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ARTICLE

How does the Appraisal Right with the Concept of the Fair Value Including Synergies Work?: Lessons from Japan

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Abstract
This article presents how the appraisal right, with the concept of the fair value which includes synergies, has worked in Japanese corporate law. The appraisal right gives dissenting shareholders the ability to protect their interests. The Delaware courts calculate a fair value by excluding synergy effects in appraisal proceedings. One can criticise the exclusion of synergies because the petitioners of the appraisal right might receive less than the merger price. It would be interesting to analyse how the situation changes if the fair value includes synergies. Japanese corporate law gives a good illustration for this. The revision of the *Companies Act of Japan* in 2005 enhanced the role of the appraisal right by empowering the Court to include synergy value into the determination of fair value. However, Japan's Court developed the doctrine to use the deal price as a fair value with a relatively lax review of the fairness of the deal process. This has resulted in an unattractive situation for petitioners of appraisal remedies, because they rarely gain profits through the appraisal remedy. Empowering minorities in black letter law does not necessarily strengthen minority protection in reality.

Introduction

The Companies Act of Japan and the Delaware General Corporation Law (DGCL) have differences in their definition of the appraisal right.[1] They differ on whether to reflect the synergy effect expected from the merger in the concept of 'fair value.' Fair value is a concept that indicates the price when a company purchases the shares of the shareholders who have exercised their appraisal right. The Delaware courts calculate a fair value by excluding synergy effects.[2] Japanese courts calculate it as follows: (1) If the corporate value does not increase by the merger, the Court calculates the value of the stock that would have been prevalent on the date of exercising the appraisal right

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[1]The appraisal right is the right given to shareholders who oppose certain proposed actions of a corporation (eg, a merger) to obtain the fair value of their shares appraised by a court and to demand that the company purchase their shares at the appraised value. In Japan, this right is available in the case of organisational restructurings, such as mergers, share exchanges, share transfers, corporate splits, sales of the business, and cash-outs.

[2]*Global GT LP v Golden Telecom, Inc,* 993 A2d 497, 507 (Del Ch 2010), aff'd, 11 A3d 214 (Del 2010); *DFC Glob Corp v Muirfield Value P'rs*, LP, 172 A3d 346, 368 (Del 2017) (henceforth '*DFC Glob*'); *Dell, Inc v Magnetar Glob Event Driven Master Fund Ltd,* 177 A3d 1, 21 (Del 2017) (henceforth '*Dell*'). The Delaware Supreme Court explains the two policy reasons for excluding the synergies: (1) the buyer should not lose its upside for the merger by having to pay out the expected synergies, and (2) 'a balance to the Court's decision to afford pro rata value to minority stockholders.' (*DFC Glob Corp v Muirfield Value P'rs*, LP, 172 A3d 346, 368 (Del 2017)).

had the merger not taken place (ie, 'hypothetical value').[3] However, (2) if the corporate value increases by the merger, the Court calculates the value of the shares reflecting the synergy effect on the date of exercising the appraisal right (ie, 'synergy value').[4]

Moreover, there is no 'market-out' rule in Japan.[5] Under the market-out rule in Delaware, appraisal rights are not available for shareholders who hold those shares that are either (i) listed on a national securities exchange or (ii) held by more than 2,000 holders.[6] As an exception to the market-out rule, appraisal rights are available for such shareholders if the merger consideration is anything other than shares of other corporations either listed on a national securities exchange or held by more than 2,000 holders.[7] Thus, the dissenting shareholders of the target corporation, which is listed on the New York Stock Exchange, are eligible to exercise appraisal right in a cash merger in which the consideration paid in the merger is cash, but not in a stock-for-stock merger in which the consideration paid in the merger is the stock of the surviving listed corporation. In contrast, the Japanese appraisal rights are available for the dissenting shareholders whose shares are listed on the Tokyo Stock Exchange not only in the cases of cash mergers but also in the cases of a stock-for-stock merger of the listed companies. This point is also different from Delaware.

Despite these differences, the appraisal right in both laws converges rapidly in several respects. First, it is common in Japan and Delaware that the recent amendment of the corporate law has introduced the system in which the corporation has the right to make a preliminary payment of the value that the corporation finds fair. It aims to prevent the accrual of interest on the fair value. Japan revised the *Companies Act* in 2014 by introducing the new rule in which the respondent company can pay the petitioner shareholder the amount that the company deems fair value.[8] In Delaware, the revision of DGCL in 2016 introduced a similar new rule into Article 262(h) of DGCL.[9] Under the new rules in both jurisdictions, if the company makes a preliminary payment of the fair value, the interest shall accrue on the difference between the fair value determined by the Court and the amount paid by the corporation in advance.[10] This rule might discourage appraisal arbitrage, the petitioner's strategy of purchasing shares for the purpose of exercising the appraisal right.[11]

Second, in both Japan and Delaware, the recent courts' decisions used the deal price as a fair value even in the deals between parties with conflicting interests, such as the management buyouts (MBOs) and the cash-out deals by a controlling shareholder. If the Court deems the deal process fair, it tends not to make its original calculation of the fair value but rely on the deal price.[12]

[3]Saikō Saibansho [Sup Ct] Apr 19, 2011, Hei 22 (kyo) no 30, 65 Saikō Saibansho minji hanreishū [Minshū] 1311, 1315–1317 (Japan).

[4]Saikō Saibansho [Sup Ct] Feb 29, 2012, Hei 23 (kyo) no 21, 66 Saikō Saibansho minji hanreishū [Minshū] 1784, 1789 (Japan).

[5]Christopher T Hines, Tatsuya Tanigawa & Andrew P Hughes, 'Doing Deals in Japan: An Analysis of Recent Trends and Developments for the U.S. Practitioner' [2006] Columbia Business Law Review 355, 404.

[6]DGCL, s 262(b)(1).

[7]DGCL, s 262(b)(2).

[8]Kaishahō [Companies Act of Japan] art 182-5 para 5, art 786 para 5, art 787 para 5, and art 807 para 5. See Manabu Matsunaka, '117 Jou' [*Commentary on §117*], in Shinsaku Iwahara (ed), *Kaishahō konmentāru, hokan, heisei 26-nen kaisei* [*Companies Act Commentary, Supplementary Volume, 2014 Revision*] (Shōji hōmu 2019) 112 (The background for the introduction of the advance preliminary payment system was that interest was charged on the fair value from 60 days after the effective date until the payment date, based on 6% per annum, which was high in light of the low interest rate environment. This was not only a burden on the respondent company, but also led to abuse of the appraisal right).

[9]2016 Del ALS 265, 80 Del Laws 265, 2015 Del HB 371, 2016 Del ALS 265, 80 Del Laws 265, 2015 Del HB 371. For the detail of this revision, see Charles R Korsmo & Minor Myers, 'Interest in Appraisal' (2016) 42 Journal of Corporate Law 109.

[10]See Matsunaka (n 8) 114.

[11]See Charles R Korsmo & Minor Myers, 'Appraisal Arbitrage and the Future of Public Company M&A' (2015) 92 Washington University Law Review 1551; Wei Jiang et al, 'Appraisal: Shareholder Remedy or Litigation Arbitrage?' (2016) 59 Journal of Law and Economics 697.

[12]For the case of the cash out by controlling shareholders in Japan, see Saikō Saibansho [Sup Ct] Jul 1, 2016, Hei 28 (kyo) no 4, 70 Saikō Saibansho minji hanreishū [Minshū] 1445 (Japan). For the MBO case in Delaware, see *Dell* (n 2) 177 A3d 1.

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Third, both jurisdictions' Supreme Court refer to the possibility of using stock market price when calculating the fair value. Japan's Supreme Court held that it is rational to use the market price as a basis for determining the fair value. The reason is that it reflects the fundamental value of the corporation.[13] Although the Delaware courts had not traditionally used the market price in the appraisal cases,[14] the Delaware Supreme Court recently held that it supports the efficient market hypothesis[15] and, in another case, affirmed the Court of Chancery's judgment adopting the unaffected market price as the fair value of its stock as of the date of the merger.[16]

The development of the laws on the appraisal right in both jurisdictions shows a tendency to approach even though the concept of the fair value differs. This is because the issues inherent in the appraisal right are common in both Japan and Delaware; thus, their solutions are also common.[17] Calculating a stock's value cannot provide the unique correct answer. The valuation experts usually create the so-called football field chart showing the range of the corporate value, but they do not report one specific price. Nevertheless, the Court must determine the specific price as a fair value. The stock value calculation by the discounted cash flow (DCF) analysis submitted by the shareholders and the company, which are the trial parties, tends to use favorable figures for themselves. The price submitted by the shareholder's side is often many times higher than the price submitted by the company. It is troublesome for the Court to determine whether one or the other is correct or wrong.[18]

On the one hand, if this value is too low, the minority shareholders' interests may be harmed. On the other hand, if this value is too high, there is a risk that the incentive for exercising the appraisal right will increase too much. Tasks requiring this delicate balance are challenging for courts because judges are law-trained but not finance-trained. Therefore, when some objective indicators are available, it is reasonable for the courts to utilise them and avoid their own calculation.[19] It is understandable that the Court formulated the rule to rely on the deal price if the deal process was as fair as the arms' length deals.[20] This formulation frees the Court from such a delicate task. Moreover, since the parties to the lawsuit cannot control the stock market price, the stock market price is more objective than the DCF analysis.[21]

[13]Saikō Saibansho [Sup Ct] Apr 19, 2011, Hei 22 (kyo) no 30, 65 Saikō Saibansho minji hanreishū [Minshū] 1311 (Japan).

