THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW

FOURTH EDITION

Editor
Francis J Aquila

THE LAWREVIEWS

THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW

FOURTH EDITION

Reproduced with permission from Law Business Research Ltd
This article was first published in September 2019
For further information please contact Nick.Barette@thelawreviews.co.uk

Editor
Francis J Aquila

THE LAWREVIEWS

PUBLISHER
Tom Barnes

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGER
Joel Woods

SENIOR ACCOUNT MANAGERS
Pere Aspinall, Jack Bagnall

ACCOUNT MANAGERS
Olivia Budd, Katie Hodgetts, Reece Whelan

PRODUCT MARKETING EXECUTIVE
Rebecca Mogridge

RESEARCH LEAD
Kieran Hansen

EDITORIAL COORDINATOR
Tommy Lawson

HEAD OF PRODUCTION
Adam Myers

PRODUCTION EDITOR
Helen Smith

SUBEDITOR
Rakesh Rajani

CHIEF EXECUTIVE OFFICER
Nick Brailey

Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34-35 Farringdon Street, London, EC4A 4HL, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-052-3

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

© 2019 Law Business Research Ltd

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

BAKER & MCKENZIE – CIS, LIMITED

BOWMANS

CLEARY GOTTLIEB STEEN & HAMILTON LLP

DARROIS VILLEY MAILLOT BROCHIER

DE BRAUW BLACKSTONE WESTBROEK NV

HERBERT SMITH FREEHILLS

HOMBURGER AG

KHAITAN & CO

KIM & CHANG

MORGAN LEWIS STAMFORD LLC

MORI HAMADA & MATSUMOTO

NAUTADUTILH

SULLIVAN & CROMWELL LLP

WOLF THEISS

CONTENTS

PREFACE

In the years since the last financial crisis, shareholder activism has been on the rise around the world. Institutional shareholders are taking a broad range of actions to leverage their ownership position to influence public company behaviour. Activist investors often advocate for changes to the company, such as its corporate governance practices, financial decisions and strategic direction. Shareholder activism comes in many forms, from privately engaging in a dialogue with a company on certain issues, to waging a contest to replace members of a company's board of directors, to publicly agitating for a company to undergo a fundamental transaction.

Although the types of activists and forms of activism may vary, there is no question that shareholder activism is a prominent, and likely permanent, feature of the corporate landscape. Boards of directors, management and the markets are now more attuned to and prepared for shareholder activism, and engaging with investors is a priority for boards and management as a hallmark of basic good governance.

Shareholder activism is a global phenomenon that is effecting change to the corporate landscape and grabbing headlines not only in North America but also in Europe, Australia and Asia. Although shareholder activism is still most prevalent in North America, and particularly in the United States, almost half of the publicly announced activism campaigns in 2018 targeted non-US companies. This movement is being driven by, among other things, a search by hedge funds for new investment opportunities and a cultural shift toward increased shareholder engagement in Europe, Australia and Asia.

As both shareholder activists and the companies they target have become more geographically diverse, it is increasingly important for legal and corporate practitioners to understand the legal framework and emerging trends of shareholder activism in the various international jurisdictions facing activism. *The Shareholder Rights and Activism Review* is designed as a primer on these aspects of shareholder activism in such jurisdictions.

My sincere thanks to all of the authors who contributed their expertise, time and labour to this fourth edition of *The Shareholder Rights and Activism Review*. As shareholder activism continues to diversify and increase its global footprint, this review will continue to serve as an invaluable resource for legal and corporate practitioners worldwide.

Francis J Aquila
Sullivan & Cromwell LLP
New York
August 2019

Chapter 6

JAPAN

Akira Matsushita[1]

I OVERVIEW

In recent years, the corporate governance of listed companies in Japan has gradually changed for various reasons. Japan's Corporate Governance Code (the Governance Code), issued in June 2015, and Japan's Stewardship Code (the Stewardship Code), issued in February 2014, have worked as 'the two wheels of a cart' to promote and achieve effective corporate governance. The management of listed companies in Japan may also be experiencing changes because the ownership of shares in listed companies in Japan by foreign entities has increased (29.1 per cent of the shares in all listed companies in Japan were owned by foreign entities as at 31 March 2019)[2] in comparison with the ownership of such shares by individual shareholders, which has decreased. Under such circumstances, shareholder activism in Japan has grown in recent years. As a result, the management of listed companies in Japan need to consider the possibilities and effects of shareholder activism when managing these companies.

