



Case Study: Sumitomo Trust vs. Mitsubishi & UFJ

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The merger of UFJ Group (UFJ) with Tokyo-Mitsubishi Financial Group (Mitsubishi) was influential to M&A legal practice in Japan because of litigation arising from UFJ's unilateral withdrawal from its preceding business merger negotiations with Sumitomo Trust & Banking. (Sumitomo).

Sumitomo's reaction to UFJ's unilateral withdrawal and to the subsequent creation of Mitsubishi UFJ Financial Group forced the Japanese courts to consider the nature of pre-merger agreements, such as commitments under a letter of intent (LOI) or memorandum of understanding (MOU). The basic agreement (the Agreement) between UFJ and Sumitomo included an exclusive negotiation obligation and a faithful consultation obligation. UFJ's exclusive negotiation obligation required that UFJ not enter into negotiations with a third party that would possibly conflict with the proposed transaction with Sumitomo. However, no penalty clause was included in the Agreement. It also did not include any specific commitment to enter into a final merger agreement.

Provisional injunction

Upon UFJ's termination of negotiations with Sumitomo, the latter filed an application for a provisional injunction with the Tokyo District Court in order to stop consultations with any third parties with respect to UFJ's merger transactions on its trust business until the end of March 2006. The District Court ruled for Sumitomo and ordered the injunction. UFJ appealed and the case eventually went to the Supreme Court of Japan. The Supreme Court held that although UFJ's exclusive negotiation and faithful consultation obligation had not yet expired, there was no necessity to avoid special damage or urgent danger to Sumitomo, which is a requirement for a provisional injunction to be granted. The Supreme Court held that Sumitomo's damages were not large enough that they could not be compensated for later and that the long injunction period could lead to damages to UFJ whereas the possibility of reaching a final agreement with Sumitomo was remote.

Claiming damages

After filing a formal lawsuit seeking an injunction in the Tokyo District Court, Sumitomo added a claim for expected damages of ¥100 billion (US\$870 million), arguing that such damages were caused by UFJ's breach of its exclusive negotiation and faithful consultation obligation. On February 13 2006, the Tokyo District rejected this claim, as the agreement did not include a binding commitment to enter into a final agreement and, as such, causation between UFJ's breach and the profit that would have possibly been obtained as a result of Sumitomo's takeover of UFJ's trust banking business was not found.

However, the court did state that UFJ was clearly liable for its failure to perform its exclusive negotiation and faithful consultation obligation. As Sumitomo did not make a claim for any other damages, such as its costs for reliance on the exclusive negotiation obligation, the Tokyo District Court did not award any damages. Sumitomo appealed this judgement. At the time of writing, the case was still pending.

Practical implications

This case demonstrates the need for careful consideration of exclusive negotiation provisions. Based upon the rights arising from such obligations, parties conduct due diligence and take other costly steps toward mergers. It is important to stipulate the content of such rights clearly, including duration, whether an injunction would be obtainable, conditions whereupon a party could unilaterally withdraw from consultations, and penalty clauses or amounts of break-up fees payable by the party that withdraws. On the other hand, it is also necessary to consider the problem from the viewpoint of the fiduciary duties of directors, particularly with regard to the seller because a strong exclusive negotiation provision could restrict the seller's choice of potential buyers, which could make lucrative offers to the shareholders of the seller.

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