[14]See *Chi Corp v Munds*, 172 A 452, 457 (1934) ('Market value undoubtedly is a pertinent consideration. So is net asset value. Neither, however, deserves necessarily to be accepted as exclusive.'); *Cede & Co v Technicolor, Inc*, 684 A2d 289, 301 (Del 1996) (the 'market price of shares may not be representative of true value.'); In re *Emerging Communs, Inc S'holders Litig*, No 16415, 2004 Del Ch LEXIS 70, at *83 (Del Ch May 3, 2004) ('Delaware law recognizes that, although market price should be considered in an appraisal, the market price of shares is not always indicative of fair value); Lawrence A Hamermesh & Michael L Wachter, 'The Short and Puzzling Life of the "Implicit Minority Discount" in Delaware Appraisal Law' (2007) 156 University of Pennsylvania Law Review 1, 8 ('Delaware appraisal law has never been particularly friendly to the idea that stock market prices always accurately represent a proportional share of the value of the enterprise as a going concern.').

[15]*Dell* (n 2) 177 A3d, 35.

[16]*Fir Tree Value Master Fund, LP v Jarden Corp*, 236 A3d 313 (Del 2020).

[17]See Hidefusa Iida, 'Kabushiki kaitori seikyū ken no derauea shū hanrei no saishin dōkō [The Latest Trend in the Delaware State Precedent on the Appraisal Right]', in Hideki Kanda (ed), *Kigyō hōsei no shōrai tenbō, shihon shijō seido no kaikaku eno teigen, 2019-nendo-ban* [*Future Outlook of Corporate Legislation; Proposals for Reform of Capital Market System, 2019 Edition*] (Zaikei Shōhō-Sha 2018) 391–92.

[18]See Scott Callahan, Darius Palia & Eric L Talley, 'Appraisal Arbitrage and Shareholder Value' (2018) 3 Journal of Law, Finance and Accounting 147, 148–149; Albert H Choi & Eric L Talley, 'Appraising the 'Merger Price' Appraisal Rule' (2018) 35 Journal of Law, Economics and Organization 543, 544; *Dell* (n 2) 177 A3d, 36 (held that both the petitioner's and the respondent's valuations 'landed galaxies apart—diverging by approximately $28 billion, or 126%.').

[19]See Charles R Korsmo, 'Information Bundling, Disclosure, and Judicial Deference to Market Valuations' (2021) 62 Boston College Law Review 571, 573 ('As a general rule, judges hate to perform financial valuations. They avoid it whenever possible.').

[20]See *Dell* (n 2) 177 A3d, 37–38.

[21]One might wonder why the Delaware Court has taken so long to adopt the market approach (I owe this insightful question to the anonymous referee). This shift looked surprising even for Vice Chancellor Laster. See *Verition Partners Master*

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The important difference between Delaware and Japan is whether to include or exclude the synergy effect. The Delaware courts calculate a fair value by excluding synergy effects in appraisal proceedings.[22] Recent Delaware cases showed the Court's tendency to rely on the 'deal price minus synergy' as the fair value if the deal process was fair. For example, if the merger price is 100 and the synergy effect of the merger is 20, the fair value would be 80 under the deal-price-minus-synergy formula.[23] The petitioner would lose 20 by exercising the appraisal right instead of selling the stock at the market price of 100, reflecting the merger effect. One can criticise this formula for limiting the ability of the appraisal right to protect minority shareholders because the petitioners of the appraisal right might receive less than the merger price.[24] Then, it would be interesting to analyse how the situation changes if the fair value includes synergies. Japanese corporate law gives a good illustration of this interest. The revision of the Companies Act of Japan in 2005 enhanced the role of the appraisal right by empowering the Court to include synergy value in determining the fair value.[25] It aimed to enhance the protection of dissenting shareholders, especially from the unfair distribution of synergies due to conflicts of interest.[26]

Although the literature hotly debates the appraisal remedy in Delaware,[27] less is known about the development in Japanese cases of appraisal rights and what happened by introducing synergy value into the definition of fair value.[28] This article fills this gap and demonstrates how the revision of Japan's Companies Act in 2005 expects the Court's scrutiny of the deals by calculating the synergy value, but, surprisingly, how differently the case law has developed from the legislators' expectation. Facing the troublesome role of judging the adequacy of the distribution of deal surplus, Japan's Court developed the doctrine to use deal price as a fair value with a relatively lax review of the

Fund Ltd v Aruba Networks, Inc, No 11448-VCL, 2018 Del Ch LEXIS 52, at *58 n 305 (Del Ch Feb 15, 2018) (questioned the Delaware Supreme Court's holding that the efficient market hypothesis is long endorsed by the Delaware Supreme Court). Although exploring this question in detail is beyond this article's scope, one can argue that this shift comes from the increased appraisal actions due to the appraisal arbitrage and the courts' struggle to reach the balanced solution to such actions. See Robert T Miller, 'Stock Market Value and Deal Value in Appraisal Proceedings' (2021) 96 Notre Dame Law Review 1403, 1405.

[22]See DGCL, s 262(h) ('the Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger, consolidation or conversion'). See also *DFC Glob* (n 2) 172 A3d, 368; *Dell* (n 2) 177 A3d, 21.

[23]See, for the recent cases where the Chancery Court determined the fair value under the deal-price-minus-synergy formula, In re *Panera Bread Co*, No 2017-0593-MTZ, 2020 Del Ch LEXIS 42 (Del Ch Jan 31, 2020); In re *Regal Entm't Grp*, 2021 Del Ch LEXIS 93 (Del Ch May 13, 2021); *BCIM Strategic Value Master Fund, LP v HFF, Inc*, No 2019-0558-JTL, 2022 Del Ch LEXIS 25 (Del Ch Feb 2, 2022).

[24]See Kenjirou Egashira, *Kabushikigaisha-hō* [*Laws of Stock Corporations*] (Yūhikaku 2021) 912 (argues, as a discussion of Japanese law, that excluding synergies in determining the fair value would be extremely detrimental to dissenting shareholders).

[25]Kenjirou Egashira, '"Kaisha hōsei no gendai-ka ni kansuru yōkō-an" no kaisetsu (5) [Commentary on the Draft Outline for the Modernization of the Companies Act Legislation (5)]' (2005) 1725 Shōji hōmu 4, 8–9.

[26]See Tomotaka Fujita, 'Shinkaisha-hō ni okeru kabushiki kaitori seikyū-ken seido [The Appraisal Right System under the New Companies Act]', in Etsurou Kuronuma & Tomotaka Fujita (eds), *Egashira kenjirou sensei kanreki kinen, kigyō-hō no riron, jōkan [Professor Kenjiro Egashira's 60th Birthday Commemorative, Theory of Corporate Law, Volume 1]* (Shōji hōmu 2007) 282–284 (in cases where there is inequality in distribution between controlling shareholders and minority shareholders, the system of synergy distribution can be seen as a new adjustment mechanism to reconcile their interests). See also, Hidefusa Iida & Kenichi Sekiguchi, 'Reappraising the Role of the Appraisal Remedy', in Zenichi Shishido (ed), *Enterprise Law* (Edward Elgar Publishing 2014) 222.

[27]See eg, Choi & Talley (n 18); Charles Korsmo & Minor Myers, 'The Flawed Corporate Finance of Dell and DFC Global' (2018) 68 Emory Law Journal 221; Miller (n 22); Edmund H Mantell & Edward Shea, 'Development and Application of Business Valuation Methods by the Delaware Courts' (2021) 17 Hastings Business Law Journal 335.

[28]Exceptions are, for example, Alan K Koh, 'Appraising Japan's Appraisal Remedy' (2014) 62 American Journal of Comparative Law 417, and Kenju Watanabe, 'Control Transaction Governance: Collective Action and Asymmetric Information Problems and Ex post Policing' (2016) 36 Northwestern Journal of International Law & Business 45, 136. In the United States, the concept of a synergy has received little judicial or scholarly attention. See Korsmo & Myers (n 27) 280.

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fairness of the deal procedure.[29] This has resulted in an unattractive situation for petitioners of the appraisal remedy because they can rarely gain profits through the appraisal remedy. This shows that empowering the minorities in the black letter law does not necessarily strengthen minority protection in reality.

The article will proceed by first giving a brief overview of the history of the appraisal right in Japan. It then examines the judicial precedents on fair value. Thereafter, the article makes a comparative analysis of the conditions to use the deal price to determine the fair value between Delaware and Japan, before analysing Japan's courts' current attitude toward the passive review of the fairness of the deal. The final part of the article states the conclusion.