This chapter discusses details of shareholder rights and shareholder activism with respect to a stock company that has shares listed on a financial instruments exchange.

II LEGAL AND REGULATORY FRAMEWORK

i Shareholder rights

In Japan, rights of shareholders are provided under the Companies Act (Act No. 86 of 26 July 2005). Outlines of the shareholder rights that may typically be exercised by shareholders in the context of shareholder activism, among others, are set out below.[3]

Inspection rights

Shareholders have the right to request a company to provide relevant access for them to inspect or copy the shareholder registry, with certain exceptions.[4] This request right enables activist shareholders to access the information on other shareholders in the company when waging a proxy fight.

---

1 Akira Matsushita is a partner at Mori Hamada & Matsumoto.

2 Tokyo Stock Exchange Inc., et al., Result of Survey of Distribution Condition of Shares in 2018, 26 June 2019.

3 The numerical requirements under the Companies Act that are described below may be changed by a company by setting out the changed numerical requirements in the company's articles of incorporation.

4 Article 125(2–3) of the Companies Act.

Shareholders also have the right to request a company to provide relevant access for them to inspect or copy minutes of board of directors' meetings by obtaining the permission of the court if access is necessary to exercise the rights of a shareholder.[5] Shareholders having 3 per cent or more of the votes of all shareholders or shareholders having 3 per cent or more of outstanding shares have the right to request the company to provide relevant access for them to inspect or copy accounting books, with certain exceptions.[6] Activist shareholders may gather information by utilising these inspection rights for use in gaining leverage against or exerting pressure on the management of the company.

Shareholder proposals

The Companies Act provides shareholder proposal rights that are quite favourable to shareholders. A shareholder of a listed company who owns, consecutively for the preceding six months or more, at least 1 per cent of the voting rights of all shareholders in the company or at least 300 votes of the voting rights of all shareholders in the company may demand directors of the company to present proposals submitted by the shareholder as an agenda at the shareholders' meeting and demand the directors to describe the summary of the proposals in convocation notices of the shareholders' meeting by submitting the demand to the directors no later than eight weeks prior to the day of the shareholders' meeting.[7] Additionally, a shareholder attending the shareholders' meeting may submit proposals at the meeting with respect to the matters that are within the purpose of the shareholders' meeting.[8]

In this way, a shareholder who submits proposals to the company can deliver the proposals to the other shareholders at the company's expense, and cause the other shareholders to vote on the shareholder proposals using the voting card mailed by the company without conducting a proxy solicitation by itself at its expense.

In response to recent cases of abusive exercises by shareholders of such shareholder proposal rights, in January 2019, the subcommittee of the Legislative Council of the Ministry of Justice issued an outline of amendments to the Companies Act to limit to 10 the number of proposals that each shareholder can demand the directors to describe, in the summaries thereof, in the convocation notice of the shareholders' meeting (whereas under the current Companies Act, the number of proposals that an eligible shareholder can submit is unlimited), and to enable a company to refuse, among other matters, shareholder proposals that may significantly hinder appropriate operation of the shareholders' meeting such that it would impair the common interests of the shareholders.

Calling of a shareholders' meeting

A shareholder of a listed company who owns, consecutively for the preceding six months or more, at least 3 per cent of the voting rights of all shareholders in the company may demand the directors of the company to call a shareholders' meeting regarding any matter that the shareholder calling the meeting is entitled to vote on. If the calling procedure is not effected without delay after the demand, or the notice calling the shareholders' meeting designating

5 Article 371(2) of the Companies Act.

6 Article 433 of the Companies Act.

7 Articles 303 and 305 of the Companies Act.

8 Article 304 of the Companies Act.

the date of the shareholders' meeting to fall within the eight weeks of the date of the demand is not dispatched, the shareholder who made the demand may call the shareholders' meeting by itself with the permission of the court.[9]

Enjoinment of acts of directors

If a director of a company engages, or is likely to engage, in any act in violation of laws and regulations or the articles of incorporation, and if the act is likely to cause irreparable damage to the company, a shareholder who owns the shares consecutively for the preceding six months or more may enjoin the director's act, usually by obtaining an order of provisional disposition from the court.[10] Violations of a director's duties of care and loyalty may constitute a violation of such laws and regulations.

