# DOING DEALS IN JAPAN: AN ANALYSIS OF RECENT TRENDS AND DEVELOPMENTS FOR THE U.S. PRACTITIONER

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## I. INTRODUCTION

Japanese deals are back. During the so-called "lost decade" of the 1990s when Japanese banks were saddled with non-performing loans and Japanese companies posted minimal earnings growth, it seemed as though the Japanese economy was left out of the globalization trend that was sweeping across western economies and much of the developing world. Perhaps lost in the shuffle of the tech boom, the fallout from Enron and WorldCom, the passage of the Sarbanes-Oxley Act of 2002 and the subsequent rules issued by securities regulators, the investigations by New York Attorney General Eliot Spitzer and the Securities and Exchange Commission into the recommendations made by certain securities analysts, and the market timing abuses committed by some mutual funds—on top of the grave concerns arising in a post-September 11 era—there was little time left to discuss the critical changes that were taking place in the world's second largest economy. Although some companies and investors took another look at Japan somewhat earlier in the business cycle (and have consequently reaped the benefits of such investments), only recently have the numbers come back to generate renewed interest across the market.

The numbers have come back big. According to Thomson Financial, in 2005 the total number of Japanese deals was 2552—second only to the United States—resulting in total deal volume exceeding $167 billion—third in the world following the United States and the United Kingdom.[1] Japanese deals were up 109.2% in 2005 from their 2004 levels, while the United States and the United Kingdom were up 33.3% and 15.6%, respectively.[2] Although Japanese deals may still account for a smaller percentage of the overall Japanese economy when measured against comparable figures in many western economies, there is little doubt that the trends are up. Indeed, Thomson Financial concluded that "Japan proved a hot market in 2005, far outpacing growth in the United States, the United Kingdom, and Australia."[3]

The reasons for these developments are many and include the decrease in cross-shareholdings between Japanese companies, an increase in shareholder activism as represented by notable market players, and simple business

[1] *See* Thomson Financial, *Mergers & Acquisition Review Fourth Quarter 2005*, at 3, http://www.thomson.com/pdf/financial/league_table/ma/4Q 2005/4Q05_MA_ Financial_Advisory.pdf.

[2] *Id.*

[3] *Id.* at 29.

fundamentals that made doing a deal much more attractive than may have been the case only a few years earlier. In addition to these market developments, Japan has experienced tremendous changes in the legal profession itself, such as the establishment of a law school system modeled on that of the United States to train the next generation of Japanese attorneys (*bengoshi*),[4] as well as recent amendments to the Japanese Federation of Bar Association rules which now permit *bengoshi* and foreign attorneys to partner to a certain extent.[5] Other notable developments in the M&A practice in Japan include:

> *An increase in the hostile or contested deal.* While still relatively small compared to the historic activity in the United States, it is no longer the case that every deal in Japan must be a friendly one.
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> *New defensive measures to combat the hostile bidder.* In the aftermath of the Livedoor hostile bid for Nippon Broadcasting System, Inc., Japanese boards have actively pursued a variety of defensive measures, such as the possible issuance of share purchase warrants (*shinkabu-yoyaku-ken*), which can operate in a manner similar to U.S.-style poison pills.[6]

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[4] *See generally* David A. Boling, *Legal Reform in Japan*, ASIA PERSPECTIVES, Fall 2002, at 33-36.

[5] *See* Gaikoku Bengoshi ni yoru Horitsujimu no Toriatsukai ni kansuru Tokubetsusochi-ho [Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers], Law No. 66 of 1986, art. 2, no. 15; art. 49-3 (amended 2003).

[6] Although share purchase warrants are technically not shareholder rights plans or poison pills in the American sense of the term, in this article we have used such terms in cases when share purchase warrants are used as defensive measures since, in the vernacular of practitioners in Japan, there has not been, at least as of yet, any one label that has gained a strong and devout following. The ambiguity in commonly used phrases, however, should not blur the crucial differences in law between Japanese and U.S. "poison pills." *See, e.g.,* Curtis J. Milhaupt, *Symposium: Prescribing the Pill in Japan?: Foreword to the Hostile M&A Conference Issue*, 2004 COLUM. BUS. L. REV. 1 (2004); Satoshi Kawai, *Symposium: Poison Pill in Japan*, 2004 COLUM. BUS. L. REV. 11 (2004); Ronald J. Gilson,

> *More competition even in the mega-deals.* Business opportunities to undertake more deals have resulted in increased competition at all levels, which has further highlighted the attractiveness of reaching an agreement with the target while adequately protecting such an agreement. For instance, the recent merger between UFJ Holdings and Mitsubishi Tokyo Financial Group for $41 billion included the issuance of shares with certain veto rights as well as a fiduciary out provision, both of which were firsts in major Japanese M&A deals.

> *Greater flexibility for cross-border transactions.* Amendments to the Corporation Law that permit the use of certain types of triangular mergers have recently been enacted. In addition, as a means of keeping the laws on the books up to speed with the dynamic changes in the market, the Japanese government has issued new guidelines on M&A defensive strategies.

All of these changes may leave the U.S. legal practitioner somewhat perplexed as to where to start learning about how to get deals done in the new Japan. A widely shared opinion is that Japan is currently experiencing an increase in takeover activity that is comparable to the heyday of U.S. takeovers during the mid-to-late 1980s, a time which largely provided the foundation for present American takeovers jurisprudence.[7] Still, while much has changed in Japanese

*Symposium: The Poison Pill in Japan: The Missing Infrastructure*, 2004 COLUM. BUS. L. REV. 21 (2004); William B. Chandler III, *Symposium: Hostile M&A and the Poison Pill in Japan: A Judicial Perspective*, 2004 COLUM. BUS. L. REV. 45 (2004); Hideki Kanda, *Symposium: Does Corporate Law Really Matter in Hostile Takeovers?: Commenting on Professor Gilson and Chancellor Chandler*, 2004 COLUM. BUS. L. REV. 67 (2004).

[7] *See, e.g.*, Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171, 2174 (2005). For an interesting real-time account from the Japanese perspective of the events that took place in the United States during the 1980s, *see* NIHON KEIZAI SHIMBUN [NIHON KEIZAI SHIMBUN, INC.], SEC NO SUGAO [THE SEC'S TRUE FACE] (Nihon Keizai Shimbun ed., 1989).

law and practice of late, the challenges of doing a cross-border deal with a Japanese company remain.

This article examines the process that is currently being played out in Japan by: (i) analyzing the recent changes in Japanese law of relevance to M&A deals; (ii) discussing some recent contested deals in Japan that may shed light on current market practices; and (iii) providing an overview of the key issues that a U.S. practitioner will likely face when working on a Japanese deal. While this analysis is by no means an exhaustive or comprehensive treatment of the subject matter, hopefully it will provide insight into the changes that are taking place in Japan, while also noting future developments that may, to some degree, be anticipated.

## II. RECENT CHANGES IN JAPANESE LAW

A good starting point to better understand the remarkable changes in the Japanese M&A markets is to review the recent amendments to Japanese law, certain policy initiatives by the functional regulators, and other guidelines issued by Japanese government agencies. When taken as a whole, these reforms are substantial and may well be the most ambitious and far-reaching in a generation. While the specific measures in these reforms may not have a direct comparison to a particular event in the U.S. legal experience, one could reasonably characterize them as representing a degree of change on the same level as the enactment of the Sarbanes-Oxley Act. Fortunately for the U.S. practitioner, the Japanese reforms were drafted with the purpose of facilitating more cross-border deals. Thus, at least in principle, the reforms should not increase the number of regulatory hurdles that a U.S. company must pass to enter the Japanese market.

### A. Enactment of the New Corporation Law

The most significant of these reforms was the enactment of a new Corporation Law (*Kaisha-ho*) in June 2005. These reforms largely took effect in May 2006, except for certain provisions regarding possible cash-out and triangular mergers, which are scheduled to take effect in May 2007. The Corporation Law is the primary source of Japanese corporate law and may be compared to the Delaware General Corporation Law, although there are notable differences that must always be considered prior to entering into any transaction.[8] The vast majority of the changes to the Corporation Law involve the structuring and governance of Japanese entities, which by and large should not affect the legal compliance issues for a U.S. corporation. However, where a U.S. corporation does business with a Japanese entity, or perhaps has an interest in a Japanese company as part of its international operations, the amendments to the Corporation Law will have a significant impact. Some of the more important changes include:

> *Revision of Japanese corporate structures.* The Corporation Law adopts a number of important changes to the available corporate structures including: (i) the introduction of limited liability partnership companies (*godo-kaisha*) modeled after LLCs in the United States; (ii) the abolishment of limited liability companies typically used by small businesses (*yugen-kaisha*); and (iii) the expansion of the definition of parent-subsidiary relationships from a straight majority of the vote test to include cases where the parent has control of the subsidiary.[9]
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> *Streamlining of Japanese corporate governance rules.* The Corporation Law also clarifies the applicable governance requirements of each of these entities. While a joint stock company (*kabushiki kaisha*) still has the option to utilize a corporate auditor or a committee system,[10] the Corporation Law provides

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[8] For instance, the Corporation Law does not permit cash-out mergers for 90% holders of voting shares in the absence of a merger agreement with the target company, as is commonly the case in Delaware. *See* DEL. CODE ANN. tit. 8, § 253 (2006).

[9] Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 2, no. 3.

[10] *Id.* art. 326, para. 2.

numerous changes to the applicable corporate governance rules including: (i) enhancing the qualification requirements of directors;[11] (ii) permitting the creation of an accounting counselor (*kaikei-sanyo*) in the articles of incorporation of a joint stock company;[12] (iii) allowing for board approval in writing through amendment of the articles of incorporation, in contrast to the prior requirement of, at minimum, a telephone conference; [13] and (iv) providing that a majority vote of shareholders suffices to dismiss a director with or without cause, in contrast to the prior supermajority vote requirement.[14]

*Expansion of cash-out and triangular mergers.* The provisions to take effect in May 2007 will make cash-out and triangular mergers more available to foreign companies, which can currently engage in such transactions only when carried out under a special law that requires government consent. [15] The new structures will permit the surviving company in a statutory merger between two Japanese companies to use cash and/or stock of its non-Japanese parent company as consideration for the shareholders of the disappearing company.

*New limited voting right pills.* In addition to the types of poison pills currently available under Japanese law, the Corporation Law permits Japanese companies to issue a poison pill that can limit the voting rights of a hostile acquirer, in contrast to the customary dilution

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[11] *Id.* art. 331, para. 1.

[12] *Id.* art. 326, para. 2.

[13] *Id.* art. 370.

[14] *Id.* art. 341. The company may still elect to increase the voting requirement to a supermajority by amending its articles of incorporation. *Id.*

[15] Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 749, para. 1, no. 2; *see also* Sangyo-Katsuryoku-Saisei-Tokubetsu-Sochi-Ho [Law on Special Measures for Industrial Revitalization], Law No. 131 of 1999, art. 12-9, para. 1.

of voting power in a flip-in/flip-out pill in the United States.[16]

## B. Amendments to the Securities and Exchange Law

In addition to the new requirements of the Corporation Law, certain amendments to the Securities and Exchange Law[17] have gone into effect, and further government and cabinet ordinances are currently being considered by the Japan Financial Services Agency ("FSA"), which include the following:

*Definition of "market" trading in the tender offer rules.* These amendments,[18] which went into effect in July 2005, were made largely in response to Livedoor's purchases of shares in Nippon Broadcasting System, Inc. by means of an after-hours, off-exchange trading system of Tokyo Stock Exchange, Inc. (the "Tokyo Stock Exchange"). As a general matter, the Japanese tender offer rules under the Securities and Exchange Law apply when an acquirer obtains more than one-third of the voting rights in the target company.[19] Once the tender offer rules are triggered, the acquirer

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[16] Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 108.

[17] The Securities and Exchange Law was originally modeled on the U.S. federal securities laws, although in operation there are substantial differences between the two systems of securities regulation. *See generally* HIROSHI ODA, JAPANESE LAW 268-271 (2d ed. 1999). The recent amendments to the Securities and Exchange Law, enacted in June 2006, change the title of the statute to Kinyu Shohin Torihiki-ho [The Financial Instruments and Exchange Law]. This change in name is scheduled to take effect in the second half of 2007, although certain other amendments to the Securities and Exchange Law will become effective at an earlier time. For the purposes of this article, therefore, we refer to the Securities and Exchange Law by its current title. Please note that references to Shoken-torihiki-ho Seko-Rei [Government Ordinance for the Securities and Exchange Law], ordinance No. 321 of 1965, are based on the most recent draft as of November 30, 2006.

[18] Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-2, para. 1.

[19] *Id.* For additional details, see *infra* note 96.

generally must either submit a tender offer to all shareholders or continue to obtain shares by market purchases. The particular issue with the Livedoor trades was whether the after-hours, off-exchange trades were "market" purchases that complied with the tender offer rules. While the law at that time was unclear on the issue, the amendments to the Securities and Exchange Law now generally prohibit such trading in the absence of a tender offer that otherwise complies with the applicable rules and regulations.

*Permitted withdrawal of tender offers.* Based on the expectation that larger numbers of Japanese companies will adopt defensive measures in response to the increase in hostile activity in Japan, the FSA is in the process of amending the rules that govern when a hostile acquirer may withdraw a tender offer. The current tender offer rules do not explicitly provide that an offeror can withdraw a tender offer in response to certain defensive mechanisms, such as share purchase warrants or the issuance of new shares. After the tender offer rules become effective, they are likely to explicitly provide that an offeror may withdraw a tender offer when the board of the target company refuses to cancel its defensive measures.[20]

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[20] *See* Shoken-torihiki-ho Seko-Rei no Ichibu wo Kaiseisuru Seirei An [Draft of Government Ordinance to Amend Part of Government Ordinance for the Securities and Exchange Law], Ordinance No. 321 of 1965, art. 14, para. 1, no. 2 [hereinafter (Draft) Government Ordinance for the Securities and Exchange Law]; KINYUSHINGIKAI KINYUBUNKAKAI DAIICHIBUKAI [THE FIRST SECTION OF THE FINANCE DIVISION OF THE FINANCE COUNCIL], KOKAIKAITSUKESEIDOTO WORKING GROUP HOKOKU [THE REPORT OF THE WORKING GROUP CONCERNING THE TENDER OFFER AND OTHER RULES] 8 (2005), http://www.fsa.go.jp/singi/singi_kinyu/siryou/kinyu/dai1/tob/f-2005 1216-3..pdf [hereinafter THE TENDER OFFER REPORT]. Additionally, on July 22, 2005, a minister of the FSA suggested that the existing tender offer rules be interpreted so that a tender offer can be withdrawn due to a stock split that would constitute a material adverse effect with respect to the tender offer. Transcript, FSA News Conference (July 22, 2005), http://www.fsa.go.jp/gaiyou/gaiyouj/daijin2005b/20050722-1.html; *see also* FINANCIAL SERVICES AGENCY, JAPAN, BILLS FOR NEW LEGISLATIVE

*Changes to substantial shareholder reports.* The FSA has revised the rules for substantial shareholder reports under the Securities and Exchange Law, which are similar to Schedule 13D filings in the United States. These revisions will take effect in January 2007. Under the prior rules, a shareholder and its group who held more than 5% of the issued shares of a Japanese public company were required to file the substantial shareholder report within five business days after crossing the 5% threshold, except for certain institutional investors, which were permitted to file the reports within a longer period of time. Recent amendments to the Securities and Exchange Law shorten the period for institutional investors.[21] Additionally, other recent amendments to the Securities and Exchange Law require that all substantial shareholder reports be filed electronically.[22]

## C. Notable Guidelines and Rules

In addition to the many changes to Japanese law, government ministries and other organizations have addressed the issues raised by the recent increase in hostile deals through the issuance of guidelines and rules. Although these guidelines and rules may not necessarily result in binding legal obligations, they do provide important guidance as to how the Japanese legal and business communities currently analyze the issues associated with the increase in takeover activity.

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FRAMEWORK FOR INVESTOR PROTECTION – "FINANCIAL INSTRUMENTS AND EXCHANGE LAW" 15 (2006), http://www.fsa.go.jp/en/news/2006/20060324.pdf [hereinafter THE FRAMEWORK OF THE FINANCIAL INSTRUMENTS AND EXCHANGE LAW] (stating as a matter of policy that, in the event the target company decides to activate takeover defenses, the withdrawal of a takeover bid or changes in the conditions to a takeover bid are permissible).

[21] Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-26, para. 1.

[22] *Id.* art. 27-30-2; art. 27-30-3, para. 1.

*The Corporate Value Report.* The Ministry of Economy, Trade and Industry ("METI") established the Corporate Value Study Group, composed of noted legal scholars and business representatives, to consider the rules governing hostile deals in other jurisdictions, including the United States and Europe. In May 2005, the Group issued its report recommending rules for defensive measures in Japan (the "Corporate Value Report"). While discussing Delaware's experience with takeovers and the *Unocal* standard,[23] the Group observed that changes to the rules in foreign jurisdictions would be necessary to comport with Japanese practices.[24] In November 2005, the Group also provided a written opinion on how stock exchanges should treat rights plans, including the desired level of disclosure for such plans. The Group stated in this opinion that shares with veto rights (so-called "golden shares") should be allowed for public companies that: (i) establish clear exercise conditions; (ii) provide that such shares can be cancelled at a shareholder or board meeting; and (iii) limit the effective period for such shares.[25]

*The Defensive Measures Guidelines.* Based on the Corporate Value Report, in May 2005, METI and the

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[23] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). *See also* Jack B. Jacobs, *Implementing Japan's New Anti-Takeover Defense Guidelines: Part I: Some Lessons from Delaware's Experience in Crafting "Fair" Takeover Rules*, 2 N.Y.U. J.L. & BUS. 323 (2006).

[24] KIGYOKACHI KENKYUKAI [CORPORATE VALUE STUDY GROUP], KIGYOKACHI HOKOKUSHO [CORPORATE VALUE REPORT] (2005), http://www.meti.go.jp/press/20050527005/3-houkokusho-honntai-set.pdf [hereinafter THE CORPORATE VALUE STUDY GROUP and THE CORPORATE VALUE REPORT, respectively]. *See also* Akihiro Hironaka, *Jurisdictional Theory "Made in Japan": Convergence of U.S. and Continental European Approaches*, 37 VAND. J. TRANSNAT'L L. 1317 (2004) (discussing the convergence of U.S. and European models of jurisdictional rules in the Japanese experience).

[25] THE CORPORATE VALUE STUDY GROUP, KOSEINA BAISHUBOEISAKU NO ARIKATA NI KANSURU RONTENKOKAI [DISCLOSURE OF ISSUES REGARDING FAIRNESS OF DEFENSIVE MEASURES] 9 (2005), http://www.meti.go.jp/press/20051110002/3-ronntennkoukai-set.pdf.

Ministry of Justice announced guidelines regarding the preferred uses of and advised limitations to rights plans (the "Defensive Measures Guidelines").[26] Although these guidelines do not have the force of law, most Japanese companies follow them when designing their rights plans.

*Tokyo Stock Exchange Rules.* In March 2006, the Tokyo Stock Exchange announced new rules on the permitted defensive measures of listed companies.[27] These rules require sufficient disclosure of defensive measures and prior consultation with the Tokyo Stock Exchange. The FSA and METI strongly objected to draft rules prohibiting golden shares; thus, the new rules permit them "when the Tokyo Stock Exchange acknowledges that the defensive measure is not likely to infringe the benefits of shareholders and investors in light of the company's business purposes, the purpose for issuing the golden shares, the content of the rights, the attributes of subscribers, and other conditions of the golden shares."[28] In contrast, the New York Stock Exchange prohibits the issuance of golden shares by listed companies.[29]

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[26] KEIZAISANGYO-SHO [MINISTRY OF ECONOMY, TRADE AND INDUSTRY] & HOMU-SHO [MINISTRY OF JUSTICE], KIGYOKACHI KABUNUSHI KYODO NO RIEKI NO KAKUHO MATAWA KOJO NO TAMENO BAISHUBOEISAKU NI KANSURU SHISHIN [GUIDELINE REGARDING DEFENSIVE MEASURES TO SECURE AND INCREASE CORPORATE VALUE AND SHAREHOLDERS' COMMON BENEFITS] (2005) [hereinafter THE DEFENSIVE MEASURES GUIDELINES], http://www.meti.go.jp/press/20050527005/3-shishinn-honntai-set.pdf.