Overview of History of the Appraisal Rights in Japan

Introduction of the appraisal right by the amendment in 1950

The appraisal right was introduced into Japanese corporate law by the amendment of the Commercial Code in 1950 for the first time.[30] This introduction occurred because, at that time, Japanese law followed American law (especially the Illinois Business Corporation Act of 1933) under the direction of General Headquarters.[31] The Japanese provisions initially provided for dissenting shareholders to be entitled to the fair value that the shares would have if there were no shareholder meeting resolution approving mergers. The Court had to determine the hypothetical value assuming no such merger, although a shareholder meeting's resolution approved the merger.[32]

The rationale of the appraisal right introduced in 1950 was the protection of the economic interests of minority shareholders against the majority's decision.[33] The revision of 1950 was meaningful to protect shareholders against the negative side of the merger. As Figure 1 shows, suppose that the unaffected market price was 300. At the announcement of the merger, the market price went down to 200 because the merger decreased the total firms' value. If the dissenting shareholders exercise the appraisal right, they can receive a fair value of 300. This system protects the dissenting shareholders from such a value-decreasing merger. Contrary to the reform of 2005, there was no viewpoint of fair participation to the merger's positive side, such as the distribution of the synergies to the dissenting shareholders, in 1950. Therefore, there was no argument about whether the appraisal remedy should distribute the profits arising from the merger at that time.[34]

Enhancing the role of the appraisal right by the reform in 2005

The reform of the Companies Act in 2005 enhanced the role of the appraisal right.[35] It changed the concept of the fair value to enable the Court to reflect not only the hypothetical value but also the synergy value. The wording of the provisions of the appraisal right was amended in 2005 from 'fair value that the shares would have had if there had been no shareholder meeting's resolution

[29] I explain this point in the final part of the article below.

[30] See Hideki Kanda, 'Shihon tasūketsu to kabunushi-kan no rigai chōsei (1) [Capital Majority Voting and Alignment of Interests among Shareholders]' (1981) 98 Hōgaku kyōkai zasshi 761, 810–815.

[31] Mark D West, 'The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States' (2001) 150 University of Pennsylvania Law Review 527, 529, 544; Masafumi Nakahigashi, *Shōhō kaisei: `Shōwa 25-nen 26-nen' GHQ/ SCAP bunsho* [*Commercial Code Amendment: "1950 and 1951" GHQ / SCAP Document*] (Shinzansha Publisher Co 2003) (presents a collection of the GHQ documents and describes the detailed process of the amendment of Commercial Code in 1950).

[32] See Koh (n 28) 432.

[33] See Kanda (n 30) 815.

[34] See Hidefusa Iida, *Kabushiki kaitori seikyuuken no kouzou to kaitori kakaku santei no kouryo youso* [*Structure of the Appraisal Rights and Factors for Evaluating the Fair Value*] (Shōji hōmu 2013) 9–11.

[35] See Fujita (n 26) 280–284.

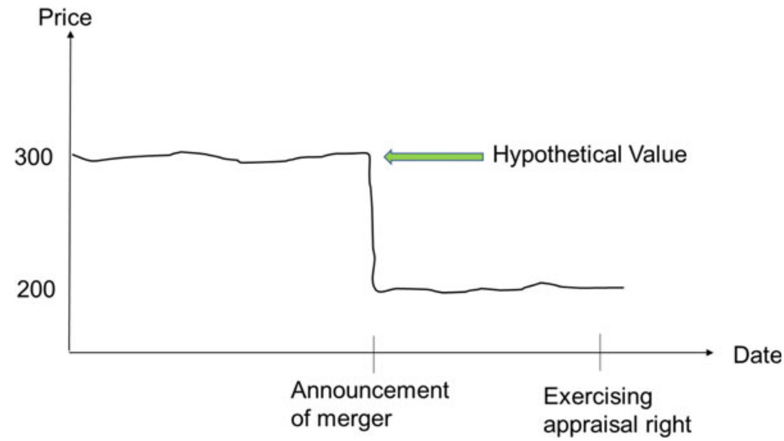

Figure 1. Value-decreasing Merger and Hypothetical Value

approving the merger' to just 'fair value' to facilitate the consideration of the distribution of synergies in determining the fair value. The revision gives the measure of a remedy to dissenting shareholders dissatisfied with the synergy distribution. The purpose of the 2005 reform of appraisal rights was to provide a remedy that protects minority shareholders from freeze-out mergers, which were also made clearly available for the first time by the Companies Act of 2005.[36]

Suppose the total synergy from the merger between Firm A and Firm B is 50, and the merger price paid to Firm A's shareholders is 110, of which 100 is the stand-alone value and 10 is the distributed synergy effect (see the left side of Figure 2). Under the current Japanese law, if the Court determines the deal price does not reflect a fair distribution of synergy, it can determine the fair value to be 120, which is higher than the deal price and the stand-alone value.

This solution is essential, especially in a merger case with conflicts of interest, such as the merger between the parent and subsidiary company.[37] As the parent company controls the subsidiary company, it is possible, in theory, to determine the deal price to be unilaterally advantageous to the parent company. In an extreme case where the parent company abuses its control rights, the parent company receives all of the synergistic value, and the minority shareholders of the subsidiary company receive no upside return from the merger.

Of course, the directors of each company are obliged to negotiate on behalf of each company's interests. If the director breaches a fiduciary duty in negotiating the deal, the director is liable for damages. However, in Japan, the content of the directors' fiduciary duties regarding mergers and acquisitions is unclear. Contrary to the experience of Delaware[38], there have been few cases in which the shareholder has sued the directors or the controlling shareholder; consequently, the case law has remained undeveloped.[39] Thus, if the shareholder files a lawsuit against the director in such a case, the standard of review on fiduciary duties is unclear in Japan. Moreover, Japanese

[36]See Iida & Sekiguchi (n 26) 222.

[37]See Koh (n 28) 456–459 (argues Japan's appraisal is successful in protecting minority shareholders from a controlling shareholder).

[38]See eg, *Weinberger v UOP, Inc*, 457 A2d 701 (Del 1983); *Kahn v M&F Worldwide Corp*, 88 A3d 635 (Del 2014); *Corwin v KKR Fin Holdings LLC*, 125 A3d 304 (Del 2015).

[39]It is in 2013 that the Tokyo High Court held that the directors, as part of their duty of care, owe an obligation to ensure the fair transfer of corporate value in the event of an MBO; and that even if the MBO itself is based on reasonable business judgment, if the fair transfer of corporate value among shareholders is impaired by an acquisition price that does not properly reflect the corporate value, there is room for the directors to be found to have breached their duty of care. Tōkyō Kōtō Saibansho [Tokyo High Ct] Apr 17, 2013, Hei 23 (ne) no 2230, 2190 Hanrei jihō [Hanji] 96 (Japan).

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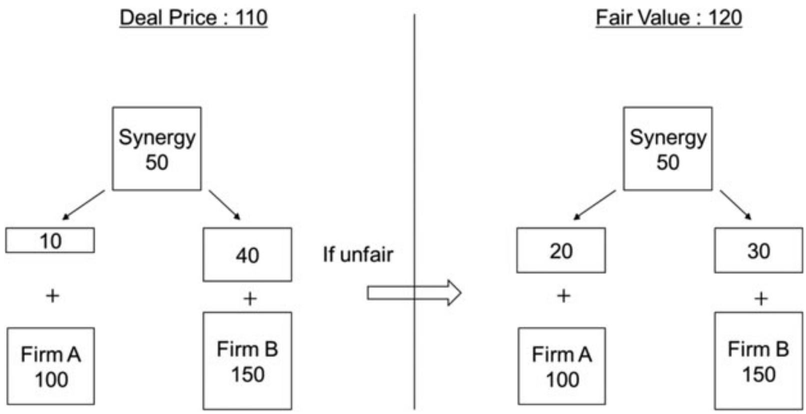

Figure 2. Fair Value Reflecting Synergy Value

law does not clarify whether the controlling shareholder owes the fiduciary duty to the company or to the minority shareholders.[40]

Therefore, the revision in 2005 enhanced the role of the appraisal right to protect the minority shareholders.[41] Under the appraisal remedy, the petitioner need not establish the breach of the fiduciary duties. Thus, strengthening the appraisal right does not need difficult rule-making to clarify the fiduciary duties. The appropriate institution in charge of clarifying the content of the fiduciary duty is not the legislator but the Court. The Court determines the fair value regardless of whether the directors breached the fiduciary duties or not. The Court was left with the task of determining a fair value including synergies, which is highly challenging. For the Court, determining fair value should be as difficult as clarifying the content of the fiduciary duties. The Court formed its framework for determining fair value through decisions in several cases. Such a framework is outlined below.

Judicial Precedents on Fair Value

This section describes the judicial precedents on the meaning of fair value under Japanese corporate law. How much will the company have to pay if the dissenting shareholder exercises the appraisal right? The Companies Act refers to 'fair value' in the statute's text. Its concrete meaning is left to interpretation. Since the reform of the Companies Act in 2005, the Court understands that dissenting shareholders are entitled to: (i) a fair value that the shares would have had if there were no resolution approving the merger (hypothetical value); or (ii) a fair value that reflects synergies arising from the merger (synergy value).

The purpose of the appraisal right

In the TBS case,[42] the Supreme Court clearly stated the purpose of the appraisal right for the first time after the amendment in 2005. This case was about a corporate split[43] in which TBS, a

[40]See Iida & Sekiguchi (n 26) 228–230.

[41]See Fujita (n 26) 284 (points out that since there were no alternative rules [eg, no general rule such as the controlling shareholder's fiduciary duties] that served the function of enforcing the fairness of mergers, including the distribution of synergies, a role was assigned to the appraisal rights).

[42]Saikō Saibansho [Sup Ct] Apr 19, 2011, Hei 22 (kyo) no 30, 65 Saikō Saibansho minji hanreishū [Minshū] 1311 (Japan). See Koh (n 29) 438–441.

[43]A corporate split under the Companies act of Japan refers to the action of causing another company to succeed all or a part of its rights and obligations that a company holds in connection with its business undertakings. Kaishahō [Companies Act of Japan], art 2, no xxix.