Derivative actions

A shareholder who owns shares consecutively for the preceding six months or more may demand that the company file an action to recover for damages and liabilities caused by its directors due to their violation of their duty of care and loyalty, and if the company does not file the action within 60 days of the date of the demand, the shareholder may file a derivative action on behalf of the company.[11]

Dissenting shareholders' appraisal rights

Shareholders who object to certain agenda items at the shareholders' meeting, such as a merger, certain consolidation of shares or certain amendments to the articles of incorporation that may be related to a transaction to squeeze out minority shareholders from the company, may demand that the company purchase their shares in the company at a fair price. If dissenting shareholders and the company cannot reach agreement on the price of the shares within a certain period, the dissenting shareholders or the company may file a petition to the court for a determination of the price.

ii Regulations on shareholder activism

Large-scale shareholding report

A shareholder is generally required to file a large-scale shareholding report with the relevant local finance bureau within five business days of the shareholder's shareholding ratio in a listed company exceeding 5 per cent under Article 27-23 of the Financial Instruments and Exchange Act (Act No. 25 of 13 April 1948) (FIEA). The shareholding ratio is calculated by aggregating shares held by the shareholder with any other shareholders with whom the shareholder has agreed to jointly acquire or transfer shares in the company, or to jointly exercise the voting rights or other rights as shareholders of the company (a joint holder). After filing the report, if the shareholding ratio increases or decreases by 1 per cent or more, an amendment to the report must be filed within five business days of the date of the increase or decrease. Certain financial institutions that do not intend to take actions to materially influence the business activities of the company are required to file the report only twice a month.

9 Article 297 of the Companies Act.

10 Article 360 of the Companies Act.

11 Article 847 of the Companies Act.

The Financial Services Agency (FSA) expressed its position that if different shareholders communicate to each other their plans to exercise their voting rights in a certain manner and their plans happen to be the same, this does not cause the shareholders to be deemed as joint holders because an 'agreement' means an undertaking to act (whether in writing or orally, and explicitly or implicitly) rather than the mere exchange of opinions.[12] Therefore, activist shareholders may not be required to file a large-scale shareholding report as joint holders even if they communicate with each other privately and act in the same manner without explicit agreement.

Under the FIEA, rights to request delivery of shares under a sales and purchase contract, as well as options to purchase shares and borrow shares, are subject to the large-scale shareholding reporting obligations. However, the holding of equity derivatives that are cash-settled and that do not involve the transfer of the right to acquire shares would likely not trigger the reporting obligations. The FSA released guidelines that provide that derivatives that transfer only economic profit and loss in relation to target shares, such as total return swaps, are generally not subject to the disclosure obligations, provided that holding such cash-settled equity derivatives may trigger such obligations if a holder purchases long positions on the assumption that a dealer will acquire and hold matched shares to hedge its exposure.[13]

Proxy regulations

Any person who intends to solicit a proxy with respect to shares in a listed company shall deliver a proxy form and reference documents containing the information specified in the Cabinet Office Ordinance to the person solicited.[14] However, a solicitation of a proxy with respect to shares in a listed company that is made by persons other than the company or the officers, including the directors and the executive officers, thereof and in which the solicited persons are fewer than 10 is exempt from the proxy regulations.

When a solicitor has delivered the proxy form and reference documents to the solicited persons, the solicitor shall immediately submit a copy of the documents to the relevant local finance bureau, provided that if the reference documents and form of voting card are delivered by the company to all of the shareholders of the company who are entitled to vote with respect to the relevant shareholders' meeting pursuant to the Companies Act, the solicitor does not have to submit those documents to the relevant local finance bureau. No solicitor may make a solicitation of a proxy by using a proxy form, reference documents or any other documents, or an electromagnetic record, in each case that contains false statements or records on important matters, or that lacks a statement or record on important matters that should be stated, or a material fact that is necessary to avoid a misunderstanding.

iii The Governance Code and the Stewardship Code

The Governance Code has had a major effect on the corporate governance of listed companies in Japan since its release in June 2015. The Governance Code does not adopt a rule-based

12 FSA, Clarification of Legal Issues Related to the Development of the Japan's Stewardship Code, 26 February 2014, at 11.

