from LexisNexis
The 3rd Annual Guide to Practicing M&A Law
1. What are the key laws and regulation that govern mergers and acquisitions in your jurisdiction?

The Companies Act, the Financial Instruments and Exchange Act (the ‘FIEA’) and the stock exchange rules are the key laws and regulations that should be taken into account in M&A deals in Japan. Also, depending on the nature of the acquirer and target business, the merger control regime under the Antimonopoly Act (the ‘AMA’), the foreign investment regulations under the Foreign Exchange and Foreign Trade Act (the ‘FEFTA’) and various industry specific regulations (especially regulations on the financial sector such as the Bank Act or Insurance Business Act) could come into play. Additionally, the Civil Law matters in relation to contracts in M&A deals if such contracts are governed in Japanese laws.

M&A transactions in Japan can be roughly broken down into four categories: (a) a transfer of shares in a target company, (b) an asset transfer, (c) a statutory corporate reorganization and (d) an issuance of shares to the acquirer by means of third-party allotment.

In the case of a transfer of shares, the key laws are the Companies Act, under which the approval of the board of directors (or other corporate organs) of the target company may be required depending on the articles of incorporation of the target company. In addition, if the target company is a company which is obligated to file an annual securities report pursuant to the FIEA (including a listed company, hereinafter a ‘Reporting Company’) and the acquirer intends to acquire significant voting shares (e.g., more than 33.3%) of the target company through an out-of-market transaction, the acquirer is required to conduct a tender offer and comply with disclosure requirements pursuant to the FIEA. In the case of an asset transfer, the Companies Act sets forth certain procedures (e.g., shareholders’ approval by super-majority vote) for the transfer of an organizational business unit.

The Companies Act also stipulates procedures for statutory corporate reorganizations, including a merger (gapper), a corporate split (kaisha bunkatsu), a share transfer (kabushiki iten) and a share exchange (kabushiki koukan).

With regard to the issuance of shares by means of third-party allotment, the Companies Act sets out procedural requirements such as shareholders’ approval or board approval. The FIEA also matters when it comes to cases where a Reporting Company issues shares.

Furthermore, if the parties or the target company is a listed company, the timely-disclosure rules of the relevant stock exchange could also come into play. For other antitrust and regulatory requirements, please see the answers to Questions 13 and 14.

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

In connection with a tender offer and issuance of shares by a Reporting Company, which require the filing of a tender offer registration statement and securities registration statement respectively, it is necessary to consult with the Kanto Local
Finance Bureau (the ‘KLFB’) prior to the filing of such statement, and to go through a review process with the KLFB. The Financial Services Agency (‘FSA’), which administers the FIEA and oversees securities transactions, may also have some input, either directly or through the KLFB. Such review processes by the KLFB and FSA should be carefully taken into account when scheduling the transaction and drafting such statements.

In addition, if timely-disclosure rules are relevant (e.g., an acquisition of a listed company), prior consultation with the stock exchange would also be required or advisable, and the relevant press release needs to be reviewed by the stock exchange.

If the transaction requires a merger filing under the AMA, such filing will be made with the Fair Trade Commission (the ‘FTC’). Negotiation with and approval by the FTC could be a key factor to complete the transaction if the transaction presents substantial antitrust concerns. Also, if regulatory approval under the FEFTA or other industry specific approval is required (for details please see question the answer to Question 14), the relevant supervising ministries such as the Ministry of Finance and the Ministry of Economy, Trade and Industry could take a role.

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

Yes, hostile bids are permitted but are currently not very common. There were a number of precedents in the period from 2003 to 2008, but only a few of such bids were successful. It has been difficult in practice for a bidder to obtain sufficient support from existing shareholders (e.g., tenders to a hostile tender offer) without obtaining approval from the board of directors of the target company. In the wake of a number of hostile bids in 2004 and 2005, a number of listed companies introduced various forms of anti-takeover defence measures, some of which have already been discontinued or abandoned due to subsequent criticisms by institutional shareholders.

