, 2005), the court held that "the issuance of stock acquisition rights that would affect the attribution of corporate control of a company cannot be enjoined if the company establishes a prima facie case that there are special circumstances justifying the issuance of such rights from the viewpoint of protecting the interests of all shareholders, specifically, that the hostile acquiring party is not sincerely aiming at rational management and that the acquisition of control by the hostile acquiring party will cause irreparable damage to the company."

[83] The decision provides the following four types of "a prima facie case that the hostile acquiring party is not sincerely aiming at rational management and that the acquisition of control by the hostile acquiring party will cause irreparable damage to the company." It should be noted that this is only an example of a case in which strong countermeasures were used, and the court's decision does not in itself define the outer limits of legitimacy.

- Buying up shares and demanding the company to buy them back at a higher price (so-called "greenmailing")
- Management that achieves profits for the acquiring party at the expense of the company, such as acquiring important assets at a low price by temporarily taking control of the company (so-called "scorched-earth management")
- Misappropriation of company assets as collateral or source of repayment of debts etc. of the acquiring party or its group companies
- Temporarily controlling the management of a company to dispose high-value assets that have no current relevance to the company's business, and using the profits gained from the disposal to temporarily distribute high dividends, or selling the shares at a high price taking advantage of the opportunity afforded by the sudden rise in share prices created by the temporary distribution of high dividends

system to ensure appropriate information disclosure are insufficient, the company can adopt its own response policy to allow shareholders to compare and consider whether the acquiring party's offer or the current management's policy would enhance corporate value, or to allow the company to provide shareholders with its board of director's opinion or an alternative proposal, and to ensure that shareholders have the time and information necessary for these purposes. Such action also may be aimed at securing negotiation opportunities to obtain more favorable terms than those initially offered by the acquiring party.

In such cases, when countermeasures are invoked in response to an acquiring party's violation of the procedural rules set forth in the company's response policy, the countermeasures are likely to be found tied with the necessity from a perspective of securing time, information, and negotiation opportunities.

However, designing or operating a response policy that allows a target company to endlessly request information from the acquiring party on the grounds of securing time, information, and negotiation opportunities, or arbitrarily prolong the period for consideration of acquisition offers unnecessarily, should not be permitted.[84]

For example, a company's policy that requires an acquiring party which intends to make open-market purchases or a tender offer to suspend the execution of its acquisition procedures for the same period as the maximum period of a tender offer (60 business days, in principle[85]) or that requires an acquiring party which intends to make open-market purchases to provide at least the same level of appropriate information to shareholders as required for a tender offer registration statement (such as the purpose and number of purchases, outline of the acquiring party and basic management policy after the acquisition), are considered reasonable to a certain degree from the perspective of securing time, information, and negotiation opportunities. In

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[84] The 2008 Report also states that, "The Board of Directors must not deprive shareholders of the opportunity of deciding whether to accept or reject the acquisition by unnecessarily extending the period for considering the acquisition proposal beyond the reasonable extent or by intentionally and repeatedly extending that period."

[85] Under the tender offer regulation, it is expected that the period may be extended beyond 60 business days in the event that another party launches a tender offer, etc., so the 60-business-day period is provided as a guide. See Article 27-6, Paragraph 1, Item 4 of the Financial Instruments and Exchange Act, and Article 8, Paragraph 1 and Article 13, Paragraph 2, Item 2 of the Order for Enforcement of the Financial Instruments and Exchange Act.

cases where it is considered that the time and information sought by the target company are beyond these comparable requirements, what is being sought should be fully considered and explained by the target company on an individual, case-by-case basis.

If a significant change in the relationship between the target company and its stakeholders (such as employees and major business partners) is expected after the acquisition, and awareness of such a change and its potential impact is particularly important for shareholders to make a decision, it is also reasonable to request the acquiring party to provide information regarding this change.

**b) Dealing with Coercive Acquisition Tactics**

Advocates have pointed out that, depending on the form of the acquisition proposal, the coercive nature of an acquisition may distort the rational decision-making of shareholders and result in acquisitions that undermine corporate value. In such a limited circumstance, when the possible remedies afforded by the legal system governing acquisition techniques are considered insufficient, a company's response policy may be utilized as a means to negotiate for a less coercive acquisition arrangement (e.g., an "all or nothing" offer) or to confirm shareholders' intentions at a shareholders' meeting in a less coercive manner.

