
The Bull-Dog Sauce Takeover Defense

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I. Introduction

On 11 July 2007, Bull-Dog Sauce, a company listed on the second section of the Tokyo Stock Exchange, issued stock warrants based on a board resolution approved by its general shareholders' meeting on 24 June. These stock warrants had discriminatory terms that prevented Steel Partners Strategic Fund, a US-based investment funds that is Bull-Dog Sauce's leading shareholder with 10.25% of outstanding shares, and its affiliates from exercising the warrants.

As we will describe below, Steel Partners had made a tender offer for Bull-Dog Sauce, and the warrants were clearly part of a takeover defense aimed at lowering Steel Partners' equity stake to make it difficult for the investment fund to acquire management control.

Steel partners immediately dubbed the stock warrants as blatantly unfair, and sought a court injunction to block their issue. Nevertheless, both the Tokyo District Court (on 28 June) and the Tokyo High Court (on 9 July) rejected Steel Partners' request for injunction. Steel Partners filed an appeal with the Supreme Court, which overturned that appeal on 7 August.

With hostile takeover attempts by investment funds and other parties becoming more common, there is rising interest in takeover defense plans among listed companies in Japan. Takeover defenses, including so-called rights plans, have been widely introduced among listed companies in the US, but there seem to be almost no examples of their actually being implemented. This implementation of a takeover defense, or "poison pill," by Bull-Dog Sauce is Japan's first ever, and the courts' decision to allow that defense is also of great significance.

II. Details of the takeover defense and the events leading up to its implementation

Steel Partners was already Bull-Dog Sauce's leading shareholder by May 2007 with a 10.25% stake, and on 18 May initiated a tender offer at ¥1,584 per share with the intention of acquiring 100% of the company's stock.

Bull-Dog Sauce's management team responded by asking Steel Partners about its intentions and post-acquisition management plans, deemed the answers that it got to

be unsatisfactory, and announced on 7 June that it opposed the tender offer on the grounds that it could possibly harm the common interests of shareholders. At the same time, Bull-Dog Sauce's management proposed changes in the corporate charter and the issuance of stock warrants at the general shareholders' meeting on 24 June, where the proposals were approved by special resolution.

Stock warrant issues, which distribute free of charge share subscription rights (the right to receive shares) to all shareholders, can in principle be approved by board resolution (Article 278-3 of the Company Law). Bull-Dog Sauce decided to seek a special resolution from the general shareholders' meeting, which must be agreed by two-thirds of all shareholders in attendance, even though only a board resolution is sufficient, because the stock warrants were part of a takeover defense aimed at Steel Partners.

Specifically, all shareholders as of 10 July were to be awarded three stock warrants for each share that they held. The warrants, which could be exercised from 1 September until 30 September 2007 at an exercise price of ¥1, enabled each shareholder to quadruple the number of shares they held with a payment of only ¥3. Steel Partners and its affiliates, however, were ruled ineligible, and thus unable to exercise the stock warrants. Accordingly, with no change in the number of shares held by Steel Partners and all of the other shareholders exercising their warrants, Steel Partners' ownership stake would decline to 2.82%. In addition, the company was able to acquire the stock warrants held by shareholders other than those ineligible prior to the exercise period for the price of three shares in kind.¹ In other words, in order to avoid a situation in which the impact of the takeover defense could be weakened by shareholders not actively exercising their stock warrants, the plan was devised to ensure the same effect as if the company distributed gratuitously three shares of stock to shareholders other than Steel Partners.

Meanwhile, the company could acquire the stock warrants allotted to Steel Partners at a price of ¥396 each (one quarter of Steel Partners' tender offer price of ¥1584). Assuming no change in the company's financial position, a quadrupling of the number of outstanding shares would theoretically cause a decline in the share price to one quarter of its previous value. Steel Partner's offer price included a "control" premium, and it is unlikely that the share price would rise much higher than one quarter of the offer price after the takeover defense was actually implemented. Accordingly, if the company were to acquire the stock warrants allotted to Steel Partners, then Steel Partners could use the funds it received from the company to purchase shares on the market if it wanted to restore its stake back to what it was in percentage terms prior to initiating the buyout offer.²

¹ In this case, it was unclear whether the transfer of stock warrants to the company created a taxable event for shareholders who received shares, but it has been reported that the National Tax Agency (NTA) has decided not to tax shareholders (page 11 of the *Nihon Keizai Shimbun*, 12 July edition (in Japanese)).

² According to the same *Nihon Keizai Shimbun* article cited in Footnote 1 above, the NTA has taken the position that when cash is paid as compensation for stock warrants, that cash would be taxed as a gain on sale, and thus if Steel Partners were to receive cash, there is a possibility that it would be taxed on the event.

The resolution says that the stock warrants will not be issued if Steel Partners withdraws its tender offer prior to 5 July.³

Steel Partners responded to this on 13 June by seeking an injunction from the Tokyo District Court prohibiting the directors of Bull-Dog Sauce from passing a resolution on stock warrants and blocking issuance of the stock warrants. On 15 June, it then changed the terms of its tender offer, raising the price to ¥1,700 and pushing the expiration date back from 28 June to 10 August. On 19 June, it withdrew the portion of the injunction requesting prohibition of the stock warrant resolution. At the general shareholders' meeting held by Bull-Dog Sauce on 24 June, meanwhile, the company's proposals to change the corporate charter and issue stock warrants were both approved with 83.4% of the vote.

This decision by Bull-Dog Sauce to initiate a poison pill was thus made after Steel Partners initiated its hostile takeover attempt, and thus could be considered a "contingency" takeover defense, or "morning after pill."