13 FSA, Q&A Regarding Large Scale Shareholding Report of Share Certificates, etc., 31 March 2010, at 10.

14 Article 194 of the FIEA and Article 36-2 of the Order for Enforcement of the Financial Instruments and Exchange Act (Cabinet Order No. 321 of 30 September 1965).

approach, rather, it adopts a principle-based approach that is not legally binding on companies with a 'comply or explain' approach (i.e., either comply with a principle or, if not, explain the reasons why the company is not complying with the principle).

The Governance Code provides that companies should, positively and to the extent reasonable, respond to requests from shareholders to engage in dialogue, and the board of directors should establish, approve and disclose policies relating to measures and organisational structures that aim to promote constructive dialogue with shareholders. Specifically, the senior management or directors, including outside directors, are expected to be more directly involved in dialogue with shareholders. Furthermore, although listed companies cannot accurately know their substantive shareholder ownership structure without conducting shareholder identification searches owing to indirect shareholding – such as shareholding through trusts or custodians – the Governance Code provides that companies should endeavour to identify their shareholder ownership structure as necessary to promote constructive dialogue with their shareholders.

The Governance Code was amended on 1 June 2018. The amended Governance Code expressly provides that companies should disclose their policies regarding the reduction of cross-shareholdings. It also provides that the board should annually assess whether to hold each individual cross-shareholding, specifically examining whether the purpose is appropriate and whether the benefits and risks from each holding cover the company's cost of capital.

The Stewardship Code was amended on 29 May 2017 and the amendment provides that institutional investors should disclose their voting records for each of its investee companies on an individual agenda item basis to enhance visibility of the consistency of the voting activities of institutional investors with their stewardship policies. This amendment may affect the voting behaviour of institutional investors and, consequently, supportive votes for listed companies may decrease.

The amended Stewardship Code also provides that in addition to institutional investors engaging with investee companies independently, it would be beneficial for the institutional investors to engage with investee companies in collaboration with other institutional investors (collective engagement) as necessary.

iv Rules for directors

Directors facing shareholder activism must abide by their duties of care and loyalty, and treat all shareholders equally under the Companies Act.

Settlement agreements

Settlement agreements with activist shareholders, which may include agreements regarding agenda items of shareholders' meetings, the exercise of voting rights and restraint in acquiring additional shares in the company, have not often been entered into between activist shareholders and listed companies in Japan. There are several precedents of such settlement agreements though, such as the case of Aderans Holdings Ltd entering into an agreement with Steel Partners, a US-based hedge fund, regarding a slate of directors to be submitted to the extraordinary shareholders' meeting in 2008.

Since the Companies Act prohibits a company from giving any property benefits to any person in connection with the exercise of shareholder rights, including voting rights,[15]

15 Articles 120 and 970 of the Companies Act.

the company generally cannot agree to reimburse any costs incurred by activist shareholders from their shareholder activism campaigns in connection with their entering into any voting agreement.

Takeover defence measures

The board of directors of a company may adopt takeover defence measures to deter the building of a large stake in the company by activist shareholders. Most common takeover defence measures adopted by Japanese listed companies are the 'advance warning' type of defence measures. Under such defence measures, a company establishes rules that must be followed by any potential acquirer who intends to acquire more than a certain level of shares (typically, 20 per cent) in the company, and the company publicly announces the rules before an acquirer actually emerges. No rights or stock options are issued upon the adoption of such rules. If an acquirer violates the rules, or an acquisition is considered to be harmful to the corporate value of the company or the common interest of the shareholders of the company, the company would allot stock options to all shareholders without contribution that are only exercisable by, or callable for new shares by the company from, those shareholders other than the acquirer.

The number of takeover defence measures adopted by listed companies has decreased in recent years (whereas 567 listed companies had adopted the measures as at 2009, 386 listed companies had adopted the measures as at 2018,[16] due to opposition by institutional investors).

