

THE SHAREHOLDER
RIGHTS AND
ACTIVISM REVIEW

FIFTH EDITION

Editor
Francis J Aquila

THE LAWREVIEWS

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ACTIVISM REVIEW

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PREFACE

In the years since the last financial crisis, shareholder activism has been on the rise around the world. Institutional shareholders are taking a broad range of actions to leverage their ownership position to influence public company behaviour. Activist investors often advocate for changes to the company, such as its corporate governance practices, financial decisions and strategic direction. Shareholder activism comes in many forms, from privately engaging in a dialogue with a company on certain issues, to waging a contest to replace members of a company's board of directors, to publicly agitating for a company to undergo a fundamental transaction.

Although the types of activists and forms of activism may vary, there is no question that shareholder activism is a prominent, and likely permanent, feature of the corporate landscape. Boards of directors, management and the markets are now more attuned to and prepared for shareholder activism, and engaging with investors is a priority for boards and management as a hallmark of basic good governance.

Shareholder activism is a global phenomenon that is effecting change to the corporate landscape and grabbing headlines not only in North America but also in Europe, Australia and Asia. Although shareholder activism is still most prevalent in North America, and particularly in the United States, activism campaigns directed at non-US companies continue to make up a large share of global activism. This movement is being driven by, among other things, a search by hedge funds for new investment opportunities and a cultural shift towards increased shareholder engagement in Europe, Australia and Asia.

The outbreak of the covid-19 pandemic in early 2020 caused an unprecedented economic crisis that has further heightened focus on corporate governance. The crisis has significantly tested companies' oversight, coordination and leadership capabilities to manage a fluid and complex situation impacting companies' business, operations, prospects, employees, stockholders, other stakeholders and government relationships – and activists have been paying attention. Although the covid-19 pandemic has decreased activist campaign activity in the short-term, practitioners generally expect to see activism activity return with full force in the next year. Furthermore, activists are likely to incorporate critique over a company's pandemic response into their campaign thesis.

As both shareholder activists and the companies they target have become more geographically diverse, it is increasingly important for legal and corporate practitioners to understand the legal framework and emerging trends of shareholder activism in the various international jurisdictions facing activism. *The Shareholder Rights and Activism Review* is designed as a primer on these aspects of shareholder activism in such jurisdictions.

My sincere thanks to all of the authors who contributed their expertise, time and labour to this fifth edition of *The Shareholder Rights and Activism Review*. As shareholder activism

continues to diversify and increase its global footprint, this review will continue to serve as an invaluable resource for legal and corporate practitioners worldwide.

Francis J Aquila

Sullivan & Cromwell LLP

New York

August 2020

JAPAN

*Akira Matsushita*¹

I OVERVIEW

In recent years, the corporate governance of listed companies in Japan has gradually changed for various reasons. Japan's Corporate Governance Code (the Governance Code), issued in June 2015, and Japan's Stewardship Code (the Stewardship Code), issued in February 2014, have worked as 'the two wheels of a cart' to promote and achieve effective corporate governance. The management of listed companies in Japan is also experiencing changes because the ownership of shares in listed companies in Japan by institutional investors has increased in comparison with the ownership of such shares by individual shareholders, which has decreased. Under such circumstances, shareholder activism in Japan has grown in recent years. As a result, the management of listed companies in Japan needs to consider the possibilities and effects of shareholder activism when managing these companies.

This chapter discusses details of shareholder rights and shareholder activism with respect to a stock company that has shares listed on a financial instruments exchange.

II LEGAL AND REGULATORY FRAMEWORK

i Shareholder rights

In Japan, rights of shareholders are provided under the Companies Act (Act No. 86 of 26 July 2005). Outlines of the shareholder rights that may typically be exercised by shareholders in the context of shareholder activism, among others, are set out below.²

Inspection rights

Shareholders have the right to request a company to provide relevant access for them to inspect or copy the shareholder registry, with certain exceptions.³ This request right enables activist shareholders to access information on other shareholders in the company when waging a proxy fight.

