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Corporate System Division
Economic and Industrial Policy Bureau
Ministry of Economy, Trade and Industry
1-3-1 Kasumigaseki, Chiyoda-ku
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Date: 3 August 2023

Draft Guidelines for Corporate Takeovers

We refer to the invitation for public comments issued by Japan's Ministry of Economy, Trade and Industry (METI) on the Draft Guidelines for Corporate Takeovers on 8 June 2023. We appreciate the opportunity to provide our feedback to the guidelines.

Norges Bank Investment Management (NBIM) is the investment management division of the Norwegian Central Bank and is responsible for investing the Norwegian Government Pension Fund Global. NBIM is a globally diversified investment manager with ¥176,770 billion at year end 2022, 8,479 billion of which invested in the shares of Japanese companies. As a long-term investor, we support well-functioning financial markets that facilitate the efficient allocation of capital and promote long-term economic growth.

We welcome METI's work to encourage acquisitions that result in a healthy M&A market, and to improve predictability both for parties involved in acquisitions and broader capital market participants. The guidelines can facilitate best practices in the Japanese market, and improve transparency and fairness for the parties involved as well as minority shareholders. We appreciate in particular METI's intention to seek feedback from global investors.

We find the definition of "corporate value" underpinning the Board's assessment of an acquisition offer somewhat unclear. In particular, we query why the wording of the guidelines implies that corporate value and shareholders' interests can be in contrast with each other, as we believe that shareholders' interests are aligned with maximisation of corporate value. Furthermore, we note that there is no transparency obligation on the Board's assessment of corporate value, which can encompass a subjective judgment (e.g. on the factor used to discount the company's future cash flows) and should be disclosed to shareholders to facilitate accountability. An acquisition offer could under the guidelines be rejected on the sole basis of the Board's assessment of corporate value, with no transparency on this assessment and no possibility for shareholders to hold the Board to account. This is key as directors' incentives are not always aligned with those of shareholders.

Importantly, we believe that acquisition offers should only be submitted to independent directors, meaning those directors who are independent from both the parties involved in the acquisition and the success or failure of such acquisition (i.e. not having any material interest

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that differs from the shareholders). This would reflect common market practice and avoid conflicts of interests driving the perception of the entire Board. Relatedly, we believe that the establishment of a special committee of such independent board members would not be too burdensome and should be required in all cases.

Regarding takeover response policies, we believe that they should be subject to mandatory shareholders' approval in line with market practice. This approval, as expressed through a vote held at either an annual general meeting or an extraordinary meeting, should be required both for the company to adopt a takeover response policy in "normal times", and for the company to apply a countermeasure under the adopted policy in "emergent phase" – i.e. to react to a specific hostile takeover bid. In other words, shareholders' support should be expressed twice, first on the general establishment of such a policy, and second for its concrete implementation. It is important that such a shareholder vote requires a majority vote of minority shareholders, to avoid any conflict of interest of controlling shareholders driving the result of this vote. More broadly, minority shareholders' interest would be better protected if the guidelines included a requirement for "majority of minority" shareholders vote to approve an acquisition offer.

While this is not directly addressed in the draft guidelines, we also suggest METI considers establishing an enforcement mechanism for the guidelines, such as an independent arbiter for takeovers. A takeover panel or similar organisation can prevent corporate actions from proceeding in cases where regulations are not being adhered too, and such organisations have legal powers to ensure compliance. We welcome the consideration of other jurisdictions' legal systems and practices by the "Fair Acquisition Study Group", however we regret that the material provided in English does not include such a comparative overview of other major regulated markets. We would appreciate the opportunity to see an English translation of all the documents and inputs considered by the Group.

We thank you for considering our perspective and remain at your disposal should you wish to discuss these matters further.

