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## **Follow-up Report: High Court Upholds Decision in Bull-Dog Case**

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On June 28 the Tokyo District Court handed down a provisional disposition dismissing a claim by Steel Partners for an injunction against the issuance of stock acquisition rights with respect to anti-takeover measures adopted by Bull-Dog Sauce Co., Ltd. On July 9 the Tokyo High Court upheld the district court decision, rejecting Steel Partners' appeal.

This report looks at trends in court decisions in the lead-up to these two decisions and the characteristics that make this case important.

### **Conventional Thinking**

Up until now, the thinking that the courts have taken with respect to the argument over whether it is possible to issue an injunction against an issuance of new shares or stock acquisition rights as an anti-takeover measure against a hostile bidder in order to dilute the equity ownership of that hostile bidder, on the basis that such issuance is an “unfair issuance”, has been known as the “principal objective rule.” In other words, in comparing the “objective of maintaining control” by the current management with the justification for issuing shares or other securities—typically the need to raise funds—as long as the latter is for the most part reasonable and the former is not the “principal objective” of the issuance of new shares or other securities, this type of takeover defense cannot be prevented by an injunction on the basis that it is an unfair issuance. On the other hand, the Tokyo High Court ruled in the Livedoor case that even if maintaining control by the current management is considered the “principal objective,” the issuance will not be considered unfair if the court believes there are “special circumstances.” This approach is somewhat of a deviation from the traditional principle, regardless of whether it is considered different from the conventional principal objective rule, or a so-called “new principal objective rule” that is an extension of the conventional principal objective rule.

To be a little more specific, in the Livedoor case the High Court said that even if the principal objective of maintaining control by the current management was to dilute the equity ownership of a hostile bidder, if the target company could prove that there are circumstances that would cause

the company to be irreparably harmed if the hostile bidder gained control of it, issuing shares or other securities as an anti-takeover measure would not be considered an “unfair issuance” because there would be “special circumstances.” The court in that case also said specifically that a company would be able to take anti-takeover measures because there are special circumstances if the hostile bidder (1) is a greenmailer, (2) plans to transfer important assets, including intellectual property rights, know-how and trade secrets of the target company to the bidder or its related companies (*scorched earth*), (3) plans to carry out a hostile LBO, or (4) plans to obtain high dividends or sell the shares at a higher price by compelling the target company to dispose of its valuable assets such as real properties or securities (*asset stripping*). It is not absolutely clear whether the High Court in the Livedoor case intended to limit the “special circumstances” to these four situations, but it is effectively impossible for a company to prove any of them, so in reality most of the anti-takeover measures of “prior warning” that have been introduced to date do not limit anti-takeover trigger events to these four situations and also include a so-called comprehensive provision that is triggered where a takeover substantially reduces the target company’s corporate value.

#### Tokyo District Court Decision

The District Court decision in the Bull-Dog Sauce case, which was handed down against this background, ruled that decision-making standards like those listed in the Livedoor High Court ruling should be applied when the board of directors takes anti-takeover measures and should not be applied when anti-takeover measures are taken based on the wishes of a general meeting of shareholders, and, because it is the general meeting of shareholders that has the authority to finally decide who is to have control over the company and should decide whether it is necessary to take anti-takeover measures, a judicial decision is to made only on whether the shareholders’ decision is clearly unreasonable. In other words, if anti-takeover measures are taken based on the authority of a general meeting of shareholders, the company taking the measures does not need to prove any attributes concerning the hostile bidder or that its corporate value will be harmed as a result of the acquisition. On the contrary, the hostile bidder must prove that the decision of the majority shareholders against the takeover is unreasonable.

Although there are no doubt many uncertainties about what kind of case is considered “clearly unreasonable,” there is good reason to expect with a fair degree of certainty a conclusion that ultimately affirms the need to take anti-takeover measures if there is an approval of a meeting of shareholders.

The District Court decision found that the shareholders’ decision must be based on a comparison of business plans proposed by the bidder and the current management and must be made in consideration of matters such as employee opinions and analyst valuations. Therefore, even according to the District Court, for example, it would not be possible to operate in a way where a target company amends its articles of incorporation so that it

leaves the decision of whether to take anti-takeover measures up to the discretion of the board of directors, and after that amendment the board of directors makes the decision whether to take anti-takeover measures.