Shareholders also have the right to request a company to provide relevant access for them to inspect or copy minutes of board of directors' meetings by obtaining the permission of the court if such access is necessary to exercise the rights of such shareholders.⁴ Shareholders

1 Akira Matsushita is a partner at Mori Hamada & Matsumoto.

2 The numerical requirements under the Companies Act that are described below may be changed by a company by setting out the changed numerical requirements in the company's articles of incorporation.

3 Article 125(2–3) of the Companies Act.

4 Article 371(2) of the Companies Act.

having 3 per cent or more of the votes of all shareholders or shareholders having 3 per cent or more of outstanding shares have the right to request the company to provide relevant access for them to inspect or copy accounting books, with certain exceptions.⁵ Activist shareholders may gather information by utilising these inspection rights for use in gaining leverage against or exerting pressure on the management of the company.

Shareholder proposals

The Companies Act provides shareholder proposal rights that are quite favourable to shareholders. A shareholder of a listed company who owns, consecutively for the preceding six months or more, at least 1 per cent of the voting rights of all shareholders in the company or at least 300 votes of the voting rights of all shareholders in the company may demand directors of the company to present proposals submitted by the shareholder, as an agenda at the shareholders' meeting, and demand the directors to describe the summary of the proposals in convocation notices of the shareholders' meeting by submitting the demand to the directors no later than eight weeks prior to the day of the shareholders' meeting.⁶ Additionally, a shareholder attending the shareholders' meeting may submit proposals at the meeting with respect to the matters that are within the purpose of the shareholders' meeting.⁷

In this way, a shareholder who submits proposals to the company can deliver the proposals to the other shareholders at the company's expense, and cause the other shareholders to vote on the shareholder proposals using the voting card mailed by the company without such shareholder conducting a proxy solicitation by itself at its expense.

Under the current Companies Act, the number of proposals that an eligible shareholder can submit to the company is unlimited. In response to recent cases of abusive exercises by shareholders of such shareholder proposal right, the Diet in December 2019 approved an amendment to the Companies Act to limit to 10 the number of proposals that each shareholder can demand the directors to provide summaries thereof, in the convocation notice of the shareholders' meeting. The amendment is expected to become effective in early 2021.

Calling of a shareholders' meeting

A shareholder of a listed company who owns, consecutively for the preceding six months or more, at least 3 per cent of the voting rights of all shareholders in the company may demand the directors of the company to call a shareholders' meeting regarding any matter that the shareholder calling the meeting is entitled to vote on. If the calling procedure is not effected without delay after the demand, or the notice calling the shareholders' meeting designating the date of the shareholders' meeting to fall within eight weeks of the date of the demand is not dispatched, the shareholder who made the demand may call the shareholders' meeting by itself with the permission of the court.⁸

5 Article 433 of the Companies Act.

6 Articles 303 and 305 of the Companies Act.

7 Article 304 of the Companies Act.

8 Article 297 of the Companies Act.

Enjoinment of acts of directors

If a director of a company engages, or is likely to engage, in any act in violation of laws and regulations or the articles of incorporation, and if the act is likely to cause irreparable damage to the company, a shareholder who owns any share in the company consecutively for the preceding six months or more may enjoin the director's act, usually by obtaining an order of provisional disposition from the court.⁹ Violations of a director's duties of care and loyalty may constitute a violation of such laws and regulations.

Derivative actions and direct claims

A shareholder who owns any share in the company consecutively for the preceding six months or more may demand that the company file an action to recover for damages and liabilities caused by its directors due to their violation of their duty of care and loyalty, and if the company does not file the action within 60 days of the date of the demand, the shareholder may file a derivative action on behalf of the company.¹⁰

If directors have acted in bad faith or with gross negligence in the performance of their duties, such directors are jointly and severally liable for damages suffered by any third party arising as a result of such performance of their duties;¹¹ and shareholders may be eligible to directly claim damages from the directors pursuant to such provision.

