



# New Supreme Court case on squeeze out compensation in Japan

On 29 May 2009, the Japanese Supreme Court issued its first ruling on the application of the Japanese Companies Act to compulsory acquisitions of minority shareholders following a takeover bid (a squeeze out). The case provides up-to-date guidance on the approach the courts take in determining if minority shareholders, whose shares are acquired compulsorily, have been fairly compensated.

## Analysis

On 29 May 2009, the Japanese Supreme Court issued its first ruling on the application of the Japanese Companies Act to compulsory acquisitions of minority shareholders following a takeover bid (a squeeze out). Following this Supreme Court ruling, a bidder structuring a squeeze out should keep in mind the following factors when determining the compensation to be offered:

- the market price of the shares and an appropriate premium to compensate for loss of expected future share price rises;
- if there are any special circumstances (eg market rumours, earnings announcements or any other factor causing a temporary fluctuation in the share price) that mean that the average market price is not representative of the fair value of the shares; and
- recent offer price premiums in similar TOBs or management buy-outs (MBOs). Twenty per cent may be a good starting point for analogous MBOs and the Court's reasoning suggests the appropriate premium should be based on market practice at the time of a particular squeeze out.

In preparing for a squeeze out, it is also advisable for a company to prepare evidence justifying the compensation that it offers.

## The facts

In November 2006, restaurant and convenience store operator Rex Holdings announced that it was the target of an MBO at an offer price of ¥230,000 per share. The

MBO was successful, with 91.51 per cent of shares being tendered or separately acquired. A squeeze out was proposed with the remaining minority shareholders' interests to be acquired at the same consideration ¥230,000 per share.

## Court proceedings

Under the relevant provisions of the Companies Act, any shareholder objecting to a compulsory acquisition may file a petition with the court to determine the fair compulsory acquisition price. Minority shareholders petitioned the Tokyo District Court asserting that the consideration for the squeeze out (which was equal to the TOB price) did not reflect the shares' fair value and requested the Court to set a higher price. The shareholders submitted that Rex's downward earnings estimate revision before the announcement of the MBO was intended to lower its share price.

Although the shareholders were unsuccessful in the first instance, they prevailed after an appeal to the Tokyo High Court. The High Court determined that the Companies Act requires fair compensation to be given to shareholders who have been squeezed out and that such compensation should be determined based on: (a) the value of the shares acquired at the time of the squeeze out (calculated on the basis of an average share price across an extended period); and (b) the loss of expected future price rises in the shares (taking account of various company-specific facts such as the business plans, expected profitability and performance of the business).

On that basis, the High Court determined that fair compensation was ¥336,966 per share, which is significantly higher than the TOB price.

The Supreme Court upheld the High Court's findings that Rex had not sufficiently rebutted the shareholders' claim that it had intentionally lowered its earnings estimates with a view to lowering the market price for its shares prior to the MBO, which led the High Court to assess the fair value of the shares over a lengthy (six-month) period. It indicated that courts have considerable discretion in assessing the level of premium to compensate a shareholder for the loss of expected future share price increases. In the absence of evidence from Rex on the calculations that had resulted in the original compensation offer of ¥230,000, the Court decided to refer to premiums offered on recent analogous MBOs and concluded that a 20 per cent premium was appropriate.

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