A RENGO Perspective - Approaches and Policy Issues Concerning Hedge and Private Equity Funds

RENGO - Japanese Trade Union Confederation

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INTRODUCTION

(1) The Current Situation and the Background to the Emergence of Investment Funds

In recent years, the increase in corporate mergers and acquisitions (M&A) involving investment funds, notably private equity (PE) funds and hedge funds, has had a significant impact on the economy and on employment, raising important issues for the international labour movement. The inflow of funds into investment funds has been expanding steadily, with assets managed globally by hedge funds reaching $1,740 billion and by PE funds $700 billion.

This rise is said to be caused by a global “money glut,” there being an expanding inflow of oil money due to rising oil prices and growing foreign currency reserves among emerging economies. Also, financial institutions and pension funds have recently incorporated into their portfolios investment funds that used to be investment vehicles which were reserved mainly for wealthy individuals. There is also a problem in that the money that workers have deposited or contributed through investment funds can be used to help destabilize jobs and working conditions.

(2) The Relationship between Enterprise Value and Workers

In the meantime, there have been public debates at various forums over “who owns companies.” If one subscribes to the notion of shareholder supremacy, where the ownership of a majority of equity shares in a company ensures control, then a company is just a physical object for buying and selling (a commodity), with little attention paid to the flesh-and-blood employees who work there. The enterprise value of the company as a commodity is simply the market capitalization of its shares and the appraised value of assets held. As shareholders are overly eager to pursue higher share prices and fat dividends, corporate managers pursue short-term results and profits and become reluctant to invest in the development of human resources and basic research from a longer-term perspective.

However, a company, in our view, is a public organ in society where a group of employees as human beings develops a business, generates intellectual property and contributes to society, that is to say, it is a company of human beings (a community).

The meaning and value of labour differs significantly depending on whether one considers it a cost or a resource. If labour is taken as a cost, a company’s management acts as if it is guided by the notion that the lower the cost, the better. However, when labour is considered a resource, management behavior is geared toward the enhancement of the quality of labour through capacity development and education. In a company as a community, needless to say, labour is a resource. In order for a company to enhance enterprise value and realize sustained development, it needs to develop an environment where employees can work enthusiastically.

(3) The Formation of an Undisciplined Market and Policy Issues

In Japan, however, the revision of the Company Law, oriented toward a shift to the U.S.-style system, has led to excessive deregulation, and an undisciplined market is being developed to promote corporate buy-outs.

While the Financial Instruments and Exchange Law, put into force in September 2007, may ensure a certain degree of control over and transparency in investment funds, it falls short of regulating their investment behavior. Furthermore, in labour-related legislation, some fundamental problems, including that of employer liability, remain unresolved.

Based on this understanding of the current situation, we have looked at the policy issues involved in the development of a disciplined and sound capital market and at trade union responses, and have formulated RENGO's basic approach to M&A activities by investment funds. We hope the "Basic Approach" will serve as a good reference for trade union responses and for policy recommendations regarding investment funds not only within RENGO organizations but also in other quarters.

1. INVESTMENT FUNDS AND THE LEGAL FRAMEWORK FOR CORPORATE BUY-OUTS AND M&A

(1) The Current State of Investment Funds and M&A and the Problems Involved

Investment funds are "collective investment schemes for funds and money, where funds are collected from investors for investment in companies, etc. and investors are rewarded with dividends from target companies and with proceeds from their exchange listings." Investment funds are diverse in type, depending on the investment target and stance. They include such traditional investment funds as mutual funds as well as hedge funds, private equity (PE) funds and activist funds, which have shown continued growth in recent years.

RENGO has no intention of rejecting investment funds or their activities per se. Rather, RENGO fully understands that these funds can perform an important social role in that they can financially support the sustained growth and development of companies and the economy, and provide job security for workers. The problem lies in the existence of some investment funds that are preoccupied with paying the highest possible dividends to investors, thereby distorting the genuine raison d'etre of an investment fund. Such funds eat away at the growth potential of companies by acquiring them through a circumvention of market rules and by slipping through holes in the law by using for leverage a massive pool of funds. They then demand exorbitant dividends through personnel cuts and the sell-off of company assets, or they obtain huge margins in an extremely short span of time by demanding that the management or some other party concerned buy back the company at prices far in excess of the fund's own acquisition costs.