Appraisal rights

Shareholders who object to certain agenda items at the shareholders' meeting, such as a merger, certain consolidation of shares or certain amendments to the articles of incorporation that may be related to a transaction to squeeze out minority shareholders from the company, may demand that the company purchase their shares in the company at a fair price. If dissenting shareholders and the company cannot reach agreement on the price of the shares within a certain period, the dissenting shareholders or the company may file a petition to the court for a determination of the price.

ii Regulations relating to shareholder activism

Large-scale shareholding report

A shareholder is generally required to file a large-scale shareholding report with the relevant local finance bureau within five business days of the shareholder's shareholding ratio in a listed company exceeding 5 per cent under Article 27-23 of the Financial Instruments and Exchange Act (FIEA) (Act No. 25 of 13 April 1948). The shareholding ratio is calculated by aggregating shares held by the shareholder with any other shareholders with whom the shareholder has agreed to jointly acquire or transfer shares in the company, or to jointly exercise the voting rights or other rights as shareholders of the company (joint holders). After filing the report, if the shareholding ratio increases or decreases by 1 per cent or more, an amendment to the report must be filed within five business days of the date of the increase or decrease. Certain financial institutions that do not intend to take actions to materially influence the business activities of the company are required to file the report only twice a month.

9 Article 360 of the Companies Act.

10 Article 847 of the Companies Act.

11 Article 429 of the Companies Act.

The Financial Services Agency (FSA) expressed its position that if different shareholders communicate to each other their plans to exercise their voting rights in a certain manner and their plans happen to be the same, this does not cause the shareholders to be deemed as joint holders because an 'agreement' means an undertaking to act (whether in writing or orally, and explicitly or implicitly) rather than the mere exchange of opinions.¹² Therefore, activist shareholders may not be required to file a large-scale shareholding report as joint holders even if they communicate with each other privately and act in the same manner without explicit agreement.

Under the FIEA, rights to request delivery of shares under a sales and purchase contract, as well as options to purchase shares and borrow shares, are subject to the large-scale shareholding reporting obligations. However, the holding of equity derivatives that are cash-settled and that do not involve the transfer of the right to acquire shares would likely not trigger the reporting obligations. The FSA released guidelines that provide that derivatives that transfer only economic profit and loss in relation to target shares, such as total return swaps, are generally not subject to the disclosure obligations, provided that holding such cash-settled equity derivatives may trigger such obligations if a holder purchases long positions on the assumption that a dealer will acquire and hold matched shares to hedge its exposure.¹³

Proxy regulations

Any person who intends to solicit a proxy with respect to shares in a listed company shall deliver a proxy form and reference documents containing the information specified in the Cabinet Office Ordinance to the person solicited.¹⁴ However, a solicitation of a proxy with respect to shares in a listed company that is made by persons other than the company or its officers, including the directors and the executive officers, and in which the solicited persons are fewer than 10 is exempt from the proxy regulations.

When a solicitor has delivered the proxy form and reference documents to the solicited persons, the solicitor shall immediately submit a copy of the documents to the relevant local finance bureau, provided that if the reference documents and form of voting card are delivered by the company to all of the shareholders of the company who are entitled to vote with respect to the relevant shareholders' meeting pursuant to the Companies Act, the solicitor does not have to submit those documents to the relevant local finance bureau. No solicitor may make a solicitation of a proxy by using a proxy form, reference documents or any other documents, or an electromagnetic record, in each case that contains false statements or records on important matters, or that lacks a statement or record on important matters that should be stated, or a material fact that is necessary to avoid a misunderstanding.

12 FSA, Clarification of Legal Issues Related to the Development of the Japan's Stewardship Code, 26 February 2014, at 11.

13 FSA, Q&A Regarding Large Scale Shareholding Report of Share Certificates, etc., 31 March 2010, at 10.

14 Article 194 of the FIEA and Article 36-2 of the Order for Enforcement of the Financial Instruments and Exchange Act (Cabinet Order No. 321 of 30 September 1965).

iii The Governance Code and the Stewardship Code

The Governance Code has had a major effect on the corporate governance of listed companies in Japan since its release in June 2015. The Governance Code does not adopt a rule-based approach, rather, it adopts a principle-based approach that is not legally binding on companies with a ‘comply or explain’ approach (i.e., either comply with a principle or, if not, explain the reasons why the company is not complying with the principle).

