CORPORATE NEWSLETTER

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Pre-transaction Notification Requirements under the Japanese FDI Regulations Expanded, and Further Expansion Anticipated

Mori Hamada & Matsumoto
Yohsuke Higashi
+81 3 6266-8599
yohsuke.higashi@mhm-global.com
Shintaro Okawa
+81 3 6213-8150
shintaro.okawa@mhm-global.com

The Foreign Exchange and Foreign Trade Act (the "**FEFTA**" or "**Act**") obliges a foreign investor contemplating a certain foreign direct investment (an "**FDI**") to make a pre-transaction notification if the FDI targets certain restricted businesses (the "**Restricted Businesses**").

Recently, there have been a series of amendments to the pre-transaction notification requirements under the FEFTA. As a result of the amendments to the FEFTA in 2017, acquisition of shares in a non-listed company by a foreign investor from another foreign investor became subject to pre-transaction notification requirements under the FEFTA, and the regulators were granted the authority to order disposal of shares or other appropriate remediation measures in the event that they identify any failure to make the required notification, or any false statement in the notification.

In May 2019, in tune with the global trend of tightening scrutiny on foreign investments in critical technologies, the announcement to add 20 types of businesses to the list of the Restricted Businesses was published (which is already in effect), and the regulations published in September 2019 will expand the scope of FDIs so that acquisition of 10% or more of the total voting rights of a Japanese listed company (including through proxy voting) will also be subject to the notification requirement (which will become effective as of October 26). In addition, there was a press report indicating that additional amendments to the FEFTA are anticipated to further expand the scope of FDIs for enforcement in 2020.

This newsletter outlines the announcement published in May 2019 and the regulations published in September 2019, and also briefly touches upon the

prospects of the amendment to the FEFTA scheduled for enforcement in 2020 (the "**Anticipated Amendment**"). We will also discuss the recent trends of more detailed review of pre-transaction notifications.

I. Current Notification Requirements

Under the FEFTA, a foreign investor who contemplates an FDI (which includes acquisition of 10% or more shares in a listed company, and acquisition of any number of shares in a non-listed company from a Japanese resident) in certain designated businesses relating to (i) national security, (ii) public order, (iii) public safety, or (iv) smooth management of Japan's economy (which are the Restricted Businesses) is required to submit a pre-transaction notification (Article 27, Paragraph 1 of the Act). FDIs subject to the pre-transaction notification requirements are reviewed by the Ministry of Finance and other relevant ministries and subject to a statutory waiting period of 30 days. The waiting period can be extended up to five months, but would usually be shortened to two weeks or less so long as the FDI does not raise any regulatory concern.

As a result of their review, if the Minister of Finance and the ministers having jurisdiction over the relevant Restricted Business find any issues from the viewpoint of items (i) to (iv) above, they may request the foreign investor to change terms of, or suspend, the FDI (and order such change or suspension if the foreign investor does not voluntarily accept the request) (Article 27, Paragraphs 3 to 6 and 10 of the Act). Further, the amendment in 2017 also granted the Minister of Finance and the ministers having jurisdiction over the relevant Restricted Business authority to order disposal of shares or other appropriate remediation measures in the event that they identify any failure to make the required notification, false statement in the notification, or non-compliance with the order of change or suspension with respect to an FDI involving threat to national security (Article 29 of the Act).

The amendment in 2017 also made acquisition of shares in a non-listed company by a foreign investor from another foreign investor (the "**Designated Acquisition**") potentially subject to pre-transaction notification requirements under the FEFTA (Article 26, Paragraph 3 of the Act). Prior to the amendment, acquisition of shares in a non-listed company was subject to the notification requirement only if the shares were acquired from parties that are not foreign

investors. It should be noted, however, that the pre-transaction notification for a Designated Acquisition is required only if the target engages in certain designated businesses which could affect the national security and the list of such businesses are shorter than the list for the FDIs. The applicable waiting period and procedures are identical to those applicable to FDIs.

II. Expansion of Restricted Businesses

On May 27, 2019, the announcement to add 20 types of businesses (the "**Newly Added Businesses**") to the list of the Restricted Businesses was published. The amendment became effective on August 1, 2019, and pre-transaction notifications are required for FDIs and Designated Acquisitions targeting the Newly Added Businesses consummated on or after August 31, 2019.

The Newly Added Businesses are divided into the following categories: (i) manufacturing of information processing equipment and parts, (ii) software related to information processing, and (iii) information and communications services.

