The Proper Role of Takeover Defense Measures in Light of Changes in Various Environments

June 30, 2008

METI Corporate Value Study Group

Translation by David Alan Makman
Howrey LLP
415-848-4932
makmand@howrey.com

DM_US:21330499_1

This translation is for convenience only, and the original Japanese text should be consulted before any decisions are made in reliance on this report.

1. Takeover Defense Measures, Their Purpose and Their Proper Role.

Takeover defense measures, [1] ultimately, are premised on protecting shareholder's interests. Rights plans in the United States are a mechanism that makes it possible for shareholders to coerce better acquisition conditions and/or management plans. They are premised, in the end, on the idea that shareholders will determine whether an acquisition is good or bad through the appointment and/or removal of directors at a shareholder meeting. That is to say, a rights plan is understood to be a device that protects the interests of shareholders.

In addition, when considering the proper role of defense measures, one must heed the fact that hostile takeovers have positive effects because the existence of the threat of takeover gives discipline to management and can increase shareholder gains.

Further, it should be understood that when shareholders use takeover defense measures to prevent an acquisition, those shareholders are taking away an opportunity to sell the company.

On May 27, 2005, the Ministry of Economic Trade and Industry ("METI") and the Ministry of Justice ("MOJ") published "Guidelines Regarding Takeover Defenses for the Purposes of Protection and Enhancement of Corporate Value and Shareholders' Common Interests" (hereinafter the "Policy"). In that document, METI and the MOJ approved takeover defense measures for purposes such as (i) providing adequate time so that shareholders could evaluate whether or not the acquisition should take place and, also, so that management of the acquiring company and the target company could negotiate, or (ii) preventing a transaction that would clearly damage shareholder common

[1] In this report, the term "takeover defense" refers to the general idea of such things as the allotment, without compensation, of new stock acquisition rights having discriminatory exercise conditions or unique stipulations. However, it is believed that the fundamental concepts of this report could also be used with other takeover defense measures.

interests. Such defenses were conceived as a way to protect and enhance the common interests[2] of shareholders.

It is absolutely not permitted for management, in violation of the above-mentioned purposes of takeover defense measures, to use such measures to protect their own positions and thereby prevent an acquisition that would enhance the common interests of shareholders. This Corporate Value Study Group cannot support any such use of a takeover defense measure.

In the report below, given the fact that more than 500 companies in our country have implemented takeover defense measures based on the Policy, we want today to set forth the way that rational takeover defense measures should established be in order to properly obtain the assent and understanding of shareholders and investors. We will explain those rational takeover defense measures and their relationship to past court decisions.

2. The Proper Role of Takeover Defense Measures in Light of Current Circumstances.

Since the establishment of the policy, many different takeover defense measures have been adopted in our country. As a result, there have been a number of cases involving takeover defense measures and there are several civil court decisions.

Therefore, we think that, in light of current circumstances, takeover defense measures should be as stated below.

(1) With regard to the exercise of takeover defenses: because the provision of monetary compensation[3] would have the contrary effect of inducing the exercise

---

[2] In the Policy, from the third page onward, the term "corporate valuation along with shareholder common interests" was simplified and referred to as "shareholder common interests." We will use the same terminology in this report. In that regard, in the Policy and in this report, the term "corporate value" is conceived to mean the "current value as a discounted valuation of cash flow," and it should be understood that the term should not be arbitrarily expanded when interpreting the policy or this report.

of takeover defenses and,[4] as a result, would cause the shareholders to lose the opportunity to make an appropriate decision, based on adequate time and information, as to whether or not the acquisition should go forward, there is a problem that providing monetary consideration could prevent the development of a healthy capital market. Accordingly, the acquirer should not be provided with monetary compensation.

Furthermore, there is the concern that this kind of provision of monetary compensation, essentially, could result in money being transferred to the acquirer, which would damage the interests of shareholders, when the money should, instead have been used in the common interest of shareholders by being distributed to shareholders or re-invested in the company.

To begin with, the directors of the target company should not exercise takeover defense measures unless they can responsibly explain that they can exercise such measures without providing monetary compensation because the acquisition would damage shareholder common interests.