Currently, activists seem to rely more on shareholder proposals (e.g., requests for increasing shareholder returns by means of share buy-backs) than hostile bids. The Tokyo Stock Exchange has enacted a corporate governance code, which in part requests listed companies to have productive communications with their shareholders and to establish and disclose fair corporate governance measures. Additionally, the FSA has promulgated the Stewardship Code that has principles that are mostly similar to those in the U.K. Stewardship Code. Considering such changes to the legal framework as well as recent actions taken by activists, it is becoming more vital for listed companies to reach out to shareholders (especially institutional investors) and proxy advisors to assess shareholders’ intentions and movements.

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

Acquisitions of shares in a Reporting Company (such as a listed company) can be restricted by the FIEA and related regulations. Firstly, as in the answer to Question 1, there are various situations in which the acquirer is required to conduct a tender offer, such as when the acquirer purchases shares in a Reporting Company representing voting rights exceeding one-third of total voting rights in one or series of out-of-market transaction(s). There is no “best price rule” under the tender offer regulations in Japan, but the offer needs to be made equally to all shareholders. The tender offer period must be not less than twenty (20) business days but not more than sixty (60) business days in principle. The offerer may set a minimum and maximum number of shares to be purchased, although the acquirer is required to offer to purchase all types of shares and purchase all shares tendered if it intends to
purchase shares representing more than two-thirds of total voting rights. Secondly, the transaction can be restricted on the grounds of insider trading regulations, which prevent sales or purchases of listed shares (whether in or out of the market) while in possession of material non-public information.

In addition, the issuance of shares by a Reporting Company could trigger the mandatory filing of a securities registration document and relevant waiting periods pursuant to the FIEA.

In terms of antitrust regulations, the AMA requires the filing of a prior notification for M&A deals meeting in particular thresholds that are mainly based on revenue and share percentages. For example, roughly speaking, an acquirer needs to file a prior notification, if (a) the total domestic sales of the acquirer and its subsidiaries exceed JPY 20 billion, (b) the total domestic sales of the target company and its subsidiaries exceed JPY 5 billion, and (c) the acquirer will come to own in excess of either 20% or 50% of the voting rights of the target company. In addition to such procedural requirement, if the transaction would result in the substantial restraint of competition in any particular field of trade, the FTC may issue a cease and desist order or a restraint order.

In the case of an acquisition by a foreign investor, the parties should take note of foreign investment regulations under the FEFTA. If the target company is engaged in certain sensitive businesses (e.g., aircraft, weaponry, nuclear power, space development, energy, telecommunications, broadcasting, railway, passenger transportation, oil or leather goods), a prior notification to the Minister of Finance and other relevant ministries (through the Bank of Japan) could be necessary. Depending on the situation, the Ministry of Finance and other relevant ministry may order the transaction to be amended or halted. Also, transactions may entail certain industry-specific regulations (please see the answer to Question 14), in which case the relevant ministry could also play a role.

5. What documentation is required to implement these transactions?

For a transfer of shares in a private company, a stock purchase agreement is typically executed between the seller and purchaser. On the other hand, for a transfer of a substantial amount of shares in a Reporting Company, a tender offer registration statement may need to be filed as explained in the answer to Question 4. In a tender offer transaction, the target company is also required to file a position statement. Also, it is not uncommon for the tender offeror to enter into a tender offer acceptance agreement with selling major shareholder(s) at the time of launch of the tender offer.

For an asset transfer transaction, an asset transfer agreement or business transfer agreement is typically executed.

For a statutory corporate reorganization, such as a merger or corporate split, the Companies Act specifies items that should be described or set forth in relevant reorganization documents. The contents of such statutory documents, which will be approved at a shareholders’ meeting if necessary, include only basic terms. In practice, however, the parties often enter into a separate agreement (which is not publicly disclosed) setting forth detailed terms and conditions of the transaction. In addition, depending on the transaction, the Companies Act may require preparation of certain documents with respect to creditors’ protection procedures, shareholders’ appraisal rights or shareholders’ meetings.

