THE MERGERS AND ACQUISITIONS LITIGATION REVIEW

SECOND EDITION

Editor
Roger A Cooper

THE LAWREVIEWS

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Editor
Roger A Cooper

THE LAWREVIEWS

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PREFACE

It is my great privilege to serve as the editor of the second edition of this volume on M&A litigation for the Law Reviews series. As with the first edition, this volume is intended to be as much a resource for litigators handling M&A disputes as it is for the deal lawyers, general counsel and dealmakers aiming to assess and manage the potential litigation risks in connection with a transaction. The multi-jurisdictional approach taken here, as in other volumes in the Law Reviews series, reflects the profoundly global nature of business and corporate transactions, and gathers a diverse body of law from around the world to provide a broad overview of the global litigation terrain. The aim here is not to be comprehensive, either in terms of the countries included or the depth of topics covered, but to provide more of a survey of key jurisdictions in the Americas, Europe and Asia, and a high-level overview and analysis of the main litigation issues and trends in those jurisdictions.

Together, the chapters show a remarkably high level of consistency across jurisdictions in the types of common disputes and the kinds of claims that may be pursued, but also significant differences in procedural and substantive law affecting the legal merits of such claims, and the frequency and means of their pursuit.

Shareholder actions for breaches of fiduciary duties provides a good example. The law in many countries imposes fiduciary duties on board members in the context of mergers or acquisitions, and many jurisdictions therefore provide for litigation to enforce those duties. Similarly common is some type of business judgement protection for certain board decisions, which in one form or another prohibits parties and a court from second-guessing those decisions. The frequency with which such actions are brought, however, varies substantially from country to country. That is due to a variety of different factors, from the number of publicly listed companies in a country, to differences in the substantive law, to whether such claims may be brought as class actions, as permitted in the United States, and whether fees may be awarded to class action plaintiffs' lawyers. The class action procedural mechanism and the availability of attorney fee awards in particular are significant factors driving the disproportionate volume of shareholder litigation in the United States, as they provide strong incentives to the plaintiffs' bar that does not exist in many other countries.

In contrast, counterparty claims, arising out of disputes over parties' transaction agreements, appear to be far more common across the countries in this edition and, in many countries, to be the dominant type of M&A litigation activity. While there is some meaningful overlap in the types of provisions and disputes that commonly arise, the chapters also display the significant variation in disputes, reflecting in part differences in business practices both within and across jurisdictions. As with class actions, one significant procedural component for counterparty claims is arbitration, which has become an increasingly common procedure

for resolving post-closing disputes, particularly those involving cross-border transactions. This appears to be because, among other reasons, arbitration is confidential (unlike court proceedings), and thought to be cheaper, faster and more efficient.

Finally, I would like to thank the many distinguished contributors to *The Mergers and Acquisitions Litigation Review*, and give particular thanks to the new authors in this second edition whose contributions expand the range of jurisdictions covered. Their biographies can be found in the About the Authors Appendix and display the impressive depth of experience and expertise they bring to this edition. I hope you will find their analysis and insights valuable when dealing with issues arising in M&A disputes. Should you have any comments, questions or suggestions, please do not hesitate to contact me or any of the contributors directly.

Roger A Cooper
Cleary Gottlieb Steen & Hamilton LLP
New York
October 2021

Chapter 9

JAPAN

Ryo Chikasawa and Tomoaki Kutami[1]

I OVERVIEW

Merger and acquisition-related litigation in Japan has been increasing since the enactment of the Companies Act in 2005. Most notable is the significant increase in appraisal proceedings in connection with public M&A transactions. In appraisal proceedings, minority shareholders petition a court to determine the fair price of their shares. The Supreme Court of Japan has rendered a number of decisions clarifying the rules and principles regarding appraisal rights. Given the availability of appraisal rights in various types of M&A transactions, post-closing damages claims against individual directors are not prevalent in Japan. Although rare in the public M&A context, pre-closing claims for injunctive relief are also possible, especially in connection with hostile takeovers or transactions involving material procedural issues such as self-dealing in conflicted transactions.

Litigation involving private M&A transactions is also increasing in Japan. Disputes often arise in connection with claims for post-closing indemnification for breaches of representations and warranties. As the use of earn-out provisions appears to be gradually expanding even in mid to large-scale transactions, post-closing litigation may also increase with respect to calculation and other issues relating to earn-outs in Japan.

