

[English Version]

October 31, 2008

To whom it may concern

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Report on the Results of an Investigation by the Third-Party Committee for Investigation into the Procedures and Processes Leading up to the Company's Announcement of an Affirmative View Regarding a Tender Offer for the Shares of the Company

Charle Co., Ltd. (the "Company") is pleased to announce that the Company today received the results of an investigation by the Third-Party Committee for Investigation into the Procedures and Processes Leading up to the Company's Announcement of an Affirmative View Regarding a Tender Offer for the Shares of the Company (the committee shall be hereinafter referred to as the "Third-Party Committee"). The investigation was carried out by the Third-Party Committee established on October 26, 2008.

The details of the investigation results are provided in the attached document.

The Company accepts the results of the investigation with sincerity, and plans to promptly consider future actions to be taken in response to the said results.

The details of such future actions will be announced at a later date when they have been determined.

Attachment: Investigation Report (dated October 31, 2008 and prepared by the Charle Co., Ltd. Third-Party Committee)

End

INVESTIGATION REPORT

October 31, 2008

Charle Co., Ltd. Third-Party Committee

October 31, 2008

To Charle Co., Ltd.

The Third-Party Committee hereby submits an investigation report as per attached.

Third-Party Committee of Charle Co., Ltd.

Committee chairperson: Toru Watanabe, Lawyer
(Kitahama Partners, Foreign Law Joint Enterprise)
Committee member: Taisuke Igaki, Lawyer
(Kitahama Partners, Foreign Law Joint Enterprise)
Committee member: Takehiro Oishi, Lawyer
(Kitahama Partners, Foreign Law Joint Enterprise)
Committee member: Toru Miki, Lawyer
(Kitahama Partners, Foreign Law Joint Enterprise)

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Section 1 Background to and Outline of the Investigation

1 Background to the request for an investigation by the Third-Party Committee

In anticipation of the management buyout transaction (the “MBO” or “Transaction”) through a tender offer (the “Tender Offer”) by Southern Eagle Inc. and Otto Inc. for the common stock of Charle Co., Ltd. (the “Company”), the Company adopted a resolution at a meeting of its Board of Directors held on September 19, 2008 to announce an affirmative view with regard to the Tender Offer.

However, subsequent to October 16, 2008 there were several reports made within the Company regarding unlawful or unfair aspects in the procedures used for the valuation of stock value in the Tender Offer.

In response to these internal reports, the Company made a decision to commence an investigation of the relevant facts in accordance with Paragraph 4, Article 28 of the Compliance Rules and Section 4 and Section 5 of the Compliance Consultation and Reporting Guidelines, and established an investigation committee in accordance with Section 5 and the provisory clause in Section 2 of the same guidelines. Four lawyers from Kitahama Partners, Foreign Law Joint Enterprise (Toru Watanabe, Taisuke Igaki, Takehiro Oishi and Toru Miki) were appointed as the members of the said investigation committee (the “Committee”).

For an outline of the Tender Offer, please refer to the Company’s press release dated September 19, 2008 (“Announcement of an Affirmative View Regarding a Tender Offer in the Company Shares”).

2 Purpose of the investigation

The purpose of the investigation carried out by the Committee (the “Investigation”) was to fulfill a request by the Company to look into the facts relevant to the subject matter described below. This report has been prepared solely for such purpose and, therefore, is not intended to clarify any other matters relating to the Company or the MBO. In addition, the scope of investigation was limited to the materials and documents submitted by the Company and the voluntary questioning of the individuals concerned.

Subject matter of the investigation

Whether or not there was any act that constituted a conflict of interest by any of the directors of the Company or any person associated therewith from the onset of the Transaction to the present in connection with the MBO through the tender offer described in the press release dated September 19, 2008 (“Announcement of an Affirmative View Regarding a Tender Offer in the Company Shares”).

3 Duration and methods of the investigation

The duration and methods of this investigation are outlined below:

(1) Duration of the investigation

October 26, 2008 to October 31, 2008

(2) Methods of the investigation

A. Investigation of documentation

The Company’s Board of Directors meetings’ minutes and draft forms of the said minutes, documents relating to the calculation of the Company’s stock value, proposal documents submitted by the tender offerors, presentation documents used within the Company, internal reports and other materials (the aforementioned materials and documents disclosed by the Company for the purpose of the Investigation shall be referred to collectively as “Documents” or individually as “Document”). Under the assumption that the Documents have been prepared authentically, the Committee investigated and examined them from a legal standpoint.