The Governance Code provides that companies should, positively and to the extent reasonable, respond to requests from shareholders to engage in dialogue, and the board of directors should establish, approve and disclose policies relating to measures and organisational structures that aim to promote constructive dialogue with shareholders. Specifically, the senior management or directors, including outside directors, are expected to be more directly involved in dialogue with shareholders. Furthermore, although listed companies cannot accurately know their substantive shareholder ownership structure without conducting shareholder identification searches owing to indirect shareholding – such as shareholding through trusts or custodians – the Governance Code provides that companies should endeavour to identify their shareholder ownership structure as necessary to promote constructive dialogue with their shareholders.

The Governance Code was amended on 1 June 2018. The amended Governance Code expressly provides that companies should disclose their policies regarding the reduction of cross-shareholdings. It also provides that the board should annually assess whether to hold each individual cross-shareholding, specifically examining whether the purpose is appropriate and whether the benefits and risks from each holding cover the company’s cost of capital.

The Stewardship Code, as amended on 29 May 2017, provides that institutional investors should disclose their voting records for each of its investee companies on an individual agenda item basis to enhance visibility of the consistency of the voting activities of institutional investors with their stewardship policies. This amendment seems to have affected the voting behaviour of institutional investors and, consequently, supportive votes for listed companies seem to have decreased. The amended Stewardship Code also provides that in addition to institutional investors engaging with investee companies independently, it would be beneficial for the institutional investors to engage with investee companies in collaboration with other institutional investors (collective engagement) as necessary.

The Stewardship Code was further amended on 24 March 2020 to enhance qualities of services provided by proxy advisers to institutional investors by addressing concerns about proxy advisers’ conflicts of interests and the appropriateness of their recommendations.

iv Rules for directors

Directors facing shareholder activism must abide by their duties of care and loyalty, and treat all shareholders equally under the Companies Act.

Settlement agreements

Settlement agreements with activist shareholders, which may include agreements regarding agenda items of shareholders’ meetings, the exercise of voting rights and restraint in acquiring additional shares in the company (a standstill agreement), have not often been entered into between activist shareholders and listed companies in Japan. However, management of companies may more frequently consider entering into such settlement agreements in

the near future because the mindset of management towards shareholder activism has been gradually shifting to more constructive engagement with activist shareholders, due to the corporate governance reform and the growth of influence of activist shareholders in Japan.

Since the Companies Act prohibits a company from giving any property benefits to any person in connection with the exercise of shareholder rights, including voting rights,¹⁵ the company generally cannot agree to reimburse any costs incurred by activist shareholders from their shareholder activism campaigns in connection with their entering into any voting agreement.

Takeover defence measures

The board of directors of a company may adopt takeover defence measures to deter the building of a large stake in the company by activist shareholders. Most common takeover defence measures adopted by Japanese listed companies are the ‘advance warning’ type of defence measures. Under such defence measures, a company establishes rules that must be followed by any potential acquirer who intends to acquire more than a certain level of shares (typically, 20 per cent) in the company, and the company publicly announces the rules before an acquirer actually emerges. No rights or stock options are issued upon the adoption of such rules. If an acquirer violates the rules, or an acquisition is considered to be harmful to the corporate value of the company or the common interest of the shareholders of the company, the company would allot stock options to all shareholders without contribution that are only exercisable by, or callable for new shares by the company from, those shareholders other than the acquirer.

The number of takeover defence measures adopted by listed companies has decreased in recent years due to opposition by institutional investors (whereas 567 listed companies had adopted such measures as at 2009, 329 listed companies had adopted such measures as at July 2019).¹⁶

III KEY TRENDS IN SHAREHOLDER ACTIVISM

i Profile of activist shareholders

Activist shareholders who engage in shareholder activism are mainly domestic and global hedge funds, and individual investors. In particular, in recent years, more prominent foreign activist funds that manage a large amount of assets have invested in the Japanese market. Additionally, institutional investors that have not been recognised as activist shareholders have tended in the past few years to become more aggressive in making demands on the management of companies that are similar to those typically made by activist shareholders to management.