III KEY TRENDS IN SHAREHOLDER ACTIVISM

i Profile of activist shareholders

Activist shareholders who engage in shareholder activism are mainly domestic and global hedge funds, and individual investors. In particular, in recent years, more foreign activist funds have invested in the Japanese market. Additionally, institutional investors that have not been recognised as activist shareholders have tended in the past few years to become more aggressive in making demands on the management of companies that are similar to those typically made by activist shareholders to management.

ii Types of companies targeted by activist shareholders

Activist shareholders have targeted companies of different sizes and in all types of industries. In particular, activist shareholders are more likely to target companies that own a large amount of surplus cash or other assets, have a low return on equity (ROE) or have share prices that are undervalued by the market. Until the end of 2007, activist shareholders often focused on building large stakes in small-cap or medium-cap companies to apply pressure on the managements of those companies. In recent years, activist shareholders have also been targeting large prominent companies, including companies with market capitalisation of over US$20 billion. Another source of targets for activist shareholders is listed companies that have a parent company or a controlling shareholder, and in which there is a structural conflict of interest between the controlling shareholder and minority shareholders.

16 Miki Mogi and Koji Tanino, 'Introduction situation of countermeasures to hostile takeovers: based on shareholders' meetings held in June 2018', *Shoji-homu* No. 2185, at 18 (2018).

iii Objectives of shareholder activism

The most common objective of shareholder activism in Japan is to improve capital efficiency of Japanese companies. ROEs of many Japanese companies are low compared to the average ROEs of US companies. Activist shareholders usually demand that Japanese companies conduct a buy-back of their shares or increase the amount of dividends to improve their ROEs. Moreover, activist shareholders urge companies to carve out their non-profitable businesses[17] and sell their assets that are not utilised or not related to their primary business, including cross-holding shares. A lot of activist shareholders tend to take these actions to gain returns on their investments in the short term.

In recent years, proposals for companies by activist shareholders to conduct potential mergers and acquisitions (M&A) transactions with another company or to undertake changes in business strategies are becoming common in Japan. Some activist shareholders usually conduct detailed due diligence on the company's business prior to engaging in this kind of shareholder activism. Some activist hedge funds, if they consider that a company is not adequately responsive to their demands, may push the company to elect a person recommended by the hedge funds to serve as a director on the company's board of directors. This person would often be a manager or partner of the hedge funds, a person who has experience in the management of other companies in the industry to which the company belongs, or a person who has expertise in capital allocation or restructuring.

Improving corporate governance is also a common objective of shareholder activism. Although the corporate governance of many listed companies has changed as a result of the application of the Governance Code – which, for example, recommends that listed companies appoint at least two independent directors – activist shareholders have continued to advocate for changes in the corporate governance of companies such as with respect to increasing the number of independent directors and adopting stock price-linked remuneration of directors.

Furthermore, activist shareholders often bring attention in their campaigns to incidents and actions in which directors are not abiding by their duties of care and loyalty. For instance, as activist shareholders often acquire large amounts of shares in companies that have a controlling shareholder, the activist shareholders speak against transactions that may involve conflicts of interest between the controlling shareholder and minority shareholders.

Activist shareholders are also engaging in shareholder activism with respect to M&A transactions, including mergers, share exchanges or tender offers, in which the support of a certain number of shareholders is necessary to successfully complete such transactions. Activist shareholders may speak against the disclosed transactions, and demand that the company amend certain terms that are, in their view, inappropriate, such as purchase price. These cases often occur in transactions involving conflicts of interests between a controlling shareholder and minority shareholders. This M&A activism may result in a change in the acquisition structure or increase of acquisition costs for the transaction. Some activist shareholders also exercise, after completion of the transaction, their appraisal rights as dissenting shareholders, and file a petition to the court for a determination of the fair price for the relevant shares.

Some Japanese companies have been targeted by short selling activist funds. These funds short the shares of a target company by borrowing shares of the target company and then issuing reports to the public stating that shares in the target company are overvalued.

17 As a result of the tax reform in 2017, the deferral of taxation arising from certain spin-off transactions in which a part of the company's business is carved out and shares in the business are distributed to its shareholders through dividends in kind, is permitted.

After the price of the target company's shares drop, the funds purchase the shares to make a profit through the difference between the price of these purchased shares and the price of the borrowed shares.

There are also activist shareholders who take actions mainly in consideration of social issues, which is different from the more common type of shareholder activism that focuses on the increasing shareholder value of the company. For example, shareholder proposals concerning nuclear power generation have been submitted to electric power companies.

iv Tactics used by activist shareholders

Closed engagements

An activist shareholder typically initiates contact with the company in which it has acquired shares by sending a letter to the company describing its demands, after which the shareholder and company engage in private communications. An activist shareholder usually requests quarterly or biannual meetings with the management of the company. Some activist shareholders try to resolve issues of the company by proposing alternatives or solutions, or providing advice in a friendly manner, and are reluctant to make their engagement with the company public.