For private M&A transactions where the target company is a Japanese company, the Tokyo District Court has been the most popular jurisdiction for settling disputes. However, there is a growing trend of parties preferring arbitration as a dispute resolution mechanism, especially for cross-border transactions.

II LEGAL AND REGULATORY BACKGROUND

In Japan, the Companies Act provides the fundamental statutory framework for M&A transactions and litigations. In conjunction with the Civil Code, the Companies Act also forms the legal basis for transaction agreements involving Japanese corporations. Although the Companies Act provides mandatory rules to be followed by parties in most types of M&A transactions, there is no specific governmental or regulatory agency that enforces those rules and regulates M&A activities under the Companies Act. In practice, those rules are ultimately enforced by courts through shareholder actions and lawsuits.

For public M&A transactions, the Financial Instruments and Exchange Act (FIEA) is an important part of the regulatory framework. The FIEA makes provision for, among other things, tender offers, public offerings, insider trading and the filing of large-scale shareholding

1 Ryo Chikasawa is a partner and Tomoaki Kutami is a senior associate at Mori Hamada & Matsumoto.

reports. The Financial Services Agency of Japan or its regional bureau reviews and comments on documents filed under the FIEA, such as tender offer registration statements. Alleged violations of securities laws and regulations under the FIEA are subject to investigation by the Securities and Exchange Surveillance Commission of Japan.

In addition, the listing rules of stock exchanges further reinforce the regulatory framework for M&A transactions involving listed corporations. Those listing rules include a code of conduct for transactions between a listed corporation and its controlling shareholder, as well as timely disclosure obligations, corporate governance guidelines and delisting requirements. The Tokyo Stock Exchange and other exchanges regulate M&A activities of listed corporations through review of relevant timely disclosure documents.

Further, guidelines published by the Ministry of Economy, Trade and Industry (METI) have had an impact on M&A practice in Japan. Most recently, the METI formulated the Fair M&A Guidelines in 2019, which propose best practices to address conflicts of interest with a focus on management buyouts and acquisitions of controlled companies by controlling shareholders. While these METI guidelines do not have any statutory effect, they have been, and are expected to be, considered by Japanese courts in rendering decisions on the fairness or reasonableness of transactions at issue.

The Antimonopoly Act, which provides merger control rules, also constitutes an important source for the regulatory framework governing M&A. The Japan Fair Trade Commission regulates transactions that may substantially restrain competition in violation of the Antimonopoly Act. In the context of cross-border transactions, the Ministry of Finance, METI and other relevant ministries regulate investment by foreign investors into Japanese corporations under the Foreign Exchange and Foreign Trade Act (FEFTA).

III SHAREHOLDER CLAIMS

i Common claims and procedures

Appraisal actions are frequently brought by shareholders following the announcement of Japanese M&A transactions. Appraisal rights provide a statutory remedy for shareholders who are not satisfied with the terms on which they will lose their shares as a result of an M&A transaction. In an appraisal proceeding, shareholders often claim that the consideration for the transaction was inadequate due to a flawed process or conflicts of interest. However, given recent developments in appraisal case law (explained below), courts usually first focus on the M&A transaction process at issue rather than the substantive valuation.

To bring an appraisal action, a shareholder must follow a process provided in the Companies Act, which includes:

a voting against the transaction at the shareholders' meeting (if shareholder approval is required);

b delivering an appraisal demand notice; and

c filing a petition for appraisal within a statutorily specified time period.

Shareholders may also assert that a target company's directors breached their fiduciary duties[2] in connection with an unfair price or flawed process, including a material misstatement or omission in relevant disclosure documents. With respect to management buyouts, Japanese courts have held that directors of a Japanese corporation have duties to:

a ensure the fairness of the M&A process;

b make best efforts to ensure that fair value is received by the shareholders; and

c disclose all material information within the board's control in seeking shareholder approval of the transaction (including a tender of shares).[3]

Although the scope of these decisions is still being tested, shareholders usually assert a breach of these duties in litigation involving any type of M&A transaction, whether or not a management buyout.

Claims premised on a breach of fiduciary duties may be brought as either a direct or derivative action. In a direct action, a shareholder files a lawsuit directly against the company or the directors for compensation of the shareholder's own personal damage. The action proceeds like a typical civil suit. On the other hand, a derivative action involves shareholders suing on behalf of the corporation for damage suffered by the corporation. In bringing a derivative action, shareholders must comply with the pre-suit demand requirement under the Companies Act.[4] For claims based on breach of fiduciary duties, shareholders must, without a comprehensive discovery system, plead and prove specific facts that demonstrate each defendant director's negligence or gross negligence depending on the nature of the claim. As such, it is generally easier for shareholders to bring appraisal actions rather than claims for breach of fiduciary duty, and thus appraisal claims are the most commonly asserted type of claim in public M&A transactions in Japan.

ii Remedies

The remedies available in M&A litigation against a target company or its directors generally include pre-closing injunctive relief, post-closing monetary damages and appraisal of the fair value of shares.