For an issuance of shares, a subscription agreement or investment agreement is typically executed between the issuer and subscriber. Also, when a Reporting Company issues shares, the filing of a
6. What government charges or fees apply to these transactions?

A transfer of shares does not trigger any stamp duty, but a merger agreement and corporate split agreement could trigger stamp duty, which is JPY 40,000 per document. Also, an asset transfer agreement (including business transfer agreement) could trigger higher stamp duty depending on assets to be transferred. Some statutory corporate reorganizations or issuances of new shares that increase paid-in capital may trigger the imposition of a registration tax (which is, subject to exceptions, approximately 0.7% (0.15% for a merger) of the amount of the paid-in capital or 0.7% (0.15% for a merger) of the increase in the paid-in capital). In addition, it should be noted that other registration taxes can be imposed in an asset transfer or business transfer depending on the nature of assets to be transferred.

No filing fee is required in connection with the prior notification under the AMA or FEFTA.

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

For a statutory corporate reorganization, subject to certain exceptions, shareholders’ approval by super-majority vote is necessary to consummate the reorganization. For a business transfer and a transfer of shares in a subsidiary, in principle, the approval of shareholders of the seller could also be necessary, if the value of business or shares in the subsidiary sold in the transaction exceeds 20% of total assets of the seller.

For an issuance of shares via third-party allotment, generally speaking, no shareholder approval is necessary where the issuer is a public company, except in cases where the shares are issued on terms that are favourable to the subscriber (please see discussion of recent amendments to the Companies Act in the answer to Question 17).

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

Traditionally, directors have been viewed as owing fiduciary duties to the company, not directly to the shareholders of the company. However, recent court cases indicate that directors are required to consider not only the interest of the company but also the interest of all shareholders. Also, in one precedent involving a management buyout, the court held that the directors are required, in the exercise of their fiduciary duties, to ensure that a fair price is paid and that fair disclosure is made to the shareholders.

On the other hand, it is generally understood that controlling shareholders do not owe any duties to minority shareholders.

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

Generally speaking, break-up fees are not prohibited and could be used as a deal protection measure, but practically speaking, it is not common for the target company to agree on break-up fees with the acquirer.
Due to tax considerations and various other reasons, an acquisition of a Reporting company in Japan is often conducted in a two-step transaction (i.e., a tender offer and subsequent squeeze-out). Under this structure, generally speaking, it is not still so common for the target company to enter into a tender offer support agreement or other transaction agreement with the acquirer (in practice, in a friendly transaction, the acquirer announces the tender offer at the same time as the target company announces its support, but no binding agreement exists between them), while the acquirer often seeks to enter into an agreement with selling shareholders to bind those shareholders to tender their shares in the tender offer. In this type of transaction, break-up fees are sometimes put in place in the agreement between the acquirer and the selling shareholders, but the target company rarely agrees on break-up fees, as there is no agreement between the acquirer and the target company in the first place.

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

In an acquisition of a non-Reporting Company, conditions can be attached in the stock purchase agreement.

In the case of an acquisition of a Reporting Company via tender offer, the tender offer regulations must be taken into account. Under Japanese tender offer regulations, it is permissible to set a ‘minimum threshold’ (i.e., if the number of shares tendered does not meet such minimum threshold, the tender offeror is not obligated to purchase any shares) or a ‘maximum threshold’ (i.e., if the number of shares tendered exceeds such maximum threshold, the tender offeror will purchase only shares that are equivalent to the maximum threshold on a pro-rata basis from all tendering shareholders). However, apart from these thresholds, withdrawal of a tender offer is permitted only in very limited circumstances (e.g., bankruptcy of the target company and takeover defence measures taken by the target). In particular, it is important to note that the tender offeror is not permitted to withdraw a tender offer on the grounds of a broad ‘Material Adverse Change’ of the target company (‘MAC-out provision’) or failure to obtain financing.

On the other hand, in the case of an acquisition of a Reporting Company via a one-step statutory merger, strict restrictions under the FIEA (such as tender offer regulations) are not applicable and the parties can agree on conditions with more flexibility, making it possible, for example, for the parties to agree on a MAC-out provision.

