Morgan Lewis-TMI
A JOINT VENTURE IN JAPAN
legal news
www.morganlewis-tmi.jp

Tokyo High Court Permits First Exercise of Poison Pill

July 18, 2007

On July 9, the Tokyo High Court rejected an appeal by U.S. investment fund Steel Partners to set aside the "poison pill" rights plan of Bull-Dog Sauce Co. Following that ruling, Bull-Dog issued stock warrants to its shareholders on July 11, making it the first company to exercise a poison pill in Japan.

Bull-Dog adopted a poison pill at its annual shareholder meeting in June, roughly a month after Steel Partners had launched a tender offer for its shares. Because the rights plan was approved after the launch of the tender offer, and because Bull-Dog anticipated a judicial challenge by Steel Partners, the pill had some unique features. Under the Bull-Dog plan, if it were activated, Bull-Dog would issue three equity warrants for each of its shares, including those held by Steel Partners. Steel Partners would, however, be unable to exercise its warrants and would instead receive cash based on the price per share Steel Partners had set for the tender offer. When Steel Partners challenged the rights plan, the Tokyo District Court ruled in favor of Bull-Dog, holding that its rights plan did not violate the Japanese principle requiring equality in the treatment of shareholders and did not involve an issuance of share options in an unfair manner, primarily relying on the fact that the plan was approved by the holders of a supermajority of Bull-Dog shares and that Steel Partners would be compensated for its dilution.

On appeal, the Tokyo High Court affirmed the District Court's decision and also provided a broader standard for evaluating poison pills. First, the High Court ruled that a corporation's management has the discretion to undertake defensive measures against threats posed to its corporate value by abusive acquirers so long as the measures are reasonable. The reasonableness standard articulated by the High Court in this case appears similar to the *Unocal* standard established by the Delaware Supreme Court in the United States. Second, the High Court ruled that the company does not exist solely for its shareholders, and that the concerns of other stakeholders such as employees, business partners, and customers should be considered when determining what is beneficial to the corporate value of the company. Third, the High Court ruled that Steel Partners had the characteristics of an abusive acquirer based on all of its activities in Japan, including its investments in other companies.

Poison pills in Japan differ from U.S. poison pills in several ways. Most notably, due to restrictions under Japanese law, Japanese poison pills cannot be triggered automatically. Typically, pills in Japan are triggered by a vote of the shareholders or the board, often after receiving input from an independent committee. Second, Japanese pills typically have an "advance warning" feature in which a shareholder that plans to acquire more than a threshold level of shares (e.g., 20%) must notify the target company of its intention. The target company can then request that the acquirer provide information to the company regarding its business plan and intentions for the target, as well as its financial information. (Unlike U.S.

tender offer regulations, Japan's tender offer rules do not require substantial disclosure by the acquiring shareholder.) Although the Bull-Dog rights plan is not, strictly speaking, an "advance warning" plan, the High Court found that Steel Partners' failure to comply with requests made by Bull-Dog's management for such information was evidence of its abusive intent.

It is important to note that the facts of this case were very favorable to Bull-Dog and that typical rights plans in Japan differ in significant ways from the Bull-Dog plan. In particular, it is rare for plans to require that the company compensate the diluted acquirer upon exercise of the poison pill. All poison pills adopted by Japanese corporations will not necessarily pass the standard set by the High Court in the *Bull-Dog* case. In future instances, it will be important to carefully evaluate the facts and circumstances of the poison pill, and the nature of the hostile acquirer, to assess whether the *Bull-Dog* standard can be met.

Notwithstanding this uncertainty, the *Bull-Dog* case will likely have a significant impact on the M&A market in Japan. Most importantly, it has established a new principle under Japanese law permitting the exercise of a reasonable rights plan to block an acquisition by an abusive shareholder. In addition, the High Court's "stakeholder" analysis and its review of Steel Partners' conduct suggest that financial investors may have a harder time overcoming a poison pill than strategic acquirers. Courts may question whether financial investors have considered the interests of a target company's stakeholders and may require financial investors to provide a more detailed plan for their continued operation of the target company.

Steel Partners has appealed the case to the Supreme Court of Japan, which could overrule the High Court. Notwithstanding this appeal, Bull-Dog issued equity warrants to its shareholders on July 11. Bull-Dog is expected to repurchase those equity warrants for stock (or, in the case of Steel Partners, cash) before September 1, 2007, at which time Steel Partners' current 10.52% stake in the company will be diluted to 2.86%.

Our lawyers regularly advise corporations and foreign investment funds on poison pills in Japan.

If you have any questions regarding the information discussed in this LawFlash, please contact any of the following Morgan Lewis-TMI attorneys:

Tokyo

Kunio Namekata	+81.3.6438.5503	knamekata@tmi.gr.jp
Gregory R. Salathé	+81.3.5219.2509	gsalathe@ morganlewis.com
Kiyoshi Takahashi	+81.3.6438.5533	ktakahashi@tmi.gr.jp
Lisa Yano	+81.3.5219.2507	lyano@morganlewis.com

About Morgan Lewis-TMI
Morgan Lewis-TMI is a unique joint venture in Japan formed by Morgan, Lewis & Bockius LLP and TMI Associates. This is the first joint venture of its kind between major U.S. and Japanese law firms. Morgan Lewis-TMI is an equal partnership designed to leverage the strengths of both firms in serving our clients. For more information about Morgan Lewis-TMI, please visit www.morganlewis-tmi.jp.

About Morgan, Lewis & Bockius LLP
Morgan Lewis is a global law firm with more than 1,300 lawyers in 22 offices located in Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los Angeles, Miami,

Minneapolis, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, and Washington, D.C. For more information about Morgan Lewis or its practices, please visit us online at www.morganlewis.com.