Jurisdiction: Japan

Firm: Momo-o, Matsuo & Namba

Author: Kakuji Mitani

1. What are the key laws and regulations that govern mergers and acquisitions in your jurisdiction?

The corporate type which is the most frequently used in Japan is a stock corporation referred to as "*Kabushiki Kaisha*" (KK), which is established and governed by the Companies Act (*Kaisha Hou*). All listed companies in the Tokyo Stock Exchange are KKs (excluding REITs or investment trusts).

a. The most typical action in M&A transactions is a share transfer of a target company. The Companies Act stipulates the required procedures surrounding the transfer of ownership of the shares. Parties should fully comply with the Companies Act and the process will be agreed on in a share transfer agreement. Although the share transfer agreement should be drafted in accordance with the Companies Act, general contractual terms in the agreement are concurrently governed by the Civil Law *(Minpou)*.

b. The Companies Act also regulates statutory corporate organizational restructuring actions such as merger *(Gappei)*, corporate split *(Kaisha Bunkatsu)*, share exchange *(Kabushiki Koukan)*, and statutory share transfer *(Kabushiki Iten)*. Parties need to implement the applicable procedure required by the Companies Act to conduct these actions. For instance, these actions need to be approved by the Board of Directors or the shareholders meeting, as applicable.

c. Other forms of M&A include asset sales (referred to as "business transfers" *(Jigyou Joto)* in Japan) and third-party allotment of new shares *(Dai-sansha Wariate Zoshi)*. The Companies Act also stipulates relevant procedures required for these transactions.

If a listed company is involved, the M&A process must be implemented in full compliance with the Financial Instruments and Exchange Act *(Kinsho Hou)* and relevant rules and regulations set forth by the stock exchange. The Financial Instruments and Exchange Act establishes rules relating to tender offer, disclosures, reporting system of the ownership of shares more than a certain percentage (5%), in addition to insider trading. Further, stock exchanges (the main stock exchange in Japan is the Tokyo Stock Exchange) also have rules on timely disclosures.

Other than the above, depending upon deal size and situation, parties may need to consider antitrust implications under the Antimonopoly Act. The Foreign Exchange and Foreign Trade Control Law ("Foreign Exchange Law") may also apply, depending upon business category. Notification to relevant authorities may be required in certain circumstances.

2. What are the government regulators and agencies that play key roles in mergers and acquisitions?

From a legal perspective, in principle, there are no governmental restrictions that generally apply to M&A transactions, except if the transaction meets thresholds under the Antimonopoly Act or a target company conducts a certain category of businesses related to national security.

If the size of both an acquired company and an acquiring company exceeds certain thresholds set forth in the Antimonopoly Act, the transaction is subject to merger review by the Japan Fair Trade Commission ("JFTC"). The parties are required to obtain clearance from the JFTC prior to closing. In the case where the M&A transaction includes a combination between competitors with large market shares, the JFTC may carefully review the case and request curative measures.

In the case of special business fields such as the military, nuclear power, and broadcasting and telecommunications, the parties are also required to obtain an approval from relevant governmental authorities pursuant to the Foreign Exchange Law.

From a practical perspective, a party needs to pay attention to the competent authority of the central government or local government. Approval or business license obtained from these entities is required in practice to implement the M&A transaction, and therefore an explanation or a consultation with them may be important to continue the business after the transaction closes.

3. Are hostile bids permitted? If so, are they common in your jurisdiction?

Hostile bids are permitted in Japan. They are not necessarily common, but have occurred in the past. However, there were few cases which resulted in success.

The bottom-line rule under the Financial Instruments and Exchange Act, which regulates a listed company or securities, is that a share acquisition should be made through a public tender offer if it results in the possession of more than one-third of all of voting rights of a listed company. A public tender offer is generally called a "TOB" (takeover bid). A TOB is a public offer of the purchase of a certain listed company at a designated price. Most TOBs are "friendly deals," where the process is initiated with the prior consent from the board of directors of a target company. If the TOB is initiated without the consent of the board of a target company, it will be called a hostile TOB.