(2) With regard to the argument that the directors only need to formally seek a decision at a general shareholders meeting and receive a majority approval in order to avoid making their own decision, if there is a structure that causes measures to pass the shareholder decision, there is a problem because this can

---

[3] Naturally, the provision to the acquirer of new stock acquisition rights having discriminatory exercise conditions or unique stipulations itself is not included in the meaning of "monetary compensation" as used here.

[4] Under an American rights plan, the target company, from the beginning, provides new stock acquisition rights to the shareholders, and the defense is contrived so that, when there is an acquisition that would damage shareholder common interests, the acquirer's ownership percentage is greatly diluted because a large volume of shares are issued to a third party. However, the purpose is not to actually stop the acquisition by exercising the defense, but to temporarily stop the takeover from going forward both so that there is time for the acquirer and the target company to negotiate, and also so that pressure can be applied to the acquirer. Concretely, because there is a structure such that the acquirer would suffer losses if it went forward with the acquisition, it becomes necessary for the acquirer to pause before starting the acquisition. The acquirer must negotiate with the target company in order to eliminate the new stock acquisition rights. As a result, the directors of the target company are able to guarantee sufficient time and information to allow shareholders to decide whether or not to permit the acquisition. Alternatively, it becomes possible for the directors of the target company to improve and increase the terms of the proposed acquisition. Accordingly, so long as the acquirer behaves rationally, there is no need to execute the rights plan.

Taking heed of the points above, the provision of monetary compensation does not damage the acquirer and therefore provides no incentive to temporarily stop the acquisition. As a result, the provision of monetary compensation has the contrary result of helping induce the exercise of takeover defense measures.

Also, if the company provides monetary compensation, it becomes very difficult for a court to deny the appropriateness of the takeover defense measures, and therefore such provisions might encourage the directors of the target company to exercise the defense rather than actually guaranteeing that shareholders have the time and information that are needed to properly deliberate and review the acquisition plan.

only send the unfortunate message to interested parties that the company is capable of forming an unassailable defensive structure.[5]

For the situation with actual acquirers, we can go so far as to say that it would be an avoidance of responsibility for the directors of the target company, who bear a duty of good care (*zenkanchuuigimu*) as managers to completely entrust the decision of whether or not to go forward with an acquisition to shareholders and thereby avoid making their own initial determination of whether or not a proposed acquisition plan is appropriate to the common interests of shareholders.

Accordingly, in the event of a takeover situation, the directors of the target company have a responsibility and must act with discipline.

Under these circumstances, we are concerned that takeover defense measure could be used by management for the purpose of protecting themselves, and not for the purpose of protecting shareholder common interests as was the original purpose of the defenses. In order to restrain the possibility of such improper uses, at this time, we should investigate, from the standpoint of the purpose of takeover defense measures, "the proper way for the acquirer and the target company to proceed in actual takeover situations."

In connection with our investigation, it should be remembered that the Policy relates to the adoption of takeover defense measures before a takeover. Just because a takeover defense measure was properly adopted does not make it unconditionally appropriate to exercise that defense. In addition, the Policy was developed without considering what takeover defense measures ought to be adopted if a potential acquisition has already been initiated.

---

[5] The Supreme Court opinion in the Bulldog Sauce Case (Supreme Court Decision August 7, 2007) states: "When the contents of the new stock acquisition rights that are distributed to shareholders include allotment without compensation of discriminatory new stock acquisition rights, and do not support the value of the company or shareholder common interests, but are clearly intended to support the management control rights of a particular director in charge of management or of a specific shareholder that supports management, in principle we should interpret that allocation of new stock acquisition rights as having been the result of improper procedure." This is what is meant when we refer to an "unassailable defensive structure."

In this report, the discussion below will consider the full range of how one should adopt and execute takeover defense measures, as of today, with all of these problems in mind.

In that regard, the court decisions to date have almost all involved misappropriation (or abuse) of shareholder common interests, and addressed takeover defense measures that were being used to prevent a takeover from taking place. Such cases are different from cases where takeover defense measures are intended to provide adequate time and information to consider and negotiate an acquisition. It is necessary to fully understand this and consider it when reviewing the thought processes that are explained in the court decisions that have been handed down to date.

3. Investigation

(1) The proper fundamental viewpoint, and the way that the directors of a target company should act.

The Policy asserts that "takeover defense measures are dependant on the rational intent of the shareholders" (principle of shareholder intent), and leaves the final determination of whether or not to go forward with the acquisition to the shareholders.

