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THE NIRECO POISON PILL: THE IMPACT OF A COURT INJUNCTION

From New Business Law Journal No. 812 (2005.7.1)

By Toshihiko Shimizu and Toshihiro Igi
Translated by Christopher J. Kodama[†]

Translator's Note: The emergence of a market for corporate control in Japan is a phenomenon that many commentators on Japan's business and legal environs had been anticipating since the turn of the new millennium. A gradual decline in corporate cross-shareholding and stable shareholding by financial institutions along with a concomitant increase in foreign and individual shareholders, a significant number of inefficient firms still being affected by Japan's prolonged recession until recent years and trading at prices below their market value, and Commercial Code revisions making the legal environment more conducive to merger and acquisition activity and providing for more flexible restructuring mechanisms, all pointed to a potential hostile takeover trend akin to that which occurred in the United States during the 1980s. However, it was not until early 2005, when Takafumi Horie, CEO of the internet firm Livedoor, made an unsolicited bid for majority control over Nippon Broadcasting System, Inc., that the hostile-takeover era seemed to have officially arrived upon Japan's doorstep. The ensuing media frenzy surrounding the rare hostile takeover attempt and the eventual decision by the Tokyo District Court to block Nippon Broadcasting System, Inc.'s issuance of stock purchase warrants to a friendly shareholder to thwart the takeover attempt compelled Japan's government and business sectors into action. The result was a wide embrace of an anti-takeover mechanism commonly known as the "poison pill."

A Japanese manufacturer of hi-tech measuring devices was the first to officially act, when on March 14, 2005, just days after the Tokyo District Court's first ruling in the Nippon Broadcasting case and a couple of months before the Japanese government would respond with its recommendations on the adoption of anti-takeover mechanisms, the board of directors of Nireco Co. voted to adopt a poison pill as a preliminary anti-takeover device. The Nireco poison pill authorized the issuance of stock purchase warrants to the company's current shareholders. These warrants could be exercised to dilute a hostile bidder's shareholding in circumstances where the board of directors deems the acquisition not to be in the long-term interests of the company. However, the Nireco poison pill did not go unchallenged. On May 9, 2005, an investment fund owning 6.8% of Nireco's outstanding shares filed a petition for a provisional injunction against the poison pill, arguing that the issuance of stock purchase warrants in the absence of a hostile bidder was grossly unfair because it would cause unforeseen financial harm to existing shareholders as well as to future shareholders.

This Article focuses upon the attempt by Nireco's board of directors to implement what would have been Japan's first poison pill and the subsequent decision by the Tokyo courts to enjoin the preliminary anti-takeover device as grossly unfair. The authors examine the substantive and procedural characteristics of the poison pill, including the deficiencies prompting the Tokyo District Court to block Nireco's implementation, as

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well as the potential impact of the court's decision on future business practice in Japan. By placing the court's decision in the Nireco case within the history of jurisprudence relating to corporate issuances of new shares or stock purchase warrants challenged as grossly unfair under Japan's Commercial Code, now the Company law, the authors seek to emphasize (1) the court's shift away from the *main purpose rule* standard of judgment in favor of a *reasonable means* standard for evaluating anti-takeover mechanisms, whether adopted in the face of a hostile acquirer or simply as a preliminary anti-takeover device; (2) the court's addition of *pure economic harm* to the list of potential harms to shareholders; and (3) lingering questions regarding the role of the general shareholder meeting in approving an anti-takeover mechanism. While the authors eschew any strong stance on the appropriateness of the poison pill within Japan's corporate governance structure, they do predict that the judiciary will play a prominent role in the future development of anti-takeover mechanisms like the poison pill, in part due to the developments in the Nireco case.

Summary: The much heralded arrival of the corporate hostile-takeover era in Japan has prompted a variety of responses from Japan's legislature, bureaucracy, and business sector. Among these responses was what could have been Japan's first poison pill, an issuance of stock purchase warrants approved by Nireco Co.'s Board of Directors as part of a shareholder rights plan. However, concerns over potential harm to Nireco shareholders due to structural flaws in the poison pill prompted a court battle and ultimately led to a judicial order preventing the issuance. This paper seeks to uncover the substantive aspects of the Nireco case by examining the various legal issues it raised and its potential impact on the future of corporate defensive measures in Japan.

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1. THE NIRECO POISON PILL

(1) On March 14, 2005, in the midst of a highly publicized battle between Livedoor, Inc. and Fuji Television Network, Inc. over managerial control of Nippon Broadcasting Systems, and directly after a decision by the Tokyo District Court enjoining Nippon Broadcasting's Board of Directors

from issuing stock purchase warrants to dilute Livedoor's ownership,¹ Nireco Co. ("Nireco") publicly announced its own decision to issue stock purchase warrants under a shareholder rights plan.² This so-called "*poison pill*," if realized, would become the first of its kind in Japan.