In Japan, activist funds gradually became more prevalent in the 2000s. These funds sought companies with undervalued share prices and extended buyout offers. In most cases, the activist fund acquired a certain number of shares of the company and approached its target as a shareholder. If negotiations were not successful, a hostile TOB was commenced. Other than the activities of activist funds, there were some cases of hostile bids emanating from working companies with real business strategies in mind. The most famous example of this is the hostile bid made by Livedoor to Nippon Broadcasting in 2007.

As the number of the cases of hostile bids increased in Japan, listed companies began to introduce takeover defense measures based on the Companies Act and the Financial Instruments and Exchange Act. Today, the most prevalent takeover defense measure is the so-called "pre-warning type defense measure." It seeks information disclosure of acquisition plans, etc., from the acquirer and then requests an independent third-party advisory to issue an opinion on whether such acquisition would improve corporate value. However, many listed companies have abolished such takeover defense measure as it appears too protective for current officers and rather lowers the corporate value.

4. What laws may restrict or regulate certain takeovers and mergers, if any? (For example, anti-monopoly or national security legislation).

a. Under the Antimonopoly Act, if the amount of annual sales and the size of assets of involved parties exceed a certain threshold, notification to the JFTC is required. In summary, in the case of stock acquisition or merger, the transaction is subject to merger review by the JFTC if the total amount of local annual sales of the company group to which an acquiring company belongs exceed 20 billion Yen and the total amount of local annual sales of the company group

Kakuji Mitani

Partner, Momo-o, Matsuo & Namba

Kakuji Mitani is a partner of Momo-o, Matsuo & Namba. Mr. Mitani's main area of practice comprises general corporate law matters including Mergers & Acquisitions and corporate governance. Mr. Mitani also handles complex commercial litigation and international arbitration cases concerning Mergers & Acquisition transactions.

Mr. Mitani also has broad experience in antitrust and competition law. Mr. Mitani has represented numerous companies and individuals investigated or accused by the US Department of Justice and other competition authorities.

Mr. Mitani received his LL.B. from The University of Tokyo, Faculty of Law in 2000 and was admitted to the Japanese Bar in 2002. He obtained his LL.M. from Columbia Law School in 2007 and was admitted to the New York Bar in 2008.

to which a target company belongs exceed 5 billion Yen, and the acquiring company is going to obtain more than 20% or 50% of voting rights. In the case of asset sale (business transfer), the threshold regarding local annual sales of a target company group is 3 billion Yen.

The waiting period in Phase I is 30 days after receipt of notification. In the case of acquisitions without competition law concerns, the review of the JFTC will be completed within this period. If there is an issue under competition law, the process shifts to Phase II.

b. The Foreign Exchange Law also requires prior notification when a contemplated investment falls into an inward direct investment by a foreign investor, and the investment will be made into a company which is conducting business in relation to the maintenance of national security or public order in Japan. For example, the rule of prior notification will apply if a target company (or any of its subsidiaries) conducts business concerning weapons, aircraft, nuclear power related business, electric power, telecommunications, pharmaceutical manufacturing, or security services. The waiting period is 30 days. This rule will apply to the case where only more than 10% of shares are obtained. Even if a subsidiary of the target company is engaged in a business corresponding to a pre-notification business category, this obligation of prior notification is required.

5. What documentation is required to implement these transactions?

The required documentation differs depending on the structure of M&A, i.e., whether the shares of the target company contain restrictions on transfer, whether it is a listed company, etc. In any case, an internal corporate process for making the decision of entering into an M&A transaction is necessary for both the acquiring company and the acquired company. Typically, a resolution of the board of directors will be required, in principle, and the shareholders meeting will be required depending upon the structure of the transaction. After the implementation of the M&A, it might be necessary to apply for the change of registration with submission of the minutes of these meetings at the Legal Affairs Bureau if there is a change in the registered items as corporate information.

