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M&As and the Law

Presentations

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«CONTENTS»

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Graduate Schools for Law and Politics, University of Tokyo
7-3-1 Hongo, Bunkyo-ku, Tokyo 113-0033, Japan
Tel: 03-5805-7297 Fax: 03-5805-7143
E-mail: gcoe@j.u-tokyo.ac.jp

Presentations

Market for Corporate Control in Japan

Kenichi OSUGI*

I. The Theme

In Japan, the case law on hostile takeover and defensive tactics has progressed since the well-known takeover battle between *Livedoor* and *NBS* in 2005[1]. The Supreme Court decision on *Steel Partners* vs *Bulldog Sauce* in 2007 attracted the attention of both merger-and-acquisition (M&A) lawyers and the general public[2]. The Financial Services Agency (FSA) revised the "Financial Instruments and Exchange Act" (FIEA) to update the tender offer rules in Japan in 2006. The Ministry of Economy, Trade and Industry (METI) has been keen on the maintenance of administrative guidelines on defensive measures, making and revising them in 2005 and 2008, respectively.

The same has been true of friendly mergers and acquisitions: a particular management buyout transaction in 2006 raised questions about self-dealing on the part of the company's chief executive officer. The deal led to the creation of METI's administrative guidelines on management buyout in 2007[3], as well as to a Supreme Court decision in 2009[4].

It may seem that the legal infrastructure for M&A transactions is gaining its roots, as solid as the ones in other developed countries. However, it is not clear whether the legal infrastructure for M&As in Japan is appropriate. This paper discusses this issue from the viewpoint of "Market for Corporate Control (MCC)." It suggests that the infrastructure here is not sufficiently robust in some respects. The paper also discusses some of the many problems Japanese policy makers face.

This essay is organized as follows. Part II clarifies the notion of Market for Corporate Con-

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* Professor of Commercial Law, Chuo University Law School. LL.B. 1990 University of Tokyo. Associate Professor, Tokyo Metropolitan University from 1993 to 2004.

This paper is based on my presentation at the Seminar "M&As and the Law," held in Tokyo, Japan on June 18, 2010. I thank all the participants who attended the seminar and gave me fruitful comments.

1 *NBS* vs. *Livedoor*, 1899 Hanrei Jihô 56 (Tokyo High Court, March 23, 2005).

2 *Steel Partners Japan Strategic Fund (Offshore), L.P.* v. *Bulldog Sauce Co. Ltd.*, 61-5 Minshû 2215 (Supr. Ct. August 7, 2007).

3 Kigyô Kachi Kenkyû-kai, "Kigyô Kachi no Kôjô oyobi Kôsei na Tetsuzuki Kakuho no tameno Keieisha ni yoru Kigyô Baishû ni kansuru Hôkoku-sho [Report on Management Buyouts to Improve Corporate Value and Ensure Fair Procedure]".

4 Rex Holdings case, 1326 Kinyû Shôji Hanrei 35 (Supr. Ct. May 29, 2009).

trol (MCC), and its linkage with "shareholder supremacy." Part III provides several examples of hostile takeover attempts in Japan and analyses the weakness of legal infrastructure for M&As in Japan. Part IV deals with several examples of friendly M&As, and looks into the infrastructure's weaknesses. Finally, Part V concludes the paper by discussing the extent to which the legal institution satisfies the notion of MCC.

II. Concept of "Market for Corporate Control" and Shareholder Supremacy

II. -1 Concept of MCC

The phrase "Market for Corporate Control" (MCC) is known in Japan by academics, M&A lawyers and other professionals, most of whom consider the MCC to be a free market for hostile takeovers. However, when the phrase was used in 1965 by Henry G. Manne (probably for the first time), it clearly extended to friendly takeovers as well.[5]

The typical definition of MCC is one introduced by Jensen and Ruback: "The market for corporate control is the arena in which management teams compete for the right to manage resources."[6] Corporate control is supposed to be traded between seller and buyer as goods and services are. "Market" implies a competition among the parties involved.

To amplify the notion of "market," it should be noted that the sales of goods and services generally increase the utilities of both sellers and buyers. If Seller A sells a book to Buyer B at JPY 5,000, A prefers the money to the book while B prefers the book to the money. Therefore, the exchange of the goods and money usually makes both parties happier than before. It is believed that law and other institutions are structured so as to encourage voluntary transactions[7] .

II. -2 MCC and Shareholder Supremacy

In the MCC, the controlling rights to a corporation are sold, sometimes by the shareholders and in other times by the manager of the company. In the case where Company A and Company B are competing with each other in tender offer bids for Company T, it is the shareholders in T who determine whom they will sell their shares to. On the other hand, asset sales are usually decided by the manager of the company that sells the asset.

Even when it is corporate managers' discretion to decide whether the company is sold or not, they are not empowered to do so arbitrarily. Rather, they are obliged to exercise their power to embrace the interests of the company itself, or that of all the shareholders. The shareholder supremacy model requires the managers to maximize the shareholders' value while the stakeholder model of corporation will require them to do so on behalf of the stake-

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5 Henry G. Manne, "Mergers and the Market for Corporate Control," 73 J. Pol. Econ. 110 (1965).

6 Michael C. Jensen & Richard S. Ruback, "The Market for Corporate Control: The Scientific Evidence," 11 Fin. Econ. 1 (1983).

7 See Thomas J. Miceli, THE ECONOMIC APPROACH TO LAW, 109-112 (Stanford Economics and Finance, 2004).

holders of the company.

In Japan, there are two corporate law textbooks which are cited and consulted more frequently than others, both of which clearly adopt the shareholder supremacy model[8]. On the other hand, it is widely known that social norms and the parties in M&A transactions are best explained by the stakeholder model[9].

III. MCC in Japan: Hostile Takeovers

III. -1 Poison Pills in the US

Many publicly-held corporations in the US are equipped with "rights plans" or so-called "poison pills." These enable the board of directors of these companies to decide on whether to sell or not the company when a hostile offer is made to it.

However, the poison pills are not said to lead to serious problems in the US because rules such as shareholders supremacy and the directors' fiduciary duties of maximizing shareholders' value have been well established, and there have been those who enforce fiduciary duties in boardrooms (independent directors), shareholders' meetings (institutional investors) and courtrooms (Delaware judges), thus mitigating the abuse of the poison pills[10].

III. -2 Poison Pills in Japan

(A) Courts

Before the outbreak of hostile takeover attempts in Japan in 2005, Gilson in 2004 predicted that the courts should play a critical role in policing the abuse of poison pills due to the lack of independent directors or powerful institutional investors in Japan. Indeed, courts in Japan have developed the principle that "shareholders determine where the control of the company should lie." There are, however, two exceptions to that principle: the board of directors can exercise their power to fend off hostile bidders in the case that the hostile bidders lack the will to run the company in a good manner, aiming, rather, only to exploit it[11], or in the case that the target board aims to provide the shareholders with adequate time and information to enable them to make informed decisions[12]. Also, where a super-majority of the share-

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8 Kenjirô Egashira, *Kabushiki Kaisha-Hô* [Stock Corporation Law], 3rd ed. at 20 et al (Yûhikaku, 2009); Hideki Kanda, Kaisha-Hô [Corporation Law], 12th ed. at 25 (Kôbundô, 2010).

9 Gregory Jackson, "The Origins of Nonliberal Corporate Governance," in Wolfgang Streeck and Kozo Yamamura (ed.), The Origins of Capitalism: Germany and Japan in Comparison, at 161 et al (Cornell University Press, 2001); Edward J. Lincoln, Arthritic Japan, at 137 and 146 (Brookings Institution Press, 2001).

10 Ronald J. Gilson (2004) "The Poison Pill in Japan: The Missing Infrastructure," *Columbia Business Law Review*, No. 2004, p. 21.

11 *Livedoor* vs *NBS*, supra note 1. This formula, however, is *obiter dictum*. The court invalidated the defensive measures that the defendant company had taken. See Kenichi Osugi, "Transplanting poison pills in foreign soil: Japan's experiment," in Hideki Kanda, Kon-Sik Kim and Curtis J. Milhaupt, eds., Transforming Corporate Governance in East Asia (2008), pp. 36, 44–46.

12 *Yumeshin* vs *Nihon Gijutsu Kaihatsu [JEC]*, 1909 Hanrei Jihô 87 (Tokyo District Court, July 29,

holders in the target company approve the poison pill, it is not invalidated by the court as long as it satisfies the suitability test[13].

Here, notice should be taken of the fact the court rulings above look like the "proportionality test" as set forth in the *Unocal* standard[14] in the Delaware jurisdiction. However, these court rulings differ from those of the courts in Japan, which do not allow the target board to negotiate with the bidder unless the target shareholders approve it. Therefore, case law in Japan is even stricter on directors' discretion, probably because there are few independent directors in boardrooms in Japan.

However, poison pills are abused outside the courtroom, as seen in the takeover battles between Rakuten and TBS in 2006. A battle between Oji Paper and Hokuetsu Paper Mills, also fought in 2006, is another example[15].

This is probably because the authorities of courts in Japan and Delaware are different: Chancery court in Delaware can be involved in a dispute continually from its early stages, and as the suit is pending, as seen in the example of the hostile bids made by Oracle in the acquisition of PeopleSoft from June 2003 to October 2004. In Japanese judicial practice, however, the court does not become involved in an M&A dispute in its early stages; a petition to the court is believed to be possible only after the target board triggers the defensive measure, i.e., resolves to issue share warrants. This limitation on the court's authority enabled target boards to adopt opportunistic behavior toward management entrenchment. Target companies such as TBS and Hokuetsu were able to require the bidder to offer time and information over and over again, thus prolonging the process indefinitely. Most academic theses have been silent on this issue though there are exceptions[16].

(B) Shareholders

Do shareholders in Japan behave reasonably in M&A disputes? This question is particularly intriguing when one considers of the fact that more than 80% of shareholders in Bulldog voted in favor of poison pills in 2007, which not only barred the hostile acquirer Steel Partners from achieving its bid but probably impaired the value of the shares of those shareholders[17].

2005). According to this second formula, the court denied the invalidation of the poison pills taken on by the target company.

13 *Steel Partners* vs *Bulldog*, *supra* note 2. The court denied the invalidation of the poison pills on the ground that is shown in the text.

14 The "*Unocal* standard" refers to the standard used in the seminal case *Unocal Corp.* v. *Mesa Petroleum*, 493 A.2d 946 (Del. Supr. 1985).

15 Kenichi Osugi, "What Is Converging ? Rules on Hostile Takeover in Japan and the Convergence Debate," 9 Asian-Pacific Law & Policy Journal, 143, 157 (2007).

16 One of the exceptions is Kenichi Osugi, "Kabushiki no Tairyô Shutoku Kôi ni taisuru Hôteki Kisei no Arikata [How to Regulate Acquisition of Shares]," in Etsurô Kuronuma and Tomotaka. Fujita (eds.) KIGYÔ HÔ NO RIRON [Theories of Enterprise Law], Vol.2, at 1, 36-37 (2007), which argued that an acquirer may seek injunctive relief to the court even before the poison pill is triggered, as long as the dispute between the hostile bidder and target board becomes mature.

17 For the facts and court decisions of the Bulldog case *supra* note 2, See Osugi, *supra* note 15, at 158-

Perhaps this was a once in a lifetime event. Shareholders will act with more caution when they are asked to decide on whether or not they approve of poison pills. That is not the end of the story, however. In terms of the structure of the Japanese stock market and its investors, the behavior of some institutional investors[18] is even more problematic, as is the interlocking shareholding pattern among target companies[19].

(C) Advisors

Concerns also lie with the behavior of M&A lawyers, investment bankers and other advisors. Rock[20] insisted that the court's decision was deemed to be a "preach" by both lawyers' and managers' circles in the US. Those advisors tell corporate managers to conform to the fiduciary duty, so that the core concept of fiduciary duty is self-enforcing during an M&A negotiation.

On the other hand, the interactions of this sort are weaker in Japan. The advisors' role is relatively limited to the technical aspects of law. Lawyers focused on discussing issues such as "how to structure poison pills to avoid its injunction," and "is it permissible to do harm on a hostile bidder via poison pills." Many advisors were interested in protecting "corporate culture" which is often difficult to translate into shareholders' value. The fiduciary duty discipline has fewer impacts on the players during M&A negotiations.

This difficulty may come from the balance of power between the corporate managers and the M&A advisors mentioned above. Or it may be that even law professionals have little power in policy-making for M&As, as Japan is such a compartmentalized society[21].

(D) Lack of Fiduciary Duties and Stakeholder Model of Corporation as a Social Norm

The law in Japan is clear in that directors of a corporation have a fiduciary duty to the corporation. It is not clear that they owe duties to the shareholders. To accommodate good legal infrastructure for M&A transactions, the notion of fiduciary duty to shareholders is needed in order to both facilitate value-increasing transactions and curtail attempts by entrenched man-

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158. As a defensive measure, the company issued share warrants and allocated them to all of its shareholders, including Steel Partners, on a 3 warrants to 1 share ratio. Because the share warrants had provisions enabling Bulldog to purchase Steel Partners' warrants at the tender-offer price, essentially, with 15 percent premium over the market value, the plan would more likely endanger the interests of the company itself and other shareholders than Steel Partners.

18 It is said that life insurance companies in Japan, though being blockholders in listed companies, hope to sell their insurance policies to businesses, and thus withhold a voting hostile to incumbent managers in the company. In other words, if that is the case, they give priority to their own business's benefit over that of their policy holders.

19 Detailed examples are collected and analyzed in Peng Xu and Wataru Tanaka, "Baishû Bôeisaku in the Shadow of Kabushiki Mochiai [Poison Pills in the Shadow of Interlocking Shares]," 1885 Shôji Hômu 4 (2009).

20 Edward B. Rock, "Saints and Sinners: How Does Delaware Corporate Law Work?" 44 UCLA L. REV. 1009, 1013, 1016 (1997).

21 Masahiko Aoki (1988) *Information, Incentives, and Bargaining in the Japanese Economy*, pp. 293-297.

agement to secure their positions.

But, then, how is management's duty enforced in M&A transactions? As is seen already, the issuance of shares and share options is in the realm of judicial injunction. Other defensive mechanisms are relatively hard to resolve in the courtroom.

Recent case laws[22], however, referred to the directors' duty to shareholders. A theoretical obstacle against "fiduciary duty" is small while a cultural barrier in Japan is large. Prevalent is a stakeholder model of corporation in which not only shareholders but employees and trade creditors are deemed to be the owners of the company.

IV. MCC in Japan: Friendly Deals

IV. -1 Theme

Tender offer regulation in Japan is not rigid, but is roughly similar to the Williams Act in the US, and much less rigid than in the EU countries[23]. Partial offer is allowed in Japan, and according to an event study, partial offers probably generate a coercive effect on the target shareholders[24].

In the following section are a couple examples in which acquiring companies use both tender offers and private placements of shares to consummate friendly takeovers. Since share issuance of a target company is only marginally subject to the tender offer regulation in Japan, this combination of a tender offer and private placement is possible.

The latest Tokyo Stock Exchange (TSE) rules on listed companies in the fall of 2009 adopted a rule somewhat similar to the New York Stock Exchange (NYSE) 20 percent rule[25] on private placement. However, the TSE rule has broader exceptions[26], so listed companies in

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22 E.g., Rex Holding case, 1301 Kinyû Shôji Hanrei 28 (Tokyo High Court, September 12, 2008); Sunstar case, 1326 Kinyû Shôji Hanrei 20 (Osaka High Court, September 1, 2009).

23 The Williams Act of 1968 in the US has regulated tender offers. Because most US Congresspersons have little interest in amending takeover regulation, the Williams Act has remained almost untouched since its enactment.

Japanese tender offer rules were formulated under the heavy influence of the Williams Act. A discrepancy between Japanese and US tender offer rules began when the Securities and Exchange Act adopted the so-called "one-third rule" in 1990, which bans an acquirer who aims to obtain a third or more of the outstanding shares in the target company from buying them privately from a small number of shareholders. However, the rule does not prohibit such an acquirer from buying target shares via the stock market, thus, the transfer of corporate control may occur through market transactions. On the other hand, UK and EU rules require control transactions to be made with, or accompanied by, a tender offer. This difference between European and Japanese rules derives from fundamental policy differences.

24 Kotaro Inoue, "TOB to Shôsû Kabunushi Rieki [Tender Offers and the Interests of Minority Shareholders']," 1874 Shôji Hômu 34 (2009).

25 See NYSE Listed Company Manual, Rule 312.03 et al, at http://www.nyse.com/regulation/listed/1182508124422.html

26 According to the TSE rules, a company shall obtain the approval of a shareholders' meeting or an independent committee when it plans to make a private placement of shares of 25% or more of its outstanding

Japan often use private placement into friendly hands by board resolutions to acquire another company.

Through a rough search, I was able to find one transaction using both a tender offer and private placement in a short period of time to achieve a single M&A transaction, announced and consummated in 2004. There was one of these transactions to go through in 2005, three in 2007, one in 2008, two in 2009, and one in 2010. These are, however, incomplete numbers. There must be many more cases of combining a tender offer with private placement.

IV. -2 Case Studies

The following three examples of friendly takeovers combined a tender offer and private placement, and each has a distinct character from the others.

(A) Case 1 in November, 2007

Company A announced that it would launch a tender offer to Company B shares, and that it would subscribe the new shares which Company B would issue in December after the tender offer period closed. The price of the offer was JPY 556, which included approximately a 20 percent premium over the market value of the time it was announced. The bid set the minimum, but not the maximum, number of shares to be bought. Company A acquired 8.1 million shares out of 19.4 million outstanding shares via tender offer. The founding family had promised to sell their shares to Company A. Company A and B disclosed that the shares in Company B might be delisted after the consummation of the acquisition.

The private placement gave 14.2 million shares to Company A at JPY 417 per share, which made it 66% (= 22.3 / 33.6) of the shareholders in Company B.

(B) Case 2 in November, 2009

Company C already had 5.7 million shares (22%) in Company D. Company C announced that it would start a bid for Company D up to 12.2 million shares, and that it would subscribe 5 million new shares which Company D would issue during the offer period, which made Company C at maximum 56% of the shareholders in Company D. The prices of the tender offer and the new share issuance were set to be the same amount, JPY 89, with no premium over the market price. Company D continued to be listed.