Yours sincerely

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Detailed comments

Relevant parts: Chapter 2 – Principles and Basic Perspectives

Content of your opinions and reasons:

- *Principle of Corporate Value*. The guidelines attempt to establish an ill-defined concept of "corporate value" which is defined by the Board of Directors, and presented as possibly not aligned with the interests of shareholders. The wording on page 5 "acquisitions that both increase corporate value and secure the interests of shareholders" implies that the two are not aligned. The definition of "corporate value" as a sum of discounted cash flows relies on the Board's opinion of what the future cash flows might be (and the discounting factor used in the NPV calculation), however Boards might not have the incentive to be realistic in their assessment. A takeover approach could therefore be rejected without challenge on the sole basis of the Board's opinion on "corporate value", with no recognition that the value of a takeover encompasses a portion of the strategic elements and net synergies that the acquirer gains as part of the acquisition, and not only the current NPV of the target company's cash flows. These synergies include for example cost savings, tax loss carry forwards, lower debt financing, etc. Furthermore, the definition is not consistent between its quantitative and qualitative elements, as the guidelines refer not only to the discounted future cash flows, but also to a "company's assets, profitability, stability, efficiency, growth potential and other company attributes that contribute to the interests of shareholders". The latter series of factors can be the subject of a highly subjective management assessment, which is often not aligned with market pricing. Shareholders' common interest is also very difficult to consider, as shareholders might not have common interests. Similarly, the principle of shareholders' intent could be replaced with the concept of a fiduciary duty to maximise shareholder returns.

- *Principle of Transparency*. Under the current guidelines, the Board does not have to publicly state the value they believe a company should be worth, and a decision can be made to block an acquisition without shareholder approval. If the Board rejects a bona fide bid, they should be required to state the value they believe the company to be worth publicly under Principle 3: Transparency. This would allow shareholders to hold the Board to account if this value is not attained in a reasonable timeframe. The guidelines also do not explicitly require an acquisition offer to be equal in terms and value to all shareholders of the same class of shares, and that the consideration being offered must be offered equally to all shareholders. This can be very detrimental to the interest of shareholders, particularly minority shareholders.

- *2.2.1 Desirable acquisitions*. The wording "desirable acquisitions" might imply that a hostile takeover (which is an instance of what the guidelines define as "acquisitions

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without consent" on page 8) might never occur, which does not reflect common market practice in developed markets.

Relevant parts: Chapter 3 – Code of Conduct for Directors and Board of Directors regarding Acquisition proposals

Content of your opinions and reasons:

- *3.1.1. Submitting and reporting the proposal to the Board of Directors*. The guidelines state that an acquisition proposal should be taken upon receipt to the entire Board, and not to the independent Board members. This could allow non-independent directors to influence the perspective of independent directors tasked with judging fair value. We believe that any acquisition proposal should be submitted only to the independent directors to prevent any conflict of interest from hindering an impartial assessment of the offer's value. Relatedly, footnote 14 does not formally require the adoption of appropriate measures to address potential conflicts of interest, as it merely states that "it is necessary to consider" them. We think the wording should be reinforced so that these measures must be applied. The details of this process are also not transparent, thereby hindering the Board's accountability towards shareholders. Moreover, we believe that the distinction between only reporting and submitting a proposal to the Board could be clarified.

- *3.1.2. Consideration by the Board of Directors*. The guidelines state that the Board should consider a "bona fide" offer and include an explanation of what is meant by this expression, however the inclusion of the "rationale of purpose" of the acquisition offer in this definition is subjective. Relatedly, the argument that this rationale can be considered doubtful if the acquisition proposal is made by competitors for the purpose of gaining confidential information could always allow the Board to reject a takeover approach. The acquisition proposal's aim to obtain controlling interest is referenced as part of the assessment of feasibility; however, there is no definition of what constitutes a controlling interest or shareholders. This term should be defined on page 8-9, and the controlling shareholder should be excluded from the deliberation of the Board to avoid any conflict of interest. Furthermore, when the Board proceeds in its consideration of a bona fide offer, it should consider its appropriateness from the perspective of corporate value. As mentioned above, we believe that the Board (and especially non-independent directors) is likely to over-emphasise the ability of current management to deliver value. The requirement to compare the corporate value to be realised under the offer with the corporate value to be realised under current management should be accompanied with a transparent disclosure of what the Board's current assessment of corporate value is, as the process would otherwise allow the Board to reject the offer with no consequence or accountability. Relatedly, the Board should be required to provide a post-decision explanation if it decides not to support an acquisition proposal, not merely to "act in a manner that allows it to be responsible for explaining the rationale behind its reactions and decisions".