(2) The following is a general outline of the poison pill adopted by the Nireco Board of Directors:

1. Nireco will allocate two gratuitous stock purchase warrants for each Nireco share held by shareholders of record as of March 31, 2004.³
2. The stock purchase warrants are non-transferable and non-assignable.
3. Upon a determination by the Nireco Board of Directors that a hostile bidder had sought to acquire twenty percent or more of the corporation's outstanding shares, shareholders who have received the stock purchase warrants can exercise them to acquire Nireco shares at a cost of 1 yen per share.
4. The Nireco Board of Directors has the authority to redeem or refuse to redeem the stock purchase warrants. In making this decision, the Board of Directors will respect the recommendation of a special committee comprised of three outside experts; however, situations in which the committee's recommendation is not followed also are possible.
5. The Board of Director's refusal to redeem the stock purchase warrants is limited to the following circumstances:
 - i. The acquirer is a greenmailer;
 - ii. The acquirer is planning a scorched earth policy;
 - iii. The acquirer is planning a leveraged buyout;⁴
 - iv. The acquirer is a corporate raider planning to resell the corporation to the highest bidder;⁵

¹ The three Livedoor v. Nippon Broadcasting decisions, *Livedoor K.K. v. Nippon Broad. K.K.*, 252 Shōji Hōmu Shiryōban 275 (Tōkyō D.Ct., March 11, 2005); *Livedoor K.K. v. Nippon Broad. K.K.*, 252 Shōji Hōmu Shiryōban 294 (Tōkyō D.Ct., March 16, 2005); and *Nippon Broad. K.K. v. Livedoor K.K.*, 252 Shōji Hōmu Shiryōban 300 (Tōkyō High Ct., March 23, 2005) are referred herein collectively as the "Nippon Broadcasting decision," while the case itself generally will be referred to as the "Nippon Broadcasting case."

² Nireco's announcement came between the first and second Nippon Broadcasting decisions.

³ In this article, the terms "share" or "stock" refer to voting shares and "shareholder" or "stockholder" refer to the owner of a voting share or shares.

⁴ *Translator's note*: in his more recent articles on similar topics, the author Toshihiko Shimizu has pointed out the Nippon Broadcasting decision, from which this language likely was borrowed, did not specifically address leveraged buyouts, but rather situations in which the acquirer would abuse the target corporation's assets for the acquirer's own matters.

⁵ It is likely that Nireco incorporated these conditions borrowing directly from the Tokyo High Court's decision in the Nippon Broadcasting Case. [*Translator's Note*: There is a strong similarity

- v. Other situations, such as where there is an obvious threat of harm to the corporate value of the Nireco group, including but not limited to existing Nireco shareholders, business affiliates, customers, employees, regional companies, or other stakeholders.

(3) Since a stock purchase warrant generally is not transferred along with the share to which it was allocated and individual assignment of the warrant is prohibited under the terms of Nireco's poison pill, potential acquirers have no way to obtain any stock purchase warrants after they have been allocated; they are limited to an acquisition of shares already outstanding at that moment. Thus, even if a prospective acquirer obtains twenty percent or more of the corporation's outstanding shares, his or her share ownership could be diluted to one-third if and when the stock purchase warrants are exercised to acquire new shares. Accordingly, any potential acquirer would have no choice but to request the target management to redeem the stock purchase warrants before reaching twenty percent ownership of the outstanding shares and hope that the target management responds favorably by agreeing to partake in acquisition negotiations. In this way, even if a corporate bidder does present itself, the target management can avoid hasty decision making and take reasonable time to negotiate with the bidder, thereby making the poison pill an effective defensive mechanism. This type of poison pill has also been regarded as a comparatively simple, low cost, and convenient defense scheme,⁶ particularly suitable for small to medium-sized corporations seeking to avoid the burdens of corporate defense as much as possible.⁷

(4) Under the terms of the Nireco poison pill, the issuance of stock purchase warrants was scheduled for June 16, 2005.

2. THE INVESTMENT FUND'S PETITION FOR AN INJUNCTION

(1) On May 9, 2005, an investment fund owning a little less than three percent of Nireco's outstanding shares submitted a petition for a temporary

between the language used in the final appellate decision in the Nippon Broadcasting case and the Nireco poison pill. For an English translation of the relevant portion of the Nippon Broadcasting decision, see Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171, 2193-94 (November 2005).]

⁶ Whereas the Nireco poison pill allotted stock purchase warrants to current shareholders, other types of poison pills have utilized different mechanisms, such as the "trust model," the issuance registration system, and the third-party issuance.

⁷ Ōta Yō, *Japanese-Style Rights Plan—A Focus on the Nireco Security Plan*, MARR, June 2005, at 14.

injunction against Nireco's issuance of the stock purchase warrants.⁸ The main argument raised by the investment fund is that the issuance of stock purchase warrants is grossly unfair. If the issuance were allowed, potential investors in Nireco would be submitting themselves to a considerable and incalculable risk that their shareholding will be substantially diluted, thereby forcing them to take an extremely cautious approach when considering any purchase of Nireco shares. This cautious approach leads to a decline in Nireco's business reputation, which in turn causes unanticipated harm to existing shareholders because of a potential negative effect on the economic value of their current shareholding. Accordingly, the investment fund argued, the issuance of stock purchase warrants under the shareholder rights plan is grossly unfair and should be enjoined by the court.