Shareholders may also bring claims seeking a declaration of the invalidity of the subject transaction, such as a merger.[5] However, the bar for such a declaratory judgment is very high in Japan, and shareholders generally do not pursue this remedy, at least rarely in public M&A transactions.

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2 Under the Companies Act, directors of a Japanese corporation owe duties to the corporation to act in compliance with the applicable law, articles of incorporation and resolutions adopted at shareholders' meetings, as well as to act in the best interests of the company. As agents for the corporation, directors also have duties to conduct the affairs of the corporation with the care of a good manager. In this chapter, the fiduciary duties of a director refer to such duties that a director owes under the Companies Act. For duty of compliance and loyalty, see Article 355 of the Companies Act; for duty of care, see Article 330 of the Companies Act and Article 644 of the Civil Code.

3 *In re REX Holdings, Inc*, the Tokyo High Court, 17 April 2013; *In re CHARLE CO, LTD*, the Osaka High Court, 29 October 2015.

4 Article 847 of the Companies Act.

5 For declaration of invalidity of certain types of corporate reorganisations including mergers, company splits and share-to-share exchanges, see Article 828 of the Companies Act.

Pre-closing injunctive relief

Shareholders may seek pre-closing injunctive relief against a company if certain conditions prescribed in the Companies Act are met. However, pre-closing injunctions are generally an extraordinary remedy and difficult for shareholders to obtain in connection with M&A transactions. To obtain such a statutory injunction against a company to prevent it from conducting a corporate reorganisation such as a merger or certain types of cash-out transactions, the plaintiff shareholders in principle must show a violation of law or the articles of incorporation, and a reasonable likelihood of damage to the shareholders.[6] A breach of fiduciary duty by directors is not generally considered a violation of law here and cannot constitute grounds for this type of injunctive relief. However, in cases where a breach of duty of disclosure is at issue, it could also be a violation of law if it constitutes a violation of mandatory disclosure rules under the Companies Act or the FIEA.

Shareholders may also bring claims for a statutory injunction against individual directors based on breach of fiduciary duties, or violation of law or the articles of incorporation or a likelihood of such breach or violation.[7] To obtain this type of injunction, however, the shareholders are in principle required to demonstrate a high probability of irreparable harm to the company, not to the shareholders, caused by such breach or violation. In practice, this requirement of irreparable harm to the company raises the bar for shareholders to succeed in obtaining this type of pre-closing injunctive relief based on an alleged breach of fiduciary duties.[8]

Post-closing damages

Shareholders may pursue post-closing damages in the M&A context. As mentioned above, shareholders may bring a damages claim as either a derivative or a direct action. In practice, a derivative suit is usually not a favoured form of action in the M&A context.[9] We more often see shareholders bringing direct claims for damages against a corporation or its directors. In Japan, shareholders may bring statutory direct claims against individual directors if the shareholders sustain damage arising out of breach of fiduciary duties.[10] To bring statutory direct claims, shareholders must show wilful misconduct or gross negligence of the defendant individuals in their breach of duties. Shareholders may also bring direct claims against the corporation and its directors and officers based on tortious misconduct.[11]

In Japan, courts are not permitted to award punitive damages but have considerable discretion in calculating the amount of damages that plaintiff shareholders sustained. Courts may award quasi-appraisal damages to shareholders, calculating the amount awarded based

6 For injunctions in connection with corporate reorganisations including mergers, see Articles 784-2, 796-2 and 805-2 of the Companies Act; for injunctions regarding cash-out transactions, see Articles 179-7, 171-3 and 182-3 of the Companies Act.

7 Articles 360, 385, 399-6, 407 and 422 of the Companies Act.

8 Irreparable harm to the company does not include shareholders' own damage such as their loss due to an unfair merger price or decrease in the value of their shares.

9 Shareholders of a target company usually lose their shares in the company and thus may not bring derivative actions post-closing. Derivative actions are more often brought in uncompleted M&A transactions where shareholders continue to hold the shares. See, e.g., *CHARLE*, footnote 3.