On the other hand, the directors have the duty to maximize shareholder value, and therefore cannot evade their responsibilities by formally seeking a decision at a shareholder meeting, but must meet their own responsibility by making their own determination of whether or not it is necessary to adopt and exercise takeover defense measures. They must also meet their obligation to explain their opinion to shareholders. Accordingly, it is necessary to explain how directors of a target company should behave in acquisition situations from the viewpoint of the purpose of takeover defense measures, *i.e.*, the shareholder common interests.

However, the appropriate actions of directors in an acquisition situation will differ depending on the contents of the acquisition plan and the appropriateness of the acquiring party. Therefore, each situation is unique. Accordingly, it is difficult to identify uniform standards for action. Instead, we have identified below the fundamental way of thinking that should be used when employing takeover defense measures.

① In cases that don't genuinely involve the protection and increase of shareholder common interests, directors shall not make it unclear what interests the takeover defense measures are intended to protect by broadly interpreting the necessary conditions of exercising the measures to include the interests of people other than shareholders.

② When it is difficult to say that there will actually be damage to shareholder common interests, directors shall not assert that, in their opinion, it is necessary to execute takeover defense measures based only on the fact that it is likely that the target company's assets will be used to secure the acquisition or that the target company's idle capital will be disposed of through distribution.

③ Directors shall not usurp any opportunity for acquisition by intentionally and repeatedly extending the time to determine whether or not the acquisition should take place such that the time for considering the acquisition plan is extended beyond logical limits.

④ Directors must conduct a sincere investigation[6] of the attributes and means of the acquirer, and must consider such things as the contents of the acquisition plan, the terms of the acquisition and the effect of the acquisition on shareholder common interests. The investigation must be conducted from the viewpoint of whether or not the planned acquisition will enhance the common interests of shareholders.

⑤ Directors must negotiate sincerely with the acquirer and seek to obtain improved terms of acquisition in cases when there is a possibility that the acquisition terms could be improved in such a way as to enhance the common interests of shareholders.

---

[6] With regards to the acquisition plan, the directors should conduct an investigation that includes a financial analysis and an analysis by an external expert.

⑥ In cases where the directors are of the opinion that the acquisition plan will increase shareholder common interests, the directors shall decline to execute takeover defense measures and shall not refer the issue to a general meeting of shareholders.

⑦ In order that shareholders can determine whether or not the acquisition should take place, directors must meet their obligation to explain the acquisition to shareholders by using facts to the extent that it is possible to do so, and by explaining their own evaluation of the acquisition plan.

⑧ In cases where a special committee is formed, the directors must meet their obligation to ensure that the committee is independent from current management and must accept responsibility for the decision to follow any recommendation of the committee.

(2) Summary of thoughts regarding defensive measures.

The question of whether or not takeover defense measures will increase shareholder common interests can be different depending properties of the actual acquisition conduct, and therefore each case can be strongly different from the last. Holding this understanding in mind, in order to investigate the various problems that arise in with takeover defense measures, we set forth below a summary of our investigation of the various court examples that have arisen in the past. Our investigation is made with reference to the purpose and facts of each case.

① The case where shareholders are given adequate time and information to make the decision about the acquisition, and the acquirer and target company have time to negotiate

Tokyo District Court Decision in the Japanese Technology Development Case (July 29, 2005).[7]

---

[7] *Hanrei Jihou* Vol. 1909, page 87. This case did not involve the use of takeover defense measures that included the allotment without compensation of new stock acquisition rights. Rather, it is a case where a device was used that, when exercised, diluted shares without changing the acquirer's percentage of

② **The case where the acquisition plan is reviewed and a substantive decision is made that stops the acquisition.**

In general, when an acquisition is stopped and does not go forward because takeover defense measures were exercised, it means that those shareholders who are against the acquisition have appropriated an opportunity for those shareholders who want to sell their shares to do so. Accordingly, in principle it should only happen in limited cases that, after consideration of the substance of an acquisition plan, the takeover defense measures are exercised. When looking at cases where this has occurred in the past, there are two main categories.

(a) The case of an abusive transaction that would clearly cause damage to shareholder interests.

The opinion of the Tokyo District Court in the Nippon Broadcasting case (March 23, 2005).[8]

(b) The case where there has been a substantive decision that the acquisition would cause damage to shareholder interests.