(C) Case 3 in March, 2009

Company E already had 14.5 million shares (37%) in Company F. Company E announced that it would start a bid for Company F to make it a 100% subsidiary, and that Company E would subscribe 2.9 million new shares which Company F would issue during the offer period.

The bid set the minimum number, but did not set the maximum number, of shares to be bought. The price of the bid was JPY 63, with 6.8 percent premium over the market value. The price of private placement was set at JPY 55.

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shares.

Table 1 Summary of the three transactions

	Before the deal	Tender offer	Private placement	After the deal
1	A held no share (0%) in B.	Buying at least 8.1M shares (with no cap) at JPY 556 per share (20% premium). Founding family agreed to sell.	After the bid closed, B issued 14.2M shares to A at JPY 417 per share.	At least 22.3M shares (66%) of 33.6M outstanding. Possibly being delisted.
2	C held 5.7M shares (22%) in D.	Buying up to 6.5M shares at JPY 89 per share (no premium).	During the bid period, D issued 5M shares to C at JPY 89 per share.	17.2M shares at maximum (56%) of 31M outstanding. Remained listed.
3	E held 14.5M shares (37%) in F.	Buying at least 17M shares (with no cap) at JPY 63 per share (6.8% premium).	During the bid period, F issued 29M shares to E at JPY 55 per share.	At least 45M shares (67%) of 69M outstanding. E planned to make F 100% subsidiary and thus be delisted.

* A, C and E represent acquirers in each transaction while B, D and F represent the target. "M" stands for "million(s)."

IV. -3 Analysis: Unfair?

In Cases 1 and 3, the acquirers tried to obtain two thirds or more of the target shares, while the acquirer hoped to have only a majority in Case 2. Why did the acquirers in these deals not rely solely on a tender offer? Most likely, the target needed fresh money which would come only from a private placement.

Why did the acquirers not count only on private placement? In Case 1, a block trading of shares from the founding family to the acquirer was planned, and that was the reason the transaction needed the tender offer. In other cases, though, the reason was not evident.

It is supposed that the acquirers tried to minimize the expense in the transaction as well as to maximize the probability of the transaction. Tender offer is preferable in decreasing the buyout expense. However, a plan relying solely on a tender offer would require a higher premium to induce a certain percentage of shareholders into selling their shares.

Private placement can secure the consummation of the deal, and sometimes lower the cost of transaction, because the purchase price can be set at a lower price than that of the tender offer, just as can be seen in Cases 1 and 3.

How would these cases be treated if they were subject to Delaware judiciary? How would the Delaware judges decide under the *Unocal* or *Revlon*[27] test? The combination of tender

27 The "Revlon test" here refers to the standard used in the case of *Revlon, Inc., v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173 (Del. Supr. 1986).

offer and private placement could be an unfair deal protection measure which went too far in excluding competitive bids. Or it may be deemed to be a coercive measure which generated pressure to sell to shareholders at an inequitable price.

However, it is not yet clear whether those transactions harmed minority shareholders. Thus, empirical studies on those cases and other transactions with private placement of new shares are needed. Event studies may well make clear that the tender offer rules should be amended so as to obligate companies using this combination to obtain shareholders' approval in advance.

V. Conclusion

Judging from the observations in III and IV, MCC seems not to be strong enough in Japan. In pursuit of hostile bids, one can find loopholes in written laws, lack of interaction among courts and various advisors, and the negative influence of social norms. For friendly bids, although more research is needed on the pros and cons of the present tender offer rules, the prevalence of the combined usage of a tender offer and private placement raises concerns about the protection of minority shareholders.

In relation to the notion of MCC and the situation of takeovers in Japan, there are a couple of questions. Firstly, who is, and who should be, the owner of a company? In other words, is "shareholder supremacy" only a slogan/ ideology or does it have some merit? Fama and Jensen[28] in 1983 emphasized that stockholders in modern corporations are agents that specialize in risk bearing. Be they owners of the company or not, shareholders are the central stakeholder in listed companies. Also, the maximization of shareholders' wealth approximates, though does not equate, that of social welfare[29]. In setting up a practical index in planning and executing an M&A transaction, the maximization of shareholders' value is probably the only one available.

With this in mind, the next question arises: Is corporate law converging? Hansmann & Kraakman[30], in 2001, argued that corporate law around the world would be converging to the Anglo-American model of "long-term maximization of shareholders' value." I agree with this in regard to M&A situations. Corporate law in Japan does seem to be moving in that direction. There is, however, inertia in legal doctrine as well as in players' behavior, and the latter is more stagnant than the former. The convergence will probably be a long and slow winding road.

Apart from the fundamental question of shareholder supremacy versus the stakeholder model, details of M&A transactions within the legal infrastructure are becoming a matter of

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28 Eugene F. Fama & Michael C. Jensen, "Separation of Ownership and Control," 26 J.L. ECON. 301 (1983).

29 See Henry Hansmann, "Ownership of the firm," in Lucian Arye Bebchuk (ed.), CORPORATE LAW AND ECONOMIC ANALYSIS, at 281 (Cambridge University Press 1990).

30 Henry Hansmann & Reinier Kraakman, "The End of History for Corporate Law," 89 *Georgetown Law Journal* 439 (2001).

scrutiny. In other words, should M&A rules in Japan be changed to follow the EU model? In fact, policy makers, market players and others in the policy-making community have gradually lost interest in the Delaware model and instead have become intrigued with the EU model. In 2009, the Japan Securities Research Institute organized study groups to look into the laws of the UK, Germany and other jurisdictions. The study groups included law scholars and other experts as well as officials from the Financial Services Agency (FSA), Ministry of Justice (MOJ), Ministry of Economy, Trade and Industry (METI) as well as the TSE. The Institute published a report on UK regulations in June 2009, and another report on German and French regulations in September 2010.

The UK rules and institutions, as a whole, are typical of the EU model tender offer rules: the Panel and City Code regulate both friendly and hostile takeovers.

It is not yet certain whether Japan will adopt tender offer rules according to the EU model. In any case, a referee is needed to adjudicate M&A disputes, and the adjudication process requires hearings and guidance for the parties involved.

There is concern with how a Japanese panel would operate. In setting up a Japanese panel, someone has to engage in its operation such as the consultation from and the reprimands to the parties involved in M&A transactions. In the UK, lawyers, accountants and bankers in specialized firms are seconded to the panel so as to put the panel into operation. The system so far has been successful in assuring the transparency of M&A deals as well as balancing the interests of both acquirers and the target shareholders. However, it may be that the system would work differently in Japan. As shown in Part III. -2 (C), M&A advisors in Japan tend to yield to the managers of the client company. With that in mind, a Japanese panel could prejudice incumbent managers even more than the present system does.

Going-private and the Role of Courts: A Comparison of Delaware and Japan*

Wataru TANAKA**

Thank you for introducing me. It is a great honor to speak before such honorable guests from the US, UK and China.

My presentation is titled as a "going-private" transaction. In the broadest sense, this term means a 100% acquisition of a publicly-traded firm by a private firm.[1] This presentation, however, will focus on one category of going-private transactions: *management buyouts* (MBOs), that is, transactions in which top-managers of target companies participate as (one of) acquirers. They have appeared recently in Japan, and some of them have been disputed in courts. I will introduce two Japanese MBO cases (*Rex Holdings*[2] and *CYBIRD Holdings*[3]), and also discuss one Delaware case, *In re Emerging Communications, Inc.,*[4] which was decided by our honorable guest, Justice Jack Jacobs. *Emerging Communications* is a lower court decision and does not establish a new law. Still, this case is informative because it shows us how courts can do to scrutinize potentially abusive transactions.

Economic and Legal Background

Before analyzing cases, let me explain some background. Management buyouts, or more generally, going-private transactions are rather recent phenomena in Japan. As Figure 1

* This essay is based on my presentation at the symposium on "M&As and the Law," the 7th symposium of the Global COE (Center of Excellence) program on "Soft Law and the State-Market Relationship" of Graduate Schools for Law and Politics of University of Tokyo, cosponsored by Center for Japanese Legal Studies of Columbia Law School, and Program on the Financial Instruments and Exchange Law (Tokyo Stock Exchange) of University of Tokyo, held on June 18, 2010, in Roppongi, Tokyo. I appreciate comments of participants of the conference, especially Justice Jack Jacobs and Professor Zenichi Shishido. This work was supported by JSPS Grant-in-Aid Scientific Research No. 20730057.

** Associate Professor, Institute of Social Science, University of Tokyo.

1 *See, e.g.,* Robert P. Bartlett III, *Going Private but Staying Public: Reexamining the Effect of Sarbanes-Oxley on Firms' Going-private Decisions*, 76 U. Chi. L. Rev. 7, 8 (2009).

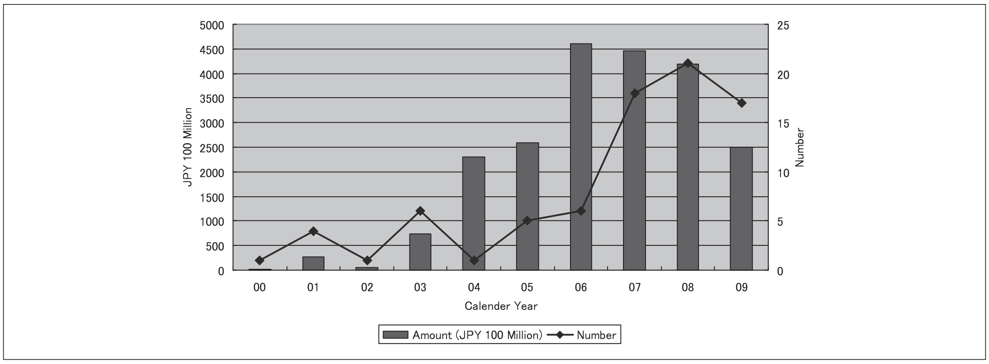
2 Rex Holdings Co. v. Anonym, 1326 Kinyū shōji hanrei 35 (Sup. Ct., May 29, 2009).

3 Anonym v. CYBIRD Holdings Co., 1329 Kinyū shōji hanrei 45 (Tokyo Dist. Ct., Sep.18, 2009).

4 *In re* Emerging Communications, Inc., S'holders Litig., 2004 Del. Ch. LEXIS 70 (Del. Ch., May 3, 2004), *judgment entered by* In re Emerging Communications, Inc., S'holders Litig., 2006 Del. Ch. LEXIS 25 (Del. Ch., Jan. 9, 2006).

shows, many of them took place as recently as late 2000s, after the company law reform prepared procedures for minority cash-out (freeze-out).[5]

Figure 1: Going-private of Public Corporations in Japan (2000-09)



Source: Nihon baiauto kenkyujo [Japan Buy-out Research Corporation], *Nihon baiauto shijo nenkan – 2009 nen shimo hanki ban* – [Japanese Buyout Market Yearbook: Second-half of 2009 Edition], 2010, p.15. "Going-private" transactions are defined as "buying out public corporations with a tender-offer bid by Special Purpose Companies [SPCs], followed by delisting of shares" (id. at 8).

There are both positive and negative views of management buyouts. According to the positive view, MBOs can mitigate the problems of information asymmetry between shareholders and managers. Since share ownership is concentrated in the hands of managers and small number of investors who are familiar with businesses of their company, this view goes, managers can conduct bold restructuring without two much concern of short-term profit, and sophisticated shareholders can monitor managers' behavior effectively. Those critical of MBOs, on the other hand, claim that mangers have strong incentives to buy shares at a low price and deprive current shareholders of future profit opportunities.[6]

In fact, shareholders of target companies of tender offer bids (TOBs) conducted as a part of MBOs have enjoyed on average *larger* profit (in terms of premiums over market prices) than the other TOBs, according to a recent survey (see Figure 2)[7]. This statistics is not a determinative proof that MBOs are generally beneficial to shareholders, since managers may

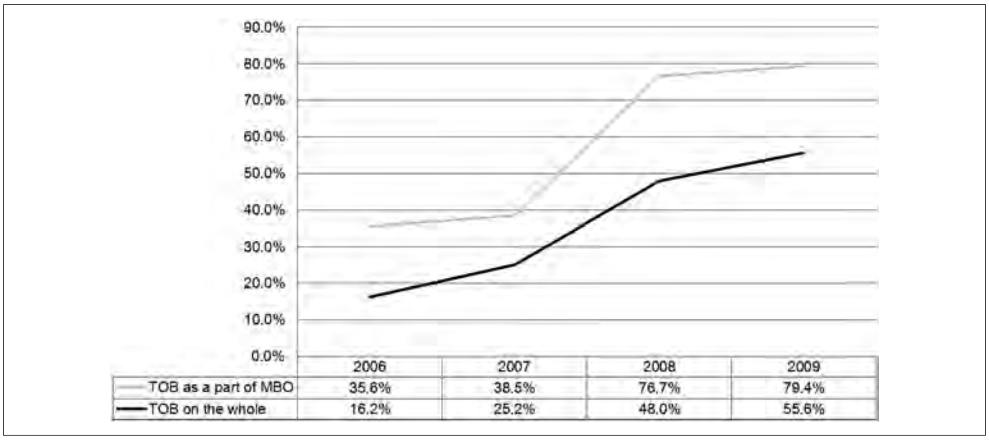
5 Companies Act of Japan (*kaisha ho*), Act No. 86, July 26, 2005, which took effect in May 2006, has legalized cash-out mergers and other types of reorganizations in which shareholders are paid cash or any other types of assets. *See* Companies Act Arts. 749(1)(ii) & 768(1)(ii). The act has also authorized a company to issue a special type of shares named "Wholly Callable Shares," which also can be used to cash out minority shareholders. *See infra* note 11.

6 On pros and cons of MBOs, *see* RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS, chap.11 (2nd ed., 1995 & 2003-04 Supp.).

7 For another survey suggesting sharehodlers of target companies in MBOs enjoy higher premiums than in other TOBs, *see* Yuko Yoshitomi, MBO *ni yoru hijojoka no doko* (2) [Real State of Going-private by MBOs, no.2], MARR Oct. 2010, at p.7, Fig.3 (2010).

have launched MBOs at the very time when the stock market underestimated the value of target companies. Still, this result is consistent with the positive view of MBOs, and supports the policy that the law should take a selective approach – that is, the law should not categorically ban or discourage MBOs, but should regulate only abusive ones. Such a policy is now generally taken in Japan (as well as in the U.S.), and I basically agree with this approach.

Figure 2: TOB premiums over average market prices during the period of three months before the TOB announcement in 2006-2009



Source: Kunihiko Arai, "*2009 nen TOB no baishu puremiamu bunseki* [Analysis of TOB premiums in 2009]," 1241 Junkan keiri joho 58, fig.9 (2010)

Now let me turn to the legal structure. Perhaps the most prominent feature of Japanese law concerning going-private transactions is the lack of law -- at least if we compare it with American law. In Delaware and many other states, directors who decide to place their company on "sale" have the duty to seek the best value reasonably available to shareholders – so called *Revlon* duty.[8] In Japan, there is no clear statute or case-law recognizing directors have *Revlon*-like duty – or actually, any duty to shareholders. Companies Act provides that directors owe duty of care and loyalty to their *companies*,[9] but it does not say anything about what kind of duty (if any) they have to *shareholders*.[10]

Another relevant legal rule is a duty of controlling shareholders. A management buyout in Japan is usually conducted through a two-step acquisition – a tender offer bid (TOB) at the

8 *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1985); Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 48 (Del. 1994).

9 Companies Act Art. 355.

10 Several lower court decisions have said, though in dicta, "directors are in a fiduciary relationship with shareholders who are owners of the company" (NIRECO Corp. v. SFP Value Realization Master Fund Ltd., 1735 Shōji hōmu 48, 56 (Tokyo High Ct., June 15, 2005)), or "managers owe the shareholders a duty of care to promote their interests" (Anonym v. SUNSTAR Inc., 1326 Kinyū shōji hanrei 20, 25 (Osaka High Ct., Sep. 1, 2009)).

first stage and then minority cash-out[11] at the second stage – rather than through a one-step cash-out merger. (This is partly because of tax consideration.[12]) Thus, at the second stage of a management buyout there is always a transaction between a controlling shareholder and the company, so the duty of controlling shareholders is of concern. However, Japan has no statute or case-law clearly recognizing that a controlling shareholder owes fiduciary duty to the company or its minority shareholders. This does not mean controlling shareholders face no risk of liability. They may be liable for torts or based on some special statutory provisions.[13] Still, legal standard to scrutinize a conduct of controlling shareholders is generally underdeveloped.[14]

Also important is a procedural rule. Japan has no class action system. We do have a system of derivative suits, but a derivative suit can be used only to recover damage to the *company*,[15] and generally cannot be used as a remedy for minority shareholders who have been cashed out at unfairly low prices. This effectively means that remedies for dissenting shareholders in a going-private transaction are limited to statutory appraisal rights.[16] Even worse for dissenting shareholders, the appraisal proceeding lacks a procedure to force parties to submit any documentary evidence to courts.[17]

Our foreign guests may be surprised at how underdeveloped Japanese law is. What is more surprising is, in my opinion, that Japan has developed its capital market and its entire economy without paying much cost of legal intervention to protect shareholders' interests. Indeed,

11 Minority cash-out in Japan is typically conducted by the charter amendment, for which a two-thirds majority vote is required, see Companies Act Arts. 466 & 309(2)(xi)), thereby turning the outstanding shares into a special type of shares named "Wholly Callable Shares (*zenbu shutoku jōkō tsuki shurui kabushiki*)," and immediately after that, calling these shares and distributing cash to minority shareholders. *See* Companies Act Arts. 108(1)(vii), 171-173, 234(1)(ii). *See infra* note 22 and the accompanying text.

12 One-step acquisition by a cash-out merger or share exchange (*kabushiki kōkan*) often suffers from disadvantageous tax treatment. In particular, the acquired company is required to reevaluate its assets and taxed on its built-in gain. *See* Corporation Tax Act Art. 62-9.

13 For example, controlling shareholders may be liable based on Company Act Art.120 [prohibiting companies from "giving benefits on exercise of shareholders' rights"].

14 In particular, there is no statute or case-law recognizing the principle that, in a transaction between a company and its controlling shareholder, the controlling shareholder generally has the burden of proof to show the transaction is fair. Compare with Delaware law; Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Kahn v. Lynch Communications Systems, Inc., 638 A.2d 1210 (Del. 1994).

