JAPAN

Law and Practice

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1. TRENDS

1.1 M&A Market

After eight consecutive year-on-year increases, both the number of M&A transactions and total transaction value decreased in 2020. Notwithstanding the ongoing pandemic, the Japanese M&A market recovered in 2021 with the number of transactions increasing 14.7% from 2020, making 2021 a record year. Transaction value also increased 11.7% from 2020.

1.2 Key Trends

A continuing trend is the sale by Japanese companies of non-core businesses and the acquisition of growing businesses. For example, following its sale of Hitachi Chemical in 2020, Hitachi announced in 2021 its sale of Hitachi Metal, which has traditionally been one of its three major group companies. Conversely, Hitachi acquired US software company Global Logic for JPY1,036 billion. In face of the rapidly growing need for carbon neutrality, ENEOS, a large oil refinery, acquired Japan Renewable Energy Corporation for JPY200 billion, and it sold its substantial economic stake of NIPPO, which is in the road paving business.

Another notable recent trend in the Japanese M&A market has been the rise of unsolicited or hostile takeovers. In 2021, SBI Holdings successfully completed its unsolicited tender offer for Shinsei Bank, resulting in it holding almost a majority of the shares of the target. In opposition to this unsolicited takeover bid, Shinsei Bank announced poison pill type defensive measures, but ultimately decided not to trigger the pill. There were a number of hostile takeover cases in 2021 where poison pills were disputed in court, which resulted in some interesting court decisions that are discussed below.

1.3 Key Industries

M&A activity in Japan has been seen in a wide range of industries, including the pharmaceutical, healthcare, consumer, financial, chemical and electronics sectors. One highlight is the IT service/technology industry given that digital transformation (DX) is a key priority for management of Japanese companies. Hitachi's acquisition of Global Logic is one example, and Panasonic acquired a US IT vendor Blue Yonder for JPY779 billion.

2. OVERVIEW OF REGULATORY FIELD

2.1 Acquiring a Company

A company is acquired in Japan by a share acquisition or a business (asset) acquisition. This can be accomplished through a contractual purchase of shares or business (assets), or a statutory business combination (or corporate restructuring), conducted pursuant to the provisions of the Companies Act (ie, a merger, share exchange, share transfer, company split, or share delivery mechanism).

A forward triangular business combination – such as a merger whereby a merger subsidiary of an acquirer merges with a target company whose shareholders receive the parent's (acquirer's) stock – is permitted under the Companies Act.

Share Acquisition

A share acquisition from one or more third parties (other than the issuing company itself) may be made through an "on-market" or "off-market" transaction. Whilst the tender offer rules under the Financial Instruments and Exchange Act (FIEA) do not generally apply to market transactions, an off-market acquisition of shares of a listed company is subject to the tender offer rules if an acquirer seeks to acquire shares in

excess of certain thresholds provided in the FIEA (see **6.2 Mandatory Offer Threshold**).

A share acquisition may also be made by a "share exchange", one of the statutory business combinations, whereby an acquiring company can acquire 100% of the shares of a target company upon a two-thirds shareholder vote. An acquiring company can also acquire all or a part of the shares of a target company by use of a statutory "share delivery" mechanism.

An alternative is a subscription of shares issued by a target company. Generally, a listed company can issue shares by a board resolution unless the issue price is a significant discount from the market price or the total outstanding shares after the issuance will exceed the authorised number of shares provided for in the articles of incorporation. Even if the board approves an issuance that results in an acquirer holding a majority of the shares of a target company, the acquirer is not required to offer to purchase shares from minority shareholders.

Business Acquisition

A business (asset) acquisition is generally conducted through a contractual buy-sell agreement or a statutory company split, which is a statutory spin-off procedure. Third-party consents are required to effect a contractual business acquisition; for example, consents from counterparties to transferred contracts and transferred employees are required.

However, these consents are not statutorily required in the case of a company split. Instead, the Companies Act requires the parties to a company split to comply with various procedures, including the ones for creditor protection.

2.2 Primary Regulators

The Financial Services Agency (FSA) administers securities regulations under the FIEA, including regulations involving tender offers, public offerings and proxy solicitations. The Ministry of Finance (MOF), the Ministry of Economy, Trade and Industry (METI), and other relevant ministries regulate cross-border transactions under the Foreign Exchange and Foreign Trade Act (FEFTA), including inward/outward investments.

The Japan Fair Trade Commission (JFTC) regulates transactions that substantially restrain competition under the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (the Anti-monopoly Act).

Tokyo Stock Exchange, Inc (TSE) and other stock exchanges oversee transactions involving a listed company.

2.3 Restrictions on Foreign Investments

Under the FEFTA, a foreign investor is required to file prior notification with the MOF and the competent ministers and wait a certain period (in principle 30 days, which may be extended up to five months, or shortened if the ministers determine there is no need of further examination), if the foreign investor intends to acquire: shares of a private company (except an acquisition of shares of a private company from another foreign investor, unless the acquisition may have potential risk of harming national security) or 1% or more of shares or voting rights of a listed company; and such target company engages in the restricted businesses regarding national security, public order, public safety or smooth management of the Japanese economy identified in the FEFTA. The FEFTA also provides a post-acquisition notification requirement for foreign investors.

Restricted Businesses

The restricted businesses were expanded in May 2019 by adding manufacturing of information processing equipment and parts, software related to information processing, and informa-

tion and communications services. Due to this expansion, the applicability of the prior notification requirement under the FEFTA has become much wider.