(2) In comparison to the Nippon Broadcasting case, the Nireco case may not have attracted as much media attention in Japan or elsewhere, but in terms of providing guidance to corporations and to relevant experts regarding the appropriateness of adopting anti-takeover mechanisms, the Nireco case is much more important.

It is also important to keep in mind that the courts are not the only actors who have felt compelled to respond to the apparent arrival of the hostile takeover era in Japan. Immediately following the Nippon Broadcasting case, a number of other corporations besides Nireco announced their own plans to adopt corporate defense measures. These defensive measures took a variety of forms, with some even being discussed at the general shareholder meetings held that June. In May 2005, the Ministry of Economy, Trade, and Industry ("METI"), and the Ministry of Justice published their Guidelines on Hostile Takeover Defense and Corporate Value Protection Measures and METI's Corporate Value Study Group published its final report. Around the same time, the National Diet was discussing a bill relating to corporate takeover defense mechanisms. Thus, as businesses like Nireco experimented with methods to defend against the perceived threat of corporate takeovers in the real world, Japan's legislature, administration, and judiciary all grappled with the problem from a policy perspective—without any guidance from Japan's domestic legal history.

⁸ *Translator's Note:* According to the actual court decision, the petitioner SVP Value Realization Master Fund Limited owned 2.85% of Nireco's outstanding shares; however, news reports indicated that the petitioner's share ownership was 6.85%. In any case, the actual amount of the petitioner's shareholding is not important in the court's decision.

3. THE TOKYO DISTRICT COURT DECISION

(1) On June 1, 2005, the Tokyo District Court found that Nireco's stock purchase warrants were grossly unfair and granted a temporary injunction against their issuance.⁹ Nireco filed an objection, but the District Court's decision was affirmed on June 9, 2005.¹⁰ Although this case may seem to be just another battle over anti-takeover measures following on the heels of the Nippon Broadcasting case, in actuality, its potential impact on business practices is much greater than the Nippon Broadcasting case because it addresses *peacetime* poison pills—that is, anti-takeover measures enacted in the absence of a hostile bidder.

(2) The Tokyo District Court offered the following reasons for finding that Nireco's issuance of stock purchase warrants authorized under the terms of the poison pill was grossly unfair:

1. The poison pill was not “structured to reflect the views of the shareholders regarding the issuance of stock purchase warrants as a preliminary countermeasure.”
2. The poison pill was not “structured to prevent arbitrary decisions by the board of directors in connection with redemption of the stock purchase warrants.”
3. It could not be said that “the issuance of the stock purchase warrants did not potentially harm shareholders unconnected to the acquirer.”

As a result, the court could not find that “the issuance of stock purchase warrants, as a preliminary countermeasure, was accomplished through *reasonable means*.”

Upon a closer examination of the court's decision, with respect to reason 1, the court pointed out that the Nireco Board of Directors did not intend to obtain approval for the poison pill at the general shareholder meeting scheduled for June 2005, nor did it establish a method through which the redemption of the stock purchase warrants could be made by a decision at the general shareholder meeting.

With respect to reason 2, according to the Nireco decision, in order for the means to be considered reasonable, first of all, as a substantive matter

⁹ *SFP Value Realization Master Fund, Ltd. v. Nireco K.K.*, 1734 Shōji Hōmu 37 (Tōkyō D.Ct., June 1, 2005).

¹⁰ *SFP Value Realization Master Fund, Ltd. v. Nireco K.K.*, 1735 Shōji Hōmu 44 (Tōkyō D.Ct., June 9, 2005). Although this appellate decision did include some additional arguments, since it agreed with the decision and rationale of the original decision, any citations to the Tokyo District Court decision will refer to the original decision referenced in *SFP Value Realization Master Fund, Ltd. v. Nireco K.K.*, 1734 Shōji Hōmu 37.

“the conditions triggering the exercise of the share purchase warrants should be limited to circumstances where the hostile bidder’s acquisition of the target corporation would cause irreparable harm and not where the bidder intends to manage the target corporation in a rational manner.”¹¹ The Nireco decision points out that since one of the justifications for the board’s refusal to redeem the share purchase warrants was overly broad and unclear, the poison pill as a whole failed to provide a standard of judgment adequate to prevent arbitrary decisions by the board. Therefore, the poison pill could not be considered reasonable.

Next, from the standpoint of procedural fairness, the court found that in providing leeway to the board to disregard the expert committee’s recommendations, the Nireco poison pill effectively allowed the board to make arbitrary decisions, and therefore failed to “secure a fair method for determining whether the triggering conditions have been met.”

With respect to reason 3, the court found, in accordance with the investment fund’s argument, that the Nireco poison pill caused problems relating to the valuation of Nireco shares and that it therefore caused unanticipated harm to existing shareholders.