15 Articles 120 and 970 of the Companies Act.

16 Miki Mogi and Koji Tanino, ‘Introduction situation of countermeasures to hostile takeovers and trend of activist shareholders: based on shareholders’ meetings held in June 2019’, *Shoji-homu* No. 2212, at 33 (2019).

ii Types of companies targeted by activist shareholders

Activist shareholders have targeted companies of different sizes and in all types of industries. In particular, activist shareholders are more likely to target companies that own a large amount of surplus cash or other assets, have a low return on equity (ROE) or have share prices that are undervalued by the market. In the past, activist shareholders often focused on building large stakes in small- or medium-cap companies to apply pressure on the managements of those companies. In recent years, activist shareholders have also been targeting large prominent companies, including companies with market capitalisation of over US\$50 billion. Another source of targets for activist shareholders is listed companies that have a parent company or a controlling shareholder, and in which there is a structural conflict of interest between the controlling shareholder and minority shareholders.

iii Objectives of shareholder activism

The most common objective of shareholder activism in Japan is to improve capital efficiency of Japanese companies. While ROEs of many Japanese companies are low compared with the average ROEs of US companies, the management of listed companies has become more conscious of a company's capital efficiency in recent years due to the corporate governance reform. Activist shareholders usually demand that Japanese companies conduct a buy-back of their shares or increase the amount of dividends to improve their ROEs. Activist shareholders also urge companies to carve out their non-profitable businesses¹⁷ and sell their assets that are not utilised or not related to their primary business, including cross-holding shares. A lot of activist shareholders tend to take these actions to gain returns on their investments in the short term.

Proposals for companies by activist shareholders to conduct potential mergers and acquisitions (M&A) transactions with another company or to undertake changes in business strategies are becoming common in Japan. Also, activist shareholders often demand that management conduct a strategic review of the company's businesses and business plans by retaining an outside consulting firm. Some activist hedge funds, if they consider that a company is not adequately responsive to their demands, may push the company to elect a person recommended by the hedge funds to serve as a director on the company's board of directors. This person would often be a manager or partner of the hedge funds, a person who has experience in the management of other companies in the industry to which the company belongs, or a person who has expertise in capital allocation or restructuring.

Improving corporate governance is also a common objective of shareholder activism. Although the corporate governance of many listed companies has changed as a result of the application of the Governance Code – which, for example, recommends that listed companies appoint at least two independent directors – activist shareholders have continued to advocate for changes in the corporate governance of companies such as with respect to increasing the number of independent directors and adopting stock price-linked remuneration of directors.

Furthermore, activist shareholders often bring attention in their campaigns to incidents and actions in which directors are not abiding by their duties of care and loyalty. For instance,

17 As a result of the tax reform in 2017, the deferral of taxation arising from certain spin-off transactions, in which a part of the company's business is carved out and shares in the business are distributed to its shareholders through dividends in kind, is permitted.

as activist shareholders often acquire large amounts of shares in companies that have a controlling shareholder, the activist shareholders speak against transactions that may involve conflicts of interest between the controlling shareholder and minority shareholders.

Activist shareholders are also engaging in shareholder activism with respect to announced M&A transactions, including mergers, share exchanges or tender offers, in which the support of a certain number of shareholders is necessary to successfully complete such transactions (bumpitragé). Activist shareholders demand that the company amend certain terms that are, in their view, inappropriate, such as purchase price. These cases often occur in transactions involving conflicts of interests between a controlling shareholder and minority shareholders. This M&A activism may result in a change in the acquisition structure or increase of acquisition costs for the transaction. Some activist shareholders also exercise, after completion of the transaction, their appraisal rights as dissenting shareholders, and file a petition to the court for a determination of the fair price for the relevant shares.

There are also activist shareholders who take actions mainly in consideration of social issues, which is different from the more common type of shareholder activism that focuses on increasing shareholder value of the company. For example, shareholder proposals concerning nuclear power generation have been submitted to electric power companies.

iv Tactics used by activist shareholders

Non-public engagements

An activist shareholder typically initiates contact with the company in which it has acquired shares by sending a letter to the company describing its demands, after which the shareholder and company engage in private communications. An activist shareholder usually requests quarterly or biannual meetings with the management of the company. Some activist shareholders try to resolve issues of the company by proposing alternatives or solutions, or providing advice in a friendly manner, and are reluctant to make their engagements with the company public.