B. Voluntary questioning

During the duration of the investigation, the Committee conducted voluntary questioning of each of the individuals that are described below through interviews concerning matters relating to the MBO. These interviews were held at the head office of the Company (located at Yasaka-dai 3-chome 1-2, Suma-ku, Kobe), the Tokyo office of Kitahama Partners, or the offices of the individuals interviewed. In addition, the Committee supplemented the above voluntary questioning of these individuals when necessary through questioning via e-mail and telephone.

- (A) Individuals who are employees of the Company
 - Five directors (three of whom are outside directors)
 - Two executive officers
 - Five MBO project members
- (B) Individuals external to the Company
 - Two representatives of Hayate Investment Co., Ltd.
 - One representative of Morgan Stanley Capital K.K.
 - Three lawyers of Mitsui Company
 - Three lawyers of Mori Hamada & Matsumoto
 - Three lawyers of Oh-Ebashi LPC & Partners
 - Two representatives of KPMG FAS Co., Ltd.

Section 2 Findings

The facts that were recognized by the Committee based on the Documents and the results of the aforesaid voluntary questioning of the individuals concerned are described below.

1 Events that led to the formulation of the medium-term management plan as of April 15, 2008

The Company had long experienced declines in its earnings and, as a result, was in need of drastic business reforms. In the summer of 2007, the Company, through Hayate Investment Co., Ltd. (“Hayate”), with whom the Company’s founding family had an advisory service contract (the founding family and Hayate shall be collectively referred to as “Founding Family Group”), was introduced to Morgan Stanley Capital K.K. (“MSC”; the Morgan Stanley Group to which MSC belongs shall be referred to as the “MS Group”). In order to make a judgment as to whether or not an investment in the Company should be made, MSC felt that it was necessary for the Company to have a solid business plan and made a recommendation that the Company perform an analysis of its business, and therefore introduced to the Company Bain & Company (“Bain”), a leading consulting firm.

The Company, on the recommendation of MSC, asked Bain to perform a review of its business, and in October 2007 the results of the review were presented to the Company. Subsequently, the necessary tasks were carried out to incorporate the results of the said review into the specific business strategies of the Company in accordance with its actual circumstances, and in January 2008 the “Charle Co., Ltd. Medium-Term Management Plan” was formulated and announced within the Company (hereinafter the year “2008” shall be omitted when references are made to events that took place during the Fiscal Term 2008). The said Medium-Term Business Plan included a number of strategic projects (the “Strategic PJs”). Since it was necessary to further examine specific details of the Strategic PJs and the methods for realizing them, the Company, while receiving suggestions from MSC, spent approximately three months carrying out the necessary analytical tasks, and eventually formulated a medium-term management plan as of April 15 (the “Plan as of April 15”). Under the Plan as of April 15, the Company projected that it would generate an operating income of approximately 2 billion yen in the 34th Fiscal Term, approx. 2.2 billion yen in the 35th Fiscal Term, approx. 2.9 billion yen in the 36th Fiscal Term, approx. 2.8 billion in the 37th Fiscal Term and approx. 2.5 billion yen in the 38th Fiscal Term.

Meanwhile, MSC, in order to evaluate the investment into the Company, began to approach financial institutions which it would potentially ask to provide loans.

2 Events that led to the formulation of the medium-term management plan as of July 22, 2008

(1) Formulation of the plan as of July 22

Following the release of the Company's financial results for the Fiscal Term ended March 2008 (the 33rd Fiscal Term) in May, MSC commenced a close examination of the details of the said financial results. Even after the previous plan was formulated on April 15, the Company had continued to revise the management plan by taking into consideration the possibility of realizing the Strategic PJs and the latest business results. The revised management plan as of June 2 was also submitted to the Bank of Tokyo-Mitsubishi UFJ, Ltd. ("MUFG"), which was considering the provision of a loan for the transaction through MSC. Subsequently, at the end of June the Company revealed the business results of the first quarterly period of the 34th Fiscal Term. Given that the said results were worse than the same period of the previous year, the Company decided to further revise its management plan. By mid-July, the Company had prepared multiple proposed management plans while receiving suggestions from MSC, and ultimately created on July 22 an updated version of the Plan as of April 15 (the "Plan as of July 22"). The Plan as of July 22 was presented to both MSC and MUFG. It should be noted, however, that a resolution at a meeting of the Company's Board of Directors has not been adopted with regard to the Plan as of July 22.