Moreover, since many PE funds procure acquisition funds using the assets of target companies for collateral, these borrowings are recorded as debts in the balance sheets of the acquired company after the takeover. The horizon of a PE fund is generally said to be three to five years. Thus, investment and business plans mapped out on the basis of strategies for a few years down the road can hardly be regarded either as sufficiently sustainable to contribute to the long-term interests of an acquired company or as adequate to maintain good working conditions and steady employment.

In addition, due to the derivatives trading that is practiced by hedge funds and others, amounts of money far in excess of the actual investments made are racing around global markets in a fraction of a second, raising the specter of the failure of just a handful of funds causing dysfunction in the global financial system as a whole.

Some investment funds escape legal requirements such as for registration, notification of incorporation, and information disclosure by taking the form of investment associations. The real investors in such funds remain unknown to the outside world due to the high degree of anonymity involved, and, in many cases, their investment performance or the scale of funds under their management are far from transparent.

The total amount of capital dedicated to private equity business globally is said to be a little over $700 billion as of the end of 2006. Large corporate buy-out funds have set foot in Japan one by one in recent years. Trade unions must give full heed to the possibility of most of their money being used to acquire Japanese companies.

Also, rules for corporate acquisitions have been significantly relaxed due to the recent revision of the Company Act. The stock swap system was introduced in 1999, and the ban on the so-called triangular merger structure was lifted in May 2007. These measures are perceived to have made it easier for foreign corporations with enormous capital strength to acquire Japanese companies. RENGO does not necessarily regard every case in which a foreign firm acquires a Japanese company as evil. What matters is whether the acquisition is really conducive to enhancing the enterprise value of an acquired company and whether enough heed is given to working conditions and jobs as well as to industrial relations.

At general meetings of shareholders in 2007, many Japanese companies proposed measures to defend themselves against hostile acquisitions and have had them endorsed. While some criticism was heard that corporate managers were proposing defensive measures for their own protection, the widespread approval for these measures at the meetings was seen as vindication that management was indeed introducing defensive measures in the interests of shareholders as a whole. Given that the relevant laws and market rules are still inadequate, individual companies' efforts to introduce defensive measures against takeovers are to some extent worthwhile. However, a mechanism to prevent corporate acquisitions that threaten the sustained growth of industries and companies should primarily rely on legislation and market rules.

(2) Currently Legal Forms of Corporate Buy-outs and M&A in Japan

In a normal corporate buy-out and M&A, an acquirer makes an approach of some sort to a target company and after negotiations they proceed toward some form of business integration. Procedures and issues of concern differ depending on whether the target company accepts or does not accept the acquiring company's proposal.

In a management buyout (MBO) where the managers and/or executives purchase the controlling interest in a company from existing shareholders, a possible conflict of interest needs to be taken into account because the acquirer would continue to serve as the management team of the acquired company.

a) When a Target Company Accepts an Acquirer's Bid

When a target company accepts an acquirer's proposal, the acquirer and the to-be-acquired company consider the most suitable procedures for the integration of their business. They then adopt integration procedures based on a bilateral agreement between the two parties. More specifically, various procedures, such as the following, can be assumed: a merger and a stock swap or a transfer arrangement, depending on the business operations of both companies, together with a post-integration vision for the company. Another possibility is for the acquirer to launch a takeover bid (TOB) and for the target company to give its consent to the TOB procedure.

However, even if the target company ultimately accepts the acquirer's bid, it is possible that the to-be-acquired company was compelled to accept it due to heavy pressure being brought to bear on it by the acquirer or by major shareholders in the run-up to the final accord. Also, the managers of the target company may agree to the takeover because they put their own personal interests ahead of the enhancement of the enterprise value of the to-be-acquired company. Therefore, even when the target company accepts an acquirer's bid, trade unions need to ascertain whether or not unreasonable decisions were made in the process leading up to the acquisition agreement.

b) When a Target Company Rejects an Acquirer's Bid

When a target company rejects an acquirer's acquisition proposal, procedures for their integration cannot be taken on the basis of an agreement between the acquirer and the to-be-acquired company. Thus, if the acquirer is to realize the proposed acquisition, it has to replace the management team of the target company in some way or other and elect a new management team that complies with the acquirer's wishes, and then it can take the appropriate integration procedures.

In order to replace the management team of the to-be-acquired company, the acquirer must have enough votes to pass an agenda item for the election of board members at the target company. It is therefore necessary for the acquirer to obtain a majority of the outstanding shares of the target company or to secure enough supporters among the shareholders so that their holdings, combined with those of the acquirer, make up the majority of outstanding shares.

