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Japan: Trends & Developments

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Trends and Developments

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New Guidelines for Corporate Takeovers

On 31 August 2023 the Ministry of Economy, Trade and Industry published Guidelines for Corporate Takeovers (the "Guidelines"), after discussions in its working group, which includes scholars and practitioners, including representatives of investors and listed companies. The Guidelines articulate rules and best practices for target companies and acquirers to achieve desirable acquisitions. Although the Guidelines are not legally binding, historically, courts have taken account of similar guidelines in their rulings. Accordingly, in practice, both target companies and acquirers would be required to comply with the Guidelines when engaging in transactions or making transaction proposals that involve takeovers of corporate control of Japanese listed companies.

The Guidelines state that development of a fair M&A market will ensure that the market functions more soundly and that desirable acquisitions are conducted. The Guidelines define "desirable acquisitions" as acquisitions that both increase corporate value and procure the common interests of shareholders. It is believed that active engagement in desirable acquisitions may not only provide target companies with good opportunities to embrace superior management strategies, but also offer opportunities for corporate growth. The Guidelines primarily address transactions involving takeovers of corporate control of listed companies, including both situations in which acquirers make acquisition proposals based on requests or approaches from the target company management and those in which acquirers' proposals are made in the absence of such requests (ie, "unsolicited offers," "unsolicited bids," or "unsolicited takeovers"), with the objective of accelerating the active implementation of desirable acquisitions.

The Guidelines contain three principles that target companies and acquirers should follow when engaging in transactions involving takeovers of corporate control of listed companies:

- Principle 1: Principle of Corporate Value and Shareholders' Common Interests;
- Principle 2: Principle of Shareholders' Intent; and
- Principle 3: Principle of Transparency.

Principle 2 and Principle 3 are seen as essential requirements for achieving Principle 1. Each of these Principles is addressed in several chapters of the Guidelines, which illustrate the rules and best practices for transactions or transaction proposals involving the acquisition of corporate control of listed companies, with a focus on how listed companies and acquirers should behave.

One core concept behind the Guidelines is that matters relating to corporate control should rely on the rational intentions of shareholders (Section 2.2, Chapter 2). The Guidelines also state that sufficient information should be provided to shareholders, to allow them to make appropriate decisions on whether to agree to acquisition proposals (including transaction terms). In general, there is information asymmetry between the management of target companies and acquirers and the shareholders of target companies; thus, it is vital to ensure that shareholders obtain sufficient information to ensure their informed judgment. One notable point in the Guidelines is the requirement that both companies listed in Japan and acquiring investors (whether or not listed, and whether Japanese entities or non-Japanese entities) appropriately and proactively disclose appropriate information to shareholders to facilitate decision-making, ensuring acquisition transparency (Sections 4.1 and 4.2, Chapter 4).

Current Situation Concerning Hostile or Unsolicited Takeovers

In recent years, due to relatively favourable market and financial conditions in Japan, a large number of mid- and small-cap listed companies have been subject to hostile or unsolicited takeover actions. In some instances, certain groups of investors, acting in the aggregate, acquire significant portions (for example, more than 20%) of the shares of target companies through market sweeps to obtain corporate control (mainly through submitting shareholder proposals, either at ordinary general shareholders' meetings or at extraordinary general shareholders' meetings, to change all or a majority of the board members).

This trend raises two significant issues, discussed below, which could detract from the fairness and transparency of the market and impede desirable acquisitions. To resolve these issues and ensure transparency in takeover transactions, on 15 May 2024, the National Diet enacted an amendment to the Financial Instruments and Financial Exchange Act (FIEA) that partially modified the mandatory tender offer rule and large shareholding report rule (the revised FIEA is referred to hereafter as the "Amended FIEA"). Although the enforcement date of the Amended FIEA has not yet been decided, it will occur within two years from the date the Amended FIEA was announced. The content of the Amended FIEA is based primarily on a report published by the Working Group on Tender Offer Rules and Large Shareholding Reporting Rules of the Financial Systems Council on 25 December 2023 (the "Working Group Report").

First Issue – Requiring Mandatory Tender Offers for Acquisitions of Substantial Stakes Through Market Trading

In Japan, the primary purpose of the mandatory tender offer rule is to provide shareholders with sufficient information and fair opportunities to sell their shares of target companies when an acquirer seeks to purchase shares from many, unspecified shareholders of a target company, or when a transaction may cause a change of control of the target company. Under the current version of the FIEA, the mandatory tender offer rule typically is triggered in the following situations:

- an acquirer purchases shares of a target listed company outside the market, from more than ten shareholders, during a 60-day period, as a result of which, the acquirer's shareholding percentage in the target company exceeds 5%; or
- an acquirer purchases shares of a target listed company outside the market, and as a result, the acquirer's shareholding ratio in the target company exceeds one-third, regardless of the number of selling shareholders.

In other words, mandatory tender offer regulations are triggered only when an acquirer acquires shares other than via a stock exchange; as long as certain groups of investors acquire shares of target companies via market transactions, they need not comply with the mandatory tender offer procedures set forth in detail in the FIEA.