(2) Proposal of a plan for the MBO by the tender offerors group

The tender offerors group attended a meeting of the directors that was held on June 13, and announced the fact that Director Katsuya Hayashi, Hayate and MSC were considering the MBO and sought the approval of the Company to perform due diligence. At the same time, the tender offerors group indicated that it would like to acquire 100% of the outstanding shares of the Company, that the capital structure of the Company after the execution of the MBO would be such that the founding family would hold a 49% interest and the MS Group would hold a 51% interest, and that it was expected that a total of 13 billion yen to 15 billion yen would be raised through equity and loans to cover the necessary funds for the execution of the MBO.

3 Hiring of KPMG FAS for the calculation of the Company's stock value and the submission of a draft report of the valuation results

On June 24, the Company made a request to KPMG FAS Co., Ltd. ("KPMG FAS") to perform a calculation of the Company's stock value based on the premise that a tender offer would be executed for its shares, and submitted the Annual Securities Reports (yukashokenhoukokusho) for the most recent three fiscal terms, the corporate tax return documents for the 33rd Fiscal Term and other relevant documents, as well as the Plan as of July 22. Subsequently, on July 30 the Company received from KPMG FAS a draft form of the report of the valuation results. In the draft report of the valuation results as of July 30, the Company's stock value was calculated to be between 1,104 yen and 1,300 yen based on the discounted cash flow (DCF) method, between 528 yen and 544 yen based on the market price method, between 897 yen and 1,129 yen based on the market multiple method, and 925 yen based on the adjusted net asset method (the "Valuation Results as of July 30").

4 Background to the request for involvement of the Outside Directors

On the other hand, calculation of the Company's stock value carried out by Ernst & Young Transaction Advisory Services Co., Ltd. ("EYTAS"), which had been hired by the MS Group (part of the tender offerors group), the Company's stock value was calculated to be between 498 yen and 600 yen based on the market share price method, between 599 yen and 855 yen based on the comparable peer company method, and between 646 yen and 908 yen based on

the DCF method (the “EYTAS Valuation Results”). As a result, it turned out that when the Company’s stock value was evaluated using the DCF method, the method upon which particular importance was placed by both the tender offerors group and the Company, the range of the Company’s stock value as calculated by KPMG FAS, which was hired by the Company, did not overlap at all with the range of the Company’s stock value as calculated by EYTAS, which was who was hired by the MS Group.

In order to obtain alternate calculation results by resubmitting management plans with tighter assumptions to KPMG FAS, the Company created, at the request of its director, Katsuya Hayashi, five separate management plans in mid-August and provided them to KPMG FAS. The results of the calculation by KPMG FAS based on the DCF method using the said five management plans reduced the Company’s stock value to only 902 yen. It should be noted that up to this point none of the three outside directors of the Company (collectively “Outside Directors”) had been actually involved, while on the other hand, MSC had been involved on an ongoing basis through making suggestions to the Company with regard to the figures in its management plans.

At the meeting of the directors of the Company held on August 12, the Outside Directors were informed for the first time of the Valuation Results as of July 30 prepared by KPMG FAS. At the said meeting, no decisions were clearly made on any specific actions that should be taken by the Outside Directors and the meeting only went so far as to point out the fact that there was a significant gap between the Valuation Results as of July 30 prepared by KPMG FAS and the EYTAS Valuation Results. Subsequently, as described earlier, it was found that the range of the Company’s stock value as calculated by KPMG FAS using the aforesaid five management plans prepared by the Company in mid-August still did not overlap with the range of the Company’s stock value in the EYTAS Valuation Results, and, therefore, on August 27 the Outside Directors were again called to a meeting where they discussed what actions should be undertaken in the future. It should be noted that on the day of the meeting of August 27, representatives of Hayate and MSC visited the Company and a consultation was held following the meeting of the directors.