(3) The Japanese judiciary has compiled a considerable number of decisions, spanning several decades, which address the question of unfairness in issuing new shares of stock, or in the case of the recent Nippon Broadcasting decision, stock purchase warrants to thwart potential takeovers. The sections below seek to unearth the substantive meaning of the Nireco decision by examining how it fits into this history of unfair issuance jurisprudence and how it might affect shareholder rights plans in the future.¹²

4. THE MAIN PURPOSE RULE: EXTENDING THE CONVENTIONAL RUBRIC

(1) Despite the fact that the Nireco decision, in dealing with a so-called *peacetime*¹³ poison pill, addresses an issuance of stock purchase warrants adopted for a different purpose than those contested in prior unfair

¹¹ This is considered to be in general agreement with the conditions necessary for an issuance of share purchase warrants in the presence of a hostile bidder to be tolerated as an emergency measure as delineated by the second appellate court decision in the Nippon Broadcasting case.

¹² *Translator’s Note:* Although the authors frequently refer to the “conventional unfair issuance cases,” they do not identify any particular cases except for those included in the footnotes throughout this article.

¹³ In this article, the term “emergency” refers to circumstances where a hostile bidder is present, while the term “peacetime” refers to circumstances where no hostile bidder is present. Although the dividing line between the two can be very subtle, this article does not address that aspect any more deeply since it does not immediately affect the arguments raised herein.

issuance cases, rather than adopt an entirely new standard to determine whether the issuance was unfair, the court in Nireco opted to apply the main purpose rule, the standard conventionally used to determine whether an issuance of new shares or stock purchase warrants to a third party in response to a present takeover attempt is unfair.^{14 15}

(2) In order to understand this more completely, it is necessary to address how the Nippon Broadcasting decision expanded the scope of the main purpose rule, and by doing so, altered the framework for judging whether an issuance of new shares or stock purchase warrants is grossly unfair. To put it more specifically, whereas in decisions prior to Nippon Broadcasting any issuance of new shares adopted for the main purpose of protecting the target management's corporate control (as opposed to legitimate capital raising purposes) would likely be regarded as grossly unfair, in the Nippon Broadcasting case, which questioned the legitimacy of issuing stock purchase warrants for corporate defense purposes, the court acknowledged that even if the main purpose behind the issuance was to protect the target management, there could be circumstances where the issuance is deemed a legitimate measure enacted to protect the corporation's long-term value.^{16 17} Under the conventional rubric of the main purpose rule, however, corporate defense measures never could be legitimate because they necessarily connote a plan to manipulate the composition of shareholders, and as such, were nothing more than a tool to entrench the target management.

¹⁴ There have also been circumstances where the company sets aside new shares for a preferential bidder as part of a public appeal for potential friendly investors.

¹⁵ *Translator's Note:* The authors go into more detail on this point in the paragraphs below.

¹⁶ The conventional cases dealing with new stock issuances demonstrate that the same result could be obtained by ruling that when both capital-raising and management-entrenching purposes are present, the capital-raising purposes will be given superiority. This interpretation was occurring even in circumstances where the company's defensive measures would have been allowed under an exception to the main purpose rule, such as the when a greenmailer was present. At the same time this technique was being criticized as encouraging courts to authorize conduct as having a legitimate capital-raising purpose in more instances. Since the Nippon Broadcasting case involved stock purchase warrants, which are generally difficult to justify as having legitimate capital-raising purposes, the court had no choice but to reorganize the corporate defense purpose.

¹⁷ This rationale already had been tested in *Chūjitsuya K.K./Inageya K.K.*, 1317 Hanrei Jihō 28 (Tōkyō D.Ct., July 25, 1989). However, due to a number of logical flaws, among which was an apparent contradiction with the principles of the authorized capital system and the freedom of allocation, the argument was subsequently rejected in *CSK K.K. v. Bell Sys.*, 24 K.K., 245 Shiryōban Shōji Hōmu 130 (Tōkyō D.Ct. July 30, 2004), (though it should be noted that since *Bell Systems* did not involve a hostile takeover attempt, it would have been difficult to demonstrate the necessity of invoking an exception to the main purpose rule). Although this article does not address this aspect any further, some might say that the argument made in the Nippon Broadcasting case was a revival of the argument raised in *Chūjitsuya*, just in a different form.

The Nippon Broadcasting decision noted that the main reason an issuance of new stock or stock purchase warrants for management entrenchment purposes is unfair is because of the separation of ownership and control in a joint stock corporation.¹⁸ In other words, shareholders, as the owners of a joint stock corporation, hold the power to appoint and remove members of the board of directors, while members of the board of directors, on the other hand, as the entrusted corporate fiduciaries, are expected to execute their managerial duties for the benefit of the shareholders as a whole.¹⁹ However, this premise also allows for the board of directors to enact emergency provisions on behalf of the shareholders when there is a clear risk of harm to shareholder value, without infringing upon the shareholder's ownership rights, and thus, it also justifies the court's reading of certain exceptions into the main purpose rule framework, at least in situations where the issuance of new stock or stock purchase warrants have been made in the face of a hostile bidder.

(3) In this way, the Nireco decision can be seen as building upon the main purpose rule,²⁰ not as interpreted by the conventional unfair issuance cases,²¹ but as reinterpreted by the court in Nippon Broadcasting. The following excerpt from the Nireco decision discusses the appropriate methods through which a corporation could enact defensive measures in the absence of a clear risk of harm to shareholder value, such as the adoption of a poison pill as a preliminary countermeasure to a hostile takeover.