When the acquirer wishes to obtain the majority of outstanding shares in the target company, it launches a hostile TOB for the to-be-acquired company. When the acquirer seeks the support of like-minded shareholders whose holdings, together with its own holdings, make up the majority of outstanding shares, it submits a shareholder's proposal for the election of members to the board of directors and solicits proxy votes to garner enough support to have its proposal approved.

When the target company rejects the acquirer's bid and the acquirer launches a hostile TOB or chooses to solicit proxy votes from supportive shareholders, the takeover battle is decided by which side, that of the acquirer or that of the target company, wins the support of the majority of the shareholders. In such a case, the target company's management can be expected to carry out defensive measures against the hostile bid in an effort to increase its support among the shareholders. Usual measures of this kind can include the management increasing the company's capital through a third-party allotment of new shares or the issuance of share warrants with discriminatory conditions, following which it can then ask shareholders to vote in support of the management. However, once management launches such a defense action, the acquirer will very probably file a court injunction against the issuance of new shares or share warrants and thus bring the battle into the courtroom.

Even when the target company rejects the acquirer's bid, the management team of the target company may make decisions by putting their own personal interests ahead of the potential enhancement of the enterprise value of the target company. Thus, trade unions need to ascertain whether or not unreasonable decisions were made by the existing management team in the series of developments leading up to management's final decision to turn down an acquisition bid.

c) When the Management Buys Out the Company

Aside from acquisitions by outside acquirers, the managers and/or executives of a company may decide to buy out the controlling interest in the company and turn it into a privately-owned company. Most of the management buyouts (MBOs) carried out in recent years are described as "buy-outs by the management." In reality, however, many MBOs were carried out under schemes where the funding for the acquisitions came from investment funds and other sources, with the management financing only part of the acquisition costs. The existing management team then continues to operate the bought-out companies.

At any rate, in MBOs, the problem of a conflict of interest arises because the acquirer of the company is the existing management team of the same company. Therefore, trade unions need to ascertain whether or not the management team is acting genuinely for the interests of the company or is trying to advance its own personal interests at the expense of the interests of the company.

2. POLICY ISSUES AND DIRECTION

In this section, given the current situation surrounding investment funds and on the basis of our existing policies, we propose the future direction of RENGO's policy. If and when we decide to propose new demands in this area, the Policy Committee should have an opportunity to make a review.

(1) Issues Concerning Enterprise Laws and Related Measures

a) Issues about Laws and Market Rules and Our Responses

[The Company Law in the Loss of the Original Form of the Company]

The enforcement of the revised Company Law in 2006 led to the loss of the original form of a joint-stock company, as companies that used to be categorized as companies with limited liability were made into joint-stock companies, and policy-related systems introduced under laws with limited periods of validity, such as easier regulations on equity capital and a company's ability to buy back its own shares on the market, became permanent. Primarily, joint-stock companies should be those companies that have many stakeholders, have a great deal of social influence and are the hardest to manage. Another big problem is that the basic concept of a company has become ambiguous, with corporate governance and other systems disintegrating and becoming inconsistent because of the concept of 'free design.'

[Lack of the Notion of 'Workers']

We are also concerned about the lack of the notion of 'workers' in the Company Law. Workers and trade unions are legitimate constituents for the achievement of the mission of a company and are indispensable entities for the enhancement of an enterprise's value. However, considering the current situation where judicial precedents regarding corporate acquisitions and defensive measures against acquisitions have partially taken trade unions' views into account if we understand the legislation of the Law Concerning the Succession of Labour Contracts, Etc. upon the Divisive Reorganization of Company as a special exception to the Company Law, the notion of workers is actually being incorporated into the concept and framework of the Company Law.

[Role of the Trade Unions and the Revision of the Company Law]

Trade unions, as stakeholders responsible in part for the enhancement of an enterprise's value, should objectively and matter-of-factly judge whether investment funds and other acquirers of companies are truly investors and equity participants who can help enhance the enterprise value of a company. The tasks and responsibilities of trade unions in strengthening corporate governance are extremely serious and important, so trade unions must strengthen their ability to deal with management so that they can accurately understand and grasp the company's financial situation and business environment.

Over the medium- and long-term, RENGO needs to work to have the Company Law provide for the positions and roles of workers and trade unions in some form or other.