The District Court has not clarified whether an ordinary resolution of a majority of voting rights or a special resolution of two-thirds of the voting rights is necessary for a general meeting of shareholders to decide to take anti-takeover measures. However, the District Court did clarify that, looking at the question of whether the ability to prevent a hostile bidder from exercising stock acquisition rights and then to compel that hostile bidder to exchange its stock acquisition rights for cash is in conflict with the principle of shareholder equality, the Corporation Law permits practices such as squeezing out minority shareholders, with a special resolution of the shareholders, and therefore, in this case, if the company has at least a special resolution and equal economic benefit is assured, it will not conflict with the principle of shareholder equality. It is therefore believed that in any situation, taking anti-takeover measures will require a two-thirds majority resolution. In spite of these limitations, the District Court ruled that with respect to the validity of anti-takeover measures, which has been subject to considerable debate to this point, a two-thirds majority resolution represents a type of safe harbor for the target side.

Previously, even if a company adopted anti-takeover measures, the decision to actually use them has been a difficult one for the board of directors because there was a risk that both the shareholders and the hostile bidder might hold the board of directors liable if the court ruled that exercising the measures was illegal. It is believed that the decision by the District Court could have significant impact on the practical aspects of using anti-takeover measures.

Although there is still some doubt about the conclusion of the District Court decision in the Bull-Dog Sauce case, it was important because it set out some actual standards under which the use of anti-takeover measures would be permitted. On the other hand, it avoided dealing with controversial issues such as how to determine if a certain buyer is a greenmailer or other type of “abusive bidder”, and on other issues led to the conclusion that it is not possible to obtain an injunction against the issuance of stock acquisition rights, which is an orthodox decision that is consistent with the limited nature of a court’s involvement.

#### High Court Decision

In the appeal of the District Court decision, the High Court handed down a direct ruling that Steel Partners is an abusive bidder. Although the outcome of the High Court case was the same as that of the District Court, there is substantial variation between the two lines of reasoning that led to these decisions in the sense that the High Court incorporated matters that were unnecessary for the court to decide based on the District Court’s reasoning, and it appears the practical standards set out by the District Court, which are why the case was significant, have been withdrawn by the High Court.

In determining that Steel Partners is an abusive bidder, the High Court set out the following facts that were used as a basis to reach such a conclusion:

- (a) The bidder has proposed MBOs and carried out TOBs against past target companies such as Sotoh, Yushiro, Myojo Foods, and Sapporo Holdings, and ultimately earned large profits as a result of selling the shares it held.
- (b) Before commencing the TOB against Bull-Dog Sauce, the bidder had proposed no specific management policy whatsoever and commenced the TOB suddenly.
- (c) The TOB registration statement states that the purpose of the purchase is to make a profit by selling securities, it is possible the shares the bidder holds will be sold in the future through negotiated or market transactions, and it is expected that the assets of the company will be disposed of after a squeeze out.
- (d) The questionnaire states that the bidder has no plan or intent to manage the target company, no proposal to improve the corporate value of the target company, which is expected to be proposed by the target company, and no management policy after it acquires control of the company.

From these facts, the High Court ruled that Steel Partners is an abusive bidder because it is a corporation “whose structure is that of an investment fund, which naturally owes a fiduciary duty to put the interest of its clients first, and which operates on the motivation of contingent fees, which means it acts with this as its priority,” and it “does not show any particular interest and is not involved in the management of the target company and, after acquiring shares of the target company, will take various measures such as requesting management to purchase the shares while undergoing procedures for a sudden TOB for the shares, all of which is a purely short-term strategy aimed at achieving a profit on sales by reselling the shares of the target company to a third party or back to the target company itself, and will ultimately attempt to earn a profit for itself even by considering selling the assets of the target company.”

As explained above, it appears the High Court framed its decision by first determining if Steel Partners is an abusive bidder, and then used that recognition as a premise for determining whether the adoption by Bull-Dog Sauce of anti-takeover measures would be in violation of the principle of shareholder equality and whether it would be an unfair issuance. Aside from the question of whether the determination that Steel Partners is an abusive bidder is correct, by adopting this line of thinking, if the standards for determining what is an “abusive bidder” are clear then the court can follow the reasoning that “anti-takeover measures cannot be exercised unless the bidder is found to be an abusive bidder,” which might also actually have a deterrent effect on taking anti-takeover measures.

Considering the reasoning of the High Court in coming to the decision that Steel Partners is an abusive bidder, however, the very nature of investment

funds is to make a profit on sales by holding shares for the short to mid-term and then selling them through a market or negotiated transaction. On the possibility of Steel Partners disposing of Bull-Dog Sauce assets after making it a wholly-owned subsidiary, this would not be necessarily be a negative move, if, for example, the disposal of unnecessary assets through restructuring of the target company is considered.

