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Japan’s new Meti driven M&A guidelines boost special committee, independent directors roles

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- New MBO and parent/subsidiary deal guidelines ready by end June
- 50-page document devotes 10-pages to Special Committees
- Activist Oasis supportive of new non-binding guidelines

The Japanese government is in the final stage of establishing new non-binding guidelines for management buyouts (MBOs) and the acquisitions of companies by controlling shareholders as part of its efforts to develop the domestic M&A market in a fair and healthy manner, said government officials.

In light of corporate governance progress, Japan’s ministry of economy, trade and industry (Meti) launched its “Fair M&A Study Group”, which is chaired by Gakushuin University Professor Hideki Kanda, on 9 November 2018 in order to revise and update Japan’s 2007 guidelines on MBOs.

The study group's move follows concerns that the 2007 MBO guidelines needed to be revised to include other conflict of interest M&A transactions as well as to support the progress of corporate governance reform and the recent increase in the number of independent directors in corporate Japan.

Fresh guidelines, which Meti is expected to come up with by the end of June, drastically boost the role of **special committees**, especially, independent directors, in the case of MBOs and the acquisition of a controlled company by its controlling shareholder, said Riwa Sakamoto, director of the corporate system division at Meti.

A target company will be urged to consult with its special committee on the legitimacy and conditions of the M&A transaction in question, entrust the special committee with negotiations with the buyer and respect the decision by the special committee, the draft guidelines said.

MBOs and the acquisition of a controlled company by its controlling shareholder are regarded as problems in the Japanese M&A space because these cases are affected by the issues of conflict of interest and information asymmetry, the draft guidelines said.

Special committee acts as agent for minority shareholders

"Special committees play a key role in the new guidelines [in resolving the problem of conflict of interest and information asymmetry]. They also exert the utmost effort to maximize the benefit of minority shareholders, just like the situation that could be achieved by the merger between two independent partners where there is no conflict of interest," said Meti's Sakamoto.

Moreover, the special committee should be comprised of independent directors, elected by shareholders and who could be sued by shareholders if there is any failure of a good director's duty of care, the draft guidelines state.

The old 20-page MBO guidelines simply suggested - just in a page or two - the target company listen to the opinion of independent directors or a third-party committee. But the new guidelines, which are comprised of 50 pages, has dedicated as many as 10 pages solely to the discussion of the role of a special committee - the focal point of which is that independent directors should be an agent of shareholders, according to Sakamoto.

The draft guidelines say the current Tokyo Stock Exchange's definition of independence in relation to independent directors should be extended, such that all independent directors are genuinely independent with no connection to any related company for more than 10 years.

Furthermore, independent directors of the target company are urged to be involved practically in the process of establishing a special committee as well as in the process of negotiating M&A conditions and terms.

In last year's public campaign against **Alps Electric**'s [TYO: 6770] proposed purchase of affiliated company **Alpine Electronics**, Hong Kong-based activist Oasis Management criticized valuation opinions of Alpine's financial advisor SMBC Nikko for being biased in lowering guidance. Oasis said the valuer was a subsidiary of Alps' major lender and was therefore not independent.

Under the new M&A guidelines, the special committee could choose its own separate independent financial advisor to come up with unbiased valuation opinions if the committee is concerned about the independence of the target company's financial advisor, according to Shinpei Ochi, deputy director of Meti's corporate system division.

Meti's study group, meanwhile, concluded that **fairness opinions** could become an effective measure aimed at securing fair value depending upon the credibility and reputation of third-party assessment institutions.

The reputation of these institutions will be the key, said the guidelines, because, unlike some other countries, Japan does not have adequate regulations governing these assessment institutions yet.

The guidelines also say conducting a proactive **market check**, such as "go shop" or auctions, is necessary to ensure fair M&A transactions that would enhance corporate value and secure the fairness of the price of the transaction concerned.

As for the **majority of the minority** conditions, the guidelines said the establishment of the majority of the minority conditions would strengthen the target company's ability to negotiate terms and achieve an M&A transaction price favorable to minority shareholders.

The majority of the minority conditions are in place for in many cases of MBO in Japan today, but the effectiveness of such conditions is a complex subject in cases of the acquisition of a controlled company by its controlling shareholder. For instance, the recent expansion of Japanese passive index funds, some of which in principle do not tender their shares, prevents the majority of the minority conditions from effectively fulfilling its inherent function, according to the guidelines' supplemental explanations.

Oasis, in its first public comments submitted to the Meti in January, suggested that in acquisitions by related parties, any non-votes should be considered votes against the merger, and any related party to the offeror should not be considered a minority shareholder.

The guidelines said, however, in a transaction where a large controlling shareholder is acquiring a company, the target company's board and special committee are urged to study, in a comprehensive manner, the necessity of the majority of the minority condition. They should take into account the concrete circumstances and the effectiveness or adverse effect of the existence or non-existence of the majority of the minority condition.

If the majority of the minority conditions are not in place in a transaction, it is important to secure the overall fairness of the deal using other types of measures designed to ensure fairness, according to the draft guidelines.

The most important issue after the special committee is the **enhanced disclosure** of various information. The guidelines encourage the disclosure, in full, of valuation reports and fair opinion reports obtained by the third-party committee as well as the disclosure, in full, of the backgrounds of all special committee members and as well as full details of payments to all parties among other things.

“We're supportive of the new draft MBO guidelines which increase minority shareholder protection. We believe these guidelines and other such measures focused on improving corporate governance will improve Japan's capital markets as an investment destination,” Seth Fischer, Chief Investment Officer of Oasis Management in Hong Kong, told this news service.

“We are encouraged by the initiation of the Fair M&A Study Group and the broad array of comments submitted by engaged market participants. As a result, we expect increased transparency into fair value opinions, increased independence of third-party [special] committees, and improved prices in transactions – all resulting in fairer M&A transactions for minority shareholders. We thank and commend the committee members for their efforts on this important issue,” Fisher said.

“I think the new guidelines have made a considerable advance from the current situation. Just like the old MBO guidelines, the new guidelines, though not binding, will be well respected in Japan’s M&A practice,” said Meti’s Sakamoto.

by Norie Hata in Tokyo

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