15 *See* Companies Act Art. 847.

16 *See* Companies Act Arts. 172, 785-786, 806-807.

17 Civil Procedure Act of Japan provides that a court may order a party to submit documents in general circumstances (Civil Procedure Act Art. 223), and in case the party does not comply with the order, the court may recognize that the opponent's allegations concerning the statements in the document are true (*id.* Art. 224). Peculiarly, however, those provisions are not applied in the appraisal proceeding, which is characterized as a "non-contentious case (*hishō jiken*)" in Japanese law. *See* Non-Contentious Cases Procedures Act Art. 10.

if financial economists had advocated "Law Matters" hypothesis before 1990,[18] we could have used Japan's success to rebut their argument and push for an alternative "Law Doesn't Matter," or "Less Is More," hypothesis. Unfortunately, such a claim now appears weaker considering stagnant Japanese economy these twenty years. Now we face a difficult policy question, however: Is it necessary to pay more cost of legal intervention to protect shareholders' interests for future development of our capital market? Will stronger intervention provide benefit overwhelming the cost? Today's topic I am now discussing is just one part of such a larger policy debate, and I will return to the general policy matter at the end of my presentation.

For now, let me turn to specific topics of management buyouts. When such transactions appeared and some criticism arose against them, there were both regulatory and practical responses. The TOB rule was revised in 2006 to tighten the disclosure requirement in going-private transactions.[19] In 2007, the Corporate Value Study Group set up by Ministry of Economy, Trade and Industry published "MBO Report", advocating best practices to assure management buyouts to be conducted in a way fair to shareholders.[20]

These responses, however, do not directly establish legal standards to examine directors' behavior in MBOs, nor do they solve the problem how the "fair price" should be determined in the appraisal proceeding. These matters must be decided by courts, so I now discuss how courts have tackled with these problems.

Rex Holdings

The first case is *Rex Holdings*, which occurred in 2006 and legal dispute continued up to the decision by the Supreme Court of Japan.[21] Rex Holdings (Rex) was a JASDAQ-listed company and was acquired by a Special Purpose Company (SPC) having been set up by Rex's president and representative director, Mr. Nishiyama, and a private equity fund named Advantage Partners. Like most MBOs in Japan, this transaction was a two-step acquisition. First the SPC launched a TOB to all the shareholders of Rex and acquired over 90% of the outstanding shares. Then the acquirer cashed out remaining minority shareholders by the procedure using "Wholly Callable Shares."[22] In short, this procedure enables the company to acquire all the

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18 *See, e.g.,* Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); Rafael L Porta et al., *Law and Finance*. 106 J. POL. ECON. 1113 (1998); Rafael La Porta et al., *Investor Protection and Corporate Valuation*. 57 J. FIN. 1147 (2002). Cf. Holger Spamann, *The 'Antidirector Rights Index' Revisited*, 23 REV. FIN. STUD. 467 (2010).

19 See Cabinet Office Ordinance on Tender Offer for Share Certificates, etc. by Person Other Than Issuer, Form 2, notes (6)f & (25).

20 KIGYO KACHI KENKYU KAI [The Corporate Value Study Group], Kigyo KACHI NO KOJO OYOBI KOSEI NA TETSUZUKI KAKUHO NO TAMENO KEIEISHA NIYORU KIGYO BAISHU (MBO) NI KANSURU HOKOKUSHO [Study Report on Management Buyouts (MBOs): To Enhance Corporate Value and Ensure Fair Dealing] (Aug. 2, 2007), *available at* http://www.meti.go.jp/press/20070802008/20070802008.htm [hereinafter MBO Report].

21 Rex Holdings Co. v. Anonym, 1326 KINYŪ SHŌJI HANREI 35 (Sup. Ct., May 29, 2009).

22 *See supra* note 11.

shares of its minority shareholders by a special resolution (a two-thirds majority vote) of the shareholders' meeting.[23] Against this resolution, more than one hundred dissenting shareholders of Rex applied to the court for appraisal of their shares.[24]

Rex Holdings was among the earliest MBOs, having taken place before the Corporate Value Study Group published "MBO Report,"[25] so the company took few measures that MBO Report recommended in order to avoid the problem of conflict of interests. The acquisition price was ¥230,000 per share, adding 13.9% premium to the average of market prices during one month before the date of TOB announcement. This premium was itself small (see Figure 2 on the average takeover premium), and even worse, Rex had revised its forecast of annual income downward about three months before the TOB announcement, having caused a sharp decline of its share prices. If we took an average of market prices during the period of six months (instead of one month) before the TOB announcement, it turned out to be ¥280,805, which was higher than the acquisition price.

Rex had no outside directors, nor did it set up a special committee to scrutinize the transaction, nor did it get a fairness opinion. Instead, it obtained a "share valuation report" from a consulting company, but in the appraisal proceeding, Rex only submitted to the court a "summary" of the report and refused to disclose its detailed analysis and the information of cash-flow projections based on the business plan of the Rex's management.[26]

Finally, the announcement of the TOB disclosed the plan of the second-stage cash-out transaction, and stated that the price to be paid to minority shareholders "may be different from the TOB price."[27] In fact, such a representation is seen in many TOB announcements in Japan and today's participants on the floor coming from Japanese law firms would claim that it has no malicious intention and only has a purpose of dealing with very unusual circumstances – such as, a big earthquake may attack Tokyo and destroy all the assets of the target company. And, despite such a statement, it appears that Rex paid minority shareholders the same price as the TOB price (¥230,000) in the second-stage cash-out transaction.[28] Rex Holdings case, however, was among the earliest cases of management buyouts with minority cash-out using Wholly Callable Shares, so public investors had had little experience of being cashed out by a two-step acquisition. In such a circumstance, Rex's shareholders who read the TOB announcement may well have really worried that, if they did not tender their shares, then they would be treated even worse after the acquirer took the control of Rex. In other words,

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23 *See supra* note 11 and the accompanying text.

24 *See* Companies Act Art. 172(1)(giving dissenting shareholders appraisal rights).

25 *See supra* note 20 and the accompanying text.

26 There is no statutory provision authorizing the court to order the party to submit any documentary evidence in the appraisal proceeding. *See supra* note 17 and the accompanying text.

27 *See* AP8 Co. Ltd., Tender Offer Notification, Chap.1, sec.3 (Nov. 13, 2006), *available at* EDINET: http://info.edinet-fsa.go.jp

28 I know no MBO transaction in which the price paid to minority shareholders at the second-stage cash-out transaction is really set at the lower price than the first-stage TOB price.

the TOB arguably had some "coercive" nature.[29]

Let me explain in brief how courts decided this case. Tokyo District Court appraised the shares of dissenting shareholders at ¥230,000 per share.[30] In other words, the court recognized the actual acquisition price as a "fair" price of Rex's share. On appeal of shareholders, however, Tokyo High Court reappraised the share at ¥336,966.[31] In particular, the high court found problematic the way in which Rex had announced the revision of its annual income forecast just one month before the TOB announcement. Although the revision itself had been in accord with the generally accepted accounting principle, Rex's management disclosed only negative information without disclosing positive one -- especially the information that the management was planning MBO and restructuring of Rex's businesses thereafter. Thus, according to the court, the stock market could have been reacted too pessimistically.[32] The court also criticized that Rex refused to submit the detailed analysis of the share valuation report and its cash-flow predictions, making it difficult for the court to appraise the fair value of Rex's share.[33]

Taking above facts into consideration, Tokyo High Court appraised fair value of Rex's share by taking an average of market prices during six months before the TOB announcement (¥280,805) and adding 20% premium to it.[34] This calculative method was very rough, of course, but the court justified its approach by the fact Rex failed to submit enough information for the court to conduct more elaborate valuation.[35] Rex appealed, but the Supreme Court affirmed the decision of Tokyo High Court.[36]

Although the decisions of Tokyo High Court and the Supreme Court are sometimes criticized as discouraging even value-creating MBOs,[37] I basically agree with the opinion of both courts. They effectively sent a message to practitioners in the M&A market that a management buyout is a conflict-of-interests transaction, so it is the company (and its managers), not dissenting shareholders, who should have a burden of proof to show that the dealing and the actual acquisition price were fair to shareholders.

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29 One justice of the Supreme Court, Mutsuo Tahara, did say in his concurring opinion in *Rex Holdings* that the TOB announcement used some expressions potentially having "coercive effects," *Rex Holdings*, 1326 KINYŪ SHŌJI HANREI at 36 (J. Tahara), though the expressions he pointed out were somewhat different from what I mention in the text.

30 Anonym v. Rex Holdings Co., 1283 KINYŪ SHŌJI HANREI 22 (Tokyo Dist. Ct., Dec. 19, 2007).

31 Anonym v. Rex Holdings Co., 1301 KINYŪ SHŌJI HANREI 28 (Tokyo High Ct., Sep. 19, 2008).

32 *Id.* at 35-36.

33 *Id.* at 39.

34 The court determined 20% as an appropriate amount of premium based on past MBOs and other TOBs conducted in Japan. *Id.* at 39.

35 *Id.*

36 Rex Holdings Co. v. Anonym, 1326 KINYŪ SHŌJI HANREI 35 (Sup. Ct., May 29, 2009).

37 *See, e.g.,* Yo Ota, *Rekkusu hoorudingusu jiken tokyo kosai kettei no kento* [Examination of the Decision of Tokyo High Court in Rex Holdings Case], 1848 SHŌJI HŌMU 4 (2008).

CYBIRD Holdings

Next case is *CYBIRD Holdings*, which occurred in 2007 and was decided by Tokyo District Court in June 2009[38] – four months after the Supreme Court's decision of Rex Holdings. Facts of *CYBIRD Holdings* are somewhat similar to *Rex Holdings*. It was a buyout of a JASDAQ-listed company (CYBIRD) by a special purpose company (the acquiring company), in which the top manager of CYBIRD, Mr. Hori, and a private equity fund named Longreach Group would participate. It was a two-step acquisition, first the TOB and secondly minority cash-out using Wholly Callable Shares, and dissenting shareholders applied to the court for appraisal of their shares. Also like *Rex Holdings*, CYBIRD had revised downward the forecast of its annual income before the TOB announcement.[39]

Tokyo District Court again decided that the actual acquisition price, ¥60,000 per share, was a "fair" price of a CYBIRD's share.[40] But the opinion was much more carefully reasoned than the decision of Tokyo District Court in *Rex Holdings*. The court said that the "fair" price of the share should be determined taking the whole process of the dealing into account. More particularly, the court examined such matters as "whether the MBO was conducted in a way similar to the transaction between independent parties," and "whether it reached to an agreement through the negotiation with the reasonable ground based on the evaluation of third parties."[41]

The court found that CYBIRD had set up a "third-party committee" consisting of two outside directors and two outside experts in order to "discuss and negotiate" with the acquirer, and employed an independent financial adviser and a legal advisor.[42] In addition, the court emphasized that CYBIRD's top manager, Mr. Hori, who would participate in the acquiring company that would acquire the whole share of CYBIRD, actually had already had about 10% of CYBIRD's share before the acquisition.[43] After the acquisition, his shareholding in the acquiring company (so indirectly in CYBIRD) would be slightly less than 8%, and most of the other shares would be held by Longreach Group.[44] Therefore, according to the court's opinion, Mr. Hori stood more as a seller than as a buyer in this transaction. The court also found that he had indeed vigorously negotiated with Longreach Group in order to raise the acquisition price.[45]

Taking all these facts into consideration, the court approved the actual acquisition price as

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38 Anonym v. CYBIRD Holdings Co., 1329 KINYŪ SHŌJI HANREI 45 (Tokyo Dist. Ct., Sep.18, 2009).

39 *See id*. at 49.

40 *See id*. at 63.

41 *See id*. at 59.

42 *See id*. at 60-61.

43 *See id*. at 50.

44 *See id*. at 61.

45 *See id*. at 60.

"fair."[46] Shareholders appealed and the case is now being reviewed at Tokyo High Court.

The decision of *CYBIRD Holdings* is carefully reasoned and I agree with the court's general opinion that we should examine the process of the MBO transaction and, if the process is fair, we can basically regard the actual acquisition price as a "fair" price. Still, several questionable points can be mentioned. First, although Mr. Hori's shareholding in CYBIRD would decrease after the acquisition, he would be given call options for the share of the acquiring company according to the MBO contract between Mr. Hori and Longreach group. These options would give Mr. Hori another 8% of share (including 5% of stock options) in CYBIRD at the maxim.[47] Thus, we might be able to say, in contrast to the court's opinion, Mr. Hori had more interest as a buyer than as a seller in this transaction. Anyway, since the manager and the private-equity fund can make various arrangements on the managers' remuneration after the MBO, it might be misleading just to compare the sizes of shareholdings by the manager before and after the acquisition.

Another questionable point is that, while the court found that the "third-party committee" had been set up, it did not find any facts concerning how the committee had really worked. The committee was set up on Oct 18, 2007, after Mr. Hori and Longreach Group had reached an agreement on the acquisition price (i.e., ¥60,000), and it approved the transaction on Oct 30.[48] I do not mean twelve days are necessarily short. If the committee discussed and negotiated eight hours every day, then twelve days would be more than enough. But the court did not find any facts about how many times the committee had met, how long they had discussed each session, and what kind of negotiation they had done with the acquirer.

Finally, while the court found that CYBIRD had employed a financial adviser (one auditing firm), it did not find any facts about how it had worked. The advisory firm was also employed on Oct 18, and we do not even know whether it made any written opinion. -- The court did not find any fact on that. On the other hand, the acquiring company employed its own financial adviser (one securities company) and obtained the share valuation report by it. Like *Rex Holdings* case, however, only the summary of the report was disclosed and CYBIRD refused to submit to the court the projections of future cash-flows by the management, based on which the share valuation report had been presumably written.[49]

My questions can be summarized as follows: how thoroughly should the court scrutinizes the transaction before it determines the dealing was "fair"? With this respect, I would like to introduce one Delaware case: *Emerging Communications*.[50]

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46 *See id.* at 63.

47 *See id.* at 50.

48 *See id.* at 60-61.

49 *See id.* at 60.

50 *In re* Emerging Communications, Inc., S'holders Litig., 2004 Del. Ch. LEXIS 70 (Del. Ch., May 3, 2004), *judgment entered by* In re Emerging Communications, Inc., S'holders Litig., 2006 Del. Ch. LEXIS 25 (Del. Ch., Jan. 9, 2006).

Emerging Communications

This case was on a going private transaction of a publicly-traded corporation named Emerging Communications (EMC), which was totally acquired by Mr. Prosser, EMC's Chairman and Chief Executive Officer and also its controlling shareholder.[51] Market prices of EMC's share ranged from a high of $8.9375 to a low of $6.25 before the acquisition,[52] whereas the acquisition price was $10.25.[53] In the appraisal proceeding, however, the court decided that the fair price was $38.05.[54]

In this transaction, a committee consisting of three independent directors ("the Special Committee") was set up to negotiate with Mr. Prosser with the advice of its own financial adviser.[55] The Special Committee did achieve improvement of the condition of the acquisition. Through the negotiation between one member of the Committee and Prosser, acquisition price increased from $9.125 (which was Prosser's initial offer) to $10.25.[56]

According to the court, however, the dealing was seriously flawed. In March of 1998 (the year the acquisition took place), Mr. Prosser ordered EMC's Chief Financial Offier to make projections of future cash-flows ("March projections") and disclosed them to the financial adviser of the Special Committee.[57] In June, Prosser prepared another, more optimistic projections ("June projections"), but disclosed them only to his own legal adviser, his financial adviser, and his lender (a financial institution providing him the fund for acquisition), not to the Special Committee, its financial adviser, or the ECM board.[58] Prosser's lender assessed EMC's share at $28 based on June predictions,[59] while the Special Committee's financial adviser, based on March projections, wrote its opinion that $10.25 was fair.[60] The court decided that June projections were more reliable,[61] and based on them, it appraised EMC's share at $38.05.[62] The court also found that the dealing as well as the actual acquisition price was

51 *Emmerging Communications*, 2004 Del. Ch. LEXIS 70, at *2-*6.
52 *See id*. at *18 n.7.
53 *See id*. at *2.
54 *See id*. at *155.
55 *See id*. at *22-*24.
56 *See id*. at *27-*31.
57 *See id*. at *25.
58 *See id*. at *25-*27.
59 *See id*. at *25.
60 *See id*. at *32.
61 *See id*. at *45.
62 *See id*. at *81. The court accorded no weight on the market prices of EMC's share because of the small public float, the fact that the stock was not followed by Wall Street analysts, *see id*. at *84, and the fact "the market never had the benefit of any disclosed earnings or projections of future results, including the June Projections." *Id*. at *85.

unfair to ECM's minority shareholders,[63] and held Prosser and some of other directors liable for breach of fiducially duty.[64]

Emerging Communications is arguably a very unusual, even egregious case. For example, members of the Special Committee communicated with one another through Prosser's own secretary, so Prosser got an access to the discussion of the Committee.[65] So it may not be easily compared with other, more "normal" management buyout cases. Still, *Emerging Communications* informs us how thoroughly the Delaware court scrutinizes the transaction before it determines whether or not the dealing is "fair." It also brings me a doubt whether the court in *CYBIRD Holdings* made sufficient scrutiny. If – hypothetically – CYBIRD's MBO had problems similar to *Emerging Communications*, could Tokyo District Court find them without scrutinizing the negotiation process between the committee and the acquirer and without reading (let alone examining) the report of financial advisers?

I like to raise one more related question. Practitioners in Japan often show a concern that requirement to submit to the court the projections of future cash-flows based on the management's business plan would have negative effects, such as a leakage of a secret business plan and/or giving managers an incentive to make too conservative projections in the first place. Such a concern is reasonable on its face. My reading of several Delaware cases, however, gives me an impression that Delaware courts require the parties to submit the projections of future cash-flows almost as a matter of course.[66] They don't seem to find any difficulty in doing so. Perhaps the concern of Japanese practitioners may be overstated. But I am not sure on this matter, and would like to discuss with our guests and participants on the floor later in the question/discussion session.