III. The Tokyo District Court's decision to overturn Steel Partners' motion

1. Overview of the District Court decision

On 28 June, Chief Judge Yasushi Kanokogi of the Tokyo District Court's 8th Civil Bench rejected Steel Partners' request for an injunction blocking Bull-Dog Sauce's takeover defense. The Tokyo District Court argued the following.⁴

(1) Even if a particular shareholder suffers a decline in its shareholder ratio owing to discriminatory terms placed on the exercise or acquisition of stock warrants distributed to shareholders, when the decision to issue said stock warrants is made by special resolution at the general shareholders' meeting, and shareholders are properly and equally compensated in proportion to the number of shares they own, said stock warrants do not violate the principle of equal treatment of shareholders.

(2) In this particular case, the compensation of ¥396 per share paid to Steel Partners for the stock warrants that it is unable to exercise appears to approximate the value of those stock warrants, and Steel Partners appears to be receiving its fair share of the economic benefits accruing to shareholders; therefore, this issuance of stock warrants does not violate the principle of shareholder equality.

³ Although the position has been that a tender offer could not be withdrawn except in exceptional cases such as the bankruptcy of the target company, in the revision to the SEL (implemented December 2006) resulting from passage of the Financial Instruments and Exchange Law in June 2006, there is allowance for withdrawal in the case of a takeover defense being implemented, and thus a tender offer can be withdrawn if the decision is made to issue stock warrants (Article 11-1 of the SEL and Article 14-1-1 (xiii) of the SEL enforcement order).

⁴ The entire text of the court's decision is posted (in Japanese) on the court website (<http://www.courts.go.jp/>) under Overview of Recent Cases.

(3) When there are disputes regarding management control of a company, it is the shareholders who should decide whether the current management or the party making the unsolicited tender offer runs the company. Accordingly, when the board of directors issues stock warrants for the primary purpose of reducing the shareholding ratio of a particular shareholder and ensuring that the current management team retains management control, unless the hostile bidders are not seriously aiming to rationalize the business and the acquisition of management control by the hostile bidders would make the company's recovery more difficult, the injunction should be granted on the grounds of an unfair issuance.⁵

(4) In this case, however, the corporate charter was changed at the general shareholders' meeting so as to give the general shareholders' meeting the authority to issue stock warrants, after which this authority was exercised and the resolution to issue stock warrants was passed. The question of who, and under what business principles, to entrust with the management of the company is one that must be decided through majority vote at the general shareholders' meeting, and even though the purpose of these stock warrants is to prevent Steel Partners from acquiring management control, this cannot be forthwith construed as an abuse of authority by the general shareholders' meeting.

(5) Although this stock warrant resolution was made during an active tender offer by Steel Partners, given that the regulations pertaining to tender offers are not meant to guarantee a priority status for the buyer in purchasing shares, separate from giving shareholders the opportunity to choose between accepting or rejecting the tender offer, recognizing this choice made at the general shareholders' meeting is not contrary to the rules on tender offers outlined in the Securities and Exchange Law. In addition, there would probably exist shareholders who would feel that, despite supporting the current management team, they had to accept the tender offer risk losing an opportunity to sell their shares as a result of a delisting triggered by their rejection of the tender offer. Therefore, during a tender offer considerable defensive measures can be tolerated from the perspective of allowing the general shareholders' meeting to protect the interests of all shareholders.

(6) Given that the general shareholders' meeting is the company's ultimate decision-making body, when there is fear of a loss in enterprise value resulting from a specific buyer gaining management control, the decision as to whether defensive measures are necessary is one that must in principle be left up to the general

⁵ This was based on previous case law concerning disputes over management control, including the temporary injunction granted in the Nippon Broadcasting case in 2005. For more regarding previous court decisions, see Yukei Fujita, *Nippon Houso Shinkabu Youyakuken Hakkou Sashidome Jiken no Kento* (Considering the injunction barring stock warrant issuance in the Nippon Broadcasting case), *Shoji Homu* Nos. 1745 and 1746; Ken'ichi Oosugi, *Kabushiki no Ouryou Shutoku Gyoyi ni taisuru Houteki Kisei no Arikata - Baishu Boeisaku to Shuuyou Mokuteki Ruuru no Shorai* (Laws governing large-scale share acquisitions -- the future of takeover defenses and the principal objective rule), *Egashira Kenjiro Sensei Kanreki Kinen Kigyoo Hou no Riron* (The Professor Kenjiro Egashira 60th Birthday Commemorative Theory on Company Law), Last volume, edited by Etsuro Kuronuma and Yukei Fujita (in Japanese). For an article describing the author's own opinion, see *Regulation of Japan's Capital Markets and the Battle for Control of Nippon Broadcasting System*, *Nomura Capital Market Review*, Summer 2005 issue.

shareholders' meeting; only when the general shareholders' meeting decision in that regard is clearly irrational should the need for such defensive measures be overruled. The court also allowed, however, that defensive measures must be reasonable, and noted that such measures should not go beyond the scope necessary to meet the objectives of blocking the acquisition of management control by a specific buyer, to the point that they damage the interests of said buyer or other shareholders.

(7) There are no grounds to believe that Steel Partners is engaged in green mail, which is when the purchaser has no intention of actually participating in the company's management, but rather is acquiring shares for the purpose of driving up the share price and forcing the company's stakeholders to repurchase the shares at a higher price. Nevertheless, the decision by the general shareholders' meeting, that a takeover defense was necessary based on Steel Partners' lack of any clear business plan or plan for recovering invested capital subsequent to taking management control, does not appear to be irrational.