The opinion of the Supreme Court of Japan in the Bulldog Sauce Case (August 7, 2008).[9]

---

ownership. The court held that, for the purpose of providing time to shareholders so that they could decide whether to entrust management of the company to existing management or to the possible acquirer, it was the directors' duty to ensure that shareholders were given adequate time to make their decision. Therefore, the directors could take appropriate steps to provide that time, so long as those steps were within the content and intent of relevant statutes.

[8] *Hanrei Jihou* Vol. 1899, Page 56. In this case, the conclusion was that the acquisition was not abusive, and the court granted a preliminary injunction to prevent the issuance of new stock acquisition rights, but the court also indicated that in specific circumstances where the acquisition was abusive, directors could exercise takeover defense measures.

[9] *Minshuu* 61 Vol. 5, Page 2215. In a case where takeover defense measures were exercised on the basis of a decision made by shareholders at a general meeting, where almost all of the shareholders other than the

In the discussion below, we consolidate our thoughts about the above two sorts of decisions with regards to the issues of the intent of the shareholders and also with regard to the issue of providing monetary compensation to the acquirer.

(3) The case where shareholders are given adequate time and information to make the decision about the acquisition, and the acquirer and target company are given adequate time to negotiate.

① The relationship to the principle of shareholder intent.

Using the needs for time, information and a chance to negotiation as a pretext but with the purpose of stopping the acquisition, and repeatedly delaying by asking the acquirer to provide more information and to provide additional time to consider the acquisition plan, when such conduct is intentional, should not be permitted.[10]

If this sort of arbitrary practice is not at issue, but instead the case is one where the delay is intended to create time to provide information to shareholders and allow them to determine whether the acquisition is appropriate or not (or, alternatively, when the extensions are intended to provide additional time to negotiate with the acquirer in order to obtain better acquisition conditions) and, if the directors have put defensive measures in place but the acquirer, in violation of procedures that are clearly rational, declines to slow down the acquisition, then it would be appropriate to exercise the takeover defense measures.

Related to this point, in the Japan Technology Development case, the court's opinion says that "[t]he directors are permitted to exercise their rights in a manner that appropriately provides the necessary information for the shareholders to make their decision, and in addition, provides them sufficient time to make that decision." And,

---

potential acquirer determined that the acquisition would damage the interests of the company and harm shareholder common interests, the court allowed the exercise of the defense measures.

[10] It is not appropriate to exercise takeover defense measures for the reason that the acquirer has not provided information in response to a request for more information than the level that is necessary in order for shareholders to evaluate the pros and cons of the acquisition. Of course, the level of information that is necessary in order for shareholders to make their decision should be determined objectively, and it is not appropriate for the directors to make their determination of that level for selfish reasons.

"there will also be cases where it is permissible to take steps to protect shareholder interests for the reason that shareholders do not have the necessary information or appropriate amount of time to make their decision."[11]

Against this, if the acquirer adopts a rational procedure, and the shareholders are provided sufficient time and information to make a decision and there is an opportunity for negotiations, and the decision is made to execute the takeover defense measures based on a substantive decision that the acquisition plan would cause damage to shareholder common interests, then one should consider the issues discussed in section (4) below, and not the issues that are discussed here.[12]

② **The provision of monetary compensation to the acquirer.**

The final decision of whether or not the acquisition should take place should be made by the shareholders. Accordingly, if the acquirer violates rational procedure, and does not provide the shareholders with sufficient time or information to make a decision or an adequate opportunity for negotiations, then it is not necessary to provide monetary or other compensation to the acquirers. In such a situation, the acquirer has had the opportunity to provide time and information and an opportunity to negotiate, and having

---

[11] Specifically, the opinion reads as follows. (Japan Technology Development Case, Tokyo District Court Decision, July 29, 2005.) "When there is a dispute over whether current management or a hostile acquirer should have right to control management of a company, the decision should be made by shareholders. Therefore, it is permissible for the directors to seek to provide necessary information and time to deliberate on the issue. Accordingly, when there is a dispute with a potential acquirer over control of the company, it is not an abuse of the director's rights for the directors to request the acquiring party to provide a business plan and for time to consider that plan. In addition, it must be said that the directors, with the purpose of obtaining appropriate information to allow shareholders to make their decision, can take steps to protect all shareholders' interests when the acquirer does not respond to rational requests or provide necessary information and adequate time to deliberate." (Emphasis added.)