[27] TOKYO STOCK EXCHANGE, BAISHUBOEISAKU NO DONYU NI KAKARU JOJOSEIDO NO SEIBITO NI TOMONAU KABUKENJOJOSHINSAKIJUNTO NO ICHIBUKAISEI NI TSUITE [RE: PARTIAL AMENDMENT TO THE STOCK LISTING REQUIREMENTS, ETC. ACCOMPANYING THE ADJUSTMENT, ETC. OF THE LISTING SYSTEM REGARDING THE ADOPTION OF DEFENSIVE MEASURES] (Mar. 7, 2006), http://www.tse.or.jp/guide/rule/taisho/060307_a1.pdf.

[28] *Id.* at 2.

[29] NYSE, Inc., Listed Company Manual § 308.00 (1999). However, one should note that while "golden shares" in the United States or Japan may have the common element of veto rights, they may operate quite differently in practice. For instance, as further discussed *infra* note 39,

*Pension Fund Association Guidelines.* In April 2005, the Pension Fund Association (the "PFA") announced guidelines regarding the exercise of voting rights in connection with proposed defensive measures.[30] The PFA represents the interests of pension fund participants at various Japanese companies.[31] The PFA guidelines generally approve of rights plans provided that (i) the company in question sufficiently explains how the rights plan will increase corporate value; (ii) the company's shareholders approve the rights plan at a shareholders meeting; (iii) the directors refrain from arbitrary decision-making; and (iv) the company limits the duration of the rights plan. The guidelines also object to golden shares and dead hand poison pills.

## III. RECENT CONTESTED DEALS IN JAPAN

In concert with the recent changes in Japanese law, there has been an increase in the number of contested deals in

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the Class E Preferred Shares in the UFJ Holdings – Mitsubishi Tokyo Financial Group merger had deal protection elements when reading the specific text of the Basic Agreement of Recapitalization, which provided for a break-up fee upon the exercise of put/call options for the Class E Preferred Shares upon certain triggering events. Thus, while the Class E Preferred Shares were given certain veto rights in a manner similar to golden shares, they were redeemable with the cost of any redemption operating essentially as a break-up fee for the transaction.

[30] These guidelines were subsequently amended on April 10, 2006. KOSEI NENKIN KIKIN RENGOKAI [PENSION FUND ASSOCIATION], KIGYOBAISHUBOEISAKU NI KANSURU KABUNUSHI GIKETSUKEN KOSHI NO HANDANKIJUN [DECISION STANDARD OF EXERCISE OF VOTING RIGHTS REGARDING DEFENSIVE MEASURES] (Apr. 10, 2006), http://www.pfa.or.jp/top/jigyou/pdf/gov_20050428.pdf.

[31] It should be noted that, as a matter of practice, there are significant differences between Japanese and U.S. pension funds. For instance, Japanese pension funds are not as likely to be lead plaintiffs in securities class actions or derivative suits in a manner that has increasingly become the norm in the United States.

Japan.[32] Although people may reasonably disagree as to what this means for the Japanese M&A markets as a whole, 2005 provided the first clear signs that, unlike in the past, contested deals can now take place. Given the primary importance of the facts in these new types of transactions, it is worth reviewing the specifics of a few selected contested deals from 2005.

## A. UFJ – MTFG Merger[33]

The events that ultimately led to the merger of UFJ Holdings, Inc. ("UFJ Holdings") with Mitsubishi Tokyo Financial Group, Inc. ("MTFG") actually began in the spring of 2004, when UFJ Holdings and its subsidiaries, UFJ Bank Limited ("UFJ Bank") and UFJ Trust Bank Limited ("UFJ Trust Bank"), entered into a Basic Agreement with The Sumitomo Trust & Banking Co., Ltd. ("STB").[34] Signed on May 21, 2004, the Basic Agreement provided, *inter alia*, STB with the right to further discuss the possible acquisition of UFJ Trust Bank for a two-year period, together with a no-

[32] In this section, we use the broader term "contested" deals rather than "hostile" deals since some of the transactions may not be properly defined as hostile. For instance, the UFJ Holdings – Mitsubishi Tokyo Financial Group merger involved an unsolicited third-party bid but not a tender offer or proxy contest. However, for purposes of the definition of "contested" deals in this article, we do not intend to include those deals that are subject to a regular bidding process designed by the target company.

[33] As a matter of full disclosure, during his tenure as Foreign Counsel at Nishimura & Partners, Mr. Hines participated in the firm's representation of UFJ Holdings in connection with its merger discussions with MTFG. The Nishimura team was led by Masakazu Iwakura, a member partner of the firm, and the firm's negotiation team included partners Takefumi Sato and Hirotada Inoshita, and associates Daisuke Matsubara, Yuki Oi, and Hidetoshi Matsumura.

[34] A more detailed summary of the facts leading up to the vote at the UFJ and MTFG shareholders meetings is available in the registration statement filed by MTFG with the Commission. *See* Kabushiki Kaisha Mitsubishi Tokyo Financial Group Registration Statement (Form F-4), Amend. 3, 63-68 (May 18, 2005), http://www.sec.gov/Archives/edgar/data/67088/000119312505110582/df4a.htm [hereinafter Kabushiki Kaisha Mitsubishi Tokyo Financial Group].

shop clause. On July 14, 2004, however, the UFJ Group notified STB of the termination of their discussions under the Basic Agreement and began separate discussions with MTFG on the possible acquisition by MTFG of the UFJ Group's entire business.[35]

On July 16, 2004, UFJ Holdings and MTFG signed a memorandum of understanding that provided for further discussions regarding a complete integration of their two banking groups. That same day, STB filed a preliminary injunction at the Tokyo District Court against UFJ Holdings, UFJ Bank, and UFJ Trust Bank to prevent any further discussions with MTFG regarding a possible integration. STB prevailed at the Tokyo District Court on July 27, 2004.[36] However, this ruling was later overturned on appeal before the Tokyo High Court on August 11, 2004.[37] The Supreme Court of Japan affirmed the Tokyo High Court's decision on August 30, 2004.[38]

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[35] The UFJ Group was composed of UFJ Holdings, UFJ Bank, UFJ Trust Bank, and UFJ Tsubasa Securities Co., Ltd.

[36] STB v. UFJ Holdings, 1708 SHOJI HOMU 22 (Tokyo Dist. Ct., Aug. 4, 2004).

[37] UFJ Holdings v. STB, 1708 SHOJI HOMU 23 (Tokyo High Ct., Aug. 11, 2004).

[38] STB v. UFJ Holdings, 1708 SHOJI HOMU 23 (Sup. Ct., Aug. 30, 2004) (adjudicating STB's claims for injunctive relief). However, STB was still able to continue suit against UFJ Holdings, UFJ Bank, and UFJ Trust Bank for monetary damages due to the alleged breach and termination of the Basic Agreement. On February 13, 2006, the Tokyo District Court denied STB's request for 100 billion yen in damages. STB v. UFJ Holdings, 1928 HANREI JIHO 3 (Tokyo Dist. Ct., Feb. 13, 2006). STB appealed this ruling to the Tokyo High Court on February 24, 2006. On November 21, 2006, STB and Mitsubishi UFJ Financial Group, Inc. ("MUFG") entered into a settlement agreement as recommended by the Tokyo High Court, which provided that MUFG pay STB 2.5 billion yen to settle the litigation proceedings. *See* Press Release, STB, *Settlement on Litigation against UFJ Group (currently, Mitsubishi UFJ Group)* (Nov. 21, 2006), http://www.sumitomotrust.co.jp/IR/company/en/pdf/nr2006/E061121.pdf; Press Release, MUFG, *Settlement Agreed with The Sumitomo Trust & Banking Co., Ltd.* (Nov. 21, 2006), http://www.mufg.jp/data/current/pressrelease-20061121-001-e.pdf.

On August 24, 2004, Sumitomo Mitsui Financial Group, Inc. ("SMFG") made an unsolicited proposal to UFJ Holdings for a one-for-one stock merger, which represented approximately a 30% premium to UFJ Holdings shareholders based on the share prices of the two companies around that time. On September 10, 2004, MTFG, UFJ Holdings, and UFJ Bank signed the Basic Agreement of Recapitalization, which provided a 700 billion yen cash infusion from MTFG in consideration of certain Class E Preferred Shares of UFJ Bank. These preferred shares provided MTFG with veto rights upon certain triggering events, as set forth in the Basic Agreement of Recapitalization.[39]

On February 18, 2005, the UFJ Group and MTFG Group[40] signed an Integration Agreement that provided the merger ratios for the proposed integration, in addition to the first fiduciary out clause in the history of major Japanese M&A deals to the extent known through publicly available sources.[41] On February 25, 2005, SMFG withdrew its

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[39] An English-language summary of the Basic Agreement of Recapitalization is included in the Form F-4 filing. Kabushiki Kaisha Mitsubishi Tokyo Financial Group, *supra* note 34, at 111-13; *see also* Masakazu Iwakura & Yuki Oi, *M&A Torihiki Keiyaku ni okeru Hibaishukaisha no Kabunushi no Riekihogo 3(i)* [*Protection of the Interests of Target Company Shareholders in M&A Agreements 3(i)*], 1747 SHOJI HOMU 30, 35 (2005) (discussing how the Class E Preferred Shares had deal protection elements such as a break-up fee, whereby UFJ had a call option to purchase such shares at a price higher than the issuance price); Ken Siegel & Jeff Schrepfer, *UFJ no Gappeitogohogojoko no Beikokuhojo no Hyoka* [*An Assessment of the UFJ Merger and Integration Protective Provisions Under U.S. Law*], 33 KOKUSAI SHOJI HOMU 1 (2005) (considering the possible application of the *Unocal* and *Revlon* standards of review to the Basic Agreement of Recapitalization).

[40] The MTFG Group included MTFG, The Bank of Tokyo-Mitsubishi Limited, The Mitsubishi Trust and Banking Corporation, and Mitsubishi Securities, Co., Ltd.

[41] An English-language translation of the Integration Agreement is included in the Form F-4 filing. *See* Kabushiki Kaisha Mitsubishi Tokyo Financial Group, *supra* note 34, at A-A-1 to A-A-21. The fiduciary out clause is at § 50 of the Integration Agreement and provides language that is slightly different from a "superior proposal" formulation that would be

outstanding offer to UFJ Holdings for a proposed integration. On April 20, 2005, UFJ Holdings and MTFG signed the Merger Agreement.[42] The proposed integration, as set forth in the Merger Agreement, was approved at each of the shareholders meetings of UFJ Holdings and MTFG in June 2005. The merger date was October 1, 2005 for most of the group entities, with the remaining UFJ Bank and The Bank of Tokyo Mitsubishi having a merger date of January 1, 2006.

The UFJ – MTFG merger is important for numerous reasons, not least of which is that the combined entity MUFG is the largest Japanese financial institution and, upon closing, was the largest bank in the world in terms of assets. Beyond the business ramifications, however, the merger is noteworthy from the M&A practitioner's perspective in that it involved a number of firsts: the first bidding war among major Japanese banks in recent memory, the first time that shares with veto rights were used in a major Japanese M&A deal as a deal protection strategy, and, as noted previously, the first time a fiduciary out clause was included in a major Japanese M&A deal to the extent publicly known. Although it is yet to be seen whether such new aspects to Japanese deals will become "market" or the exception to existing trends and customs,[43] the fact that all

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considered customary in U.S. public company deals. *See id.* at A-A-14, A-A-15. In particular, the fiduciary out is subject to the agreement of the parties and provides, "If, as the result of such discussion [on the Business Integration, New Terms (if any), and Third Party Proposal], MTFG and UFJ Holdings reach an agreement (such agreement shall not be refused or delayed without any reasonable cause; and the burden of proving in advance that there is no such reasonable cause is placed on the Proposal Receiving Party), they may, on the agreed terms and conditions, (i) modify the terms and conditions of the Mergers; (ii) exempt the Proposal Receiving Party from its obligations under this Agreement . . .; or (iii) terminate this Agreement." *Id.* at A-A-15.

[42] An English-language translation of the Merger Agreement is included in the Form F-4 filing. *See id.* at A-B-1 to A-B-6.

[43] For instance, the discussion concerning the possible impact of the fiduciary out clause in the UFJ – MTFG Integration Agreement continues. *See* Masakazu Iwakura & Yuki Oi, *M&A Torihiki Keiyaku ni okeru Hibaishukaisha no Kabunushi no Riekihogo 3(ii)* [*Protection of the Interests of Target Company Shareholders in M&A Agreements 3(ii)*], 1748

these firsts occurred within the scope of one transaction clearly suggests that Japanese M&A markets are much more dynamic and creative than may have been the case only a few years ago.

## B. Livedoor – Fuji Television

While the UFJ – MTFG merger represented many firsts for Japanese M&A, the Livedoor – Fuji Television saga is noteworthy on a different level because it caught the public imagination and was a topic of discussion in many boardroom meetings, since it possibly signaled the beginning

SHOJI HOMU 37, 40 (2005) (articulating that the necessity for discussions about the protection of target company shareholders' benefits is increasing); *see also* Robert G. DeLaMater, *Director Fiduciary Duties in the Context of M&A Transactions: Relevance of U.S. Experience in Japan* 18 (Mar. 9, 2005) (paper presented at Association of the Bar of the City of New York symposium, *M&A Transaction: Does the U.S. Style Work in Japan?*) ("Under the present state of fiduciary duty jurisprudence in Japan, the bidder and its counsel should consider carefully and generally seek to resist any proposal by the target to include fiduciary out provisions in the acquisition agreement."). However, there are some indications that fiduciary outs may be on the rise. For example, the Corporate Value Report and the Defensive Measures Guidelines generally recommend that a target company consider possible competing proposals even when there is a white knight. *See* THE CORPORATE VALUE REPORT, *supra* note 24, at 85 ("In the event that a board has already decided on a sale of the company and is negotiating the sale with a third party, if a competing hostile acquirer emerges, the board is generally required to study a competing proposal of such acquirer. *A measure that completely takes away the opportunity to study such proposal is inappropriate without any special rationale not to study such proposal.*") (emphasis added); THE DEFENSIVE MEASURES GUIDELINES, *supra* note 26, at 4-5. Additionally, a recent MBO transaction for Toshiba Ceramics Co., Ltd., in which Toshiba Corporation owned approximately 40% of Toshiba Ceramics and where The Carlyle Group and Unison Capital Group were the acquirers, provided a fiduciary out as part of a going private transaction. *See* Press Release, Toshiba Corporation, *Tender in Takeover Bid* (Oct. 31, 2006), http://www.toshiba.co.jp/about/press/2006_10/pr3101.htm ("The Company [Toshiba Corporation] will tender all of the above-mentioned shares owned by it in the TOB by the Takeover Bidder to acquire the share of common stock of Toshiba Ceramics, except in certain cases, such as where the Company's tender in the TOB constitutes a violation of duty of prudent care of the directors and/or executive officers of the Company.").

of the true hostile bid.[44] It would not be unreasonable to believe that executives at many Japanese public companies, witnessing the dramatic events of the Livedoor hostile bid unfold in the press, quickly revisited their existing defensive measures and contemplated possibly improving their defensive profile by issuing poison pills and the like. The facts of the Livedoor hostile bid are well known in Japan and may not require much repeating, but the essentials are as follows.

In January 2005, Fuji Television Network, Inc. ("Fuji Television"), which held 12.4% of shares issued by Nippon Broadcasting System, Inc. ("NBS"), launched a tender offer for 100% of NBS shares at 5950 yen per share. The tender offer represented approximately a 21% premium over the market price, and was launched partly because Fuji Television sought to rectify the situation where its de facto subsidiary, NBS, owned 22.51% of Fuji Television issued shares. The NBS board approved the Fuji Television tender offer. During the tender offer period, Livedoor, Inc. ("Livedoor"), an Internet business company, acquired NBS issued shares through an after-hours, off-exchange trading system operated by the Tokyo Stock Exchange, which resulted in its holding 39.56% of NBS issued shares. This system is not a fully liquid market in that the buyer, to a certain extent, may purchase from specific sellers on an anonymous basis. Although the Livedoor trades were legal at the time, many observers thought that such trading circumvented the tender offer rules, which generally require an acquirer to make a tender offer or purchase shares in the

[44] For additional discussion of the Livedoor transaction, *see* NBS v. Livedoor, 1728 SHOJI HOMU 41 (Tokyo High Ct., Mar. 23, 2005); *Kobo Livedoor vs. Fuji Television Kensho (1)* [*Inspection of Battle between Livedoor and Fuji Television (1)*], THE YOMIURI SHIMBUN (Japan), Apr. 26, 2005, at 11; *Kobo Livedoor vs. Fuji Television Kensho (2)* [*Inspection of Battle between Livedoor and Fuji Television (2)*], THE YOMIURI SHIMBUN (Japan), Apr. 27, 2005, at 10.

market after passing the one-third ownership threshold for target shares.[45]

On February 28, 2005, the market price of NBS shares was 6700 yen. In March 2005, Fuji Television purchased NBS issued shares as a result of its tender offer, which resulted in its holding 36.47% of NBS issued shares.

On February 23, 2005, NBS announced that it was issuing to Fuji Television certain share purchase warrants[46] exercisable at 5950 yen per share. The effect of these share purchase warrants was that it would give Fuji Television majority control in NBS and dilute Livedoor's shareholding to less than 20%. Livedoor brought an action to enjoin the issuance of the warrants and prevailed in March 2005 at both the Tokyo District Court and the Tokyo High Court.[47]

By the end of March 2005, Livedoor's shareholdings in NBS issued shares exceeded 50%. In April 2005, Fuji Television, NBS, and Livedoor agreed to a settlement which had three main points. First, NBS would become Fuji Television's wholly owned subsidiary, and Fuji Television and NBS agreed to pay 6300 yen per share to NBS shareholders. This price was almost the same as or slightly

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[45] Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-2, para. 1.

[46] Share purchase warrants are securities under Japanese law and can be issued with or without consideration. Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 238, para. 1, no. 2. In accordance with the specific terms and conditions of such warrants, a holder can exercise and receive additional company shares. *Id.* art. 236, para. 1. In this manner, share purchase warrants can serve a function similar to a shareholder rights plan in the United States.

[47] *See* NBS v. Livedoor, 1728 SHOJI HOMU 41 (Tokyo High Ct., Mar. 23, 2005). Japanese courts have established a "primary purpose rule" whereby the issuance of equity securities can be enjoined if dilution of an acquirer's shareholding ratio predominates over other reasons for such issuance. *See* KENJIRO EGASHIRA, KABUSHIKI KAISHA-HO [LAWS OF STOCK CORPORATIONS] 683 (2006). This rule can generally be applied in poison pill situations. However, in its ruling, the Tokyo High Court enunciated certain exceptions to the primary purpose rule such as greenmailing, corporate raiding, and issuing extraordinary dividends through assets sales. *See NBS*, 1728 SHOJI HOMU at 46. None of these exceptions applied in the Livedoor case. *Id.* at 47-49.

higher than Livedoor's cost to acquire its NBS shares. The going private transaction closed on September 1, 2005. Second, Fuji Television agreed to subscribe to 12.75% of Livedoor issued shares, which fell just short of the 15% threshold that would trigger a partial consolidation of Livedoor under applicable accounting rules. This share subscription closed in May 2005. Third, Fuji Television, NBS, and Livedoor agreed to discuss possible business alliances.

The long-term effects of the Livedoor hostile bid are still difficult to gauge in light of subsequent allegations of accounting fraud at Livedoor and certain of its affiliated entities. Whether Livedoor will indeed become "Japan's Enron," as many have initially observed, will be an issue to consider in the months and years ahead.[48] However, what can be observed with some degree of confidence at this time is that the Livedoor hostile bid dramatically increased the awareness of Japanese boards to the various legal issues that arise in hostile deals. Thus, if the Livedoor cases have an effect similar to that which *Unocal* or *Revlon*[49] had in the U.S. experience, the Livedoor cases will have substantially expanded the development of Japanese takeovers jurisprudence.

## C. Yumeshin – Japan Engineering Consultants

The Yumeshin – Japan Engineering Consultants deal is another important transaction due to the issues it raised under Japanese law.[50] Although perhaps not as well known

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[48] At least in the United States, the more appropriate measure may be years since the Enron bankruptcy case was filed in 2001, but the trials of top Enron executives were not in the final stages until 2006. *See generally* BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (Portfolio 2004).