Conclusion

Legal intervention is costly. We must carefully examine whether additional intervention can be expected to produce benefits overwhelming costs. So I never mean to say that Japanese courts are wrong just because Delaware courts do more. Still, now that the company law has been deregulated and the method of minority freeze-out is widely available, we must expect abusive transactions sometimes occur. And the courts' intervention, if properly done, can be helpful to prevent such abuses. Anyway, since going-private transactions have taken place only for ten years in Japan, we are still on the earliest stage of the debate how to regulate them. And I believe we can learn a lot of things from comparative-laws analysis. Thank

63 *See id.* at *137.

64 *See id.* at *139-*147.

65 *See id.* at *31 n.27 & *131.

66 DCF (discounted-cash-flow) method, which is routinely used by Delaware courts in the appraisal proceedings, inevitably needs cash-flow projections. Courts use very detailed, division by division cash-flow projections to appraise shares. *See, e.g.,* Cede & Co. and Cinerama v. Technicolor, Inc., 2003 Del. Ch. LECIS 146, C.A. No.7129, 2003 WL 23104613 (Del. Ch. Dec. 31, 2003), *reversed on other grounds*, CEDE & Co. and Cinerama, Inc. v. Technicolor, 884 A.2d 26 (Del. 2005).

you very much.

Postscript:

On October 27, 2010, Tokyo High Court revised the decision of Tokyo District Court in *CYBIRD Holdings* case (Anonym v. CYBIRD Holdings, K.K., 322 Shiryōban Shōji Hōmu 174 (Tokyo High Ct., Oct. 27, 2010)). Tokyo High Court held that, although CYBIRD had taken several measures to mitigate the problem of conflict-of-interests, it could not be said that there had been no conflict of interests in this transaction (id.at 178). The court also pointed out that the TOB announcement had included some expressions very similar to those in *Rex Holdings* case, and held that it could not be said that those expressions had no structurally "coercive" characteristics (ibid). Taking those factors into consideration, Tokyo High Court reassessed the fair price of CYBIRD's share at ¥61,360 – about 2.3% higher than the price having been assessed by Tokyo District Court (¥60,000).

The Takeover Regulation in Japan: Peculiar Developments in the Mandatory Offer Rule

Tomotaka FUJITA*

I. Introduction

A substantial number of comparative studies have focused on takeover defense in Japan[1]. It is commonly understood that when discussing the comparative merger and acquisition (M&A) regime, the rules on takeover bid (TOB) procedure and on the takeover defense should be considered together. If only one of these regulations is examined, the study is incomplete. It may be a little surprising, therefore, that few examinations have focused on a detailed examination of Japanese TOB regulation from a comparative point of view[2]. A possible reason is that observers have understood that Japanese regulations are akin to European regulations[3], in that both require a TOB (tender offer) for corporate control transactions, and there are very few, if any, aspects that are particular to Japanese law[4]. As the analysis below reveals, however, this affinity with European law is not the case. Rather, Japanese TOB regulations, despite the apparent similarity, are quite different in nature from European regulations.

This article focuses on the unique features of Japanese TOB regulations compared with the rules in European states. Part II reviews a brief history of Japanese TOB regulation. The four most important differences from European regulations are identified, and corresponding

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* Professor of Law, Graduate Schools for Law and Politics, University of Tokyo

1 *See*, for example, Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*,105 Columbia Law Review 2170 (2005) ["Milhaupt, Shadow"]; Hideki Kanda, *Takeover Defenses and the Role of Law in Japan*, 2 UT Soft Law Review 2 (2009); Curtis J. Milhaupt, *Bull-Dog Sauce for the Japanese Soul? Courts, Corporations, and Communities—A Comment on Haley's View Of Japanese Law*, 8 Washington University Global Studies Law Review 345 (2009).

2 Kenichi Osugi, *What is Conversing?: Rules on Hostile Takeovers in Japan and the Convergence Debate*, 9 Asian-Pacific Law & Policy Journal 143, 148-155 [analyzing the history of Japanese TOB regulation.]

3 TOB regulations in EU states are based on Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids ["Directive"].

4 *See*, for example, Curtis J. Milhaupt and Mark D. West, *Institutional Change and M&A in Japan: Diversity Through Deals*, in CURTIS MILHAUPT, ED., GLOBAL MARKETS, DOMESTIC INSTITUTIONS: COMPARATIVE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS, COLUMBIA UNIVERSITY PRESS, 2003, p. 293, 306 ["In 1991, Japan instituted a mandatory bid rule patterned after (but more stringent than) London's City Code."]

different policy goals are revealed in Part III. After the examination of function of the mandatory offer in Part IV, the possible future of Japanese TOB regulations will be discussed in Part IV.

II. A Brief History of Japanese TOB Regulation

A. Introduction of TOB Regulation : 1971-1990

Let us look at a brief history of TOB regulation in Japan, which was first introduced by the 1971 Amendment of Securities Exchange Act[5]. It was mostly a procedual regulation along the lines of the Williams Act 1968 in the United States[6]. The rule went unchanged for about 20 years, and there were very few tender offers during this period[7].

B. Introduction of «Mandatory Offer» :1990-2006

The 1990 Amendment of Securities Exchange Act[8] changed this situation. It introduced the "mandatory offer," which requires that the controlling shares have to be obtained through TOB, except for several exempted cases. Article 27-2 (1) of the Securities Exchange Act provides: "*Purchase, etc.* (meaning purchase or other type of acceptance of transfer for value of Share Certificates, etc. and including acts designated by a Cabinet Order as being similar to such acceptance; hereinafter the same shall apply in this Section) of Shares, convertible bonds and other Securities…… for which their Issuer is required to submit Annual Securities Reports *shall be made by means of a Tender Offer*, if the Purchase, etc. is made outside of Securities Market by a person other than the Issuer *unless it falls under any of the categories listed in the following items*." (Emphasis added) Item (iv)[9] provides for the exception: "Purchase, etc. of Share Certificates, etc. which is regarded by a Cabinet Order as Purchase, etc. from an extremely small number of persons (*Holding Rate of Share Certificates, etc. in possession by the person who conducted the Purchase, etc. should not exceed one third*)." (Emphasis added) In short, if the acquirer obtains more than one third of the target's share, the exemption does not apply. Therefore, if an acquirer wishes to obtain more than one third of the issuer's voting shares outside of the market, a TOB is required for such purchase since the 1990 Revision ("mandatory offer rule"). Although the driving force for this revision is a mystery, in retrospect, this was an important moment of departure from the American-

5 The Law Amending a Part of Securities Exchange Act (Law No.4, 1971).

6 15 U.S.C.A. § 78a et seq. The Williams Act of 1968 amended the Securities and Exchange Act of 1934 to require mandatory disclosure of information regarding tender offers.

7 It was three cases throughout the period. See HIDEKI KANDA, *COMPARATIVE CORPORATE GOVERNANCE REPORT: JAPAN*, IN KLAUS J. HOPT ET.AL. EDS., COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF ART AND EMERGING RESEARCH, OXFORD UNIVERSITY PRESS, 1998, p.921, 935.

8 The Law Amending a Part of Securities Exchange Act (Law No.43, 1990). The new rule came into force since December 12, 1990. For the amendment, *see* Kanda, *supra* note 7, p.934.

9 The provision corresponds with Article 27-2(1)(ii) of the current Financial Instruments and Exchange Act.

type of TOB regulation.

C. The 2005 and 2006 Revision

During the decade after the 1990 revision, there were still few tender offers[10]. The situation changed in the late 1990s when the market for corporate control suddenly awoke. Since then, a few amendments have been added.

1. The Nippon Broadcasting v. Livedoor and the 2005 Revision

First, a small amendment was made to the definition of "sale and purchase, etc. conducted in Financial Instruments Exchange Markets" in 2005[11]. The amendment was the byproduct of a famous takeover of Nippon Broadcasting, Inc. by Livedoor[12]. Before launching the bid to the investors, Livedoor purchased a substantial volume of Nippon Broadcasting's shares through after- or pre-market hours trading known as "ToSTNeT (Tokyo Stock Exchange Trading Network System). While the target (Nippon Broadcasting) argued that such purchases violated the requirement of mandatory offer (Article 27-2 (1) of the Securities Exchange Act), the Tokyo High Court finally decided that purchases through ToSTNeT constitute "Purchase, etc. of Share Certificates" in a securities market (market purchase exemption[13]) and therefore do not trigger the mandatory offer required for the acquirer[14]. Although Livedoor's purchase was held lawful in the case, many saw that it took advantage of a loophole in the Securities and Exchange Act. The 2005 Amendment was intended to close the backdoor of the market purchase exemption by explicitly excluding shares through after- or pre-market hours trading including "Purchase, etc.... outside of Securities Market"[15].

2. The 2006 Revision and the Obligation to Purchase All Shares

The 2005 revision simply fixed a small loophole in the previous regulation but more substantial revision immediately followed. The 2006 Revision[16] added the following rules with the

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10 Most TOB cases were "friendly" offers to which the management of the target company agreed (Kanda, *supra* note 7, p.935-936). Although hostile bidders were quite rare in this period, there were some hostile takeovers through market purchase of the controlling shares. (*See* Osugi, *supra* note 2, pp.150-151.) Japanese TOB regulation, unlike its European counterpart, does not impose mandatory offer when a corporate control shifts via market transaction.

11 The Law Amending a Part of Securities Exchange Act (Law No.76, 2005).

12 *See* Milhaupt, Shadow, *supra* note 1, 2178-2180.

13 *See* Part III.2 for the details of this exception.

14 Tokyo High Court Decision on March 23, 2005, Kôsai Minshû [High Court Reporter], vol. 58, no. 1, p.39.

15 The revised Article 27-2 of the Securities and Exchange Act regulates "Purchase, etc. other than those through Sale and Purchase etc. in Securities Exchanges Market (*excluding Sale and Purchase etc. designated by Prime Minister as being conducted through the method other than auction*)" [emphasis added]. All after- or pre-market hours trading in relevant exchanges are designated as "the method other than auction" (Public Notice of Financial Services Agency No.53, July 8, 2005).

16 The Law Amending a Part of Securities Exchange Act (Law No.65, 2006). The title of the Act was

result that the differences from the United States' laws grew even greater.

(i) Regulation on Combined Purchase Method. Under the existing rule, there was room for the acquirer to escape from mandatory offer by the combination of market purchase and private purchase. For instance, the acquirer could avoid mandatory offer by purchasing 32% of voting shares through private purchase and another 2% from the stock market. The 2006 Amendment prohibited such "combined purchases" within a short period of time that had fallen outside of the regulation[17].

(ii) Enhanced Disclosure. The information required for disclosure with respect to TOB was substantially expanded[18]. For instance, the information with respect to the purpose of the purchase (including the management policy after the acquisition), the grounds for deciding the bid price and the arrangement to avoid conflicts of interest in certain cases such as a management buyout (MBO).

The target company was required to express its opinion on the TOB[19]. It must also disclose its defense policy against the takeover[20]. If a question to the acquirer is included in the target's opinion, the acquirer should submit a Report on the Response to Question[21].

(iii) Flexibility in TOB Process. The 2006 Amendment added flexibility to several procedural aspects of a TOB. On one hand, a target company can, under certain conditions, demand the extension of TOB period[22], which gives the target's management the opportunity to propose a competing offer and the target's shareholders enough time to decide whether to accept the offer. On the other hand, the 2006 Amendment widened the possibility for the acquirer to revoke the offer or change its conditions[23]. It was pointed out that the acquirer could incur unexpected loss when certain types of defensive measures were implemented by the target company. This amendment would prevent the unnecessary deterrence effect on the potential acquirer.

(iv) The Obligation to Purchase All Shares. The most important change added in the 2006 was the acquirer's obligation to purchase all shares of the target company. Until the 2006 Revision, the acquirer was free to place the limitation of shares that it wished to purchase regardless of whether the offer was mandatory or voluntary, which was one of the most impor-

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changed to "Financial Instruments and Exchange Act" since the 2006 Revision. The revision of TOB rules came into force since December 13, 2006 prior to other part of new Financial Instruments and Exchange Act.

17 Financial Instruments and Exchange Act Art. 27-2(1)(iv).

18 Financial Instruments and Exchange Act Art. 27-3.

19 Financial Instruments and Exchange Act Art. Until the 2006 Revision, a target company could express its opinion on non-mandatory basis.

20 Cabinet Order on Disclosure with Respect to the Tender Offer of the Shares etc. by Persons Other Than the Issuer ("Order") Article 25(1)(vi).

21 Order Article 25(3).

22 Financial Instruments and Exchange Act Art.27-10(3).

23 Order 14(1).

tant differences from the European regulation[24]. The 2006 Revision imposed the acquirer to purchase all shares that are tendered if it obtain more than two thirds of the total voting shares of the target company[25]. Although the Revision did not impose the obligation to purchase all shares *in all mandatory offers*, it is important that the Japanese legislator, for the first time, recognized the necessity to give exit for the minority shareholders under limited circumstances. Future commentators might regard this Revision as the second important structural change in the history of Japanese TOB regulation[26].

III. Major Differences from European Regulation

A "mandatory offer" rule for the acquisition of controlling shares exists in both European states and Japan. However, a close examination reveals several differences between European and Japanese regulation. The following four are the most important.

A. Four Main Differences

1. Difference #1: Ex Ante v. Ex Post Offer

The first difference is that in Japan the regulation (mandatory offer) applies to the acquisition of the controlling share itself. If an acquirer obtains, as a result of a certain purchase, more than one third of company's total voting shares, such purchase is subject to mandatory offer regulation. For instance, if the acquire has 25% of the target's shares and wish to acquire 10% more, such a purchase must be achieved through a tender offer (or other exempted method). Under European regulations, once the acquirer's shareholding reaches the threshold (e.g., 30%[27]) an offer is required[28]. The purchase of controlling shares itself can be made privately and the mandatory offer comes next. In this case, the additional 10% of the target's shares can be purchased by either private transaction or any other method. In short, the mandatory offer is required *after* becoming a controlling shareholder in Europe (*ex post* regula-

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24 *See* III.D below.

25 Act Art.27-14(4), Order Art. 14-2(2)

26 *See* III D. below.

27 The threshold differs among EU member states. For the comparative table of the threshold in each state, *see* Paul Van Hooghten ed., The European Takeover Directive and Its Implementation, Oxford University Press, 2009, pp. 86-87.

28 Directive Art.5(1) provides "Where a natural or legal person, as a result of his/her own acquisition or the acquisition by persons acting in concert with him/her, holds securities of a company as referred to in Article 1(1) which, added to any existing holdings of those securities of his/hers and the holdings of those securities of persons acting in concert with him/her, directly or indirectly give him/her a specified percentage of voting rights in that company, giving him/her control of that company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company. Such a bid shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings at the equitable price as defined in paragraph 4."

tion), while it is required *to become a controlling shareholder* in Japan (*ex ante* regulation).

A related difference is that the purchase price in a mandatory offer is regulated under European regulation[29], while there is no minimum price requirement in Japan. No price regulation is necessary under Japanese regulation, which requires a mandatory offer to become a controlling shareholder in Japan. If the offer price is too low, then the bid will fail, and the acquirer cannot gain control. In contrast, in Europe a mandatory bid occurs after control shifts, and it is necessary to impose limits on the acquirer in order to ensure a meaningful bid. It is apparent that the minimum price regulation in European states is a byproduct of *ex post* regulation.

2. Difference #2: Exemption for a Purchase in a Market

There is an important exemption to the mandatory bid rule in Japan: When the acquirer obtains a target's share through the stock market, a mandatory bid is not required. Article 27-2 (1) (ii) of Financial Instruments and Exchange Act provides the exemption for "sale and purchase etc., conducted in Financial Instrument Exchange Markets". In contrast, under European Regulation, the mandatory offer requirement applies when the acquirer obtains controlling shares, no matter the form of the acquisition of controlling shares. Of course, several exemptions exist even under European regulation[30], but a purchase in a stock market does not constitute an exemption.

3. Difference #3: Exemption for the Issuance of Target's Shares

Another important exemption for a mandatory offer in Japan is for transactions in the primary market such as the issuance of new stocks. Even if a company issues new stocks to a certain person and it acquires more than 30% of the total voting shares, no mandatory offer is required. In Europe, such an acquisition could trigger a mandatory offer unless specific exemption applies the stock issuance[31].

4. Difference #4: Is Partial Acquisition Allowed in a Mandatory Offer?

Under European Regulation, when a mandatory offer applies, the acquirer, in principle,

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29 The bid should be "at the equitable price." The "equitable price" is defined as "The highest price paid for the same securities by the offeror, or by persons acting in concert with him/her, over a period, to be determined by Member States, of not less than six months and not more than 12 before the bid referred to in paragraph 1 shall be regarded as the equitable price. If, after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in concert with him/her purchases securities at a price higher than the offer price, the offeror shall increase his/her offer so that it is not less than the highest price paid for the securities so acquired." (Directive Art.5(4))

30 Directive Art.5(2) and 10. *See* Jan Wouters, Paul Van Hooghten, and Mattias Bruyneel, The European Takeover Directive: A Commentary, in Hooghten *supra* note 27, p. 30

31 *See supra* note 30.

must purchase all shares that are tendered[32]. In contrast, the acquirer does not necessarily have to purchase all shares in Japan. Before the 2006 Revision, the acquirer was required to give all shareholders the opportunity to tender but could always limit the maximum shares for the purchase (i.e., partial acquisition) even in a mandatory offer. The 2006 Revision introduced the acquirer's obligation to purchase all shares in order to protect minority shareholders' interests. However, such an obligation is triggered only by a much higher acquisition, i.e., two third of the total voting shares. One should note that the thresholds for mandatory offer (third of total voting shares) and for protection of minority shareholders (two thirds of total voting shares) are substantially different and both obligations are based on different grounds in Japan[33].

B. The Different Legislative Goals behind the Rules

These differences between European and Japanese regulations may give the reader an impression that the Japanese mandatory offer rule is simply a "weak" or "incomplete" version of European regulation. In fact, they are more than that. The basic policy goals behind the rules are quite different.

Japanese regulation can best understood as being built on the basic norm that ***the change of corporate control should not occur through a private purchase*** ("prohibition of private purchase of controlling shares"). In contrast, European regulations seem to rest on a quite different policy goal: ***once the corporate control is acquired by or transferred to a certain person, the remaining shareholders should have the right to exit from the company at a fair price***[34]**.** Curiously, this explanation is seldom heard in connection with mandatory offer rule in Japan (the explanation applies only to the acquirer's obligation to purchase all shares, not to the mandatory offer rule[35]). Perhaps the best analogy of Japanese law is an "appraisal remedy" in the case of fundamental corporate changes[36]. Mandatory offers under European regulation can be best understood as the minority shareholders' exit right, as if an acquisition or transfer of corporate control is a kind of fundamental change similar to a corporate merger.