5 Events that led to the formulation of the management plan by the Outside Directors

(1) Background to the approval of the Plan as of August 31

At a meeting of the directors of the Company held on August 27, it was decided that the Outside Directors would personally interview the executive officers and the project members for the MBO, review the specific business strategies that formed the basis of the Plan as of July 22, their details and the possibility of realizing these strategies, so that a new management plan could be formulated. Specifically, on August 29 the Outside Directors personally held interviews as described above and performed an analysis of the management plan based on the results of these interviews. Then, they summarized the results of the said analysis into a document entitled “Calculation Instructions” (the “Calculation Instructions”) and gave specific calculation instructions to the project members for the MBO. Subsequently, in order for the Outside Directors to discuss with the executive officer who was the project leader for the MBO the validity of the management plan which was created on August 31 (the “Plan as of August 31”) on the basis of the Calculation Instructions, a meeting of the directors of the Company was held via telephone between 6:40 PM and 9:15 PM on August 31 (the “Directors’ Meeting Seeking Approval”). As a consequence, a resolution was adopted for the approval of the Plan as of August 31 as the official management plan of the Company to be submitted to KPMG FAS (the series of processes required for the said approval shall be referred to as the “Approval Process for the Plan as of August 31”).

(2) Involvement of the Founding Family Group in the Approval Process for the Plan as of August 31

The investigation of the Committee has shown that there are significant discrepancies among the statements made by individuals interviewed by the Committee during the voluntary

questioning with respect to the Approval Process for the Plan as of August 31. Some of these statements also did not match objective documents and materials. Nonetheless, based on the overall results of the interviews conducted during the voluntary questioning and the objective documents and materials, it became clear that Hayate, the advisor to the founding family, was involved in the preparation of the Calculation Instructions, and that Hayate had indeed given specific advice to the Outside Directors with respect to preparing the meeting agenda for the Directors' Meeting Seeking Approval and arming themselves with the arguments necessary to persuade the executive officer who was opposed to granting approval for the Plan as of August 31. Furthermore, it became clear that the Outside Directors had indeed accepted the involvement and advice of Hayate referred to above.

6 Opinion of Oh-Ebashi LPC & Partners

(1) Communication of the opinion

On September 4, the Outside Directors paid a visit to Oh-Ebashi LPC & Partners ("Oh-Ebashi LPC & Partners"), which is a legal advisor to the Company, in order to find out what kind of legal opinion could be prepared. Oh-Ebashi LPC & Partners gave a response to the effect that there would be no choice but to produce a harsh opinion, since there were no reasonable grounds for explaining why the Company's medium-term management plan had to be re-examined at that point.

(2) Delivery of the draft legal opinion

On September 5, Oh-Ebashi LPC & Partners personally delivered a draft of the legal opinion to the executive officer of the Company who was the project leader for the MBO. The contents of the draft can be summarized as follows: Considering that the Plan as of April 15 was found to have grounds for reason to a certain degree, that the Plan as of August 31 was prepared after the calculation of the Company's stock value was presented by KPMG FAS, and that it is clear that the stock value calculated by KPMG FAS would be lower based on the Plan as of August 31, it is highly possible that the view will be formed that the Plan as of August 31 was prepared for the purpose of lowering the stock value calculated by KPMG FAS, and, therefore, the possibility exists that the Outside Directors may be questioned with regard to their duty to exercise reasonable care, skill and diligence."

However, the Outside Directors believed that the legal opinion of Oh-Ebashi LPC & Partners failed to take into consideration the fact that there existed only a small possibility of the management plan to be realized, and, therefore, the opinion was unacceptable. On September 7 the Outside Directors sent a reply to Oh-Ebashi LPC & Partners, stating that "it is unnecessary to provide an original of the letter of legal opinion."

7 Events that led to the formulation of the medium-term management plan as of September 13

(1) Suspension by KPMG FAS of the calculation of the Company's stock value

On September 10, KPMG FAS informed the Company that "There was a large gap between the Plan as of August 31 and the Plan as of July 22. Since despite significant changes made to the figures, there was no reasonable explanation provided with respect to such changes, it wishes to hold off producing an official valuation statement."

(2) Formulation of the plan as of September 13

On September 11, the Outside Directors and KPMG FAS held a telephone conference with regard to the Plan as of August 31. The Outside Directors told KPMG FAS that the Plan as of August 31 was too conservative, and, therefore, they would like to consider revising the said plan as soon as possible, and requested that KPMG FAS perform the calculation of the Company's stock value based on the revised plan. This telephone conference was attended by a representative of MSC at the request of the Outside Directors.