As a result, when acquirers attempt to take over corporate control in a short period through purchases of shares through market trading, both the board of directors of target companies and the shareholders of those companies may not have sufficient time and information to ascertain whether the investors' investment and management strategies are well-crafted for the purposes of increasing corporate value and promoting shareholders' common interests. In particular, in these situations, shareholders of target companies cannot make appropriate decisions on whether to proceed with the acquirers' proposals, due to a lack of time and information. In reality, some investors do not make adequate and timely disclosures of sufficient information, such as investment objectives and management strategies, to shareholders of target companies. For instance, in 2022, Yamauchi No.10 Family Office and its affiliated investment vehicles (hereafter, collectively, YFO) rapidly acquired an aggregate stake in TOYO CONSTRUCTION CO., LTD. (the "Toyo Construction"), a major marine contracting business, in excess of 20%, through a market sweep. After the acquisitions, YFO made a public proposal opposing the majority of Toyo Construction's proposed directors and appointing new board members by submitting a shareholder proposal at the general shareholders' meeting of Toyo Construction at its ordinary general shareholders' meeting held in 2023.

To enable shareholders to make rational decisions in these situations, the Guidelines expressly state that acquirers who acquire significant amounts of shares in a market sweep should provide at least the same level of appropriate information to the capital market and target companies as would be required in tender offer procedures, in a timely manner (Section 4.1, Chapter 4). Thus, if an acquirer intends to propose a takeover of a listed company by acquiring shares of the target company in the market that do not meet the mandatory tender offer thresholds, such acquirer still needs to disclose sufficient information in an adequate, timely manner.

In addition, the Amended FIEA partly modifies the mandatory tender offer rules to address this issue; mandatory tender offer procedures will apply when an acquirer acquires shares through market trading. It should also be noted that the one-third threshold will be reduced to 30%.

Therefore, after the Amended FIEA comes into effect, an acquirer that intends to acquire a more than a 30% stake in a listed target company through market trading must comply with the mandatory tender offer procedures.

Second Issue – Disclosure of Shareholders Acting in Concert

Under the FIEA, if a shareholder possesses more than 5% of the shares of a listed company, the shareholder must file a large shareholding report within five business days after the shareholder's shareholding percentage reaches 5%. In the large shareholder report, the shareholder must disclose the purpose of the investment. In addition, the shareholder also must disclose any intent to make certain management proposals and shareholder proposals. Where multiple investors acquire shares of the same company in concert, or agree on the exercise of voting rights, the 5% threshold is measured based on the aggregate number of shares held by all of those investors. A violation of the reporting obligation may result in an assessment of a monetary administrative penalty.

However, certain groups of investors sometimes do not disclose the required information, such as their relationships and investment purposes, properly in mandatory large shareholding reports. Due to a lack of beneficial information, shareholders and target companies may have difficulty understanding that those investors are "acting in concert".

It is widely accepted that the Japanese authority (the Securities and Exchanges Surveillance Commission, hereinafter SESC) rarely enforces sanctions on violations of the large shareholding reporting rule. This might have been one of reasons why some investors did not submit, or made false statements in, large shareholding reports. The Working Group Report acknowledged these situations. In order to address situations in which investor groups fail to comply with large shareholding reporting rules, the Working Group Report proposes strengthening enforcement measures against non-compliance with the large shareholding report rule. In particular, the Working Group Report strongly suggests that aggressive measures should be taken in cases that may have a detrimental impact on market fairness, for example, intentional failures to submit and significant submission delays.

Following the publication of the Working Group Report, there was one remarkable case in which, on 28 June 2024, the SESC made a recommendation to impose administrative monetary sanctions on certain groups of investors who breached the large shareholding report rule. This appears to have been the first such case in decades; the only existing precedent is from 2002. Consequently, on 27 August 2024, the Financial Services Agency issued orders to impose administrative monetary sanctions on certain investors violating the large shareholding reporting rule in response to the recommendation.

In the recent case, certain investors acquired more than a 5% stake in MITSUBOSHI CO. LTD, an established Japanese electronic wire manufacturer; the SESC pointed out that the investors (which included SINCERE Corporation and Kabushiki Kaisha Waen Shoji) failed to disclose large shareholding reports in a timely manner and made false statements in their large shareholding reports. This case is notable not only for being the first such case in decades, but also for the SESC's determination that the breaching shareholders were acting in concert. Considering that the SESC's recommendation was made after the Working Group Report was published, it is expected that enforcement of the large shareholding reporting rule will be strengthened in the Japanese market.

At the same time, the Working Group Report has also met with certain push-back from investors, resulting in a partial modification of the large shareholding report rule in the Amended FIEA. Essentially, agreements between institutional investors, whose aim is not to engage in the act of joint material proposals and who are not in agreement regarding the exercise of voting rights on an ongoing basis, will be excluded from the scope of "acting in concert". Therefore, those investors will not need to aggregate other investors' shares when calculating whether their interests reach the 5% threshold.