Public campaigns

If activist shareholders decide that they cannot achieve their objectives through non-public engagements with the company, they may wage public campaigns with the aim of attracting the support of other shareholders for their objectives. Elements of public campaigns include the following:

- a* issuing press releases;
- b* posting white papers or relevant information on websites prepared by the activist shareholders for the campaigns;
- c* placing web advertisements;
- d* disseminating letters to shareholders;
- e* providing information through the media; and
- f* holding information sessions for other shareholders.

Given that the support of public opinion, especially institutional investors, is important in the public campaigns, the tools used by activist shareholders to conduct public campaigns are becoming more sophisticated as ways to deliver information to the public have become more diverse. If the company and the activist shareholder reach agreement prior to the submission of a shareholder proposal and commencement of a proxy fight, the activist shareholder can avoid bearing the expenses relating to the proxy fight.

Shareholder proposals and proxy fights

To effect changes in companies, activist shareholders can use the right of shareholder proposals under the Companies Act. Moreover, activist shareholders may conduct proxy solicitation in accordance with the FIEA to obtain votes for the shareholder proposals or votes against agendas proposed by companies that are opposed by the activist shareholders. As explained above, activist shareholders who intend to obtain approval for certain agenda items at the shareholders' meeting do not necessarily have to make a proxy solicitation because they can communicate their proposals and the reasons for these proposals to other shareholders, by having the company dispatch the convocation notice and reference documents that provide summaries of the proposals at the company's expense. However, there are practical advantages for an activist shareholder to engage in proxy solicitation, including:

- a* the submission by shareholders of a voting card to the company that is left blank is generally treated as a vote in favour of the company's proposal and against the shareholders' proposal;
- b* the reason for the shareholder proposal set forth in the company's reference documents is subject to a character count limit set by the company, but there is no such limit in the case of a proxy solicitation; and
- c* a proxy can authorise a procedural motion at a shareholders' meeting.

If an activist shareholder conducts the proxy solicitation to garner support for its cause, it often approaches and tries to persuade proxy advisers, such as Institutional Shareholder Services, Inc (ISS), and Glass, Lewis & Co. Foreign institutional investors tend to refer to recommendations by the proxy advisers whereas Japanese institutional investors tend to vote according to their internal voting policies. The proxy advisers often recommend that investors vote against proposals made by the board of directors and that they should vote for shareholder proposals. In such cases, companies should promptly issue press releases stating their objections against recommendations by the proxy advisers.

Empty voting and morphable ownership

Empty voting (i.e., votes by shareholders who have more voting rights of shares than economic ownership in the shares because the shareholders own voting rights of shares that are decoupled from the economic ownership of the shares) may be used by activist shareholders. Empty voting may be implemented by, among other means, equity swaps or record date capture by borrowing shares. Empty voting deviates from the principle of one-share-one-vote in stock companies, and may result in resolutions of shareholders' meetings that are not properly aligned with the interests of the company or its shareholders as a whole because empty voters' voting rights in the company are not in proportion to their economic interests in the company. Thus far, there has been no reported case in Japan in which a grossly improper resolution was made or a proper agenda item was voted down at a shareholders' meeting as a result of empty voting.

As a related issue, an activist shareholder may substantively own shares in the company without disclosure by using equity derivatives. Given that dealers that sell equity derivatives usually purchase matched shares in practice to hedge their risks involved in the equity derivatives, activist shareholders, when necessary, may have the ability to terminate the equity derivatives and purchase the matched shares held by the dealers (morphable ownership).

Activist shareholders may suddenly emerge in this way as shareholders owning a large amount of the shares without giving the company adequate time to prepare for the shareholder activism.

Litigation

Activist shareholders sometimes engage in litigation as a tactic of shareholder activism, such as seeking an order of provisional disposition for enjoinder of directors' actions and bringing a derivative action against directors of the company to recover for damages and liabilities caused by such directors. Activist shareholders often place pressure on the directors by expressing their willingness to bring actions to the courts to achieve their goals.

Hostile takeovers

The most aggressive approach of shareholder activism is a hostile takeover, which is an acquisition of shares in a company by an activist shareholder without the consent of the management of the company through on-market transactions or tender offers. Historically, a limited number of hostile takeovers have been successfully consummated in Japan partly because there have been stable shareholders in the companies subjected to such takeovers; however, in the past few years, a number of hostile takeovers have gradually increased.