10 Article 429 of the Companies Act.

11 Articles 709 and 715 of Civil Code. For a company's vicarious liability for tortious acts of representative directors or officers, see Article 350 of the Companies Act.

on an assessment of the fair value of the shares, as would be the case in an appraisal action. In Japan, however, shareholders do not often pursue such quasi-appraisal damages post-closing, as actual appraisal claims are widely available in various types of M&A transactions.

Appraisal proceedings

Under the Companies Act, shareholders who are not satisfied with the terms on which they lose their shares in a target company as a result of an M&A transaction generally have the right to demand that their shares be purchased by the company (or in certain cases the buyer) at a judicially appraised fair value. Such appraisal rights are available in stock-for-stock deals as well. Even the shareholders of an acquiring corporation may have appraisal rights in transactions involving certain types of corporate reorganisations, such as mergers, company splits, business transfers and stock-for-stock exchanges, as long as the materiality threshold provided in the Companies Act is satisfied.

Under Japanese law, courts have 'reasonable discretion' to determine the fair value of the shares in appraisal actions.[12] When Japanese courts rely on a valuation methodology based on financial analysis to determine fair value, discounted cash flow is usually relied on more than other methodologies. However, courts often attempt to weigh several approaches and may ultimately set a value that does not match any of the petitioners' suggestions. More importantly, it is generally considered that the fair value should reflect a fair distribution of the synergies (if any) from the transaction, which is contrary to some other jurisdictions.

Recently, a series of decisions of the Supreme Court of Japan have clarified that, as evidence of fair value in arm's-length transactions, courts may rely on the negotiated transaction price for cash-out deals;[13] and the market price upon delivery of appraisal demand for stock-for-stock deals.[14]

In *In re Appraisal of Jupiter Telecommunications Co, Ltd (JCOM)*, the Supreme Court stressed that the court should first review the procedural aspects of the transaction and, if the transaction is determined to have been conducted in a generally accepted fair process, the court does not need to look into the substance of the valuation and may rely on the transaction price or market price depending on the structure of the transaction.[15] The Supreme Court suggested that factors determinative of a generally accepted fair process include measures to mitigate conflicts of interest, such as the use of an independent special committee and professional or expert advice; and measures to provide shareholders a fair opportunity to make a decision on the transaction, such as fair disclosure to eliminate coercion. Under this framework, a court will still strictly review the substantive valuation where there was a flawed sales process that impaired arm's-length negotiations or where there is evidence of market manipulation.

iii Defences

Directors of Japanese corporations may be able to assert a variety of defences to claims brought against them for a breach of duty in connection with an M&A transaction. Depending on the claims being brought, these defences may include the business judgement rule; reliance; and, possibly, fully informed and uncoerced approval of shareholders.

12 *In re Appraisal of Tokyo Broadcasting System Holdings, Inc*, the Supreme Court of Japan, 19 April 2012.

13 *In re Appraisal of Jupiter Telecommunications Co, Ltd*, the Supreme Court of Japan, 1 July 2014.

14 *In re Appraisal of TECMO Ltd*, the Supreme Court of Japan, 29 February 2012.

15 *JCOM*, footnote 13.

The Japanese version of the business judgement rule applies where the directors have:

a made a business judgement (that is, a decision to take or not take action in respect of a matter relevant to the business operations of a corporation, including an M&A transaction);

b not violated any applicable law; and

c not had a material interest in the subject matter of the judgement.

In these circumstances, the court will defer to the business judgement made by the directors and will only review whether the directors informed themselves about the subject matter of the business judgement to a reasonable extent; and whether the judgment is grossly irrational.[16]

The reliance defence is also generally available where a defendant director has relied on information, or professional or expert advice, given or prepared by a fellow director of the corporation, an officer or employee of the corporation, or a professional adviser or expert retained by the corporation.

However, the defendant director must have had reasonable grounds to believe the person providing the information or advice to be reliable and competent in relation to the matters concerned, and then relied thereon in good faith.[17] The case law of the reliance defence is still under development in Japan, especially with respect to reliance on advice from outside professionals or experts such as legal and financial advisers.