. . . When there is no present threat to corporate control but one is envisioned through a hostile acquisition of shares sometime in the future, the actual emergence of which would make

¹⁸ Previous cases had always treated unfairness as a natural fact and therefore had never offered a rationale.

¹⁹ However, it is thought to be improper to base this solely on the separation of ownership and control. In the first appellate decision in the Nippon Broadcasting case, the court references some of the more substantial conflicts between the board of directors and the shareholders, such as their differing views on corporate profits.

²⁰ To prevent any possible confusion concerning whether the term "main purpose rule" includes or excludes the exceptions, this article will continue to use the term to refer only to the basic provision as conventionally used. In contexts where the exceptions also should be considered, such will be noted.

²¹ In terms of court precedence, the basic principle of the main purpose rule (e.g., comparing the relative predominance of various purposes) emerged during the 1960s and 1970s after the chaos of the postwar period, and finally became more established during the bubble period. Around the same time, an exception to the main purpose rule was created to deal with such circumstances such as the presence of a greenmailer. Finally after various attempts by Japan's courts to establish certain exceptions, the Nippon Broadcasting decision proposed a main purpose rule with more clearly delineated exceptions. This version of the rule was established with reference to cases addressing the issuance of new shares of stock to a third party in order to weaken the influence of a particular majority shareholder or to fend off any potential acquirers. The Tokyo District Court applied this version of the main purpose rule in developing its analysis of the peacetime poison pill in the Nireco case.

possible the exercise of stock purchase warrants with the main purpose of decreasing the hostile bidder's ownership share, and in circumstances where these stock purchase warrants are actually issued but ultimately determined not to be in response to a hostile bidder whose lack of sincere intent to manage the company in a rational manner would cause irreparable harm to shareholder value, the need to take preliminary countermeasures as a type of emergency response will not be recognized. The same result would occur even in circumstances where after determining that the hostile bidder's acquisition of corporate control would not be appropriate from the standpoint of preserving long-term corporate value, the board of directors will make possible the exercise of stock purchase warrants.

Accordingly, any issuance of new shares or stock purchase warrants as a preliminary countermeasure, such as presented here, as a general rule, should only be adopted based upon the views of the shareholders at the general shareholder meeting

These additional considerations embraced in the Nireco decision can be regarded collectively as the peacetime version of the main purpose rule.²²

(4) Even though the adoption of a peacetime poison pill by a board of directors relates to a future occurrence, because it evidences an intention to change the shareholder composition the obvious purpose of which is to entrench management, it should not be permitted in theory or in principle in the same manner that new share issuances to third parties in the face of a hostile bidder are not permitted.²³

It could be argued that an issuance of stock purchase warrants, in contrast to an issuance of new shares, does not immediately affect the shareholder composition, and that therefore, a poison pill utilizing stock purchase warrants does not necessarily have an entrenching purpose. However, this argument is faulted by the fact that an issuance of stock

²² From a practical business aspect, it should be noted that it has become fairly difficult to successfully adopt a poison pill without approval by a resolution at the general shareholder meeting. [*Translator's Note:* This would seem to flow directly from the requirement of approval at the general shareholder meeting for many other acts, such as the authorization of dividend payments or share repurchases]. It is even more difficult to legitimately adopt a poison pill authorizing an allotment to a third party through a decision by the board of directors. To be sure, this does not mean that poison pills that have met the necessary conditions will not be allowed; however, that topic is beyond the scope of this article.

²³ This is recognized in the appellate decision as well.

purchase warrants foretells a change in the shareholder composition, thereby causing a hesitation on the part any potential acquirers.²⁴ This in turn would serve to protect the target management, albeit less directly.

5. REASONABLE DEFENSIVE MEASURES

(1) In continuation of the above excerpt, the Nireco decision went on to state:

. . . It would be difficult to say that the general shareholder meeting is the only potential forum [for enacting corporate defense measures in the absence of a clear risk of harm to shareholder value]. The possibility that a hostile bidder whose acquisition of control could cause irreparable harm to the corporation might appear sometime before the next general shareholder meeting cannot be ruled out entirely; therefore, it is thought that in some circumstances, preliminary countermeasures to an attempted takeover adopted by the board of directors may be allowed, provided that the means utilized are reasonable in relation to the threat posed. However, even in such circumstances, at the very least, a poison pill consisting of an issuance of stock purchase warrants must include a system for considering views presented at the shareholder meeting. Additionally, the poison pill must provide measures to prevent arbitrary decisions by the board because of the potential for abuse that exists in entrusting the board with the authority to determine whether the requisite conditions triggering the exercise of the stock purchase warrants have been met.

The reasons provided by the court for ruling that the preliminary countermeasures in this case were not reasonable and imposing the injunction against the issuance of stock purchase warrants are described above in 3.(2).1, 2, and 3.