[Tougher Regulations over M&A by Investment Funds]

We must also intensify our efforts in policy areas regarding the regulation and the securing of the transparency of investment funds as well as regarding improvements in corporate acquisition rules. With the enforcement of the Financial Instruments and Exchange Law, a registration system was introduced for financial instruments companies. Compared to the previous framework, the new law marked a step forward in that we can now have a picture of what kinds of funds are operating in Japan and we can also track the flow of funds from financial institutions to investment funds. However, provisions under the new law fall short of securing the transparency of investment funds through disclosure of information and of safeguarding the rights of workers at companies in which funds invest. We need to continue our efforts in these areas.

Regarding legal regulations and the rules for corporate acquisitions and defensive measures against takeovers, we need to consider improvements in market rules. The Company Law was revised with U.S.-style free competition in mind. Because of inadequate market rules, however, individual companies find it necessary to devise their own defensive measures against hostile acquisition bids. However, since the United States has different legal systems concerning corporate organizations and corporate acquisitions, as shown by the lack both of federal corporate laws and of takeover defense measures in state law, there seems to be little Japan can refer to in U.S. systems to help it improve corporate acquisition rules in the Japanese market. Thus, Japan needs to develop and improve its corporate acquisition rules fitting in a way that suits conditions in Japan (including the introduction of an obligation to purchase all outstanding shares) with reference to the "City Code" introduced in U.K. and other European countries, while seeking to strengthen the monitoring ability of the Securities and Exchange Surveillance Commission (SESC) and of other public supervisory institutions.

We must also seek an integrated improvement of the legal system concerning corporate acquisitions, including a stricter monitoring of corporate merger screening under the Anti-Monopoly Law and a review of inward investment regulations under the Foreign Exchange and Foreign Trade Control Law.

b) Strengthening Responses in Taxation

The behavior of investment funds is likely not only to affect the productivity of acquired companies and the employment and working conditions of their workers but also to result in tax revenue reductions for national and local governments. For example, when an acquired company pays dividends to an investment fund with borrowed money, the tax base shrinks because of the deduction of the acquired company's interest payments on debt and because of the measure that excludes dividends received by the investment fund from gross revenue. Profit-making even jeopardizing the sustainability of companies and jobs must be taxed in an appropriate manner under the principle of equity and from the viewpoint of securing tax revenues. Efforts are under way to tax investment funds properly in other countries. In 2007, the governing and opposition parties in Denmark forged an agreement on tax reform, and a supra-partisan group of legislators is examining the issue in the United States.

Investment funds often take the form of associations under the Civil Code, i.e. they are anonymous associations and investment business limited partnerships. In these cases, associations or partnerships are not taxed, and taxes are imposed on individuals and corporate entities that invest in the associations or partnerships (pass-through taxation). Thus, the question is how we can ensure proper taxation of these investors.

Previously in Japan, when funds distributed profits to non-residents and foreign judicial persons, they were not required to withhold income taxes. But a measure to collect the 20% withholding tax was introduced under the FY 2005 tax system reform. However, associations with a membership of less than 10 are still exempt from the withholding obligation. Furthermore, there was not enough information available on the assets and income levels of these funds. Under these circumstances, in the FY 2007 tax reform, Japan required all anonymous associations to collect income taxes at source, and funds that are organized as associations were also required to submit documents regarding their financial situation. For the time being, we need to monitor the implementation of these measures.

Following the lifting of the ban on triangular mergers, under the FY 2007 tax reform, a measure was introduced to defer taxation at the time of a merger if business continuity and certain other conditions are met, while gains on the sale were made subject to taxation without deferment in the two cases of a merger through a subsidiary that exists in name only or of a merger brought about by the delivery of shares from an insubstantial parent company registered in a tax haven. Going forward, tax authorities need to boost their organizational preparedness to help enhance the effectiveness of these measures.

However, it is still possible that taxation may remain inadequate in cases of cross-border corporate acquisitions. In triangular mergers, for example, under the FY 2007 tax reform, if the shareholders of an acquiring parent company and an acquired company are both non-residents, gains on the sale of shares are taxed at the time of a merger in order to secure taxation in Japan. However, in revisions in recent years to the bi-lateral tax treaties that Japan has concluded with other countries, there has been a trend toward changing the point of taxation in dividends and other income from the country that is the source of the income to the taxpayer's country of residence. These changes are accompanied by reduced rates or exemptions on withholding income taxes for non-residents and foreign judicial persons. Depending on the tax treaty, it is conceivable that taxes are uncollected not only in Japan but also in the country that is the other party to the treaty.