[49] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

[50] For additional discussion of the Yumeshin – Japan Engineering Consultants transaction, *see* Yumeshin v. JEC, 1739 SHOJI HOMU 100 (Tokyo Dist. Ct., July 29, 2005); *see also* Press Release, JEC, *Shuyo Kabunushi no Ido nikansuru Oshirase* [*Announcement of Change of Major*

as the UFJ – MTFG merger or the Livedoor hostile bid, the interplay of the Japanese tender offer rules with permissible defensive measures in the Yumeshin transaction merits its own consideration and discussion. In May 2005, a financial adviser of Yumeshin Holdings Co., Ltd. ("Yumeshin"), a holding company for construction management and other related businesses, informed Japan Engineering Consultants Co., Ltd. ("JEC"), a construction consulting company, that Yumeshin sought to acquire additional JEC shares so that it would become a 51% owner. At that time, Yumeshin held 6.83% of JEC issued shares. On July 7, 2005, Yumeshin proposed a business alliance with JEC.

On July 8, 2005, JEC announced its general defense policy, which provided that the company would exercise certain defensive measures if an acquirer began purchasing JEC shares prior to the completion of JEC's review of the proposed acquisition, as presented by such acquirer. JEC noted that such defensives measures were yet to be determined. In response, on July 11, 2005, Yumeshin announced a tender offer for, at maximum, 46.88% of JEC issued shares at 550 yen per share, which would result in its holding 53.71% of JEC issued shares. This tender offer

*Shareholders*] (Oct. 18, 2005), http://www.jecc. co.jp/topics/H171018a.pdf; Press Release, JEC, *Kabushiki Kaisha Eight Consultant niyoru Kokai Kaitsuke Sando nikansuru Oshirase* [*Announcement of Approval for Tender Offer by Eight Consultant Co., Ltd.*] (Oct. 6, 2005), http://www.jecc.co.jp/topics/H171006b.pdf; Press Release, JEC, *Kabunushi Wariate niyoru Shinkabu Yoyaku Ken Hakko Chushi nikansuru Oshirase* [*Announcement of Cancellation of Issuance of Share Purchase Warrants by Shareholders Allotment*] (Sept. 12, 2005), http://www.jecc.co.jp/topics/H170912.pdf; Press Release, JEC, *Shuyo Kabunushi no Ido nikansuru Oshirase* [*Announcement of Change of Major Shareholders*] (Aug. 29, 2005), http://www.jecc.co.jp/topics/H170829.pdf; Press Release, JEC, *Kabushiki Kaisha Eight Consultant niyoru Kokai Kaitsuke Sando nikansuru Oshirase* [*Announcement of Approval for Tender Offer by Eight Consultants Co., Ltd.*] (Aug. 8, 2005), http://www.jecc.co.jp/topics/H170808b.pdf; Press Release, JEC, *Kabunushi Wariate niyoru Shinkabu Yoyaku Ken Hakko nikansuru Oshirase* [*Announcement of Issuance of Share Purchase Warrants by Shareholders Allotment*] (July 29, 2005), http://www.jecc.co.jp/topics/H170729b.pdf.

priced JEC shares at about a 68% premium over the market price.

On July 18, 2005, JEC announced a stock split, where one share would be split into five shares. The shares were to be distributed to shareholders of record as of August 8, 2005, prior to the end of Yumeshin's tender offer period.[51] The stock split was scheduled to take place in October 2005—after Yumeshin's tender offer period—and thus the settlement date of the tender offer was necessarily delayed to account for the upcoming stock split. On July 20, 2005, however, Yumeshin launched a tender offer at 110 yen per share, which accounted for the one-for-five stock split. In addition, Yumeshin brought an action at the Tokyo District Court to temporarily enjoin the stock split. On July 29, 2005, the Tokyo District Court denied Yumeshin's request for a temporary injunction.[52] On that same day, JEC announced

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[51] Under the current tender offer rules, a tender offeror is generally not allowed to reduce its tender offer price, and it is unclear whether it may reduce its tender offer price in the case of a stock split by the target. *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-6, para. 3. Thus, JEC could have announced the stock split *after* Yumeshin launched the tender offer so that there would be uncertainty as to whether Yumeshin could reduce its tender offer price to account for the impending stock split. However, it appears that JEC announced the stock split *prior* to Yumeshin's tender offer in order to avoid any possible confusion among JEC shareholders. Parts of the June 2006 amendments to the Securities and Exchange Law, which are expected to take effect in late 2006, appear to resolve this issue by providing that, in the case of a stock split by the target, a tender offeror may reduce the tender offer price in accordance with government ordinances. *Id.* art. 27-6, para. 1.

[52] Yumeshin v. JEC, 1739 SHOJI HOMU 100 (Tokyo Dist. Ct., July 29, 2005). The Tokyo District Court noted that, as a general matter, the board of directors of a target company may request additional information from a tender offeror and arrange for a discussion period in furtherance of the proper judgment of shareholders. *Id.* at 107. Furthermore, the court observed that a board of directors of a target company can take proportionate defensive measures when an acquirer does not respond to the target company's reasonable requests. *Id.* at 108. Although the court suggested that JEC could have obtained the necessary information by responding to Yumeshin's proposal for a possible business alliance, it held that JEC's stock split was not unreasonable because JEC's stock split did

that it planned to issue share purchase warrants to all of its shareholders upon shareholder approval at the upcoming annual general shareholders meeting in September 2005. Such warrants provided that they could not be exercised by a hostile acquirer who held in excess of 20% of JEC issued shares.

The next development was, as might be anticipated, the entry of a white squire. On August 8, 2005, Eight Consultants Co., Ltd. ("Eight Consultants") announced a tender offer for 50.1% of JEC voting shares at the minimum price of 118 yen per share. Eight Consultants also made public a business alliance with JEC. The Eight Consultants tender offer was launched on August 9, 2005 and was approved by the JEC board. In August, Yumeshin purchased only about 4% of JEC shares. In October 2005, Eight Consultants decreased the minimum number of JEC shares to be purchased in its tender offer to 20%, and ultimately purchased about 23% of JEC issued shares. Due to the entry of a white squire, JEC did not issue share purchase warrants at its annual general shareholders meeting in September 2005.

Yumeshin's failed tender offer provides a good example of successful defensive measures. While the Tokyo District Court did not give its definitive approval to JEC's proposed stock split, the court did not enjoin JEC's defensive measures, in contrast to the Livedoor hostile bid. Thus, the combination of the announcement of a general defense policy, a proposed stock split that delayed the hostile tender offer, the threat of an issuance of share purchase warrants, and the entry of a white squire ultimately defeated the Yumeshin bid.[53]

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not make Yumeshin's tender offer impossible, although it pushed back the settlement date. *Id.* at 108-09.

[53] During the summer of 2006, a hostile transaction played out in a way similar to the Yumeshin bid in what became the first hostile takeover bid by a blue chip Japanese company. Oji Paper Co., Ltd. ("Oji Paper"), Japan's top paper producer in terms of sales, made an acquisition proposal to the target, Hokuetsu Paper Mills, Ltd. ("Hokuetsu Paper") on July 3, 2006. Shortly thereafter, Hokuetsu Paper announced a defensive plan

## D. Other Notable Contested Deals

The list of recent contested deals could continue at length and provide a number of insights into current practices and strategies in Japanese M&A. However, in order to highlight the essential points and move on to an analysis of the key issues for the U.S. practitioner, we have narrowed the list down to two additional deals from last year.

### 1. Rakuten – TBS

Another hostile bid that generated a great deal of coverage in Japan was the Rakuten, Inc. ("Rakuten") bid for Tokyo Broadcasting System, Inc. ("TBS").[54] In October 2005,

that included a prior warning pill. *See infra* Section IV.D.1. It also announced the issuance of new Hokuetsu Paper shares (approximately 24% of Hokuetsu shares) to Mitsubishi Corporation. Even though Mitsubishi Corporation subsequently rejected Oji Paper's request to withdraw from the subscription of such new shares, Oji Paper launched a hostile takeover bid. To complicate matters further, and to Oji Paper's surprise, Nippon Paper Industries Co., Ltd. ("Nippon Paper Industries"), the second largest player in the Japanese paper industry, thereafter announced that it had purchased approximately 8.85% of Hokuetsu Paper shares through market purchases. The sum of Hokuetsu Paper shares owned by both Mitsubishi Corporation and Nippon Paper Industries, in their capacity as white knights, made it impossible for Oji Paper to acquire the supermajority of shares that is often necessary to effectuate fundamental corporate transactions under Japanese law. See *infra* note 66 for an explanation of the supermajority vote requirement. In response to these and other developments, a significant number of Hokuetsu Paper shareholders objected to the Oji Paper deal, and ultimately the Oji Paper takeover bid failed. *See Seishi Kobo [Paper Battle]*, THE NIHON KEIZAI SHIMBUN (Japan), Aug. 31, 2006, at 11. Since the Oji Paper bid was withdrawn, unlike the Yumeshin bid, it is not completely clear as a matter of Japanese law how the various legal issues in the Oji Paper deal would have played out if, for instance, the issuance of new Hokuetsu shares to Mitsubishi Corporation were challenged in injunction proceedings before the Japanese courts.

[54] For additional discussion of the Rakuten – TBS transaction, see Press Release, TBS, *Rakuten Kabushiki Kaisha tono Oboegaki Teiketsu nitsuite [Re: Execution of MOU with Rakuten]* (Nov. 30, 2005), http://www.tbs.co.jp/ir/images/h1803houdou10.pdf; Press Release, TBS, *Rakuten Kabushiki Kaisha tono Kyogi Kikan Encho nitsuite [Re: Extension of*

Rakuten, an Internet business company, purchased 19.09% of TBS issued shares and proposed the integration of the two companies to create a holding company under which both Rakuten and TBS would become subsidiaries.[55] However, Rakuten was not able to purchase additional TBS shares in part because Nikko Principal Investments Japan Inc. ("NPI")[56] already owned certain TBS share purchase warrants that would be triggered upon the hostile acquisition of more than 20% of TBS issued shares.[57] Rakuten and TBS ultimately resolved the matter by reaching a settlement at the end of November 2005. The terms of the settlement provided that: (i) Rakuten would withdraw its integration proposal; (ii) Rakuten and TBS would discuss possible business alliances until the end of March 2006 (later amended to be automatically renewed every month); and (iii) until the end of March 2006 (later amended to be automatically renewed every month), Rakuten's holdings of TBS shares would be less than 10% and any holdings in excess of such threshold would be placed into a trust account.

*Discussion Period with Rakuten*] (June 29, 2005), http://www.tbs.co.jp/ir/images/h1803houdou13.pdf; Press Release, TBS, *Daisansha Wariate niyoru Shinkabu Yoyaku Ken no Hakko oyobi Tosha Kabushiki nikakaru Baishuteian heno Taio Hoshin nikansuru Oshirase* [*Announcement of Issuance of Share Purchase Warrants by Third Party Allotment and of Defense Policy Regarding Acquisition Proposal of the Company Shares*] (May 18, 2005), http://www.tbs.co.jp/ir/images/h1703taiou.pdf. *See also Rakuten TBS Mondai* [*Issues of Rakuten and TBS*], THE YOMIURI SHIMBUN (Japan), Dec. 10, 2005, at 15; *Rakuten TBS Togo* [*Integration of Rakuten and TBS*], THE YOMIURI SHIMBUN (Japan), Oct. 18, 2005, at 11.

[55] An additional element to this transaction was that both parties owned professional Japanese baseball teams: Rakuten with its Rakuten Eagles of Sendai in northern Japan and TBS with its Yokohama Bay Stars. *See Rakuten TBS Mondai* [*Issues of Rakuten and TBS*], THE YOMIURI SHIMBUN (Japan), Dec. 10, 2005, at 15.

[56] NPI is a subsidiary of Nikko Cordial Corporation, a financial services group.

[57] Once triggered, such share purchase warrants gave NPI a right to acquire approximately 21.2% of TBS issued shares at 90% of the average market price during the six months prior to the hostile acquirer's crossing of the 20% threshold.

The Rakuten hostile bid is an example of share purchase warrants that operated in a manner familiar to the U.S. practitioner. Specifically, the warrants forced Rakuten to negotiate with the TBS board or roll the dice by going straight to the shareholders through a tender offer or proxy contest. This is in stark contrast to the Livedoor hostile bid, where for the reasons noted previously, Livedoor was able to acquire shares without negotiating with the NBS board or launching a tender offer. A critical point for TBS was that its poison pill was already in place and was not contested by Rakuten in injunction proceedings before the Japanese courts. On this point, the cautionary tale of Fuji Television's prior difficulties was no doubt helpful to TBS in its advance preparation against a hostile bidder.

### 2. M&A Consulting – Hanshin

In recent years, a number of contested deals involved M&A Consulting, Inc. ("M&A Consulting"), the well-known fund formerly led by Mr. Yoshiaki Murakami.[58] One of the

[58] In January 2000, M&A Consulting launched a tender offer for shares of Shoei Co., Ltd. ("Shoei"), a real estate business company. However, certain major shareholders of Shoei, which together held the majority of Shoei shares, opposed the tender offer. Thus, the tender offer failed. *See Kaisha Bunseki - Shoei [Company Analysis - Shoei]*, THE NIKKEI FINANCIAL SHIMBUN (Japan), Feb. 23, 2000, at 18; *Shihyo [Index]*, SHUKAN DIAMOND (Japan), Feb. 12, 2000, at 16; *Tekitaiteki TOB Fuhatsu ni [Misfire of Hostile Tender Offer]*, THE NIKKEI SHIMBUN (Japan), Feb. 15, 2000, at 11. In May 2002, M&A Consulting engaged in a proxy contest for control of Tokyo Style Co., Ltd., an apparel company. However, M&A Consulting eventually lost the proxy contest. *See* Press Release, M&A Consulting, *Tokyo Style Teiji Kabunushi Sokai Kekka Hokoku [Report on the Result of Annual Shareholders' Meeting of Tokyo Style]* (May 27, 2002), http://www.maconsulting.co.jp/PDF/020527_pressrelease(J)_final.pdf. In November 2005, M&A Consulting launched a competitive tender offer against a friendly tender offer by Nisshinbo Industries, Inc. ("Nisshinbo") for shares of New Japan Radio Co., Ltd. ("New Japan Radio"), a microwave-related product manufacturer. The highest tender offer price for M&A Consulting was 950 yen per share compared to a high of 880 yen per share for Nisshinbo. However, Japan Radio Co., Ltd., the parent company of New Japan Radio, accepted Nisshinbo's tender offer. Consequently, the M&A Consulting tender offer failed. *See* Shunsuke

more recent deals for M&A Consulting, which also resulted in extensive Japanese press coverage, was the acquisition of shares in Hanshin Electric Railway Co., Ltd. ("Hanshin").[59] In September 2005, M&A Consulting announced that an affiliated entity held approximately 27% of Hanshin shares on a fully diluted basis. Hanshin did not expressly consent to this acquisition of shares. In January 2006, these shareholdings eventually increased to a high of 44.49%. Importantly, and in contrast to TBS, Hanshin did not have any share purchase warrants in place to deter this acquisition of shares. The subsequent discussions between M&A Consulting and Hanshin were unsuccessful. Thereafter, M&A Consulting proposed its director candidates for the Hanshin shareholders meeting to be held in June 2006. Without reaching an understanding with M&A Consulting, Hanshin agreed on May 29, 2006 to its acquisition by a white knight, Hankyu Holdings. After the public announcement of the acquisition, M&A Consulting sold its Hanshin shares to Hankyu Holdings in June 2006. Notably, M&A Consulting only sold its Hanshin shares after the allegations of insider trading by M&A Consulting came

Inaba, *IR Tsuiseki* [*IR Tracing*], THE NIKKEI FINANCIAL SHIMBUN (Japan), May 30, 2006, at 11.

[59] For additional discussion of the Hanshin transaction, see *Murakami Fund Hanshin Dentetsu Kabu 27% Hoyu he* [*Murakami Fund Holds 27% of Hanshin Dentetsu Shares*], THE YOMIURI SHIMBUN (Japan), Sept. 27, 2005, at 1; *see also Hanshin Kabu Subete Baikyaku he* [*Sold All Hanshin Shares*], THE YOMIURI SHIMBUN (Japan), June 17, 2006, at 9; *Hankyu Hanshin Kabu TOB Kaishi* [*Hankyu Launched the Tender Offer for Hanshin Shares*], THE YOMIURI SHIMBUN (Japan), May 30, 2006, at 1; *Murakami Fund Torishimariyaku no Kahansu Yokyu* [*Murakami Fund Required the Majority of Directors*], THE YOMIURI SHIMBUN (Japan), May 3, 2006, at 1; *Hanshin Kabu Kaimashi* [*Increased Purchases of Hanshin Shares*], THE YOMIURI SHIMBUN (Japan), Feb. 2, 2006, at 9. Coincidentally, the Hanshin transaction also included a famous Japanese professional baseball team, the Hanshin Tigers. *See supra* note 55. For additional information on the history and culture of Japanese baseball, see ROBERT K. FITTS, REMEMBERING JAPANESE BASEBALL: AN ORAL HISTORY OF THE GAME (S. Ill. Univ. Press 2005).

to light.[60] Although it is not certain what actions M&A Consulting would have taken in the absence of the insider trading allegations, the Hanshin deal makes clear that in the absence of duly issued share purchase warrants, a target is considerably more vulnerable to the acquisition of its shares by a hostile bidder.

## IV. KEY ISSUES FOR THE U.S. PRACTITIONER

Having now reviewed the recent changes in Japanese law and a few recent contested deals from 2005, the challenge for the U.S. practitioner is to boil down the complexity of Japanese M&A to a list of key issues that should be reviewed in any transaction involving Japanese entities. However, the problem with such a concentrated analysis is that it cannot replace a thorough analysis of the variety of legal issues in different jurisdictions, which will necessarily arise in any cross-border deal. At the same time, in practice, such lists are frequently helpful in organizing the various tasks and issues that must be considered. With these thoughts in mind, in this section we have set forth some of the main issues under Japanese law and U.S. securities laws that have often come into play in Japanese deals.

### A. Structuring the Transaction under Japanese Law

Beginning with the fundamentals, there are seven basic transaction structures that are most often used in takeovers under the Corporation Law. Although these structures may be similar to certain transactions familiar to U.S. practitioners under the Delaware General Corporation Law, it is important to remember the obvious but essential point—these are not your usual Delaware transactions. In any

[60] On June 5, 2006, Mr. Murakami was arrested on allegations of insider trading by M&A Consulting. M&A Consulting allegedly purchased NBS shares in 2004 and 2005 after obtaining inside information on Livedoor's intention to purchase NBS shares as part of the Livedoor hostile bid. *See supra* discussion in Section III.B; *see also Murakami Daihyo wo Taiho* [*Mr. Murakami is Arrested*], THE YOMIURI SHIMBUN (Japan), June 6, 2006, at 1.

given deal, therefore, the seven structures detailed below will likely require some measure of additional time and consideration prior to the final determination of an appropriate transaction structure.[61]

### 1. Stock Purchase

A simple stock purchase of public company shares through the market is one option to obtain control of the target.[62] However, when the acquirer purchases a certain number of shares of a public company outside of the market, such purchases may be subject to the mandatory tender offer rules in Japan.[63]

### 2. Issuance of New Shares

As a general matter, under Japanese law, the board of the target public company can issue new shares to a third party or to shareholders who seek to acquire the target public company, up to the authorized number of shares as set forth in such target's articles of incorporation.[64] However, if the subscription price for newly issued shares is deemed "especially favorable"[65] to the subscribing shareholders and

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[61] As is often the case, tax and accounting issues, as well as possible rights and obligations under certain contracts that are reviewed as part of the due diligence process, will play a large role in determining the appropriate structure for a Japanese deal. These issues are beyond the intended scope of this article.

[62] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 127.

[63] *See infra* Section IV.B.1, for a detailed discussion of these issues.

[64] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 199, para. 2; art. 201, para. 1.

[65] There are no bright line rules in the Japanese cases as to what is an "especially favorable" issuance. In practice, however, the subscription price per share is often regarded as "especially favorable" if it is less than 90% of the recent average market prices. *See* Matsuka v. Miyairi Barubu Seisakujo (Tokyo Dist. Ct., June 1, 2004), summarized in Yo Ota, *Miyairi Barubu no Shinkabuhakko Sashidome Moshitate Jiken Tokyo District Court Kettei [Ruling of Tokyo District Court regarding a Claim for Injunction of Issuance of New Shares of Miyairi Barubu]*, 1702 SHOJI HOMU 24, 24-25 (July 5, 2004).

all the outstanding shareholders are not entitled to subscribe for them, it will become necessary to obtain a supermajority vote of two-thirds or more of all voting rights ("Supermajority Vote").[66] Under Japanese law and stock exchange regulations, there is no rule that is equivalent to the New York Stock Exchange rule where shareholder approval is required for the issuance of 20% or more of outstanding shares.[67]

### 3. Merger (*gappei*)

Japanese *gappei* are statutory mergers under the Corporation Law. Similar to a direct proposed merger in the United States, *gappei* require a negotiated merger agreement between the acquirer and the target company that provides that the target company (the disappearing company) will merge into the acquirer (the surviving company).[68] In Japanese mergers, all assets and liabilities of the target company are transferred to the surviving company by operation of law and target company shareholders receive shares of the surviving company as consideration.[69] However, under the Corporation Law, target company shareholders may receive other forms of consideration such as cash and shares of other companies (*i.e.*, consideration will no longer be limited to shares of the surviving company).[70] Japanese mergers are generally subject to a Supermajority Vote at the

[66] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 309, para. 2, no. 5 (stating that the supermajority requirement is two-thirds or more of the voting rights of shareholders who attend the shareholders meeting, unless a higher threshold is required by the target's articles of incorporation).