Let us confirm how these different policy goals are related to the differences mentioned above. Difference #1 (*ex ante* v. *ex post* regulation) is immediately discernable from the different goals. European regulation, which allows the private purchase of a controlling share, even if a mandatory offer immediately follows after the purchase, is not appropriate from the viewpoint of "*the prohibition of private purchase of controlling shares.*" The *ex post* regulation combined with price regulation, however, is sufficient if the goal is *to offer remaining*

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32 Directive Art.5(1) provides "Such a bid shall be addressed at the earliest opportunity to *all the holders of those securities for all their holdings* ……." (Emphasis added).

33 *See* Part III.D below.

34 Wouters, Hooghten, and Bruyneel, *supra* note 30, p.25-26.

35 *See*, Part. III.D below.

36 *See* Corporate Code Art. 785, 797 and 806.

shareholders a right to exit from the company at a fair price.

Difference #2 (exemption for the purchase in a market) can also be easily understood. Japanese law only prohibits the acquirer from obtaining controlling shares through private purchase. In Europe, minority shareholders' exit right must be guaranteed whatever the reason for an acquisition or transfer of corporate control.

Difference #3 (exemption for *the issuance of target's shares*) is obvious. Although the exemption cannot be understood if the policy goal is *to offer remaining shareholders the right to exit from the company at a fair price*, it is a natural consequence of "prohibition of the acquisition of controlling shares through private purchase."

Finally, difference #4 (the obligation to purchase all shares) is also consistent with the different policy goal. Because the guarantee of an exit right for minority shareholders is the essence of mandatory offers, the acquirer must purchase all shares when it gains corporate control under European regulation. In contrast, the goal of Japanese regulation is to prohibit private purchase of controlling shares and not to guarantee the exit right of the shareholders. The obligation to purchase all shares is triggered only in limited circumstances based on a different consideration.

C. Why did the Japanese Legislature Adopt a Unique Policy Goal?

What is the rationale for the norm of "prohibition of the acquisition of controlling shares through private purchase" that lies behind the Japanese TOB regulation? It is usually explained in one of two ways: (a) transparency of corporate control transactions or (b) a fair distribution of the "control premium."

1. Transparency of Corporate Control Transactions

The official explanation by the person who was involved in the 1990 Revision is based on transparency of corporate control transactions[37]. In essence, it argues that **a corporate control transaction that would give substantial influence to the stock market should be conducted in a transparent manner; i.e., through a transaction in an open market, through a tender offer or equity finance in a primary market.** Many commentators follow this explanation[38].

The justification based on "transparency of corporate control transactions" needs an explanation of why a primary market is regarded as "transparent" because the issuance of stocks to a specific person, for instance, resembles a private sale of shares. The Japanese legislature seems to have believed that the concern for transparency also does not exist for transactions in the primary market because such transactions are subject to mandatory disclosure. This

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37 Jun-ichi Naito, *Kabushiki Kôkai-kaitsuke Seido No Kaisei [The Revision of Stock Tender Offer System]*, 1208 Shoji-homu 2, 5 (1990) (in Japanese). This is an explanatory article by a member of Ministry of Finance which is in charge of the Revision.

38 *See*, for example, MITSUO KONDO, KAZUSHI YOSHIHARA AND ETSURO KURONUMA, KINYÛ SHÔHIN TORIHIKI-HÔ NYÛMON [INTRODUCTION TO THE FINANCIAL INSTRUMENT EXCHANGE ACT], SHOJI-HOMU 2009, p. 343. (in Japanese)

interesting perception may not be shared by others, but this point of view is also found in other pieces of Japanese legislation. For instance, the regulation of insider trading does not apply to transactions in the primary market in Japan.

One may wonder why such a different policy was adopted by the Japanese legislator when the mandatory offer was introduced in 1990. Although the legislator seemed to have investigated European regulation, especially the rules in the U.K[39], curiously the policy goals embraced by both legislations were completely different. There has been no explicit explanation on this point. The most plausible explanation is bureaucratic thinking such as the following. The role of the Securities Exchange Act, according to the legislator or the Ministry of Finance in charge of the Act at the time, is to regulate the securities market. The protection of the minority shareholders of a specific company is a policy goal achieved by corporate law of which the Ministry of Justice is in charge. Therefore, if a mandatory offer rule is to be incorporated into the Securities Exchange Act, such a regulation should be explained in the context of market regulation and the purpose of guaranteeing the minority shareholder's right to exit in the wake of creation or change of control is not acceptable. Therefore, the legislator needed an alternative policy goal that would be more consistent with market regulation. This line of thinking finally resulted in a unique policy goal: "prohibition of private purchase of controlling shares to make corporate control transaction transparent which could have significant impact on the stock market."

2. Fair Distribution of "Control Premium"

Some commentators offer the following alternative explanation: if the private purchase of controlling stock is allowed, the seller (the current controlling shareholder) can sell the shares at a substantially higher price than the market price and can enjoy a substantial "control premium." This is, they argue, simply unfair, and other shareholders should have an equal opportunity to participate in the premium[40].

The viewpoint of "fair distribution of control premium" can easily explain why the Japanese mandatory offer rule exempts corporate acquisition though market purchase. An acquirer cannot enjoy a purchase price from a market transaction. This viewpoint can also explain why a corporate control transaction through the primary market is exempted. When a company issues shares to the acquirer and the acquirer gains control, the increase of the corporate value created by the shift of control is distributed to *all* shareholders in proportion to the shareholdings. According to this viewpoint, it is necessary and sufficient to prohibit the acquisition of control through private purchase just as the Japanese TOB rule did in the 1990 Revision.

The argument might to be influenced by academic arguments in the United States in the

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39 Naito, *supra* note 37, p.5

40 NAGASHIMA OHNO & TSHUNEMATSU HÔRITSHU-JIMUSHO ED., KÔKAI-KAITSUKE NO RIRON TO JITSUMU [THE THEORY AND PRACTICE OF TENDER OFFER], SHOJI-HOMU, 2010, p. 4. (in Japanese)

1960s[41]. Whether these explanations are persuasive is, of course, a different question. There is a strong opposition against the "fairness" argument for the distribution of controlling premiums[42]. The critics argue that the rule imposing "fair distribution" of controlling premiums could unreasonably deter otherwise possible corporate control transactions, and thus the shareholders would suffer an opportunity loss, which would decrease the company's expected value and would result in shareholder losses (including minorities). The validity of this argument is examined in Part IV.

In any event, these commentators, although the reasoning was different from the legislator's, supported the mandatory offer rules introduced in 1990. It should be noted that they did not pay much attention to the difference from the European regulation: the rules of both would be consistent with the "fair distribution" of controlling premiums although the European rule seems a little too far-reaching for this purpose.

D. The 2006 Revision and the Obligation to Purchase All Shares

The 2006 Revision added complexity not only in the text language but also in the policy behind Japanese TOB regulation. Neither of the two explanations mentioned in Part III.C can explain the obligation on the acquirer to purchase all shares tendered in the mandatory offer, which was added by the 2006 Revision. It requires justification along the lines of European rule: *to guarantee the opportunity to exit from a company for minority shareholders*[43]. This does not mean, however, that the Japanese mandatory offer rule abandoned its previous policy goal (prohibition of private purchase of controlling shares) because the obligation to purchase all shares does not apply to all mandatory offers. Rather, it is triggered only if the acquirer obtains more than two thirds of the total voting shares[44]. It is important to recognize that the current Japanese TOB rules need different justifications for the mandatory offer rule itself and for the obligation to purchase all shares in limited mandatory offers, while the European rules are explained by only one policy goal: to guarantee the opportunity to exit from a company for minority shareholders.

Unfortunately, the combination of the two different policy goals introduced a serious inconsistency in the Japanese TOB system. If the purpose of the obligation of the acquirer to

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41 *See* William D. Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 Harvard Law Review 505 (1965)

42 *See* Frank H. Easterbrook and Daniel R. Fischel, The Economic Structure of Corporate Law, Harvard University Press, 1991, Ch. 5.

43 In fact, the explanation by the member of Financial Services Agency explicitly mentions the protection of minority shareholders in this context. *See* Yûichi Ikeda, Shirô Ôkita and Yukito Machida eds., Atarashi-i Kôkai-kaitsuke Seido to Tairyo Hoyû Hôkoku Seido [The New Tender Offer System and Reports of Possession of Large Volume], Shoji-homu, 2007, p. 95. (in Japanese)

44 Note that Japanese corporate law requires the approval of two thirds majority (super majority) for important decision such as corporate fundamental changes (Corporate Act Art.309(2)). The minority shareholders have a legitimate concern when someone obtains super majority. For instance, acquirer with two thirds of the total voting shares can "squeeze out" the minority shareholders.

purchase all shares is to give minority shareholders the opportunity to exit, the protection should apply regardless of the way in which the acquirer obtained two thirds of the total voting shares. The obligation to purchase all shares under the 2006 Revision applies to the tender offer[45], and when a tender offer is not imposed on the acquirer, it has no obligation to purchase all shares from the minorities even if it obtains a super majority of the voting shares. Therefore, when the acquirer obtains a super majority through market purchase or by the target's issuance of shares, the obligation to purchase all shares is not triggered. This result is clearly inconsistent with the policy goal to guarantee minority shareholders the opportunity to exit[46].

IV. Function of the Mandatory Offer

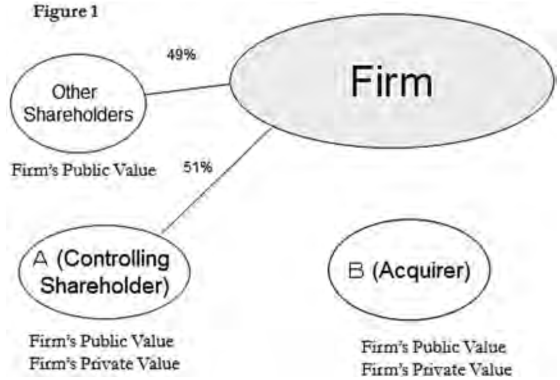
Apart from the intention of the legislature, it is worth considering the question of the function of the Japanese version of mandatory offers.

A. Efficient and Inefficient Change of Control

It has been well recognized that the mandatory offer rule has two opposite economic implications: 1) the mandatory offer rule would prevent inefficient transfer of control; and 2) the mandatory offer rule could also prevent efficient transfer of control[47]. Let us confirm that the above is true for Japanese version of the mandatory offer rules using a simple numerical example[48].

Based on most of the recent economic models on takeover, let us assume that the value of a firm is divided into (i) *public value* that all shareholders can enjoy (and hence reflected in the share price) and (ii) *private value* for the controlling shareholders, which does not benefit other shareholders (and hence is not reflected in the share price). The source of private value varies. The controlling shareholder may squeeze the wealth of minority shareholders. The controlling shareholder may have another business that has synergy with the target's business. Whatever the reason is that the controlling shareholder has a private value in the firm,

Figure 1



45 Act Art. 27-14(4) provides the obligation to purchase all shares as an imposed condition of the offer.

46 *See* Part V.B for the possibly remedy to the inconsistency.

47 Lucian Ayre Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Quarterly Journal of Economics 957 (1994)

48 For more formal proof of the model, *see* Bebchuk, *supra* note 47.

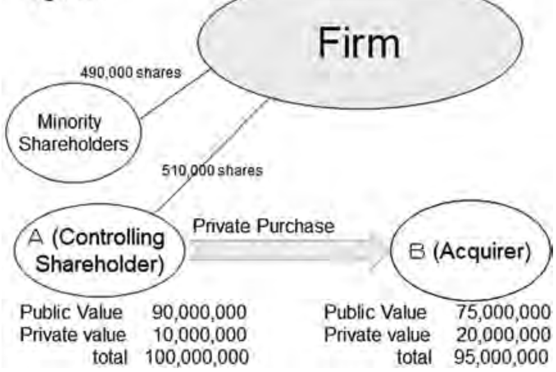
the following argument applies[49].

The basic model is as follows. The current controlling shareholder A owns 51% of the firm's total voting shares. The rest of shares (49%) are held by other shareholders. Acquirer B wishes to take control of the firm by obtaining 51% of the firm's total voting shares. The firm's value consists of both public and private value. All shareholders can enjoy the public value of the firm in proportion to the number of their shares. A controlling shareholder can enjoy both the public value and private value of the firm. The firm's public and private value might be increased or decreased by the takeover.

1. Preventing Inefficient Transfer of Control

(i) The Assumptions Assume that a firm's value is $100,000,000 with the incumbent controlling shareholder A, who has 51% of the total share. A enjoys a private benefit of $10,000,000. The firm issues 1,000,000 shares and the share price is $90 (corresponding the firm's public value $90,000,000). If B acquires the firm, its value declines to $95,000,000, and B's private value is $20,000,000. Because the firm's public value is now $75,000,000, its share price will decline to $75.

Figure 2



(ii) Result When Private Purchase of Controlling Shares is Allowed

Although the transfer of control is value decreasing, it occurs if private purchase of controlling share is allowed. A owns $45,900,000 of the firm's shares (51% of $90,000,000 (firm's public value)) and $10,000,000 of the firm's private value ($55,900,000 in total). B, if he successfully acquires control, will have $38,250,000 of the firm's shares (51% of $750,000,000 (firm's public value)) and $20,000,000 of the firm's private value ($58,250,000 in total). Therefore, B can purchase A's shares at a price between $58,250,000 and $55,900,000. Both parties will be better off. *See* Table 1.

Table 1

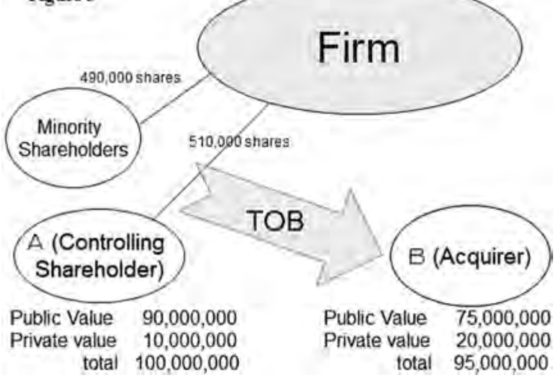
A's total benefit before the acquisition:	
51% of firm's public value:	45,900,000
A's private value:	10,000,000

49 Please note that although the source is irrelevant, the existence of private value is essential for a takeover. Otherwise, the acquirer has no incentive to gain control of a company. *See* Sanford J. Grossman and Oliver D. Hart, *Takeover Bids, the Free-rider Problem, and the Theory of the Corporation*, 11 Bell Journal of Economics 42 (1980).

Total:	55,900,000
B's total benefit after the acquisition:	
51% of firm's public value:	38,250,000
B's private value:	20,000,000
Total:	58,250,000

(iii) Result When Private Purchase of Controlling Shares is Prohibited

Figure 3



The inefficient transfer of control referred to in (ii) would effectively be prevented if a mandatory offer is required. Under the rule, A cannot sell its shares directly to B. Instead, B must launch a bid to all of the firm's shareholders. Let us assume that B makes a bid for 51% of firm's share at a price P. Please note that the Japanese version of the mandatory offer rule allows such a partial acquisition[50]. For the sake of simplicity, the all the firm's shareholders participate in the offer. In this case A can sell only 51% of its shares.

If the bid is successful, A's position is as follows: (1) P*510,000*0.51 [sales price of the shares] and (2) 75*510,000*0.49 [the value of remaining shares] which is P*260,100+18,742,500 in total. B's position is as follows: (1)75*510,000 [the value of acquired shares], (2) 20,000,000 [firm's private value], minus (3) P*510,000 [purchase price of the shares] which is 582,500,000-51*P in total.

In this case, the bidding price should be higher than $142.86[51]. Otherwise, A would be worse off. However, B cannot make a bid at such a price because it would be worse off. The TOB fails and the transfer of control does not occur. *See* Table 2.

Table 2

A's total benefit before the acquisition:	
51% of firm's public value:	45,900,000
A's private value:	10,000,000
Total:	55,900,000

50 Even after the 2006 Revision, B is not required to purchase all shares that are tendered. Such a partial acquisition is not allowed under European rule. *See supra* Part III.A.4.

51 The bid would make A better off if and only if P*260,100+18,742,500>55,900,000. P should be higher than approximately 142.86.

A's total benefit after the acquisition:

Sales price of the stocks:	P*26,010
Value of the remaining shares:	18,742,500 [75*249,990]
Total:	260,100P+1,874,250

P should be higher than $142.86 to compensate

B's total benefit after the acquisition (P=142):

51% of firm's public value:	38,250,000
B's private value:	20,000,000
Purchase price of the stocks:	72,420,000
Total:	-14,170,000

2. Preventing Efficient Transfer of Control

(i) The Assumptions Let us next consider an example that involves an efficient transfer of control. Assume the firm's value is $100,000,000 under current owner A, who has 51% of the total share. It consists of $80,000,000 of the public value and $20,000,000 of the private value. If the acquirer B takes control, the firm's value increases to $110,000,000, which consists of $100,000,000 of public value and $10,000,000 of private value. The firm issues 100,000,000 shares, and the share price consists of $80 under A's control and $100 under B's, reflecting the public value of the firm. The transfer of control is desirable in that it enhances the firm's value.

(ii) Result When Private Purchase of Controlling Shares is Allowed

The control transfers under the rule that does not require a TOB for the purchase of controlling shares. A owns $40,800,000 of the firm's shares (51% of $800,000,000 (firm's public value)) and $20,000,000 of the firm's private value, which is $60,800,000 in total. B, if it successfully acquires the control, will have $51,000, 000 of the firm's shares (51% of $100,000,000 (firm's public value)) and $10,000,000 of the firm's private value ($61,000,000 in total). Therefore, B can purchase A's shares at a price between $60,800,000 and $61,000,000. Both parties will be better off and the control successfully transfers. *See* Table 3.