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broadcasting company, succeeded to the wholly-owned subsidiary some of TBS's rights and obligations.

The Supreme Court held that the purpose of the appraisal right was to make it possible to conduct an essential change to the foundation of the company organisation, such as a merger, by a majority vote at the general shareholders' meeting.[44] Moreover, it held that the appraisal right gives dissenting shareholders the opportunity to leave the company and secures for them an economically equivalent situation to where there were not a merger.[45] It held that if the corporate value increases due to the merger, the appraisal right will protect the shareholders' interests by the Court's determination of the fair value that reflects the appropriate distribution of the synergies to the dissenting shareholder.[46]

The issue of the distribution of synergies arises if and only if the merger increases the corporate value compared to both corporations' pre-merger value. Based on this purpose, the Supreme Court developed the doctrine by separating cases depending on whether the corporate value increases due to the merger. The reason for paying attention to whether the corporate value is increased is because of the purpose of the 2005 amendment.

When there is no increase in corporate value: hypothetical value

Concept

In the TBS case, the Supreme Court held that the Court must determine the hypothetical value as a fair value when there is no increase in corporate value due to the merger.[47] It held that there is no room to consider an appropriate distribution of increased corporate value if there is no increase in synergies or other corporate values due to the merger.[48] It did not mention how to calculate the synergy value when the merger increases corporate value. The reason for this is that there was no increase in corporate value in the TBS case. The Court held that this deal did not increase or decrease firm value as this was a deal between the parent company and the wholly-owned subsidiary company.[49]

This decision framework was also taken by the Supreme Court decision in the Intelligence case,[50] one week after the TBS case. The Intelligence case was a share exchange[51] between the parent and subsidiary companies. The dissenting shareholders of the subsidiary exercised their appraisal right. The petitioner shareholders argued that the share exchange was detrimental to their corporate value and that the hypothetical value should be calculated. They argued so because there was, allegedly, no sufficient disclosure of information to shareholders and the process of determining the exchange ratio lacked fairness. The respondent company argued that the share exchange in this case would not damage its corporate value because the parties have conducted independent and diligent negotiations, the process of determining the terms of the share exchange is fair, and the terms of the share exchange are objectively reasonable. The Tokyo High Court recognised that this share exchange damaged the corporate value since the main reason for the continued decline in the stock price of the subsidiary was the announcement of the share exchange, even though the general fairness of the share exchange procedure and the objective reasonableness of the terms of the share

[44] Saikō Saibansho [Sup Ct] Apr 19, 2011, Hei 22 (kyo) no 30, 65 Saikō Saibansho minji hanreishū [Minshū] 1311, 1315 (Japan).

[45] ibid.

[46] ibid.

[47] ibid 1315–1316.

[48] ibid 1315.

[49] See ibid 1314.

[50] Saikō Saibansho [Sup Ct] Apr 26, 2011, Hei 22 (kyo) no 47, 1352 Hanrei taimuzu [Hanta] 135 (Japan).

[51] A share exchange refers to any exchange of shares whereby a company causes all of its issued shares to be acquired by another company. Kaishahō [Companies Act of Japan], art 2, no xxxi.

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exchange are prima facie clear.[52] Thus, the Supreme Court held that the Court must calculate the hypothetical value.[53]

Calculation

Then, the next issue is how to calculate hypothetical value. The Court must determine the hypothetical value because the deal decreases the corporate value. Thus, the deal price is not an appropriate indicator for calculating the hypothetical value because the hypothetical value, by definition, refers to the value of the stock if the deal had not taken place.

It is necessary to determine on what date (ie, 'base date') the fair value must be calculated. In the cases of a stock-for-stock deal, the Supreme Court in the TBS case held that the base date of calculation is the day on the dissenting shareholder's exercise of the appraisal right because its exercise gives rise to a similar legal relationship as if a sales contract were formed between the dissenting shareholder and the company by operation of law.[54] After its exercise, the company is obliged to purchase the shares at fair value whereas the dissenting shareholder cannot withdraw their share purchase demand without obtaining the company's approval (Kaishahō [Companies Act of Japan] Article 785, paragraph 6).[55]

In its reasoning, the Supreme Court held that other candidates of the base date are not adequate because they will result in an unreasonable distribution of risk to the dissenting shareholder. Its logic is as follows. Suppose that the fair value is to be determined on a day that comes later than the day on which the dissenting shareholder has exercised the appraisal right. The dissenting shareholder would have to assume the risk of share price fluctuations after the share purchase demand. The market price may fluctuate due to factors other than the merger, such as the general factors that impact the market as a whole. Even though the dissenting shareholder cannot withdraw their share purchase demand at their own will, it is unreasonable to make them stand in such a situation.[56] Conversely, suppose that fair value is determined as of the day the relevant resolution is adopted. This case is also unreasonable because the dissenting shareholder would assume no risk of fluctuations in the stock market price after the resolution's date.[57]

Although the Supreme Court did not elaborate on the last point, one can understand that the Court is concerned with the following situation: if the market price were to decline following the resolution, the shareholders could exercise the appraisal right and be able to obtain the unaffected market price higher than the affected market price on the date when the dissenting shareholder exercises the appraisal right. If the market price rises since the resolution, the shareholders will not exercise the appraisal right but will sell their shares at a higher market price than that at the date of the resolution. Therefore, the Court held that it is appropriate to construe that the fair value is determined as of the day that the share purchase demand is made.[58]

[52]Tōkyō Kōtō Saibansho [Tokyo High Ct] Oct 19, 2010, Hei 22 (ra) no 798, 1341 Hanrei taimuzu [Hanta] 186, 196 (Japan). The Tokyo High Court's evaluation on the fairness of the process is questionable because the majority of minority shareholders of the subsidiary company voted against the deal. See Hidefusa Iida, 'Kigyō saihen kigyō baishū ni okeru kabushiki kaitori seikyū shutoku kakaku kettei no mōshitatete, kabushiki no hyōka [Appraisal Rights and Petitions for Acquisition Price Determinations in Corporate Restructuring and Corporate Acquisitions, Stock Valuation]' (2012) 384 Hōgaku kyōshitsu 26, 30.

[53]Saikō Saibansho [Sup Ct] Apr 26, 2011, Hei 22 (kyo) no 47, 1352 Hanrei taimuzu [Hanta] 135, 137 (Japan).

[54]Saikō Saibansho [Sup Ct] Apr 19, 2011, Hei 22 (kyo) no 30, 65 Saikō Saibansho minji hanreishū [Minshū] 1311, 1316 (Japan).

[55]ibid.

[56]ibid.

[57]ibid.

[58]See Masakazu Shirai, 'Kabushiki kaitori seikyū ni okeru kōseina kakaku no santei kijun-bi [Base Date for Calculation of Fair Value in the Appraisal Remedy]', in Hidefusa Iida, Masakazu Shirai & Manabu Matsunaka (eds), *Kaisha-hō hanrei no yomikata, hanrei bunseki no daiippo* [*How to Read Corporate Law Judicial Precedents, The First Step in Analyzing Judicial Precedents*] (Yuhikaku 2017) 357, 361–364 (argues that the Supreme Court's position can be justified in terms of deterring speculative behaviour by shareholders and excessive incentives to oppose the mergers).

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The base date issue is significant, especially in cases where the Court refers to the stock market price. The Japanese Court usually uses the market price, if available, rather than utilising DCF analysis.[59] In the TBS case, the Supreme Court held that it is within the Court's discretion to refer to the market price to calculate the hypothetical value.[60] If the Court uses the DCF analysis, the difference in the base date within several weeks will not result in a different valuation. However, if the Court refers to the market price, the market price could dramatically differ between months, weeks, days, hours, minutes, or even seconds. Moreover, this question is essential, especially when the merger consideration is a stock. Generally speaking, in the case of a cash merger, the market price of the target company will converge to the announced deal price and not show a dynamic fluctuation. However, in the cases of a stock-for-stock merger, the market price will fluctuate depending on the daily change in both companies' firm value. As mentioned above, the Supreme Court has clarified the base date in the cases of stock-for-stock deals, whereas no clear ruling was made in the cash-out deals.

Then, the next question arises at what period of the market price the Court can refer to calculate the fair value as of the base date. The market price after the deal's announcement is useless for calculating the hypothetical value because it is affected by its announcement. Thus, if the Court refers to the market price for this purpose, it must refer to the market price before its announcement. However, there is a gap between the announcement date of the deal and the base date for calculating the fair value. Using the market price as of the announcement date is not consistent with the above-stated reasoning of the Supreme Court on the issue of the base date. Then, the Supreme Court held that it is within the discretion of the Court to use and make corrections in the market price as of the announcement date.[61] It held that it is reasonable to use regression analysis (ie, using the market model, for example) as such corrections to exclude the impact of factors other than the deal itself.[62]

One can argue that a few months would have elapsed between the announcement date of the deal and the day that the appraisal rights were exercised, and consequently, the accuracy of the estimated stock price by a market model would be doubtful at best.[63] Yet, if the Court made no corrections to the unaffected market price, the Court would contradict their interpretation of the law.[64] Thus, we must accept a certain amount of inaccuracy in making such corrections.[65]

When the corporate value increases: synergy value

The Supreme Court, in the Tecmo case, held that the Court must determine the synergy value as a fair value when the corporate value increases due to the merger.[66] Then, the next question is how

[59]See Hidefusa Iida, 'Kabushiki kaitori seikyū shutoku kakaku kettei jiken ni okeru kabushiki ichiba kakaku no kinō [Function of Stock Market Price in Cases of Appraisal Rights]' (2015) 2076 Shōji Hōmu 38.