[67] *See* NYSE, Inc., Listed Company Manual § 312.03(c) (2004).

[68] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, ch. 5, subchapter 2.

[69] *See id.* art. 749, para. 1, no. 2(i).

[70] *See infra* Section IV.C, for a detailed discussion on triangular mergers.

shareholders meeting of each of the disappearing and surviving companies.[71]

### 4. Business Transfer (*jigyo joto*)

Business transfers are similar to asset sales in the United States. They also require a negotiated agreement between the target company and the acquirer, with such agreement providing that certain assets and liabilities will be transferred from the target company to the acquirer.[72] The transfer of contracts (including employment contracts) generally requires the consent of the other parties to such contracts under Japanese law.[73] Furthermore, if the transferred assets and liabilities constitute "all or an important part" of the target company's business, the business transfer in question generally requires a Supermajority Vote of target company shareholders.[74] In addition, if the transferred assets and liabilities constitute *all* of the target company's business, the business transfer generally requires a Supermajority Vote of acquirer shareholders.[75]

### 5. Demerger (*bunkatsu*)

The demerger structure is in many ways similar to business transfers as discussed above. There are two kinds of demergers under the Corporation Law.

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[71] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 783, para. 1; art. 795, para. 1; art. 309, para. 2, no. 12.

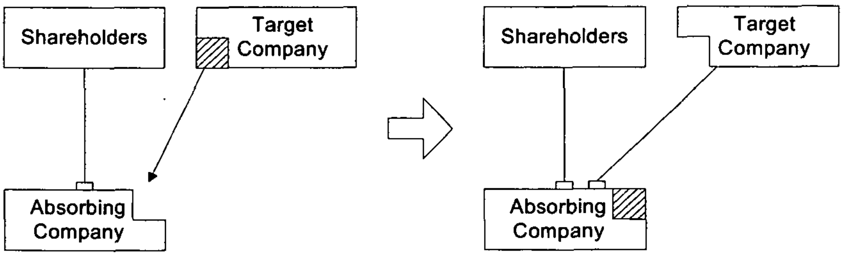
[72] *See id.* art. 467.

[73] *See* No. (o)971 of 1954, 53 HANREI TAIMUZU 52, 52 (Sup. Ct., Sept. 29, 1955); Kumagai v. Miura, 105 BESSATSU JURISUTO 74, 74 (Taishin'in, Dec. 15, 1925).

[74] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 467, para. 1, no. 1 and 2; art. 309, para. 2, no. 11. Under the Corporation Law, if the book value of the transferred assets does not exceed 20% of the amount of all assets of the target company (with such amount calculated in accordance with an ordinance of the Ministry of Justice), the business transfer is not regarded as "important" unless as may otherwise be provided in the articles of incorporation of the target company.

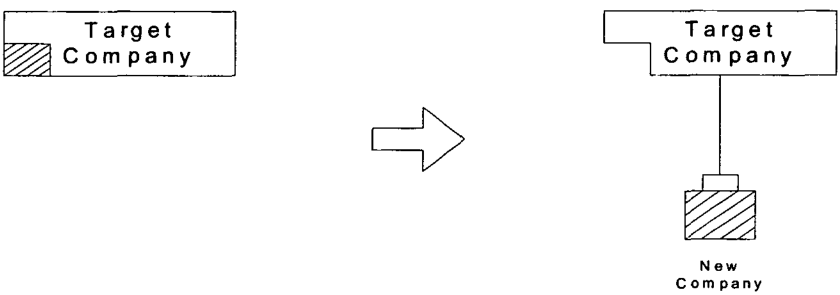
[75] *See id.* art. 467, para. 1, no. 3; art. 309, para. 2, no. 11.

### i. Absorption Demerger (*kyushu bunkatsu*)




In an absorption demerger, by means of a negotiated agreement between the target company and the absorbing company, (i) certain assets and liabilities of the target company are transferred to the absorbing company, and (ii) the target company receives absorbing company shares as consideration.[76] However, similar to the merger context, under the Corporation Law, in an absorption demerger the target company may receive other forms of consideration such as cash and shares of other companies (*i.e.*, consideration is no longer limited to shares of the absorbing company).[77] Note, however, that the Corporation Law does not permit such other forms of consideration in the second kind of demerger—the incorporation demerger.

### ii. Incorporation Demerger (*shinsetsu bunkatsu*)




[76] *See id.* art. 758, no. 4(i).

[77] *See id.* art. 758, no. 4(ii)-(v).

In an incorporation demerger, by means of a *demerger plan* of the target company, (i) the target company incorporates a new company by transferring certain of its assets and liabilities to such new company, and (ii) the target company receives new company shares as consideration.[78] In both absorption and incorporation demergers, assets and liabilities are generally transferred by operation of law.[79] In contrast to business transfers, however, in both absorption and incorporation demergers the transfer of contracts (including employment contracts) generally *does not* require the consent of the other parties to such contracts.[80] However, both absorption and incorporation demergers involve certain additional disclosure requirements and mandatory procedures to protect creditors. These requirements and procedures do not apply in the case of business transfers.[81]

A key benefit of both absorption and incorporation demergers is that any number of companies can jointly conduct the demerger.[82] This facet makes demergers attractive structures in joint ventures where each party holds a certain number of subsidiaries, but may wish to effect a business transfer (*i.e.*, an asset sale) rather than a stock sale of one or more of the subsidiaries to be contributed to the joint venture due to certain business, tax, accounting, or other reasons.[83] Demergers can also be useful structures in LBO transactions where adverse tax effects are not at issue by allowing the target company to demerge certain assets and liabilities to a new company, which will then be acquired in a stock purchase by an acquisition vehicle. Such

[78] *See id.* art. 763, no. 6.

[79] *See id.* art. 759, para. 1; art. 764, para. 1.

[80] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 759, para. 1; art. 764, para. 1.

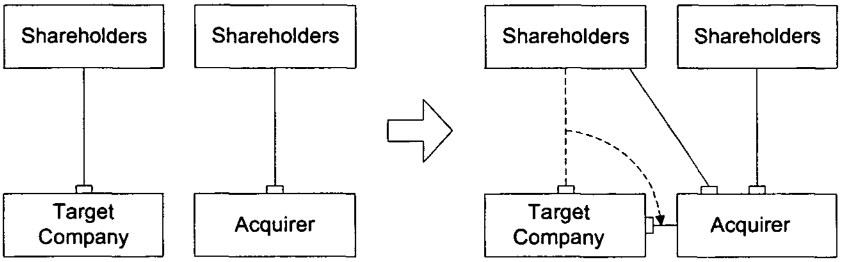
[81] *See id.* art. 782; art. 789; art. 791; art. 803; art. 810; art. 811.

[82] *See* EGASHIRA, *supra* note 47, at 792; Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 762, para. 1.

[83] For an overview of the key issues that often arise in the formation and documentation of international joint ventures and other strategic alliances, see Christopher Smeall, *Structuring International Acquisition and Joint Venture Agreements* (Oct. 25, 1995) (paper presented at Practising Law Institute seminar, *International Commercial Agreements*).

a structure may be particularly advantageous in circumstances where the parties seek to exclude contingent liabilities from the deal. Finally, it should be noted that demergers generally require a Supermajority Vote of (i) the target company shareholders and absorbing company shareholders in an absorption demerger[84] or (ii) the target company shareholders in an incorporation demerger.[85]

### 6. Stock-for-Stock Exchange (*kabushiki kokan*)




The stock-for-stock exchange is an interesting structure under Japanese law that can often be used to "squeeze out" minority shareholders. In a *kabushiki kokan*, pursuant to a negotiated agreement between the target company and the acquirer, (i) the acquirer obtains all of target company shares by operation of law, and (ii) target company shareholders receive acquirer shares as consideration.[86] Stock-for-stock exchanges generally require a Supermajority Vote of each of the target company and acquirer shareholders.[87] Accordingly, if one can obtain the approval of two-thirds or more of target shareholders (as well as, of course, the approval of the target board when signing the stock-for-stock exchange agreement), the remaining one-third of target shareholders will have their target shares exchanged for acquirer shares, which should decrease their

[84] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 783, para. 1; art. 795, para. 1; art. 309, para. 2, no. 12.

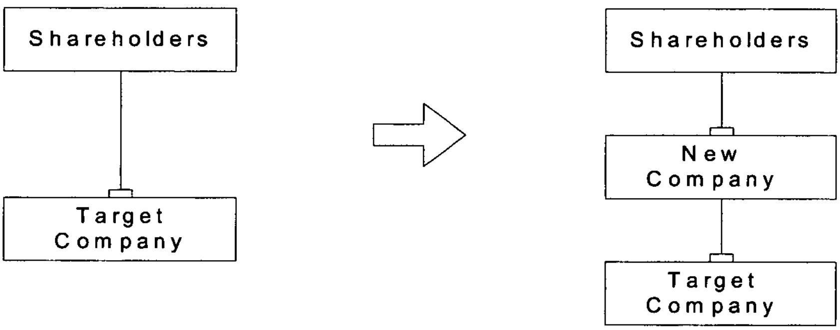
[85] *See id.* art. 804, para. 1; art. 309, para. 2, no. 12.

[86] *See id.* art. 769, para. 1.

[87] *See id.* art. 783, para. 1; art. 795, para. 1; art. 309, para. 2, no. 12.

voting power on a fully diluted basis. At the same time, however, the exchange of shares will affect the voting power of all the target company and acquirer shareholders because the total number of acquirer shares will necessarily increase as a result of the stock-for-stock exchange. The Corporation Law rules on consideration apply in stock-for-stock exchange transactions and thus target company shareholders may receive other forms of consideration, such as cash and shares of other companies (*i.e.*, consideration is not limited to acquirer shares).[88] Such changes to Japanese law may facilitate more cash-out mergers of minority shareholders, as is common in the United States.[89]

### 7. Stock Transfer (*kabushiki iten*)




Another structure that permits the consolidation of shares, but in a manner distinct from stock-for-stock exchanges, is the stock transfer. A *kabushiki iten* requires a *stock transfer plan* of the target company, by means of which (i) a new company will be incorporated, (ii) the new company will acquire all of target company shares by operation of law, and (iii) target company shareholders will receive new company shares.[90] Stock transfers require a Supermajority Vote of the target company shareholders.[91] Moreover, any

[88] *See id.* art. 768, para. 1, no. 2(ii)-(v).

[89] *See, e.g.*, DEL. CODE ANN. tit. 8, § 253 (2006).

[90] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 772, para. 1; art. 774, para. 1; art. 774, para. 2.

[91] *See id.* art. 804, para. 1; art. 309, para. 2, no. 12.

number of companies can jointly conduct a stock transfer.[92] In such joint stock transfers (*kyodo kabushiki iten*), several target companies can create a new joint holding company, with each of the target companies becoming a wholly owned subsidiary.[93] These transactions are particularly useful when parties agree to integrate their businesses, but would like to keep certain operations separate as a practical matter. Such a structure can correct any distortions in such company's shareholding relationships with its affiliates since the company will become a wholly owned subsidiary of a new holding company, thus consolidating the shareholdings in a group of companies and possibly improving the defensive profile of a company that is likely to be a target of a hostile bidder.

## B. Tender Offers and Proxy Contests

A common factor among all the basic transaction structures under the Corporation Law discussed above is that, with the notable exception of general stock purchases, they all require some type of negotiated agreement or plan with the target board. If negotiations do not result in an agreement or plan or are impractical, Japanese law provides for tender offers in a manner that will be familiar to the U.S. practitioner. The Japanese takeover bid[94] rules ("TOB rules") were modeled after the Williams Act and became part of the Securities and Exchange Law in 1971.[95] While it is

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[92] *See id.* art. 772.

[93] For example, on April 20, 2005, Seven-Eleven Co., Ltd., Ito-Yokado Co., Ltd., and Denny's Japan Co., Ltd. announced that they would conduct a joint stock transfer, which resulted in a $12 billion transaction when closed on September 1, 2005. *See Mochikabu Kaisha Setsuritsu* [*Incorporation of Holding Company*], THE NIKKEI SHIMBUN (Japan), Apr. 21, 2005, at 1; Thomson Financial, *supra* note 1, at 29.

[94] In the United States, we often refer to the "tender offer rules" under Regulations 14D and 14E of the Exchange Act. Although Japanese securities law has historically referred to U.S. securities law when making new rules and regulations, in this case it appears that the U.K. term "takeover bids" is the more favored expression among practitioners.

[95] *See generally* THE TENDER OFFER REPORT, *supra* note 20, at 1.

still relatively rare in Japan for a hostile bidder to go directly to the shareholders by means of a TOB, Japanese companies (*e.g.*, Yumeshin and Oji Paper) and certain shareholder activists (*e.g.*, M&A Consulting) have more aggressively pursued such strategies in recent years. However, even in cases where an acquirer can reach an agreement with management, the TOB rules may still apply and thus should be included as part of the overall consideration of a possible transaction.

### 1. TOB Rules

Many acquisitions of Japanese public companies technically begin with a tender offer because of the mandatory TOB rules in Japan that apply irrespective of whether a specific acquisition is friendly or hostile. As a general matter, an off-market acquisition of shares requires compliance with the TOB rules if (i) an acquirer group purchases more than 5% of the voting rights of the target company from more than ten sellers within a period of sixty days or (ii) an acquirer group purchases more than one-third of the voting rights in the target company.[96]

[96] *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-2, para. 1. Note that, as a general matter, the mandatory TOB rules do not apply to market purchases, acquisitions of newly issued shares, mergers, and stock-for-stock exchanges. *See id.*; THE TENDER OFFER REPORT, *supra* note 20, at 4; NISHIMURA & PARTNERS, M&A-HO TAIZEN [CORPUS JURIS M&A] 59-60 (2001). The recently proposed amendments to the TOB Rules provide, however, for two restrictions on market purchases and acquisitions of newly issued shares in the context of a TOB. Under the first restriction, in general, the mandatory TOB rules apply to any purchases of shares (including off-market and market purchases, and after hours, off-exchange trading system purchases) conducted during a three-month period that results in the acquirer and its "group" entities owning more than one-third of the voting rights of the target company after acquisitions of (i) more than 5% of the voting rights (including potential voting rights owned by such acquirer and its "group" entities) in the target company during such three-month period by means of off-market purchases and/or after hours, off-exchange trading system purchases, and (ii) more than 10% of the voting rights (including potential voting rights owned by such acquirer and its "group" entities) in the target company during such three-month period. *See* Shoken-torihiki-ho [Securi-

Once the mandatory TOB rules are triggered, various disclosure and procedural requirements apply to the transaction in a manner similar to U.S. practice. For instance, under the recently proposed TOB rules, the tender offer period must be scheduled to last between twenty and sixty business days.[97] In general, there is no requirement that the tender offeror purchase all of the shares tendered. However, under the recently proposed TOB rules, the tender offeror must purchase all of the tendered shares if the tender offeror would hold two-thirds or more of the voting rights after the TOB.[98] Absent the possible application of such forthcoming regulations, the tender offeror will usually set a minimum and/or a maximum number of shares it will purchase.[99] When the shares tendered fall below the stated minimum, the tender offeror will not purchase any shares. In cases where the shares tendered exceed the stated maximum, the tender offeror purchases shares on a pro-rata basis. Although the TOB rules permit the use of securities as consideration in tender offers, there have been relatively

ties and Exchange Law], Law No. 25 of 1948, art. 27-2, para. 1, no. 4. Under the second restriction, the mandatory TOB rules apply to any purchases of shares in excess of 5% of the voting rights in the target company, provided that the acquirer holds more than one-third of such voting rights and another acquirer launches a TOB. *See id.* art. 27-2, para. 1, no. 5.

[97] *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-2, para. 2; (Draft) Government Ordinance for the Securities and Exchange Law, art. 8, para. 1. The FSA has recently promulgated amended rules that (i) change calendar days to business days and (ii) require a target company to extend the TOB period to thirty business days when necessary for shareholders to make an informed investment decision. *See id.*; THE TENDER OFFER REPORT, *supra* note 20, at 7; THE FRAMEWORK OF THE FINANCIAL INSTRUMENTS AND EXCHANGE LAW, *supra* note 20, at 15; Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-10, para. 3; (Draft) Government Ordinance for the Securities and Exchange Law, art. 13-2, para. 1.

[98] *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-13, para. 4; (Draft) Government Ordinance for the Securities and Exchange Law, art. 8, para. 5, no. 3.

[99] *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-13, para. 4.

few instances of exchange offers in Japan primarily due to the absence of tax rules which would permit tendering shareholders to defer their capital gains in exchange offers.[100]

After the launch of a tender offer, the tender offeror may withdraw the offer only for certain enumerated reasons as set forth in the TOB rules, such as an impending merger, the initiation of bankruptcy proceedings, and so forth.[101] Additionally, a tender offeror may not reduce the maximum number of shares to be purchased or reduce its tender offer price except in certain limited circumstances, such as a stock split by the target company.[102]

As demonstrated in the earlier discussion of the Yumeshin bid for JEC, an important point to take away is that compliance with the applicable TOB rules is not always the end of the analysis. As you may recall, in response to Yumeshin's business alliance proposal, JEC announced a general defensive policy which stated that defensive measures would be taken if an acquirer attempted to

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[100] In contrast to cash tender offers, the issuer of securities in an exchange offer in Japan may become subject to disclosure obligations under the Securities and Exchange Law, which are comparable to the registration statement requirements of the Securities Act and the continuing disclosure obligations of the Exchange Act. *See id.* art. 27-4, para. 1. In a recent amendment to the Securities and Exchange Law (enacted in December 2005, but with an effective date prior to March 2009 as yet to be determined), non-Japanese companies may submit English-language documents together with Japanese-language summaries to satisfy the applicable disclosure requirements in certain cases. *See* Supplementary Provisions of Securities and Exchange Law, Law No. 76 of 2005, art. 1, art. 2. These changes to Japanese securities laws are expected to ease the burden on non-Japanese companies that already have continuing disclosure obligations under Japanese law.

[101] *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-11, para. 1. As noted in *supra* note 20, the FSA is expanding the list of reasons for withdrawal of TOBs in response to an increase in the defensive measures used by Japanese companies. *See* THE TENDER OFFER REPORT, *supra* note 20, at 8-9; THE FRAMEWORK OF THE FINANCIAL INSTRUMENTS AND EXCHANGE LAW, *supra* note 20, at 15; (Draft) Government Ordinance for the Securities and Exchange Law, art. 14, para. 1, no. 2.

[102] *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-6, para. 1, no. 1.

continue purchasing shares prior to JEC's review of any proposal submitted by such acquirer. When Yumeshin announced that it would launch a tender offer for JEC shares, JEC subsequently announced an impending stock split, which had the practical effect of delaying the settlement date of the tender offer. Although the Tokyo District Court has upheld the legality of such a defensive tactic,[103] the necessary balance between the interests of the target company and the tender offeror will likely remain a hot topic in Japanese M&A law, with additional amendments to the TOB rules being an important development to monitor in the months and years ahead.

### 2. Proxy Contests

While proxy contests remain somewhat of a rare event in Japanese deals,[104] they do occur and thus remain an option for the acquirer.[105] For instance, in certain cases the tender offeror may wish to engage in or threaten a possible proxy

[103] *See supra* note 52.

[104] Even in the United States, proxy contests are rare due to the effective results that can often be realized by a well-planned tender offer. Additionally, the high profile costs and risks associated with staging a proxy contest should not be underestimated. This said, the threat of an impending proxy contest has long been a potential strategy for the acquirer. The Delaware Supreme Court in *Unocal* observed this organic and multifaceted nature of M&A strategies when noting:

> [O]ur corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs . . . . In the days when [prior cases] were decided, the tender offer, while not an unknown device, was virtually unused, and little was known of such methods as two-tier 'front-end' loaded offers with their coercive effects. Then, the favored attack of a raider was stock acquisition followed by a proxy contest. Various defensive tactics, which provided no benefit whatever to the raider, evolved. Thus, the use of corporate funds by management to counter a proxy battle was approved.

Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957 (Del. 1985).

[105] See *supra* note 58 for a discussion of the M&A Consulting proxy contest for control of Tokyo Style Co., Ltd.

contest as an ancillary strategy against the target company. Specifically, the tender offeror may consider a proxy contest when (i) its tender offer closes after the record date for shareholders who may attend the next shareholders meeting of the target company or (ii) the tender offeror requires voting rights in excess of the stated maximum in its tender offer in order to obtain control of the target company (*e.g.*, the tender offeror purchases a simple majority of target company shares through the tender offer, but needs a supermajority of voting rights at the upcoming shareholders meeting in order to defeat the incumbent board).

The Defensive Measures Guidelines briefly discuss these issues in noting that a tender offer combined with a proxy contest would enhance the efficacy of a proxy contest to cancel a rights plan.[106] In dealing with such issues, the Defensive Measures Guidelines recommend that a rights plan be redeemed by a vote at a single shareholders meeting.[107] Unlike in the United States, shark repellants, such as staggered boards, are not as common a defensive strategy in Japan and thus Japanese companies should be able to follow this recommendation without much difficulty.[108] Accordingly, for a Japanese deal, only one proxy contest may be sufficient to replace incumbent directors, whereas it may be necessary to have more than one proxy contest to take control of the board in the United States.

## C. Triangular Mergers

As noted previously, some of the most significant changes to come out of the new Corporation Law are the provisions dealing with the expansion of cash-out and triangular

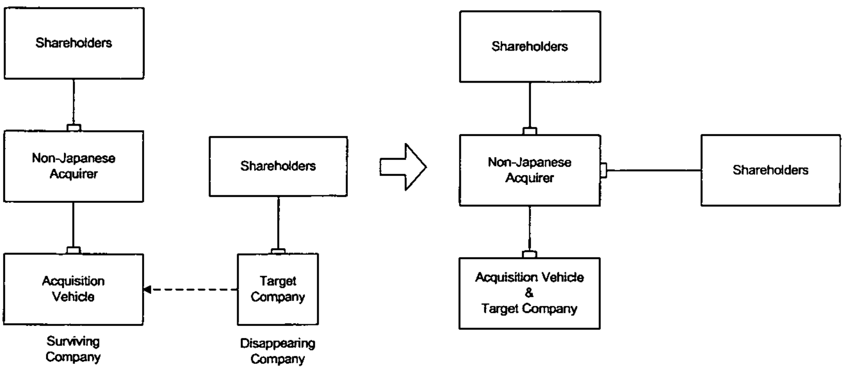
[106] *See* THE DEFENSIVE MEASURES GUIDELINES, *supra* note 26, at 15-16. Note that the Defensive Measures Guidelines prohibit dead hand poison pills. Specifically, they prohibit a rights plan that cannot be redeemed: (i) if one of the directors who was a director at the time of the adoption of such rights plan is replaced; (ii) unless a majority of directors at the time of adoption of such rights plan is replaced; or (iii) for a certain period of time even if a majority of the directors is replaced. *See id.* at 16.

[107] *See id.* at 9.

[108] *See* discussion *infra* Section IV.D.2 on staggered boards.

mergers.[109] Specifically, these new provisions permit the acquirer, as surviving company in a merger, to distribute cash and/or shares of another company (*e.g.*, a non-Japanese parent company of the acquirer) to the shareholders of the disappearing company.[110] The practical effect of these amendments to the Corporation Law is that, for the first time, non-Japanese entities may acquire all of the shares of a Japanese public company through either a forward triangular merger or a de facto reverse triangular merger without government approval, which is normally required under the Law on Special Measures for Industrial Revitalization. Provided below are descriptions of these two structures that may appear after the provisions of the new Corporation Law take effect in May 2007.

### 1. Forward Triangular Merger



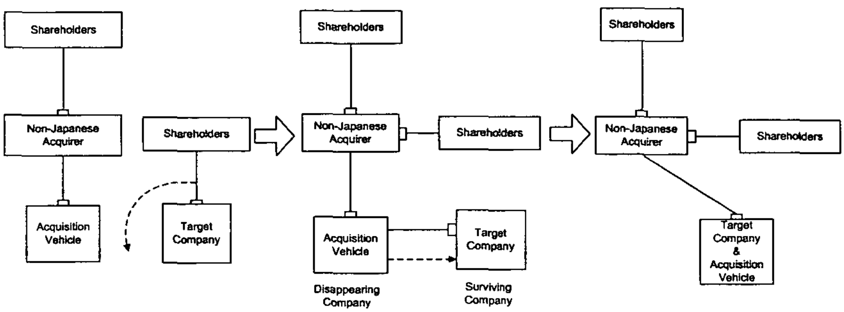

The amendments to the Corporation Law have not changed the provisions prohibiting mergers between Japanese companies and non-Japanese companies.

[109] For a more detailed analysis of the new rules relating to triangular mergers, see Takefumi Sato & Daisuke Matsubara, *Cash-out option means more M&A flexibility, The IFLR Guide to Japan 2006*, INT'L FIN. L. REV., Jan. 2006, at 21.

[110] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 749, para. 1, no. 2; art. 768, para. 1, no. 2. The surviving entity may also distribute other assets such as share purchase warrants and bonds. *See id.*

Accordingly, in order to utilize the new rules permitting various forms of consideration in cross-border transactions, the non-Japanese acquirer must first either create or own a Japanese acquisition vehicle, which will hold the cash and/or shares of the non-Japanese acquirer that will serve as the consideration for the transaction. A forward triangular merger results when the target company merges into the acquisition vehicle and the non-Japanese acquirer causes such acquisition vehicle to distribute cash and/or shares to the target company shareholders.

### 2. De Facto Reverse Triangular Merger




A de facto reverse triangular merger largely resembles a forward triangular merger with one significant structural difference. Instead of a merger of the target company into the acquisition vehicle, as is the case in a forward triangular merger, a de facto reverse triangular merger involves the acquisition vehicle and target company conducting a stock-for-stock exchange, whereby the acquisition vehicle acquires all of the target company shares by operation of law.[111] Thus, the acquisition vehicle and target company will enter into a stock-for-stock exchange agreement that will provide that the non-Japanese acquirer's cash and/or stock will serve as the consideration for the acquisition of all target company shares. As noted previously, the stock-for-stock exchange will generally require a Supermajority Vote of each of the

[111] *See id.* art. 767-68.

acquisition vehicle and target company shareholders. After the completion of the stock-for-stock exchange, the target company will become a wholly owned subsidiary of the acquisition vehicle. In order to complete the de facto reverse triangular merger, the acquisition vehicle will then merge into the target company, which will result in the target company becoming a wholly owned subsidiary of the non-Japanese acquirer. The primary benefits of this structure are that, similar to a reverse triangular merger in the United States, it will enable (i) the target company to remain the surviving company, (ii) the non-Japanese acquirer to own all of the target company shares, and (iii) target company shareholders to receive cash and/or shares of the non-Japanese acquirer.

### 3. Effective Date of the Amendments

Although the triangular merger amendments to the Corporation Law were requested by certain Japanese business interests, the effective date for these amendments has been delayed until May 2007, which will be precisely one year after the other provisions of the new Corporate Law come into effect. However, these same triangular merger structures can be used prior to May 2007 in the event that the Law on Special Measures for Industrial Revitalization (the "Industrial Revitalization Law") applies to the transaction.[112] The Industrial Revitalization Law, a special purpose law that is expected to continue for a limited period of time, is a result of the legislative initiatives of METI and seeks to enhance the productivity of certain Japanese industries. In a transaction subject to the Industrial Revitalization Law, the approval of a competent government minister is required as part of the application to be filed with the proper authorities. This approval is provided under

[112] An English-language summary of the recent amendment of the Industrial Revitalization Law, which includes the provisions on triangular mergers, is available at http://www.meti.go.jp/policy/business_infra/downloadfiles/3-4.pdf (last visited Oct. 16, 2006).

certain enumerated conditions,[113] and in recent years there have been a number of MBO and LBO transactions that received the necessary approvals under the Industrial Revitalization Law.[114]

### 4. Tax Treatment

The ability of U.S. companies to access international capital markets to finance Japanese deals is one reason why it is anticipated that U.S. companies will prefer using a triangular merger structure when acquiring a Japanese company.[115] While the triangular merger amendments will

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[113] Among other requirements, a transaction must fall within one of the following categories to be approved: (i) a self-restructuring plan; (ii) a business transfer and restart plan; or (iii) a co-restructuring plan. *See* Sato & Matsubara, *supra* note 109, at 23-24.

[114] For instance, The Carlyle Group acquired KITO Corporation, a manufacturer of material handling equipment, in 2003 through an LBO, the first cash-out merger under the Industrial Revitalization Law. For a discussion of the various issues associated with going-private transactions under the Industrial Revitalization Law, see generally Hiroshi Uchima & Masaki Noda, *Going Private no Hoteki Shuho to Ryuiten [Legal Structures and Issues of Going Private]*, 1675 SHOJI HOMU 81 (2003); Tatsuya Tanigawa & Mihoko Fukuzawa, *Sangyosaiseiho wo Riyoshita Going Private no Jitsumu [Practice of Going Private under the Industrial Revitalization Law]*, 1676 SHOJI HOMU 22 (2003). Note, however, that while many buyout firms and other business entities acquired Japanese public companies through the de facto reverse triangular merger structure, they may now need to devise a new structure due to recent amendments to Japanese tax law, which took effect in October 2006. *See* Yo Ota & Masaki Noda, *Kabushiki Kokan – Kabushiki Iten Zeisei no Bapponteki Kaisei to M&A Jitsumu heno Eikyo [Drastic Amendments to Taxation of Stock-for-Stock and Stock-Transfer and their Effects on M&A Practices]*, 1778 SHOJI HOMU 33, 37-38 (Sept. 25, 2006). These amendments generally require a target company to recognize capital gains on its assets as a result of a stock-for-stock exchange in the event that target company shareholders receive any assets, other than shares of the direct acquirer (*e.g.*, an acquisition vehicle), which may include cash and shares of a direct acquirer's parent. *See* Hojinzei-ho [Corporation Tax Law], Law No. 34 of 1965, art. 2, no. 12-16; art. 62-9.

[115] The Corporate Value Report noted that the aggregate amount of market capital of corporations listed on the first division of the Tokyo Stock Exchange is approximately $3.1 trillion (when assuming that $1 is

permit stock deals in the manner described above, at the present time there are no tax laws that provide incentives to non-Japanese companies along the lines of the tax free reorganization rules for triangular mergers that currently apply in the United States.[116] In order to harmonize the rules on triangular mergers in the United States and Japan to facilitate more cross-border transactions in the future, it would be desirable if the necessary amendments to Japanese tax laws were considered in concert with the scheduled changes to take effect in May 2007. In the absence of such changes to Japanese tax laws, the effective cost of capital in a Japanese triangular merger may be considerably higher than in a similar transaction that qualifies as a tax free reorganization in the United States. Such increased financing costs may ultimately be shouldered by the surviving business and become an issue for further negotiation between the parties. Thus, aligning the objectives of Japanese corporate and tax law is a goal worth pursuing.[117]

### 5. Appraisal Rights

The Corporation Law has also amended the provisions relating to the appraisal rights of shareholders in, *inter alia*, a merger (for forward triangular mergers) or a stock-for-stock exchange (for de facto reverse triangular mergers). In particular, the amendments provide that the appraisal price

equal to ¥110) as of August 2004, whereas the comparable figure for the New York Stock Exchange is $12.3 trillion as of August 2004. *See* THE CORPORATE VALUE REPORT, *supra* note 24, at 15.

[116] For a discussion of the tax issues associated with transactions under the Industrial Revitalization Law, see Yo Ota & Tatsuya Tanigawa, *Japan's New M&A Measures Open Door for Tax Benefits*, 30 TAX NOTES INT'L 887 (2003). Please also note the recent amendments to Japanese tax laws as further discussed *supra* note 114.

[117] Since amendments to Japanese tax laws are often made public in January or December, due consideration should be paid to any possible guidance that may be provided in the coming months, particularly in advance of the effective date of the triangular merger provisions of the Corporation Law in May 2007.

must be a "fair price," which would include any synergies arising from the deal.[118] Under prior law, the appraisal price did not include any possible valuation effects of the merger or the stock-for-stock exchange on the relevant shares of the surviving company. In contrast to Delaware,[119] there is no market-out rule in Japan and thus appraisal rights are granted even if the stock used as consideration in the merger or stock-for-stock exchange is publicly traded. Consequently, future developments in Japanese case law concerning the appropriate methods to calculate fair price in the appraisal context should be a matter that is monitored on a consistent basis.

## D. Defensive Measures

In response to the increase in hostile deal activity in Japan, we have seen a marked increase in the defensive measures being considered by Japanese companies in order to forestall any would-be corporate raiders.[120] These actions by possible target companies first gained publicity when the Livedoor hostile bid for NBS dominated the front pages of Japanese newspapers. As a consequence of Livedoor, many Japanese companies suddenly viewed themselves as more susceptible to takeovers. Since the exact extent to which Japanese companies can properly employ defensive measures is still an evolving area of law, we have outlined

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[118] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 785, para. 1; art. 797, para. 1; art. 806, para. 1; *see also* Kenjiro Egashira, *Kaisha Hosei no Gendaika ni kansuru Yokoan (V)* [*Commentary on Draft Outline of Modernization of Corporation Law System (V)*], 1725 SHOJI HOMU 4, 9 (2005). Note, however, that precisely how a court would determine the value of any perceived synergies remains an unresolved issue.

[119] *See* DEL. CODE ANN. tit. 8, § 262(b)(1)-(2) (2006).

[120] For additional discussion and analysis of such defensive measures, see Katsuyuki Yamaguchi & Daisuke Morimoto, *Tekitaiteki Baishu karano Kigyo Boei* [*Corporate Defense against Hostile Takeovers*], 5-6 BUSINESS HOMU 83 (2005); Asa Shinkawa & Masaki Noda, *Tekitaiteki Kigyo Baishu niokeru Kobosaku* [*Offensive and Defensive Measures in Hostile Takeovers*], 106 JIGYO SAISEI TO SAIKEN KANRI 56 (2004).

below some of the main issues that can be observed at present.

### 1. Japanese Rights Plans

The most significant new defensive measure used by Japanese companies and the one that has justifiably received the most attention and scrutiny is the use of rights plans, typically through the issuance of share purchase warrants (*shinkabu-yoyaku-ken*).[121] The Defensive Measures Guidelines have provided the most recent guidance on the extent to which Japanese companies should be able to adopt rights plans, especially through the issuance of share purchase warrants, with the hope that such rules will prevail in practice although they do not have the force of law in a strict sense. As a result, some Japanese companies have adopted rights plans under the Defensive Measures Guidelines while others have not. The various legal issues concerning rights plans have been analyzed intensively since the Livedoor case. What we have seen is what one might expect in these circumstances: much variety and flexibility across the market with companies adopting rights plans directly tailored to address the particular issues associated with their businesses. Although the specific terms and conditions of each of these rights plans may differ, as a legal matter the poison pills presently used in Japan by target companies can be roughly categorized into four types, three of which involve the issuance of share purchase warrants.

> *Prior Warning Pills.* In this type of poison pill, as a general matter the target company issues a public warning by announcing that any potential acquirers must (i) submit certain information in order for the target company to evaluate their acquisition proposal, and (ii) refrain from purchasing target company shares until the evaluation of such acquisition proposal is reasonably completed. In the event that the acquirer

[121] See *supra* note 6 regarding the use of the terms "rights plans" and "poison pills" in this article. *See also* Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

fails to comply with such procedures or, in some cases, the target company believes that the acquisition will significantly decrease corporate value, the target company will take certain defensive measures.[122] The general defensive policy announced by JEC in response to Yumeshin's proposed business alliance is an example of a prior warning pill. Prior warning pills are also sometimes used in conjunction with other types of defensive measures as part of a company's entire defensive profile.[123]

*Trust Pills.* In the past year, a number of Japanese companies have issued so-called trust pills.[124] The key

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[122] In some cases, a target company simply announces its evaluation of an acquisition proposal and only asks its shareholders to reject a tender offer (*i.e.*, the target company does not take additional defensive measures), which remains the case as long as the acquirer complies with procedures required by the target company. *See* Press Release, Matsushita Electric Industrial Co., Ltd., *Matsushita Announces Plans to Maximize Shareholder Value* (Apr. 28, 2005), http://panasonic.co.jp/corp/news/official.data/data.dir/en050428-8/en050428-8.html.

[123] For example, Nippon Steel Corporation announced on March 29, 2006 that (i) it adopted a prior warning pill; (ii) Nippon Steel Corporation, Sumitomo Metal Industries, Ltd., and Kobe Steel, Ltd. signed a memorandum of understanding "which ensures the process for the three companies to cooperatively study the impacts on the strategic alliance and countermeasures in the event that an unsolicited offer is made to one of the three companies"; and (iii) "the three companies have purchased the shares of each other." *See* Press Release, Nippon Steel Corporation, *Nippon Steel Announces the Adoption of Fair Rules for the Acquisition of Substantial Shareholdings (Takeover Defense Measure) and the Shelf Registration of Stock Acquisition Rights* 1 (Mar. 29, 2006) (on file with author), *available at* http://www0.nsc.co.jp/data/20060330115130.pdf; Press Release, Nippon Steel Corporation, *Progress in Tie-Up Measures by Nippon Steel, Sumitomo Metals and Kobe Steel, and Agreement on Further Enhancement of Cooperation* 1-2 (Mar. 29, 2006) (on file with author), *available at* http://www0.nsc.co.jp/data/20060329120934.pdf.

[124] For example, Wood One Co., Ltd., Seino Transportation Co., Ltd., and Pentax Corporation. *See* Press Release, Wood One Co., Ltd., *Shinkabu Yoyakuken wo Katsuyo shita Kigyokachi Boeisaku no Donyu nikansuru Oshirase* [*Announcement of the Adoption of the Defensive Measures by Share Purchase Warrants*] (May 25, 2005), http://www.woodone.co.jp/ir/pdf/20050526_shinkabu.pdf; Press Release, Seino Trans-

point for trust pills is the use of an intermediary, usually a trust, between the issuer and the shareholders. In trust pills, the target company usually issues the share purchase warrants to the trust without consideration and with an exercise price of nominal value. Depending on the specific terms of the trust pill, upon the occurrence of certain trigger events (*e.g.*, crossing a percentage ownership threshold by a hostile bidder), the trust will distribute the share purchase warrants to target company shareholders. The hostile bidder, however, will not be able to exercise the warrants it receives, which results in the dilution effects of the poison pill.[125]

*Conditional Issuance Pills.* Here, instead of issuing the share purchase warrants without delay, the target company may conditionally resolve to issue (or resolve to conditionally issue) the warrants without consideration at a nominal price to shareholders. As in the case with trust pills, this conditional resolution or issuance takes effect only upon the occurrence of certain triggering events, with all shareholders except the hostile bidder receiving the right to exercise the warrants.

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portation Co., Ltd., *Issuance of Stock Acquisition Rights for Trust-type Rights Plan* (May 17, 2005), http://seino.co.jp/seino/e/news/pdf/17may 2005-01.pdf; Press Release, Pentax Corporation, *Notice Concerning Private Placement of Equity Warrants (as a Defense against Hostile Acquisition Attempts)* (May 23, 2005), http://www.pentax.co.jp/english/news/ information/200505231.html.

[125] Note that Japanese law does not permit Japanese companies to attach an option right to their shares. This is a critical point since share purchase warrants are not transferred upon a subsequent sale by shareholders of their underlying shares, while in the United States the rights "stick" to the shares in question. *See generally* DEL. CODE ANN. tit. 8, § 157(a) (2006). This unique aspect of share purchase warrants poses numerous issues under the Corporation Law and applicable U.S. securities laws as further discussed in Section IV.E *infra*.

*Limited Voting Right Pills.* This pill can be adopted under the new Corporation Law.[126] Limited voting right pills permit a company to convert its common shares to limited voting right shares by amending its articles of incorporation, and as part of such conversion the hostile acquirer will be excluded from voting such limited voting right shares in the future.

While some Japanese companies have adopted prior warning and/or trust pills, one should note that conditional issuance or limited voting right pills have been quite rare. Furthermore, as of the end of May 2006, 157 companies (approximately 4% of all public companies and 7% of all companies listed in the First Section of the Tokyo Stock Exchange) adopted defensive measures, while around the same time in 2005, only twenty-seven companies adopted defensive measures.[127] Thus, it appears that Japanese poison pills will continue to evolve in the near future and remain a matter of intense discussion amongst practitioners.