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

In the case of an acquisition of a Reporting Company via tender offer, there are no ‘certain funds’ requirements under the FIEA, but there are some regulations regarding the certainty of funding from the perspective of disclosure. Specifically, the acquirer needs to disclose the source of funds in the tender offer registration statement, and is also required to attach a document that shows the existence of sufficient funds for the tender offer to the tender offer statement (in practice, in terms of the acquisition financing, a ‘certificate of lending’ issued by a bank is used for this purpose). The FSA requires the ‘certificate of lending’ to speak of the material conditions (if any) to utilisation of the financing, and accordingly, it is common to list in the certificate of lending the conditions to utilisation, as well as to provide a summary of representations and warranties and events of default.

On the other hand, in the case of an acquisition of a non-Reporting Company or a business transfer or statutory corporate reorganisation, there is no legal requirement on the level of financing.
12. Can minority shareholders be squeezed out? If so, what procedures must be observed?

Yes, minority shareholders can be squeezed out in several ways. Note that unlike other jurisdictions, a cash merger is not commonly used in Japan for the squeeze-out, because it is classified as a taxable transaction on the target company (i.e., ‘non-qualified’ business combination), which would lead to a realisation of capital gains on the target company’s assets (including goodwill).

If the controlling shareholder holds (directly or through one or more wholly owned subsidiaries) at least 90% of the total voting shares of the target company, it is entitled to a ‘Cash-Out right’, which was newly introduced in the Companies Act in May 2015. The main procedural advantage of the ‘Cash-Out right’ is that it does not require a shareholder resolution of the target company and therefore the process is cost and time efficient compared to other squeeze-out structures (in practice, in the case of a public-to-private transaction of a listed company, a ‘Cash-Out right’ method of squeeze-out is commenced immediately after the settlement of the first-step tender offer, and can be effective within approximately one month after such commencement).

On the other hand, if the controlling shareholder holds only less than 90% of the total voting shares, it is common to use a ‘share consolidation’ as a squeeze-out method. Under this method, there is a share consolidation (effectively a reverse stock split) of the target whereby outstanding shares are reduced to a level at which all shares held by shareholders other than the controlling shareholder become fractional shares, which can then be cashed out pursuant to procedures under the Companies Act. The most important procedural difference with a ‘Cash-out right’ is that the squeeze-out of fractional shares by means of a ‘share consolidation’ requires the approval of shareholders of the target company, and therefore requires more time and work.

Under both squeeze-out methods, if minority shareholders are not satisfied with price to be paid upon the squeeze out, they are entitled to bring a lawsuit to seek fair consideration in a court procedure. If minority shareholders prevail in that lawsuit, the prevailing shareholders may be entitled to receive a fair price determined by the court (which could be a higher price than that set by the controlling shareholder). However, such result does not directly affect the effectiveness of the squeeze out, or prices to be paid to other shareholders.

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

For a merger filing under the AMA, there is usually a 30-day waiting period starting from the time when the filing of the prior notification is accepted by the FTC, although it may be shortened by the FTC at its discretion. The prior notification can be made on confidential basis before the execution of the definitive agreement.

For a prior notification under the FEFTA, which is required in connection with investments into certain categories of industry by a foreign investor (please see the answer to question 4), the standard waiting period is 30 days. However, if such investment is not related to national security, such period may be shortened (usually to two weeks), or the regulator may extend such period up to four months (five months at maximum) if necessary.

In addition to such regulatory waiting or notification periods, for a corporate restructuring, a notification in connection with a creditors’ protection procedure is required to be made at least one month before the effective date, and creditors may make objections during that period (if creditors who are entitled
to this protection make objections in accordance with the Companies Act, in principle, the company is required to perform outstanding obligations, provide sufficient security or entrust sufficient properties to a trust company, except for the case where such corporate restructuring does not harm the creditors). Also, a notification must be sent to shareholders at least 20 days prior to the effective date in order to give shareholders the chance to exercise appraisal rights.

