PAUL
HASTINGS

Stay Current

June 2022

Follow **@Paul_Hastings**

Poison Pill without Shareholders' Blessing: can it withstand the courts' review?

-Japanese courts strike down a poison pill devised and implemented by the board of directors alone

By Toshiyuki Arai

Background

In many jurisdictions, poison pills are devised and implemented by the board of directors without shareholders being involved. Since the 2007 Supreme Court case[1] (*in re Bulldog Sauce*) in Japan, however, courts have largely relied on the voice of shareholders in reviewing the legality of pills. This raises several issues: how realistic it is to rely on shareholders' resolution as a matter of corporate governance, and whether it is practically appropriate to seek shareholders' approval when in-market purchases can be achieved in Japan in a short period of time in large quantities. We discussed a similar issue involving shareholders' confirmatory meeting of a pill without the participation of the acquirer in our recent client alert (*in re Tokyo Kikai Seisakusho*[2]), and the current case[3] (*in re Japan Asia Group*) highlights similar but different legal issues. In this case, the courts consistently outlawed the pill by citing the lack of shareholders' involvement.

Facts

1. Initially, the incumbent management of the company (the "Target") had a plan to achieve an MBO with an investment fund (the "Fund") supporting them. On November 5, 2020, the Fund rolled out a tender offer for the price of 600 yen per share with the minimum purchase of 66.67% with a plan to squeeze out the rest of the shareholders thereafter.

2. In the meantime, another acquirer (the "Acquirer") had purchased the Target's shares up to 20.24% in the market. On January 14, 2021, it announced a competing tender offer and proposed offering 840 yen per share with no minimum purchase requirement.

3. On January 26, the Fund increased the offer price to 1200 yen to counter the Acquirer's announcement.

4. Then on February 4, the Acquirer commenced a tender offer at 1210 yen per share with a plan to squeeze out the shareholders if 40% has been purchased.

5. The Fund's tender offer ended with 37.45%, well below the minimum requirement and the Fund terminated the offer on February 10.

6. While the Acquirer's tender offer was ongoing, on March 1, the Target announced a special dividend of 300 yen per share subject to April shareholders' approval. The Acquirer took back the tender offer by responding to the special dividend.
7. On March 9, the Target decided to introduce certain takeover defense measures (the "Measures") through its board of directors' resolutions. By this date, the Acquirer had purchased 22.53% in the market, above the threshold set forth by the Measures of 20.50%.
8. On March 17, the Acquirer announced to commence a second tender offer at 910 yen (i.e., 1210 yen less 300 yen of special dividend). No minimum or maximum requirement was attached and there was a plan to squeeze out remaining shareholders.
9. On March 22, the Target's board resolved to implement the Measures (as discussed below) citing (a) certain breaches of procedural requirements under the Measures, (b) the sell pressure caused by the announced tender offer, (c) the likely loss of corporate value and (d) the adverse impacts on stakeholders.
10. On March 24, the Acquirer sought injunctive relief with the Tokyo District Court against triggering the Measures. Tokyo District Court on both the original review and objection review granted the injunction sought. Upon appeal, the Tokyo High Court rejected the appeal thereby confirming the injunction.
11. The Acquirer carried through with the second tender offer and completed the takeover.

Specifics of the Measures

The anti-takeover measures devised by the Target had the following features (the "Measures"):

- The issuance of free warrants to counter a concrete takeover attempt being made by the Acquirer (i.e., a wartime pill).
- The threshold was set at 20.50%.
- Certain procedural requirements are imposed on the Acquirer to allow for adequate time and information for the Target to digest the proposal (by the board reserving time to review), without completion of which the Acquirer is banned from share purchases altogether.
- If the Acquirer fails to abide by the procedural rules, and continues to purchase a large number of shares, the board of the Target may issue free warrants to regular shareholders.

Issues

1. Can the Target implement and trigger the Measures without any shareholders' determination about them?
2. How much "sell pressure" is observed under the facts and how does it affect the evaluation of the Measures?
3. Can violations of the procedural requirements justify the implementation of the Measures? Or do the specifics of the procedural requirements matter?

Summary of Decision

Since the conclusion was the same among the three decisions, we will discuss as a rule the appellate decision and add references as appropriate to the original decision and the objection decision:

1. In assessing whether the incumbent management had the overriding purpose in implementing the Measures of sustaining the corporate value of the Target and enhancing the common good of the shareholders, it requires showing special circumstances to justify the Measures in reference to (a) whether the Acquirer presented a *bona fide* plan to execute reasonable management vision, and (b) whether it is probable that the Acquirer's running of business would cause irreparable harm to the Target.

2. [The objection review court pointed out that] the Measures involved no possibility of shareholders' determination reversing the issuance of warrants and it would have been more desirable to have the shareholders decide even retroactively whether the warrant issuance was appropriate particularly in light of the ongoing contest for the better management team.

3. The Acquirer was mindful in not building up the sell pressure by, e.g., limiting the in-market purchase to 1/3 of the outstanding shares and with the announced plan of squeeze out in the event of 2/3 acquisition in total. In those circumstances, the sell pressure cannot be found to be unreasonably high or it may be found that adequate measures have been put in place to lessen the sell pressure.

