ICGN
International Corporate Governance Network
Inspiring good governance & stewardship

The Ministry of Economy, Trade and Industry
1-3-1 Kasumigaseki, Chiyoda-ku
Tokyo 100-8901, Japan

E-mail: bzl-Guidelines@meti.go.jp

4 August 2023

Dear Minister Yasutoshi,

Re: Invitation for Public Comments on the Draft of the Guidelines for Corporate Takeovers

The International Corporate Governance Network (ICGN) appreciates the opportunity to comment on the Consultation Paper for the Draft of the Guidelines for Corporate Takeovers (Draft Guidelines) by the Ministry of Economy, Trade and Industry (METI).

Led by investors responsible for assets under management of $77 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship contributing to long-term corporate value, sustainable economies and wider society. Headquartered in London, our membership is based in more than 40 countries, largely in Europe and North America, with growing representation in Asia, particularly in Japan.

First published in 2001, the ICGN Global Governance Principles (ICGN Principles) inform our work programme and are widely used by our members in their company assessments and voting decisions, and by regulators when developing corporate governance policies. Guidance 9.2 of the ICGN Principles address the responsibility of board members to ensure that investors have the right to vote on major decisions which may change the nature of the company in which they have invested, for example, any extraordinary transactions such as mergers and acquisitions (M&A) or structures that act as anti-takeover mechanisms.

ICGN appreciates the work of the Fair Acquisition Study Group Members in the development of METI's Draft Guidelines. We agree that a fair and well-functioning M&A market should facilitate corporate takeovers that benefit the economy and society. In this regard we welcome most of the proposals, however we would like to respectfully highlight some suggestions for your consideration as detailed below.

Prioritisation of shareholder interests

We welcome the creation of a Code of Conduct as proposed in the Draft Guidelines that requires directors and managers to act in ways that provide the best possible outcomes for shareholders, while enhancing corporate value. This aligns with recommendations in ICGN's Japan Governance Priorities[1] wherein we refer to the importance of acquisitions and large capital investments being considered as part of a Capital Allocation Policy. The Policy should be disclosed and reviewed annually by the board to ensure that cash is employed in activities which are aligned with the company's purpose and strategic objectives to generate long term value.

Shareholder rights and partial takeovers

As capital providers in companies subject to the takeover or M&A, the rights and economic interests of shareholders should be prioritised in the proceedings and should be afforded

[1] ICGN Japan Governance Priorities, October 2022

due consideration before the commencement of any action.[2] To this end, partial takeovers, with control taken by bidding with just 51% of the shares, should be discouraged. We believe that partial takeovers benefit controlling shareholders, impacting other shareholders who may not be able to sell their shares in a tender offer. This situation may not lead to a favourable result for the bidder company's shareholders either. They will become part of a listed subsidiary. The FSA (Financial Services Agency) has expressed concerns related to shareholders' rights and protections due to the control exerted by the parent company.

Independent judgement

The Board, comprised of a majority of independent directors, must ensure fairness and transparency for corporate takeovers from the perspective of both the targeted company and the acquiring company. In case the board of directors is not adequately comprised of independent directors, the decision should be made by the votes at the meeting of shareholders. Ultimately, the Board should consider proposals that serve the best interests of shareholders, even if an entrenched management could be impacted. In this regard, the new Code of Conduct will help clarify roles and responsibilities[3] regarding proposals to acquire corporate control.

Timely disclosure

Shareholders must receive information from the targeted company and the acquiring company to make informed decisions in a timely manner. Companies should be transparent about conflicts of interest, any outsized role of majority shareholders and how the outcome will benefit investors or potentially dilute their share value.[4] We encourage METI to establish clear rules when an offer needs to be disclosed beyond when the tender offer is made. Any approaches to a board should be made public and the board should explain to its shareholders why the offer was not suitable or attractive enough to consider seriously. Otherwise, the rumours about potential M&A activity can be inaccurate and potentially harm corporate value.

Takeover defence measures

The parties involved in an acquisition should provide complete information to shareholders if they plan to pursue takeover defence mechanisms or countermeasures that will require an informed judgment by shareholders on whether to approve the countermeasures. Such measures may enhance share value *or* cause the share value to be negatively impacted; therefore, investors need to understand the consequences of these actions.[5]

We also note that there are court cases that have ruled on defence measures, such as the "Majority of Minority" (MoM) resolutions. A footnote in the Draft Guidelines references the term "MoM resolution" and explains why a MoM is not generally considered because "shareholders with voting rights (other than interested shareholders) are usually not minorities".[6] These decisions have upheld the exclusion of the voting rights of the acquiring party, the target company's directors and their related parties from being counted and

[2] 20230608002-4.pdf (meti.go.jp), Section 2.2.3 Respecting the Intent of Shareholders and Ensuring Transparency, p. 16.
[3] 20230608002-4.pdf (meti.go.jp), Chapter 3 Code of Conduct for Directors and Board of Directors regarding Acquisition Proposals, p.18.,
[4] 20230608002-4.pdf (meti.go.jp), Chapter 4 Increased Transparency Regarding Acquisitions, p. 31.
[5] 20230608002-4.pdf (meti.go.jp), Chapter 5, Takeover Response Policies and Countermeasures, p. 39.
[6] 20230608002-4.pdf (meti.go.jp), Footnote 73, p. 55.