IV RECENT SHAREHOLDER ACTIVISM CAMPAIGNS

i Campaigns against large-cap companies

Activist shareholders have recently targeted large-cap companies in Japan. One of the most well-known activist hedge funds in the United States, Third Point, proposed Sony Corporation (Sony) to spin-off its entertainment business in 2013 and to spin-off its semiconductors business in 2019; however, in these cases, Sony refused to carry out the proposals. The press has reported that another well-known activist hedge fund in the United States, Elliott Management (Elliott), urged SoftBank Group Corp. (Softbank Group) to buy back its shares in 2020, and after the demand, SoftBank Group announced a plan for the repurchase of up to JPY 2 trillion of its shares.

ii Nomination of directors

In the past few years, there have been a number of cases of companies accepting the elections of directors recommended by activist shareholders. For example, in 2019, Olympus Corporation nominated a partner of ValueAct, the US-based activist fund, as a director, and Kawasaki Kisen Kaisha, Ltd nominated a director of Effissimo Capital Management (Effissimo), a Singapore-based activist fund, as a director. Toshiba Corporation (Toshiba) disclosed in 2019 that it engaged in discussions with its major shareholders, including activist shareholders, in the course of its determination of the company's director candidates.

Reno, Inc (Reno) (which is considered to have some connection with the former well-known Japanese activist fund Murakami Fund and owned approximately 35 per cent of the shares in Kuroda Electric Co, Ltd (Kuroda Electric) with Reno's joint holders) submitted a shareholder proposal to elect an outside director designated by Reno for the annual shareholders' meeting of Kuroda Electric in June 2017, which was approved at the shareholders' meeting. In April 2020, a Hong Kong-based activist fund, Oasis Management Company Ltd (Oasis), which owned approximately 9 per cent of Suncorporation, submitted

shareholder proposals to the company to dismiss the company's executive directors and elect directors designated by Oasis. The shareholder proposals were approved at an extraordinary shareholders meeting with approximately 70 per cent of shareholders providing affirmative votes. These examples suggest that shareholders in Japan are becoming comfortable with, and supportive of, shareholder activism.

iii Litigation

Effissimo has acquired shares in a number of listed companies that have a parent company. Effissimo, which owned approximately 30 per cent of the shares in car manufacturer Nissan Shatai Co, Ltd (Nissan Shatai), brought a derivative action to recover damages caused by directors of the car manufacturer and sought an injunction in court against certain acts of the directors on the grounds that the directors were violating their duties of care and loyalty. The fund Effissimo claimed that the directors were violating their duties because Nissan Shatai deposited a large amount of cash bearing a low interest rate in a subsidiary of Nissan Motor Co, Ltd (Nissan), which is a parent company of Nissan Shatai, the directors were causing the company to participate in the cash management system of the Nissan group without reasonable reasons, and the directors did not manage the cash of Nissan Shatai efficiently. Yokohama District Court dismissed the case in favour of the directors in February 2012.¹⁸ According to news reports, Oasis filed a provisional injunction against the directors of Toshiba Plant Systems & Services Corporation (Toshiba Plant Systems) with the Yokohama District Court in March 2017 to prevent it from depositing funds with the parent company, Toshiba. As a result, Toshiba Plant Systems withdrew the deposit amount, which was, as at 31 March 2016, approximately US\$760 million, from Toshiba. These cases indicate that activist shareholders are willing to engage in court and litigation procedures to accomplish their goals.

iv M&A activism

Oasis waged a public campaign in 2016–2017 against the acquisition by Panasonic Corporation (Panasonic) of its listed subsidiary, PanaHome Corporation (PanaHome), by asserting that the consideration to be paid was lower than the fair value of the shares in PanaHome. Panasonic changed the structure of the acquisition from a share consideration transaction through a share exchange to a cash consideration transaction through a tender offer after Oasis commenced the public campaign. Oasis also waged a public campaign in 2017–2018 against the integration of a business through a share exchange in which Alps Electric Co, Ltd (Alps Electric) would acquire all the shares in its listed subsidiary, Alpine Electronics Inc (Alpine). In this case, Elliott also purchased approximately 9.8 per cent of the shares in Alpine as well as approximately 11.2 per cent of the shares in Alps Electric after the public announcement of the share exchange. Oasis filed a suit in court after the completion of the transaction asserting that the share exchange was invalid; the suit is still pending in court.