Another possible defence is approval by a fully informed and uncoerced majority of the disinterested shareholders through a vote in favour of the transaction or a tender of shares. Under Japanese law, shareholder approval is not really a defence, but may practically function as a defence because it is one of the most important factors considered by courts in determining the fairness of the transaction at issue.[18] In this regard, the Fair M&A Guidelines recognise the effectiveness of, but do not require, a majority-of-minority condition,[19] while emphasising the importance of measures to secure arm's-length negotiations such as a well-functioning special committee of independent directors in conflicted transactions. Given these guidelines, courts will now generally defer to the terms and conditions negotiated between the parties and the decisions taken by the target company's board (even in conflicted transactions) as long as there was a properly functioning special committee consisting of independent directors and approval by a fully informed and uncoerced majority of the disinterested shareholders.[20]

iv Advisers and third parties

It is rarely seen, but it is theoretically possible under Japanese law for shareholders to bring claims against advisers and other third parties in the M&A context. The law and practice in this area are still developing in Japan.

16 See, e.g., *In re APAMANSHOP HOLDINGS CO, LTD*, the Supreme Court of Japan, 15 July 2010.

17 See, e.g., *In re Yakult Honsha Co, Ltd*, the Tokyo High Court, 21 May 2008; *In re NFK HOLDINGS CO, LTD*, the District Court of Yokohama, 22 October 2013. If it is a reliance on a fellow director or officer or employee of the company, courts will consider the complexity of the structure and operations of the corporation, including its delegation system.

18 For appraisal claims, see *TECMO*, footnote 14; for breach of fiduciary duty claims, see *REX Holdings*, footnote 3.

19 The guidelines provide that the effectiveness and necessity of a majority-of-minority condition should be determined in light of the specific circumstances of the relevant transaction.

20 In Japan, special committees are sometimes comprised not only of independent directors, but also of independent corporate auditors (*kansa-yaku*) and even independent outside experts.

v Class and collective actions

Japanese law does not provide for class or collective action proceedings in connection with M&A transactions. Although not usually relevant in the M&A context, Japanese law does permit collective civil actions by certified consumer protection organisations for the purposes of consumer protection. However, it is possible for plaintiff shareholders or their attorneys to solicit other shareholders to jointly seek appraisal or bring lawsuits and then ask the court to consolidate the proceedings of such actions.

vi Insurance and indemnification

In Japan, unlike Delaware and some other states in the US, a company cannot include an exculpation clause in its articles of incorporation eliminating the personal liability of directors and officers for monetary damages for certain types of breaches of fiduciary duty (e.g., duty of care). Although Japanese law provides for some limitations on the amount of liability that directors will owe to the corporation, such limitations are not available for directors concurrently serving as officers and do not cover direct claims by shareholders.[21] Prior to a recently published amendment to the Companies Act (explained below), Japanese law has been unclear on the requirements and procedures for a company to indemnify, or advance the legal fees of, its directors in shareholder litigation. As a result, directors' and officers' (D&O) insurance plays a significant role in shareholder litigation against directors and officers of Japanese corporations.

In Japan, D&O insurance generally covers damages and defence costs payable in relation to claims by shareholders against directors and officers for monetary damages incurred by shareholders. If a director or officer has acted with gross negligence or in bad faith, D&O insurance usually is not available.

In this regard, a recent amendment to the Companies Act came into effect on 1 March 2021. The amendment includes codification and clarification of rules applicable to a company's indemnification of damages and advancement of legal fees and other defence expenses to eligible directors and officers, as well as procedural rules regarding D&O insurance. It remains to be seen whether and how this amendment will change the M&A litigation landscape in Japan.

vii Settlement

There are generally no special issues with respect to settling M&A litigation. In a derivative action, however, the company is prohibited in principle from entering into a settlement with plaintiff shareholders without involvement of a court unless the settlement is unanimously approved by all shareholders.[22] If a settlement is made after the filing of a derivative lawsuit and with the involvement of the court, the settlement will be binding on the company and other shareholders as long as the company affirms such settlement upon execution.[23]

21 For more details, see Articles 424 to 427 of the Companies Act.

22 This is because a settlement with shareholders in a derivative action against directors usually includes an exemption of liabilities of the directors to the corporation, which requires unanimous approval of all the shareholders. (Article 424 of the Companies Act).

23 Article 850 of the Companies Act. If the company is not a party (as an intervener) to the derivative suit, the court must notify the company of the settlement and request the company to make any objection within two weeks. If the company does not respond within two weeks, the company is deemed to have affirmed the settlement.

viii Other issues

Under Japanese law, the court with exclusive jurisdiction to hear shareholder litigation regarding the legality or validity of M&A transactions and breaches of fiduciary duty (except for post-closing direct claims) is the district court having jurisdiction over the headquarters of the company.[24] Forum selection clauses in a company's articles of incorporation or other constitutional documents are not permitted.