[60]Saikō Saibansho [Sup Ct] Apr 19, 2011, Hei 22 (kyo) no 30, 65 Saikō Saibansho minji hanreishū [Minshū] 1311, 1317 (Japan).

[61]ibid 1317; Saikō Saibansho [Sup Ct] Apr 26, 2011, Hei 22 (kyo) no 47, 1352 Hanrei taimuzu [Hanta] 135, 137 (Japan).

[62]Saikō Saibansho [Sup Ct] Apr 26, 2011, Hei 22 (kyo) no 47, 1352 Hanrei taimuzu [Hanta] 135, 137 (Japan).

[63]See Hatsuru Morita, 'Aete iou, kasudearuto!, kaishasoshō shōken soshō de riyō sa reru mākettomoderu wa doko made ro basutona no ka? [How Robust Are the Market Models Used in Corporate and Securities Litigation?]', in Etsurou Kuronuma & Tomotaka Fujita (eds), *Egashira kenjirō sensei koki kinen, kigyō-hō no shinro* [*Professor Kenjiro Egashira's 70th Birthday Commemorative, Corporate Law Paths*] (Yuhikaku 2017) 497, 528 (argues that the market model estimation results in corporate and securities litigation are not robust). The Delaware Chancery Court determined the fair value by adjusting the deal price by the method the expert presented in the case, but contrary to the Japanese Court, rejected the adjusting of the price for trends in the market index between signing and closing. *BCIM Strategic Value Master Fund, LP v HFF, Inc*, No 2019-0558-JTL, 2022 Del Ch LEXIS 25, at *91 (Ch Feb 2, 2022).

[64]See Hidefusa Iida, 'Kabushiki kaitori no kōseina kakaku kettei [Determination of Fair Value in an Appraisal Case]' (2011) 145 Minshōhōzasshi 118, 122.

[65]See Morita (n 63) 528 (argues that it is far better to use the market model than not to use it).

[66]Saikō Saibansho [Sup Ct] Feb 29, 2012, Hei 23 (kyo) no 21, 66 Saikō Saibansho minji hanreishū [Minshū] 1784, 1788–1789 (Japan).

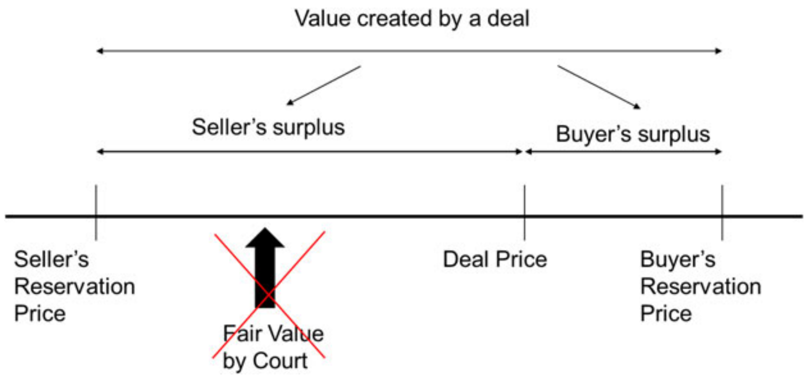

Figure 3. Distribution of Deal Surplus

the Court shall determine the synergy value. At the time of the lawsuit of the appraisal right, the synergy effect is not realised. Thus, it takes a while to be able to observe the synergy effect. Furthermore, supposing that the Court could observe the amount of the synergy value, there is no theory on how to divide it equitably.[67]

In general, the distribution of the residuals of the deals is determined through the negotiation among the deal's parties[68] and is rarely decided by the Court. For example, if you buy a used car from a friend, the deal price is fixed by negotiation. As Figure 3 shows, the Court will not evaluate the reservation prices and will not determine what the deal price should be unless, for instance, your friend scams you. Therefore, case law has not developed a theory of equitable distribution of the deal surplus. However, the Japanese appraisal right's concept of synergy value requires the Court to make such an intervention.

The Japanese Court developed the framework for determining the synergy value depending on whether the deal was at arms' length or not. This framework minimises the area where the Court must make the original calculation of the synergy value.[69]

Arms' length case: deal price as a fair value

The Supreme Court used the deal price as the fair value in the Tecmo case, which was an arms-length case of a 'share transfer.' A share transfer is one variation of a merger: share transfer is any transfer whereby one or multiple companies cause all of their issued shares to be acquired by a newly incorporated company.[70] In the Tecmo case, there were no conflicts of interest between the parties of the deal. The Supreme Court held that the fair value, in cases where the corporate value increases, means the price the shares would have had on the date of exercising the appraisal right if the share transfer ratio specified in the share transfer plan had been fair.[71] The Court focused on the

[67] See James C Bonbright, *The Valuation of Property, A Treatise on The Appraisal of Property for Different Legal Purposes, Volume II* (McGraw-Hill 1937) 816.

[68] Fujita (n 26) 289.

[69] Before the Court developed the framework, Fujita (n 26) 288–289 provided the basic theory when the Court should intervene the distribution of the deal's surplus. He argued that there is no need, in a merger between independent companies, for the Courts to intervene with respect to the distribution of surplus. This is because, although the distribution may be skewed, this is merely a matter of distribution of the surplus that always exists between the parties to the transaction. However, where there is a structural conflict of interests between the majority and minority shareholders and decisions are made in accordance with the wishes of the majority shareholders, the Court should intervene with respect to the distribution of surplus. The Japanese Court developed the framework, as explained in the next subsection, which is consistent with the argument by Fujita (n 26).

[70] Kaishahō [Companies Act of Japan], art 2, no 32.

[71] Saikō Saibansho [Sup Ct] Feb 29, 2012, Hei 23 (kyo) no 21, 66 Saikō Saibansho minji hanreishū [Minshū] 1784, 1789 (Japan).

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fairness of the share transfer ratio because if the corporate value increased due to the share transfer, the corporate value after the share transfer would have been distributed to shareholders by allocating the new stock.[72]

Regarding whether the ratio was fair, the Supreme Court divided the case depending on whether there was a special capital relationship[73] between the parties to the deal. It held that, in general, if a share transfer plan is made by companies that do not have special capital relationships with each other, the Court should respect the judgment of the directors and the shareholders.[74] As the directors owe fiduciary duties to each company, and there are no conflicts of interest, the directors would be likely to prepare a plan in line with the company's interests.[75] Moreover, shareholders vote in favour of the share transfer at the shareholders' meeting if they determine that the share transfer ratio is fair, considering how the share transfer will change their interests.[76]

Based on the above, the Supreme Court set the specific criterion for judgment as follows. The ratio of such a share transfer shall be fair when the share transfer between companies without any special capital relationship is made effective through the procedure generally deemed fair, such as the case where the shareholder meeting was legally held, and the disclosure of the information was appropriate.[77] However, this is not the case if there is any particular circumstance to acknowledge that the shareholders' reasonable judgment was hindered.[78] In conclusion, the Supreme Court in the Tecmo case decided to respect the judgment of the shareholders and the directors.[79] It held that the decline of the target company's market price after the announcement of the deal does not reflect the said particular circumstance because market fluctuations occur due to various factors.[80]

Given that the ratio of share transfer is fair, the market price would be the most reliable evidence for determining synergy value. In the Tecmo case, the Supreme Court held that it is within the Court's discretion to either use the base date's market price or an average market price of a period near that date.[81]

From the dissenting shareholder's perspective, this way of determining the synergy value means that exercising their rights does not lead to any financial gain. In this case, there is virtually no difference between the selling price of the stocks in the market and what the shareholder could receive in terms of financial benefits by exercising their appraisal rights. Of course, if the liquidity in the market is low, there is no guarantee that they could sell all their stocks at the same desired price. In contrast, with appraisal rights, there will at least be some interest, and it may look slightly more attractive to the dissenting shareholder to exercise this right. However, with the reform in 2014 mentioned above, there is now a preliminary payment system in place; therefore, such benefits from interests can no longer be obtained. In sum, if the corporate value has increased through a merger, and the distribution of that value is fair, the use of the market value as discussed above functions as a deterrent for the dissenting shareholder by denying any substantial relief. One can argue that this approach is reasonable because there is no reason to give relief beyond the market price to dissenting shareholders as long as the merger is conducted fairly.[82]

[72] ibid.

[73] The Supreme Court has not clarified what the 'special capital relationships' means. One can understand it means the relationship which distorts the shareholder meetings' decision such as a parent-subsidiary relationship or an MBO. See Wataru Tanaka, *Kaishahō* [*Corporate Law*] (3rd edn, Tōkyō daigaku shuppankai 2021) 674–676.

[74] Saikō Saibansho [Sup Ct] Feb 29, 2012, Hei 23 (kyo) no 21, 66 Saikō Saibansho minji hanreishū [Minshū] 1784, 1789 (Japan).

[75] ibid.

[76] ibid.

[77] ibid 1789–1790.

[78] ibid 1790.

[79] ibid 1790–1791.

[80] ibid.

[81] ibid 1790.

[82] Iida (n 59) 42.