(2) The *reasonable means* dilemma appears to be a key feature in the Nireco decision, in particular when compared to the conventional unfair issuance cases. To be sure, the conventional unfair issuance cases did generally state that, if the purpose was legitimate but the means were not reasonable in relation to the threat, then it was possible that the issuance

²⁴ This forms the basis for extending the application of the main purpose rule to stock purchase warrants. However, it is not clear from the Nippon Broadcasting case whether this was something of a special circumstance because the stock purchase warrants were to be exercised immediately after being issued.

would be regarded as unfair; however as a practical matter, no previous cases had ever recognized a means as being unreasonable.²⁵

From now on, however, thanks to the pioneering spirit of the Nireco court, the key question in future disputes relating to poison pills likely will be the reasonableness of the means utilized, as opposed to the main purpose under which the poison pill was adopted.²⁶

(3) Reason 1, *supra*, poses a problem with the reasonableness of the means, but there is an even greater concern that goes to the core of the main purpose rule, that is under what conditions the exception to the main purpose rule, as stated in *Nippon Broadcasting*, is justified.

On the other hand, with respect to reason 3, *supra*, since it is natural for any scheme causing unanticipated harm to existing shareholders to be evaluated negatively from a reasonable means standpoint, if the court finds that “another means by which the same purposes could have been achieved should have been undertaken,”²⁷ this negative view is likely to be the deciding factor in the court’s decision.²⁸

With respect to the potential for arbitrary decision-making by the board noted in reason 2, there are both substantive (justifications for refusing to redeem the poison pill) and procedural (special committee’s authority vis-à-vis the board of directors) problems that would need to be addressed. Several important substantive problems from reason 2 should be examined further.

(4) The Nireco decision approved of four of the five circumstances that would allow the board of directors to justifiably refuse to redeem the poison pill (1.(2).5.i-iv), but rejected the last circumstance (1.(2).5.v), which would have allowed the board of directors to refuse to redeem the poison pill in “other situations, such as where there is an obvious threat of harm to the corporate value of the Nireco group, including but not limited to existing Nireco shareholders, business affiliates, customers, employees, regional companies, or other stakeholders.”

The first four justifications for board refusal were found to be legitimate, insofar as they were based on the court’s decision in the *Nippon*

²⁵ The *Nippon Broadcasting* decision also expressed this viewpoint, but it never inquired into the reasonableness of the means because it found that the purpose itself was unjust on its face. On the other hand, where there does seem to be some examination into the reasonableness of the means in previous cases, they all find that if the purpose was just then the means were also reasonable (or at least were within the limits of business judgment).

²⁶ *Translator’s Note*: This next section discusses more specifically how the provisions of the Nireco poison pill violated the reasonable means requirement.

²⁷ This is mentioned in the first appellate decision.

²⁸ Whether or not the Nireco poison pill *actually* caused existing shareholders unforeseen harm necessarily involves an economic analysis and as such will not be addressed any further in this article.

Broadcasting case; but, it should be noted that their applicability in the face of a hostile bidder has never been tested. It is unknown whether they would be applied in a real dispute as hypothesized in the Nippon Broadcasting decision. Yet, as a practical matter, since no other appropriate clues as to their origin have been found, the circumstances likely are attributable to the Nippon Broadcasting decision.

The last circumstance, which was not accepted by the Nireco court as a legitimate justification for the board of director's refusal to redeem the poison pill, must be examined in two parts. First, is it appropriate for the board of directors to take into consideration potential harm to parties who are not shareholders, but otherwise have a substantial relationship with the corporation? While the notion of stakeholder interests had been raised in the Nippon Broadcasting decision, ultimately, there was never any clear resolution.²⁹ Next, do circumstances obviously evidencing potential harm to long-term corporate value justify the enactment of corporate defense measures within the exception to the main purpose rule? While the first appellate decision in the Nippon Broadcasting case seemed to answer in the affirmative, the final appellate decision did not.³⁰ Furthermore, it is completely unclear what meaning the phrase "other such circumstances" holds or how much importance should be attributed to it. The Nireco decision is by no means clear with respect to where it stands on these issues, but nevertheless, it rejects this final justification for the board's refusal to redeem the stock purchase warrants as "overly broad and indefinite."³¹

6. HARM TO EXISTING SHAREHOLDERS

(1) In the conventional unfair issuance cases, the shareholder harm caused by an issuance of new shares or stock purchase warrants to a third party included the loss of corporate control, the loss of the possibility to gain corporate control, and in some circumstances, the loss of certain rights guaranteed to minority shareholders. Though these points may not have

²⁹ METI's Corporate Value Study Group also raised this issue in its Final Report, but nothing conclusive was stated.

³⁰ In the final appellate decision, the argument that harm to corporate value constitutes a corporate defense measure was rejected. If viewed from the notion that "difficult judgments concerning corporate value should be put to a shareholder vote," which formed the basis of the court's view, it would seem likely that a claim for non-obvious harm would be rejected. However, the same probably could not be said for harm that is *obvious*, or in other words, circumstances which a reasonable person (including judges in this context), as opposed to the business elite, would unmistakably determine to be harmful.