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

Yes, there are industry specific rules, including among others:

- With respect to banks, roughly speaking, if the acquirer obtains more than 5% of total voting rights of a bank, the acquirer must submit a large shareholding report under the Bank Act; and an acquirer is required to obtain approval of the FSA to acquire more than either 15% or 20% of the total voting rights of a bank and will be subject to certain regulatory requirements as a bank major shareholder. Also, if the acquirer obtains more than 50% of total voting rights of a bank, the acquirer may be subject to additional regulatory requirements.

- Similar rules are applied to the acquisition of an insurance company.

Also, there are foreign investment regulations in certain industries. For instance, the Broadcast Law provides that a broadcasting license can be revoked if foreign investors come to own at least one-fifth of total voting rights. The Radio Act also provides that a radio station license can be revoked if foreign investors come to own at least one-third of the total voting rights. Also, the Civil Aeronautics Act limits foreign investments to not more than one-third of total voting rights.

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

For out-bound transactions, there are no special legal requirements under Japanese law, whereas foreign investment regulations under the FEFTA (please see the answer to Question 14) and other industry specific regulations may apply to in-bound transactions.

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

For an acquisition of shares of the target company, absent restrictions under a collective bargaining agreement or individual employment agreement, employment arrangements between the target company and its employees will not be affected and will remain the same after the transaction. However, if the target company’s employees are enrolled in a group pension plan of the seller group, in many cases the pension arrangements must be separated from the seller’s group plan and transferred to a new plan.

For a merger among multiple companies, generally speaking, the employment arrangements (including any applicable collective bargaining agreement) will be automatically assigned to the surviving entity without any changes.

For an acquisition of assets or business unit, consent of each employee must be obtained in order to transfer such employee’s employment to the acquirer. Terms of employment may be changed upon such transfer if so agreed between the employee and new employer. On the other hand, for a statutory corporate split, there is a special rule whereby the employment of employees who are primarily engaged in the transferred business may be transferred without obtaining their consent. In this case, the terms of employment will remain the same (albeit with the acquirer) after the effectiveness of the corporate split.
17. Have there been any recent proposals for reforms or regulatory changes that will impact M&A activity?

An amendment to the Companies Act took effect in May 2015, which has had some impact on M&A activity.

First of all, the amendment tightened the procedural requirements for an issuance of shares in certain circumstances. Specifically, before the amendment, the issue of shares of a public company did not require a shareholder resolution unless either (a) the subscription price was particularly favourable to the subscriber or (b) the number of shares to be issued exceeded the remaining number of authorised shares. After the amendment, a shareholder resolution is also required, in principle, if both:

- the issue of new shares to a third party would result in it holding a majority of voting power; and
- shareholders with at least 10% voting power object to the issue.

Second, with respect to a squeeze-out transaction, the amendment introduced new rules, including:

- the introduction of the Cash-Out right (kabushiki-tou uriwatashi seikyuken) which enables a shareholder holding at least 90% of voting rights to force a cash-out acquisition of shares of the minority shareholders without a shareholder vote at the target company; and
- the introduction of appraisal rights of the shareholders dissenting to a share consolidation, which would give minority shareholders an appropriate level of protection and enable a share consolidation to be used for squeeze-outs in practice.

Third, in connection with a corporate split, there are certain additional protections for creditors who remain with an assigning company. Namely, if (a) a company assigns certain rights and obligations to another company via a corporate split and (b) creditors of the assignor are harmed by such corporate split (e.g., the assignor becomes insolvent due to the corporate split), and the parties of the corporate split were aware of that harm, then the creditors may directly claim against the assignee.

Furthermore, there were some other changes to creditors’ protection procedures and appraisal rights, such as allowing a provisional payment to dissenting shareholders to avoid the accrual of interest.

ABOUT THE AUTHORS

NAOYA SHIOTA
Mori Hamada & Matsumoto
E naoya.shiota@mhmjapan.com
A Marunouchi Park Building, 2-6-1 Marunouchi, Chiyoda-ku, Tokyo 100-8222, Japan
T +81-3-6266-8524