August 1, 2023
Institutional Investors Collective Engagement Forum

Opinions in Response to the Invitation for Public Comments on the "Guidelines for Corporate Takeovers (Draft)" by the Ministry of Economy, Trade and Industry

We, Institutional Investors Collective Engagement Forum (IICEF) have submitted the following opinions in response to the "Invitation for Public Comments on the Draft of the Guidelines for Corporate Takeovers" by the Corporate System Division, Economic and Industrial Policy Bureau of the Ministry of Economy, Trade and Industry (hereinafter referred to as "METI").

1. General Comments

[Opinion]

We welcome the publication of the Draft of the Guidelines for Corporate Takeovers (hereinafter referred to as the "Draft") expecting that it will bring correct disciplines on the actions of both companies and investors and thereby promote fair M&A transactions.

[Reason]

Institutional investors are concerned that there may be a misconception among the management of listed companies that takeover defense measures introduced in a normal phase can prevent takeover bids that do not meet the management's intentions. Such a misconception could lead to insufficient management discipline and rigid management that excludes objections by outsiders. If the continuation of takeover defense measures introduced in a normal phase is permitted too much on the grounds of inadequacies in the legal systems, it could impede the promotion of fair M&A transactions and weaken the management's self-discipline. We believe that the Guidelines provide us with important perspectives in coping with this problem and working to increase fairness in M&A practices in Japan.

2. Individual Opinions

(1) Concept of corporate value

[Opinion]

We support the Draft in that it indicates "corporate value" as a quantitative concept on page 9. This statement is appropriate and should be left as is.

[Reason]

In the past, there have been many cases in which listed companies have interpreted the term "corporate value" freely as a concept to justify their own positions. Such cases have often caused conflicts in dialogue between companies and investors due to a discrepancy between the way investors perceive "corporate value" as a quantitative and measurable concept and the way companies perceive its value. As the Draft has adopted a view that corporate value is a quantitative concept and is expressed as the sum of shareholder value and debt value, we expect that barren exchanges over the basic concept in corporate acquisitions will be eliminated to a considerable extent.

It is also important to note that the Draft on page 9 states that "The target company management should not make the concept of corporate value unclear by emphasizing qualitative value, which is difficult to measure, nor should the "corporate value" concept be used as a tool for management to defend themselves (including management referring to retention

of employees as an excuse to defend themselves).” The part on pages 30 to 31 “the takeover response policies should not be intended to protect or entrench the incumbent management from ‘parties who are undesirable to the incumbent management.’” is equally important.
It is believed that some companies continue to use takeover defense measures introduced in a normal phase on the ground that they need to secure time and information due to inadequacies in the legal systems, while concealing their true motive to prevent acquisition proposals that do not meet the management’s intention and exclude objections by outsiders.

(2) Relationship between Principle 1 and Principles 2 and 3 of the Draft

[Opinion]

On page 11 of the Draft, Section 2.2.3 states that “Principles 2 and 3 are required as a prerequisite for materializing Principle1.” We interpret this statement to mean that it is necessary to satisfy Principles 2 and 3 in order to satisfy Principle 1. If so, unless Principles 2 and 3 are satisfied, Principle 1 would not be satisfied, and it would be concluded that the proposed acquisition is not a desirable one. In other words, we interpret that it is not permissible to assert that the acquisition, which was executed without confirmation of the intention of shareholders and without transparency, was desirable because both corporate value and shareholder value have increased after the acquisition. We would like METI to clarify whether this understanding is correct.

[Reason]

As we are concerned with the possibility that the management will arbitrarily assert that Principle 1 (Principle of Corporate Value and Shareholders’ Common Interests) is materialized, and it is necessary to eliminate any room for arbitrary interpretation just in case.

(3) Environment that enables shareholders to make informed judgments

[Opinion]

On the statement in Section 2.2.3 on page 11 of the Draft, “Basically, the expectation is that … with the sufficient information and time, appropriate decision (informed judgment) shall be made by the shareholders,” we propose to delete the word “basically” and change the last part to “it is required to secure an environment that enables shareholders to make informed judgments.” If METI intends to leave this sentence as is, we would like the Ministry to clarify conceivable specific circumstances in which it is acceptable for them not to provide sufficient information and time and not to secure an environment that enables shareholders to make informed judgments.

[Reason]

We interpret that the Draft is based on the assumption that there are circumstances in which it is acceptable not to provide sufficient information and time and not to enable shareholders to make informed judgments. However, we cannot think of any such circumstances and believe it is mandatory to provide shareholders with sufficient information and time. For this reason, we propose the abovementioned revision.

(4) Independence and objectivity of special committee

[Opinion]

We propose to add the following note to the Draft on a special committee consisting of outside directors (page 22): “Despite the high degree of their independence, outside directors have already been involved in decision making at board meetings held after the assumption of office and therefore they are in a position to promote the current management policy of the company. As such, they should recognize that they could be psychologically prone to bias against acquisition proposals submitted from external parties and should strive to deal with any

acquisition proposals with especially strong neutrality and objectivity."
We also propose to revise the fourth line from the bottom of page 22 of the Draft "to retain advisors to seek for professional advice." to "to appoint their own advisors who are independent from the current management to seek for professional advice."

[Reason]
Judgment of a special committee consisting of outside directors, who represent the interest of shareholders and all other stakeholders, is extremely important. We propose the revision mentioned above as we would like outside directors, who are highly independent from the current management, to be aware that even higher degree of neutrality and objectivity is required of them.

(5) Timeliness of the provision of information
[Opinion]
Section 4.1.1.1 on page 23 of the Draft states that "it is advisable for the acquirer to provide at least the same level of appropriate information to the capital markets and the target company as in the tender offer registration statement in an appropriate form, such as the purpose of the purchase, the number of shares to be purchased, summary of the acquiring party, and the basic management strategy after the acquisition." We would like METI to consider revising it to "it is required… at an appropriate timing and in an appropriate form" to clarify that the timing of information disclosure is also important.