³¹ Although the Nippon Broadcasting decisions express a slightly different view regarding the circumstances in which corporate defense purposes may be justified, they still may have influenced the Nireco decisions in this respect.

garnered specific recognition in every case, they are self evident in those cases dealing with battles over managerial control. And, as the degree of harm suffered by shareholders started to gain more consideration through the court's application of the main purpose rule, whether or not there had been a change causing minority shareholders to lose their rights came to be regarded as one possible dividing line between issuances that were fair and those that were not.³² As a result, an increase or decrease in a shareholder's ownership percentage or the degree of such change came to be regarded as factors which may influence the success (or failure) of a petition for an injunction against the underlying issuance.

(2) In contrast, the Nireco case presents a type of shareholder harm of a different nature than those presented above. The problem, as viewed by the court in Nireco, had become one of purely economic harm represented by a tangible decrease in the value of the company's individual shares. Even though this notion of simple economic harm stands in stark contrast to the conventional unfair issuance cases, the court seems to have regarded it as axiomatic, as there is no trace of any arguments challenging or even questioning whether this type of harm is something which shareholders should be protected against under the unfair issuance framework.³³

If the harm suffered by shareholders is purely economic in nature, then a shareholder's ownership percentage is no longer a substantial issue in unfair issuance cases. In fact, the Nireco decision made it possible for an injunction sought by a shareholder owning less than three percent of the corporation's outstanding shares to be granted.³⁴ To extend this even further, under this new interpretation of what constitutes shareholder harm, a shareholder owning no more than one share would be able to demand an injunction against the issuance of new shares or stock purchase warrants on the basis that it negatively affected the economic value of that one share.

³² For other examples of cases that have pointed out just how few shares were held by the shareholder requesting the injunction, see *Daisō*, 1204 Kinyū Hanrei 6 (Osaka D.Ct., Sept. 27, 2004); *Ichiya*, 251 Shiryōban Shōji Hōmu 220 (Kōchi D.Ct. July 8, 2004); and *Nippon Broad.*, 1496 Hanrei Jihō 123 (Tokyo D.Ct. March 28, 1994).

³³ Factors relating to both the substantive judgments of the courts and the necessary qualifications of the claimant (standing) have their settled place within discussions concerning the conventional unfair issuance cases. These discussions have also demonstrated the court-centric point of view that "with respect to injunction requests alleging that an issuance is grossly unfair, it is thought that only those shareholders who are presently battling for corporate control or who will lose minority shareholder rights [as a result of the issue] are considered to have standing." Ōyori Hisashi, et al., *Lawsuit Seeking Injunction of Issuance of Share Purchase Warrants*, 1172 HANREI TIMES 60, 61 (April 2005).

³⁴ From what can be gleaned from various news reports, the investment fund held six percent of Nireco's outstanding shares. Regardless, there would be no effect on the ultimate outcome if that number was two or six percent.

(3) The Nireco poison pill was deemed to have caused this type of unexpected harm to its existing shareholders because of the aforementioned characteristics of the Nireco poison pill. However, the effect of this consideration of share value is not limited to such circumstances. Because a decline in shareholder value is a problem that commonly occurs when excessively protective corporate measures have been adopted, any shareholder (even an owner of just one share) would be able to request an injunction against a peacetime poison pill for provisions viewed as excessively protective.

Since whether or not a protective measure is excessive will depend upon its relative reasonableness (as addressed in 5.(3), *supra*), it is possible that an injunction claim asserting that the enacted measures are excessive may be based upon mere comparison of two different measures.³⁵

7. THE GENERAL SHAREHOLDER MEETING

(1) As demonstrated in 4.(3), *supra*, the District Court in Nireco opined that, as a general rule, poison pills are to be enacted only upon approval at the general shareholders meeting or, at least, are to reflect the intention of the general shareholders meeting.

Conversely, does this mean that the problems associated with a poison pill may be disregarded simply because the poison pill was adopted by a resolution at the general shareholder meeting? The answer still is not clear, since the Nireco decision limited its discussion of “reasonable preliminary countermeasures” to poison pills adopted by the board of directors, as opposed to the general shareholders.³⁶ The conventional unfair issuance cases do not seem to indicate that approval at the general shareholder meeting immediately absolves the otherwise unfair issuance of its problematic features.³⁷

(2) The notion that an issuance of new shares or stock purchase warrants, even if approved by a resolution at the general shareholder

³⁵ If this is the case, then it is likely that as soon as a poison pill is enacted, it will require proper revisions.

³⁶ The Corporate Value Study Group’s Final Report does not mention this either.

³⁷ Since, at that time, *Nippon Broad.*, 1496 Hanrei Jihō 123 (Tokyo D.Ct. March 28, 1994) restricted the transfer of its shares, any allotment to a third party must have been approved by a special resolution at the general shareholder meeting. However, courts were willing to examine the fairness of any such issuance, even in circumstances where eighty-five percent or more of those holding voting rights had approved the issuance. In the first appellate review of *Ichiya*, 251 Shiryōban Shōji Hōmu 220 (Kōchi D.Ct. July 8, 2004), the court subjected an issuance of stock purchase warrants to a third party that had been approved by special resolution to a similar of review. Since in both cases the courts ultimately dismissed the request for an injunction, the relationship between the court’s decision to review the issuance and its conclusion is rather unclear.