Guidelines for Unsolicited Offers and Recent Notable Cases Since Publication of the Guidelines

As mentioned above, the Guidelines also cover unsolicited takeovers, when those takeovers are used to obtain corporate control over listed target companies. Before the publication of the Guidelines, there was no precise statement of the rules that the boards of directors of target companies should follow upon receipt of a bona fide acquisition offer from an acquirer, even though the Japanese Companies Act did, and still does, establish the fiduciary duties of directors (board members) that led to the principles for handling unsolicited offers. Because the Guidelines refer to how listed companies and acquirers should behave in the context of unsolicited offers, it is expected that practical rules and best practices for handling unsolicited takeover attempts will be clarified and developed.

The Guidelines provide that upon receipt of a proposal to acquire corporate control that has a certain degree of credibility, and the specifics thereof, management or directors should promptly submit or report the matter to the board of directors (Section 3.1.1, Chapter 3). To determine whether a proposal is specific, target companies may review several factors, such as the disclosed identity of the acquirer (rather than anonymity) and the inclusion of the purchase price and timing of the acquisition. When evaluating the credibility of a proposal, target companies may consider the acquirer's track record and financial strength. Thereafter, the board of directors, to which the proposal is submitted, must engage in sincere consideration of a bona fide offer.

The Guidelines define a "bona fide offer" as an acquisition proposal that is specific, rational in purpose and feasible. In addition, the Guidelines include several factors a board of directors should use to ascertain whether a proposal should be seen as a bona fide offer (Section 3.1.2, Chapter 3).

In evaluating bona fide offers, the boards of directors of target companies should make reasonable efforts to ensure that the acquisition will be based on terms that will secure the corporate value of the target company and the interests of the shareholders (Section 2.2.2, Chapter 2).

After the Guidelines were made public, there were noteworthy cases involving unsolicited takeover bids or competing takeover bids for Japanese listed companies. Brief summaries of these notable cases are set out below.

- After M3, Inc. (M3) launched a solicited tender offer bid, and during the tender offer period, on 7 December 2023, Dai-ichi Life Holdings, Inc. ("DLHD") announced a plan to launch a competing non-solicited tender offer bid to acquire all of the shares of Benefit One Inc. ("Benefit One"). Due to DLHD's tender offer price competitiveness, which meant more favourable terms for shareholders of Benefit One, the board of Benefit One ultimately decided, on 8 February 2024, to accept DLHD's competing non-solicited tender offer. As a result, the tender offer launched by M3 failed on 29 February 2024 and DLHD's competing non-solicited tender offer was successfully completed on 11 March 2024.
- On 13 February 2024, the acquisition vehicle incorporated by Taiyo XYZ Group, L.P. ("Taiyo"), launched a solicited tender offer bid to acquire all of the shares of Roland DG Corporation ("Roland DG") and implement a management buyout. On 13 March 2024, BROTHER INDUSTRIES, LTD. ("Brother Industries") announced a plan to launch a competing non-solicited tender offer bid to acquire all of the shares of the Roland DG, at a higher purchase price than that in the preceding tender offer bid. To overcome subordination of the purchase price, Taiyo raised its purchase price above Brother Industries' announced price. Because Brother Industries did not raise its purchase price, the preceding solicited tender offer launched by Taiyo was successfully completed on 15 May 2024.
- On 21 March 2024, AZ-COM MARUWA Holdings Inc. ("AZ-Com Maruwa") disclosed a plan to launch an unsolicited tender offer bid to acquire all of the shares of Chilled & Frozen Logistics Holdings Co., Ltd. ("C&F Holdings"); the unsolicited tender offer bid was launched on 1 May 2024. In response to the first public announcement, C&F Holdings invited other potential buyers to submit acquisition proposals in a closed auction process, as part of a market check. Consequently, C&F Holdings selected SG Holdings Co., Ltd. ("SG Holdings"), as the solicited acquirer (or "white knight"), and SG Holdings launched a solicited competing tender offer (on 31 May 2024)

to acquire all of the shares of C&F Holdings at a price more favourable than AZ-Com Maruwa's purchase price. AZ-Com Maruwa did not raise its purchase price. Ultimately, due to price competitiveness, the solicited tender offer by SG Holdings was successfully completed on 12 July 2024, while the preceding unsolicited tender offer bid by AZ-Com Maruwa failed on 19 June 2024.

These cases are notable because they involve reputable Japanese listed companies launching, or announcing the launch of, unsolicited offers to acquire other Japanese listed companies. Cases similar to these were rare before publication of the Guidelines. Based on the fact that these cases occurred within a year after publication of the Guidelines, competing takeover bids and unsolicited takeover bids may be becoming more common in the Japanese market. Even though there are no court precedents in which the Guidelines are at issue, all of the parties in these cases referenced the Guidelines. Both the boards of directors of target companies and acquirers are encouraged to abide by the rules and best practices articulated in the Guidelines.

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