The Japanese government announces a guideline for good practice in management buyouts

By Noritaka Niwano

Recently, the number of tender offers in the course of so-called management buyouts (defined as a buyout by management, a buyout by an investor that is asked by the management to do so, or a buyout in which the management is participating) is increasing in Japan.

In management buyout (MBO) transactions, there would inevitably be potential conflicts of interest between the management conducting or participating in the tender offer on the one hand, and the target company (or, ultimately, its shareholders as a whole) on the other hand, because the target company (the board of directors) is required by law to announce its opinion on the tender offer, that is by supporting, disagreeing, being neutral, or withholding to express its opinion.

However, except for certain disclosure requirements under the securities law and the stock exchange rules, there used not to be any framework from the viewpoint of corporate governance in the process of determining such opinion. Under Japanese corporation law, directors are generally subject to a fiduciary duty and a duty of care as good manager and should, in determining the company's attitude toward the tender offer, behave in the interest of all shareholders and the company as a whole. At the very least, the interested directors should be excluded from the final vote, but there is no other clear requirement under the law. Under Japanese law, it is not generally recognized that directors and/or officers of the target company (excluding the interested directors and officers) are legally required to actively negotiate with the party offering a tender to obtain a higher offer price or seek other opportunities (for example another potential party making a tender at a higher price).

On September 4 2007, the Ministry of Economy, Trade and Industry of Japan (METI) announced a guideline for MBOs in order to increase corporate value and secure fair process. The guideline is not intended to be a promulgation of regulations in a legal sense, but rather it clarifies best practices in MBO transactions. In terms of the decision-making process, in order to avoid conflict of interests, the guideline suggests that the target company take one or more of the following measures in order to establish transparency and fairness in the MBO transaction:

(i) Consult with an advisory board consisting of outside directors (and/or independent third party members), and respect such opinion of the advisory board;

(ii) Require unanimous approval by directors and corporate auditors (excluding interested directors);

(iii) Engage independent counsel or an adviser for the target company; and/or

(iv) Obtain a third-party valuation of the target company.

After the METI announcement, more and more companies involved in MBO have come to follow the suggested measures and disclose the details thereof in their press releases.

The guideline also suggests, in light of securing appropriate opportunities of other or better deals, that the tender offer period for MBO transaction should be set relatively longer, and that the target company should not enter into an MBO agreement which imposes on the target company too much restriction by prohibiting any contact with a competing bidder if it actually arises.

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