Coercion is an issue whereby shareholders of the target company are pressured to accept an acquisition against their will, where they anticipate disadvantages if an acquisition is completed while they do not accept, as compared to when they accept the offer. When coercion exists, even if many shareholders believe that the purchase price is lower than the objective value of the shares, they feel forced to accept the offer.

Certain court decisions to date have considered this issue of coercion as one of the circumstances inferring the necessity for countermeasures.[86]

Alternatively, however, other advocates point out that there is no clear case in which coercion actually has been observed to have occurred. Some note that shareholders who sell their shares when the share price temporarily rises in response to open-market purchases are not doing so

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[86] Fuji Kosan case (Tokyo High Court decision, August 10, 2021), Tokyo Kikai Seisakusho case (Supreme Court decision, November 18, 2021), among others.

out of fear that the effect of such purchases will damage the company's corporate value. In addition, even if the nature of an acquisition technique may have coercive elements, this does not necessarily mean that the transaction being conducted is contrary to current laws and regulations.

Emphasizing coercion, simply on the basis of a few facts (such as that the purchases are made in the open market or that an acquiring party is making a partial tender offer), as a means to easily justify the use of a response policy or countermeasures without conducting a specific examination of the circumstances in individual cases, is not advisable. Such specific examination should include, among other things, a review of the behavior of the acquiring party, and the behavior of shareholders and other factors (see "**Appendix 2: Assessment of Coercion**"). Even if a response policy or countermeasures are considered, the basic concept should be to negotiate such that an acquiring party uses less coercive acquisition techniques.

**c) Factors Establishing the Necessity for Measures**

In cases especially where a shareholders' meeting is held to determine whether the company's corporate value and shareholders' common interests will be harmed due to the "details" of an acquisition proposal, after taking various factors into consideration,[87, 88] it may not always be possible to avoid invocating countermeasures even if the acquiring party improves the "method" of its acquisition. Therefore, if the target company broadly interprets the necessity for countermeasures on the grounds of "details," for example, it may deprive shareholders in favor of the acquisition of the opportunity to sell their shares.[89]

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[87] Invocation of countermeasures to secure time, information, and opportunities for negotiation, or to assert against coercion, is an attempt to address issues related to the method of the acquisition. On the other hand, in practice, in addition to these objectives, the necessity of countermeasures is often discussed based on a combination of multiple factors, such as inadequate purchase conditions and the threat of damage to corporate value resulting from changes in relationships with stakeholders other than shareholders (such as employees and business partners), so the necessity of countermeasures will require comprehensive evaluation, not only in terms of purchase methods but also in terms of their details.

[88] The Bull-Dog Sauce case (Supreme Court decision, August 7, 2007) is a case in which a shareholder believed that the corporate value of the company and the common interests of shareholders would be harmed, and resolved to adopt and invocate countermeasures at a shareholders' meeting. The court in principle permitted to respect the judgment of shareholders and to take countermeasures to the extent approportionate.

[89] The invocation of countermeasures implies that the company chooses to use the former of two methods: a shareholders' decision through a resolution at a shareholders' meeting, or a shareholders' decision through applying to tender offers. It should be noted that there may be differences between the

Therefore, the board of directors is required to consider carefully the necessity of countermeasures, ensuring fairness (e.g., through the involvement of a highly independent board of directors or special committee), and sufficiently fulfilling their duty to explain, rather than simply relying on a decision by the shareholders' meeting.

From the viewpoint of not impeding desirable acquisitions, it is also important to increase predictability for the acquiring party regarding the likely invocation of countermeasures. For example, if an "all or nothing" tender offer which eliminates the coercion issue is employed, and the procedural rules set forth in the response policy are complied with by the acquiring party to ensure time and information (except in exceptional cases as described above in 1.(3) b) "**Adoption and Invocation based on Judgment by the Board of Directors**"), it is beneficial to consider the necessity of countermeasures as generally limited and thus to refrain from invoking countermeasures (or to design a response policy to limit the possibility of invocation in such a case) in order to avoid impeding a desirable acquisition.

### (2) Ensuring Proportionality

#### a) Possibility to Avoid Damage

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two methods in the respects below, for example, and that the judgment of shareholders through a resolution of a shareholders' meeting is not always superior to the judgment of shareholders through applying to tender offers.