(8) As noted in (1) above, this issuance of stock warrants does not harm the economic interests of Steel Partners. In addition, Steel Partners is able to maintain its shareholder ratio by withdrawing its takeover offer. The takeover defense does not cause any inadvertent harm to other shareholders either, and therefore cannot be considered unreasonable.

(9) Although the stock warrant has discriminatory exercise terms, it preserves Steel Partners' economic interests, and as a defense against a hostile takeover attempt is neither unnecessary nor unreasonable; therefore, the general shareholders' meeting special resolution should not be overturned as a blatantly unfair resolution pursuant to Article 831-1-3 of the Company Law. Nor should the decision be nullified or overturned on the grounds that it represents an abuse of majority rule.

2. Analogous application of right to injunction against stock warrants

This decision by the Tokyo District Court was the first regarding the important dispute under the Company Law as to whether requests for injunctions against stock warrants should be approved, a dispute that predates the actual decision concerning the motion filed by Steel Partners.

The Company Law clearly allows for injunctions blocking the issuance of additional shares, the disposition of treasury shares, and the issuance of stock warrants for subscription when said actions are contrary to regulations or to the corporate charter, or are done in a blatantly unfair manner (Articles 210 and 247). There is nothing in the law, however, written specifically about the gratuitous distribution of stock warrants. This does seem somewhat reasonable, when considering that stock warrants are normally issued equally to shareholders in proportion to the number of shares held, and are not typically seen as risking harm to the interests of shareholders. The stock warrants issued by Bull-Dog Sauce had discriminatory terms that ruled Steel Partners ineligible and thus unable to exercise its allotted stock warrants, despite being a shareholder.

The Tokyo District Court ruled that the reason that the Company Law contains no specific provisions regarding the right to request injunctions against stock warrants is because said stock warrants do not in principle harm the interests of existing shareholders, and that it would be difficult to interpret the Law as purporting to exclude the right to injunction in cases where there is a material change in the status of an existing shareholder. The court clearly interpreted the provisions of Article 247 of the Company Law as analogously applying to the issuance of stock warrants that materially change the status of shareholders.⁶

IV. The Tokyo High Court's decision to reject Steel Partners' appeal

1. Overview of the High Court decision

Steel Partners, dissatisfied with the Tokyo District Court's decision, filed an appeal with the Tokyo High Court. On 9 July, the Tokyo High Court's 15th Civil Bench's presiding judge, Kei Fujimura, rejected Steel Partners' appeal, thereby upholding the Tokyo District Court's denial of Steel Partners' injunction request. The High Court, following a line of reasoning similar to that of the District Court in regard to the necessity and reasonableness of Bull-Dog Sauce's takeover defense, rejected Steel Partners' arguments, but unlike the District Court, also deemed it reasonable to label the prospective acquirer in this case as "abusive."

The Tokyo High Court argued the following.⁷

(1) An "abusive" acquirer, with the intention of buying up shares for its own benefit as a majority shareholder, engages in abusive company management or control, without due regard to the sound management of the company. This leads to a damaging of said company's enterprise value or a harming of the common interests of shareholders. That such an abusive acquirer would be subject to discriminatory treatment as a shareholder is unavoidable.

(2) Given that Steel Partners is organized as an investment fund, which has a fiduciary duty to give priority to the interests of its clients, is motivated by the prospect of earning success fees, and acts with those interests as its greatest priority, it is natural that after acquiring the stock of a company, it would pursue, without having any particularly strong interest in or involvement with the management of that company, various means aimed at its own profit over the short to medium term, such as by profiting from the sale of said company's stock back to the company itself or to a third party, by means of soliciting a buyout from the management team or by

⁶ The same arguments could be made regarding both stock splits and reverse splits, but in its 29 July 2005 decision in the Japan Technology Consultants case (*Hanrei Jiho* No. 1909.87), the Tokyo District Court did not recognize a stock split as causing a material change in the status of shareholders, and ruled that the regulations concerning the right to injunction could not be analogously applied.

⁷ The entire text of the court's decision is posted (in Japanese) on the court website (<http://www.courts.go.jp/>) under Overview of Recent Cases.

suddenly initiating a tender offer, or ultimately even by selling off the targeted company's assets. Steel Partners could also ignore business issues with a firm that it should be cooperating with, creating instability in that firm.

(3) Taking this into account, a tender offer from Steel Partners is unsuitable and contrary to the principle of good faith, in view of the negative impact on enterprise value or the common interests of shareholders, and thus Steel Partners could fairly be deemed an abusive acquirer in this case.

(4) The issuance of stock warrants by Bull-Dog Sauce was a measure that could not be avoided, was at least procedurally correct in that it was introduced via a special resolution at the general shareholders' meeting, and did not excessively damage the property of Steel Partners. In addition, the interests of shareholders other than Steel Partners were not harmed to an extent that would render the stock warrants illegal. Bull-Dog Sauce's takeover defense was therefore not unreasonable.

2. Comparison with the District Court decision

The Tokyo High Court's decision to allow Bull-Dog Sauce's issuance of stock warrants with discriminatory terms to stand was the same decision reached by the Tokyo District Court earlier, but the reasoning upon which the two decisions were reached differed in the following ways.

1) Regarding the principle of equal treatment of shareholders

A takeover defense attempts to create a disadvantage for the shareholder making the hostile tender offer that does not impact other shareholders, and this seems to be a problem with respect to the principle of equal treatment of shareholders. Accordingly, a key question when justifying a specific takeover defense measure is whether said measure violates the shareholders' equal treatment principle. Both the District Court and the High Court ruled that Bull-Dog Sauce's takeover defense did not violate the equal treatment principle, but they based their rulings on completely different arguments.