Adequate taxation measures are not taken either concerning the income of equity participants in investment funds or fund managers. Tax rates for income taxes on dividend income and capital gains on stock sales, currently assessed separately, have been lowered several times in the past, and further preferential treatment was accorded under the FY 2003 tax reform. As a result, these people's present tax rates are lower than the income tax rates for ordinary workers.

Given these circumstances, it is necessary to prepare an appropriate framework of taxation for investment funds and fund managers and also to work toward greater international co-ordination. Specific measures can include (a) the immediate abolition of preferential treatment for income tax on dividend income and capital gains and the establishment of higher-than-usual withholding tax rates on high dividend income and large capital gains, particularly those arising from short-term transactions; (b) the introduction of a taxpayer identification number system and the shifting of financial income taxation from a separate to a consolidated income taxation system; (c) limitations on measures for the exclusion from gross revenue of dividend receipts in corporate taxation, when investment funds, as judicial persons, receive excessive dividends or fees from acquired companies; (d) efforts to secure Japan's right of taxation and to increase the withholding tax rates in tax treaty revisions; and (e) the review of guidelines (such as the "OECD Model Tax Convention") at the Organization for Economic Cooperation and Development and other international organizations in view of the behavior of investment funds, together with continuous consultations with countries that serve as tax havens.

c) The Need for Socially Responsible Investment (SRI)

Various pension funds and financial institutions often invest in investment funds. It is necessary to work on pension funds and financial institutions to practice socially responsible investment (SRI) so that funds contributed by workers and trade unions do not have an adverse impact on jobs and workers' conditions because of the activities of investment funds.

(2) Labour Policy-Related Issues

One of the major issues related to labour laws and/or labour policy and investment funds is the problem of employer liability on the part of the investment funds. Regarding this problem, at the urging of RENGO, the Ministry of Health, Labour and Welfare (MHLW) set up a study group (The Study Group on Industrial Relations at Companies Acquired by Investment Funds, etc.) and in May 2006 this group produced a report (see the attachment, "A Report by the Study Group on Industrial Relations at Companies Acquired by Investment Funds, etc.").

When an investment fund acquires shares in an acquisition target company, it is just one shareholder, and no one can claim that the fund, simply because it is a major shareholder, is a negotiating partner for a trade union in collective bargaining. The big problem with the current Trade Union Law is the lack of provisions for the definition of an employer. According to past court precedents, even in the absence of a direct employment relationship, a party can be recognized as having employer liability if it is in a "position to realistically and specifically control and make decisions on basic working conditions, etc. to a degree identical, even partially, with that of an employer." The afore-mentioned report by the study group of the MHLW also concluded that as it is difficult to present uniform criteria for judgment regarding specific requirements for employer liability, it is appropriate to make judgments on a case-by-case basis.

RENGO believes that in judging the employer liability of investment funds, an investment fund should be recognized as having employer liability if the fund owns a certain ratio of shares in an acquired company and actually wields influence over the acquired company both qualitatively and from a personnel viewpoint, for instance, if it sends in its people to sit on the board of directors of the acquired company. The definition of employer liability should be clarified in relevant labour laws.

Furthermore, the report of the study group stated, as "points" to build good industrial relations between investment funds, etc. and acquired companies and their workers, that (1) investment funds, etc. recognize that they could become employers; (2) both acquired companies and investment funds, etc. recognize the importance of collective bargaining at acquired companies; and (3) investment funds, etc. offer opportunities for pre-acquisition explanations and for an exchange of views about post-acquisition management policies. It is of particular importance to have labour-management consultations to clearly convey the views of employees and to exchange views.

While the MHLW has said it will strive to make the above-mentioned "points" widely known, given developments so far, that effort alone can hardly be expected to ensure their effectiveness. RENGO, in addition to legal provisions for the definition of employer liability, will press the MHLW to at least develop guidelines as quickly as possible and to formulate measures to make it possible to provide guidance to investment funds, etc. RENGO will also make continued efforts to develop amicable industrial relations in corporate acquisition cases.

3. COOPERATION WITH THE INTERNATIONAL LABOUR MOVEMENT

In March 2007, the Trade Union Advisory Committee to OECD (TUAC) issued a statement calling for a new set of international regulations regarding the transparency and taxation of PE funds. Recognizing that "the very high rates of return required to finance private equity debt-driven buy-outs can jeopardize target companies' long-term interests and the provision of decent working conditions and security for employees," the statement called on the Group of Eight (G8) leaders to create an international regulatory task force, comprised mainly of OECD member states, to address the following four areas: the principle of transparency, the securing and promotion of workers' rights, the reconfiguration of tax regulations, and the establishment of corporate governance. In response, the OECD is considering the application of the OECD Guidelines for Multinational Enterprises.