In an attempt to compile relaxed cases that were more likely to be actually realized, the Outside Directors held an extraordinary meeting of the Company's Board of Directors on September 13, and a resolution was adopted for two types of a medium-term management plan as relaxed cases (of the two types of the management plan, the case based on the more relaxed assumptions shall be referred to as the "Upside Case as of September 13," and the case based on the less relaxed assumptions shall be referred to as the "Downside Case of September 13"). However, even in the Upside Case as of September 13 the operating income of the Company in the 38th Fiscal Term would only be approx. 700 million yen, and in the Downside Case as of September 13 the operating income in the same fiscal term was projected to drop to nearly 300 million yen.

Furthermore, one of the Outside Directors was dissatisfied that there had not been exhaustive discussions with regard to the calculation of figures in the Downside Case as of September 13. In order to ensure a thorough discussion of this matter, another extraordinary meeting of the Company's Board of Directors was held on September 14, at which a resolution was adopted for the revival of the Plan as of August 31 as a finalized downside case to be submitted to KPMG FAS.

(3) Re-calculation of the Company's stock value by KPMG FAS

In the end, KPMG FAS received the Plan as of August 31 and the Upside Case as of September 13, and on September 14 submitted the valuation results to the Company. According to the said valuation results, the range of the Company's stock value based on the DCF method was calculated to be between 681 yen and 1,010 yen.

8 Negotiation between the Outside Directors and the tender offerors group, and the commencement of the Tender Offer

(1) Negotiation between the Outside Directors and the tender offerors group

Prior to the negotiation with the tender offerors group that was scheduled for September 16, the Outside Directors had agreed with one another that they would resign from their duty if the tender offer price did not reach 800 yen as a result of the negotiation. Based on this agreement, the Outsider Directors attended the negotiation on September 16 where they proposed to the tender offerors group an offer price of 850 yen, upon which consensus had already been achieved among the Outside Directors. The tender offerors group and the Outside Directors continued to negotiate thereafter, and on September 17 the Outside Directors proposed to the tender offerors group that the tender offer price would be 800 yen. In response to this new offer, on September 18 the tender offerors group submitted to the Company a "Letter of Proposal Regarding a Management buyout for the Shares of the Company," thereby accepting the proposed offer price of 800 yen. As a result, at a meeting of the Company's Board of Directors that was held on September 19 a resolution was adopted for approval of the Tender Offer.

It should be noted that the tender offerors group in the end accepted the tender offer price of 800 yen despite the fact that up to this point the said group had consistently sought to purchase the shares at a price of around 700 yen per share. This was made possible because the founding family had lowered the value of the shares in Southern Eagle Inc. and in Otto Inc. that they held and were to be sold to the MS Group.

(2) Commencement of the Tender Offer and the submission of an opinion on the tender offer

On September 22, the tender offerors group submitted a tender offer notification, while the Company submitted an opinion on the tender offer.

Section 3 Legal Evaluation

1 Systemic conflicts of interest in Management Buyouts

(1) Relevance to the Case of Management Buyouts

Being as equity participation is planned by the Director and Representative Executive Officer, Katsuya Hayashi, and other founding family members who are among the Tender Offerors,

whereby there is to be a transaction in which “an existing manager invests funds and acquires shares in a company on the predication that it is to continue as a going concern,” it is judged that the present transaction corresponds to a management buyout as defined in “Guidelines for Management Buyouts That Increase Corporate Value and Ensure Fair Process,” released by the Ministry of Economy, Trade and Industry on September 4, 2007.

(2) Systemic conflicts of interest in Management Buyouts

Whereas it has been stated that in a management buyout “fundamentally, when a director of a company, who is charged with representing the interests of shareholders by increasing the corporate value of the target company, acquires shares in that company from its shareholders, it necessarily creates a conflict of interests. Further, since the director possesses accurate and abundant information about the company, in the case of a management buyout a formidable asymmetry of information arises between the director who is the acquirer of shares and the shareholder who is the seller of the shares,” in the case of the present transaction if attention is focused on the point that the scheme used is that of a founding family member ultimately having capital participation in the buyer, even in the case that a majority of shares are not acquired, it must be said that there remains the possibility that the issues of the above-mentioned “systemic conflict of interest” and “asymmetry of information” are said to exist.