4. The fact that the procedural rules were violated will not automatically justify the implementation of Measures because it requires that the procedural rules are reasonable and proportionate to the threats presented. In these circumstances, this court suspects that the rules were devised to support the incumbents' eagerness for dominance over management.

Discussion

1. *Where did the courts derive the notion that shareholders are required to bless anti-takeover measures?*

Ever since the Bulldog Sauce Supreme Court decision, the principle argument has been that the shareholders as the ultimate owners of the corporation must make a decision on what the right balance should be in anti-takeover measures between the enhancement of corporate value/common good of the shareholders and the appropriate way to deal with a corporate suiter that may not be *bona fide* in its purpose. Given that the incumbent board of directors is suspected of an ulterior desire to keep the management control under the guise of corporate value defense, the courts laid out (a) the presumption of ulterior motive and (b) the requirement of a *bona fide* management plan and a means to avoid irreparable harm to the corporation to overcome it. Then it would be natural to argue that the shareholders as the ultimate owner of the corporation are fit to determine what is appropriate to do. Practitioners view this approach to be logical but idealistic.

2. *As a matter of practical corporate governance, is it realistic to rely on shareholders' determination on anti-takeover measures?*

As a practical matter, it can take weeks to prepare and convene a shareholders' meeting to vote on anti-takeover measures and, in the meantime, the acquirer can continue buying large quantities of shares in the interim under Japanese law. Assuming that the acquirer's new shares will be disallowed to vote (as implemented in the decisions *in re Tokyo Kikai Seisakusho*), the shareholders' action can become just a window-dressing without much substance for the concerns discussed below.

Shareholders in a public company are not a cohesive corporate organ by any means. Many just don't review carefully management issues and they can't act (or aren't incented to act) quickly enough to make decisions. Unless proxy advisory firms can provide meaningful assistance in evaluating a takeover attempt, it is usually foreseeable that the measures are going to be approved for fear of the unknown.

In the current case, probably because both the creation and implementation were board action-based, the courts could cut through the chase more readily; the presumption of ulterior motive was emphasized, exceptions summarily disposed and an injunction was granted. Practitioners wonder what the takeover law landscape will be like if the courts do away with the shareholder blessing concept for once. We would probably have many more injunctions granted. Practically speaking, the shareholders' blessing may be a way to passively endorse anti-takeover measures in effect.

3. In reviewing anti-takeover measures, how fair must the procedural rules be?

Target companies often argue that the acquirers were egregious in violating procedural requirements in anti-takeover measures and tend to downplay the [lack of] fairness and proportionality of their own procedural rules. In this case the procedural rules required that any large volume purchase may only commence upon the lapse of the evaluation period designated by the board of directors. How such "evaluation period" is practiced can be self-serving and the procedural rules are after all rules created unilaterally by the board (in this case without the input from an independent committee.)

We should be mindful that the procedural rules must conform to the market standard and any notable deviation would be viewed as an attempt to force the presumed ulterior motive. This of course is largely a non-issue when the shareholders bless the measures, however.

4. Is this case a one-off decision that derived from an immediate contest for better management?

There are remarks and suggestions throughout the decisions about the fact that this is a contest for a better management team and the issue is which one is better, rather than the Acquirer is evil and ill-intentioned for common goods of shareholders. Such underlying facts tended to tip the scale in favor of the Acquirer in this particular situation with the presumption of ulterior motive.

Takeaways

1. An acquirer would have an improved chance of being successful in takeovers if the target implements pills without the involvement of shareholders. As a target, it is clearly safer to include shareholders in the process.

2. An acquirer may not necessarily be disadvantaged by not following the procedural rules of anti-takeover measures. Careful assessment of fairness and proportionality of the rules is key to distinguishing material breach from casual breach with no serious consequence.

3. An acquirer should, where it can, avoid building up unnecessary sell pressure by being ambiguous about management plans and the plans of takeover mechanics. In-market purchase of a large number of shares is always labeled as a suspicious act that needs to be countered by poison pills. In tender offers, terms should be set out unambiguously with minimum and maximum percentages with a plan of squeeze out, if the intentions support them.

If you have any questions concerning these developing issues, please do not hesitate to contact the following Paul Hastings Tokyo lawyer:

Toshiyuki Arai
81.3.6229.6010
toshiyukiarai@paulhastings.com

[1] Supreme Ct. Decision, August 7, 2007, Minshu 61-5-2215

[2] Tokyo District Ct. Decision, October 29, 2021, Shoji Homu 453-107; Tokyo High Ct. Decision, November 29, 2021, Shoji Homu 453-98; and Supreme Ct. Decision, November 18, 2021, Shoji Homu 453-94.

[3] Tokyo District Ct. Decision, April 7, 2021, Shoji Homu 446-166; Tokyo District Ct. Decision, April 7, 2021, Shoji Homu 446-163; and Tokyo High Ct. Decision, April 23, 2021, Shoji Homu 446-154.

Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2022 Paul Hastings LLP.