[12] For example, when an actual acquisition has commenced, if we assume that the shareholder's opinion of whether the acquisition is good or bad shall be ascertained at a shareholder meeting that is already scheduled to take place on a specific date, then if takeover defense measures are used to temporarily stop the acquisition until the time of the scheduled shareholder meeting, section (4) would not apply, but instead, section (3). Similarly, in situations of this sort, when the director's proposed management appointment plan and the shareholders proposed management appointment plan are presented in opposition at a shareholders' meetings, and a choice is made, section (4) would not apply, but instead section (3).

failed to follow procedure, it is appropriate (see discussion on page 14) to provide cash when the measures are executed.

③ The standard for disclosure of information to the shareholders.

In this category (3), it is necessary to discuss the appropriate way to provide information in light of the fact that the purpose of takeover defense measures is to allow the shareholders the necessary time, information and negotiation opportunity that will allow them to make an appropriate decision about the acquisition.[13]

(a) The way that the target company should provide information.

As already stated, the directors have a duty to provide explanations to shareholders that will allow them to make the decision as to whether or not the acquisition should happen, but, from this viewpoint, it is desirable that management of the target company provide specific explanations of (i) current management's vision, management policies, and change of ownership (ii) current management's evaluation of the acquisition value, and (iii) if current management is of the opinion that the acquisition would cause harm to the common interests of shareholders, then an explanation of the thinking and financial amount of that harm.[14]

---

[13] In this section, we are investigating, from the viewpoint of management's obligation to explain the amount of information that can be required from the acquirer and from existing management in order for shareholders to be able to evaluate whether the acquisition is good or bad.

In order to ensure justice in capital markets, from the viewpoint of providing information to shareholders and capitalists, there are public disclosure laws provided in the law of financial transactions, and, of course, the acquirer and the target company must follow those laws.

[14] However, with regards to the acquisition price discussed in item (ii), it is difficult to require disclosure of the estimated lowest acceptable price.

However, with regard to the statement of management vision and policies (item (i) above), such statements have long been part of managements duties to shareholders. Therefore, if such disclosures have been properly made, then in an actual acquisition situation it should be sufficient to provide a timely update to the existing statement.

(b) The standard for the disclosure of information by the acquirer.[15]

If an acquirer were forced to disclose either its own lack of due diligence or the specific amount of the profits that it hopes to make after the sale, such disclosure would expose the acquirer's full hand, making it difficult for the acquirer to execute any acquisition strategy. Therefore, there is a limit to the amount of information that the acquirer should voluntarily disclose. That is to say, the acquirer should only be required to make a limited disclosure of its detailed management plans, forecasts or planned achievements.[16] [17]

---

[15] It is desirable that the acquirer and the target company both communicate the contents of their plans directly to shareholders, and that opportunities to communicate and negotiate are justly preserved. For that purpose, it is desirable that the acquirer be able to accurately ascertain who the shareholders are by inspecting the register of shareholder names. In the case of an acquirer requesting to inspect the register of shareholder names even if there were a legitimate reason to reject that request, under the company law, it is not contemplated that such requests can be uniformly rejected. (Japan Housing Case, Tokyo High Court, June 12, 2008).

[16] For example, it would not be appropriate (i) to demand from the acquirer an exhaustive disclosure of the bases for calculating the acquisition price including things like the facts that underlie the computation, the hypotheses, the information about the values associated with those hypotheses, the values associated with any synergies, or the bases for calculating those values, or (ii) with regards to policies after acquisition to demand details of business plans, financial plans, capital structure, dividend policies, or use of properties, and then to rely on the fact that these exhaustive demands are not met as a basis to exercise takeover defense measures.

[17] Especially in the event of an acquisition that is 100% cash and leaves no minority shareholders (*i.e.*, the amount of monetary compensation being offered to each shareholder is a publicly-disclosed value, and the offer is on condition that two thirds or more of the shareholders must accept and the acquirer commits that, on obtaining the rights of more than two thirds of the shareholders, the remaining shareholders will be bought out at the same price) it is thought that these is no need for the acquirer to disclose their detailed business plans, forecasts or expectations.

