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Oasis calls for establishment of UK-style takeover panel in Tokyo guidelines

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- Oasis seeks involvement of minority shareholders in third-party committees
- Meti official says independent directors to be central to third-party committees
- Market checks uncommon in Japan; but is the 'only true test for fair value'
- Meti calls for more public comments in early May ahead of new MBO guidelines

Oasis Management, the activist fund, has urged Japan's ministry of economy, trade and industry (Meti) to form a Meti, FSA or TSE-appointed M&A approval committee — similar to the UK's Takeover Panel — to ensure fair value for minority shareholders in Japanese M&A deals, according to the fund's submission to the trade ministry on 31 January.

This committee, comprised of regulators, lawyers, accountants, bankers, buy-side investors among others, should be used to approve all related party transactions exceeding JPY 30bn (USD 269m) to ensure fair prices are agreed between the deal parties, the fund said.

In the statement, the fund also calls on the ministry to urge companies that engage in large related party transactions to establish third-party special committees elected by minority shareholders not affiliated with the transaction.

"A third-party Special Committee should be comprised of valuation specialists, bankers, minority shareholder representatives, lawyers and accountants, and all the independent directors of the board," said the fund's Chief Investment Officer Seth Fischer in his statement. Moreover, the third-party special committee should be elected by the majority of minority shareholders at a special EGM, he said.

"We believe special committees have often failed in their duties to protect minority shareholders as the result of being insufficiently independent and competent," he added.

The Hong Kong-based hedge fund, which last year led several prominent and confrontational battles with Japanese boards that were involved in parent/subsidiary deals, submitted its recommendations to a public consultation by the Meti's "Fair M&A Study Group", which was launched on 9 November 2018 and is aimed at evaluating potential new MBO guidelines.

Meti undecided on minority shareholders' inclusion

The study group, which is comprised of 23 professionals led by Gakushuin University Professor Hideki Kanda, has been discussing since November the revision of the 2007 MBO guidelines and the issue of conflict of interest in acquisitions of a controlled company by its controlling shareholder. To this end, Meti, between 28 December 2018 and 5 February 2019, solicited opinions on the issues from a broad array of stakeholders within and outside of Japan.

A revision to the guidelines that is more in line with Japan's corporate governance progress is expected to be put into effect by around mid-June, following another one-month public comment period starting in early May, a Meti official told this news service.

"The revised guidelines are likely to focus on the role of third-party special committees to ensure fair prices. The involvement of independent directors in the committees will be most appropriate to make the committees independent," said the official.

"True, third-party special committees exist for [the benefit of] minority shareholders. Yes, we received opinions to include minority shareholders in third-party special committees, but we have not yet decided whether minority shareholder representatives should be included," added the official.

The 2007 MBO guidelines do note the importance of using independent directors and third-party special committees. But at the time, the ministry could not address these issues adequately partly because independent directors were not pervasive among Japanese corporates, according to the official.

Alpine/Alps and the whims of management

Oasis, which held a 9.9% stake in Japan's Alpine, argued last year that the company's board was allowing larger affiliate Alps Electric to buy out the company at an unfairly low valuation. "Alpine's third-party committee accepted the offer without challenging the valuation of SMBC Nikko, a financial advisor to Alpine, which does not appear truly independent", Fischer said last year. He pointed out that the advisor's affiliate SMBC (Sumitomo Mitsui Banking Co) is the main bank for both Alps and Alpine.

"We believe valuation opinions to date have often been biased by company management unrealistically lowering guidance. This lowered guidance leads to valuation opinions that are disconnected from economic reality," Fischer said in his 31 January statement submitted to Meti.

Oasis's statement submitted to Meti also pointed to the use of outdated model assumptions which lack underlying logic but have become market standard in Japan.

For example, using a 0% growth rate after three years of substantial growth for a growing company is common in Japan but not common internationally. All cash and securities should be considered "non-working capital" in the valuation. The definition of working capital should come from public independent studies, not the "whims of management", he said.

In the Alpine/Alps situation, Oasis argued last year that SMBC Nikko did not include all the cash and securities Alpine owned in its discounted cash flow (DCF) analysis, thereby bringing down the equity value of Alpine. The automotive component company declined to disclose the details of the DCF analysis.

Go-Shop is only true test for fair value

In its statement, Oasis also said that conducting a market check and an active “Go-Shop” process is necessary because “shopping the deal is the only true test of fair value” and the best way to achieve fair value for minority shareholders. The adoption of a market check, which is a common feature in many developed markets, will bolster belief in the integrity in the Japanese financial markets, said Oasis.

A Tokyo-based director of a US private equity fund says it is very important for a third-party special committee to be granted the function of a market check. “In the US and Europe, deals are generally triggered by company management. Management talk to various potential buyers before selecting the best bid. In Japan, on the contrary, it is very rare for deals to be initiated by company management. It is PE that approach and persuade company management after lengthy negotiations, the director said.

A Tokyo-based M&A lawyer of a US law firm also said: “In Japan, almost no market checks have been carried out prior to deals. If there is any, there have been some “indirect” market checks during a 30-day tender offer period. No wonder why there are no rival bidders in this country.”

“Many [Japanese] securities trade at depressed levels because of existing and feared corporate governance breaches. Many of these breaches relate to unfair M&A practices. These discounted valuations have a significant impact on valuations broadly, leading to a higher cost of capital for all of corporate Japan,” Fischer added.

According to the Meti official, the study group, which has already met five times since November 2018, will meet again on 5 April and 19 April to summarize the discussions. After that, the ministry will commence in early May another one-month period of public comments, where the parties concerned in and outside Japan will be asked to comment on the draft guidelines.

“We want to invite all parties, not only professionals but also individuals. We are keen to listen to various opinions so as to reflect their views in the new guidelines,” the official said.

by Norie Hata in Tokyo

Grade: Strong evidence

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