[Reason]
We agree with the intent of this section. However, in the Tokyo Kikai Seisakusho case, for example, when a statement of large-volume holdings was submitted for the first time, 26.5% of shares had already been acquired. In cases like this, for those shareholders who sold shares before such disclosure, information disclosure was insufficient even if sufficient disclosure was made after that. As information provided by the acquirer is important for minority shareholders to make investment decisions, the acquirer is required to provide information in a voluntary form "in a timely manner." Therefore, it is important to clearly state that the timing of information disclosure is also important.

(6) Approach to the target company's business partners who are also its shareholders
[Opinion]
We propose to insert "including shareholders who hold shares of the target company in the form of cross-shareholdings; approach includes both explicit and implicit approach" as a note to "Leveraging the acquiring party's dominant position, such as to approach the acquiring party's business partners who are also shareholders of the target company" on page 29 of the Draft.

[Reason]
Business partners include shareholders who hold shares in the form of so-called cross-shareholdings. We propose the addition of the note indicated above because it is necessary, for the avoidance of any doubt, to clarify that any implicit approach to these business partners who are also the target company's shareholders is also prohibited.

(7) Neutrality of takeover response policies
[Opinion]
The Draft on page 31 states that "there is an inherent risk … that it may be designed and operated in a manner preventing an acquisition to materialize" and "it may not function as a neutral procedural rule for the parties concerned, so efforts should be made to dispel such concerns." The same statements should be maintained in the final version of the Guidelines as

they aptly express investors' concerns.

[Reason]

Institutional investors are concerned that some companies are continuing their takeover defense measures on the ground that they need to secure time and information while hiding their true motive to prevent acquisition proposals that are against the intention of the management and preclude different opinions of external parties. In order to clarify the existence of such concerns, these statements should be maintained in the final version of the Guidelines.

(8) Detailed dialogue and information disclosure

[Opinion]

The Draft on page 34 states that "Since the necessity of a response policy and the particulars of required features may differ depending on the size and situation of each company, a constructive dialogue between the target company and institutional investors from the perspective of improving corporate value over the medium to long-term is advisable. If the target company believes that the adoption of a response policy is necessary as part of its management strategies, it should communicate and disclose information in detail regarding its reasons for adoption of such a response policy, ensure fairness by enhancing the independence of the composition of its board of directors (for example, by increasing the ratio of outside directors to majority), and respect to the maximum extent possible the judgment of the special committee consisting mainly of outside directors." We believe this part is appropriate and should be left as is.

[Reason]

Institutional investors are concerned with possible misunderstanding among the management that they can preclude any unwanted acquisition proposals, even if it is a strategic acquisition with legitimate purposes, by introducing takeover defense measures during a normal phase, which may cause them to be oblivious to their fiduciary duty to shareholders and to engage in lax management. Introducing takeover defense measures during a normal phase may cause institutional investors to be distrustful of the management because institutional investors tend to think that these measures are meant to protect the management's own position, to prioritize their internal interest and not to listen to different opinions of external parties, which may lead to rigid management. For these reasons, institutional investors may evaluate such a company at a discount from a governance viewpoint. We support the statement quoted above as it is particularly important for the management to engage in careful dialogue and provide detailed information disclosure in order to dispel any concerns, distrust, and poor governance evaluation by institutional investors.

(9) The need to avoid arbitrary operation

[Opinion]

The Draft on the bottom line of page 44 states that "it is advisable for the target company to take measures to avoid arbitrary operation of their response policy." We would like METI to consider replacing the word "advisable" in this statement with "required" or other equivalent expressions.

[Reason]

We propose the revision mentioned above because we believe that taking "measures to avoid arbitrary operation" with regard to the introduction of a takeover response policy is part of natural duties of the board of directors.

(10) The statement to the effect that arbitrary operation should not be permitted

[Opinion]

The Draft on page 48 states that “designing or operating a response policy that allows a target company to endlessly request information from the acquiring party on the grounds of securing time, information, and negotiation opportunities, or arbitrarily prolong the period for consideration of acquisition offers unnecessarily, should not be permitted.” We believe this part is appropriate and should be left as is.

[Reason]

We believe that some companies are continuing their takeover defense measures introduced during a normal phase on the ground that they need to secure time and information while hiding their true motive to prevent acquisition proposals that are against the intention of the management and preclude different opinions of external parties. We propose to maintain the statement quoted above in order to explicitly prohibit the measures that could be taken by the management of such companies.

(11) Scope of circumstances in which the majority of minority resolution is permitted

[Opinion]

The Draft on page 45 states that “Therefore, it must be noted that the invocation of countermeasures based on a resolution of a shareholders’ meeting when certain shareholders’ voting rights have been excluded as above must not be abused, and that such invocation may be permitted only in very exceptional and limited cases, taking into consideration the special circumstances of the case with respect to the mode of acquisition among other factors (such as coercion arising from the acquisition method, legality, time margin for confirmation of shareholders’ intentions) .76” This means that the so-called majority of minority resolution is permissible “only in very exceptional and limited cases.” We believe this is appropriate and should be maintained as is.

[Reason]

Given the composition of shareholders in the current Japanese capital market, we believe that, in many cases, so-called stable shareholders who are supportive of the current management account for a sizable portion of minority shareholders other than those who are supportive of the acquirer. In this situation, if the so-called majority of minority resolution is widely permitted, the current management would be in an excessively advantageous position, and discipline on management through acquisition opportunities would not function sufficiently. For this reason, we propose to maintain the statement quoted above.

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