However, it is necessary for the acquirer to disclose its enough of its management plans and fundamental policies to allow the shareholders the time, information and negotiating opportunity that the takeover defense measures are intended to guarantee.[18]

(4) The case where the acquisition is stopped after a substantive decision has been made based on the contents of the acquisition plan. (See 3.(2)②(a),(b))

① Relationship to the principle of shareholder intent.

(a) Exercise in response to an abusive acquisition that would clearly cause damage to shareholder common interests. (See above 3.(2)②(a))

With regard to an acquisition where it has been determined that the acquirer has an abusive purpose that would clearly cause damage to shareholder common interests, it is accepted that, from the viewpoint of protecting shareholder common interests, the directors can exercise takeover defense measures at their discretion. (Nippon Broadcasting Tokyo High Court Decision.)[19]

(b) Exercise after a substantive decision regarding whether or not the acquisition plan would damage shareholder common interests. (See above 3.(2)②(b))

As stated above, the exercise of takeover defense measures should based on a substantive decision regarding whether or not the acquisition plan would damage

---

[18] It is necessary for the acquirer to disclose its fundamental policies for after the acquisition takes place so that the shareholders can evaluate the appropriateness of the offer, and so that the directors of the target company can provide their plan for subrogation.

[19] Specifically, the opinion indicates as follows (Nippon Broadcasting Case, Tokyo High Court Opinion, March 23, 2005): "From the viewpoint of protecting all shareholders, if the company can clearly prove there are special circumstances regarding the appropriateness of issuing new stock acquisition rights, specifically that the hostile acquirer is not sincerely aiming to manage the company rationally, and the change of control resulting from the hostile acquisition will cause a harm from which the company would have difficulty recovering, then we would not be able to enjoin the issuance of new stock acquisition rights that would have the effect of returning management control to the company."

shareholder's common interests should be limited.[20] And, even assuming such exercise occurs, it is necessary to meet the requirements of demonstrating the need and appropriateness of the decision to exercise the defense.

One might think that the expression by shareholders at a general meeting of an intent to agree is sufficient information to provide the rational basis for exercising the defensive measures (See Cautions 1 and 2 below). However, one should realize that the fact that a majority of shareholders have expressed an intent to agree to the exercise of takeover defense measures is not sufficient to justify the takeover defense measure itself. That is to say, in relationship to the legality of the measures, in addition to evaluating whether or not the directors have met their obligation of providing an explanation to shareholders before confirming their intent, it is necessary to determine the appropriateness of the takeover defense measures by taking into consideration the quality of the acquirer, the contents of the acquisition plan, and the structure of the shareholders of the target company. (See Footnote 5 on Page 4 above).

> (Caution 1.): Under the corporate law, other than the items that are to be determined at a general meeting of shareholders, the directors (in companies that have directors) make the important decisions regarding managing the company, and, if we take into consideration the fact that one method for shareholders to make decisions regarding the management and the way the company should be run is through the appointment and/or removal of directors, the adoption or exercise of takeover defense measures, even when the right to decide is received from a majority of shareholders through the use of a so-called recommended decision, one could debate whether the takeover defense measures at issue are demonstrably based on the rational intent of shareholders.

> (Caution 2): In the case of (b) above, in addition to the time of adoption of the takeover defense measures, in an actual acquisition situation, there is an opinion that it would lack maneuverability if there were a rule requiring a general

---

[20] Even when the contents of the takeover defense measure are disclosed before an acquisition was commenced, if an acquirer respects and follows rational procedure, and respects the shareholder's right to adequate time and information to consider the offer as a matter of principle, the pros and cons of the acquisition should be determined by the shareholders either through a shareholder resolution of intent regarding the acquisition plan, or through the appointment and/or removal of directors.

shareholder meeting every time that the decision of whether or not to exercise takeover defense measures. However, on the one hand, it is essential that any decision be founded on the opinion of shareholders. Accordingly, in order for the directors alone to make the decision to exercise defensive measures, at a minimum, the conditions of exercise should be established at the time the measures are adopted, as appropriate to the individual situation, and there should be confirmation that the stockholders have approved of delegating the decision of whether or not to exercise the defensive measures to the directors. In such cases, it is necessary for the directors, when exercising defensive measures, to comply with the specific relevant conditions so as to remain within the scope of their approval. But, when determining whether or not they have complied with the conditions and acted within the scope of shareholder approval, one should pay attention to whether or not the directors have met their special obligations of explanation.