IV COUNTERPARTY CLAIMS

i Common claims and procedures

In M&A litigation between a seller and a buyer, claims commonly arise out of the terms of the purchase agreement, including claims for breaches of representations and warranties or covenants. These claims are often made pursuant to indemnity provisions in the purchase agreement, which provisions increasingly include an exclusive remedy clause. In addition, a buyer may assert claims premised on fraud under tort law, including a claim for fraudulent misrepresentation in the formation of the agreement.

Counterparty claims in the M&A context may be subject to the statute of limitations depending on the nature of claim, but transaction agreements usually also provide contractual limitations and procedures for indemnification claims, which are generally enforceable under Japanese law.

ii Remedies

For counterparty claims in the M&A context, indemnification is the most commonly pursued remedy. Other remedies include damages and specific performance or injunction.[25]

Indemnification

In Japan, purchase agreements generally include indemnity provisions, which cover claims and damages arising from a breach of the indemnitor's representations and warranties or covenants set forth in the purchase agreement.

In disputes over breaches of representations and warranties, the calculation of the damage incurred by the plaintiff (usually the buyer) is always an issue. There have been some court decisions that could be interpreted to hold that, depending on the language of the indemnity provision, the amount of damage is equal to the difference between the purchase price and the value of the company as received,[26] while other courts seem to assume that only out-of-pocket expenses are recoverable.[27] The case law in this area is still developing in Japan.

24 Articles 835 and 848 of the Companies Act.

25 Another possible remedy at the pre-closing stage is termination. Changing the default rules under the Civil Code, a typical purchase agreement in Japan provides that a party may only terminate the agreement before closing upon, among other things, a material breach by the other party of covenants or representations and warranties; initiation of bankruptcy proceedings by or against the other party; and failure to close by the long-stop date.

26 Decision of the Tokyo District Court, 17 January 2006; decision of the Tokyo District Court, 15 April 2011.

27 Decision of the Tokyo District Court, 27 January 2012; decision of the Tokyo District Court, 4 November 2015.

As in other jurisdictions, indemnity provisions in Japan are often specified by the parties to be the exclusive remedy. Although it is uncertain whether Japanese courts will enforce such exclusive remedy provisions in the case of fraud or other types of tortious misconduct,[28] a plaintiff often brings only contractual indemnification claims since they are usually easier to assert compared to damages claims based on provisions of the Civil Code.

Damages

Subject to any exclusive remedy clauses agreed upon between the parties, a party to a contract is generally entitled to seek monetary damages as a remedy for breach of contract under the Civil Code.[29] If a party to an M&A agreement fails to perform its obligations thereunder, the other party may in principle seek recovery for the damage arising from such failure to perform. In addition, a party may pursue damages claims under tort law provisions of the Civil Code for any fraudulent misrepresentation made by the other party in connection with the subject M&A transaction.[30] Tort claims under the Civil Code are especially used for fraudulent misrepresentations with respect to issues not otherwise covered by the representations and warranties under the transaction agreements.

Specific performance and injunctions

Japanese courts can order specific performance (mandatory injunctions) as a remedy for breach of contract under the Civil Code.[31] For example, if a party to a sales contract fails to deliver certain unique goods, the other party may seek the enforcement of such delivery. In the M&A context, specific performance could be used to enforce the delivery of shares (or share certificates) in a stock purchase transaction. The party seeking specific performance must demonstrate the satisfaction of conditions precedent provided in the purchase agreement. The parties should be aware that, in practice, obtaining injunctive relief to force a deal to close is not easy and is often time-consuming, even in provisional proceedings.

In Japan, a court may also render a prohibitory injunction as a remedy for breach of contract. In a dispute among the parties to an M&A transaction, a party may bring a claim for a prohibitory injunction in the case of, among other things, a breach of a restrictive covenant in the transaction agreement. The court may impose a civil fine for a violation of an injunctive order. Although we do not often see the parties to mid-to-large-scale transactions seeking injunctive relief pre-closing, there was a high-profile court case in 2004 where the parties sought injunctions against breach of an exclusive negotiation clause in the memorandum of understanding for an M&A transaction.[32]

28 Decision of the Tokyo District Court, 17 January 2003, suggests that an exclusive remedy clause does not necessarily preclude tort claims in the case of a tortious misrepresentation.