### 2. Other Notable Defensive Measures

In addition to share purchase warrants, there are other defensive measures that a Japanese company can take which will be familiar to the U.S. practitioner. At the same time, there are certain strategies that are common in the United States which are not frequently used in Japan. Thus, provided below is a description of selected defensive measures that do and do not work in Japanese deals.

*Dividend Increases.* Japanese target companies can use dividend increases as a defensive measure to counter the efforts of hostile acquirers. In cases where

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[126] *See* Masami Hadama, *Giketsuken Seigen Kabushiki wo Riyoshita Baishuboeisaku [Defensive Measures to Use Limited Voting Right Shares]*, 1742 SHOJI HOMU 28 (2005); Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 322, para. 1, no. 1(ii); art. 108, para. 2, no. 3.

[127] *Baishu-boeisaku Donyu 153 sha [153 Companies Adopted a Defensive Measure]*, THE YOMIURI SHIMBUN (Japan), June 18, 2006, at 2. Recent reports have calculated that approximately 90% of the defensive measures employed by Japanese companies are of the prior warning type. *Id.*

the target company can expect that an increase in dividends will result in a higher stock price, such a strategy may work in pushing the stock price above the hostile bidder's price in the context of a tender offer. Two notable deals from the past few years involving Steel Partners, the U.S. investment fund, have applied this approach.[128]

*Stock splits.* As demonstrated in the Yumeshin – JEC deal, stock splits can be effective defensive measures in tender offers by delaying the settlement date of the tender offer, which will make the tender offer less attractive to shareholders and the tender offeror. In the case of JEC's stock split, this resulted in the delay of the tender offer settlement by fifty-six days. However, as a result of recent amendments to the Tokyo Stock Exchange rules, the maximum delay period has effectively become approximately fifty days.[129]

*Staggered boards.* In contrast to U.S. practice, staggered boards are usually not an effective strategy in Japanese deals. This is because the maximum term

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[128] In December 2003, Steel Partners launched a hostile tender offer for shares of Sotoh Co., Ltd. ("Sotoh"), a texture dyeing company. Although a white knight launched a competing tender offer, Steel Partners' final price (1550 yen per share) was higher than that of the white knight. In response to these developments, Sotoh announced that it would increase its dividend from 6.5 yen to 193.5 yen per share. The market price of Sotoh shares increased from 1590 yen to 1800 yen per share, and thereafter the Steel Partners tender offer failed. Also in December 2003, Steel Partners launched a hostile tender offer for shares of Yushiro Chemical Industry Co., Ltd. ("Yushiro") at 1150 yen per share. Yushiro announced that it would increase its dividend from 11 yen to 192 yen per share. The market price of Yushiro shares then fluctuated between 1600 yen and 1900 yen from a previous 1156 yen per share before the announcement. The result was the same: the Steel Partners tender offer failed. *See* Atsushi Endo, *Do Taio? Kabushiki Kokai Kaitsuke* [*How to React to Tender Offer*], THE NIKKEI SHIMBUN (Japan), Mar. 7, 2004, at 11.

[129] *See* Yo Ota, *Nihon Gijutsu Kaihatsu no Kabushiki Bunkatsu Sashitome Karishobun Meirei Moshitate Jiken* [*Preliminary Injunction Case of Enjoinment of Stock Split of JEC*], 1742 SHOJI HOMU 42, 44, 52 (2005).

of directors is two years under Japanese law,[130] whereas in Delaware the directors can be separated into three classes with three-year terms.[131] Thus, a staggered board for a Japanese company can only delay the hostile acquirer for approximately one year. Additionally, the Defensive Measures Guidelines recommend that a company provide directors with one-year terms when the company in question has adopted a rights plan that lasts longer than one year, so that shareholders can indirectly approve the rights plan annually when voting on the slate of directors.[132] Furthermore, another reason for the ineffectiveness of staggered boards in Japan is that it is possible to dismiss directors at shareholders meetings without cause.[133]

*Supermajority voting requirements.* In a manner similar to staggered boards, the use of supermajority voting requirements is not a commonly used defensive strategy in Japanese deals. In contrast to Delaware law, under which the default rule is that a majority of outstanding shares can approve a merger,[134] Japanese law generally requires a Supermajority Vote for mergers or other significant corporate actions.[135] The Corporation Law permits Japanese companies to

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[130] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 332, para. 1.

[131] *See* DEL. CODE ANN. tit. 8, § 141(d) (2006).

[132] *See* THE DEFENSIVE MEASURES GUIDELINES, *supra* note 26, at 9, 12, 19.

[133] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 339, para. 1; art. 339, para. 2 (noting that indemnification may be available to a director who was dismissed without cause). In Delaware, the general rule is that any director may be removed with or without cause, although removal without cause may not be possible in certain cases when the corporation has elected to classify its board or have cumulative voting. *See* DEL. CODE ANN. tit. 8, § 141(k) (2006).

[134] This threshold may be increased, as provided in the certificate of incorporation. *See id.* §§ 102(b)(4), 251(c).

[135] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 309, para. 2.

*increase* this supermajority vote requirement by amending the articles of incorporation, but it is not possible to *decrease* the requirement to a majority of the outstanding shares, as is the case in Delaware.[136] However, one area in which the Corporation Law provides for a simple majority vote is in the dismissal of directors with or without cause. This requirement may be increased by amendment to the articles of incorporation.[137]

### 3. Emerging Issues: Special Committee of Directors

As a corollary to the increase in defensive measures employed by Japanese companies, an issue that has received additional attention recently is under what circumstances should a special committee of directors be formed to review and consider proposals from hostile bidders. In takeovers under Delaware law, special committees are formed when there is a question as to the independence of target company directors. This frequently occurs in going private transactions, or when a controlling shareholder of the target is the acquirer. In such cases, the entire fairness test, as enunciated by the Delaware courts, will most likely apply to the transaction that is the subject of judicial review.[138] The

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[136] *Id.*

[137] *See id.* art. 341.

[138] The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock. However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue

Delaware special committee process, therefore, is often used in furtherance of satisfying the requirements of the entire fairness test,[139] since a well- planned and executed special committee process can shift the burden of proof to plaintiff shareholders in future litigation proceedings.[140]

Special committees in Japan share many of the aspects that one usually finds in a special committee that operates under Delaware law, with the interest of maintaining independence in the decision-making process playing a fundamental role.[141] However, one key difference between current practices in Japan and Delaware is that under present Japanese law, there are no clear prudential standards for reviewing the decisions of target boards. A consequence of the continuing development of Japanese law is that the special committee process is evolving parallel to the consideration of new defensive measures.

At the present time, special committees are most often used when a Japanese company adopts a rights plan. A customary example is when, as part of the announcement of a rights plan, a Japanese company will require that activation and cancellation of the rights plan be determined by the board of directors that "assigns maximum value to the recommendations" of a special committee.[142] In contrast to the customary practice in the United States, in Japan the

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> must be examined as a whole since the question is one of entire fairness.

Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994) (quoting Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983)). *See also* DEL. CODE ANN. tit. 8, § 144(a)(3) (2006).

[139] *See Kahn*, 638 A.2d at 1115.

[140] "Particular consideration must be given to evidence of whether the special committee was truly independent, fully informed, and had the freedom to negotiate at arm's length." *Id.* at 1120-21.

[141] *See* THE CORPORATE VALUE REPORT, *supra* note 24, at 91-94.

[142] LION CORPORATION, NOTICE CONCERNING THE ISSUANCE OF SUBSCRIPTION RIGHTS IN PREPARATION FOR THE INTRODUCTION OF A TRUST-TYPE RIGHTS PLAN 7 (Feb. 6, 2006), http://www.lion.co.jp/en/press/html/2006009f.htm; SEINO TRANSPORTATION CO., LTD., ISSUANCE OF STOCK ACQUISITION RIGHTS FOR A TRUST-TYPE RIGHTS PLAN 10 (May 17, 2005), http://www.seino.co.jp/seino/e/news/pdf/ 17may2005-01.pdf.

members of the special committee are not only directors of the target company, but may also include independent statutory auditors or outside advisors, such as legal counsel.[143] As in the United States, the concerns related to maintaining the necessary independence of the special committee process are present in Japan.[144] These concerns have resonated with investors and have led some to vote against rights plans in which the special committee was not considered sufficiently independent from management.[145]

Given this evolving nature of special committees in Japanese deals, we will likely see additional changes in how special committees are constituted and operated in the near future.

## E. U.S. Federal Securities Laws

In addition to Japanese law considerations, practitioners should keep in mind the possible implications of U.S. securities laws when doing Japanese deals. In particular, given the globalization of both institutional and individual

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[143] *See* LION CORPORATION, at 7; SEINO TRANSPORTATION CO., LTD., at 9.

[144] Defining "independence" is a well known issue for U.S. practitioners, who must comply with the new corporate governance rules and regulations that came into effect after the enactment of the Sarbanes-Oxley Act. *See* 17 C.F.R. § 240.10A-3 (2006); NYSE Listed Company Manual § 303A.02; NASD Manual Rule 4200(a)(15), 4350(c). Indeed, the challenge of determining the appropriate level of independence often extends to the selection of counsel when conducting internal corporate investigations. *See* Jonathan R. Tuttle & Christopher T. Hines, *First Things First: Deciding Who Should Conduct Your Internal Investigation* (Jun. 24, 2003) (paper presented at American Conference Institute symposium, *Trying and Defending Securities Class Actions*).

[145] For example, it is reported that the Pension Fund Association voted against rights plans proposed by two companies at their respective shareholders meetings in 2005 because of their dissatisfaction with the independence of special committee members in one case and the authority given to the special committee in making decisions for the corporation in the other. *See Poison Pill Donyu Hantai no Case* [*Cases of Objecting to the Introduction of Poison Pills*], THE YOMIURI SHIMBUN (Japan), July 7, 2005, at 9, *available at* http://www.yomiuri.co.jp/atmoney/mnews/20050707mh05.htm.

investment, securities of Japanese issuers that have never been listed on an exchange outside of Japan are oftentimes beneficially owned by persons resident in the United States. Thus, a deal with a Japanese issuer may trigger various requirements under U.S. securities laws. This section provides guidance for structuring M&A transactions in compliance with U.S. securities laws, reviews the consequences for violating such laws, and also examines the potential impact of U.S. securities laws on Japanese rights plans.

### 1. Application of U.S. Securities Laws to Japanese Business Combinations and Tender Offers

The Securities Act of 1933, as amended (the "Securities Act"), regulates offers and sales of securities in the United States. Pursuant to Section 5 of the Securities Act, issuers must either file a registration statement in respect of securities offered and sold in the United States or comply with an exemption from the registration requirement.[146] "Offer" and "sale" include proposals to U.S. security holders requiring a vote on whether to accept new or different securities in exchange for their existing securities.[147] The three typical Japanese business combination structures (*gappei* or mergers, *kabushiki kokan* or stock-for-stock exchanges, and *kabushiki iten* or stock transfers) generally require approval by the shareholders who will receive new or different securities as a result of the transaction. These combination structures are subject to the Securities Act when U.S. holders are asked to vote on the transaction.[148]

[146] *See* 15 U.S.C. § 77e (2000).

[147] *Id.* § 77b(a)(3).

[148] See *supra* Sections IV.A.3, 6, and 7 for discussions of *gappei*, *kabushiki kokan*, and *kabushiki iten*, respectively. In the case of a cash-out merger or cash-out stock for stock exchange, the offeror does not make an offer or sale of securities to the target company shareholders; therefore, the Securities Act is not applicable. However, note that the Corporation Law does not permit cash-out mergers in the manner provided under Delaware law. *See supra* note 8.

Section 14(d) of the Securities Exchange Act of 1934,[149] as amended (the "Exchange Act"), and the rules promulgated thereunder provide detailed disclosure, procedural, and filing requirements regarding tender offers for securities registered under the Exchange Act. Section 14(e) of the Exchange Act[150] and the rules promulgated thereunder create procedural rules for all tender offers made in the United States. Moreover, Section 13(e) of the Exchange Act[151] and the rules promulgated thereunder set forth additional rules applicable to all issuer tender offers and going private transactions conducted in the United States. Any tender offer made with respect to shares held by U.S. persons or shares registered with the Securities and Exchange Commission must therefore comply with these requirements, as applicable, unless the tender offer falls within an exemption from the Exchange Act tender offer requirements.

An entity seeking to acquire the shares of a foreign private issuer[152] through a business combination or tender offer can nonetheless avoid the requirements of the Securities Act and Exchange Act by excluding U.S. holders from the transaction. In addition, the requirements of the Securities Act can be avoided in the case of a tender offer where part of the consideration is securities (*i.e.*, an exchange offer), by offering U.S. holders only the cash proceeds of shares pursuant to a so-called vendor placement. As discussed below, these alternatives are frequently impractical or prohibited under Japanese law.[153] Therefore,

[149] 15 U.S.C. § 78n(d) (2000).

[150] *Id.* § 78n(e).

[151] *Id.* § 78m(e).

[152] A foreign private issuer is any issuer not organized under the laws of the United States, provided that more than 50% of its outstanding voting securities are not owned by U.S. residents and: (i) less than half of the executive officers or directors of the issuer are U.S. citizens or residents; (ii) more than 50% of the assets of the issuer are not located in the United States; or (iii) the United States is not the issuer's primary place of business. *See* 17 C.F.R. § 230.405 (2006).

[153] There are additional means of conducting a transaction with U.S. shareholders that are also problematic. In the context of a business

the Cross-Border Rules, which are exceptions to the general requirements of the Securities Act and Exchange Act,[154] are the primary means by which U.S. shareholders can be included in Japanese tender offers and business combinations.[155]

### i. Exclusion of U.S. Shareholders

Offerors can avoid SEC jurisdiction over a business combination or tender offer by excluding U.S. holders from the offer or sale.[156] The offeror's ability to take this approach depends on whether, under the laws of its own jurisdiction, some shareholders may be excluded from the offer and whether the offeror can win approval for the transaction

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combination or a tender offer in which securities make up part of the consideration, Japanese issuers could also issue shares to U.S. holders pursuant to a private placement under Section 4(2) of the Securities Act or register the shares to be issued to U.S. holders with the Commission. However, a private placement is often impractical because the issuer is required to know in advance that all U.S. persons who receive the offer are qualified under the Securities Act to participate in a private placement. Registering shares with the Commission is also frequently impractical because of the time and expense involved and the triggering of ongoing Securities Act reporting requirements. For a specific analysis of the application of U.S. securities laws to Japanese tender offers, see Mitsuhiro Kamiya et al., *Kokaikaitsuke ni okeru Beikoku Kabunushi no Toriatsukai no Hotekishomondai* [*Treatment of U.S. Shareholders in Japanese Tender Offers*], 1683 SHOJI HOMU 15 (2003); *see also* Stephen D. Bohrer, *The Application of U.S. Securities Laws to Overseas Business Transactions*, 11 STAN. J.L. BUS. & FIN. 126 (2005) (discussing issues under U.S. securities laws that often arise in connection with non-U.S. transactions).

[154] *See* Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings, Securities Act Release No. 7759, Exchange Act Release No. 4,2054, 60 Fed. Reg. 61,382 (Nov. 10, 1999) (codified at 17 C.F.R. pt. 200 et al.) [hereinafter Cross-Border Release].

[155] "[T]he Commission is adopting exemptive rules that are intended to encourage issuers and bidders to extend tender and exchange offers . . . and business combinations to the U.S. security holders of foreign private issuers." *Id.* at 61,382.

[156] *See id.* at 61,383 (discussing the possibility that notwithstanding the adoption of the Cross-Border Rules, some non-U.S. issuers will continue to exclude U.S. holders from participation in business combinations).

without the votes of U.S. shareholders. This approach would also require that the transaction be structured and documented in a way that makes it clear that no offer is being made in the United States.[157]

Japanese business combinations are not likely to permit the exclusion of U.S. holders because the Corporation Law requires that all shareholders of a class be treated equally.[158] This rule is most likely interpreted to require that shareholders of a class be offered identical consideration in a business combination or tender offer, not just consideration of equal value.

In order to ensure that no offer is made in the United States, documents concerning the transaction should not be disseminated in or otherwise sent to the United States and offerors should obtain undertakings from nominees not to send any such documents to the United States. Moreover,

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[157] The Securities Act definitions of "offer to sell," "offer for sale," and "offer" include "every attempt or offer to dispose of, or solicitation of an offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." 15 U.S.C. § 77b(a)(3) (2000). "Tender Offer" is not specifically defined in the Exchange Act or rules promulgated thereunder. However, tender offers are generally characterized by eight factors:

> (i) an active and widespread solicitation of public shareholders is made for shares of an issuer; (ii) the solicitation is made for a substantial percentage of the issuer's stock; (iii) the offer to purchase is made at a premium above the prevailing market price; (iv) the terms of the offer are firm rather than negotiable; (v) the offer is contingent on the tender of a fixed minimum number of shares and is often subject to a ceiling of a fixed maximum number of shares to be purchased; (vi) the offer is open for only a limited period of time; (vii) offerees are subject to pressure to sell their stock; and (viii) public announcements of an acquisition program precede or accompany the accumulation of stock.

MEREDITH M. BROWN, RALPH C. FERRARA, PAUL S. BIRD, GARY W. KUBEK & WILLIAM D. REGNER, TAKEOVERS: A STRATEGIC GUIDE TO MERGERS AND ACQUISITIONS § 4-2.A. (2d ed. 2004).

[158] Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 109, para. 1 (stating that "[a] joint stock company must treat shareholders equally in accordance with content and the number of shares owned by them").

offerors should not accept tenders from U.S. persons and should require all tendering shareholders to certify that they did not receive any documents in the United States. Japanese registration statements announcing a cash tender offer often contain a legend indicating that the acquirer does not intend to make the offer in the United States.[159] However, as indicated in Section IV.B.1 above, exchange offers are rare in Japan due to unfavorable tax treatment.

ii. Vendor Placements

The Commission has taken the position that if a foreign issuer offers and issues to U.S. residents securities as consideration in a tender offer, which are immediately resold outside the United States for the account of the U.S. residents, there is no offer or sale made to the U.S. residents for purposes of the Securities Act.[160] In such transactions, this "vendor placement" technique works as follows: (i) U.S. holders of target company securities receive the same offer that was made to all target shareholders; (ii) a U.S. holder's acceptance of the offer is deemed an agreement to have the acquiring company's shares, which would otherwise be issued to such U.S. holder, issued instead to a trustee located outside the United States; (iii) upon receiving shares from the acquiring company, the trustee promptly resells them outside the United States; and (iv) following such resale, the

[159] The following is a typical legend: "Shareholders residing overseas need to offer their shares through their standing agents in Japan. This tender offer does not intend to, directly or indirectly, be made in or towards the United States, and is not carried by use of the mails in the United States or in any other interstate commerce in the United States or international commerce nor by use of any facilities of a national securities exchange in the United States." For an analysis of the legality of such legends under the Securities and Exchange Law, see Tanigawa & Fukuzawa, *supra* note 114, at 27.

[160] *See, e.g.*, Singapore Telecommunications Ltd., SEC No-Action Letter, 2001 WL 533462 (May 15, 2001); TABCORP Holdings Ltd., SEC No-Action Letter, 1999 WL 766087 (Aug. 27, 1999); Durban Roodepoort Deep, Ltd., SEC No-Action Letter, 1999 WL 1578786 (Feb. 23, 1999); AMP Ltd., SEC No-Action Letter, 1998 WL 870709 (Sept. 17, 1998); Cross-Border Release, *supra* note 154, at 61,386.

trustee remits the cash proceeds, less expenses, to the U.S. holder.[161] However, the Commission has permitted this approach in only limited circumstances and has not codified the process. Instead, the Commission has signaled that it will evaluate the availability of vendor placements on a case by case basis.[162]

Vendor placements are typically not a useful means to avoid U.S. jurisdiction in Japanese exchange offers because, under Japanese law, shareholders cannot be forced to accept different forms of consideration in a given transaction.[163] Accordingly, where a target company's shares are owned by U.S. and Japanese shareholders, the acquirer is not permitted to offer cash to U.S. shareholders and stock to Japanese shareholders.

### 2. The Cross-Border Rules – Rule 802

Rule 802 of the Securities Act exempts from registration (i) exchange offers for the securities of foreign private issuers, and (ii) exchanges of the securities of foreign private issuers in any business combination, provided the conditions discussed below are met.[164]

#### i. 10% Ownership Test

In a *gappei* (merger) or *kabushiki kokan* (stock-for-stock exchange), less than 10% of the security holders of the target company may reside in the United States.[165] In a *kabushiki*

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[161] *See* Cross-Border Release, *supra* note 154, at 61,386.