The High Court argued that the takeover defense did not violate the principle because it is unavoidable that an "abusive" acquirer would be subject to discriminatory treatment. In contrast, the District Court argued that the principle was not violated because Steel Partners was offered fair compensation for the stock warrants it was unable to exercise, and thus its economic interests as a shareholder were preserved equitably.

This difference is also expressed in each court's assessment of the compensation given to Steel Partners. The High Court noted that the price offered to Steel Partners of ¥396 per stock warrant clearly did not cause excessive or irrational property harm, and that the takeover defense could conceivably be considered reasonable even if a price below this amount were offered. In contrast, the District Court argued that the ¥396 was a fair price that included a premium.

2) Shareholder or abusive acquirer?

The District Court's decision emphasized that in disputes over management control of a company, the decision on whether the current management team or the hostile bidder should run the business should in principle be made by the shareholders, and also emphasized the significance in this case of the takeover defense being approved by a special resolution at the general shareholders' meeting.

In the Nippon Broadcasting case of 2005, both the Tokyo District Court (in Tokyo District Court decision of 11 March 2005, *Shouji Homu* No. 1726, page 47, and Tokyo District Court decision of 16 March 2005, *Shouji Homu* No. 1726, page 59) and the Tokyo High Court ((in Tokyo High Court decision of 23 March 2005, *Shouji Homu* No. 1728, page 41) ruled that the issuance of stock warrants for the primary purpose of lowering the shareholding ratio of a hostile bidder and keeping management control with the current management team is illegal. The decision to accept the appeal by the High Court was particularly unusual in that it outlined four exceptions whereby issuance with the primary objective of maintaining management control could be allowed, including when the hostile bidder acts as a green-mailer or pursues a scorched earth strategy.

The District Court's decision in this case argued that the allowable exceptions in the Nippon Broadcasting case were narrow because the takeover defense was initiated by a Board of Directors resolution rather than a general shareholders' meeting resolution, and that a decision regarding the necessity of defensive measures made by the general shareholders' meeting should be respected except in cases when said decision is clearly irrational.

In contrast, the High Court's decision, as noted above, was based on the argument that the issuance of stock warrants with discriminatory terms was not contrary to the shareholder equality principle when it is an abusive acquirer that is being discriminated against, and therefore it was Steel Partners' status as an abusive acquirer that justified the takeover defense.

The opinion pieces on the case carried by the various newspapers tended to argue that the High Court's classification of Steel Partners as an abusive acquirer went a step too far, and that this would inevitably have a negative impact on investments in the Japanese market by investment funds. Compared with the District Court's decision, however, the High Court's decision could be seen as actually doing more to stop the abuse of takeover defenses, precisely because it went as far as classifying Steel Partners as an abusive acquirer.

In other words, the rationale underlying the District Court's decision was that a takeover defense must be allowed as long as the general shareholders' meeting's decision was not clearly irrational, irrespective of the classification of the acquirer.⁸ In contrast, the High Court's decision uses Steel Partners' classification as an abusive acquirer to justify the takeover defense, and thus appears to be based on a reasoning

⁸ Of course, the classification of the bidder would be an important element in deciding whether the decision by the general shareholders' meeting was clearly irrational, so it is probably not the case that all bidders of any type could be rebuffed.

that would leave open the possibility of not allowing a takeover defense initiated against a bidder who was not abusive.

3) Differing philosophies

It seems that the difference between the two decisions stems from differences between their underlying philosophies. If pressed to create a formula to describe the philosophical differences, the formula would be that the District Court decision is underpinned by an emphasis on shareholder's rights, whereas the High Court's decision is underpinned by an emphasis on giving consideration to stakeholders other than shareholders.

This philosophical formula is quite obvious from the general argument described in the preceding paragraph concerning the view within the High Court's decision that discriminatory treatment of abusive acquirers should be allowed. Regarding this point, the High Court argued that a company must seek to raise its enterprise value after giving consideration to all of its essential stakeholders, including employees, customers, and vendors, and that it was wrong to only take account of shareholder interests, given the limits inherent in such thinking. This philosophy leads to the logic that abusive acquirers can be locked out, based on their giving consideration only to their own shareholder interests.

It is difficult to say which of these two philosophies is the more correct. The thinking of the District Court that it is the shareholders (the owners of the corporation) who should decide where management control resides feels like a tighter logical argument, but as noted above this is problematic in that it suggests that a majority of shareholders should be able to reject any bidder they do not like, regardless of the nature of that bidder. In Japan's stock market that there is a particularly strong tendency for listed companies to try to secure stable shareholders, and this makes it likely that the general shareholders' meeting will be overly friendly toward their current management team, as evidenced by murmurings over the restoration of the cross shareholding system. Under these conditions, it is the ostensibly more emotional approach taken by the High Court that plays the more valuable role in stopping majority shareholders from rejecting acquirers who are not abusive.

There is reason for concern, of course, that too much emphasis on the High Court's thinking could lead to a virtual prohibition against giving priority to the interests of shareholders in the event that there is a conflict of interest between the shareholders and its employees and the local community. If this were to lead to legal interpretations that depart from the broad principle of corporations being for-profit entities owned by their shareholders, there would be a risk of the High Court's thinking presenting a barrier to the healthy functioning of the stock market.

3. What makes Steel Partners an abusive acquirer?

A key component of the High Court's decision was its labeling of Steel Partners as an abusive acquirer. Thus far, the thinking, as expressed in the Tokyo High Court's decision in the Nippon Broadcasting case, has been that there are four types of acquirers who are fair game for takeover defenses aimed at lowering their shareholder ratio, but the most recent High Court decision reveals new thinking in this regard.