29 Article 415 of the Civil Code.

30 Article 709 of the Civil Code.

31 Article 414 of the Civil Code.

32 *Sumitomo Trust Bank Limited v. UFJ Holdings, Inc*, the Supreme Court of Japan, 30 August 2004.

iii Defences

Knowledge of breach of representations and warranties

Where a plaintiff brings an indemnification claim based on a breach of representations and warranties provided in a transaction agreement, a Japanese court will basically allow the defendant to assert, as a defence, the plaintiff's knowledge of the breach. Japanese courts do not require a plaintiff buyer to demonstrate its reliance on the defendant seller's representations and warranties. However, if the seller shows that the buyer had actual knowledge of the breach at the time of signing, the court will usually dismiss the plaintiff's claim with prejudice on the merits.[33] In this regard, if the acquisition agreement expressly sets forth a 'pro-sandbagging' clause to the effect that the buyer's knowledge does not affect the buyer's indemnification claims, a Japanese court will probably respect such provision and will not deny a claim even where the seller can demonstrate the buyer's knowledge of breach. On the other hand, from a seller's perspectives, it would be advisable to expressly provide an anti-sandbagging clause, even though the default rule in Japan appears to be anti-sandbagging when the agreement is silent on that issue.

Non-attributability

For a damages claim based on a breach of covenant in a purchase agreement, the defence of non-attributability may be available. The concept of non-attributability is not the same as, but is similar to, the concept of force majeure. If the non-performance of a contractual obligation was due to reasons not attributable to the non-performing party, a damages claim based on such non-performance will not be supported by the court.[34] Such non-attributability defence would also be available where the plaintiff brings a contractual indemnification claim based on a breach of obligations under the transaction agreement, except for breach of representations and warranties.

Other contractual defences

In a dispute between the parties to an M&A transaction, claims are usually based on the terms of the contract, and those terms typically provide for various defences. Such contractual defences may include a time limitation for bringing claims, a cap on total liability and a deductible or threshold for indemnifiable claims.

iv Arbitration

If the target company is a Japanese company, the forum for dispute resolution is typically specified to be Japanese courts. The Tokyo District Court has been the most popular jurisdiction for M&A transactions in Japan. However, there is a growing trend of parties preferring arbitration because arbitration can resolve disputes faster, and because confidentiality can be maintained in arbitration as compared to a court process.

Arbitration clauses are generally enforceable in Japan. Although arbitral awards require a court judgment for enforcement in Japan, Japanese courts basically respect arbitral awards.

33 Decision of the District Court of Tokyo, 17 January 2006. In Japan, however, case law is not clear on whether and how the buyer's constructive or implied knowledge of breach would affect the buyer's ability to enforce the seller's contractual indemnification obligations.

34 Article 415 of the Civil Code.

As Japan has entered into the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958, Japanese courts generally enforce arbitral awards granted by arbitration forums in foreign countries that have adopted the UN Convention.

V CROSS-BORDER ISSUES

In Japanese court proceedings for cases involving cross-border transactions, service of process and enforcement of judgments may become issues. As such, parties often prefer an arbitral forum for cross-border transactions. The reasons for choosing arbitration include the following:

a the perception that an arbitral tribunal is generally more neutral;
b the private or confidential procedure of arbitration (i.e., no disclosure of case documents);
c the ease of enforcing an arbitral award in the relevant jurisdictions;[35]
d the greater control over proceedings, including their speed; and
e the ability to conduct arbitration proceedings in English (as opposed to Japanese, which is required for Japanese court proceedings).

Foreign investment regulations may also be an issue in cross-border transactions. There was a major amendment to the Foreign Exchange and Foreign Trade Act (FEFTA) in 2020. While Japan has long required foreign investors to make a notification and undergo screening prior to investments in designated business sectors, the amendment has expanded the scope of covered transactions. For the past few years, the government has tightened its review of foreign direct investments, and this tendency will continue following the amendment to the FEFTA.

VI YEAR IN REVIEW

In 2020, and thus far in 2021, there have not been many significant developments in the law and practice of M&A litigation in Japan.

Over the past couple of years, there have been a few lower court decisions based on the framework of the *JCOM* decision that have added a little more colour to the factors that constitute a generally accepted fair process.[36] In this regard, the newly published METI guidelines (the Fair M&A Guidelines) are gradually changing the practice of public M&A transactions, especially in conflicted transactions such as management buyouts and acquisitions of controlled companies by controlling shareholders. The METI guidelines will affect the court's determination once shareholders bring claims in connection with these transactions involving listed subsidiaries.

Another interesting and important development over the past few years has been an increasing number of hostile transactions, including unsolicited tender offers by Japanese

35 The UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (mentioned in Section IV.iv) ensures enforcement of arbitral awards in the countries that have adopted the Convention.