[162] *Id.* at n.38

[163] *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-2, para. 3.

[164] *See* 17 C.F.R. § 230.802 (2006). An exchange offer is a tender offer in which securities constitute part of the consideration, *see id.* § 230.800(c), and a business combination is "a statutory amalgamation, merger, arrangement or other reorganization requiring the vote of security holders of one or more of the participating companies," *see id.* § 230.800(a). As noted in Section IV.B.1, *supra*, exchange offers are generally not conducted in Japan due to unfavorable tax treatment.

[165] The 10% calculation is based on the specific instructions set forth in the regulations. *See* 17 C.F.R. § 230.800(h) (2006).

*iten* (stock transfer), the percentage of shares held by U.S. holders for the purpose of determining the availability of Rule 802 should be based on the ownership of shares of the successor company on a pro forma basis immediately following the transaction.[166]

Securities that are convertible or exchangeable into the securities that are subject to the offer are excluded from the 10% ownership calculation.[167] Securities held by owners of more than 10% of the subject securities and securities owned by the offeror are also excluded from the calculation of U.S. ownership.[168]

The ownership calculation should be made with respect to the shareholders of record thirty days prior to the commencement of the offer.[169] However, offerors may depart from the thirty-day standard when their access to security holder list information, prepared periodically by third parties, is limited.[170] In such instances, the offeror may determine the percentage of U.S. holders of the shares subject to the offer by reference to the latest security holder list available, unless the offeror has access to more accurate

166 *See id.* § 230.802(a).

167 *Id.* § 230.800(h)(2).

168 *Id.*

169 *Id.* § 230.800(h)(1). In the context of a Japanese business combination, commencement of the offer is widely understood to occur when the notice of extraordinary shareholders meeting, which calls for a vote on the proposed transaction, is distributed to the shareholders of the target company. However, parties to a Japanese business combination frequently announce the potential transaction by press release in advance of the dissemination of the notice of extraordinary shareholders meeting. Therefore, it is advisable to delay announcing the transaction until thirty days before the dissemination of such notice; otherwise, U.S. investors who purchase target company shares following the announcement of the transaction will be included in the 10% ownership calculation. In cases where security holder list information of the target company is not available thirty days prior to the commencement of the offer, this precaution may seem unnecessary, see *infra* note 171, but is nonetheless advisable.

170 SEC, Division of Corporate Finance: Third Supplement to the Manual of Publicly Available Telephone Interpretations (Supp. July 2001), Cross-Border Release, Determining U.S. Ownership, Question 8.

information.[171] Since Japanese companies typically receive their shareholder lists from the depository at fixed intervals and cannot otherwise obtain the shareholder lists unless undergoing a capital structure change, the companies are usually required to utilize this exception to the thirty-day rule.

In order to make the 10% ownership determination, the offeror must "look through" record ownership in the target company's home jurisdiction and in the United States when the target company's shares are held by brokers, dealers, banks, or other nominees, and determine the number of shares held in accounts with such nominees by U.S. holders.[172] To the extent the offeror is unable to determine beneficial ownership after a reasonable inquiry, the offeror may assume that the beneficial owners of securities held by nominees are residents of the jurisdiction in which the nominee has its principal place of business.[173] The reasonable inquiry standard is not defined in the SEC rules or guidance. However, the standard normally requires that the offeror ask each nominee located in the target company's home jurisdiction or the United States how many shares it is holding for the accounts of customers resident in the United States.[174]

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[171] *Id.* Speaking during the Commission's annual event "Live From the SEC, A Review of Recent Developments in International Securities Regulation and Enforcement," Brian Breheny, Chief of the Commission's Office of Mergers and Acquisitions, cited the 10% ownership test as an area of the Cross-Border Rules that the Commission may reevaluate, in part because issuers outside of the United States are frequently limited in their access to shareholder information. Brian Breheny, Chief, SEC Office of Mergers & Acquisitions, Remarks at the SEC's Annual Event: Live From the SEC, A Review of Recent Developments in International Securities Regulation and Enforcement (Oct. 5, 2006). Mr. Breheny's remarks were made in the context of a discussion of the Tier I and Tier II exemptions from the Commission's tender offer rules, which have the same share ownership calculation mechanics as Rule 800(h)(2). *See infra* notes 192, 202.

[172] *See* 17 C.F.R. § 230.800(h)(3) (2006).

[173] *See id.* § 230.800(h)(4).

[174] *See* Equant N.V., SEC No-Action Letter, 2005 WL 1173099 (Apr. 18, 2004). In *Equant*, the Commission approved an inquiry where the

Provided that not more than 10% of the target company's securities are held by U.S. holders when a bidder commences an offer, a competing offeror need not abide by the 10% U.S. ownership requirement.[175] Thus, if securities move into the United States after the initial offer such that more than 10% of the securities subject to the offer are owned by U.S. holders, later bids are not foreclosed by the 10% ownership test.

### ii. Equal Treatment

U.S. holders must be allowed to participate in the exchange offer or business combination on at least an equal basis with other holders.[176] However, offerors are permitted to offer U.S. holders cash-only consideration, even when non-U.S. holders are offered securities, provided the offeror has a reasonable basis to believe the value of the cash is substantially equivalent to the value of the securities.[177] Nonetheless, as noted previously, this exception to the Rule 802 equal treatment requirement is precluded by the Corporation Law.[178]

### iii. Documentary Requirements

An English-language translation of any informational document the offeror publishes or disseminates to the target company's security holders in connection with the transaction must be furnished to the Commission on Form

issuer retained an agent to conduct an investigation into the beneficial holders of the issuers' shares. The agent obtained a list of holders from the depository and sent informational requests regarding beneficial ownership to each of the nominees on the list.

[175] *See* 17 C.F.R. §§ 230.802(a), 240.14d-1(c)(1) (2006). *See also* Cross-Border Release, *supra* note 154, at 61,384.

[176] *See* 17 C.F.R. § 230.802(a)(2) (2006) ("The issuer must permit U.S. holders to participate in the exchange offer or business combination on terms at least as favorable as those offered any other holder of the subject securities.").

[177] *See id.*

[178] *See* Kaisha-ho [Corporation Law], Law No. 86 of 2005, art. 109, para. 1.

CB no later than the next business day following publication or dissemination.[179] "Informational document" is not defined in the SEC rules or guidance. Relevant factors in evaluating whether a disclosure constitutes an informational document may include: (i) whether the disclosure is required in the offeror's home jurisdiction; (ii) whether it formally commences the offer; (iii) whether it is addressed to security holders; (iv) whether it gives security holders the means to tender shares; and (v) whether it otherwise gives shareholders material information about the offer that they have not already received.[180]

### iv. Parties Responsible for Filing Form CB

Pursuant to Rule 802, in an acquisition, the acquirer (or "issuer") is required to furnish informational documents disseminated to the shareholders of the target (or "subject") company to the Commission on Form CB.[181] This allocation of responsibility is consistent with U.S. securities laws regarding exchange offers and business combinations that require an acquiring company to send the prospectus/proxy statement to target company shareholders. However, in a Japanese business combination, the target company, rather than the acquirer, typically distributes informational documents concerning the transaction to its own shareholders and thus bears the responsibility of filing such documents on Form CB.[182]

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[179] 17 C.F.R. § 230.802(a)(3)(i) (2006). Per Regulation S, if no offer or sale is made in the United States (*i.e.*, the target company has no U.S. shareholders) there is no Securities Act registration requirement, and hence no need to comply with the Rule 802 Securities Act registration exemption. *See id.* § 230.901.

[180] *See* Cross-Border Release, *supra* note 154, at 61,385, 61,391.

[181] *See* 17 C.F.R. § 230.802(a)(3)(i) (2006).

[182] In a typical Japanese business combination where the issuer disseminates information about the transaction via press release, either on its own or jointly with the target, and the target disseminates information to its own shareholders, both the issuer and the target would file Form CB and Form F-X during the course of the transaction.

v. Dissemination

An informational document is deemed to have been published or otherwise disseminated if it is made public in any manner, such as via press release, the Internet, or direct mailing.[183] Informational documents published or otherwise disseminated to shareholders in the offeror's home jurisdiction must be translated into English and disseminated to U.S. holders on a comparable basis to the means by which they were provided to security holders in the offeror's home jurisdiction.[184] Thus, when the offeror disseminates an informational document in its home jurisdiction by means of "publication" (*e.g.*, a press release via media outlets or a newspaper advertisement) rather than by sending the informational document directly to security holders, the offeror must publish the information in the United States in a manner reasonably calculated to inform U.S. holders of the relevant information.[185] The rule does not specify what publication method satisfies this requirement.[186] However, the adopting release makes clear that the dissemination requirement is not satisfied by posting materials on the Internet.[187]

The rule does not clearly identify exactly when, during the course of a transaction, the requirement to furnish and disseminate begins and ends. However, Japanese companies

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[183] *See* 17 C.F.R. §§ 230.802(a)(3)(i)-(ii) (2006); Cross-Border Release, *supra* note 154, at 61,391, 61,394.

[184] *See* 17 C.F.R. § 230.802(a)(3)(ii) (2006).

[185] *See id.* § 230.802(a)(3)(iii).

[186] The Commission generally does not impose greater dissemination requirements with respect to U.S. holders than are imposed by the home country jurisdiction. For example, an issuer could probably satisfy its Rule 802 dissemination requirement with respect to (i) a press release issued in Japan and posted on its corporate website, by translating the document into English, releasing it in the United States, and posting the translation on its corporate website, and (ii) documents mailed to holders in Japan, by sending English translations of such documents either directly to U.S. shareholders or the U.S. shareholders' standing agents (*jonin-dairinin*) in Japan.

[187] *See* Cross-Border Release, *supra* note 154, at 61,394.

often file the following documents in English on Form CB when disseminating such documents to shareholders in Japan: (i) a press release issued upon the execution of the merger agreement; (ii) a notice of the shareholders meeting, including any description of the transaction and related disclosure as to the offeror's securities; (iii) a notice of the results of the shareholders meeting; (iv) a public notice published in Japan announcing the results of the shareholders meeting and instructing shareholders on how to submit shares, or any similar letter of transmittal; (v) a request for submission of share certificates in conjunction with the share exchange; and (vi) a merger report made available at the home office and posted on the Tokyo Stock Exchange website following the share exchange.

### vi. Form CB and Form F-X Filing Deadlines

Informational documents must be furnished to the Commission on Form CB by the first business day after the date of publication or dissemination.[188] The entity furnishing the Form CB must also file a Form F-X, pursuant to which it appoints an agent for service of process in the United States in connection with any Commission action.[189]

### vii. Legends

Any informational document distributed to U.S. holders must bear a legend as set forth in Rule 802(b).[190] Where

188 *See* 17 C.F.R. § 230.802(a)(3)(i) (2006).

189 By appointing an agent for service of process in the United States, the filer agrees that the Commission may commence any proceeding by service of process upon (or notifying) such agent. The agent for service of process may be any person located in the United States, such as a corporate services company or an affiliate of the issuer.

190 *See* 17 C.F.R. § 230.802(b) (2006) ("This exchange offer or business combination is made for the securities of a foreign company. The offer is subject to disclosure requirements of a foreign country that are different from those of the United States. Financial statements included in the document, if any, have been prepared in accordance with foreign accounting standards that may not be comparable to the financial statements of United States companies. It may be difficult for you to

appropriate, informational documents disseminated to U.S. holders may include a further legend making clear that the document does not constitute an offering of securities in the United States.

### 3. The Cross-Border Rules – Tender Offers

Tiers I and II provide limited relief from the tender offer rules for bidders seeking to acquire the shares of a foreign private issuer through a cash tender offer or exchange offer.

#### i. Tier I

Pursuant to the Tier I exemption, bidders seeking to acquire the securities of a foreign private issuer with U.S. holders through a tender offer[191] are excused from most of the Exchange Act tender offer rules, subject to certain conditions.[192]

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enforce your rights and any claim you may have arising under the federal securities laws, since the issuer is located in a foreign country, and some or all of its officers and directors may be residents of a foreign country. You may not be able to sue a foreign company or its officers or directors in a foreign court for violations of the U.S. securities laws. It may be difficult to compel a foreign company and its affiliates to subject themselves to a U.S. court's judgment. You should be aware that the issuer may purchase securities otherwise than under the exchange offer, such as in open market or privately negotiated purchases.").

[191] The "tender offer" includes exchange offers. *See id.* § 240.14d-1(b).

[192] *See id.* § 240.14d-1(c). Specifically, Tier I exempts the bidder from complying with Sections 14(d)(1) through 14(d)(7) of the Exchange Act, Regulation 14D and the attendant procedural, disclosure, and dissemination requirements, Schedule TO, Rule 14e-1 regarding the conduct of the offer, Rule 14e-2 regarding the dissemination of the target company's position with respect to the offer, and Rule 14e-5 prohibiting purchases outside of the tender offer. It should be noted that since Sections 14(d)(1) through 14(d)(7), Regulation 14D, and Schedule TO are only applicable to transactions in which the target company has shares registered in the United States, in the context of a tender offer for a Japanese company, the only benefit of Tier I is usually the release from Rules 14e-1, 14e-2, and 14e-5. Transactions falling within the Tier I exemption are also not required to comply with the rules regarding going private transactions and issuer self-tenders. *See* 17 C.F.R. §§ 240.13e-3(g)(6), 240.13e-4(h)(8) (2006).

*10% Ownership.* The Tier I exemption is only available where fewer than 10% of the class of shares sought in the bid are held by U.S. persons, subject to the same conditions and exceptions as the Rule 802 10% ownership test.[193] Provided not more than 10% of the target company's securities are held by U.S. holders when a bidder commences an offer, a competing offeror need not abide by the 10% U.S. ownership requirement.[194] In the case of a tender offer by a bidder other than an affiliate of the target company (*e.g.*, a hostile bidder), the target company is deemed to be a foreign private issuer and 10% or less of the shares subject to the tender offer are deemed to be owned by U.S. persons unless: (i) the tender offer is made pursuant to an agreement between the bidder and the target company; (ii) the aggregate trading volume of the targeted securities in the United States for the twelve-month period ending thirty days before the commencement of the offer exceeds 10% of the worldwide aggregate trading volume of such securities over the same period; (iii) the target company's annual report indicates 10% or more of the targeted securities are owned by U.S. holders; or (iv) the bidder otherwise knows that 10% or more of the targeted securities are owned by U.S. holders.[195]

*Filing Requirements.* Similar to Rule 802, bidders must furnish English translations of the offering materials on Form CB, file a Form F-X consent to service, and provide U.S. holders with the tender offer circular and other offering documents in English on a comparable basis to that provided to other securities holders.[196] However, bidders are only required to submit Form CB and Form F-X if the target company

[193] *See* 17 C.F.R. § 240.14d-1(c)(1) (2006).

[194] *See id.*

[195] *See id.* at Instruction 3.

[196] *See id.* § 240.14d-1(c)(3).

shares are registered under the Exchange Act or the bidder is making a self-tender.[197]

*Equal Treatment – Cash Alternative.* Once again, in keeping with the requirements under Rule 802, the Tier I exemption requires bidders to allow U.S. holders to participate in the transaction on terms at least as favorable as those offered to other holders, and permits the bidder to offer U.S. holders a cash alternative where securities are part of the consideration.[198] This method of remitting cash to U.S. holders allows bidders to include U.S holders in the tender offer without registering the shares in the United States or relying on the Rule 802 registration exemption. Nonetheless, in the case of exchange offers, Japanese law precludes forcing a group of shareholders to accept cash consideration when other shareholders are offered securities.[199]

### ii. Tier II

Tier II provides more limited relief to the tender offer requirements where a bidder makes an offer for the securities of a foreign private issuer and more than 10% but less than 40% of the securities of the target are held by U.S. persons.[200] Under the Tier II exemption, the bidder must make filings ordinarily required by the tender offer rules and comply with certain procedural rules,[201] but is granted

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[197] *See* 17 C.F.R. §§ 240.14d-1(c)(3)(iii), 240.13e-4(h)(8)(iii)(A) (2006).

[198] *See id.* § 240.14d-1(c)(2).

[199] *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-2, para. 3.

[200] *See* 17 C.F.R. § 240.14d-1(d) (2006).

[201] *See id.* §§ 240.14d-1(c), (d). In particular, the bidder is required to comply with the disclosure requirements of Regulations 14D and 14E (and Rule 13e-3 or 13e-4 relating to going private transactions and issuer tender offers, respectively, if applicable) and must file a Schedule TO with the Commission and provide notice of the offer to the target company's shareholders. Moreover, since more than 10% of the target company's securities are held by U.S. persons, any securities offered as part of the

leeway with respect to the manner in which the tender offer is conducted so as to minimize or eliminate conflicts with home jurisdiction law.[202] There is no Form CB or F-X filing requirement for Tier II because the rule does not exempt bidders from filing the standard tender offer disclosure documents.

### iii. Regulation 14E

Tender offers for the shares of a foreign private issuer with no securities registered under the Exchange Act, which is likely to be the case for a Japanese target company, need only comply with Section 14(e) of the Exchange Act[203] and Regulation 14E. Therefore, bidders for the securities of Japanese issuers not listed in the United States who are unable to take advantage of Tier I can nonetheless comply with U.S. securities laws without a substantial burden. The primary Regulation 14E requirements for bidders are: (i) the offer must be kept open for twenty business days; (ii) the

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consideration will not be exempt from registration pursuant to Rule 802. *See* 17 C.F.R. § 230.802(a)(1) (2006). Therefore, any such securities must be registered with the Commission and a prospectus must be delivered to the target company's shareholders.

[202] *See id.* § 240.14d-1(d). Pursuant to Tier II, the bidder may make different offers to U.S. and non-U.S. holders, provided the value of the consideration is consistent with the equal treatment principle and the bidder is subject to the notice of extension and prompt payment requirements stipulated in its home jurisdiction tender offer rules rather than the U.S. tender offer rules. *See id.* § 240.14d-1(d)(2)(ii)-(iv). Nonetheless, until recently the Commission had taken the position that bidders must obtain an individual exemption from the Rule 14e-5 prohibition on purchases outside of a tender offer before conducting a dual offer. *See* Division of Corporate Finance: Third Supplement to the Manual of Publicly Available Telephone Interpretations, Cross-Border Release (Supp. July 2001), Regulation M-A, Rule 14e-5, Question 3. The Commission granted global relief from this position in cases where multiple offers qualify for Tier II relief and certain other conditions, including equal treatment for U.S. offerees, are met. *See* Mittal Steel, SEC No-Action Letter, 2006 SEC No-Act. LEXIS 522 (June 22, 2006).

[203] Section 14(e) of the Exchange Act prohibits fraudulent, deceptive, or manipulative acts or practices in connection with tender offers. *See* 15 U.S.C. § 78n(e) (2000).

offer must remain open for ten business days following a change in the number or percentage of securities sought or the amount of consideration offered; and (iii) the bidder must provide notice of any extension of the offer to investors and promptly pay the offered consideration or return the tendered securities upon termination or withdrawal of the offer.[204]

### 4. Emerging Issues: Application of U.S. Securities Laws to Japanese Rights Plans

As discussed previously, Japanese companies have reacted to the increase in hostile takeover activity by adopting various types of rights plans. However, Japanese companies with U.S. security holders are required to comply with U.S. securities laws when issuing shares to U.S. persons pursuant to a rights plan. Under a typical trust pill, for instance, the company issues share purchase warrants to the trust which are exercisable at a nominal price and are distributed to company shareholders in the event of a hostile takeover bid. The Securities Act does not require warrants distributed under a rights plan to be registered because such

[204] *See* 17 C.F.R. §§ 240.14e-1(a)-(d) (2006). In addition, Regulation 14E prohibits the (i) trading on the basis of material nonpublic information relating to the tender offer during the tender offer and communications by the transaction parties that could result in such trading, *see id.* § 240.14e-3; (ii) tender of shares in which the tender offeror has a short position, *see id.* § 240.14e-4; (iii) purchase of securities by the offeror outside of the tender offer (subject to certain exceptions), *see id.* § 240.14e-5; and (iv) announcement of an offer where the offeror (a) does not anticipate commencing and completing the transaction within a reasonable time; (b) intends to use the announcement to manipulate the target company share price; or (c) does not have a reasonable belief it will complete the transaction, *see id.* § 240.14e-8. Moreover, Rule 14e-2 requires the target company to announce its position with respect to the offer within ten business days of the commencement of such offer. This requirement is consistent with the target company's obligations under the recently proposed amendments to the Securities and Exchange Law. *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-10, para. 1; (Draft) Government Ordinance for the Securities and Exchange Law, art. 13-2, para. 1.

issuance does not involve an "offer" or a "sale." However, Section 5 of the Securities Act requires the registration of shares issued to U.S. holders upon the payment of a share purchase warrant exercise price unless either an exemption from registration exists or the issuance of shares does not involve an offer or sale.[205] Accordingly, while the issuance of Japanese rights plans does not give rise to a registration requirement, the possible exercise of share purchase warrants under such rights plans will involve issues under the U.S. securities laws that should be considered as part of the overall transaction in question.