In the Nippon Broadcasting case, the Tokyo High Court argued that there is no merit in providing shareholder protections to a hostile acquirer, and that if the hostile acquisition is allowed to take place, it would clearly harm the interests of other shareholders, in the following specific cases: when the hostile acquirer (1) has no true intention of participating in the company's management, but is rather a green mailer trying to get stakeholders to buy its shares back at a high price; (2) is attempting a scorched-Earth business strategy aimed at taking temporary management control in order to rob the company of its intellectual property, know how, corporate secrets, and key customer/vendors; (3) plans to take control of the business in order to divert the company's assets for use as collateral on, or to pay back, its own debts; (4) aims to take temporary control of management to sell off its assets or temporarily pay a high dividend in order to sell the stock at a high price; or otherwise intends to essentially consume the company. Based on this, the court argued that as long as they are necessary and reasonable, the issuance of stock warrants aimed at retaining management control and similar poison pills are allowable.

The Tokyo District Court ruled in the Bull-Dog Sauce case that there was insufficient evidence to label Steel Partners a green-mailer, since it was not aiming to sell its stock to Bull-Dog Sauce stakeholders at a high price, a decision that probably took into account the four types of acquirers noted above.⁹

In contrast, the High Court ruled that Steel Partners was an abusive acquirer because the investment fund had shown no interest in participating in the management of the companies acquired, had resorted to various schemes aimed at profiting from a sale over the short to medium term, and had also considered disposing of the target company's assets purely for its own benefit. Thus far, various arguments have been made regarding which acquirers merit the abusive label, including whether they need to meet one of the four types noted in the Nippon Broadcasting case, and it is well worth noting that the High court clearly ruled that it is possible for an acquirer to be deemed abusive without strictly falling into one of the four categories outlined by the High Court itself.

Although the High Court noted that it took account of Steel Partners' status as an investment fund with a fiduciary duty to act in the best interest of its clients, this did not necessarily serve as the sole basis for labeling Steel Partners an abusive acquirer.

In fact, it is not at all the case that Japan's courts have adopted an inflexible rule that dictates all investment funds be deemed abusive acquirers. Although it did not

⁹ There has been a fairly strong tendency to look at Steel Partners as a possible green mailer. For example, METI's Administrative Vice Minister said in a press conference on 14 June that "given their past behavior, it is natural to suspect them of being green mailers."

seem to generate much interest, on 25 June, immediately prior to the Tokyo District Court's decision in the Bull-Dog Sauce case, the Saitama District Court approved a request by the Korean investment fund M & FC for an injunction blocking the private placement of new shares by Nihon Seimitsu, a JASDAQ-listed company. It is important to view the fundamental (and proper) thinking of Japan's courts as being to not allow the unfair issuance of new shares or stock warrants aimed at protecting the current management team, even when it is an investment fund that is being targeted.

V. The Supreme Court's decision to reject Steel Partners' appeal

1. Overview of the Supreme Court decision

1) The Supreme Court appeal and its rejection

On 7 August, the Second Petty Bench of the Supreme Court (presiding Judge Isao Imai) rejected Steel Partners' appeal by permission, thereby upholding the decisions by the Tokyo District Court and the Tokyo High Court to deny Steel Partners' motions. This virtually finalizes the court decisions to allow the takeover defense by Bull-Dog Sauce.

Steel Partners had argued that the stock warrant issuance used by Bull-Dog Sauce as a takeover defense was blatantly unfair and illegal based on its violating the principle of equal treatment of shareholders outlined in the Company Law, and unhappy with the Tokyo District Court and High Court's decisions disallowing their injunction, it appealed the case to the Supreme Court.

The fund filed two types of appeals with the Supreme Court, a special appeal (pursuant to Article 336 of the Code of Civil Procedure) by reason of unconstitutionality, and an appeal by permission (pursuant to Article 337 of the same Code), which is based on there being an important issue regarding violation of case law or the interpretation of Japanese law. The latter can only be filed with the permission of the High Court. The Supreme Court made its decision in response to the Tokyo High Court's decision on 27 July to allow Steel Partners to make an appeal by permission. Although Steel Partners also filed a special appeal arguing that Bull-Dog Sauce's takeover defense violated provisions in the Constitution protecting property rights, this decision did not address any disputes related to the Constitution. Because an act that is not in violation of laws is unlikely to be unconstitutional unless the provisions of the Company Law themselves were in violation of the Constitution, this decision can be taken as affirming the constitutionality of the court rulings.

2) Key arguments in the Supreme Court decision

The Supreme Court's remarks, noted below, included a rejection of Steel Partners' appeal and marked the first-ever Supreme Court opinion concerning takeover defenses.¹⁰

(1) Regarding the principle of shareholder equality in Article 109-1 of the Company Law, "to protect the interests of individual shareholders, the company is obligated to treat shareholders fairly based on the type and number of shares they hold, but since individual shareholders interests are normally inconceivable without an ongoing and thriving company, if there is a risk that the acquisition of management control by a particular shareholder would damage the company's enterprise value, such as by interfering with the company's survival or growth, or would harm the company's interests or the common interests of shareholders, discriminatory treatment of said shareholder aimed at preventing such acquisition cannot be immediately construed as a violation of the intent of said principal unless said treatment is unreasonable and contrary to the equal treatment principle.

(2) The question of whether the acquisition of management control by a particular shareholder harms the common interests of shareholders "should be decided by the shareholders themselves, to whom the company's interests ultimately inure, and that decision should be respected unless the general shareholders' meeting was procedurally unfair, the facts upon which the decision was predicated prove to be nonexistent or false, or are there is some other important fault that renders the decision unjustified.