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- *3.2.1. Possible scenarios*. The guidelines in this section state the board should give "more careful consideration" to the interest of shareholders, if and when it has decided to reach agreement on an acquisition. This wording seems to allow the Board to be less careful when initially approached. We believe that this wording should be either edited or removed to clarify that the Board's duty of responsibility and care should be consistent in either scenario.

- *3.2.2. Differences in Acquisition Ratio and Acquisition Consideration*. This section of the guidelines states that a second-step squeeze out as part of the acquisition strategy can decrease potential coercion for shareholders, as it can guarantee an exit opportunity at the same price paid for the acquired shares. We do not believe that this diminishes shareholders' potential coercion, as the two thirds majority vote required for a reverse share-consolidation under Japan's Industrial Competitiveness Enhancement Act is significantly lower than market practice in most developed capital markets.

- *3.2.3. Negotiations aimed at best available transaction terms for shareholders*. This section of the guidelines, which underlines the positive role that competing proposals can play in improving the terms of an acquisition, does not include a requirement that competing bidders shall be given equal access to information from the company's engagement. This should be added to the guidelines to ensure the fair and equal treatment of all bidders.

- *3.3. Ensuring Fairness – Supplementary Functions of the Special Committee and Matters to be Noted*. As noted above, we believe that the requirement to establish a special committee should be enforced in all cases at the beginning of the Board's consideration, rather than be left to case-by-case assessment of its necessity. We are not convinced that the establishment of a special committee from the initial stage would represent an "excessive burden". Furthermore, we believe that allowing a committee to only contain a majority of outside directors is not sufficient, and that the guidelines should require such committees to solely consist of independent directors. Moreover, special committees should not only have a duty to act independently, but also a transparency and accountability obligation to shareholders to ensure scrutiny on their assessment of corporate value. This is particularly important as the guidelines do not refer to the synergies to be gained from an acquisition as part of the corporate value assessment, or provide any detail or transparency on the choice of engaging professional advice to obtain an independent value assessment.

Relevant parts: Chapter 4 – Increased Transparency Regarding Acquisitions

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- 4.1.1.1. Disclosure and Provision of Information at the Time of Acquisition. This section of the guidelines does not provide guidance on the shareholding level which should trigger filing of intent in the case of an open-market purchase, or on the timeframe under which the building-up of a stake triggers such a requirement. We suggest this is specified either in the guidelines or in legislation, adopting a similar approach to practice in other jurisdictions where requirements exist to disclose the gradual build-up of ownership stakes. Ideally, any such requirements should cover the use of derivatives instruments, as these are often used in takeover strategies explicitly to maintain the opacity of the stake being built up.

- 4.1.1.2. Toehold and Disclosure of Intent of Acquisition. The guidelines should state that a party intending to make an acquisition is required to provide information about its intention prior to its tender offer, not just that it is advisable that it does so.

- 4.1.1.4. Information Provision and Disclosure of Substantial Shareholders. The guidelines acknowledge that Japan does not have regulations for identifying substantial shareholders. We call on METI to consider the opportunity of introducing such a regulatory framework, which would bring Japan in line with other major markets like the US, EU or UK.

- 4.1.2. Provision of Time to Consider the Acquisition Proposal. This section refers to the importance of a “time schedule that allows sufficient time” to make decisions, however provides no specific indication of what this timeframe might be. We suggest the guidelines are edited to specify this timeframe, which should the same irrespective of whether the offer has a hostile nature or is negotiated. For instance, this timeframe could be 45 business days in line with common market and regulatory practice.