a. In the case of a share transfer, if a target company issues a share certificate, the transfer of shares will take effect by actual delivery of the share certificate(s) under the Companies Act. In the absence of physical share certificates, an application form for change of recorded items in the shareholders registry is required.

b. In the case of a merger, it is necessary to publish the many documents specified in the Companies Act, namely, a merger agreement, a statutory disclosure document (before and after the effective date), a notice to creditors, public notice to the Official Gazette, and an explanation of the situation regarding creditors who oppose the transaction.

c. Likewise, for the company split, it is necessary to prepare a division plan, disclosure documents, a notice to creditors, and public notice, etc.

In the case of a M&A transaction involving a listed company, a lot of documentation will be required in accordance with a required process, of course. A public tender offer is mandatory if a certain acquisition of a listed company meets specified criteria and does not fall under the exemptions. There are a lot of criteria and exemptions, but the primary rule is that a public tender offer is required if the transaction results in the possession of more than one-third of all of voting rights of a listed company. An acquiring party shall make a filing of a public tender offer and related documents with the local financial bureau under the Financial Instruments and Exchange Act. The filing statement shall include detailed information of the conditions of the tender offer. An acquired company (targeted company) is required to response to the tender offer and also to make a timely disclosure under timely disclosure rules of the stock exchange as well.

In the case of a third-party allotment of new shares of a listed company, the listed company is required to make a filing of a securities registration statement, in principle, to effectuate such offering of its additional shares.

6. What government charges or fees apply to these transactions?

There are no special or specific charges by the government on an M&A transaction. If the case is subject to the JFTC's review, the filing fee to the JFTC will be charged. As for the application to change the registration information at the Legal Affairs Bureau, fees and taxes will be charged.

7. Do shareholders have consent or approval rights in connection with a deal?

In the case of a share transfer of a public company, as it is basically a transaction between existing shareholders and an acquirer, consent of shareholders or shareholders meeting is not required in connection with the transaction itself. An acquirer needs to pay much more attention to the rules and regulations under the Financial Instruments and Exchange Act and/or the rules set forth by the stock exchanges.

In the case of a share transfer of a private company, a share transfer between shareholders is subject to the approval of the board of directors and/or the shareholders meeting in principle. A private company here means a stock corporation with a restriction on a share transfer in its Articles of Incorporation.

Based upon the recent amendment of the Companies Act in 2014, when a company is transferring a subsidiary's share with a value exceeding one-fifth of total assets, a super-majority (equal or more than two-thirds of voting rights) resolution of the shareholders meeting has become necessary as of 2015. This is a requirement of obtaining the consent of shareholders or shareholder of an acquired company. This rule is the same in the case of an asset sale (business transfer).

As for corporate organizational restructuring actions such as merger, corporate split, share exchange and statutory share transfer under the Companies Act, a super-majority resolution of the shareholders meeting is necessary, except when it falls under exceptional cases.

8. Do directors and controlling shareholders owe a duty to the stakeholders in connection with a deal?

In principle, as Japan operates under a civil law system unlike US/UK's common law system, the legal developments on the issue of the duty of directors have been made on the basis of written provisions of the Companies Act. Based upon relevant provisions in the Act, directors shall perform their duties for the company in a loyal manner, which is commonly interpreted as directors owing the company a duty of care to be a good manager. Having stated the above, as legal theory under common law has a big influence on corporate practices in Japan, it is safe to assume directors owe a similar level of fiduciary duties to the company. In cases where there is a dispute between controlling shareholders and minority shareholders, a derivative suit by minority shareholders against directors sometimes occurs following an M&A.

As for the duty of controlling shareholders against stake holders, there have been no significant legal developments so far.

9. In what circumstances are break-up fees payable by the target company?

Depending upon the size or character of the deal, the break-up fee clause, which allows a seller to terminate the existing contract under certain situations (e.g., in case of a proposal from a competing purchaser) by paying a certain penalty to the original acquirer, is sometimes prescribed in the definitive agreement. If it is agreed to between the parties, it becomes binding on the parties, in principle. There have been no significant legal developments to date as to what extent it becomes binding.