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Interested deals: deal price or the judge's calculation

The Supreme Court also uses this framework when the deal structure has conflicts of interest, such as the controlling shareholder's freeze-out of minority shareholders and MBOs.[83] If the proper measures to mitigate the conflicts of interests functioned well, the process of the deal could be determined as fair. Then, when the deal structure in the freeze-outs or MBOs is a kind of cash merger, the Court uses the deal price directly as synergy value because the deal price is reliable. Contrary to stock-for-stock deals where the Court needs to convert the value of a stock to cash to determine the synergy value such as in the Tecmo case, the Court need not make any calculation in the cash merger cases where the deal process is fair.

The Supreme Court illustrates this framework well in the Jupiter Telecom case.[84] In the Jupiter Telecom case, the controlling shareholders made a two-step freeze-out deal: the first was via a tender offer, and the second was via a cash-out procedure in the Companies Act.[85] The controlling shareholders set the price of both steps equal. The Supreme Court held that the Court must determine the value of the share equal to the tender offer price if the deal is made effective through the generally deemed fair process.[86] This fair process involved measures to exclude the effect of the decision-making process becoming arbitrary due to the conflicts of interest between majority and minority shareholders, such as obtaining opinions from an independent special committee and experts.[87] Furthermore, a fair process included the controlling shareholders clearly stating that the shares possessed by shareholders who did not apply for the tender offer would be acquired at the same price as the tender offer,[88] making the tender offer uncoercive.

In contrast, the Court made its original calculation of the value of the share if the deal process was not fair. The Rex Holding case[89], an MBO case, is an excellent example of this type of case. In this case, the process was not transparent enough. The business plan and the expert's report of the valuation of the shares were not disclosed. The buyer used phrases that may have had a coercive effect on the tender offer.[90] The Tokyo High Court decided the fair value at 336,696 JPY per share, much higher than the deal price of 230,000 JPY per share.[91] The Tokyo High Court calculated the objective value (stand-alone value) as 280,805 JPY, the average unaffected stock market

[83]See Saikō Saibansho [Sup Ct] Jul 1, 2016, Hei 28 (kyo) no 4, 70 Saikō Saibansho minji hanreishū [Minshū] 1445 (Japan).

[84]Saikō Saibansho [Sup Ct] Jul 1, 2016, Hei 28 (kyo) no 4, 70 Saikō Saibansho minji hanreishū [Minshū] 1445 (Japan).

[85]The wholly callable share was used, in the Jupiter Telecom case, as a tool for cash-out, which was the standard practice in Japan. It is a type of class share that may be acquired by the issuing company in its entirety by a special resolution of a shareholders' meeting. The main reason for the use of such a scheme is taxation. In other words, in the case of a share exchange with cash consideration, the unrealised gains on the assets of the target company were subject to market value taxation, whereas this problem did not exist in the case of a wholly callable share scheme. In addition, while reverse stock splits did not provide for an appraisal right, the acquisition of wholly callable shares provides for an appraisal right (Kaishahō [Companies Act of Japan] art 116, para 1, item 2) and a petition to determine the fair acquisition price (Kaishahō [Companies Act of Japan] art 172), which are procedural guarantees for the protection of minority shareholders. See Hidefusa Iida, 'Shōsū kabunushi no shimedashi, sukuīzu auto [Squeeze-outs of Minority Shareholders]' (2018) 458 Hōgaku kyōshitsu 34.

However, since the 2014 amendment which introduced an appraisal right for reverse stock splits (Kaishahō [Companies Act of Japan] art 182-4), and a new system of demand for share cash-out by special controlling shareholders with 90% or more shareholding, the practice of using these two systems has become a standard practice for cash-outs. Masafumi Nakahigashi, 'Heisei 26-nen kaisha-hō kaiseigo no kyasshu auto hōsei [Cash-out Legislation after Revision of the Companies Act in 2014]', in *Kin'yū shōhin torihiki hōsei ni kansuru shomondai, ge* [*Various Issues Concerning Financial Instruments and Exchange Legislation (Volume 2)*] (Nihon shōken keizaikenkyūsho 2018) 158, 159–164.

[86]Saikō Saibansho [Sup Ct] Jul 1, 2016, Hei 28 (kyo) no 4, 70 Saikō Saibansho minji hanreishū [Minshū] 1445, 1451 (Japan).

[87]ibid.

[88]ibid .

[89]Saikō Saibansho [Sup Ct] May 9, 2009, Hei 20 (kyo) no 48, 1326 Kin'yū shōji hanrei [Kinhan] 35, 36 (Japan).

[90]ibid 36.

[91]Tōkyō Kōtō Saibansho [Tokyo High Ct] Sep 12, 2008, Hei 20 (ra) no 80, 1301 Kin'yū shōji hanrei [Kinhan] 28 (Japan).

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price prior to the deal's announcement.[92] The Tokyo High Court then calculated synergy value by adding 20% to the stand-alone value and arrived at a value of 336,696 JPY (=280,805 × 120%).[93] The Tokyo High Court used a figure of 20% because the premiums in other MBOs during those days ranged from 16.7% to 27.4%, averaging 27.05%.[94] The Supreme Court upheld this decision by the Tokyo High Court.[95]

Comparison of The Conditions to Use the Deal Price for Determining the Fair Value

Japanese precedents are distinctive in that they appear to have established a rule of withholding court intervention subject to the fairness of the deal process. The Japanese Supreme Court made it clear that, in cases where procedures generally accepted as fair were taken, the deal price was respected for determining the fair value of the appraisal right. Of course, as in the Rex Holding case, the Court sometimes calculates the synergy value without using the deal price. Moreover, as in the Intelligence case, the Court sometimes calculates hypothetical value using the market model, requiring the judges to understand finance and econometrics. However, such cases have become extremely rare since the time of those two cases. Rather, in most of the appraisal cases in Japan, the Court finds that the deal increases the corporate value and the deal process is fair, and hence, decides the synergy value by using the deal price.[96]

In Delaware, on the one hand, such a framework of the fair value depending on the fairness of the deal process has not been adopted as a general doctrine, but, rather, has been criticised by the Court for improperly transferring the responsibility for determining the fair value from courts to private parties.[97] On the other hand, the Delaware court also emphasised that when the deal procedure is fair, respecting the deal price is required. It held that it does not intend to ignore the economic reality that robust market checks are often the most credible evidence of the fair value; and that it is hazardous to criticise, with hindsight, the prices obtained based on the collective wisdom of many sophisticated parties with real stakes in the market.[98] Furthermore, in Dell's MBO case, the Delaware Supreme Court held that the Court should respect the deal price in the appraisal case because the parties took many measures to minimise the conflicts of interest and allowed the shareholders to receive the highest possible price.[99] This line of thought appears to have the same meaning as that of the Japanese case law.[100]

In Delaware, the Supreme Court does not clarify the detailed conditions to evaluate the deal process as fair.[101] However, one of the most important factors is whether the deal negotiator conducts a

[92]ibid 38.

[93]ibid 39.

[94]ibid.

[95]Saikō Saibansho [Sup Ct] May 9, 2009, Hei 20 (kyo) no 48, 1326 Kin'yū shōji hanrei [Kinhan] 35 (Japan).

[96]Tomotaka Fujita, 'Kabushiki kaitori seikyū-ken o meguru shomondai, kaisha hō seitei go 10-nen no keiken o hete [Various Issues Concerning Rights to Demand Purchase of Shares, After 10 Years of Experience after the Enactment of the Companies Act]', in Etsurou Kuronuma & Tomotaka Fujita (eds), *Egashira kenjirō sensei koki kinen, kigyō-hō no shinro* [*Professor Kenjiro Egashira's 70th Birthday Commemorative, Corporate Law Paths*] (Yuhikaku 2017) 435–440. See eg, Ōsaka Chihō Saibansho [Osaka Dist Ct] Jan 18, 2017, 1520 Kin'yū shōji hanrei [Kinhan] 56 (Japan) (two-step cash-out by the largest shareholder with 32.74% shareholding); Ōsaka Kōtō Saibansho [Osaka High Ct] Nov. 29, 2017, Hei 29 (ra) no. 775, 1541 Kin'yū shōji hanrei [Kinhan] 35 (Japan) (MBO via two-step merger); Tōkyō Kōtō Saibansho [Tokyo High Ct] Feb 27, 2019, Hei 30 (ra) no 382, 1564 Kin'yū shōji hanrei [Kinhan] 14 (Japan) (two-step merger).

[97]*Golden Telecom, Inc v Global GT LP*, 11 A3d 214 (Del 2010).

[98]*DFC Glob* (n 2) 172 A3d, 366. Respecting the deal price seems to contradict with the previous rejection of a framework of the fair value depending on the fairness of the deal process, but it is not so. The Delaware Supreme Court refused to 'craft a statutory presumption', but did not mean to ignore 'the economic reality that the sale value resulting from a robust market check will often be the most reliable evidence of fair value' (*DFC Glob* (n 2) 172 A3d, 366).

[99]*Dell* (n 2) 177 A3d, 37.

[100]Hidefusa Iida, 'Kabushiki kaitori seikyū-ken seido no genkai tekumo jiken kettei o tegakari ni [Limitations of the Appraisal Right System, An Analysis Using the Tecmo Case as a Clue]' (2018) 449 Hōgaku kyōshitsu 80, 84.