Of course, a situation of conflict of interest arises in a management buyout as the director in question also has the nature of being an acquirer, and because it is not possible to entirely eliminate this conflict, there has been advocacy, on the basis of the assumption that such a systemic conflict of interest exists, of the adoption of measures to prevent a disadvantage to shareholders (classically this disadvantage takes the form of selling the shares at a price objectively deemed lower than justified by the corporate value).

(3) Necessity of protecting minority interests

It is by no means an easy matter, however, to judge whether a tender price objectively reflects the corporate value of the target company. According to present practice, both the party seeking to acquire the company and the target company itself each request third parties such as chartered accountants to estimate the value of the company, and each third party calculates an estimated value per share, based on the management plans for the company that each party has individually determined to be rational. Then, through the process of sincere negotiations in an atmosphere maintaining the independence of both the interests of those seeking to acquire the company and the company directors, each having obtained the results of valuation of the shares, the two sides involved in the proposed transaction announce to those concerned what they believe to be a take-over price that objectively reflects the value of the underlying shares. When there is then a difference of opinion as to whether the acquisition price objectively reflects the corporate value of the company, minority interests are protected by two means, namely through exercising the right to purchase shares from shareholders who believe the price to be inappropriate, and by having a court determine the price, through procedures based on the Corporate Law.

2 Problems inherent to management plans submitted to a third-party evaluator

(1) The binding power of management plans

The following analyzes the process whereby (i) the tender offerors group seeking to acquire the company and the target company both request third-party evaluators such as auditing firms to estimate the corporate value per share, (ii) the calculation by each such evaluator, acting independently, of a share price that each believes to use management plans of the company in question that are taken to be rational, and (iii) the sincere negotiations, based on the results of the two share price calculations, in an atmosphere believed to enable both the tender offerors group and the directors of the target company to maintain their independence. In the case of this transaction, the tender offerors group requested EYTAS and the Company requested KPMG FAS to calculate the price of shares, and as it is a fact that there is no

antagonism between the two sides to the transaction it is taken that (i) above is deemed acceptable, and this study commences with (ii).

In a situation such as this present case, concerning whether or not the fact that the tender offerors group and the target company side each had a third party evaluator to calculate the share price based on management plans that had been individually prepared and that was believed to be rational is required, broadly put there are two lines of thought: (i) that there is no problem in target company directors or their advisors who are to become part of the tender offerors group going beyond the level of merely conveying the hopes of the acquirers and getting involved in the preparation of the numbers that make up the management plans as well as the analysis of the business strategies, and it is sufficient for the outside directors to be involved only in the subsequent price negotiation based on the calculation results by the third party evaluators; and (ii) the outside directors should make sure that the work formulating the management plans that the company is to submit to the third party evaluator is free of any influence from the tender offerors group, and that target company directors or their advisors who are to become part of the tender offerors group should not go beyond the level of expressing their hopes as part of the tender offerors group and should not be involved in the preparation of the concrete numbers that make up the management plans as well as the analysis of the business strategies.

In order to judge which of these two lines of thought is appropriate, it is necessary to start by examining the *raison d'être* for the evaluation process by the third party evaluators.

Management plans are prepared by presuming the value to be generated by the company operations in the future, based on various objective conditions at the time. Hence, the results of the management plans are inevitably influenced by a base date for evaluation, relevant facts, the evaluation method of the facts, and a person or persons carrying out the evaluation. Specifically, the management plans are prepared by taking into account a wide range of considerations such as the timing of when business strategies and facts are to be adopted, as well as what judgment is to be made concerning the feasibility of business strategies and adverse factors. Therefore even if there are multiple management plans submitted to third party evaluators, there may be cases where it cannot be immediately determined that the management plans have been deliberately revised so as to coincide with the acquisition price desired by the tender offerors group.