Public campaigns

If activist shareholders decide that they cannot achieve their objectives through non-public engagements with the company, they may wage public campaigns with the aim of attracting the support of other shareholders for their objectives. Elements of public campaigns include the following:

a issuing press releases;
b posting white papers or relevant information on websites prepared by the activist shareholders for the campaigns;
c placing web advertisements;
d disseminating letters to shareholders;
e providing information through the media; and
f holding information sessions for other shareholders.

Given that the support of public opinion is important in the public campaigns, the tools used by activist shareholders to conduct public campaigns are becoming more sophisticated as ways to deliver information to the public have become more diverse. If the company and the activist shareholder reach agreement prior to the submission of a shareholder proposal and commencement of a proxy fight, the activist shareholder can avoid bearing the expenses relating to the proxy fight.

Shareholder proposals and proxy fights

To effect changes in companies, activist shareholders can use the right of shareholder proposals under the Companies Act. Moreover, activist shareholders may conduct proxy solicitation in accordance with the FIEA to obtain votes for the shareholder proposals or votes against agendas proposed by companies that are opposed by the activist shareholders. As explained above, activist shareholders who intend to obtain approval for certain agenda items at the shareholders' meeting do not necessarily have to make a proxy solicitation because they can communicate their proposals and the reasons for these proposals to other shareholders by

having the company dispatch the convocation notice and reference documents describing the summary of the proposals at the company's expense. However, there are practical advantages for an activist shareholder to engage in proxy solicitation, including (1) the submission by shareholders of a voting card to the company that is left blank is generally treated as a vote in favour of the company's proposal and against the shareholders' proposal, (2) the reason for the shareholder proposal set forth in the company's reference documents is subject to a character count limit set by the company, but there is no such limit in the case of a proxy solicitation, and (3) a proxy can authorise a procedural motion at a shareholders' meeting.

If an activist shareholder conducts the proxy solicitation to garner support for its cause, it often approaches and tries to persuade proxy advisers, such as Institutional Shareholder Services, Inc (ISS), which is considered influential, especially on US-based institutional investors, and Glass, Lewis & Co, which is considered less influential than ISS. The proxy advisers often recommend that investors vote against proposals made by the board of directors and that they vote for shareholder proposals. In such cases, companies should promptly issue press releases stating their objections against recommendations by the proxy advisers.

Empty voting and morphable ownership

Empty voting (i.e., votes by shareholders who have more voting rights of shares than economic ownership in the shares because the shareholders own voting rights of shares that are decoupled from the economic ownership of the shares) may be used by activist shareholders. Empty voting may be implemented by, among other means, equity swaps or record date capture by borrowing shares. Empty voting deviates from the principle of one-share-one-vote in stock companies, and may result in resolutions of shareholders' meetings that are not properly aligned with the interests of the company or its shareholders as a whole because empty voters' voting rights in the company are not in proportion to their economic interests in the company. Thus far, there has been no reported case in Japan in which a grossly improper resolution was made or a proper agenda item was voted down at a shareholders' meeting as a result of empty voting.

As a related issue, an activist shareholder may substantively own shares in the company without disclosure by using equity derivatives. Given that dealers that sell equity derivatives usually purchase matched shares in practice to hedge their risks involved in the equity derivatives, activist shareholders, when necessary, may have the ability to terminate the equity derivatives and purchase the matched shares held by the dealers (morphable ownership). Activist shareholders may suddenly emerge in this way as shareholders owning a large amount of the shares without giving the company adequate time to prepare for the shareholder activism.

Litigation

Activist shareholders sometimes engage in litigation as a tactic of shareholder activism, such as seeking an order of provisional disposition for enjoinment of directors' actions and bringing a derivative action against directors of the company to recover for damages and liabilities caused by such directors. Activist shareholders often place pressure on the directors by expressing their willingness to bring actions to the courts to achieve their goals.