Figure 4

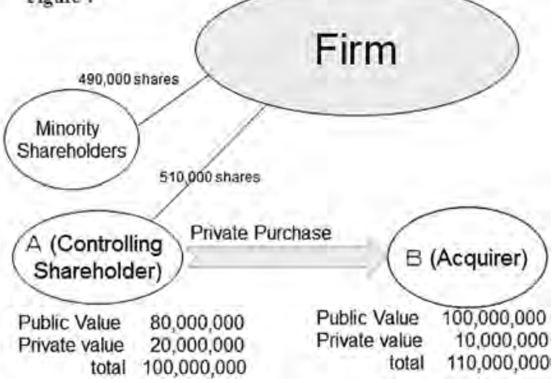


Table 3

A's total benefit before the acquisition:

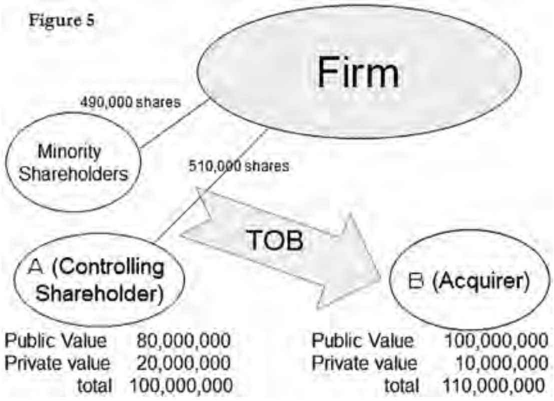
51% of firm's public value:	40,800,000
A's private value:	20,000,000

Total:	60,800,000
B's total benefit after the acquisition:	
51% of firm's public value:	51,000,000
B's private value:	10,000,000
Total:	61,000,000

(iii) Result When Private Purchase of Controlling Shares is Prohibited

What happens, though, under the Japanese TOB rule? Assume that B makes a bid for 51% of the firm's share at a price P. For the sake of simplicity, all of the firm's shareholders participate in the offer. In this case A can sell only 51% of its shares.

Figure 5



If the bid is successful, A's position is as follows: (1) P*510,000*0.51 [sales price of the shares] and (2) 100*510,000*0.49 [the value of remaining shares], which is P*260,100+24,990,000 in total. B's position is as follows: (1)100*510,000 [the value of acquired shares], (2) 10,000,000 [firm's private value], minus (3) P*510,000 [purchase price of the shares], which is 61,000,000-510,000P in total.

P must be higher than $137.61 for A to be better off[52]. However, such a purchase price will make B worse off (if P is $137, B's position would be - $8,870,000. (61,000,000-137*510,000)). B has no incentive to bid at such a high price. An efficient transfer of control is blocked. *See* Table 4.

Table 4

A's total benefit before the acquisition:	
51% of firm's public value:	40,800,000
A's private value:	20,000,000
Total:	60,800,000
A's total benefit after the acquisition:	
Sales price of the stocks:	P*260,100
Value of the remaining shares:	24,990,000 [100*249,900]
Total:	260,100*P+24,990,000

52 A's position would be improved if and only if 260,100*P +24,990,000>$60,800,000. P must be higher than approximately 137.68.

P should be higher than $137.68 to compensate A.

B's total benefit after the acquisition (assume P=137)

51% of firm's public value:	51,000,000
B's private value:	10,000,000
Purchase price of the stocks:	69,870,000
Total:	-8,870,000

3. Summary

The Japanese version of the mandatory offer rule (a) prevents inefficient transfer of control but (b) also blocks efficient transfer. In the above hypothetical case, the exemption of market purchase under the Japanese mandatory offer rule does not matter because it is impossible to purchase 51% of shares from the market.

B. Acquisition of Control through Market Transaction or Issuance of New Shares

The analysis in Section A is oversimplified in that it focuses exclusively on the choice between acquisition through private purchase and a tender offer. Although it might be sufficient for European regulation, the comparison overlooks an important aspect of Japanese regulation. As we have already seen, there are several alternatives to a tender offer for an acquirer to obtain control under the Japanese version of the mandatory offer rule. An acquirer, for instance, may gain control by market purchases, by an issuance of new shares from the target company, or by a combination thereof.

These possibilities complicate the problem. For instance, let us assume the inefficient transfer of control examined in Section A.1: the firm value is higher under the current controlling shareholder. It is impossible for the current controlling shareholder to sell its shares directly to the acquirer because such a transaction is prohibited under Japanese regulations. However, a transfer of control through a combination of market transactions and issuance of new shares in the target is still possible, at least in theory, under Japanese regulations. Under this method, the current controlling shareholder sells its shares to the market and the target company issues new shares to the acquirer. While the issuing price is the market price of the target's shares, it is substantially lower than the previous issuing price because the possible change of control reflects in the market. Although this method does not seem attractive for the current controlling shareholder because it cannot gain a control premium, the acquirer might subsidize the current controlling shareholder, as long as it is less costly than launching a bid to all of the target's shareholders. The method has a similar economic effect as a transfer of control through a private purchase. If this possibility cannot be ignored in practice, the effect of the mandatory offer rule to prevent inefficient transfer of control, which was referenced in Section A.1, should be reexamined.

A thorough examination of the function of the Japanese version of the mandatory offer rule is outside the purpose of this article. Suffice it to say, however, that the analysis of "market rule v. equal opportunity rule" referenced in Section A should be substantially modified when applied to the Japanese TOB rule, which allows broad exemptions.

C. Efficiency of Japanese Version of Mandatory Offer Rule

If a mandatory offer rule does not exist, like in the United States, the acquirer can purchase controlling shares in many ways, including (i) by a market purchase, (ii) by a private purchase, (iii) by a tender offer, or (iv) by their combination. In Europe, the acquirer can purchase in any way it wants, but a mandatory offer, in principle, is required after the acquisition. Under Japanese regulation, a private purchase is not allowed and the combination of private purchase and other methods is also regulated.

A market purchase, a private purchase, and a tender offer have both advantages and disadvantages, which could lead to inefficient results under certain conditions. Therefore, there is no obvious answer as to which rule is best. However, it may be worth noting that the Japanese TOB rule, which seems more modest than the European regulation, allows a more restricted choice to the acquirer. In Europe, a private purchase is allowed as long as it is followed by mandatory offer. In contrast, acquisition of a controlling share by private purchase or by the combination of private purchase and market purchase is simply prohibited.

It is also worth noting that the Japanese version of the mandatory offer rule cannot be a solution to the “coercive” nature of a tender offer. A “coerciveness” in the context of corporate acquisition is that the shareholders have an incentive to accept a bid at a price that is not satisfactory due to the concern that they might suffer from a disadvantage if they refuse the offer and, as a result, remain as minority shareholders. As far as partial acquisition is allowed, a tender offer, whether mandatory or not, can be coercive. At the same time, it is not evident whether the coercive nature of a tender offer should be completely eliminated. If it is eliminated, shareholders have a very weak incentive to sell the shares at the first offer, and a takeover could become unreasonably difficult[53].

V. Conclusion: The Way Forward

A. Developments of the TOB Rule

We have examined how Japanese TOB rules (i.e., the mandatory offer rule) have been developed. Its history is divided into three parts.

(1) Japan had basically the same rule as the United States: during 1971-1990, the TOB rule focused purely on procedural issues.

(2) In 1990, after the U.K. City Code, a mandatory offer rule was introduced. Despite its apparent resemblance, however, the policy goal behind the rules was quite different. It simply prohibited the private purchase of corporate control, which is explained from the view point of either the transparency of market for control or the fair distribution of controlling premiums. The unique policy goal explains the major differences between Japanese and European regulations regarding mandatory offer with respect to their scope of exemption and the tim-

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53 *See* Grossman and Hart, *supra* note 49.

ing the mandatory offer is required (*ex ante* or *ex post*).

(3) The 2006 Revision introduced the acquirer's obligation to purchase all shares when the "super majority shareholder," who owns more than two thirds of company's total voting shares, appears. This Revision can only be justified by the same policy goal as the European rule: to guarantee the opportunity to exit to minority shareholders. Since then, the Japanese TOB rules require a twofold policy goal: (a) the prohibition of a private purchase of corporate control for the ordinary mandatory offer rule and (b) the guarantee of the opportunity to exit for obligation to purchase all shares.

Because the obligation to purchase all shares is designed as a part of TOB regulation, it is not imposed as far as the TOB is not required. The 2006 Revision, except for fixing some loopholes, maintained the basic scope of the mandatory offer rule, which includes acquisition of controlling shares through market purchase or by the target's issuance of shares[54]. The result is inconsistent with the policy goal behind the obligation to purchase all shares (to guarantee the opportunity to exit for minority shareholders). The inconsistency is the result of historical developments of the Japanese TOB rule. The 1990 Revision introduced the mandatory offer rule with a policy goal different from European regulation and hence with a different form and scope. The 2006 Revision introduced the obligation to obtain all shares essentially with the same policy goal as European regulation on the mandatory offer. Nevertheless, the 2006 Revision was built on the framework of the 1990 Revision, which resulted in the inconsistency mentioned above.

B. Possible Alternatives for the Future

Where is the Japanese TOB rule going from its current state? There are, in theory, four possibilities: (a) to move towards the United States (to abolish the mandatory offer rule and return to the pre-1990 rule); (b) to move towards Europe (to abolish market purchase and primary market exemption and require to purchase all shares in mandatory offer); (c) to abolish the obligation to purchase all shares and return to the pre-2006 regulation; (d) to maintain the status quo.

1. Are Mandatory Offer Rules at all Desirable?

In order to choose between the above alternatives it should be decided whether or not mandatory offer rule is at all desirable. Unfortunately, the answer to the first question is inconclusive. As indicated in Part IV, the mandatory offer rule, in theory, has ambivalent effects. It could prevent the inefficient transfer of control but also could deter an efficient one. It is not obvious which effect is more important. The choice would, in part, depend on the other legal rules of each state. For instance, inefficient transfers of control may not be that serious in some states if their corporate law effectively prevents the wealth transfer from minority shareholders to a controlling shareholder. Furthermore, as is also indicated in Part IV.B, the possible effect of Japanese version of mandatory offer rule is even less obvious since

54 *See* III.A, 2 and 3.

the alternatives than tender offer to gain control would complicate the issue.

2. Should the Current Rule Be Amended if a Mandatory Offer Rule Remains?

If Japan chooses to retain a mandatory offer rule, should it continue to be the current Japanese version (the choice among alternative (b), (c) and (d))? There are several reasons that the current rule should be amended.

Fixing the Inconsistency. First, as mentioned earlier[55], the current rule is inconsistent in itself. The obligation to purchase all shares is not triggered if an acquirer obtains two thirds of the voting shares from market purchase or by the target's issuance of shares. Such exemptions might be justified for the purpose of mandatory offers[56]. However, they are inconsistent with the policy goal of the obligation to purchase all shares: to guarantee the opportunity to exit to minority shareholders in the wake of the appearance of a "super majority shareholder."

A revision to introduce the "European style" of regulation is necessary to fix the inconsistency if the obligation to purchase all shares is maintained. Another alternative to fix inconsistency is to abolish the obligation to purchase all shares and return to the pre-2006 regulation, which we do not explore further this time. The term, "European style," means that (i) once the acquirer reaches a certain percentage of the total voting share regardless of the method of acquisition, it is imposed to launch TOB and (ii) the acquirer should purchase all shares that are tendered by the shareholders.

There are two different ways to introduce European style of regulation:

Alternative I. The threshold to trigger the obligation to purchase all shares is maintained as two thirds of the total voting shares. Once the acquirer's shareholdings reach this level regardless of the way the shares were obtained, it is obliged to launch a bid to all shareholders and to purchase all shares that are tendered. The ordinary mandatory offer rule remains unchanged. In this case, we maintain different policy goals for the mandatory offer and the obligation to purchase all shares.

Alternative II. Another possibility is to decrease the threshold to trigger the obligation to purchase all shares to one third of total voting shares. The mandatory offer rule is transformed into *ex post* regulation and the exemptions for acquisition of controlling shares through market purchase or by the target's issuance of shares are abolished. This revision would make the Japanese TOB rule essentially the same as the European rule and the mandatory offer and obligation to purchase all shares are combined as one policy goal (to guarantee the opportunity to exit for minority shareholders).

Technical Difficulty in Managing the Ex Ante Regulation on the Mandatory Offer. The current Japanese regulation, coupled with recent supplemental regulation added by the 2006 Revision, has created further difficulties. In order to close loopholes in the mandatory offer rule, a combination of private purchase and other exempted methods became regulated. As a result, if a shareholder, for instance, purchased 33% percent of firm's shares, he/she is prohib-

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55 *See* Part III. D.

56 *See*, Part III. C. Of course, European regulation does not allow these exemptions.

ited to acquire any share either by the purchase in stock market, by issuance of new stocks or any other means for certain period. Such inflexibility is inherent to *ex ante* regulation of the mandatory offer. If one wishes to avoid this difficulty, Alternative II, which is mentioned above, is necessary.

We should note that although many people believe that European regulation is more onerous than Japanese regulation, the above example shows that it is not always true. In the above example, European regulation requires that the acquirer should launch the TOB after it reached the threshold, while, under Japanese rules, the acquirer's whole transaction is regarded as illegal if it reached the threshold during a certain period. The difference resulted from the different natures of the ex ante and ex post regulations.

Other Reasons. There is another reason to change the current rule. European regulation offers a guarantee to minority shareholders to exit from a company when the controlling shareholder appears or the control is transferred to another. Such a guarantee is even more important in Japan where the regulation of the controlling shareholder is believed to be less effective once the control is acquired by or shifted to someone. The current Japanese TOB rule is quite incomplete for this purpose. At the very least Alternative I referred to in *(i)* is necessary to guarantee the opportunity to exit to minority shareholders when a super majority shareholder appears.

Problems with European Regulation. Are there problems in Japan's move to the European style of TOB regulation? It would be argued that, under European regulation, an acquirer should prepare more cash to fulfill its obligation to purchase all shares. As indicated earlier, the mandatory offer rule, in any form, can prevent efficient transfer of control[57]. The broader the application of the mandatory offer rule and the more shares the bidder should purchase due to the obligation to purchase all shares are, the greater the potential risk for preventing efficient transactions.

Although it has not come to light that the mandatory offer rule introduced by the EU Directive depressed M&A activities in Europe[58], it does not mean that the same is true in Japan. It is partly because Japanese financial institutions (especially major banks) have been very reluctant to finance the acquirer even for a promising takeover. If the budget constraint for the acquirer is more serious in Japan, introduction of the European style of TOB rules might be problematic. However, if one takes the concern for preventing efficient takeovers seriously, it would be more logical to abolish the mandatory offer rule altogether. There is no justification for maintaining the current inconsistent and unmanageable rule as it is.

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57 *See* Part IV.2.

58 *See* Yôroppa M&A Seido Kenkyûkai Hôkokusho [The Report of the Study Group on European M&A System], Nihon Shôken Keizai Kenkyûsho [Japan securities Research Institute], 2010

Appendix: Financial Instruments and Exchange Act (Act No. 25 of 1948) finally revised May 19, 2010 by Law32, 2010

Article 27-2 (Tender Offer for Share Certificates, etc. by Person Other than Issuer)

(1) As for Shares, bonds with share option and other Securities designated by a Cabinet Order (hereinafter collectively referred to as "Share Certificates, etc." in this Chapter and Article 27-30-11 (excluding Article 27-30-11(4))) for which their Issuer is required to submit Annual Securities Reports, Purchase, etc. (meaning purchase or other type of acceptance of transfer for value of Share Certificates, etc. and including acts designated by a Cabinet Order as being similar to such acceptance; hereinafter the same shall apply in this Section) of them shall be made by means of a Tender Offer, if the Purchase, etc. is made by a person other than the Issuer and falls under any of the categories listed in the following items; provided, however, that this shall not apply to Purchase, etc. of Share Certificates, etc. conducted as exercise of share option by the holder thereof, Purchase, etc. of Share Certificates, etc. from Persons in Special Relationship with the person conducting Purchase, etc. of Share Certificates, etc.(limited to such persons specified in item (i) of paragraph (7) and designated by a Cabinet Office Ordinance) or other Purchase, etc. of Share Certificates, etc. so designated by a Cabinet Order.

(i) Purchase, etc. of Share Certificates, etc. conducted outside of Financial Instruments Exchange Markets (excluding Purchase, etc. of Share Certificates, etc. conducted through transactions designated by a Cabinet Order as being equivalent to sale and purchase, etc. conducted in Financial Instruments Exchange Markets and Purchase, etc. of Share Certificates, etc. which is regarded by a Cabinet Order as Purchase, etc. from an extremely small number of persons) after which the Share Certificates, etc. Holding Rate of Share Certificates, etc. in possession (including cases designated by a Cabinet Order as equivalent to possession of Share Certificates, etc.; hereinafter the same shall apply in this section) of the person who conducted the Purchase, etc. (or, in cases where there are Persons in Special Relationship with the person who conducted the Purchase, etc.(excluding Persons in Special Relationship specified in item (i) of paragraph (7) and designated by a Cabinet Office Ordinance), the Share Certificates, etc. Holding Rate calculated by adding the Share Certificates, etc. Holding Rate of the Persons in Special Relationship to that for the person who conducted the Purchase, etc.; hereinafter the same shall apply in this paragraph) exceeds five percent;

(ii) Purchase, etc. of Share Certificates, etc. conducted outside of Financial Instruments Exchange Markets (excluding Purchase, etc. of Share Certificates, etc. conducted through transactions designated by a Cabinet Order as being equivalent to sale and purchase, etc. conducted in Financial Instruments Exchange Markets; the same shall apply in paragraph (iv)) which falls under the categories of Purchase, etc. of Share Certificates, etc. which is regarded by a Cabinet Order as Purchase, etc. from an extremely small number of persons and after which the Share Certificates, etc. Holding Rate of Share Certificates, etc. in possession by the person who conducted the Purchase, etc. exceeds one third;

(iii) Purchase, etc. of Share Certificates, etc. conducted at Financial Instruments Exchange Markets through sale and purchase, etc. of Share Certificates, etc. using a method that is designated by the Prime Minister as a method other than method of auction (such sale and purchase, etc. of Share Certificates, etc. are hereinafter referred to as "Specified Sale and Purchase, etc." in this paragraph) after which the Share Certificates, etc. Holding Rate of Share Certificates, etc. in possession by the person who conducted the Purchase, etc. exceeds one third;

(iv) Purchase, etc. of Share Certificates, etc. in cases where acquisition of Share Certificates, etc. in excess of the proportion designated by a Cabinet Order during the period designated by a Cabinet Order not exceeding six months is made by Purchase, etc. of Share Certificates, etc. or Acquisition of Newly Issued Share Certificates, etc. (meaning acquisition of Share Certificates, etc which is newly issued by its Issuer; hereinafter the same shall apply in this item) (in cases where such acquisition of Share Certificates, etc. is made by Purchase, etc. of Share Certificates, etc., limited to Purchase, etc. of Share Certificates, etc. in excess of the proportion designated by the Cabinet Order conducted through Specified Sale and Purchase, etc. or outside of Financial Instruments Exchange Markets (excluding that conducted by a Tender Offer)) and the Share Certificates, etc. Holding Rate of Share Certificates, etc. in possession by the person who conducted the Purchase, etc. of Share Certificates, etc. exceeds one third after the Purchase, etc. of Share Certificates, etc. or the Acquisition of Newly Issued Share Certificates, etc.;

(v) Purchase, etc. of Share Certificates, etc. to be made in excess of the proportion designated by a Cabinet Order during the period designated by a Cabinet Order not exceeding six months by a person other than the Issuer of the Share Certificates, etc. (limited to cases where the Share Certificates, etc. Holding Rate of Share Certificates, etc. in possession by the person exceeds one third) in cases where another person's Tender Offer is made for the Share Certificates, etc,; and

(vi) other Purchase, etc. of Share Certificates, etc. designated by a Cabinet Order as being equivalent to Purchase, etc. of Share Certificates, etc. listed in any of the preceding items.