It is thus necessary to consider types of functions and efficacy of the management plans submitted to the third party evaluators. Given that the DCF method played a significant role in the current matter, the third party evaluators such as auditing firms, etc. determine the corporate value and value per share based on the management plans submitted by the target company, but do not perform the calculations by accepting the materials submitted by the target company on faith. They contact and interview various persons within the company, ranging from persons responsible for operations to the representative director with respect to the feasibility of business strategies which are to be the basis of the management plans, and, on the basis of these results, apply the management plans in whole or in part and when needed, request amendments. However, on the other hand, in the use of the DCF method, it is standard practice to rely principally on the management plans supplied by the company and to make limited modifications and evaluations based on the results of meetings and interviews, and conventionally a third party evaluator cannot judge that profit will be contributed by business strategies that the target company does not even have, or that profit contribution should be increased for business operations which directors or persons actually engaged in the business assert are otherwise. In that sense, the management plans submitted by the target company to the third party evaluator should be deemed to possess the function of setting an "upper limit" in the calculation results based on the DCF method. As a matter of convenience this function and efficacy are referred to as "binding power on management plans."

(2) Binding power of the calculation range

It is necessary to next give attention to the functions and efficacy of the valuation results from the third party evaluators. The tender offerors group and the directors of the target company representing the interests of the shareholders carry out price negotiations based on the calculation results by the third party evaluators separately obtained through their independent route. For example, when negotiations are carried out based on the DCF method, it is significantly difficult in practice to agree on a numerical value that is out of the calculated range (for example, to agree on 800 yen when the calculation range based on the DCF method is between 1,100 yen and 1,300 yen). The reason for this is that the value calculation produced by the third party evaluator is used to support the validity of the price agreed upon by both parties. As a result, for example, the directors of the target company are to be bound in fact by the share price range calculated by the third party evaluator that they retained. As a matter of convenience this function and efficacy are referred to as “binding power of the calculation range.”

(3) Influence of management plans on discretion during negotiations

When the “binding power of management plans” and the “binding power of the calculation range” simultaneously function, the management plans formed by the target company generate an ultimate effect which is to limit the extent of the negotiations to be made by the directors. It is therefore important that the target company and the tender offerors group submit to their third party evaluators management plans that each has prepared independently and evaluated in a rational way. In the case of the first line of thought (i) introduced above (i.e. that there is no problem in target company directors or their advisors who are to become part of the tender offerors group going beyond the level of merely conveying the hopes of the tender offerors group and getting involved in the preparation of the concrete numbers that make up the management plans as well as the analysis of the business strategies, and it is sufficient for the outside directors and independent directors to be involved only in the subsequent price negotiation based on the calculation results by the third party evaluators), the third party evaluator is not subject to the “binding power of management plans” and it also assumes that outside directors are not subject to the “binding power of the calculation range,” and as such it is a view that must be said to be at variance with the reality of actual practice.

3 Limitation of tender offerors group’s freedom to negotiate

(1) The principle of freedom of negotiation for an acquirer

It is of course natural that there be limits on the side of the acquirer with regard to the desired acquisition price and the extent to which the acquirer will yield in negotiations (for example, if the acquisition price is above 900 yen, available financing may not permit such a purchase). This is not to deny that the acquirers have the freedom to negotiate the terms with directors of the target company, who act to represent the interests of the sellers, who are the shareholders of the company. The point at issue is the degree to which the acquirer has the freedom to negotiate, and if there is intervention by any means whatsoever, at what point this intervention is determined to go beyond what is recognized as the reasonable bounds of freedom to negotiate (“unreasonable interference”). In the following, the discussion is against the background of the present case, whereby the management of the valuation process by the third party entity and the negotiation with the acquirer was carried out by outside directors as a means of alleviating the systemic conflict of interest inherent in an MBO transaction.

On this point, the act in which the acquirer communicated to the outside directors its own understanding of the specific business strategies behind the management plans and its own evaluation of the prospects for their realization is not taken to be unreasonable interference. While it is plausible that the outside directors might, due to communication of opinion by an acquirer, form their views or be influenced, it also cannot be denied that even upon receiving information from outside sources and taking it into account, it is possible that the outside directors ultimately judged by themselves that the management plan was the most rational.

(2) Importance of transparency and maintenance of fairness in the process

When it is considered, however, that the management plans supplied by the target company to the third party evaluator, at the very least, set the “upper limit” for calculations using the DCF method, taking a rigorous view of the management plans and expressing an opinion favoring a lowering of the target company’s profits should have been carried out during negotiations with the company’s outside directors. For example, if there are major differences within the target company regarding views concerning the management plans, and sincere negotiations are being carried out internally to reach a unified view within the company, to provide advice that would support the outside directors who assert that a rigorous view should be taken of the management plans, would be extremely deficient in transparency from the viewpoint of minority shareholders, and since it also would create the impression of an unfair transaction, should be avoided.