- In the case of a resolution by a shareholders' meeting, the company will be the party to establish the decision-making process.
- In the case of a resolution by a shareholders' meeting, shareholders may make a decision after listening to questions and answers at the meeting.
- Since certain passive investors may act in favor of an acquisition but not tender their shares in an acquisition offer in principle, it may be easier for them to express their true intentions at a shareholders' meeting.
- In the case of a resolution by a shareholders' meeting, the target company can ascertain how each shareholder made their decision.
- Since the composition of voting rights of shareholders at the record date to be entitled with voting rights and at the time the shareholders' meeting is held changes, confirmation of shareholder intentions at the shareholders' meeting may not reflect the latest intentions of the most current shareholders.
- If the lower limit of a tender offer is set low, even if many shareholders do not tender their shares, certain other shareholders may sell their shares.

The possibility for the acquiring party to be able to avoid the damage of having its shareholding ratio diluted by a company's invocation of countermeasures (possibility to avoid damage) may be created based on grounds such as the acquiring party having time to withdraw or terminate its acquisition. If this possibility exists, it may be considered as a factor demonstrating the proportionality of the countermeasures utilized by the target company.

Some court decisions to date have considered such possibility of avoiding damage as one of the circumstances indicating the proportionality of the countermeasures.[90]

**b) Damage Mitigation Measures**[91]

Allowing an acquiring party that is the subject of the invocation of countermeasures to receive monetary or other benefits is problematic, because it induces the invocation of countermeasures thereby depriving shareholders of the opportunity to sell their shares to the acquiring party after securing the time, information, and negotiation opportunities necessary to properly determine the merits of the acquisition. This would hinder the development of a sound capital market. Therefore, it is not advisable to allow acquiring parties to receive monetary or other benefits.[92]

Generally, it is not considered necessary to take damage mitigation measures such as providing monetary relief or other benefits to the acquiring party if the damage caused by the invocation of countermeasures can be avoided due to the fact that the acquiring party still has time to withdraw or terminate its acquisition.

On the other hand, in the situation of increasing ownership through open market purchases by an acquiring party, certain damage mitigation measures may be taken by a target company

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[90] Nippo Sangyo case (Nagoya High Court decision, April 22, 2021), Fuji Kosan case (Tokyo High Court decision, August 10, 2021), Tokyo Kikai Seisakusho case (Supreme Court decision, November 18, 2021), among others.

[91] Advocates have pointed out that if stock acquisition rights with unequal conditions for exercise, which cannot be exercised by an acquiring party, are issued, there may be a distortion in shareholder decision-making in the sense that there is a motive to approve the countermeasure at the shareholders' meeting separate and independent of the decision on the merits of the acquisition, since the shareholders other than the acquiring party can gain economic benefits by exercising their rights and increasing their ownership percentage.

[92] The same concept is expressed in the 2008 Report.

against[93] an acquiring party which disputes the legality of invocation of countermeasures by making purchases in excess of the threshold in the response policy. In practice, response policies introduced, especially in emergent phases, often adopt a mechanism to mitigate damages to a certain extent by granting so-called "second stock acquisition rights."[94, 95]

**c) Predictability of Damage (Assumption of Risk)**

If the details of the target company's response policy are disclosed prior to the commencement of the acquisition process, it is possible to consider that the acquiring party assumes the risk of incurring damages because it goes forward with the acquisition while being aware that the invocation of the countermeasure may cause dilution of its shareholding ratio (however, it is not appropriate to consider that any damage should be accepted as permissible, rather, such notion is subject to the possibility of damage avoidance and damage mitigation measures being secured to a certain degree).

Some previous court decisions also have considered the predictability of dilution caused by the invocation of countermeasures as a factor indicating the measures' proportionality, since the

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[93] Advocates have pointed out that requiring the acquiring party to cross the threshold and cause the countermeasures to be invocated in order to resolve the issue in court (and thus potentially cause costs to itself and to the target company) is circuitous, and that there should be a way for an acquiring party to seek to challenge the countermeasures in court before crossing the threshold.

[94] The term "second stock acquisition rights" refers to stock acquisition rights with (1) conditions for exercise that if the percentage of share certificates, etc. (of the acquiring party) falls below a certain percentage, such stock acquisition rights still can be exercised within the extent below that percentage; and (2) acquisition clauses (so-called "clean-up clause") that allow the company to redeem the unexercised stock acquisition rights after a certain period for a cash consideration equivalent to the market price at the time of acquisition.