(2) Purchase, etc. of Share Certificates, etc. by means of Tender Offer required under the main clause of the preceding paragraph shall be made by setting a period for Purchase, etc. which may not exceed the period designated by a Cabinet Order.

(3) When Purchase, etc. of Share Certificates, etc. is made by means of Tender Offer as required by the main clause of paragraph (1), the price for the Purchase, etc. (or, in cases where the Purchase, etc. is made by other type of acceptance of transfer for value than purchase, what is designated by a Cabinet Order as being equivalent to price for Purchase, etc.; hereinafter the same shall apply in this Section) shall be set on the same conditions for all offerees, pursuant to the provisions of a Cabinet Order.

(4) When Purchase, etc. of Share Certificates, etc. is made by means of Tender Offer as required by the main clause of paragraph (1), management of Share Certificates, etc., payment for the Purchase, etc. and other affairs specified by a Cabinet Order shall be performed by a Financial Instruments Business Operator (limited to those engaged in Type I Financial Instruments Business as defined in Article 28(1); the same shall apply in Article 27-12(3)) or a Bank, etc. (meaning a bank, cooperative structured financial institution or other financial institution specified by a Cabinet Order; the same shall apply in Article 27-12(3)).

(5) When Purchase, etc. of Share Certificates, etc. is made by means of Tender Offer as required by the main clause of paragraph (1), it shall be implemented pursuant to the conditions and methods specified by a Cabinet Order, in addition to what are prescribed in the preceding three paragraphs and other provisions of this Section.

(6) The term "Tender Offer" as used in this Article means an act of soliciting offers for Purchase, etc. or Sales, etc. (meaning sales or other type of transfer for value; hereinafter the same shall apply in this Section) of Share Certificates, etc. from many and unspecified persons though public notice, and making Purchase, etc. of Share Certificates, etc. outside of Financial Instruments Exchange Markets.

(7) The term "Persons in Special Relationship" as used in paragraph (1) means the following persons:

(i) persons having a shareholder relationship, family relationship or other special relationship specified by a Cabinet Order with the person conducting Purchase, etc. of the Share Certificates, etc. ; and

(ii) persons having agreed with the person conducting Purchase, etc. of Share Certificates, etc. to jointly acquire or transfer the Share Certificates, etc. or jointly exercise voting rights or other rights as shareholders of the Issuer of the Share Certificates, etc., or to transfer or accept transfer of the Share Certificates, etc. between them after the Purchase, etc. of the Share Certificates, etc.

(8) The term “Share Certificates, etc. Holding Rate” as used in paragraph (1) means either of the following:

(i) as for the person conducting Purchase, etc. of the Share Certificates, etc., the rate obtained, pursuant to the provisions of a Cabinet Office Ordinance, by dividing the total of the number of the voting rights (meaning the number of voting rights represented by shares calculated pursuant to the provisions of a Cabinet Office Ordinance in the case of share certificates, or the number of voting rights represented by shares calculated by converting Securities other than share certificates into shares pursuant to the provisions of a Cabinet Office Ordinance in the case of Securities other than share certificates; hereinafter the same shall apply in this paragraph) pertaining to the Share Certificates, etc. in possession by that person (excluding those specified by a Cabinet Office Ordinance considering the manner of holding or other circumstances; hereinafter the same shall apply in this paragraph), by the number obtained by adding the total number of voting rights issued by the Issuer to the number of voting rights pertaining to bonds with share option or other Securities specified a Cabinet Order issued by the Issuer and held by that person and Persons in Special Relationship with that person; or

(ii) as for Persons in Special Relationship as defined in the preceding paragraph (excluding persons who fall under the category specified in item (ii) of the preceding paragraph and conduct Purchase, etc. of any Share Certificates, etc. issued by the Issuer of the Share Certificates, etc.), the rate obtained, pursuant to the provisions of a Cabinet Office Ordinance, by dividing the total of the number of the voting rights pertaining to the Share Certificates, etc. in possession by that person, by the number obtained by adding the total number of voting rights issued by the Issuer to the number of voting rights pertaining to bonds with share option or other Securities specified a Cabinet Order issued by the Issuer and held by that person and the person conducting Purchase, etc. of the Share Certificates, etc. referred to in the preceding item.

Article

Legal Education for the Future: Global Perspectives

Daniel H. FOOTE*

Overview

This is a report on "FutureEd 2: Making Global Lawyers for the 21st Century," a conference on legal education held at Harvard Law School (HLS) on October 15-16, 2010, in which this author had the opportunity to participate. The conference was the second in a series of three conferences jointly organized by HLS and New York Law School (NYLS). The first conference was held at NYLS in April 2010; the third and final conference will also be held at NYLS, in April 2011. The goals of the conferences are to stimulate thinking and research about the future of legal education; to promote concrete action plans aimed at improving legal education; to provide a feedback mechanism for refining the action plans through the sharing of ideas among knowledgeable participants; and to aid in the implementation and spread of the most promising approaches. As explained by the chief organizers, Professor David Wilkins of HLS and Professor Elizabeth Chambliss of NYLS, the objective is not simply for legal academics to meet and discuss their ideas, but to achieve concrete results with the promise of broad impact. The first conference in the series was designed to attract a wide range of promising reform proposals. This, the second conference, was designed to help refine the proposals and identify the most promising. By the time of the final conference, it is anticipated that the most promising proposals will have taken concrete shape and will either have entered or be ready to enter the implementation phase.

Interest in and expectations for the conferences are high, and the interest extends far beyond the United States. Well over 300 people contacted the organizers seeking to participate. Space and logistics made it impossible to accommodate them all, but over 100 people participated, and the level of the participants was impressive. In addition to the deans of HLS, NYLS and several other US law schools, law school deans from several other nations, including Brazil, India, and Israel, participated. They were joined by legal academics at the cutting edge of legal education reform from the US and many other nations, including nations in Europe, Asia, North and South America, and Africa.

Another notable feature of the conferences is that they are not limited to legal educators. To the contrary, a major goal is to bring a broad range of perspectives to bear on legal education reform. Recognizing that legal education today is increasingly global in nature, the orga-

* Professor of Law, The University of Tokyo

nizers consciously sought to incorporate the views of participants from outside the US, as mentioned above. The organizers also recognize that legal education is deeply affected by, and at the same time deeply affects, a wide range of actors. Accordingly, a central organizing theme is that legal education can and should learn from the experiences and insights of others. To that end, the organizers consciously sought to incorporate the views of regulators, clients, and other professions. Here again, the level of participants was impressive. Participants included the current president, the president elect, the immediate past president, and another former president of the American Bar Association (ABA), as well as ABA officials involved in the regulation of legal education, accreditation, and lawyer discipline. The head of the UK Legal Services Board and regulators from Canada also participated. From other professions, participants included the dean for medical education at Harvard Medical School, a Harvard Business School professor, and experts on the management consulting and advertising industries. From the client perspective, representatives of several major businesses also participated actively. Notably, this incredibly highly positioned group of participants did not simply make token appearances and then excuse themselves, citing other commitments. Rather, the vast majority participated actively throughout most of two long and very full days.

Day 1: Theory and Context

The first day consisted of four panel discussions, along with keynote speeches at lunch and dinner.[1]

Panel 1: Global Perspectives on Legal Education

The first panel focused on global perspectives. The panel began with observations on the key needs in legal education for a globalizing world, by the dean of a law school in Brazil, and on trends in globalization of legal education, by a French legal sociologist who has conducted extensive research on lawyers and legal education in many regions of the world. In the latter half of the panel, this author, the dean of a law school in India, and a law professor from China discussed the experiences with legal education reform in Japan, India, and China, respectively.

One important message from this panel is that the legal profession and legal education truly are becoming globalized. Although most lawyers throughout the world continue to focus primarily on local and domestic matters, the number of lawyers specializing in international affairs is rising rapidly, and even domestic-focused lawyers increasingly find themselves handling matters involving international dimensions. To meet the increasingly internationalized nature of legal practice, legal education also is becoming much more internationalized. The

1 Videos of nearly all of the proceedings, including the panels, keynote addresses, and presentations of the proposals made on the morning of the second day of the conference, are available through the Website of the Harvard Law School Program on the Legal Profession, at the following address: <http://www.law.harvard.edu/programs/plp/pages/future_ed_conference.php> (accessed November 20, 2010).

US legal education model is exerting strong influence in many nations; but much independent innovation is occurring throughout the world with respect to the globalization of legal education.

Panel 2: Cross-Professional Comparison

The second panel sought lessons from other professions. Speakers from Harvard Medical School (HMS) and Harvard Business School, as well as an expert on management consulting from the UK and an expert on the advertising industry from Canada, offered perspectives from education for and discussed trends in those professions and industries.

Many attendees (this author included) found the remarks of Jules Dienstag, dean of medical education at HMS, especially valuable. Dienstag was appointed to that post in 2005 in order to oversee medical education reform at HMS; and under his leadership HMS has undertaken an impressive array of reforms. One of the major issues HMS sought to address through the reforms was the concern that students were losing a sense of what he labeled "professionalism" – a broad term encompassing such matters as empathy, concern for patients as people, and a sense of the medical profession's responsibility to society. Through surveys of students, HMS found that the medical education process bore some of the blame; many students had a strong sense of empathy when they entered medical school but lost it somewhere along the way.

As Dienstag explained, HMS has undertaken many reforms designed to instill professionalism and to integrate scientific and technical skills with professionalism. On the first day of medical school, students interact with a simulated patient. The first two weeks of medical school feature a strong infusion of professionalism training, by an empathetic teacher. Throughout the first two years of medical school, HMS utilizes many problem-based tutorials, including simulated patient contact and empathetic elements. Despite these efforts, HMS found that one of the key hurdles to achieving a greater sense of professionalism lay in student residencies. Once students got away from medical school and entered their residency placements, they often experienced a different culture in which the overriding objective was to maintain high turnover and dispose of cases quickly. Accordingly, HMS has undertaken great efforts to instill attention to ethical elements, emotional elements and professionalism into the residency process, as well. HMS is now developing a "capstone" course – a course at the end of the medical school process, designed to tie together the students' education and reinforce professionalism. (Incidentally, although it was not highlighted during this panel, HLS Dean Martha Minow, who prior to becoming dean chaired the committee that designed major recent reforms to the HLS curriculum, has said she found the medical school model especially valuable when considering legal education reform.[2])

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2 For an examination of the recent curricular reforms at HLS, see 柳田幸男＆ダニエル・H・フット『ハーバード：卓越の秘密—ハーバードLSの叡智に学ぶ』 [Yukio Yanagida & Daniel H. Foote, Harvard: Secrets to its Preeminence – Learning from the Wisdom of Harvard Law School], Chapter 3 (Yuhikaku, Tokyo: 2010).

Panel 3: The Regulators Weigh In

The third panel focused on regulatory perspectives. The three panelists were the Policy Counsel to the Law Society of Upper Canada (the governing body for lawyers in the Province of Ontario), Sophia Sperdakos; the US Ambassador to the African Development Bank, Hon. Walter Jones; and the current President of the ABA, Stephen Zack.

This panel raised several important issues. In his remarks, Zack praised the accreditation standards in the US (which, he noted, are developed and implemented by an independent ABA section, the Section of Legal Education and Admissions to the Bar) as being perhaps the most advanced in the world, and in another section of his remarks described the high cost of US legal education as a major issue. In a question to the panelists, NYLS Dean Richard Matasar tied these two themes together. He commented that high accreditation standards often entail high costs and stifle experimentation, and asked how law schools can create new models that lower costs, given the strict standards. Zack pointed to the potential for technology to help lower costs. Sperdakos acknowledged that vested interests often influence the push for standards that raise costs, as an example noting that elite law schools favor standards placing weight on the importance of research and hence sometimes oppose accreditation for lower cost law schools focused primarily on lawyer training. At the same time, Sperdakos urged academics to recognize the importance of the imperatives of regulators (which she described as ensuring lawyers' mastery of the essential competencies and basic skills, as well as ethics and professionalism) and the sincerity of regulators. The panel chair (Prof. Todd Rakoff of HLS) added that one also must recognize that some low cost practices, such as unsupervised externships, are simply bad education.

As a second theme related to the issue of cost, the panel highlighted transparency. Zack indicated that he has asked the Young Lawyers Division of the ABA to consider a "Truth in Law School Education" proposal, which would require law schools to provide accurate information to all accepted applicants on matters such as the law school's cost and bar passage rates and employment statistics for graduates. And the Section of Legal Education (which already requires law schools to provide bar passage statistics annually, which the ABA announces publicly) currently is examining what employment and salary questions to include on the annual questionnaire US law schools are required to complete, and how that information should be made public.

A third set of issues related to lawyer discipline and lawyer monitoring. In the Q&A session, an ABA official who has been heavily involved in lawyer discipline noted that the great majority of calls from consumers regarding their lawyers are not related to concerns over the lawyers' legal knowledge, but involve matters such as communication and other basic skills and practical personal issues. Sperdakos seconded this view. She agreed that the problems are not in the area of substantive law. ("Everybody can do that," she commented.) Rather, the key issues relate to matters such as communication, law office management, interpersonal skills, and ethics. One of the efforts being undertaken in Ontario is to spell out what the expectations are for lawyers in these various areas, to ensure students attain the skills they should have before entering practice. Another approach being undertaken in Ontario is spot audits of the books and records of law firms – not, Sperdakos emphasized, in the spirit of "We're going to punish you," but rather "We're going to help you." Since problems often result from poor law office management, she said, this approach has proven much more effective in avoiding problems in the first place.

Again in this panel, globalization emerged as an important issue. In his remarks, Zack commented that he has requested the ABA Board of Governors to consider whether a mandatory semester abroad requirement should be established for all US law school students as a condition for graduation. The ABA, he explained, surveys its members every two years to determine what issues they want the ABA to address. In the past, he said, international issues routinely ranked at the bottom, because most lawyers still have local practices; but due to such trends as technological advances, the rise in "virtual law firms," and advances by multinational firms into regional markets, concern among ABA members over international issues has been steadily increasing. Zack, who was born in Cuba and is the first Hispanic president of the ABA, expressed his view that in today's increasingly global world it is important for law students to meet and get to know students from different nations and different cultures. Thus, while Zack did not seem to expect the Board of Governors to endorse a mandatory semester abroad requirement anytime soon, he regards it as a serious proposal warranting real consideration. (Incidentally, as Zack observed in another session, the ABA currently is considering whether to authorize accreditation of law schools located outside the United States, in response to an application for ABA accreditation by a law school in China.)

Panel 4: Globalization, Lawyers and Emerging Economies – A Theoretical Synthesis

Returning to the theme of globalization, this panel (with six speakers, three – including a Chinese scholar – from Wisconsin Law School, two Brazilian scholars, and David Wilkins of HLS) introduced a research project now getting underway, examining developments relating to the legal professions in emerging economies, with a particular focus on China, India, and Brazil. The project seeks to integrate perspectives from three fields – law and development, sociology of the legal profession, and global studies.

As David Trubek of Wisconsin and Wilkins noted in introducing the project, despite the many differences among the three nations being studied, there are many commonalities. Among the commonalities: All three nations are developmental states undergoing very rapid change. The changes include internal transformations, but there are also extensive global aspects. All three nations have embraced the global economy. They have undertaken self-conscious promotion of innovation and are seeking to move up the value-added chain. Accordingly, Trubek observed, all are open to some degree of international competition. There has been a surge of outward investment from all three. At the same time, all three have attracted extensive foreign investment, but all three are seeking to channel the foreign investment through state-led strategies. As another commonality, all three want to bend or change global norms.

In highlighting some of the implications of these developments for law and legal education, Wilkins noted that all three nations regard investing in the legal profession as an aspect of a broader legal strategy. They view the legal profession as having an important role to play in many of the transformations they are seeking to achieve. All three nations have witnessed a great rise in the market for legal services. And all three have experienced a substantial increase in the number of law schools, with the state playing an active role in the promotion of legal education and in legal education reform.

Other speakers on the panel then discussed some of the developments and research plans in more detail.

Day 2: Proposals for Reform

The focus of the second day was on concrete proposals for reform. As full as the first day was, the second day was even more intense.

Morning Session: Presentations of Proposals

The morning session lasted four and a half hours, from 8 a.m. till 12:30 p.m. Wilkins aptly characterized the session as the “speed dating” portion of the conference. The proponents of thirty separate reform proposals were allocated seven minutes each in which to introduce their proposals, explain the status and significance of the proposals, solicit support or collaborators, seek feedback or guidance, etc. The proposals were grouped into four major categories: Professional Development Proposals (9 proposals), Technology-Related Proposals (8), Structural/Regulatory Proposals (8), and Public Sphere Proposals (5). The proposals ranged from the broad (e.g., “Comprehensive Review of Distance Learning Potential” and “Cradle to Grave Professional Development”) to the relatively narrow (e.g., “ABA Accreditation Standards Should be Revised to Prohibit Merit Scholarships in Excess of 10% of a Law School’s Total Expenditures for Financial Aid”). And they ranged from proposals still in the relatively early stages to proposals already in or near the implementation stage (an example of the latter was a proposal for creation of a “Global Professional Master of Laws (GPLLM) Specializing in Business Law,” which already has started).