36 See, e.g., *In re Appraisal of S-VANCE LTD*, the Osaka District Court, 18 January 2017; *In re Appraisal of Kokusan Denki Co, Ltd.* the Tokyo High Court, 30 January 2017; *In re Appraisal of URAI CO LTD*, the Osaka High Court, 29 November 2017; *In re Appraisal of Mitsui Life Insurance Company Limited*, the Tokyo High Court, 27 February 2019.

companies, which have historically been very cautious about making such offers. This trend has led to new court decisions regarding disputes over takeover defences, and in early 2021 we have seen a couple of cases where the claimant shareholder sought preliminary injunction to prevent the implementation of the Japanese version of poison pills.[37] Of these, in a case where the rights plan was deployed by the board of directors without shareholder approval after the takeover battle began, the court enjoined the issuance of stock acquisition rights under the plan. Further discussion is needed on the implications of these recent court decisions, but it will have some impact on the law and practice of takeover defence in Japan.

VII OUTLOOK AND CONCLUSIONS

While the uncertainty caused by the outbreak of covid-19 still remains, Japanese companies have again started making investments, and the Japanese M&A market has gradually become more active since the latter half of 2020. With respect to M&A litigations, there have been a number of disputes relating to attempts by buyers to delay or terminate pending M&A transactions on grounds related to covid-19. Although there have been few high-profile court cases pending over M&A disputes that have occurred due to covid-19, the turmoil and uncertainty created by the covid-19 pandemic may lead to new developments in the law and practice of M&A litigation in Japan.

Another development we may see in the coming year concerns unfriendly tender offers. We are seeing an increase in hostile or unsolicited tender offers (including competing offers that are made after the announcement of the first tender offer supported by the target company), and this trend is continuing in 2021. As the Japanese market comes to accept unfriendly tender offers, there will be more court cases involving such unfriendly offers.

37 *In re NIPPO LTD*, the Nagoya High Court, 7 April 2021 (approved by the decision of Nagoya High Court on 22 April 2021); *In re Japan Asia Group Limited*, the Tokyo District Court, 2 April 2021 (approved by the decision of Tokyo High Court on 3 April 2021); *In re Fuji Kosan Company, Ltd*, the decision of 3 June 2021 (approved by the decision of the Tokyo High Court on 10 August 2021).

Appendix 1

ABOUT THE AUTHORS

RYO CHIKASAWA

Mori Hamada & Matsumoto

Ryo Chikasawa is a partner at Mori Hamada & Matsumoto. His main practice areas include M&A, shareholder activism and corporate governance. He excels in advising public and private companies, as well as private equity funds, in complex and high-value corporate matters including acquisitions, divestitures, leveraged buyouts, joint ventures, shareholder activism, takeover defences and corporate governance matters. He also has extensive experience in representing international clients in M&A-related disputes in Japan. He has written articles in numerous professional publications on topics relating to both M&A transactions and disputes. He received his LLB degree in 2007 from the University of Tokyo and was admitted to the Japanese Bar in 2008. He also received his LLM degree in 2016 from the University of Pennsylvania and was admitted to the New York Bar in 2017. After completing his LLM, he worked with Davis Polk & Wardwell from 2016 to 2017.

TOMOAKI KUTAMI

Mori Hamada & Matsumoto

Tomoaki Kutami is a senior associate at Mori Hamada & Matsumoto. His main practice areas include litigation and corporate governance, and he has handled a broad range of domestic and international disputes including M&A litigations. He also advises public and private companies in advanced and complex corporate matters including M&A, shareholder activism, takeover defences and corporate governance matters. He received his LLB degree in 2009 from the University of Tokyo, Faculty of Law and his JD degree in 2011 from the University of Tokyo, School of Law. He was admitted to the Japanese Bar in 2012. He also received his LLM degree in 2019 from New York University School of Law and was admitted to the New York Bar in 2020. After completing his LLM, he worked at Weil, Gotshal and Manges LLP's New York office from 2019 to 2020.

MORI HAMADA & MATSUMOTO

16th Floor, Marunouchi Park Building
2-6-1 Marunouchi, Chiyoda-ku
Tokyo 100-8222
Japan
Tel: +81 3 6266 8719/8948
Fax: +81 3 6266 8619/8848
ryo.chikasawa@mhm-global.com
tomoaki.kutami@mhm-global.com
www.mhmjapan.com

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