10. Can conditions be attached to an offer in connection with a deal?

Yes, generally speaking, it is typical to attach several conditions and exceptions to an offer in connection with a deal. For instance, there being no material adverse change or obtaining a clearance with no exception from the JFTC are typical conditions attached to an offer.

It should be noted, however, that conditions to settling a public tender offer are permitted in certain cases under the Financial Instruments and Exchange Act. Also, a withdrawal of a tender offer is only allowed when there is a material adverse change in its targeted company. The rules are detailed in the relevant Enforcement Order and Cabinet Office Ordinance.

11. How is financing dealt with in the transaction document? Are there regulations that require a minimum level of financing?

Under the Companies Act or other M&A related laws, there is no specific requirement or restriction concerning financing. Particularly in a LBO deal, a loan agreement and other agreements of setting collateral/pledges with financial institutions are key aspects of an M&A transaction. Firstly, an acquiring company establishes a new company ("Newco") as a vehicle for acquisition and such Newco acquires shares of the targeted company or conducts a merger, etc., with it.

As mentioned above, although there is no requirement of a minimum level of financing, parties need to be careful of tax laws. Typically, in the case where the amount of a loan from a foreign entity exceeds three times the capital amount provided by a foreign entity, a payment of interest of loans (for such excess amount) to such a foreign entity will not be deemed deductible expenses under thin capitalization rules *(Kasyou Shion Zeisei).*

12. Can minority shareholders be squeezed out? If so, what procedures must be observed?

Yes, minority shareholders can be squeezed out through several methods. Recent amendments of the Companies Act affect such methods.

a. A controlling shareholder holding 90% or more of voting rights of the company (referred to as "special controlling shareholder" *(Tokubetsu Shihai Kabunusi*) is entitled to force minority shareholders to sell all of their shares to the special controlling shareholder *(Kabushiki Uriwatashi Seikyu).* Thus, a special controlling shareholder may forcibly acquire all shares (which should be less than 10%). As it is not necessary to hold a general shareholders meeting for this process and the special controlling shareholder may directly acquire remaining shares at one time, the controlling shareholders may complete squeezing out in the shortest time by this procedure. This has been newly adopted by the Companies Act amendment in 2014.

b. If the ratio of a controlling shareholder is less than 90% of voting rights, the shareholder may consider using the way of statutory consolidation of shares *(Kabushiki Heigou)* for squeezing out. This method is a little bit technical. The company proceeds with a statutory consolidation of shares at such a ratio that the number of shares held by minority shareholders is less than one share in the first step. Then, the company sells out such fractional shares in accordance with relevant provisions in the Companies Act. The super-majority resolution of the company is required. Minority shareholders opposing this process at the shareholders meeting have a right to request share purchase from the company at legitimate consideration to the court, if they consider the purchase price is unfairly low.

Prior to enforcement of the amendment of the Companies Act in 2017, there were many cases where squeeze-out was carried out by another method using classified shares with "all acquisition provisions." However, as this way was extremely complicated, the above two methods have become mainstream nowadays.

13. What is the waiting or notification period that must be observed before completing a business combination?

The waiting period under the Antimonopoly Law is thirty (30) days after filing of the notification, and in the case of acquisitions without concern under the competition law perspective, the JFTC's review will end within this period. In most cases, the JFTC may send a notice to the effect that any measures will not be taken. Otherwise, the deal is deemed to have an anti-competition concern and shifts to Phase II of review, which would take much longer. The actual process usually starts with a prior consultation with the JFTC before making an official filing. Parties should be careful in that the Japanese government authorities, including the JFTC, tend to be very strict regarding formalities. The filing is often not accepted officially due to lack of necessary documents or information.

The waiting period under the Foreign Exchange Law is also thirty (30) days, in principle. If there are clearly no concerns regarding national security or public order with the deal, a competent authority may grant a clearance before the period expires.