[95] Such "second stock acquisition rights" have been found by courts to establish proportionality in several decisions to date (e.g., Fuji Kosan case (Tokyo High Court decision, August 10, 2021), Tokyo Kikai Seisakusho case (Supreme Court decision, November 18, 2021), among others). These rights have a certain level of rationality, as they are an attempt to realize proportionality by reducing damages within certain limits while as much as possible avoiding the granting of monetary and other benefits that raise problems, as described above. As mentioned in the prior footnote, "second stock acquisition rights" have acquisition clauses (so-called "clean-up clause") that allow unexercised stock acquisition rights to be acquired for cash consideration after a certain period of time (e.g., 10 years), but the payment of such cash is not considered problematic by the court, and is not necessarily considered to constitute the payment of money or other benefits which was considered undesirable in the 2008 Report and other reports.

terms of the response policy were disclosed prior to commencement of the acquisition process by the acquiring party.[96]

**d) Relationship between Each Element**

Based on the findings of proportionality in recent judicial precedents,[97] the possibility to avoid damage and predictability of damage are considered to be correlated with damage mitigation measures, i.e., when possibility to avoid damage and predictability of damage are recognized, it is considered that the requirement for damage mitigation measures is relatively weakened.

## 3. Prior Disclosure

Through companies' adoption and disclosure of a response policy in a normal phase, it is believed that acquiring parties, shareholders, and other parties will be on notice that countermeasures may be used in the event of an acquisition of shares above a certain level. With this relatively enhanced predictability, such market participants may be able to take appropriate actions in connection with acquisition offers, such as by making their investment decisions carefully based on the details of the countermeasures or by structuring their acquisition offers in forms and methods likely to be successful. Additionally, with disclosed response policies, there is also the potential of putting a stop to the act of an acquiring party buying in the market

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[96] See Nippo Sangyo case (Nagoya High Court decision, April 22, 2021).

[97] Specifically, the following decisions have been issued:

- (With respect to a response policy adopted for emergent phases) There is a case in which use of the "second stock acquisition rights" mechanism was recognized as proportionate, where the damages caused by invocation of countermeasures can be avoided if the acquiring party withdraws or terminates its acquisition offer (see Tokyo Kikai Seisakusho case (Supreme Court decision, November 18, 2021)). In contrast, however, there is a case where proportionality was not found because the way for the acquiring party to withdraw its acquisition offer was practically closed (see Mitsuboshi case (Supreme Court decision, July 28, 2022)).
- There was a case in which a response policy was found by the court as proportionate because, if the procedural rules in the response policy were complied with, the damages resulting from invocation of countermeasures could be avoided. Additionally, because the terms of the response policy were disclosed prior to the acquisition offer, the dilution caused by the invocation of countermeasures could be foreseen , and even if under the response policy it was such that the company would not acquire the stock acquisition rights allotted to the acquiring party (and no money or other benefits would be delivered), damages were mitigatable by transferring such stock acquisition rights to a third party (see Nippo Sangyo case (Nagoya High Court decision, April 22, 2021)).

beyond a certain level (trigger criteria) without consequence. In addition, as mentioned earlier, predictability of damage can be considered as a factor upon which the proportionality of the countermeasures can be based. In anticipation of these effects, in practice, some companies have adopted and continue their response policy in a normal phase after a resolution of the shareholders' meeting.

On the other hand, prior disclosure may exclude the adopting company from being a potential acquisition target (and thus may deter even desirable acquisitions), and external discipline on management that comes with the possibility of there being an acquisition attempt may not result. In addition, just because it is predictable that a countermeasure may be used does not necessarily mean that the possibility of avoiding the invocation of the countermeasure exists, and thus it is considered important to have a high degree of predictability as to "in what circumstances countermeasures will be used."

## Attachment 1: List of Fair Acquisition Study Group Members

(without honorifics / Japanese alphabetical order)

