

# Wolf Pack Activism vs. Poison Pill in Japan



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## A. Introduction: The Shocking Decision in the Mitsuboshi Case

On July 28, 2022, the Japan Supreme Court upheld the decision of the Tokyo High Court to halt the implementation of the shareholders' rights plan (or poison pill) of Mitsuboshi Co., Ltd.<sup>1</sup> (“**Mitsuboshi**”) that was challenged by one of its shareholders, Adage Capital LLP (“**Adage**”). It was the first court case in Japan where a listed company implemented a shareholders' rights plan that targeted a group of activists who, without expressly agreeing to act together, were nonetheless acting in concert, and where one of them sought an injunctive remedy. Thereafter, on September 20, Mitsuboshi announced that all of its incumbent board members would step down and it would hold an extraordinary general shareholders' meeting to elect the new board members nominated by Adage.

Wolf pack activism is not new in the global market. However, the total defeat of Mitsuboshi by Adage and its group shocked many Japanese corporations that have faced a similar threat of shareholder activism, which has notably regained momentum in Japan for the past few years. The decision in the Mitsuboshi case has also prompted a vigorous debate about the vulnerabilities in

the market regulations in Japan, the need for possible improvements to the typical poison pill, and lessons to be learned from Mitsuboshi's fate. This article explores a few aspects of these most recent developments.

## B. Background: Dysfunction of Existing Regulations and Activist-Friendly Conditions

As is common in other developed countries, Japan has mandatory takeover rules. In essence, anyone who aims to acquire more than one-third of the voting rights of a listed company is obligated to initiate a takeover bid. However, this rule only applies to those who purchase stock through off-market trading, thus, a tender offer is not required if the shares are bought on-market. In this era of excessive money supply and overall lower stock prices of Japanese corporations, the skyrocketing stock prices during the course of a massive on-market purchase is no longer enough to prevent a shareholder activist with abundant funds from acquiring more shares.

The inactive enforcement of the large shareholding reporting system is another, and more serious, loophole. The Financial Instruments and Exchange Act<sup>2</sup> provides, in simple terms, that anyone who purchases more than 5%

1. To foreign readers, Mitsuboshi is not the world-famous company, Mitsubishi.

2. Act No. 25 of 1948, as amended.



of the outstanding shares of a listed corporation, on a beneficiary ownership basis, must publicly disclose the transaction within five business days. The Japanese regulator introduced an administrative fine for violating this reporting rule in 2008. Since then, however, only eight individuals and entities have ever been sanctioned. As for criminal liability, which has a history of over half a century, only two cases have ever been prosecuted. This dormant enforcement is believed to be one of the root causes of the widely known non-compliance with the disclosure rule. It is no secret that many investors ignore this reporting obligation or only report the purchase a few years later and often explain that the purpose of the purchase was to make a “net investment” even when their *real* goal was to take control of the target company. In line with this unlawful practice, it seems that in the Mitsuboshi case, some individuals and entities, which Mitsuboshi believed formed a group with Adage, have never reported their purchases until today.

Finally, the Japanese Corporate Governance Code, in harmony with the Stewardship Code, warns that no anti-takeover measures should serve as a means to entrench management. As a result, it is now challenging to introduce a shareholders’ rights plan during peacetime and management is feeling a heavy pressure to abandon existing plans.

Despite all of the difficulties mentioned above, the management of Tokyo Kikai Seisakusho, Ltd. (“TKS”) found a breakthrough in 2021. TKS introduced a shareholders’ rights plan after Asia Development Capital Co. Ltd. (“ADC”) and its subsidiary bought up more than 30% of its shares on-market. Practically, this meant that ADC already had enough power to approve or reject any proposal at a general shareholders’ meeting. The wartime poison pill introduced in TKS was relatively acceptable to the shareholders because they could see a