RH.205, The Record Hall, 16-16A Baldwins Gardens, EC1N 7RJ
VAT No. 927 1665 09 | Registered in England No. 6467372
t: +44 (0)2045417255
e: membership@icgn.org
w: www.icgn.org
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thereupon allowing the adoption of a resolution at a shareholders' meeting of the targeted company's board.[7] These defence measures can be harmful to shareholder value, so they should only be used in exceptional and limited cases. Under the Japan Companies Act, the ultimate decision on a corporate takeover will be made by the board and shareholder sentiment should be considered.

Squeeze outs

We observe that the "Code of Corporate Conduct for Matters to be Observed Pertaining to Significant Transactions with Controlling Shareholders" in Japan allows for a squeeze out by a controlling shareholder(s), who directly or indirectly owns the voting rights 90% or more of minority shareholders. ICGN recommends that a provision be included in the Draft Guidelines that provides minority shareholders with the protections they need in this circumstance to secure an attractive price, which will help facilitate a means to unlock shareholder value. As noted in the Guidelines, in two-step transactions, if there is a time gap between the completion of the first step of the acquisition and the squeeze-out of minority shareholders in the second step, there is a certain degree of coercion as a result. Coercion, resulting from a time gap between the first and second steps, could significantly be reduced if controlling shareholders promptly conduct the second squeeze-out step.[8]

Proposed Guidelines: Three Principles

ICGN agrees that there should be a greater predictability of the outcome of these transactions for investors and the companies involved in takeovers. We appreciate METI's effort to find a way to delineate best practices for the boards of directors and the parties involved in a corporate takeover. The creation of the Proposed Guidelines will help investors and capital market participants more broadly.[9]

ICGN agrees with the three Principles described as:

1. **Principle of Corporate Value and Shareholders' Common Interests** - We agree with the requirements that shareholders must be protected as they have the ultimate equity stake in one or both companies, which impacts the "corporate value." The determination of whether an acquisition or takeover is desirable depends on the perspective of the entities involved.[10]

2. **Principle of Shareholders' Intent** - The provision notes that the "rational intent" of shareholders should be relied upon in matters involving the corporate control of the company. However, we note that there are two sets of shareholders and other investors (those that hold debt instruments, etc.) that may have opposing views on the takeover terms, share prices and the control of the company. Boards should therefore ensure that shareholders and other investors receive information from the acquiring company and the target company's boards so that informed decisions can be made. The acquiring company may have the upper hand in the transaction, especially if the takeover is forced.

3. **Principle of Transparency**- Shareholders, as well as other investors, should be provided access to all information that they need to make decisions whether to

[7] 20230608002-4.pdf (meti.go.jp), Appendix 3, p. 55.
[8] 20230608002-4.pdf (meti.go.jp), p. 50.
[9] 20230608002-4.pdf (meti.go.jp)
[10] 20230608002-4.pdf (meti.go.jp), pp. 7-8.

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support the acquiring party's or the target company's proposal. Time will be of the essence as the opportunity to voice support or express concerns will be limited.

Specific comments by section

Section 2.2.3 Respecting the Intent of Shareholders and Ensuring Transparency

Investors need to understand how their shares in one or both companies will be priced within the negotiated agreement and that information will come from the targeted and acquiring company, leading to the potential for greater confusion. Full disclosure is necessary before any investor should be required to make these decisions.

Takeovers or forced acquisitions are known to be hostile or welcome actions, depending on the circumstances. Many investors may not understand the consequences of tendering shares in a takeover fight, and as a result, may have their ownership value diluted. On the other hand, shareholders may wish to support a poison pill or similar tactic raised by the targeted company to stave off a takeover attempt. Shareholders should have all the information to understand the reasons to support anti-takeover defences and the potential loss of any shareholder rights that may be triggered by supporting such manoeuvres.

The appropriate place to determine whether the actions described should be adopted by shareholders is at a shareholders' meeting in respect of approval or rejection of takeover response policies and countermeasures in response to such an acquisition attempt.

Cross shareholdings and impact on minority shareholder rights

Some companies may have dominant shareholders or significant cross-shareholdings, that limit the minority rights of shareholders. ICGN advocates that companies should disclose a plan to reduce cross-shareholdings over a specified period and regularly report progress towards achieving a specified target to shareholders. The nature of cross-shareholdings should be disclosed, along with a clarification of the impact on returns on capital, e.g., if they are a parent company, subsidiary, or supplier, and how they intend to be reduced or eliminated over a designated time-period.