The proponents (in some cases through a single spokesperson, in others with several presenters) did a remarkable job of observing the seven-minute limit. Even so, by the end of the morning session this author was no longer able to keep track of all the proposals, despite taking fairly detailed notes. The full list of proposals, with links to the proposals themselves, may be found at the conference Website.[3] The following is a summary of what this author regards as some of the most notable proposals and themes.

Professional Development Proposals

Seven of the nine professional development proposals relate in some way to integrating

3 Harvard Law School Program on the Legal Profession, FutureEd2: Making Global Lawyers for the 21st Century: <http://www.law.harvard.edu/programs/plp/pages/future_ed_conference.php> (accessed November 20, 2010).

skills (of various sorts) into legal education and developing greater linkages between academia and the legal profession. These include an elaborate proposal for incorporating transactional skills into the law school curriculum (with mandatory courses in contract drafting and business basics and a wide range of electives in three broad categories); an even more elaborate proposal for structuring the first year of law school on a "law office" model and allocating most of the second and third years to full-time field placements under the supervision of practitioners; a proposal for mandatory capstone practice simulation courses integrating doctrine, skills, and professionalism, to be required for all students in their final year of law school (with students able to choose from capstones in a wide range of fields, including Advanced Commercial Transactions, Intellectual Property, Domestic Relations, Criminal Advocacy, etc.); and the "Cradle to Grave Professional Development" proposal, which posits an educational continuum in which some elements are best mastered during law school, while others are best mastered thereafter.

Underlying all of the seven proposals for integrating skills into legal education is the view that members of the legal profession must possess a wide range of "competencies" beyond simple mastery of legal knowledge and doctrine, and several of those proposals incorporate or envision mechanisms to identify the essential competencies. The remaining two proposals focus squarely on the issue of identifying the needed competencies and measuring whether they have been achieved. Of those two, one is essentially a plea for legal academics to embrace outcomes assessment; to engage the practicing bar in the effort to identify the competencies needed by graduates, on a law school-specific basis (based on the view that the necessary competencies differ depending on location and on the career paths of the law school's graduates); and to develop mechanisms to measure achievement of those competencies. The second proposal, presented by David Oppenheimer and Kristen Holmquist of the University of California-Berkeley School of Law, is more developed. As the presenters explained, over approximately the past ten years, a professor of law and a professor of psychology at Berkeley (supported by funding from the Law School Admission Council) identified and refined, through hundreds of interviews and focus groups with lawyers, students, judges and clients, a list of 26 "Effectiveness Factors" related to competent lawyering; developed tests aimed at measuring these Effectiveness Factors; and administered the tests to over 1100 alumni of Berkeley and UC-Hastings (with peer and supervisor evaluations by other lawyers utilized in addition to the self-evaluations). (In addition to analysis and reasoning, the 26 Effectiveness Factors include, for example, such factors as advocacy, creativity, listening, negotiation, practical judgment, problem solving, and stress management.[4]) According to the

4 For the proposal, see David Oppenheimer & Kristen Holmquist, "Presentation Proposal: FutureEd 2," available at: <http://www.nyls.edu/user_files/1/3/4/30/58/1053/Holmquist&Oppenheimer.pdf> (accessed November 20, 2010). For a report on the underlying research, see Marjorie Maguire Shultz & Sheldon Zedeck, "Final Report – Identification, Development and Validation of Predictors for Successful Lawyering" (Jan. 30, 2009), available at: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1353554&rec=1&srcabs=1533778> (accessed November 20, 2010).

presenters, the LSAT and undergraduate GPA are useful for predicting only two or three of the Effectiveness Factors, whereas the new tests are useful for predicting nearly all of them. They argue that the new assessment instruments should be utilized in the admissions process, and suggest that the assessment instruments should also be considered in planning curriculum and pedagogical methods, and for licensing exams.

Technology-Related Proposals

Of the eight technology-related proposals, three involve distance learning, two involve practice simulation, and the other three focus on different aspects of use of technology in legal education.

The broadest of the distance learning proposals is a proposal for a comprehensive review of distance learning potential. The presenters noted that distance learning is increasingly widespread in the US at the high school and college levels and in many fields other than law. Among the barriers to greater utilization in legal education, they observed, are accreditation concerns and faculty resistance. (A key concern, they noted, is how to get faculty involved.) The other two distance learning proposals are more concrete: a proposal for "blended courses" in core subjects, with some sessions taught through distance learning and other sessions taught in person, and an introduction to (and plea for greater utilization of) distance learning innovations, such as a distance learning project undertaken jointly by Brigham Young University, Duke, and Penn State, in which faculty members at all three teach collaboratively utilizing videoconference facilities.

The simulated practice proposals introduce some of the recent innovations in law-related simulations, which demonstrate considerable refinement in developing effective simulations (such as awarding points to motivate students and incorporating humor to make the learning exercise more fun and thereby "trick the students into learning more"). A proposal with many parallels to the simulated practice proposals is "Law Learning by Building Software Applications." As its title suggests, in this approach (which, the presenters explained, already is being utilized at a number of US law schools), law students themselves take responsibility for developing software applications that embody legal knowledge (such as developing Web-based explanations of legal standards and legal forms with instructions for use, aimed at low-income individuals and self-represented litigants). As the proposal explains, "By constructing useful applications, students not only (1) learn about substance (doctrine, procedure) in a given area and (2) learn how technology can be used creatively to assist in legal work (and some of the policy and ethical aspects of doing so), but (3) produce tools that they or others can bring to bear to improve access to justice. They also gain credentials for current and future employment."

Structural/Regulatory Proposals

The eight proposals in this category vary widely. Three proposals seek to address concerns over the cost of legal education, but in three different ways. Four involve concrete proposals for restructuring aspects of legal education, with each of the four focusing on a different aspect. The eighth is a proposal to develop outcomes measures relating to ethics and professionalism.

Turning first to the cost containment proposals, the broadest is a proposal to reduce the time required to complete undergraduate and law school education from 7 to 5 years, largely by condensing the time required to satisfy the requirements for admission to law school. A second proposal seeks to limit the amount of financial aid law schools may devote to merit scholarships. The third seeks greater transparency by law schools regarding cost and employment prospects for graduates. (The latter two proposals stem in part from a similar concern: that law schools – motivated by law school ranking measures utilized by US News and World Report that rate law schools on the "quality" of incoming students – induce students with high LSAT scores and high undergraduate GPAs to enter through promises of large merit scholarships, but withdraw many of those scholarships thereafter by imposing strict requirements for continuation.)

Of the proposals for restructuring certain aspects of legal education, the proposals this author found most interesting are a proposal to introduce an "experiential third year curriculum" and a "law school without walls" proposal. Under the former proposal, all students would spend their entire third year of law school in "experiential" settings serving in the role of lawyer, with one semester devoted to an elaborate simulation and the other semester to a supervised clinical experience. The "law schools without walls" proposal (which already has entered the implementation stage) seeks to link students across institutions and countries, and to engage the students in concrete efforts to address important problems. As explained in the proposal, "Students from [four US law schools], Peking University, and University College London will be paired up with another student, an academic mentor, and a practitioner mentor for a series of virtual conversations. The goal for each student is to conduct research to identify a problem in legal practice or education. Then, over the course of the semester, the student will develop a Project of Worth (POW) that will offer creative solutions to the identified issue. Students will also have access to an entrepreneur advisory board and a subject expert board to ensure that the POWs are practical, realistic, and desired."

Public Sphere Proposals

All five of the public sphere proposals seek to expand public interest activities by lawyers, but approach that goal in various ways. To this author, the most interesting of the proposals are the "legal bridges" project, which seeks to achieve the "delivery of law courses … to minority and poor college students by law school faculty members, with law students serving as teaching assistants," and the "public service venture fund," which aims to create a venture fund designed to provide funding for fully-funded fellowships for students and recent graduates to enter public service positions, provide funding for students and recent graduates to create new non-profits to address pressing needs, and to encourage social entrepreneurship among students and graduates.

Afternoon Session: Working Group Breakout Sessions

In the afternoon of the second day, participants interested in the respective categories gathered in separate rooms to discuss those proposals, with the aim of refining the proposals and selecting one or more key themes or proposals especially worthy of further development. This author attended the breakout session for the professional development proposals.

The moderator for the session, William Lee (co-managing partner of a major law firm and former visiting professor at HLS), began by listing five major propositions: (1) "One size does not fit all." In other words, law schools face different needs depending on their circumstances and locations, and it would be unwise to seek a single uniform standard. (2) Taking into account competencies not tested by the LSAT and undergraduate GPA could fundamentally remake law school admissions, and through that the legal profession. (3) Paying attention to the broad range of competencies needed by the legal profession might reveal the need to teach a different set of skills than at present, such as communication skills. (4) Consideration must take into account the international/global context. (5) It is vital to measure outcomes. Failure to do so might lead to "hallucination."

In the discussion that followed, it quickly became apparent that most of the attendees regarded the identification, development and validation of "competencies" (or "predictors of successful lawyering") as a central concern, with important implications for admissions, curriculum, and teaching methods, as well as for continuing legal education and other matters. It also quickly became apparent, however, that many attendees regarded as unduly narrow the traditional reliance on legal educators themselves and practicing lawyers and law firms as the arbiters of what skills lawyers need. Most attendees agreed that the views of other constituencies, especially clients, should be taken into account in identifying the needed competencies. As a few other attendees pointed out, though, there already have been a number of efforts to identify the necessary competencies for lawyers, and there are substantial similarities in the resulting lists.[5] In their view, rather than devoting so much work to "reinventing the wheel," it would be better to spend time promoting teaching of the sort that fosters the necessary competencies that already have been identified.

The group left it to Lee to integrate the discussions and report back to the full gathering.

Final Session: Working Group Moderator Reports

In the final session, moderators from the four working groups reported back on the discussions in the breakout sessions and the conclusions reached.

For the Professional Development group, Lee first listed essentially the same five basic propositions with which he began the breakout session. He then offered a four-step concrete proposal: (1) Collect information from law school alumni, practicing lawyers (of all types), clients, other professions, etc., regarding what skills are needed by lawyers today, and what

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5 For links to eight such competency lists, see The Southern California Innovation Project, Background Materials, available at: <http://weblaw.usc.edu/centers/scip/participants/materials.cfm> (accessed November 20, 2010).

skills will be needed 25 years from now. (2) Collect the lists of competencies that have been developed to date, and analyze how those lists compare to the set of skills identified in Step 1. (3) Collect and analyze information regarding measures to assess outcomes. In doing so, consider how law school teaching fits with the information developed through Steps 1 and 2. (4) Undertake concrete measures to incorporate training in the necessary competencies into legal education. In doing so, experiment with various approaches. Do not be afraid of a trial and error process. Future activities are illuminated by failures, as well as successes.

The moderator for the Technology group identified the two key goals of (1) providing legal education to segments of society where there has been less access to legal services and less enrollment in law schools and (2) producing revenue (and/or reducing costs). As major challenges, the group identified concerns over privacy, infrastructure, and the need for models and tools. As a concrete proposal, the group recommended compiling a reliable repository for information regarding technology in legal education, with links to relevant sources. These efforts, the moderator explained, should be aimed at the following audiences: (1) Faculty who already have been using technology. (For them, the efforts would serve as a community building exercise.) (2) Colleagues who are not currently using technology. (For those colleagues, concrete case studies could serve as models that might educate them and inspire use of technology.) (3) Regulators (in the US and abroad). (The moderator reported that the ABA currently is reviewing a request for renewal of a variance from the accreditation standards by Penn State, which has been a leader in the use of distance learning, and indicated that the ABA may use this as an occasion to look more broadly at distance learning.) (4) Law school administrators.

The moderator for the Structural/Regulatory group described an animated, rather contentious discussion. Some attendees sought to focus primarily on projects to promote ethics and professionalism. Some sought to promote business collaborations. Some insisted on other goals. The group was unable to agree on a single clear set of action items. They did agree that there were many potential futures for legal education. With that in mind, they evidently agreed on the need to define clear steps to pursue one mission while recognizing many other possible models (but were unable to agree on what the primary mission should be).

Finally, the moderator for the Public Interest group explained that one of the main topics of discussion was clinics. While clinics are generally well established at US law schools, the group identified a number of challenges. Among these: Skills training is well represented in clinics, but there is not enough time for moral reflection; and clinics are overwhelmingly domestic in focus, with almost no international focus. Another major issue identified by the group was the lack of resources for public interest efforts, notwithstanding the high level of attention accorded to public interest. Given the need for resources, coupled with the desire to train students in entrepreneurial skills, concrete action items from this group included two closely related proposals to foster public interest entrepreneurship. A final goal identified by the group was the desire to foster a sense of compassion in the general student body.

Final Reflections

Above all, the FutureEd2 conference provided a graphic demonstration of the great interest in and commitment to legal education reform in the US and around the world, and the tremendous energy being devoted to reform efforts. Looking back, US legal education has changed considerably since the 1960s. Approaches have differed substantially from law school to law school; but some of the major trends include greater attention to ethics and professionalism, greater incorporation of interdisciplinary perspectives, and, most notably, a vast expansion in so-called "skills training" and clinical education. Many of those developments were reflected in and further encouraged by the 1992 report on Legal Education and Professional Development compiled by the ABA Task Force on Law Schools and the Profession (the so-called MacCrate Report).[6]

As the FutureEd2 conference showed quite dramatically, today is a period of even greater activity in legal education reform. One of the goals being pursued by many law schools throughout the world is internationalization. Another of the major goals currently being pursued at law schools in the US and elsewhere is integration of training in legal skills and professionalism with mastery of doctrine. That goal was strongly endorsed by a 2007 report on legal education prepared under the auspices of the Carnegie Foundation for the Advancement of Teaching.[7] The Carnegie report and other recent studies along similar lines have gained great attention; and, as numerous of the proposals presented at FutureEd2 reflect, many US law schools have embarked on reforms aimed at integrating training in doctrine, skills, and professionalism.

One example of such an effort at integration of the various elements of legal education may be found at HLS itself, which over the past few years has introduced the most sweeping changes to its first year curriculum in over 120 years. Within the US and abroad there has been great interest in the HLS reforms, and those reforms are likely to influence other law schools. Yet HLS is hardly alone in pursuing reforms. Innovation and experimentation are occurring widely; many law schools are rethinking curriculum, teaching methods, and, in some cases, even the fundamental structure and goals of legal education. And many models are being developed and tested, with wide variations in approach from law school to law school.

Just as much of the innovation in clinical and legal skills training has taken place at non-elite law schools, so too has much of the innovation and experimentation in such areas as use

6 American Bar Association, Section of Legal Education and Admissions to the Bar, *Legal Education and Professional Development: An Educational Continuum, Report of the Task Force on Law Schools and the Profession: Narrowing the Gap* (American Bar Association, Chicago, IL: 1992).

7 William M. Sullivan, Anne Colby, Judith Welch Wegner, Lloyd Bond, and Lee S. Shulman, *Educating Lawyers: Preparation for the Profession of Law* (Carnegie Foundation for the Advancement of Teaching, Stanford, CA: 2007).

of technology and integration of doctrine, skills, and professionalism. Indeed it is in part precisely because of their status that non-elite law schools often have been more proactive in undertaking innovation and experimentation. Not surprisingly, elite law schools often have a tendency to stick to the approaches that have proven successful in establishing their reputation in the past; in contrast, non-elite law schools often feel they have more to gain – and at the same time less to lose – by innovating. Non-elite law schools also recognize that few of their graduates are likely to have the luxury of on-the-job training at top law firms, so they typically feel a greater need to provide their graduates with the broad range of skills and competencies needed to hit the ground running. Furthermore, some non-elite law schools have undertaken major reforms out of a sense of mission to serve low-income communities in which they are located or from which many of their students come.

NYLS itself serves as a fine example of this pattern. NYLS is by no means an elite law school. If one were to go by the most widely used set of US law school rankings, the *US News and World Reports* rankings, NYLS falls into the "third tier," meaning it did not rank in the top 100 law schools in the US as of 2010. Yet NYLS has been one of the schools at the forefront in rethinking legal education.

This leads to another striking aspect of the FutureEd conferences. The mentality of these conferences is most decidedly not "us v. them," "elite schools v. 'trade' schools." Rather, the conferences embody the philosophy of learning from each other, but with a recognition that "one size does not fit all." That philosophy is clearly reflected in the list of participants; again using the *US News* rankings, the conference participants included faculty members from three of the top ten law schools, from four "fourth tier" law schools (ranked 140 or below), and from every tier in between.[8] Perhaps an even more dramatic reflection of this philosophy lies in the fact that the conferences are co-organized by HLS and NYLS, with two of the three conferences being held at NYLS. This may be the first time in history NYLS has shared top billing with HLS for a major event of this sort.

Finally, turning to the proposals themselves, the vast majority were developed in the US setting. Accordingly, several have a decidedly US feel. Yet nearly all the broad themes raised by the conference – including the importance of considering the global dimension, perspectives from other professions, and regulatory perspectives – resonate in Japan, as well. Moreover, while the details of some proposals may be US-specific, nearly all the same underlying concerns can be found in Japan. These include, for example, concerns over identifying and measuring the skills needed for effective lawyering, the importance of integrating training in skills and professionalism with mastery of doctrine, technology, distance learning, the impact of accreditation standards, improving quality while maintaining or lowering costs, transparency, and fostering public interest activities. Thus, there is much Japan can learn from this conference and the broader worldwide debate over the future of legal education. At the same

8 By this author's count, participants included faculty members from three of the top ten law schools, three law schools ranked between 11 and 20, 7 ranked between 21 and 50, 5 ranked between 51 and 100, 6 in the "third tier" (103-139), and 4 in the "fourth tier" (140 or below), as well as one unranked online law school.

time, for several of the topics, including professional development, skills identification and assessment, technology, and distance learning, there is much Japan can share.

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