② **With regard to whether or not to provide monetary compensation to the acquirer.**

(a) Exercise in response to an abusive acquisition that would clearly cause damage to shareholder common interests. (See 3.(2)②(a) above)

In this situation, one could say that the defense is being exercised for appropriate reasons, and, therefore, there is no need to provide monetary compensation to the acquirer.

(b) Exercise after a substantive decision regarding whether or not the acquisition plan would damage shareholder common interests. (See 3.(2)②(b) above)

As stated above, when one acknowledges that the substantive decision of whether or not the acquisition plan will damage shareholder common interests is founded on the opinion of shareholders, it follows that, in addition to meeting the condition that the exercise must be necessary, one must also determine whether the condition that the exercise is appropriate has also been met. From that viewpoint, the acquirer can go around the appointment and/or removal of directors by disputing the exercise of the takeover defense measures at a shareholder meeting, and if, at that point, they are unable

to obtain the approval of a majority of shareholders other than the acquirer, then it is necessary to provide the acquirer an opportunity to modify or withdraw its acquisition offer before the defensive measures are exercised. That way, the acquirer can avoid the damage of having its holdings diluted. If this process is followed with regard to the acquirer, then there is no need to provide monetary compensation to the acquirer.

> (Caution:) The Supreme Court, in its opinion on the Bulldog Sauce Case, said "when the acquisition of management control by a specific shareholder is accompanied by damage to the profitability of the company or to shareholder common interests" (necessity) the principle of shareholder equity will not be violated even if a shareholder is discriminated against, "as long as the treatment does not violate the idea of equity and is not lacking in appropriateness" (appropriateness). If one follows the court's thinking, when a majority of shareholders, through the appointment and/or removal of directors, have concluded that the acquisition plan would damage shareholder common interests, that fact would establish that the takeover defense measures are necessary. In addition, as stated above, when there is a "possibility of damage" to the acquirer, as long as the acquirer has an opportunity to change the acquisition plan or abort the acquisition plan before its holdings are diluted by the exercise of the takeover defense measures, then, even if the acquirer is not provided with monetary compensation, the takeover defense measures will not lack appropriateness. If the terms of the takeover defense measures are disclosed prior to the commencement of the acquisition, and the acquirer proceeds with knowledge of the damage of dilution that will occur due to exercise of the takeover defense measures, then one could think that they have accepted the risk of the damage (there has been an "acceptance of risk" by the acquirer). With such acceptance of risk, it is appropriate to say that monetary compensation need not be provided.

(5) The appropriate constitution of special committees.

One device to persuade shareholders that takeover defense measures will not be arbitrarily applied, is to form a special committee and to give the highest level of deference to the recommendation of that committee.

However, there is some debate as to whether the responsibility of such a committee is vague. It is important to understand that directors cannot avoid their

obligation to make an appropriate decision by simply forming a committee and following its advice.

Accordingly, directors need to act responsibly in determining whether it is necessary to form a special committee, and also in determining the constitution of such committees. In addition, directors have a responsibility to explain to shareholders why the committee's decision is rational. It is desirable for the special committee to have a structure with independent outside directors at the heart. In any event, it is necessary to ensure that the committee is substantively independent of current management.

In addition, even though, in an actual acquisition situation, one may have to form a special committee and give the highest level of deference to the recommendation of that committee, it is important to be aware that the directors still have the final responsibility for the decision to follow the recommendation of the committee as well as the responsibility to explain to shareholders the reasons that the recommendation is rational.

4. In Conclusion

This report is a compilation of the proper role of takeover defense measures based on the developments in various environments since the Policy was promulgated.

This report is being published on June 30, 2008, at a time when many shareholder meetings have just been completed. We would like to emphasize that this report could not have been used for those meetings.

Attachment

There is an attachment that lists the membership of the group and the observers. I have not translated since I have no way to verify the pronunciation of the various names.

The Corporate Value Study Group includes representatives, financial companies, non-profit organizations, academics, large cap companies, and lawyers. The meetings were observed by representatives of the Ministry of Finance, The Ministry of Justice, and Tokyo Shouken.