### 5. Consequences for Failure to Comply with the Cross-Border Rules and Informational Document Liability

Section 5 of the Securities Act provides that an issuer must either file a registration statement with the Commission or comply with an exemption from registration before publicly offering securities in the United States.[206] Therefore, if an issuer offers or sells securities in the United States without either registering such securities or complying with Rule 802 or another exemption, the issuer will be in violation of U.S. securities laws regardless of the number of persons to whom the offer is made.

Failure either to provide informational documents on Form CB or to disseminate them to U.S. holders would constitute a failure to comply with the Rule 802 exemption.[207] As a result, the exemption would not be available to issue stock in the United States. The subsequent issuance of stock without the benefit of registration or another exemption would result in violation of Section 5 of the Securities Act.[208] This violation could give rise to a civil enforcement action by the Commission,[209] and would give U.S. investors a right of

[205] *See* 15 U.S.C. § 77e (2000).

[206] *Id.*

[207] *See* 17 C.F.R. § 230.802 (2006).

[208] *See* 15 U.S.C. § 77e (2000).

[209] *See id.* § 77t.

rescission with regard to the shares received in the exchange.[210] Moreover, the Commission could seek an injunction from a U.S. federal district court prohibiting the issuer from including U.S. holders in the offer,[211] and as a result of a civil enforcement action the court could impose monetary penalties.[212] Individuals found to have willfully violated Section 5 could face additional fines and imprisonment.[213] If an issuer willfully disregards U.S. securities laws, the likelihood and severity of fines would increase. Bidders would face similar consequences for failure to comply with provisions of the Exchange Act in the context of a tender offer.[214]

If an issuer is merely late in filing or disseminating a document, the Commission is unlikely to take the view that the transaction does not fall within the Cross-Border Rules, unless the information not disseminated materially impairs the security holder's ability to make an investment decision. Indeed, pursuant to the Commission's recent guidelines regarding financial penalties, remedial steps taken by the corporation to protect investors militate against the assessment of fines.[215]

Companies that furnish informational documents to the Commission on Form CB are not subject to liability for false or misleading statements made within documents filed with the Commission pursuant to Section 18 of the Exchange Act

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[210] *See id.* § 77l.

[211] *See id.* § 77t(b).

[212] *See id.* § 77t(d)(2). Maximum monetary penalties range from $5,000 to $100,000 or the "gross amount of pecuniary gain" resulting from the wrongful action for individuals and $50,000 to $500,000 or the "gross amount of pecuniary gain" resulting from the wrongful action for entities. *See id.*

[213] *See* 15 U.S.C. § 77x (2000). Individuals found to have willfully violated the Securities Act may be fined up to $10,000 or imprisoned for up to five years, or both. *Id.*

[214] *See id.* § 78u.

[215] *See* SEC News Digest, Issue 2006-02, *Statement of the Securities and Exchange Commission Concerning Financial Penalties* (Jan. 4, 2005), *available at* http://sec.gov/news/digest/dig010406.txt [hereinafter *Statement Concerning Financial Penalties*].

because documents furnished on Form CB are not deemed "filed."[216] Nonetheless, companies may be subject to liability for material misstatements or omissions contained in informational documents furnished on Form CB by means of Rule 10b-5 of the Exchange Act, which subjects companies to liability for making any untrue statement of a material fact or omitting to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading in connection with the purchase or sale of a security.[217] Individuals and entities face significant fines, criminal penalties, and private lawsuits for 10b-5 violations.[218] Liability under Rule 10b-5 requires proof of scienter amounting to knowing or reckless conduct as an element of the cause of action.[219]

[216] *See* 15 U.S.C. § 78r (2000); SEC, Form CB Tender Offer/Rights Offering Notification Form (July 2005), http://www.sec.gov/about/forms/formcb.pdf.

[217] *See* 17 C.F.R. § 240.10b-5 (2006).

[218] Rule 10b-5 violations can give rise to SEC civil enforcement actions. *See* 15 U.S.C. § 78u (2000) (criminal prosecution); *id.* § 78ff (private action for damages). In the context of a civil enforcement action, individuals can be fined between $5,000 and $100,000 or the "gross amount of pecuniary gain" resulting from the wrongful action, *see id.* § 78u(d)(3)(B). Entities can be fined between $50,000 and $500,000 or the "gross amount of pecuniary gain" resulting from the wrongful action, *see id.* § 78u(d)(3)(B). The Commission also has the authority to apply to enjoin any further violation of the Securities Act, *see id.* § 78u(d)(1), and prohibit an individual to act as a director of a company with securities registered under the Exchange Act, *see id.* § 78u(d)(2). Rule 10b-5 violators could also face criminal prosecution, which carries a maximum penalty of $5 million and twenty years in prison for individuals and $25 million for entities. *See id.* § 78ff(a). Pursuant to the Sarbanes-Oxley Act, where the Commission obtains a judgment under the securities laws or reaches a settlement agreement for the disgorgement of funds and also obtains a civil judgment, the civil judgment can be added to the disgorgement funds held for the benefit of the victims of the securities law violation. *See id.* § 7246(a).

[219] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12 (1976) (finding scienter or "a mental state embracing intent to deceive, manipulate, or defraud" a prerequisite to 10b-5 liability); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1039 (7th Cir. 1977), *cert.*

To date, the Commission has not conducted a civil enforcement action in the context of a business combination or tender offer involving a foreign private issuer with a small number of U.S. holders that failed to take advantage of or improperly utilized Rule 802 or Tier I or II. However, the Commission's Statement Concerning Financial Penalties suggests that the Commission would impose civil penalties should it detect a foreign private issuer's failure to comply with the Securities Act or the Exchange Act. The Commission's primary considerations are whether the company in question benefited from its wrongful acts and whether a penalty will compensate or harm injured shareholders.[220] Some of the factors that weigh in favor of the assessment of civil penalties are intent to circumvent the law, the difficulty in detecting the offense, which calls for "an especially high level of deterrence," the absence of remedial action, and the lack of cooperation with the Commission.[221] Moreover, the Commission and FSA recently announced terms of an agreement for increased cooperation and collaboration, the objectives of which are "to identify and discuss regulatory issues of common concern, and promote cooperation in the exchange of information in cross-border enforcement matters."[222] The SEC – FSA agreement reflects

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*denied*, 434 U.S. 875 (1977) (finding recklessness sufficient to create 10b-5 liability).

[220] *See Statement Concerning Financial Penalties*, *supra* note 215.

[221] *See id.* Similarly, the Commission's previous guidance on the subject emphasized the importance of self-policing, self-reporting, remediation, and cooperation with the Commission. *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Securities Exchange Act Release No. 44,969, Accounting and Auditing Enforcement, Release No. 14,780 (Oct. 23, 2001), *available at* http://www.sec.gov/litigation/investreport/34-44969.htm (commonly referred to as the "Seaboard Report").

[222] Press Release, SEC 2006-14, *SEC and Japan Financial Services Agency Announce Terms for Increased Cooperation and Collaboration* (Jan. 30, 2006), http://sec.gov/news/press/2006-14.htm. Additionally, the Commission has rapidly expanded its working relationships with non-U.S. securities regulators. As noted by Susan Yashar, Assistant Director, Office of International Affairs, International Enforcement, SEC, the

a global trend of international cooperation in securities law enforcement.[223] Therefore, despite the absence of past SEC action relating to Japanese transactions, the current climate

Commission is party to more than thirty memoranda of understanding with securities regulators around the world, and is a party to the International Organization of Securities Commissions' Multilateral Memorandum of Understanding, which has been entered into by thirty-four nations. Videoconference: Live from the SEC: *A Review of Recent Developments in International Securities Regulation and Enforcement* (American Bar Association, Section of International Law, Oct. 5, 2006).

[223] *See, e.g.*, Press Release, SEC, *Royal Dutch Petroleum Company and the "Shell" Transport and Trading Company, P.L.C. Pay $120 Million to Settle SEC Fraud Case Involving Massive Overstatement of Proved Hydrocarbon Reserves* (Aug. 24, 2004), http://sec.gov/news/press/2004-116.htm. The SEC, the U.K. Financial Services Authority, and the Dutch Autoriteit Financiële Markten jointly pursued the investigation of Shell's overstatement, and the $120 million settlement was made in conjunction with a £17 million settlement with the U.K. Financial Services Authority. *See also* SEC Sues UK Accounting Firm PKF and Former Partner Anthony Mead in Connection with the AremisSoft Corporation Audit, Litigation Release No. 19652 (Apr. 12, 2006), *available at* http://sec.gov/litigation/litreleases/2006/lr19652.htm (accounting fraud action taken against PKF and Anthony Mead, and acknowledging the assistance of the U.K. Financial Services Authority); Press Release, SEC, *SEC Charges TV Azteca And Its Chairman—Ricardo Salinas Pliego—with Fraudulent Scheme to Conceal Salinas' $109 Million Windfall Through Related Party Transactions* (Jan. 4, 2005), http://sec.gov/news/press/2005-1.htm (discussing the cooperation between the Commission and the Comisión Nacional Bancaria y de Valores in Mexico); SEC v. Crescent Fin. Group, Inc., Berkshire Tax Consultants Co., Warfield Capital Mgmt. Co., SpencerFerguson Receivables Corp., Thompson & Whitehurst Acquisition Consultants, and McKenzie Goldstein & Assocs., Litigation Release No. 18967 (November 15, 2004), *available at* http://sec.gov/litigation/litreleases/lr18567.htm (civil complaint and criminal charges brought against boiler room operations directed at non-U.S. victims with the assistance of the U.K. Financial Services Authority); SEC Charges Parmalat with Financial Fraud, Litigation Release No. 18,527, 81 SEC Docket 3143 (Dec. 30, 2003), *available at* http://sec.gov/litigation/litreleases/lr18527.htm (discussing the cooperation between the Commission and the Italian Commissione Nazionale per la Società e la Borsa); Press Release, SEC, *Commission Settles Civil Fraud Action Against Vivendi Universal, S.A., its Former CEO, Jean-Marie Messier, and its Former CFO, Guillaume Hannezo* (Dec. 23, 2003), http://sec.gov/news/press/2003-184.htm (discussing the cooperation between the Commission and the French Autorité des Marches Financiers).

of international regulatory cooperation makes clear that compliance with U.S. securities laws should be a key concern when doing Japanese deals.

## F. Additional Strategic Considerations

In addition to the aforementioned issues that should be taken into account when engaging in Japanese deals, there are a few other practical issues that may be helpful to keep in mind throughout negotiations with a Japanese company. Cultural differences are always a challenge when doing a cross-border deal, but even beyond the ubiquitous differences in negotiation styles and societal norms, there are often certain methods and approaches in which successful Japanese deals are done. In a given transaction, this may include the following factors.

### 1. Practical Difficulties for the Hostile Deal

Although the number of hostile and contested deals in Japan has increased of late, it should be noted that friendly deals are still the norm. The approximate success rate of hostile deals in the United States is 35%, and the success rate in Europe is 50%.[224] In Japan, however, there have been few instances in the past decade where a hostile acquirer has eventually succeeded in obtaining control of a Japanese company.[225] Moreover, as more Japanese companies adopt

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[224] *See* THE CORPORATE VALUE REPORT, *supra* note 24, at 11.

[225] In 1999, Cable & Wireless succeeded in its hostile tender offer for IDC shares despite NTT's friendly tender offer. Prior to the tender offer, Cable & Wireless was a 17.69% shareholder of IDC. In 2000, Boehringer Ingelheim succeeded in its tender offer for SS Pharmaceutical shares, even though SS Pharmaceutical did not expressly approve the tender offer and remained silent on the issue. Boehringer Ingelheim was a 19.6% shareholder of SS Pharmaceutical before launching the tender offer. However, note that in a recent hostile deal involving Origin Toshu Co. Ltd. (the target company), Don Quijote Co., Ltd. (the hostile bidder) decided to sell its shares in the target to Aeon Co., Ltd. (a white knight) even though Don Quijote acquired approximately 47.8% of the target shares through market purchases. *See Don Quijote, Aeon TOB Obo Top Kaidan de Taio Tenkan [Don Quijote accepted Aeon's tender offer; it changed its approach*

rights plans and the rules on permissible defensive measures become clearer, it is likely that the acquirer will at some point need to enter into serious negotiations with the target company. The risks of going "all in" on a tender offer or proxy contest should probably be the gamble of last resort.

There are a number of reasons why this may be the case. For instance, the acquirer will probably not have sufficient information as part of the due diligence process to determine with confidence what its top line should be for a possible acquisition. While Japanese companies provide some information in their filings with Japanese securities regulators, such as summaries of material contracts, the amount of disclosure is not as extensive as would be the case for a company that is subject to Exchange Act reporting requirements.[226] In cases where the hostile deal may involve competition law issues under the Anti-Monopoly Law, it could be difficult to perform a market share analysis without the cooperation of the target company. Finally, the recent investigations into the accounting practices of Livedoor could mean that target companies and their investors will react more defensively to hostile bids than would otherwise be the case in the absence of Livedoor's alleged accounting fraud.[227]

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*after a senior management meeting*], THE YOMIURI SHIMBUN (Japan), Feb. 27, 2006, *available at* http://www.yomiuri.co.jp/atmoney/mnews/20060227 mh06.htm.

[226] For example, it is rare to find an explanation regarding change-of-control provisions in Japanese securities filings. The instructions for securities reports under the Securities and Exchange Law provides:

> [I]f the company has entered into a material business agreement such as a lease or management consignment agreement of all or a material part of its business, an agreement that the company shares all business profits and losses with others, technical support agreements and so on, such agreements must be disclosed in an outline format.

Kigyonaiyoto no Kaiji ni kansuru Naikakufurei [Cabinet Order regarding Disclosure of Business Contents and Others], Financial Ministry Order No. 5 of 1973, form 3 n.12, form 2 n.33.

[227] On January 16, 2006, the Tokyo District Public Prosecutors Office began an investigation into Livedoor's possible violation of the Securities

Therefore, the preferred approach in Japanese deals remains to be friendly first, and then negotiate in earnest on those matters that the acquirer considers its vital business interests. However, this precise balance between proposing a "friendly" and "hostile" deal should be carefully considered by an acquirer in light of the relevant facts in a given transaction.[228]

### 2. Obtaining "Corporate Value" in the Acquisition

The Defensive Measures Guidelines provide that "defensive measures should be adopted, activated and cancelled for purposes to secure and increase corporate value, and in turn work to the shareholders' common benefit."[229] Furthermore, the Corporate Value Report notes that an acquisition proposal that will increase corporate value should not be excluded.[230] The concern over better understanding and assessing "corporate value" is an issue that an acquirer will probably confront in some manner when negotiating a Japanese deal. In this regard, it should

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and Exchange Law in connection with its M&A activities and allegedly fraudulent accounting practices. In the days thereafter, Livedoor's share price took a beating—dropping from a closing price of 696 yen on January 16, 2006 to a closing price of 61 yen on February 13, 2006. On March 13, 2006, the Tokyo Stock Exchange announced Livedoor's delisting. Since the Livedoor – Fuji Television transaction is regarded as a symbol of the hostile deal, with the former Livedoor CEO Takefumi Horie acting as the public face of the hostile acquirer, future acquirers of Japanese companies should carefully consider whether such a climate will be conducive to certain offensive M&A strategies.

[228] Some acquirers may wish to launch a hostile TOB immediately without contacting the target so that the target will have less time to locate a white knight or squire. However, please note that while the minimum TOB period is twenty calendar days under the current TOB rules, the recently proposed TOB rules permit a target to require that the minimum TOB period be no less than thirty business days. *See supra* note 97. In connection with such concerns in a given transaction, for an authoritative analysis and review of negotiation strategies and tactics in cross-border deals, see Koichi Kusano, *Geemu toshite no Kosho* [*Negotiation as a Game*] (Maruzen Library 1994).

[229] *See* THE DEFENSIVE MEASURES GUIDELINES, *supra* note 26, at 3.

[230] *See* THE CORPORATE VALUE REPORT, *supra* note 24, at 83.

be noted that corporate value does not necessarily mean only the temporal interests of the company shareholders, but also the long-term effects that a possible acquisition could have on the company. The Defensive Measures Guidelines define corporate value as "a company's attributes and the degree thereto that contribute to the shareholders' benefit such as the company's assets, profitability, stability, efficiency, growth potential and so forth."[231] Such a principle is not foreign to Delaware takeovers jurisprudence.[232] Accordingly, the acquirer would serve itself well by appreciating the importance of obtaining corporate value in order to achieve a successful Japanese deal.

### 3. Defining the Acquisition Proposal

As mentioned in the discussion of the Yumeshin – JEC deal, a Japanese target company will probably require that an acquirer provide sufficient information on its proposed acquisition.[233] From the perspective of the target, such

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[231] *See* THE DEFENSIVE MEASURES GUIDELINES, *supra* note 26, at 2.

[232] "[T]he directors of a Delaware corporation have the prerogative to determine that the market undervalues its stock and to protect its stockholders from offers that do not reflect the long term value of the corporation under its present management plan." Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1376 (Del. 1995) (citing Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1990)).

[233] Although the court in *Yumeshin* ruled that, as a general matter, the board of directors of a target company may request additional information from a tender offeror and provide for a discussion period in furtherance of the proper judgment of target company shareholders, *see supra* note 52, the court also noted that such board's authority must be reexamined after the amendments to the TOB rules that were under discussion became law. *See* Yumeshin v. JEC, 1739 SHOJI HOMU 100, 107-08 (Tokyo Dist. Ct., July 29, 2005). Part of the June 2006 amendments to the Securities and Exchange Law that are expected to take effect in late 2006 provide that a tender offeror must (i) respond to the questions raised by the target company and (ii) extend the tender offer period, if requested by the target company, to the extent permitted by government ordinances that are expected in late 2006. *See* Shoken-torihiki-ho [Securities and Exchange Law], Law No. 25 of 1948, art. 27-10, para. 2, 3, 11. Given these amendments to the TOB rules and the forthcoming regulations, therefore,

information is necessary in order to evaluate the potential impact of the proposed acquisition on corporate value. Thus, an acquirer should anticipate that the process of completing such procedures may take more time than it is accustomed to in comparable transactions in the United States. Furthermore, there is the likelihood that the target company will respond to an unsolicited acquirer by noting that any information provided by such acquirer is insufficient. In the Yumeshin – JEC deal, JEC insisted that Yumeshin announced its tender offer without providing JEC with sufficient information.[234] As previously discussed, however, the Tokyo District Court suggested that JEC could have obtained the necessary information by responding to Yumeshin's proposal of a business alliance.[235] The acquirer, therefore, should use its best efforts to provide as much information as possible in such situations, and be open to negotiations with the target company.

## V. CONCLUSION

The current Japanese M&A market presents opportunities for U.S. companies and their advisors that are arguably the most promising in recent history. Perhaps an important observation to keep in mind, however, is that Japanese M&A is experiencing historic changes, the full effects of which will probably be completely appreciated only in hindsight. While one can note the changes on a play-by-play basis, the ultimate outcomes of various transactions, tender offers, and proxy contests can only be known with certainty after their completion. To draw a parallel to the U.S. experience with takeovers, Japan in 2006 may well be comparable to Delaware in 1985, shortly before the Delaware Supreme Court issued its historic rulings in *Unocal* and

it is not completely clear what the extent of the target board's authority is in making requests concerning an acquisition proposal.

[234] *See* Press Release, JEC, *Tosha Kabushiki ni Taisuru Kokaikaitsuke Ketsugi he no Taio ni tsuite* [*Re: Reaction to Resolution of Tender Offer for Shares of the Company*] (July 11, 2005), http://www.jecc.co.jp/topics/kaituke_3.pdf.

[235] *See supra* note 52.

*Revlon*. Thus, in Japan much has happened, but more is likely coming. With this in mind, given the challenges posed by the opportunities in the Japanese M&A market, the importance of well-informed and considered decision-making will be essential to ensure that U.S. companies compete and succeed in doing Japanese deals.