If these circumstances are used as reasons to label the bidder an “abusive bidder,” general investment funds will automatically satisfy some of the above elements (Items (a) and (c) above). Further, it has been suggested that as a result of the High Court decision, a shareholder that attempts to purchase a large number of shares will not be permitted to take the position that it “does not have any intention regarding the management of the company and only wants to purchase shares,” as it will be classified as an abusive bidder unless it has a specific management policy after the purchase such as a proposal to improve the corporate value of the company (Items (b) and (d) above), which seems to lead to the question of whether this is consistent with the principle of the separation of ownership and management of joint-stock companies.<sup>1</sup>

Ultimately, the High Court decision argued that Bull-Dog Sauce could legally issue stock acquisition rights without charge on the basis that Steel Partners is an abusive bidder. However, since (i) the standards used to determine whether the bidder is an abusive bidder are not fully clear, (ii) there are still some points that are unclear on the question of whether it was necessary to go beyond determining whether the TOB in this case is an abusive bid and instead determine whether the *bidder* in this case is an abusive *bidder*<sup>2</sup>, considering that, once the court has determined that Steel Partners is an abusive bidder based on its attributes, it is possible this will severely restrict its investment activities in the future, and (iii) it is also not clear whether it is possible to take anti-takeover measures if the bidder is not found to be an abusive bidder, this decision at least appears to have little precedent value in terms of providing a standard that can actually be relied on in practice.

Finally, the following is a comparison of the points in the judgments of the Tokyo District Court and the Tokyo High Court.

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<sup>1</sup> In this case, Steel Partners conducted a TOB with the aim of purchasing all of the shares of Bull-Dog Sauce, and considering that if it had succeeded it is believed the current shareholders would have had no involvement in the management of the target company after the purchase, there is a question of why the fact that Steel Partners did not offer any specific management policy or proposal to improve the corporate value of the company after the purchase must be viewed so seriously.

<sup>2</sup> On this point, the court held that it is reasonable to recognize Steel Partners as an abusive bidder “with respect to this case,” but that the question of whether a bidder is an abusive bidder turns on the attributes of that bidder so it appears likely that cases in the future will produce the same result. Further, even if the court did not recognize Steel Partners as an abusive bidder, it would have also been possible to simply determine that the management of Bull-Dog Sauce had reasonable grounds to believe that Steel Partners is an abusive bidder.

	<b>Tokyo District Court</b>	<b>Tokyo High Court</b>
1. Violation of the principle of shareholder equality?		
(1) Is the principle of shareholder equality applicable to issuing stock acquisition rights without charge?	Applicable	Applicable
(2) Exceptions permitted?	(a) Pursuant to at least a special resolution of a general meeting of shareholders	Necessary and appropriate to introduce as an anti-takeover defense <sup>3</sup>
	(b) Equal economic benefits are assured	No excessive or unreasonable damage to economic benefits of shareholders <sup>4</sup>
2. Significantly unfair issuance?		
(a) Recognition of abusive bidder	Avoided the issue because “it has no bearing on the court’s decision”	Recognition of SP as an abusive bidder
(b) Necessity	Necessary to prove damage to corporate value when decision is made by resolution of the board of directors. If decision is made by a resolution of a general meeting of shareholders then the will of the shareholders will be respected and the court will decide only whether the decision by the shareholders is clearly unreasonable. In this case, the decision to take anti-takeover measures by shareholders that were concerned because SP did not have a post-purchase management policy or other plan is not unreasonable.	The necessity of the anti-takeover measures is (as a matter of course) recognized under conditions where an abusive bidder is attempting to purchase the company through a TOB.
(c) Appropriateness	Consideration of all factors in the lead up to the general meeting of shareholders adopting anti-takeover measures, the degree of disadvantage suffered by existing shareholders, and the preventative effect on the TOB	Consideration of all factors in the lead up to the company adopting anti-takeover measures, the degree of disadvantage suffered by existing shareholders, the preventative effect on the TOB, and the degree of unconscionability of the purchasing act <sup>5</sup>

<sup>3</sup> The reason for determining that the anti-takeover measures are necessary and appropriate is based on the recognition that SP is an abusive bidder.

<sup>4</sup> If there is a comparison with the District Court decision that established that satisfying both (a) and (b) is a condition to ensuring there is no breach of the principle of shareholder equality, what the “conditions” are to ensure there is not a breach of the principle of shareholder equality is not entirely clear under the High Court decision.

<sup>5</sup> Even here, the fact that the TOB by SP, as an abusive bidder, was “unacceptable and unfair” is the premise that led to the decision that the issuance was appropriate.