Elliott purchased shares in Hitachi Kokusai Electric Inc (Hitachi Kokusai) representing approximately 8.6 per cent of the issued shares of the company in 2017 after the public announcement by KKR of a tender offer for the shares in Hitachi Kokusai. KKR eventually increased the tender offer price by approximately 25 per cent to facilitate the success of

18 Yokohama District Court, judgment, 28 February 2012, not cited in digests.

the tender offer transaction. Reno launched a tender offer for shares in Kosaido Co Ltd (Kosaido) after a management buyout by the management of Kosaido, sponsored by Bain Capital through a tender offer that was commenced in 2019. As a result, although Bain Capital increased its tender offer price, the tender offers of both Bain Capital and Reno ultimately failed.

V REGULATORY DEVELOPMENTS

The FIEA was amended on 1 April 2018. This amendment provides a fair disclosure rule pursuant to which if a listed company transfers a certain amount of its unpublicised material information to certain persons, including certain investors, the company must disclose the information to the public at the same time. Listed companies need to take into account this fair disclosure rule as well as the insider trading rules under the FIEA when they communicate with activist shareholders and other institutional investors.

As the reduction of cross-shareholdings has been moving forward, as encouraged in the amended Governance Code, the Cabinet Office Ordinance on Disclosure of Corporate Affairs (Ordinance of the Ministry of Finance No. 5 of 30 January 1973) was amended in January 2019 to require companies to disclose in their annual securities report more detailed information concerning cross-shareholdings, including the number of increased or decreased shares, the purchase prices thereof and the reasons for any increase.

Under the Foreign Exchange and Foreign Trade Act (FEFTA), when foreign investors acquire certain amounts of shares or voting rights in companies that engage in certain restricted businesses that relate to the national security of Japan, such investors are required to file a prior notification to, and undergo examination by, the competent ministers. In line with the global trend of tightening foreign investment regulations, the FEFTA was amended in 2020 to lower the threshold for the prior notification requirement for acquisition of shares or voting rights of a listed company from 10 per cent to 1 per cent. The amendment also established exemptions from such prior notification requirements for investments that satisfy certain requirements to be considered a passive investment; such requirements include the investors or their closely related persons will not become board members of the company, and the investors will not propose at shareholders meetings the transfer or disposition of the company's restricted businesses. Furthermore, the amendment newly introduced prior notification requirements for votes at shareholders meetings by any foreign investor holding 1 per cent or more of shares in a company engaged in any restricted business with respect to the following: nomination by the foreign investor of itself or its closely related person as a board member, and any proposal made by itself to transfer or dispose the company's restricted businesses. While critics have contended the amendment will limit shareholder activism from foreign investors, we need more time to see in practice how strictly the authorities will conduct such examinations of foreign investors' investments to assess the impact of the amendment on shareholder activism.

VI OUTLOOK

The mindset of the management of Japanese listed companies towards shareholder activism has been gradually shifting to more constructive engagement with activist shareholders since the influence of shareholder activism on such companies has increased in the past several years. This trend is expected to continue partly because more cross shareholdings may be

dissolved in light of the Japanese government's policy for the reduction of cross shareholdings. In particular, given that institutional investors have expanded their shares in the Japanese stock market, institutional investors, including those that manage their assets from mid- to long-term perspectives, may have more important roles in situations of shareholder activism and corporate management.

Regarding the short-term outlook, it is not easy to predict the impact of covid-19 on shareholder activism. If the volatility of share prices of Japanese companies continues over a long period, activist shareholders may be able to acquire large amounts of shares at lower prices, and the number of companies that are subject to shareholder activism might increase. Conversely, because many Japanese companies are facing performance difficulties in their businesses due to covid-19, it might become difficult for activist shareholders to gain support for their positions to increase shareholder returns from other shareholders, including the mid- to long-term institutional investors.

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