[101]Korsmo (n 20) 589 (points out that the Delaware Supreme Court does not 'attempt to craft a general definition of when a process would lead to a deal price sufficiently reliable to justify judicial deference as to fair value').

robust market check to investigate other potential buyers' possible offers. For example, in Jarden, the Court of Chancery held that the deal process was not fair. One of the reasons for this decision was the lack of a pre-signing or post-signing market check, and the deal price was not used to determine fair value.[102]

From the viewpoint of comparison between Japan and Delaware, the hurdles of procedural fairness required by Japanese precedents are lower. The Japanese courts tend to treat the deal process as fair and merger price as fair value irrespective of whether the market check is conducted.[103] The Japanese courts treat the deal process as fair if (i) the target board of directors retains the legal advisors, (ii) the merger price is within the range of the valuation report submitted by the financial advisors or the experts on the valuation of stocks, (iii) in the cases of two-step mergers, the first-step tender offer price is the same as the price of the second step transaction, and (iv) in the cases of interested deals, such as freeze-outs and MBOs, the target board establishes the special committee and receives its opinion stating that the merger price is fair.[104]

The Japanese courts have not required the special committee to have the power either to retain its own legal advisors and financial advisors or to negotiate the deal with the power to say no. Moreover, under the Japanese mergers and acquisitions (M&A) practice, there is rarely a competing offer. Given this market reality, a market check could be one of the best practices to deal with any conflicts of interest. Nevertheless, the Court does not demand it. The lack of the pre-signing or post-signing robust market check does not make the Court evaluate the deal process as unfair. Someone familiar with the Japanese M&A practice might oppose this argument and argue that such a market check is unnecessary because strong deal protection is not used in Japanese M&A practice. However, it is challenging for the other potential buyers to launch a competing offer, which generally becomes a hostile offer and faces many objections from the target company, even if strong deal protection is not used.[105]

The same is true even when the controlling shareholder is involved. The Japanese Supreme Court, in the Jupiter Telecom case, mentioned that getting an opinion from the special committee and experts is necessary to treat the deal process as fair but did not mention whether the special committee is required to have the power to make negotiations or conduct a market check.[106] One can criticise this holding because even the special committee could end up rubber-stamping the controlling shareholder's offer, given that the controlling shareholder controls the target company and that the special committee does not have the power to negotiate the deal price, reject the deal itself, or search for other potential buyers.[107]

[102]In re *Jarden Corp*, 2019 Del Ch LEXIS 271, at *7 (Del Ch Jul 19, 2019).

[103]Some scholars criticise the current Court's framework. See Akimasa Yanagi, '"Kōseina kakaku" no handan wakugumi to māketto chekku no igi shatei, ōkushon riron o tegakari to shite [Framework for Determining "Fair Value" and the Significance and Scope of Market Checks, Using Auction Theory as a Clue]' (2019) 2207 Shōji hōmu 32, 40 (the deal price can be recognised as fair if it can be evaluated as a rational deal process that maximizes the sale price in light of auction theory).

[104]See eg, Tōkyō Kōtō Saibansho [Tokyo High Ct] Jun 19, 2017, Hei 29 (ra) no 378 (Japan)(available at LEX/DB25549405); Ōsaka Kōtō Saibansho [Osaka High Ct] Nov 29, 2017, Hei 29 (ra) no 775, 1541 Kin'yū shōji hanrei [Kinhan] 35 (Japan); Tōkyō Kōtō Saibansho [Tokyo High Ct] Feb 27, 2019, Hei 30 (ra) no 382, 1564 Kin'yū shōji hanrei [Kinhan] 14 (Japan).

[105]Furthermore, whether non-use of any deal protection measures are beneficial to the shareholders is debatable. See Albert H Choi, 'Deal Protection Devices' (2021) 88 University of Chicago Law Review 757, 827 ('argues that when the incentives of target directors and managers are well aligned with those of the shareholders, not only can the deal protection devices increase the target shareholders' welfare, the deal price can also be a more reliable indicator [compared to a case that does not have any deal protection measures] of fair value').

[106]See Saikō Saibansho [Sup Ct] Jul 1, 2016, Hei 28 (kyo) no 4, 70 Saikō Saibansho minji hanreishū [Minshū] 1445 (Japan).

[107]See Toshiyuki Tamai, 'Tasū kabunushi ni yoru nidankai baishū to kaisha-hō 172-jō 1-kō no kabushiki shutoku kakaku, jupitāterekomu jiken [Two-Step Acquisition by Majority Shareholders and Stock Acquisition Price under Article 172,

Of course, if a target company has a controlling shareholder who is also a buyer, it is highly unlikely that any potential buyer will make an offer because the controlling shareholder will reject it. However, theoretically speaking, the Court in the Jupiter Telecom could have required the board of the target company or its special committee to seek guarantees from the controlling shareholders that they will support a higher bid if it appears and use those guarantees to attract potential buyers to treat the deal process as fair. This theoretical way of thinking is real in Delaware. In the Golden Telecom case, the Court of Chancery of Delaware held that the special committee failed to seek such guarantees from the two largest shareholders of the target company and rejected to deem the deal price as fair value.[108] Furthermore, in the Dell's MBO case, Mr. Dell, who is the founder and CEO of the target company, the shareholder with 15% of shares, and the buyer who offered the MBO, entered into confidentiality agreements with the special committee that required Mr Dell to '"explore in good faith the possibility of working with any such potential counterparty or financing source if requested by the Committee," a provision designed to prevent his prior involvement with KKR and Silver Lake from deterring other possible bidders.'[109]

In sum, including the synergy value in the fair value does not greatly change the minority shareholders' protection in Japan. The conditions based on which the deal process is deemed fair are easy to satisfy because they constitute common practice in Japan and are lenient compared to the Delaware case laws. Of course, under the synergy value concept, the petitioner of the appraisal remedy does not have to worry about losing money by exercising the appraisal right. However, if the Court tends to determine the fair value as the deal price, the petitioner's economic situation by exercising the appraisal right is almost the same as the situation where the shareholder sells their stock in the stock market.[110] Thus, it does not make much sense to make the petitioner free from such a concern of losing money by exercising their appraisal right. It gives no real protection to minority shareholders. This attitude of the Japanese courts is inconsistent with what was expected when the appraisal right was revised in 2005.

It is possible in the future for the Japanese courts to scrutinise procedural fairness more stringently. The recent 'Fair M&A Guidelines'[111] published by Japan's Ministry of Economy, Trade and Industry on June 28, 2019 might be the potential reform source. Although the Guidelines do not have any legally binding power, they encourage, as best practices, forming a special committee to substantially participate in the negotiation, conducting a market check if appropriate, and using a majority-of-minority condition if appropriate.[112] However, there has been no precedent since the publication of the Guidelines. We must wait and see in the future if the Guidelines will change the courts' attitude in appraisal cases.

Paragraph 1 of the Companies Act, The Jupiter Telecom Case]' (2018) 1543 Kin'yū shōji hanrei 2, 4–6 (without the approval by the majority of minority shareholders, the Court should not deem the deal process as fair).

[108]*Global GT LP v Golden Telecom, Inc*, 993 A2d 497 (Del Ch 2010).

[109]*Dell* (n 2) 177 A3d, 9.

[110]The appraisal functions to convert the share into cash. See Fujita (n 96) 434.

[111]Ministry of Economy, Trade and Industry, 'Fair M&A Guidelines — Enhancing Corporate Value and Securing Shareholders' Interests' (METI, 2019) <https://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/fairmaguidelines_english.pdf> accessed 3 Jul 2022.

[112]Japan's M&A practice respects the Guidelines. The special committee has come to have the power to not only state its opinion regarding the fairness of the deal, but negotiate the deal. The ratio of such cases from 2006 to 2013 was just 16% (13 of 80 cases). See Masakazu Shirai, 'Riekisōhan torihiki ni okeru riekiaihan kaihi sochi no genjō [Current Status of Measures to Avoid Conflict of Interests in Conflict of Interests Transactions]', in Wataru Tanaka & Mori, Hamada & Matsumoto (eds), *Nihon No Kōkai Kaitsuke, Seido To Jisshō* [*Japanese Tender Offer, System and Empirical Analysis*] (Yuhikaku 2016) 357, 366. Recently, its ratio is 45% (45 of 100 cases) from 2019 to 2022. Shuhei Uchida et al, '"Kōseina M& A no arikata ni kansuru shishin" sakutei-go no kōkai kaitsuke ni okeru kōsei-sei tanpo sochi no bunseki [Analysis of Measures to Ensure Fairness in Tender Offers after the Formulation of the "Guidelines for Fair M&A"]' (2022) 459 Shiryō-ban shōji hōmu 53, 59.