(i) Manufacturing of information processing equipment and parts

● Integrated circuits	● Mobile and PHS phones
● Semiconductor memory media	● Radio communication equipment
● Optical and magnetic disks, magnetic tape	● Electronic computing devices
● Electronic circuit mounting boards	● Personal computers
● Wired communication equipment	● External memory devices

(ii) Software related to information processing

● Contract development of software	● Packaged software
● Built-in software	

(iii) Information and communications services

● Regional telecommunications*	● Mobile telecommunications*
● Long-distance	● Information processing

telecommunications*	services
● Wired broadcast telephones	● Internet use support services*
● Miscellaneous fixed telecommunications*	

*Scope expanded

(Translation of excerpt from Material No.6 "Inward Direct Investment Examination System" of the 42nd Meeting of the Foreign Exchange Subcommittee)[1]

Among others, the software category is very widely defined, and any business involving development of software that is not game software could be deemed to fall under this category. The authorities also tend to interpret the internet use support services category widely, and any business providing internet services (including the services which are not typically seen as “support” services) could be deemed to fall under this category

As such, the Newly Added Businesses may apply to a wide range of businesses including startup and technology companies. The Japanese venture capital industry has been already affected by this, and the Japan Venture Capital Association published a statement requesting reforms to the Act in order to facilitate venture capital investments.[2]

III. Expansion of Covered Transactions, and Anticipated Further Expansion

1. Expansion of FDIs by Amendment in September 2019

On September 26, 2019, the amendment of the Cabinet Order on Inward Direct Investment and the Order on Inward Direct Investment was published, and the definition of the FDIs was expanded. The amendment will be effective from October 26, 2019.

Following the amendment, in addition to acquisitions of 10% or more shares in listed companies, acquisitions of 10% or more of the total voting rights of Japanese listed companies (including through proxy voting) and other similar

[1] https://www.mof.go.jp/about_mof/councils/customs_foreign_exchange/sub-foreign_exchange/proceedings/material/gai20190822/06.pdf (in Japanese)

[2] https://jvca.jp/news/14989.html (in Japanese)

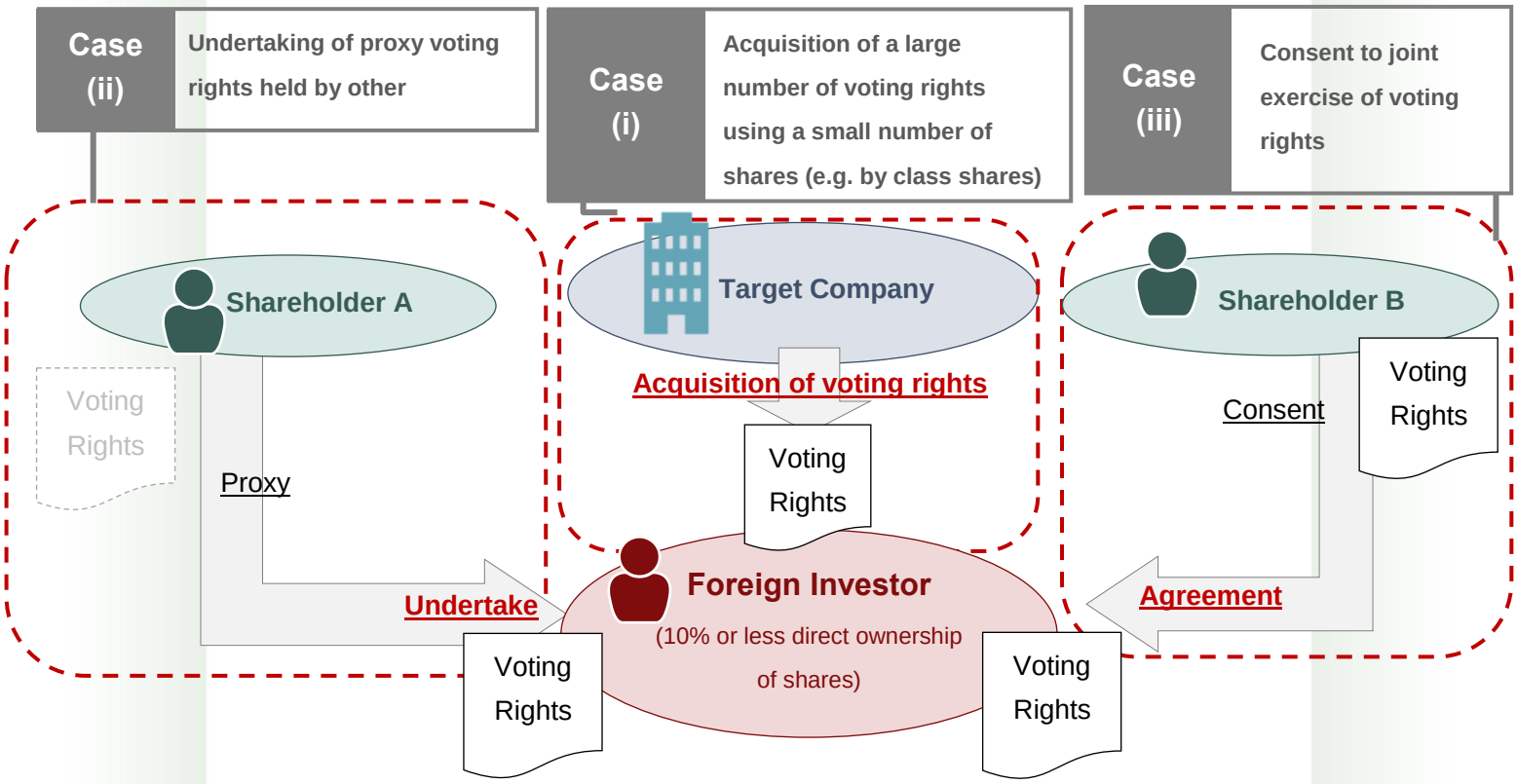
activities will also constitute FDIs for the purpose of the FEFTA. As such, if the target listed company engages in any Restricted Business, the acquisition of voting rights can also trigger the pre-transaction notification requirement at the time of acquisition of the voting rights (including through voting proxy), rather than at the time of exercise of the voting rights.