meeting, still may be regarded as grossly unfair for other reasons does not make sense from the standpoint of the “separation of corporate ownership and control.” Under the separation of ownership and control theory, if those who have the authority to appoint and remove members of the board—e.g., the majority shareholders—approve the measure, then there should be no further inquiry into the measure’s intended purpose, whether it be to protect the target management or otherwise. Thus, if we believe that the conventional unfair issuance cases have left open the possibility that an issuance be deemed unfair despite approval at the general shareholder meeting, then there must be some other considerations at play, for example the notion that the board of directors operates to protect the minority shareholders from the majority shareholders, or even broader, to protect the shareholders in general, or possibly shareholders at the individual level.³⁸

(3) This point becomes even more important if we consider that a simple decrease in the economic value of a share (addressed in 6.(3), *supra*) is deemed to constitute damage, because then the holder of even just one share would be able to request an injunction against the corporation. Could such a problem be resolved upon a resolution at the general shareholder meeting,³⁹ and if so, what must that resolution consist of?

The procedures for issuing new shares or stock purchase warrants favorable to particular parties (Commercial Code, Art. 280-2 paragraph 2, Special Resolutions) may shed some light on how to deal with possible decreases in the economic value of shares. Under these procedures, information related to potential decreases in economic value must be disclosed in an understandable manner. In addition, the procedures for changing provisions in the articles of association to restrict the transfer of shares (Commercial Code, Art. 348, Special Resolutions), which were touched on by the Court in *Nireco*, guarantee a buyout to any shareholder who opposes such change. (Commercial Code, Art. 349). Even if we acknowledge that a poison pill must be approved by a resolution at the general shareholder meeting, there are still other important factors that have yet to be clarified, such as the actual form of any such decision and whether and to what extent minority rights and interests shall be secured.^{40 41}

³⁸ The need to protect minority shareholder rights is becoming less apparent in part due to recent revisions in the Commercial Code, including the reduction of the percentage of outstanding shares required in order for a shareholder to exercise a right to inspect the company’s books from ten to three percent.

³⁹ Should it really be possible for a poison pill, even one that poses serious consequences for share value such as the *Nireco* poison pill, to be absolved of its problems simply because it has been approved by shareholders?

⁴⁰ From the perspective of the separation of ownership and control, the resolution of the general shareholder meeting to adopt a poison pill should be an ordinary resolution, the same as would be required

While it is acceptable to view the resolution of the general shareholder meeting as a necessary condition to successfully adopt a poison pill, it is important to realize that there are lingering doubts as to whether that alone will ultimately be regarded as sufficient.⁴²

8. EPILOGUE

It would be completely natural to regard the Nireco poison pill as a failure if one were to focus upon the final result in the courtroom. However, when viewed within the larger transition occurring within Japanese corporate governance, the Nireco poison pill also could be interpreted as a bold maneuver by a Japanese firm prompted by sheer necessity. And at some point in the future, it will probably be regarded as fulfilling a necessary role in the development of corporate defense measures for the practical lessons gleaned from the ensuing litigation.

What is essential now is that all of the parties with a stake in the matter, including law practitioners and scholars, determine how these practical lessons can be applied in order to support the future development of healthy corporations and a strong economic structure.

(June 12, 2005)

<Supplementary Note>

On June 15, 2005 the Tokyo High Court dismissed Nireco's final appeal (See the SFP Value Realization Master Fund, Ltd. v. Nireco K.K., 1735 Shōji Hōmu 48 (Tōkyō D.Ct., June 15, 2005)). While the decision did

for the election of board members. (Under current law, removing a member of the board requires a special resolution, but under a proposed corporate law bill, agreement by a principle majority would suffice.)

Now what would happen when a proposal requiring a special resolution is agreed to by a majority of the voters, but does not receive the particular number of votes necessary for a special resolution? Can the board of directors establish requirements for the passage of shareholder proposals that are not based upon law or interpretations of law? Can the board of directors disregard the wishes of a majority of the shareholders? Since the board's consideration of shareholder proposals is discretionary in the first place, would the board's decision to ignore a majority also be within that scope of discretion? Would this change if the shareholder's intentions have clearly become known to the board?

⁴¹ Insofar as the "trust model" is structured upon granting stock purchase warrants to a third party either gratuitously or for a minimal price, it would seem as though the procedures for favorable issuances to particular parties would be the appropriate method for its enactment. However, since the stock purchase warrants are scheduled to vest with shareholders of record as of a certain date, they are considered to be granted based upon current shareholder status. From a practical standpoint, these stock purchase warrants cannot be regarded as having been issued under emergency conditions, and therefore, there is no basis for requiring a special resolution.

⁴² *Translator's Note:* This is the view of the District Court in Nireco. The view of the High Court in Nireco is somewhat vague, but may be different. The authors are silent on this point.

not make particular mention of issues relating to general shareholder approval or prevention against arbitrary judgments by the board of directors, it did attach importance to the fact that the poison pill at issue potentially caused excessive property harm to shareholders other than the hostile bidder.⁴³

⁴³ *Translator's Note:* According to the authors, with respect to the reasoning offered by the District Court, the High Court emphasized the share valuation problems and appeared rather critical toward the rest, which is an important indicator of which direction future case law may take.