- 4.2. Information Disclosure by Target Company. If a competing proposal is made, the guidelines do not require the target company to disclose any detail about the competing proposal, only its existence, and they recommend maintaining confidentiality on such details. However, we believe that the target company should be required to report to shareholders the details and price level offered in the competing proposals. Such confidentiality would otherwise allow the Board to recommend an acquisition offer with a lower consideration price, with no possibility of challenge or accountability to shareholders. The lack of disclosure on pricing information of competing bids is a clear example of an action that could distort shareholder decision-making and should therefore also be listed in section 4.3.

Relevant parts: Chapter 5 – Takeover Response Policies and Countermeasures

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- *5.1. Approach on Takeover Response Policies and Countermeasures*. This section, while acknowledging that the number of companies adopting a response policy has continued to decline since 2008, seems to convey a positive assessment of such policies, failing to recognise that the majority of institutional investors oppose them and that they can be detrimental to equity valuations.

- *5.5. Dialogue with Capital Market*. While acknowledging that response policies have tended to be adopted by companies with sluggish performance, and therefore implicitly that such policies tend to be correlated with lower valuation, the guidelines explicitly allow the use of so-called "poison pills". This should not be necessary, and the better alternative to allow the Board to find a competing proposal, and for shareholders to engage, would be to enforce a minimum acceptance/consideration period, as suggested above. We believe that a shareholder vote should be a minimum requirement prior to the adoption of a response policy, which is not currently the case, and that the Board should be bound by the shareholders' decision. We agree that a positive feature of response policies would be to design them in a way to always require a shareholders' meeting then invoking countermeasures, however this decision should be presented to minority shareholders only, with the majority shareholder being unable to vote.

Relevant parts: Appendix 3 – Takeover Response Policies and Countermeasures (Particulars)

Content of your opinions and reasons:

- We appreciate the reference to the desirability of obtaining shareholders' approval to invoke countermeasures, however we believe that this approval, as expressed through a vote held at either an annual general meeting or an extraordinary meeting, should be required both for (1) the company to adopt a takeover response policy in "normal times", and (2) the company to apply a countermeasure under the adopted policy in "emergent phase" to react to a specific hostile takeover bid. In other words, shareholders' support should be expressed twice, first on the general establishment of such a policy, and second for its concrete implementation. It is important that such a shareholder vote requires a majority vote of the non-conflicted shareholders to avoid any conflict of interest of controlling shareholders driving the result of this vote. Therefore, we query why the guidelines refer to such a possibility being "exceptional and limited" (page 58). We also concur with the guidelines that it might be easier, and is generally preferrable, for shareholders to express their intention at a shareholders' meeting rather than through application for a tender offer. As correctly noted, some passive investors may indeed be in favour of an acquisition but not tender their shares, including for reasons linked to their mandate and benchmark limitations. Moreover, we believe that it should not be possible for the Board to invoke countermeasures based solely on their judgment, with no prior indication of shareholder intent. The existence of a previously approved response policy should

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not be interpreted by the Board as an indication of shareholder intent to invoke countermeasures in any specific cases. Footnote 77 refers to the possible limitation of the legitimacy of invoking a countermeasure by the Board to “obvious” cases where corporate value and shareholders’ common interests would be harmed, or to “urgent cases”. It would be helpful to obtain further detail on the specifics of these cases and information on the “past court decisions” which are referred to, but not explicitly mentioned, in the footnote. We also believe that whenever a company adopts a takeover response policy, this should be reflected in its articles of association. Finally, we query the rationale of the court’s decision referred to in Footnote 80, which found that one of the criteria for assessing a hostile acquiring party as not aiming at rational management was their decision to dispose high-value assets that have no current relevance to the company’s business. If such assets have no relevance to the business, their disposal seems an indication of rational management rather than the contrary. We believe that this is inconsistent with Principle 1.4 of the Corporate Governance code on cross-shareholdings, which requires an annual assessment of their appropriateness by the Board.

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