Hostile takeovers

The most aggressive approach of shareholder activism is a hostile takeover, which is an acquisition of shares in a company by an activist shareholder without the consent of the management of the company through on-market transactions or tender offers. However,

a limited number of hostile takeovers have been successfully consummated in Japan partly because there have been stable shareholders in the companies subjected to such takeovers and public opinion in Japan has been generally against hostile takeovers thus far.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Campaigns by foreign large activist funds

Activist shareholders have recently targeted large-cap companies in Japan as in the case with the United States and other countries. One of the most well-known activist hedge funds in the United States, Third Point, has held shares of several Japanese large-cap companies. For example, Third Point proposed to the electronics company Sony Corporation (market capitalisation as at August 2013: approximately US$20 billion) that it should carve out its entertainment business and make an offering of shares in the entertainment business to the public, although Sony Corporation ultimately announced that it refused to undertake the proposal in August 2013. According to public information, Third Point also urged the machinery manufacturing company Fanuc Corporation (market capitalisation as at April 2015: approximately US$43 billion) to repurchase a large amount of its shares and to increase the amount of dividends to improve its capital efficiency. Third Point's conduct may have prompted Fanuc Corporation to take actions to increase its shareholder returns during 2015 when Fanuc Corporation made a buy-back of its shares and paid a large amount of dividends.

ii Nomination of directors

In the past few years, there have been a number of cases of companies accepting the elections of directors recommended by activist shareholders. For example, in 2019, Olympus Corporation nominated a partner of ValueAct, the US-based activist fund, as a director, and Kawasaki Kisen Kaisha, Ltd nominated a director of Effissimo Capital Management, a Singapore-based activist fund, as a director. Toshiba Corporation disclosed in 2019 that it engaged in discussions with its major shareholders, including activist shareholders, in the course of its determination of the company's director candidates.

Reno, Inc – which is considered to have some connection with the well-known Japanese activist fund Murakami Fund and owned approximately 35 per cent of the shares in Kuroda Electric Co, Ltd with Reno, Inc's joint holders – submitted a shareholder proposal to elect an outside director designated by Reno, Inc for the annual shareholders' meeting of Kuroda Electric Co, Ltd in June 2017, which was approved at the shareholders' meeting. This example suggests that shareholders in Japan are becoming comfortable with, and supportive of, shareholder activism.

iii Litigation

Effissimo Capital Management has acquired shares in a number of listed companies that have a parent company. Effissimo Capital Management, which owned approximately 30 per cent of the shares in car manufacturer Nissan Shatai Co, Ltd, brought a derivative action to recover damages caused by directors of the car manufacturer and sought an injunction in court against certain acts of the directors on the grounds that the directors were violating their duties of care and loyalty. The fund claimed that the directors were violating their duties because Nissan Shatai Co, Ltd deposited a large amount of cash with a low interest rate in a subsidiary of Nissan Motor Co, Ltd, which is a parent company of Nissan Shatai Co, Ltd, by participating in the cash management system of the Nissan Motor group without reasonable reasons,

and the directors of Nissan Shatai Co, Ltd did not manage its cash efficiently. Yokohama District Court dismissed the case in favour of the directors in February 2012.[18] According to news reports, a Hong Kong-based activist fund, Oasis Management Company Ltd, filed a provisional injunction against the directors of Toshiba Plant Systems & Services Corporation with the Yokohama District Court in March 2017 to prevent it from depositing funds with the parent company, Toshiba Corporation. As a result, Toshiba Plant Systems & Services Corporation withdrew the deposit amount, which was, as at 31 March 2016, approximately US$760 million, from Toshiba Corporation. These cases indicate that activist shareholders are willing to engage in court and litigation procedures to accomplish their goals.

iv M&A activism

Oasis Management waged a public campaign in 2016–2017 against the acquisition by Panasonic Corporation of its listed subsidiary, PanaHome Corporation, by asserting that the consideration to be paid was lower than the fair value of the shares in PanaHome Corporation. Panasonic Corporation changed the structure of the acquisition from a share consideration transaction through a share exchange to a cash consideration transaction through a tender offer after Oasis Management commenced the public campaign. Oasis Management also waged a public campaign in 2017–2018 against the integration of a business through a share exchange in which Alps Electric Co, Ltd would acquire all the shares in its listed subsidiary, Alpine Electronics Inc. In this case, Elliott Management, the US-based activist fund, also purchased approximately 9.8 per cent of the shares in Alpine Electronics Inc as well as approximately 11.2 percent of the shares in Alps Electric Co, Ltd, after the public announcement of the share exchange. Oasis Management filed a suit in court after the completion of the transaction asserting that the share exchange was invalid; the suit is still pending in court.