As with M&As in other jurisdictions, obtaining necessary clearance from relevant authorities will be one of the important conditions precedent of closing stipulated in a definitive M&A agreement.

14. Are there any industry-specific rules that apply to the company being acquired?

As to the industries for which prior notification is required under the Foreign Exchange Law, such as weapons, aircraft, nuclear power related business, electric power, telecommunications, pharmaceutical manufacturing, or security services, parties also need to analyze if an M&A affects approvals or licenses which a targeted company may possess.

An M&A involving financial institutions such as a bank, trust bank, investment bank, securities company, and insurance company should proceed with caution. Banks are especially highly regulated and monitored by the Financial Services Agency ("FSA") of Japan in terms of financial soundness, and it is safe to consider that an M&A including a bank will mean that all phases are subject to pre-approval of the FSA, in principle.

Other than the above, when a target company is conducting business which requires an approval or license by the governmental authority, such as transportation, shipping, forwarding, energy, etc., the effect of the M&A should be carefully examined through the due diligence process.

15. Are cross-border transactions subject to certain special legal requirements?

No, in principle. There are no requirements that specifically applied to a cross-border transaction, except in cases where a target company is conducting certain kinds of business regarding the maintenance of national security and public order. In that case, an investment of a foreign entity requires prior notification under the Foreign Exchange Law. It should be noted that a foreign investor may be required to submit a notification if its investments into Japan meets the criteria under the Foreign Exchange Law, but it is on an ex post facto basis.

16. How will the labour regulations in your jurisdiction affect the new employment relationships?

Depending upon the M&A structure, the effect on labor relationships in a targeted company may differ.

a. In the case of a share transfer, as only the ownership of the shares of the targeted company is transferred, there is no direct impact on labor contracts between the targeted company and its employees. Existing labor contracts simply continue to be effective in the same way as it was as before the transaction.

b. In the case of a merger, a surviving company (an entity of an acquiring company) inherits the labor relationships between the company which ceases to exist and its employees without any change. Therefore, the employment conditions are transferred as they stand, and multiple employment conditions would exist in parallel in a surviving company. Please be aware that Japanese labor legislation is much more employee-friendly, compared to other jurisdictions, and so in practice it is difficult to simply reduce headcount at the company's discretion. An employee can only be dismissed for unavoidable reasons or must adhere to other strict requirements. Further, in principle, it is not possible to change the employment conditions to the disadvantage of an employee without his or her consent.

c. In the case of corporate split, there is a special law regarding the transition of employees. Labor contracts will be transferred to an acquirer's entity under the same conditions as before, although consent from individual employee is not required, in theory. The special law (The Labor Contract Succession Act) stipulates procedures for protecting employees to be assigned and also employees not to be assigned by a contemplated corporate split.

d. In the case of an asset sale (business transfer), it is necessary to agree with individual employees in order to inherit workers. Therefore, a key employee for a transferring business sometimes refuses transition to an acquiring entity and this becomes an issue.

17. Have there been any recent proposals for reforms or regulatory changes that will impact M&A activity?

The recent amendments of the Companies Act in 2016, which became effective in 2017, affected the method of squeezing out, as mentioned above. After a simple way of squeezing out by a special controlling shareholder (having more than 90% shares) was introduced, there have been a lot of cases using this method to make an entire subsidiary. Further, the statutory consolidation of shares has become the mainstream method of squeezing out. This amendment of the Companies Act also affected an activity on the seller's side. When a company sells its subsidiary of which the assets in the book exceed one-fifth of total assets, a super-majority resolution of the shareholders meeting is required.

About the Author:

Kakuji Mitani
Partner, Momo-o, Matsuo & Namba

E: mitani@mmn-law.gr.jp

W: www.mmn-law.gr.jp

A: Kojimachi Diamond Building 6F
4–1 Kojimachi Chiyoda-Ku
Tokyo, 102-0083
Japan

T: +81 3 3288 2080

F: +81 3 3288 2081