Of course, even if the acquiring side provides advice that supports the view of outside directors who believe that a rigorous view should be taken of the management plans, there is no guarantee that the views of those directors will come to reflect that advice. Because it is extremely difficult to determine to what extent such unseen influence has effect, the maintenance of transparency and fairness in the process of settling differences of opinion relating to the management plans and valuations is presumed to be the sole way to ensure that the influence of acquirers does not go so far as to be viewed as “intervention that exceeds the recognized reasonable bounds of freedom to negotiate.”

4 Application of the present legal evaluation to the transaction and conclusion

(1) Core facts

Based on the result of the share price calculation by KPMG FAS, there was a prior statement among outside directors, as they entered into negotiations with the acquirer on September 16, whereby they decided that they would resign unless the negotiated price was higher than 800 yen. The result was that the share price of 800 yen was approved upon obtaining agreement that the founders would have to sacrifice approximately 2 billion yen of profit. This can be highly evaluated in that the outside directors negotiated on behalf of minority shareholders.

Further, with regard to the personal conflict of interest of each outside director, while this is a point deserving attention, it is not considered to be a factor determining the conclusion of this inquiry. Certainly, among the three outside directors there are those with ownership of approximately 500,000 shares of the company, those with a consulting contract with the company to act as a tax accountant, and those who received inferences relating to their continuation as outside director(s) even after the management buyout. However, with regard to the ownership of shares, to the extent that it is not clear that this is the optimum timing for shareholders for a management buyout, there is potential of sustaining a loss by expressing agreement for this management buyout, and moreover, given the presumption that these shares would be tendered, the outside directors in question are placed in the same position as the sellers and hence the same position as the minority shareholders. Furthermore, with regard to the consulting contract as a tax accountant, it cannot be stated that an excessively high fee is being received and with regard to continuance of the position as an outside director after the buyout, with the exception of the case wherein it is speculated that the present position will be ended unless there is a buyout, the present situation would merely continue and hence it cannot be recognized as supporting evidence of a conflict of interest by an outside director.

Nevertheless, as stated above, the outside directors held interviews with the executive officers on August 29, prepared “Calculation Instructions” on the basis of analysis made using the results of these meetings, and supplied them to the MBO project members. Subsequently, at a board of directors meeting held on August 31, this projection was approved as the official management plan as of August 31 that would be submitted to KPMG FAS.

According to the results of interviews by this Committee and objective documents available to it, it appears to be the case that in the process of approving the management plans as of August 31, Hayate, who is the advisor to the founding family, was involved in the preparation of the Calculation Instructions, and that Hayate offered specific advice with regard to the agenda items of the Board of Directors meeting and supplied the outside directors with specific information so that they could convince the executive officer who was in opposition to the management plans as of August 31. Moreover, the outside directors did not refuse to accept support by Hayate for the preparation of the Calculation Instructions, or advice concerning the specific information.

(2) Evaluation of Facts

The fact that the founding family side provided advice and support to outside directors as indicated above and the outside directors accepted this advice and support, demonstrates a significant lack of transparency and it can be said to give the impression that there has been an unfair transaction. On that basis it is thought that there was an intervention that exceeds the recognized reasonable bounds of freedom to negotiate by the acquirer.

(3) Conclusion

Consequently, with regard to the negotiations held on September 16 and September 17, despite the approval of the share price of 800 yen which effectively made the founding family sacrifice 2 billion yen of profit and acted as an effort to eliminate systemic conflict of interest, the manner whereby the founding family's advisor was involved in the process of formulating the management plans exceeded the recognized, reasonable bounds of freedom to negotiate, and in addition, since it can be recognized that the outside directors accepted this intervention, an issue of transparency and fairness did appear to exist with regard to the process of decision-making to approve the management plans, so as to restrict the scope of judgment available to outside directors at the time of negotiation. Collectively, these conditions do not permit the assertion that there was a conflict of interest issue on the part of outside directors in this matter, but on the other hand, the suspicion that there remained a conflict of interest issue cannot be reasonably eliminated.