(3) Regarding the issuance of stock warrants in this case, it appears that nearly all shareholders other than Steel Partners have concluded that the acquisition of management control by Steel Partners would damage enterprise value and harm the common interests of shareholders. Furthermore, procedures followed at the shareholders meeting were not unfair, and there appears to be no important fault that would render the decision unjustified.

(4) Issuance of the stock warrants would substantially reduce the shareholdings ratio of Steel Partners. Nevertheless, Steel Partners had the opportunity to express its opinion at the general shareholders' meeting, and it is able to receive compensation that approximates the value of the stock warrants. Accordingly, "we do not view these stock warrants as unreasonable or contrary to the equal treatment principle."

(5) Establishing the details of the takeover defense in advance increases the predictability of shareholders, investors, and acquirers, but the fact that such details are not established in advance does not by itself mean that a plan cannot be devised after an acquisition aimed at acquiring management control is first initiated. Because this measure deals with an emergency situation, and because Steel Partners is being compensated, the approach cannot be characterized as blatantly unfair.

¹⁰ The entire text of the Supreme Court's decision is posted (in Japanese) on the court website (<http://www.courts.go.jp/>) under Overview of Recent Cases.

(6) If the issuance of stock warrants with discriminatory terms to shareholders were not aimed at supporting enterprise value or the common interests of shareholders but rather to support the directors managing the company or the management control of specific shareholders who support said directors, said stock warrant issue should in principle be interpreted as blatantly unfair. The case in questions does not meet that description, however.

2. Comparison with the District Court and High Court decisions

All three courts, the Tokyo District Court, the Tokyo High Court, and the Supreme Court, were in agreement in allowing the takeover defense of Bull-Dog Sauce, but there are important differences in the logic leading to what was the same conclusion.

All three courts used a common decision framework, arguing that in order to maintain the common interests of shareholders, the takeover defense needed to be initiated by general shareholders' meeting resolution, and that such a procedure was neither illegal nor blatantly unfair provided that it was not unreasonable.¹¹

As we have already analyzed in great detail, however, there were major differences between the District Court and the High Court decisions in regards to their underlying philosophies. Specifically, the District Court decision emphasized the intent of shareholders, and without saying that stock warrants with discriminatory terms, provided that they ensured equality of economic interests, were contrary to the shareholders' equal treatment principle, argued that the necessity of a takeover defense could not be ruled out as long as the general shareholders' meeting resolution was not "clearly unreasonable." The High Court decision, working from the standpoint of taking into account the interests of stakeholders other than shareholders, argued that a takeover defense that discriminates against an abusive acquirer pursuing only its own interests is allowable provided that it is not unreasonable.

In contrast, the Supreme Court decision took a stance that was closer to that of the District Court, arguing that a decision as to whether the common interests of shareholders was harmed should be left to the shareholders, and that said decision should be respected unless the general shareholders' meeting was procedurally unfair, the facts upon which the decision was predicated proved to be nonexistent or false, or there is some other important fault that renders the decision unjustified. While citing the monetary compensation offered to Steel Partners as one reason for the takeover defense being reasonable, the Supreme Court did not base its ruling that the plan was not contrary to the equal treatment principle purely on that, but rather on a comprehensive assessment.

¹¹ This is consistent with the Unocal standard in the US. A big difference, however, is that although the Unocal standard is a standard for decisions related to takeover defenses initiated by boards of directors, the takeover defense in this case was initiated by resolution at the general shareholders' meeting.

Although some media outlets reported¹² that the Supreme Court decision, like that of the High Court, did not deal with the question of whether Steel Partners was an abusive acquirer, but given that the Supreme Court did not deal with the question of abusiveness because it did not use the argument underlying the High Court decision that discriminatory treatment was not contrary to the equal treatment principle in the case of an abusive acquirer, but instead pursued a line of reasoning closer to that used by the District Court, whether the court did or did not deal with the question is not an issue. The Supreme Court clearly took a position that the intent of shareholders should be respected, and without addressing the question of whether the party affected by the defense was an abusive acquirer, it argued that the takeover defense should in principle be allowed if the general shareholders' meeting deemed that the common interests of shareholders would be harmed by the takeover.

3. Significance of the Supreme Court decision

The Supreme Court decision was quite significant in that it clarified how the shareholders' equal treatment principle relates to a takeover defense that discriminates against specific shareholders. The conclusions reached by the District Court and the High court were identical, but represented two opinions based on widely differing arguments, and it is quite significant that the Supreme Court clearly took one side. The Supreme Court's logic, that a takeover defense initiated by general shareholders' meeting resolution should be allowed as long as the procedures followed were not unreasonable, is likely to have a major impact on the practicalities of corporate acquisitions in the future.

Of course, it is not the case that the Supreme Court is arguing that any type of acquirer can be rejected, as long as it is done by general shareholders' meeting resolution, be it a special resolution or regular resolution. In fact, the court strongly suggested the possibility that a takeover defense could be blocked by an injunction for being blatantly unfair if it is not aimed at supporting enterprise value or the common interests of shareholders, but rather aimed instead at supporting the directors managing the company or the management control of specific shareholders who support said directors.

This author has previously noted that although the District Court decision, which like the Supreme Court decision emphasized the intent of shareholders, appears to be a logically tight argument, it is problematic in that it suggests that a majority of shareholders should be able to reject any bidder they do not like, regardless of the nature of that bidder, the Supreme Court decision appears to have tried to include safeguards aimed at eliminating such concerns.

