HOSTILE TAKEOVERS IN JAPAN: ANALYSIS AND SUGGESTIONS

A THESIS

SUBMITTED TO THE

STANFORD PROGRAM IN INTERNATIONAL LEGAL STUDIES

AT THE STANFORD LAW SCHOOL

STANFORD UNIVERSITY

IN PARTIAL FULFILLMENT OF THE REQUIREMENTS

FOR THE DEGREE OF

MASTER OF THE SCIENCE OF LAW

By

Shinsuke Matsumoto

May 2002
ABSTRACT

The recent succession of hostile tender offers is not a temporary phenomenon, but a sign of deeper structural changes in the Japanese takeover environment. These structural changes seem to be irreversible, and may eventually increase the number of hostile tender offers. Against this backdrop, defensive measures are being extensively discussed in Japan. Further, recent amendments to the Commercial Code seem to provide the opportunity for lawyers and directors to develop new defensive measures. Thus, legislators and/or courts will need to develop a national policy to govern this phenomenon.

However, thus far, there seems to be no sufficient theoretical or empirical basis for new legislation in Japan. If the lack of a legislative solution continues, the Japanese courts will likely to be required to solve this problem in the near future. One possible solution for the Japanese courts is to adopt a modified version of the Delaware legal standards. This modified version of the Delaware legal standards seems to provide efficient tools to review various defensive tactics in diverse situations. In addition, under this modified version of the Delaware legal standards, the Japanese courts can make use of the precedents of the Delaware courts. While the Delaware legal standards are still evolving, a number of decisions elaborating such legal standards have already been developed by the Delaware courts, and the Japanese courts are in a position to take advantage of the standards. Thus, this thesis suggests that the Japanese courts should adopt the modified Delaware legal standards for reviewing target managements' adoption of defensive tactics.
CONTENTS

I. INTRODUCTION ........................................................................................................... 1

II. WEAKENING OF LEGAL AND EXTRALEGAL BARRIERS TO HOSTILE TAKEOVERS IN JAPAN .......................................................................................................................... 6
   A. Legal and Extralegal Barriers to Hostile Takeovers .............................................. 7
      1. Legal and regulatory barriers ............................................................................... 8
         a. Administrative guidance and the Foreign Exchange and Foreign Trade Law .. 8
         b. Tender offer procedures .................................................................................... 13
         c. Unreliable accounting system and inadequate disclosure system .................. 14
         d. Cash-out mergers .............................................................................................. 15
      2. Structural barriers ............................................................................................... 17
      3. Cultural barriers ................................................................................................. 20
      4. Unprofitability of hostile takeovers .................................................................... 24
   B. Weakening of Legal and Extralegal Barriers ......................................................... 25
      1. Weakening of legal and regulatory barriers ......................................................... 25
         a. Administrative guidance  1992 amendment of the Foreign Exchange and Foreign Trade Law and increase of transparency of administrative procedure 25
         b. Amendment to tender offer procedures ............................................................. 30
         c. Introduction of new accounting and disclosure systems ................................. 31
         d. Cash-out mergers .............................................................................................. 33
      2. Weakening of structural barriers ......................................................................... 33
      3. Weakening of cultural barriers ........................................................................... 38
      4. Improvement of unprofitability of hostile takeovers .......................................... 42
   C. Conclusion .............................................................................................................. 43

III. 2001 AMENDMENTS TO THE COMMERCIAL CODE OF JAPAN AND POSSIBLE NEW DEFENSIVE TACTICS ............................................................................................. 43
   A. 2001 Amendments to the Commercial Code ....................................................... 45
      1. Amendment regarding removal of ban on treasury stock ................................... 45
      2. Amendment regarding the stock system .............................................................. 46
         a. Reservation right for new stock (shinkabu yoyakaken) .................................... 46
         b. Stock with limited voting rights (giketsuken seigen kabushiki) ....................... 47
         c. Class shareholders’ meeting (shurui kabunusui sōkai) ...................................... 47
         d. Compulsory conversion provision (kyōsei tenkan jōkō) .................................... 48
   B. Possible New Defensive Tactics .............................................................................. 48
      1. Defensive stock repurchases ................................................................................ 48
2. Tactics utilizing the reservation right for new stock – the Japanese version of poison pill ................................................................. 51
3. Tactics utilizing class shareholders’ meeting ........................................ 53
4. Tactics utilizing compulsory conversion provisions ............................ 54
C. Conclusion .................................................................................. 55

IV. POLICY DEBATE ABOUT HOSTILE TAKEOVERS ......................... 56
A. The Law and Economics Approach ............................................... 57
   1. The market for corporate control theory and the management entrenchment hypothesis: theories and empirical studies ........................ 58
      a. The market for corporate control theory ..................................... 58
      b. Empirical studies about the economic effects of hostile takeovers 63
      c. The management entrenchment hypothesis and empirical studies about the economic effects of defensive tactics ................... 67
      d. Implication of economic theories and prior empirical studies .......... 71
   2. Desirability of auctions ................................................................ 74
B. The Managerialist Approach – Various Justifications of Defensive Tactics .... 78
   1. Role of directors in corporate governance and other monitoring mechanisms ... 79
   2. Coercive effects of tender offers and collective action problem – bargaining power hypothesis ...................................................... 84
   3. Seeking long-term interests – the rational myopia hypothesis .......... 88
   4. Preventing illegal bids .................................................................. 89
   5. Interests of nonshareholder constituencies .................................... 90
   6. Implication of the managerialist approach .................................... 95
C. Delaware Approach – Flexible Legal Regime Properly Addressing the Conflict of Interest Issue ....................................................... 95

V. ANALYSIS OF U.S. CASES ......................................................... 101
A. Delaware Cases ........................................................................... 102
   1. The Cheff case ......................................................................... 102
   2. The Unocal case ....................................................................... 103
   3. The Revlon case .................................................................... 106
   4. The Blasius case ................................................................. 108
   5. The Time case .................................................................... 109
   6. The QVC case .................................................................... 113
   7. The Unitrin case ................................................................ 117
B. Analysis of Delaware Cases ......................................................... 120
   1. The Unocal standard ........................................................... 120
2. Linkage of the Unocal standard and the business judgment and entire fairness standard ................................................................. 125
3. The Revlon standard .......................................................................................................................... 126
4. Relationship between the Unocal standard and the Blasius standard .................................................... 129
5. Conclusion ........................................................................................................................................ 131

VI. ANALYSIS OF JAPANESE CASES AND SUGGESTED LEGAL STANDARDS .......... 133

A. Legal Framework .................................................................................................................................. 133
B. Japanese Cases ...................................................................................................................................... 135
   1. The Takuma case ............................................................................................................................... 135
   2. The first Miyairi Valve case ............................................................................................................... 137
   3. The Chujitsuya and Inageya cases .................................................................................................... 140
   4. The second Miyairi Valve case ......................................................................................................... 143
C. Analysis of Japanese Cases .................................................................................................................. 144
D. Suggested Legal Standards .................................................................................................................. 148
   1. Adoptability of modified version of Delaware legal standards ....................................................... 148
   2. Anticipated criticisms from other positions ..................................................................................... 154
      a. The mandatory power allocation theory .................................................................................... 154
      b. The business judgment rule theory ............................................................................................ 157
   3. Application of suggested standards .................................................................................................. 158
      a. Application to defensive stock repurchases ................................................................................ 159
      b. Application to Japanese version of the poison pill ...................................................................... 160

VII. CONCLUSION .................................................................................................................................... 162