The International Trade Union Confederation (ITUC) at its General Council meeting in June 2007 adopted a report entitled "Where the House Always Wins: Private Equity Funds, Hedge Funds and the New Casino Capitalism". Global Union Federations (GUFs), as part of the international labour movement and agreeing with the recognition above, have also formulated or are in the process of formulating their own responses to investment funds. Also, regarding socially responsible investment (SRI), in particular the UN Principles for Responsible Investment, the ITUC and other global trade unions are about to publicize guidance of for trade unions in the autumn of 2007.

Investment funds are operating in markets around the world. As national regulations and measures concerning investment funds have their limitations, efforts must be made from a global perspective with the cooperation of all countries. While statistics are not necessarily clear, Asian countries, where market regulations and rules remain under-developed, will probably experience even greater effects from investment funds than Japan. Thus, Japan's role and its responsibilities are extremely important.

RENGO will continue to express its views and provide information to the international labour movement regarding economic and labour policies that contribute both to the stability of workers' employment and their working conditions and to sustainable economic growth and development.

REFERENCE: GUIDELINES FOR TRADE UNION RESPONSES

In this section, we provide guidelines for trade union responses to M&A' and other investment fund activities as a reference for the formulation of manuals and policies by member organizations and individual trade unions

(1) Everyday Efforts

a) Basic Approach

A characteristic of industrial relations in Japan is the effort to maintain labour-management communication through the labour-management consultation system. Indeed, labour-management consultative organizations are set up at 84.8% of companies where trade unions are organized. According to the Survey on Labour-Management Communications (2004) by the MHLW, the labour-management communication system is in better shape at companies with trade unions than at companies without them.

In addition, Japanese companies generally have top executives who have climbed up the in-house ladder of promotion. At large corporations, it is not uncommon for top executives and other officers in managerial positions to be former trade union members.

Trade unions in this model of industrial relations play the role of partners in company management. Those who must bear the onus of management decisions made by the current managers are the next generation of managers who will take over from the current teams and employees who now work under them. In other words, many of trade union executives at present are steersmen of corporate communities who will become part of the company's management team in the future.

It is important for any shareholder to treat workers and trade unions as important stakeholders and to seek sufficient communication with them. If trade unions and management can share the same perception of corporate management and build good industrial relations with a due sense of tension, that should prove a short cut to the enhancement of enterprise value and be in the best interests of all stakeholders, including the shareholders. So, it is necessary to seek fruitful labour-management consultations on a routine basis and to develop sound industrial relations with a due sense of tension.

b) Protection of Employees in Corporate Buyouts and M&A

It should be noted that under any corporate buy-out and M&A scheme, the Companies Law or the Financial Instruments and Exchange Law do not directly provide for the protection of employees.

The Company Law governs such matters as the relationship between companies and their shareholders, who are equity participants in joint-stock companies, and supervises members of the companies' boards of directors as well as the internal auditors and accounting auditors who assist the directors. Under the law, employees are those employed by directors to sustain a company's operations. Employees are not subject to governance by the current Company Law.

The Financial Instruments and Exchange Law is designed to ensure the fair issuance of securities and fair transactions in financial instruments, the smooth circulation of securities, and fair prices for financial instruments through the full realization of capital market functions. Regarding joint-stock companies, the law provides for fair trading in stock markets (in other words, the protection of shareholders). Thus, though it has provisions for managers of share-issuing companies and for those who trade in shares (shareholders), the Financial Instruments and Exchange Law does not govern employees employed by directors to sustain a company's operations.

Furthermore, theoretically, corporate acquisition and M&A schemes alter only the capital structure and the composition of directors, and bring no changes to a company's operations. Thus, as long as business operations continue, changes in equity participation in a company or its directors do not alter the relationship between the company and its employees. Under such circumstances, labour laws and court precedents do not allow for any unilateral change that is detrimental to employees.

As discussed above, the Company Law seeks the proper management of companies by the governing equity participants, the directors, and those who oversee corporate management (internal auditors and accounting auditors), while the Financial Instruments and Exchange Law seeks to maintain a fair and sound stock market by governing equity participants (shareholders), issuing companies (companies) and their managers (directors). Thus, the maintenance of an appropriate relationship between a company and its employees has to be dealt with, legally, under the Labour Standards Law and other relevant laws.