Section 3.1.2, Consideration by the Board of Directors

In the Consultation Paper, the analysis for the board includes a situation where a controlling shareholder is known to have no intent of selling its controlling shares to a third party. It is important for a board to also consider whether the offer should be considered if the *minority shareholders* could be interested in selling their shares to a third party.

Section 3.2.2, Differences in Acquisition Ratio and Acquisition Consideration

The transaction terms and share price will be important to investors because the corporate takeover could be the last opportunity for them to be fairly compensated for their investment in the target company's stock. A partial acquisition of shares can harm minority shareholders. One of the possible solutions offered in the Consultation Paper, is to require the controlling shareholder to negotiate a full acquisition of the shares, rather than a partial acquisition of shares. This solution could support the needs of minority shareholders, who may desire to remain investors in the newly created entity.

We agree that each director and the entire board of directors should make all reasonable efforts not only to enhance corporate value but also to secure the interests of shareholders. Minority shareholders must be able to effectively exercise their right to vote on major decisions which may change the nature of their investment in a company. These rights

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should be clearly defined in the company's constitutional documents such as the articles of incorporation.

Section 3.2.3 Negotiations Aimed at Best Available Transaction Terms for Shareholders

We note that the language states that "each director and the board of directors should make all reasonable efforts not only to enhance corporate value but also to secure interests of shareholders". Whilst shareholders are entitled to the highest share price possible during negotiations, there are shareholder rights that have equal importance, including a full acquisition rather than a partial acquisition. Minority shareholders' rights should be considered fully, especially if support for the transaction could be contentious.

Section 3.3 Ensuring Fairness - Supplementary Functions of the Special Committee and Matters to be Noted

There are situations which may call for the appointment of a special committee or the hiring of external advisors. The creation of a special committee or hiring an external advisor may be necessary, depending on the degree of conflict of interests amongst the companies, majority shareholders and board members, circumstances surrounding the target company, and the transaction structure. An outside view or special committee may help ensure the interests of all investors. Selection of a special committee should be decided by the board of directors with a majority of independent directors.

Section 4.1.1.4 Information Provision and Disclosure of Substantial Shareholders

ICGN agrees with the Draft Guidelines that set out the disclosure of substantial shareholders. When a substantial shareholder is making an acquisition proposal, he or she should provide the target company with information regarding this fact and if there are any relationship between such a substantial shareholder and the nominee shareholder(s).

Section 4.1.2 Provision of Time to Consider the Acquisition Proposal

Shareholders are often located across the world, and it takes time to provide all the impacted shareholders with accurate information, which may change as the acquisition moves forward. Shareholders need sufficient time to make informed decisions, with the most accurate and relevant information available to them as possible.

Section 4.3 Preventing Acts that Distort Shareholder Decision-Making

Tactics during acquisitions or takeovers can be considered hostile to the targeted company, its board of directors, senior management, and shareholders. Efforts to curb coercive tactics and provide remedies to shareholders when inaccurate information is spread deliberately by the acquiring company through the media or shareholder communications are necessary. Any potential conflicting interests of majority shareholders, conflicts of interest, any relationships through cross-shareholdings should be disclosed and full transparency during the solicitation of proxies and votes should be required.

Chapter 5 Takeover Response Policies and Countermeasures

We agree that "corporate value and the shareholders' common interests may be harmed, if the acquisition is made without providing the target company and its shareholders the necessary time and information". There should be full *disclosure* to shareholders, with a clear explanation that the ensuing discussions may not ultimately lead to an offer.

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It is important to obtain approval by shareholders at a shareholders' meeting when a company is at the stage of adopting a poison pill, or at the stage of invoking countermeasures, as stated in **Section 5.2 Respecting Shareholders' Intent.** Otherwise, the proposal to adopt a poison pill or other countermeasures may have a chilling effect on the target company's shareholders. Not all M&A activity should be considered "hostile" and countermeasures that entrench management should be discouraged.

ICGN agrees that shareholders must be considered in such a way that any conflicting ownership by management, which would protect its own interests, should be avoided, as provided in **Section 5.3 Ensuring Necessity and Proportionality.**

Section 5.4 Dialogue with the Capital Market

We welcome recommendations for constructive dialogue between the target company and institutional investors. We support continuing dialogue between companies and their investors as an important principle, whether there is an acquisition on the horizon or other potential takeover action.

Thank you for considering our suggestions. If you would like to follow up with questions or comments, please contact our Japan Advisor, Amane Fujimoto (amane.fujimoto@icgn.org).

Yours faithfully,

Kerrie Waring
Chief Executive Officer, ICGN

Cc: Carol Nolan Drake, ICGN Governance and Stewardship Policy Manager

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