Elliott Management purchased shares in Hitachi Kokusai Electric Inc, which represented approximately 8.6 per cent of the issued shares of the company, after the public announcement by KKR of a tender offer for the shares in Hitachi Kokusai Electric Inc. KKR eventually increased the tender offer price by approximately 25 per cent to facilitate the success of the tender offer transaction.

V REGULATORY DEVELOPMENTS

The Companies Act was amended on 1 May 2015. One of the purposes of the amendment was to enhance the corporate governance of companies; for example, to prompt companies to have outside directors. The amended Companies Act allows a company to adopt a new governance structure in which the company has an audit and supervisory committee. An audit and supervisory committee audits the activities of directors of the company, and a majority of the members of the committee must be outside directors. In January 2019, the subcommittee of the Legislative Council of the Ministry of Justice issued the outline of amendments to the Companies Act, which includes changes in the shareholder proposal rights.

In addition, the Governance Code was issued in June 2015 and the Stewardship Code was issued in February 2014. Consequently, 2015 is often referred to as the first year of corporate governance for listed companies in Japan.

18 Yokohama District Court, judgment, 28 February 2012, not cited in digests.

The FSA also issued the Guidelines for Investor and Company Engagement, which is intended to be a supplemental document to the Governance Code and the Stewardship Code. (Details of the Governance Code and the Stewardship Code are discussed in Section II.iii).

The FIEA was amended on 1 April 2018. This amendment provides a fair disclosure rule pursuant to which if a listed company transfers certain of its unpublicised material information to certain persons, including investors, the company must disclose the information to the public at the same time. Listed companies need to take into account this fair disclosure rule as well as the insider trading rules under the FIEA when they communicate with activist shareholders and other institutional investors.

As the reduction of cross-shareholdings moves forward as encouraged in the amended Governance Code, the Cabinet Office Ordinance on Disclosure of Corporate Affairs (Ordinance of the Ministry of Finance No. 5 of 30 January 1973) was amended in January 2019 to require companies to disclose in their annual securities report more detailed information concerning cross-shareholdings, including the number of increased or decreased shares, the purchase prices thereof and the reasons for the increase.

VI OUTLOOK

The Governance Code has prompted, and will continue to prompt, listed companies to place greater importance on establishing and maintaining dialogue and relationships with their shareholders. The concerns and actions of institutional investors have become, and will likely become more, similar to those of activist shareholders, such that the demands and voting behaviour of institutional investors with respect to companies in which they own shares will become more strict or demanding. If more cross-shareholdings are dissolved in the future, the number of shareholders who support the management of companies may decrease, and the number of shareholders who are supportive of activist shareholders may increase. As a result, the influence of shareholder activism on the management and direction of companies may increase further. Therefore, the management of listed companies should operate the companies, including conducting proactive engagement and communications with the companies' shareholders, and make appropriate preparations to take into account increasing shareholder activism if they are actually targeted by activist shareholders.

Appendix 1

ABOUT THE AUTHORS

AKIRA MATSUSHITA

Mori Hamada & Matsumoto

Akira Matsushita is a partner at the Tokyo office of Mori Hamada & Matsumoto. He focuses on cross-border and domestic mergers and acquisitions transactions, corporate governance, shareholder activism, takeover defence, and general corporate and securities law matters. He has extensive experience in advising listed companies subject to shareholder activism, proxy fights or unsolicited takeovers, and in representing clients in high-profile inbound and outbound cross-border mergers and acquisitions transactions.

Mr Matsushita was admitted to the Japanese Bar in 2006 and the New York Bar in 2013. He received his LLB from Keio University in 2005 and his LLM from Cornell Law School in 2012. He also worked at Kirkland & Ellis LLP, Chicago, from 2012 to 2013.

MORI HAMADA & MATSUMOTO

16th Floor, Marunouchi Park Building
2-6-1 Marunouchi
Chiyoda-ku
Tokyo 100-8222
Japan
Tel: +81 3 6266 8553
Fax: +81 3 6266 8453
akira.matsushita@mhm-global.com
www.mhmjapan.com

ISBN 978-1-83862-052-3