Therefore, as it is difficult in many cases to consider responses directly based on the Company Law, trade unions must begin by preparing for matters that can be approached in the context of industrial relations and labour laws.

c) Collective Agreements: Industrial Relations, Clarification of the Status and Rights of Employees

Regardless of any change in the capital structure of companies or in the composition of a company's directors, it is necessary to secure the status and rights of employees in line with the Labour Standards Law, collective labour agreements, etc.

In particular, if ambiguous aspects remain unresolved in industrial relations, it is highly likely that they will lead to problems in the securing of proper terms and conditions for labour. Thus, it is important to keep collective labour agreements in good shape and to clarify matters between trade unions and management concerning labour-management consultations and working conditions. It is necessary for trade unions to secure satisfactory collective agreements while collaborating with superior organizations as necessary (RENGO's Guidelines for Model Collective Agreements, [2001] provide for responses in terms of corporate restructuring and collective agreements).

Furthermore, if collective agreements do not have any provision for a period of validity, companies may unilaterally give an advance notice of termination 90 days prior to the intended termination date. It is therefore important to ensure that collective agreements provide for a period of validity and not fail to make procedures for the renewal of collective agreements.

d) A Solid Labour-Management Consultation: Grasp the Situation and Strengthen Routine Activities

Even when the capital structure of companies and the composition of directors are altered, employees may not face any particular problem as long as there is no change in industrial relations, and employment and working conditions are maintained. Changes in the capital structure and the composition of directors may even produce a synergy with an acquirer being able to boost corporate performance. The execution of so-called good acquisitions can benefit employees.

However, problems arise for employees if the acquisition brings in a new capital structure and new directors, and the new employer seeks to enhance a company’s performance through the lowering of working conditions. However, we need to make it clear that even with changes in capital structure and the composition of directors it is not legally permitted to change working conditions to the disadvantage of employees without reasonable reasons.

Trade unions need to routinely keep the labour-management consultation system solid and operational in order to forestall any unilateral lowering of working conditions as a result of acquisition-driven changes in the company’s capital structure and directors. In particular, numerous cases in recent years, in Europe and the United States as well as in Japan, show that PE funds are often hostile to trade unions. It is therefore necessary to put a mechanism in place to enhance the knowledge and skills of trade union executives and internally to accumulate enough know-how through routine activities for trade unions to present their views, opinions and proposals in consultations and negotiations with the new management teams in the event of a corporate acquisition or M&A.

It is also important for trade unions to strengthen their presence not only before any acquirers but also in front of the current management through their routine efforts and activities. Each member of a trade union needs to be aware that the in-house accumulation of a variety of technologies and skills and the reliable relationship with customers are the very source of enterprise value. Trade union executives must recognize that the steady execution of day-to-day business operations and the growth of each member of a trade union contribute to the enhanced presence of the trade union.

(2) Responses to Corporate Buy-outs and M&A

a) Basic Approach

Corporate acquisitions and M&A are carried out in order to control the management of a target company through a majority acquisition of the company’s capital structure so that they can bring the company under their control, at which point the management of the two parties can then be integrated.

Changes in capital structure and in the composition of the directors are ultimately determined by the shareholders who are equity participants in the target company. Needless to say, it is impossible for an unspecified majority of shareholders to negotiate directly with a potential acquirer. As such, negotiations with the acquirer are conducted primarily by the management team that has been entrusted by shareholders with the running of the company. Yet, the shareholders make the ultimate decision. The success and failure of the acquisition bid depends on the judgment of the shareholders who decide whether or not to accept it at a general meeting of the shareholders or on whether or not to sell their holdings in response to the TOB. However, the criteria for shareholders' decisions, when deciding whether or not to accept or reject the acquisition offer, is whether the offer will enhance the enterprise value of the company they own. Employees are the human element of the company that organically combines with physical elements, such as plants and equipment, to constitute the value of the business (enterprise value), and as such, they are an extremely important element in the formation of enterprise value.

Therefore, the views of employees about the acquisition offer can be considered significant in influencing shareholders' decisions and may even affect the success or failure of the acquisition itself.

Since the views of employees about the acquisition offer are an important factor that can potentially influence the success or failure of the acquisition bid, trade unions must try and gather and transmit information in an appropriate and fair manner in order to use their de facto clout in an appropriate and fair manner.

b) Prompt Collection of Accurate Information

Since an acquirer's bid is very sensitive trade information, it is not easy for trade unions to obtain that information while behind-the-scenes negotiations are being carried out following the acquirer's approach to the management of a target company.