| | | Name | Affiliation |
|---|---|---|---|
| Chairperson | : | Hideki Kanda | Professor, Gakushuin University Law School |
| | | Gaku Ishiwata | Partner, Lawyer, Mori Hamada & Matsumoto |
| | | Akihito Ichikawa | Head of Equity Investment Department, Nippon Life Insurance Company |
| | | Kotaro Inoue | Professor, School of Engineering, Tokyo Institute of Technology |
| | | Akitsugu Era | Managing Director, Head of Investment Stewardship, BlackRock Japan Co., Ltd. |
| | | Yo Ota | Partner, Lawyer, Nishimura & Asahi |
| | | Hiroyuki Otsuka | Managing director and Deputy Head, Carlyle Japan LLC |
| | | Yoshiharu Obata | Head of Business Infrastructure Bureau, Japan Business Federation |
| | | Hiroki Kodate | Partner, Lawyer, Anderson Mori & Tomotsune |
| | | Kohei Kodama | Vice President and Executive Officer, Chief Legal Officer, General Counsel and Deputy Chief Risk Management Officer, Hitachi, Ltd. |
| | | Hiroki Sampei | Principal, Astonering Advisor LLC |
| | | Kazuhiro Takei | Partner, Lawyer, Nishimura & Asahi |
| | | Wataru Tanaka | Professor, Institute of Social Science, The University of Tokyo |
| | | Yuko Tamai | Partner, Lawyer, Nagashima Ohno & Tsunematsu |
| | | Shinsuke Tsunoda | Senior Managing Director, Nomura Securities Co., Ltd. |
| | | Tomotaka Fujita | Professor, Graduate Schools for Law and Politics, The University of Tokyo |
| | | Kensaku Bessho | Member of the Board of Directors, Deputy President, CEO of Investment Banking, Mitsubishi UFJ Morgan Stanley Securities Co., Ltd. |
| | | Katsuhiro Matsukura | Managing Director, Kansai Economic Federation |
| | | Kazuyuki Mitsuhashi | Senior Deputy General Manager and Fellow, Asset Management Division, Mitsubishi UFJ Trust and Banking Corporation |
| (Observers) | | Noriyuki Kikuchi | Director of Listing Department, Tokyo Stock Exchange |
| | | Hitoshi Hirokawa | Director, Corporate Accounting and Disclosure Division, Policy and Markets Bureau, Financial Services Agency, The Japanese Government |
| | | Satoshi Watanabe | Counsellor, Minister's Secretariat, Ministry of Justice, The Japanese Government |

# Attachment 2: Chronology of Discussions

## 1. Fair Acquisition Study Group

**First Session (November 18, 2022)**

- General Overview #1: Overall Picture, and How Parties Should Behave - Takeover Proposals
- Presentation (initial reporting): "Survey on M&A Systems and Practices in Foreign Jurisdictions", Nagashima Ohno & Tsunematsu
- Presentation: "Current Status and Issues of Takeover Defense in Japan", Yo Ota, Attorney-at-Law, Study Group Member

**Second Session (December 1, 2022)**

- General Overview #2: How Parties Should Act - Takeover Defense Measures and its Invocation
- Presentation: Case Study "Acquisition of Shinsei Bank by SBI Group", SBI Group

**Third Session (December 26, 2022)**

- Detailed Exposition #1: How Parties Should Behave – Takeover Proposals

**Fourth Session (January 26, 2023)**

- Detailed Exposition #2: How Parties Should Behave - Takeover Defense Measures and its Invocation
- Presentation: "From the Perspective of Finance Research - Takeover Defense Measures and its Implications for Institutional Design ", Kotaro Inoue, Professor, Tokyo Institute of Technology, Study Group Member

**Fifth Session (March 1, 2023)**

- In-Depth Discussion: Code of Conduct for Directors and Board of Directors in response to Takeover Proposals (based on previous discussions)

**Sixth Session (March 28, 2023)**

- Deliberation: Draft of the Guidelines
- Reporting: The Results of Public Consultation
- Presentation: "The Regulation and Practice, Tender Offer System and Large Shareholding Reporting System", Financial Services Agency

**Seventh Session (April 17, 2023)**

- Deliberation: Revised Draft of the Guidelines, based on discussions at the 6th session
- Discussion: Corporate Value and Shareholder Interests

**Eighth Session (April 28, 2023)**

- Deliberation: Revised Draft of the Guidelines, based on discussions at the 7th session

## 2. Survey on M&A Systems and Practices in Foreign Jurisdictions

- Period: July 2022 - February 2023
- Researcher: Nagashima Ohno & Tsunematsu
- Countries surveyed: U.S.A., U.K., France, Germany
- For the survey report, please refer to the following website.
  https://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/fyr4itaku_maresearch.pdf

## 3. Public Consultation on Key Issues

- Period: February 22, 2023 - March 15, 2023
- For more information on the public consultation, please refer to the following website (Japanese Only).
  https://www.meti.go.jp/press/2022/02/20230222006/20230222006.html
- For the results of the public consultation and a summary of the main comments received, please refer to the 6th session materials at the following website (Japanese Only):
  https://www.meti.go.jp/shingikai/economy/kosei_baishu/006.html

## 4. Public Comments on the Draft of the Guidelines

- Period: From June 8, 2023 to August 6, 2023
- For a summary of the public comments received and METI's thinking for them, please refer to the following website.
  https://www.meti.go.jp/shingikai/economy/kosei_baishu/20230831_report.html