It would probably not be an easy matter for an acquirer targeted by a takeover defense to show *prima facie* evidence that the takeover defense was initiated with the aim of supporting the directors managing the company or the management control of

¹² See, for example, page 3 of the *Nihon Keizai Shimbun*, 8 August 2007 edition (in Japanese).

specific shareholders who support said directors, unless a major shareholder closely related to the management team and affiliated entities (including corporate affiliates) were to form a majority to approve a takeover defense over the strong objections of institutional investors and others. This is why we noted that although the logic used by the High Court -- that discrimination against an abusive acquirer is allowable, and by corollary that there is a possibility that discrimination against a non-abusive acquirer could be disallowed -- could arguably be viewed in some respects as emotional judicial meddling, such logic will probably serve to block the abuse of takeover defenses approved by a majority of shareholders.

The Supreme Court decision did not relate the payment of compensation to Steel Partners with the equal treatment principle as did the District Court decision, but noted it as an important element in determining the reasonableness of the takeover defense measures. This is a reasoning that is shared in the High Court decision, which argued that the takeover defense was reasonable in that, owing to the compensation paid, it did not cause excessive damage to the property of Steel Partners. Following the Supreme Court's reasoning, even without the payment of compensation as provided for in Bull-Dog Sauce's plan, as long as a takeover defense could be deemed as not unreasonable based on other factors, it would seem to have the potential for being allowed without forthwith being labeled as blatantly unfair.¹³

4. Significance of the concept of an abusive acquirer

Steel Partners strongly objected to its classification in the Tokyo High Court's decision as an abusive acquirer, and some reports have noted that the Supreme Court decision could be seen as not having ratified the "abusive acquirer" label.¹⁴ Nevertheless, the absence in the Supreme Court decision of a statement as to whether Steel Partners was an abusive acquirer, as noted above, could be attributed to nothing more than the fact that the logical structure of its decision did not require such a label, and as such neither does the decision make the argument that Steel Partners is not an abusive acquirer.

Furthermore, the Supreme Court decision probably does not reduce the significance of the concept of an abusive acquirer in any way. All of the court decisions related to the Nippon Broadcasting case in 2005 concerned the initiation of a takeover defense by resolution of the board of directors, and argued that such a defense aimed at an abusive acquirer could possibly be allowed. In its Bull-Dog Sauce decision, the High Court argued the possibility that an acquirer could be deemed abusive for reasons other than the four outlined in the High Court's Nippon Broadcasting decision.

¹³ Regarding the compensation offered to Steel Partners, the High Court decision noted that it "would even be possible to deem a takeover defense as reasonable with a lower price offered as compensation," whereas the Supreme Court decision said only that "the price could be viewed as approximating the value of the stock warrants," and thus appears to take a harder-line approach toward the amount of compensation than the High Court.

¹⁴ See page 7 of the *Nihon Keizai Shimbun*, 9 August 2007 edition (in Japanese).

Even assuming that the Supreme Court decision established a framework in which it is not always necessary to determine the classification of the acquirer as long as the takeover defense is based on a general shareholders' meeting resolution, when an attempt is made to initiate a takeover defense by resolution of the Board of Directors, it is likely that establishing whether the acquirer was abusive or not would be a key element in deciding the fairness of the takeover defense. In that case, there would probably be a reasonable chance that the High Court decision in the Bull-Dog Sauce case would be referenced.

VI. Several issues to consider

These three court decisions are likely to form an important precedent when considering the situations under which a contingency takeover defense should be allowed. We now use these three decisions as a starting point to consider the takeover defenses that may be allowed in the future.

1. Is a special resolution mandatory?

In the Bull-Dog Sauce case, because there was first a change in the corporate charter by special resolution, after which was made the decision to issue discriminatory stock warrants by special resolution of the general shareholders' meeting, the takeover defense was initiated by special resolution.

But what if the corporate charter already contained a clause directing that any decision to issue discriminatory stock warrants shall be made by normal resolution of the general shareholders' meeting, or if the corporate charter was changed to that effect by special resolution, and then a takeover defense was approved by normal resolution? Would this have resulted in any major change in the court decisions?

Of course, the courts' opinion on this is not clear from these decisions. Nevertheless, even a cash-out merger that locks out minority shareholders can be initiated by special resolution as long as economic interests are protected. On the other hand, an issuance of stock or stock warrants for subscription that clearly harms the economic interests of existing shareholders could also be approved by special resolution. Looked at in comparison with these cases, in the gratuitous issuance of stock warrants as in the Bull-Dog Sauce case, the hostile acquirer (1) suffers the drawback of a lowering of its shareholding ratio, but can receive the monetary compensation necessary to recover from that, and thus its economic interests are unharmed, and (2) unlike when being shutout in the case of a merger, does not lose its shareholder status. Therefore, as long as the procedures prescribed in the corporate charter are followed, it would seem that a special resolution would not be mandatory.

On the other hand, when considering that even an issuance for subscription that harms the economic interests of existing shareholders is possible if by special resolution, even if, unlike the Bull-Dog Sauce takeover defense, the economic

interests of the hostile acquirer were harmed by a takeover defense that offered it no compensation, it seems that there would still be room to argue that such a takeover defense would be possible if done by special resolution. The fact that the High Court decision purposely did not address the suitability of the compensation paid to Steel Partners suggests that such an approach may not be all that mistaken.

In the case of an issuance for subscription, the economic interests of all shareholders other than those subscribing for the stock or stock warrants are harmed, and thus the fact that the parties whose interests are harmed agree to the issuance can be viewed as guaranteeing the legitimacy of approval by special resolution. In the Bull-Dog Sauce takeover defense, however, there is no harm to the economic interests of the shareholders who agreed to the resolution. If this point is seen as important, there would probably be little scope to allow a takeover defense that harms the economic interests of a hostile acquirer, even if it is approved by a general shareholders' meeting resolution.