However, it is necessary for trade unions to ask the management to disclose any relevant information as quickly as possible through labour-management consultations, etc., and at the same time to review the information management systems of trade unions and to make the utmost efforts to prevent any leak of such information.

After the acquirer's proposal is disclosed, trade unions should also consider making approaches to the acquirer for a broader disclosure of any information they want to know, in addition to seeing officially disclosed information and materials. While the disclosure of information to trade unions has no legal grounds, trade union approaches to the acquirer could still effectively elicit a response. Another option is to obtain necessary information by posing questions through the management to the acquirer.

Specifically, trade unions should strive to obtain information on post-acquisition policies and business plans, and must also make efforts to improve their knowledge and skills so that they can understand and analyze the contents of such management policies and plans.

In the case of a hostile takeover bid, it is useful for trade unions to examine what sort of information is necessary, even in the absence of a specific bid, so that they can make the necessary approaches in a timely and appropriate manner once such bids are actually made. It is also useful to run a simulation on who should be approached and in what manner in order to obtain any necessary information.

At the same time, it is also important to obtain and analyze information about the track record of corporate takeovers by the acquirer in question. The same acquirer can have different objectives (pure investment, participation in management, etc.) for individual cases. It is important to ascertain the intentions of the acquirer and to analyze the contents of the takeover bid.

c) Examination of the Contents of Acquisition Bids

After obtaining accurate information on the acquirer's proposal, it becomes necessary to examine the reasonableness and relevance of the proposal from a trade union standpoint. As proposals from potential acquirers can vary greatly, trade unions cannot really consider acquisition proposals until after the bids are actually filed. It is difficult to prepare in advance, but it is still possible for trade unions to consider and prepare for things like their initial response, for instance, as to which members should initially be assembled to analyze the contents of the bid.

d) Transmission of Information and the Gathering of Opinions within Trade Unions

After trade unions have obtained sufficient information and have conducted a preliminary examination, it then becomes necessary to convey this information to individual union members and to gather their opinions in order to form the collective view of the trade unions.

If trade union members are scattered among branch offices and plants across the country, it is not easy for trade unions to disseminate information to all union members and to gather their opinions in a short period of time. Therefore, trade unions need to consider, in advance, the methods and systems for disseminating such information to individual union members and for collecting their opinions accurately.

e) Systems for Forging Trade Unions' Collective Views and their Expression

Even after gathering the opinions of individual trade union members, in order to develop the collective view of the trade unions and to transmit it externally, it again becomes necessary to obtain the support of individual union members for union policies. It is necessary to consider and develop systems to make the whole process workable. Trade unions also need to consider ways of communicating their collective views about the acquisition proposals externally and to think of ways to coordinate with management concerning such communication.

Depending on the contents of the acquisition proposal, there may be cases where employees feel like accepting an acquisition bid even if it is hostile (a bid rejected by the management). In such cases, trade unions will express their support for the bid after careful analysis. There have been cases where the management unfairly pressured individual trade union members into opposing bids that they rejected. To deal with such eventualities, trade unions need to have an opportunity to express their opinions from fair and independent viewpoints and to consider ways of securing such opportunities.

f) Consultations with New Management, Confirmation of Employer Liability

After the consummation of the acquisition, trade unions should hold labour-management consultations with the new management as soon as possible and examine post-acquisition management policies and business plans anew to ascertain that they are not detrimental to jobs and working conditions. While it is necessary to conduct collective bargaining as the occasion demands, the important thing is actually to have consultations and negotiations with the counter-party that has control over the company. Even when the acquirer is an investment fund, the employer liability of the fund can be recognized if it actually has a controlling influence over the management of the acquired company. Since there are no clear legal provisions for the definition of employer liability, trade unions have to deal with the issue on a case-by-case basis. Individual trade unions and their superior organizations should cooperate with one another, while drawing upon court precedents, and they should also consult lawyers and other legal experts as necessary.

g) Strengthening of Negotiations

If, despite such action by the trade union regarding the M&A, the acquirer continues to react unfairly regarding jobs, working conditions and industrial relations, trade unions need to strengthen their negotiations and to prepare contingency responses for every possible scenario. In such a case, on the strength of full collaboration among individual unions, superior organizations and legal experts, trade unions will launch powerful responses in line with their respective policies.