Specifically, the following activities will be added to the definition of FDIs:

(i) acquisitions of 10% or more of the total voting rights of a listed company;

(ii) undertaking of proxy voting rights held by other shareholders, which results in the proxy holding 10% or more of the total voting rights; and

(iii) agreement between foreign investors to jointly exercise voting rights of a listed company, which results in the agreeing parties holding 10% or more of the total voting rights.



Consequently exercise 10% or more of voting rights

※ Not covered before the amendment

(Translation of excerpt from Material No.6 "Inward Direct Investment

Examination System" of the 42nd Meeting of the Foreign Exchange Subcommittee)

Among others, activist investors could be affected by the addition of undertaking of proxy voting rights held by other shareholders. It should be noted, however, that the undertaking of proxy voting rights will be deemed an FDI only if the agenda items of the shareholders meeting with respect to which the proxy can exercise the voting rights include certain items that would enable the proxy to substantially control the target listed company, or could materially affect the management of the target listed company, which include appointment or removal of directors, change in the business purposes of the target listed company, and mergers and other business combination transactions.

Also, the scope of an agreement between foreign investors to jointly exercise voting rights of a listed company is not very clear, and there is a risk that activities of foreign investors acting in concert without any explicit agreement could be captured.

2. Potential Expansion of FDIs by the Anticipated Amendment

The Nihon Keizai Shimbun (Nikkei) electronic edition on September 17, 2019 reported that the amendment of the Act to expand the scope of FDIs is planned for effect in 2020.

According to the report, regulations on capital contributions to Japanese businesses in such areas as nuclear power and semiconductors, which are critical to national security, are expected to be strengthened.

Also, Nikkei reported that the current “10% or more” threshold for acquisitions of a listed company will be lowered to “1% or more”, and that shareholder proposals for appointment of directors or sale of significant business units may be added to the list of covered transactions. As long as the current regulatory framework is maintained, the scope of FDIs may be expanded by such amendment. It was also reported that certain exemptions or expedited process would be made available to portfolio investments, but their details are yet to be reported.

If such amendment will be implemented in the way reported by Nikkei, subject to its details, it may have a material impact on the foreign investment in Japan

and Japanese capital markets as a whole. Stakeholders should pay close attention to the development.

IV. More Detailed Review Conducted

Recently, it appears that more details reviews are being conducted on pre-transaction notifications for FDIs and Designated Acquisitions, in particular in connection with the Restricted Businesses concerning “national security”. In some cases, the reviews take one to two months, which can have an impact on the schedules for the transactions.

Historically, clearance was usually obtained without any questions or inquiries coming from authorities after submitting the notification. In recent years, however, there are cases where prior consultation with the relevant ministries becomes necessary or the relevant ministries provide the foreign investors with questionnaires before clearing the case. Since the questions may extend not only to information about the acquirer but also to the information management system and technical information about the target company, it is desirable to prepare responses in advance to answer any inquiries promptly.

In addition, there are cases where foreign investors are required to agree to certain declaration as a condition to clearance.

Overall, we have the impression that the reviews have been becoming more and more detailed.

(Contacts)
Public Relations
mhm_info@mhm-global.com
+81-3-6212-8330
www.mhmjapan.com