An important point to note is that the courts have not argued that it is okay to arbitrarily restrict the rights of minority shareholders provided that it is done by special resolution. The District Court decision, taking into account that the shareholders had cause for concern over possible harm to the enterprise value of Bull-Dog Sauce because of Steel Partners' lack of any clear business plans or plan for recovering invested capital subsequent to taking management control, and also that the dispersion of shareholders meant that there were no major shareholders controlling the outcome of the general shareholders' meeting special resolution, concluded that the general shareholders' meeting decision could not be characterized as clearly unreasonable. The District Court decision did, however, justify the takeover defense by special resolution based on Steel Partners being an abusive acquirer. Furthermore, the Supreme Court decision noted that "If the issuance of stock warrants with discriminatory terms to shareholders were not aimed at supporting enterprise value or the common interests of shareholders but rather to support the directors managing the company or the management control of specific shareholders who support said directors, said stock warrant issue should in principle be interpreted as blatantly unfair," thereby emphasizing that general shareholders' meeting resolutions were not omnipotent.

In light of this, if a sector rival or other company with a rational business plan appeared as a hostile bidder and proposed a detailed plan that appeared fairly realistic, and the target company's affiliates and main banks (which are major friendly shareholders) conspired to lower the shareholdings ratio of the hostile bidder, there is a fairly strong probability that the takeover defense would be blocked by injunction, even if the defense was initiated by general shareholders' meeting resolution. Whether it would make a difference whether it was a special resolution or a normal resolution would probably depend on the specific circumstances surrounding the case.

2. Is there a problem initiating a takeover defense during an active tender offer?

The biggest problem with a takeover defense aimed at a hostile bidder, given the likelihood of a change in management if the hostile bid succeeds, is the fear that such a defense would be used by the current management team to save its own skin. The three court decisions seem entirely appropriate for this reason alone, because they clarify the large difference in scope for allowing a takeover defense between resolutions by the Board of Directors or those by the general shareholders' meeting.

One criticism of the Bull-Dog Sauce case was that the tender offer by Steel Partners was still active, and if the stock acquisition by Steel Partners was unwelcome to the point that the general shareholders' meeting passed a special resolution indicating so, the takeover attempt could not have succeeded anyway, and therefore that just looking closely at whether the tender offer succeeds would have been sufficient for knowing the intent of shareholders.¹⁵ Because eligibility to exercise voting rights at the general shareholders' meeting was determined by shareholders of record as of 31 March, there was also a tendency to question why changes in shareholder composition after Steel Partners initiated its tender offer were not reflected.¹⁶

Nevertheless, in the true sense a tender offer cannot possibly replace the general shareholders' meeting as a rational opportunity to express shareholder intent. In a situation in which it is unclear whether the tender offer will succeed, shareholders worried that they will be left out as minority shareholders could possibly wind up accepting the offer, even if they find the terms of the offer and the type of acquirer as undesirable. It has been pointed out that tender offers are inherently coercive, and that because of that the possibility of an inefficient acquisition succeeding cannot be ruled out.¹⁷ This suggests that it was rational in this case to check shareholders' intent at the general shareholders' meeting even with an active tender offer, and the Tokyo District Court decision recognized this.

In addition, the general shareholders' meeting was a regularly scheduled meeting, and the date of record was as previously established. The management team did not make any third party allotments to friendly shareholders aimed at forging a majority or arbitrarily change the date of record to enable voting by said shareholders. In this regard, as well, the procedures used by Bull-Dog Sauce should be seen as not problematic.

¹⁵ See, for example, the comment by Chuo University professor Shuya Nomura on page 9 of the *Nihon Keizai Shimbun*, 25 June 2007 edition (in Japanese).

¹⁶ See Daiki Shouki (Wise or Not) by Haratsutsumi on page 17 of the *Nihon Keizai Shimbun*, 14 June 2007 edition (in Japanese).

¹⁷ See Wataru Tananka, *Tekitaiteki Baishuu ni tai suru Boueisaku* (Memo on takeover defenses against hostile bidders), edited by Kazuhiro Arai and Ryutaro Nakayama, *Kigyuu Baishuu Bouei Senryaku II* (Corporate Takeover Defense Strategies II), *Shoji Homu* 2006, pp251-255 (in Japanese).

VII. Conclusion

The establishment of a market for corporate control to conduct hostile acquisitions serves as a check on management moral hazard while making the management of listed corporations more efficient. Hostile takeovers in and of themselves should not be rejected out of hand.

Nevertheless, in a case like that of Bull-Dog Sauce in which a hostile bidder abuses its rights and creates concerns that the common interests of shareholders will be harmed, and shareholders with such concerns clearly express at a general shareholders' meeting their intention not to accept the hostile bid, that intention should probably be respected.

The court's acceptance of Bull-Dog Sauce's takeover defense is in no way a glowing assessment of the skill of Bull-Dog Sauce's current management team, nor is it an affirmation that the acquisition of management control by Steel Partners would undoubtedly damage the company's enterprise value. It is merely an affirmation of the shareholder's rejection of Steel Partners, which offered no clarification of its future plans or any indication of what it was thinking. Of course, nobody knows at this point whether the shareholder's decision was a correct one from the perspective of the company's long-term growth. Corporate management should in no way interpret these court decisions as providing *carte blanche* to reject any hostile bidder at any time, merely by paying out some compensation or labeling the bidder as an abusive acquirer, but should continue pressing forward to raise enterprise value.