clear and present threat brought by ADC. The basic scheme was a typical one: (i) when management invokes the plan, share options are allocated to all shareholders; (ii) the company redeems the share options from shareholders other than the designated large acquirer in exchange for new common stock; and (iii) as a result, the acquirer’s shares become extremely diluted. What was innovative was that TKS sought a majority-of-minority resolution (“**MoM resolution**”) at the extraordinary shareholders’ meeting, meaning that TKS did not give ADC and its related parties voting rights to approve the allotment of the share options. In a way, it seemed unfair to ADC; but, the Supreme Court upheld the decision of the Tokyo High Court that rejected ADC’s petition for injunction for the reason that it was not unreasonable to listen to the voice of those who would have been affected by the coercion that the acquirer caused by purchasing shares on-market without disclosing its intention and plan to run the target company.

With the above background, there was hope that management might be able to ward off shareholder activists with a wartime-introduced poison pill and an MoM resolution. Unfortunately, this was the case up until the decision in the Mitsuboshi case was rendered.

### C. Was Anything Wrong with Mitsuboshi’s Plan Itself? — Probably Not

Mitsuboshi’s poison pill scheme was almost identical to that of TKS, and Mitsuboshi obtained a regular resolution (not an MoM resolution) at an extraordinary shareholders’ meeting. Nonetheless, it lost. Why was that so?

Although the dispute over the control of Mitsuboshi was the first high-profile case where the management countered wolf-pack activism with a conventional



shareholders' rights plan, such plan included a provision from the early days of Japanese poison pill history that defined a large acquirer very broadly to capture a typical wolf-pack group.

And it should be emphasized that the Japanese courts in the Mitsuboshi case, consistently from the District Court to the Supreme Court, found that the (original) determination of Mitsuboshi to treat Adage and its allies as a qualified large acquirer group was justifiable, although Mitsuboshi was able to show very little connection among the alleged group members. The facts were that (i) some had an equity interest in others, (ii) some of them had the same directors or officers, and (iii) they were each purchasing a large number of Mitsuboshi shares around the same time, all of which were publicly available information. This indicates that the Japanese courts were not blind to the dysfunction of the disclosure rules and the wolf packs who enjoyed it.

#### D. What was Wrong with Mitsuboshi's Handling of the Plan?

Mitsuboshi's failure was in its handling of the shareholders' rights plan.

First, when the board of directors decided on the gratis allotment of the share options, it did not announce the terms and conditions of what Adage could do to prevent the allotment from becoming effective. The court found that, for an anti-takeover measure to be reasonable and proportionate to the threat, it must instruct an acquirer in advance on how to exit.

Second, Mitsuboshi unilaterally designated additional individuals and entities as members of the Adage group before the holding of the extraordinary shareholders' meeting because they voted in favor of Adage's proposal

to replace the incumbent directors in the previous general shareholders' meeting. The court found that the shareholders who voted for the poison pill this time may have just been afraid of being treated as an enemy of the management. The court therefore gave little importance to the fact that the poison pill was approved at the extraordinary shareholders' meeting.

#### E. What Should Come Next? — Better Handling of a Poison Pill, Stricter Enforcement and Beyond

In the post-Mitsuboshi world, management should try to present reasonable terms and conditions that would allow a wolf-pack group to walk away. They should include a provision that would require the members of a group to decrease their shares to a certain threshold in concert. This means that it would not be enough for one member to simply sell its own shares – that member must work with the other members, too. However, would the court find it reasonable when the alleged members of the group argue that they do not constitute a group in the first place? This is unclear for now.

As to the government, in July 2022, Nikkei Business, a business magazine, broke the news that an official of the Financial Services Agency unofficially disclosed that the agency would establish a panel to discuss the problems of delayed reporting and false reporting to tighten monitoring. Pressure from the business community may further move the said agency to introduce comprehensive ultimate beneficial owner (UBO) disclosure regulations. This would make Japan the second-to-the-last nation in the G7 countries to do so.

Hopefully, the above measures can help Japanese companies better deal with wolf-pack activism in the future.