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Analysis

2005 Amendment and synergy value

Logically, it seems that the Japanese Supreme Court was able to require the ideal procedure even if it is not generally shared in the M&A practice. For example, there was the option for the Court to require that, if there is a conflict of interest, the special committee by an independent outside director must have the authority to appoint financial and legal advisors on its own. Furthermore, the special committee could be required to carry out robust market checks and rigorous negotiations; if the special committee considers the deal inappropriate, it must have the authority to stop it.[113]

However, such measures did not seem familiar in Japanese M&A practices at the time of these cases, and neither did the Supreme Court of Japan require such measures. The Supreme Court's criteria at the lower hurdle can be understood as being practically reasonable. This line of explanation might offer a reason for the Supreme Court's doctrine.[114]

This attitude of the Japanese courts is not consistent with what was expected when the appraisal right was revised in 2005 to enhance the protection of the minority shareholders by allowing synergy to be distributed to minority shareholders, especially in the M&A deal between controlling and subsidiary companies. Its purpose should have been to strengthen the protection of the minority shareholders[115] but not to acknowledge the common M&A practice that is taking place. In this respect, the development of Japanese case law seems to have taken a different path from what was expected of the 2005 revision.[116]

However, it is unfair to criticise the Court for giving up its responsibility. Originally, the problem was with the 2005 revision aimed at protecting both the hypothetical and synergy values. The distribution of increased enterprise value is a matter of surplus distribution arising from transactions. In the case of transactions between independent parties, it is a task of nature that the freedom of transactions must rule and that the Court should not intervene.[117] Thus, the cases in which the Court intervenes should be limited to those where an unfair transaction is carried out.[118] Avoiding false-positives could justify the Japanese precedents for setting a lower review standard for the deal process's fairness. Thus, requiring the courts to calculate the fair value as hypothetical or synergy value and rigorously intervene in the deal price is asking for too much.

In contrast, the meaning of fair value in the Delaware law is to calculate the fair value by deducting the synergy effects from the actual transaction price. As for the synergies, they are based on a policy that stands opposite to that in the Japanese law. Delaware courts must explore the intrinsic value of stocks, assuming that there had been no merger. The actual deal price is trustworthy for the evidence of such intrinsic value if the control market functions effectively. Therefore, a robust market check is required in Delaware to adopt the deal price as the fair value. Since the Delaware law keeps away from the issue of the distribution of the synergy effects, it is not necessary to argue in what kind of cases the Court should not intervene in the distribution of the synergies.[119]

Appraisal right as a screening mechanism

The Japanese courts' attitude would be reasonable from the perspective of efficiency, given that fair value means hypothetical value or synergy value. If the Court determines the fair value by using the

[113]See Masakazu Shirai, 'Genjō o fumaeta riekiaihan kaihi sochi ni kansuru kentō [Examination of Measures to Avoid Conflicts of Interest Based on the Current Situation]', in Wataru Tanaka & Mori, Hamada & Matsumoto (eds), *Nihon no kōkai kaitsuke, seido to jisshō* [*Japanese Tender Offer, System and Empirical Analysis*] (Yuhikaku 2016) 161.

[114]See Iida (n 100) 85.

[115]Egashira (n 25) 9.

[116]See Iida (n 100) 85.

[117]Fujita (n 26) 288–289.

[118]See Iida (n 100) 85.

[119]See Iida (n 100) 85.

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deal price, the excessive incentive to exercise an appraisal right can be mitigated by a lax review of the deal process. The above-stated framework of the fair value of the appraisal right under the Companies Act gives dissenting shareholders a no-lose situation. If the dissenting shareholders exercise the appraisal right, they will receive a fair value equal to the deal price or more. The fair value would be equal to or higher than the deal price in the following three possible situations. First, if the merger is a value-decreasing one, the fair value is the hypothetical value higher than the deal price. Second, if the merger is a value-increasing one and the merger process is fair, the fair value is the synergy value that equals the deal price. Third, if the merger is a value-increasing one and the merger process is unfair, the fair value is the synergy value that is higher than the deal price. Thus, considering the Japanese Court's doctrine of the appraisal remedy described above, the shareholders' incentive to file an appraisal could be excessive.[120]

This excessive incentive for shareholders to file an appraisal would deter not only inefficient mergers but also some of the efficient mergers. In theory, an appraisal right can perform a screening mechanism.[121] From the view of efficiency, such a screening mechanism should deter value-decreasing mergers but should not deter value-increasing ones. Deterring value-decreasing mergers, especially with conflicts of interest, such as MBOs and freeze-outs, might be important in Japan,[122] where the fiduciary duties of both the controlling shareholders and director are unclear. However, the appraisal remedy whose 'fair value' includes the synergy value deters value-increasing mergers more than the appraisal remedy whose 'fair value' precludes the synergy value and includes only the hypothetical value. As the Companies Act provides that the resolution of approving mergers shall be a special resolution in which at least two-thirds of the shareholders vote, mergers will not be approved if more than one-third of the shareholders vote 'no'.[123] Alternatively, the parties might not enter into the merger agreement from the beginning out of fear of cash flowing from the company due to the abounding exercises of the appraisal right.

Of course, the above-stated thinking is hypothetical and could be different from that in the real world. For example, the cost of filing an appraisal might be large enough to deter shareholders from filing it. If this is the case, we need not worry about deterring too many value-increasing mergers.[124] However, because, in an appraisal proceeding, the filing shareholder does not owe the burden of proof to establish 'fair value,' the cost of filing an appraisal might not be so high. In several appraisal proceedings whose judgments were published, individual shareholders filed the appraisal proceedings by themselves without hiring attorneys.[125] Thus, the cost of filing an appraisal is not prohibitively high, at least for some shareholders.

Considering the above analyses, the courts' attitude to avoid intervening in the deal price lowers the expected value of fair value. It moderates the excessive incentive for shareholders to vote against the deal and exercise the appraisal remedy. This function would be desirable for, at least, value-increasing deals. The aggressive intervention of the fair deal due to the judge's misunderstanding of the M&A practice would motivate minority shareholders to exercise the appraisal right excessively and would be worse than the current courts' passive review of the deal.

[120]See Iida & Sekiguchi (n 26) 232–235.

[121]See eg, Lucian Arye Bebchuk, 'Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments' (1989) 102 Harvard Law Review 1820, 1853.

[122]See Koh (n 28) 456–458.

[123]Appraisal remedy is available for shareholders who vote against the merger at the shareholders meeting. See Kaishahō [Companies Act of Japan] art 785, para 2, no i, art 797, para 2, no i, and art 806, para 2, no i.

[124]See Etsuro Kuronuma, 'Kabushiki kaitori seikyū-ken ni kansuru ichi shōsatsu [A Reflection on Stock Appraisal Rights]', in Etsurou Kuronuma & Tomotaka Fujita (eds), *Egashira kenjirō sensei koki kinen, kigyō-hō no shinro* [*Professor Kenjiro Egashira's 70th Birthday Commemorative, Corporate Law Paths*] (Yuhikaku 2017) 418 (the speculative behavior of shareholders is unlikely to prevent a resolution from being passed at the general meeting of shareholders).

[125]See eg, Ōsaka Chihō Saibansho [Osaka Dist Ct] Jan 18, 2017, 1520 Kin'yū shōji hanrei [Kinhan] 56 (Japan).

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Conclusion

Japanese legislators expected the appraisal right to work as a form of discipline on an M&A, especially in the case of an M&A with conflicts of interest. However, the Japanese courts are reluctant to intervene in the deal price by holding that the deal process was not fair enough to respect the deal price. Instead, the Court tends to treat the process that the M&A practice generally takes as fair. The establishment of the Court's framework to inquire whether the deal procedure was generally accepted as fair reduces the attractiveness of the appraisal right. Although the dissenting shareholder theoretically has the chance to get a higher synergy value than the deal price, such a framework makes it very unlikely to have such a chance.

Whether the current situation is desirable for Japanese M&A markets is unclear. On the one hand, limiting the Court's intervention through the appraisal right is efficient, especially considering the arms' length deal. Assuming a world where shareholders like hedge funds exercise the appraisal right and claim billions of yen, the Court's aggressive intervention of the fair value would have a chilling effect on M&A deals. This is true in Japan because the shareholders who exercise their appraisal right are in a no-lose position. In terms of game theory, it is a weakly dominant strategy to exercise the appraisal right if the cost of exercising it can be ignored. As the concept of fair value could make the incentive to exercise the appraisal right excessive, limiting the number of cases where the Court determines a price higher than the deal price to very few would strike the right balance.

On the other hand, if we expect a policy to strengthen regulations on the issue of conflicts of interest, the current situation is not desirable. The Court sets too low a standard for dealing with such an issue. If we expect the appraisal right to be a useful tool to regulate the conflicts of interest in Japan, we should reconsider the 2005 reform and change the concept of fair value regarding how synergy must be incorporated in the appraisal right.[126] Such a change will eliminate the need for consideration to constrain the Court's intervention in the surplus of the deals. In other words, to protect the interests of shareholders, it is not always good to strengthen the rights of shareholders; rather, by restricting the rights of shareholders a little more than in the current situation, it is possible to strengthen the protection of the interests of shareholders instead.

If we need to keep using the fair value concept using both hypothetical and synergy values, then other routes would be necessary. For example, clarifying the fiduciary duties regarding M&A would help strengthen the protection of the minority shareholders. In Delaware, the basic method to protect minority shareholders has been fiduciary duties, such as the Revlon[127] standard and the entire fairness[128] standard. The attention on the appraisal right in Delaware is relatively new compared to that on fiduciary duties.[129] Thus, if the other routes clarify what process constitutes a fair deal in Japan, the courts in the appraisal litigation will be able to rely upon such ideas without creating rules of what a fair deal is from scratch. The Fair M&A Guidelines might be helpful in this regard. We must wait and see in the future if this guideline changes the courts' attitude in the appraisal cases.

[126] See Iida (n 34).
[127] *Revlon, Inc v Macandrews & Forbes Holdings, Inc*, 506 A2d 173 (Del 1986).
[128] See *Weinberger v UOP, Inc*, 457 A2d 701, 711 (Del 1983).
[129] See Korsmo & Myers (n 27) 230 (a dramatic increase in appraisal activity began in 2011).

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