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Enhancement of corporate values and shareholders' interests in Japanese M&A

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On 31 August 2023, the Ministry of Economy, Trade and Industry of Japan issued the “Guidelines for Corporate Takeovers - Enhancing Corporate Value and Securing Shareholders’ Interests” (the “Guidelines”), with the objective of creating certainty and fair rules for M&A in Japan in respect of listed Japanese companies. The Guidelines contain recommendations for best practices by aspiring acquirers (both domestic and foreign), the boards and directors of target companies, and other stakeholders. These recommendations are intended to lead to desirable acquisitions, so as to facilitate the corporate growth of Japan, thereby benefitting the Japanese economy and society as a whole. This article provides a brief outline of the key points expounded by the Guidelines.

Scope of Guidelines

While the Guidelines primarily contemplate cases in which acquirers obtain control of a listed company by way of share acquisition, they also address cases of unilateral acquisition proposals (i.e., unsolicited acquisition proposals or bids).

Acquisitions without the consent of the target’s management had been commonly referred to as ‘hostile takeovers’ in the Japanese M&A

market. Hostile takeovers were generally avoided in Japan because of the negative connotations associated with them. As a result, some acquisitions that would have contributed to the corporate values of targets and/or the interests of their shareholders have been deterred for the sake of protecting the interests of the targets’ management teams. To address undesirable outcomes of this kind, and to promote and encourage desirable acquisitions, the Guidelines set forth three general principles that stakeholders should follow:

- (i) The desirability of an acquisition should be determined on the basis of whether it will secure or enhance corporate value and the shareholders’ common interests.
- (ii) The rational intent of shareholders should be relied upon in matters involving the corporate control of the company.
- (iii) Information useful for shareholders’ decision-making should be provided appropriately and proactively by the acquiring party and the target company. To this end, the acquiring party and the target company should ensure transparency regarding the acquisition through compliance of acquisition-related laws and regulations.



Principles 1 and 2 were mentioned in M&A-related guidelines issued in the past. Principle 3, however, is a newly introduced concept. The principles above can be considered groundbreaking because they require both aspiring acquirers and target companies to provide each other with sufficient information to enable the shareholders of a target to make rational decisions in the case of takeover bids, by the placing an onus on a target's board, when rejecting a takeover bid, to provide a rational explanation for such rejection to the target's shareholders, including institutional investors.

The relationship between the three principles can be summarised thus: Principle 1 provides the abstract criterion that desirable acquisitions should be those decided upon by shareholders of a target, and such decisions should be based on Principles 2 and 3, to ensure due process.

Code of conduct for boards and directors

There have been some cases in the Japanese M&A market where takeover bids were received but not reported to the boards of targets in a timely manner, or where boards have failed to give adequate consideration to takeover bids.



With such situations in mind, the Guidelines aim, on the basis of Principles 2 and 3 above, to ensure that takeover proposals rejected by a target's board are nevertheless appropriately considered by the target's shareholders if the takeover is expected to enhance corporate value and safeguard the interests of shareholders. More specifically, directors who receive a takeover proposal are required to carefully consider the specificity, purpose and legitimacy of the proposal and promptly report the same to the board, whereupon the target is required to seriously consider 'sincere' takeover proposals that are concrete, justifiable in purpose, and feasible.

Increased transparency of acquisitions

To facilitate adherence to Principles 2 and 3 above, the Guidelines also explains the manner in which transparency may be improved in respect of proposed acquisitions.

(i) Disclosure by the acquirer

Under the Guidelines, when an acquirer proceeds with the acquisition of a target's shares, the acquirer should ensure compliance with the applicable large shareholding and tender offer reporting requirements, as well as provide full disclosure of the purpose of acquisition.

The Guidelines further require acquirers that purchase shares in a proposed target within a short time period through an in-market purchases that are not subject to the disclosure under the Financial Instruments and Exchange Act, to fully disclose the purpose of the share purchase, the number of shares already purchased and to be further purchased,

information on the acquirer, and the acquirer's post-acquisition management plans for the target, so as to enable the target's shareholders to understand the impact of the acquisition on the target's corporate value and to decide whether to accept the acquisition.

(ii) Disclosure by the targets

The Guidelines also emphasise the desirability for a target company, where it accepts a takeover bid, to provide adequate disclosure of the process by which its board considered, and the reasons for the board's acceptance of, the proposed bid, including the terms and conditions negotiated with the acquirer.

(iii) Prevention of acts that distort shareholder decision-making

In line with Principle 2, the Guidelines state that it is undesirable for an acquirer or target to engage in any conduct that could distort the decision-making process of the target's shareholders. More specifically, the Guidelines discourages:

- (a) Aggressive or coercive acquisition techniques, such as coercive two-step acquisitions (i.e., where the first-step purchase terms are set favourably but the second-step purchase terms are unfavourable or unclear).
- (b) Disclosure or provision of inaccurate information or misleading information to the target's shareholders.
- (c) Provision of funds or property when exercising voting rights or soliciting proxies, and the like.



Takeover response policies and countermeasures

The takeover policies and countermeasures of some companies may be arbitrary and may prevent a desirable takeover.

In light of Principle 2, the Guidelines provide that takeover countermeasures must be necessary, reasonable, based on the rational will of shareholders, and lead to the enhancement of corporate value. The Guidelines also express the desirability of designing and triggering countermeasures in consultation with shareholders. More specifically, countermeasures should be subject to time limitations, have limited triggering requirements, and be exercisable only in exceptional circumstances.

The Guidelines also elaborate on appropriate countermeasures, as well as ways to deter arbitrary implementation of countermeasures to enable targets to properly consider beneficial takeover bids.

Conclusion

Although the Guidelines are not legally binding, the principles therein are generally expected to be observed. Accordingly, the



Guidelines are expected, going forward, to have a significant impact on the Japanese M&A market and the way Japanese courts adjudicate on M&A-related disputes.

The Guidelines are intended to align the interests of institutional investors with those of target companies. Moreover, the Guidelines apply equally to acquisitions of Japanese companies by foreign investors or Japanese

companies. Importantly, the Guidelines have served to create a proper basis for aspiring acquirers to make unsolicited takeover bids without fear of unjustified opposition by the boards of target companies or the triggering of unreasonable or arbitrary countermeasures. As a result, the Japanese M&A market can be expected to become ever more open, reasonable and attractive for foreign investors.



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