Acquisitions of Shares or Voting Rights

The threshold for the prior notification requirement with respect to acquisitions of shares or voting rights in listed companies was lowered from 10% to 1% by an amendment to the FEFTA in 2020. However, the amendment also established exemptions from the prior notification requirement. Under the new rules, the blanket exemption may be available for foreign financial institutions, and the regular exemption may be available for general investors (excluding state-owned enterprises) and certain SWFs accredited by the authorities.

Both exemptions are conditioned on compliance with the conditions with respect to passive investments. Under the blanket exemption, foreign investors are exempted from the prior notification requirement. Under the regular exemption, foreign investors are exempted from the prior notification requirement for investments in a company engaging in the restricted businesses other than the core sectors that relate to national security listed in the public notice, and if foreign investors being eligible for the regular exemption comply with the heightened conditions with respect to passive investments, the threshold is increased from 1% to 10% even for investments in a company engaging in such core sectors.

There are also some restrictions on the holding of shares by a foreign investor in a company engaging in certain types of businesses, such as airline and broadcasting businesses.

2.4 Antitrust Regulations

The Anti-monopoly Act prohibits any acquisition that substantially restrains competition in a particular field of trade, or that would be conducted by using unfair trade practices.

Potential acquisitions that would exceed certain thresholds require prior notification to the JFTC. In particular, if a company with domestic sales (aggregated with domestic sales of its group companies) of more than JPY20 billion intends to acquire shares in a target company with domestic sales (aggregated with domestic sales of its subsidiaries) of more than JPY5 billion and that acquisition results in holding more than 20% or 50% of the voting rights in the target company, the acquiring company must file prior notification of the plan of acquisition at least 30 days prior to the closing of acquisition (the waiting period may be shortened if the permission of the JFTC is obtained).

If the JFTC determines, during this 30-day period (the first phase review), that a more extensive review is necessary, it proceeds to a second phase review. This review is up to 120 days from the prior notification or 90 days from the acceptance by the JFTC of all information that it requests the acquiring company to provide, whichever is the later.

If the JFTC determines that an acquisition violates the Anti-monopoly Act, the JFTC may order the party to take measures to eliminate the antitrust concerns, including a disposition of shares and assets. Similar filing requirements and subsequent procedures pursuant to the Anti-monopoly Act apply to other means of acquisition of a target company or its business, such as a merger, company split, share transfer and business/asset transfer.

2.5 Labour Law Regulations

The Japanese labour law regulations of primary concern to an acquirer are restrictions on the ability of an employer to terminate employment agreements. An “at-will” employment agreement

is not legally permitted in Japan. Rather, a dismissal can be found to be invalid if it lacks objectively reasonable grounds and is not considered to be appropriate in general societal terms under the Labour Contracts Act. Therefore, an acquirer should be aware that it may be difficult to undertake typical lay-offs after the consummation of an acquisition.

2.6 National Security Review

As discussed in **2.3 Restrictions on Foreign Investments**, certain foreign investments shall be subject to the national security review by the Japanese government.

3. RECENT LEGAL DEVELOPMENTS

3.1 Significant Court Decisions or Legal Developments

Court Decisions on Defensive Measures

Although there had been no court decisions on hostile takeover defensive measures since the late 2000s, courts ruled on the validity of defensive measures taken against hostile takeover attempts in four cases in 2021. In these cases, the target company implemented poison pill type defensive measures using stock options having a dilutive effect on the hostile acquirer's voting rights. In three of the cases, the courts ultimately refused to grant injunctive relief in favour of the hostile acquirers, whereas in the Japan Asia Group case, the court granted injunctive relief and the hostile takeover was successfully completed.

These cases are discussed in greater detail in **9. Defensive Measures**.

The Fair M&A Guidelines

In June 2019 the Ministry of Economy, Trade and Industry (METI) issued the "Fair M&A Guidelines" which replaced the prior MBO guidelines issued in September 2007 and set out basic principles that should be observed to ensure fairness in M&A transactions involving conflicts of interests, as well as guidelines regarding practical measures, including the establishment of an independent special committee.

In connection with the foregoing developments, the parties to transactions involving conflicts of interests have started taking more cautious approach to ensure procedural fairness in such transactions.

3.2 Significant Changes to Takeover Law

There have not been any significant changes to takeover law in the past 12 months, and takeover legislation is not under review in a way that could result in significant changes in the coming 12 months.

In light of recent hostile takeover attempts through market transactions, some scholars and practitioners have started arguing the necessity to change takeover law and restrict market transactions that would have coercive effect on the general shareholders.

4. STAKEBUILDING

4.1 Principal Stakebuilding Strategies

A bidder who is not willing to wage a hostile takeover usually avoids building a stake as a "toehold" before launching an offer in Japan. In Japan, the building of a toehold without notice to target management is viewed as negatively affecting management's willingness to accept an acquisition offer and lower chances of a successful friendly takeover.

Should a bidder decide to build a toehold, it would purchase the shares on the market or

through a private transaction with one or a limited number of principal shareholders.

4.2 Material Shareholding Disclosure Threshold

A shareholder is required under the FIEA to file a large-scale shareholding report with the relevant local finance bureau within five business days after its shareholding ratio in a listed company exceeds 5%. When calculating the shareholding ratio, the shares held by a joint holder are aggregated. A joint holder includes certain affiliates and another shareholder with whom a shareholder has agreed on jointly acquiring or transferring shares in a target company, or on jointly exercising the voting rights or other rights as a shareholder of the target company.

After filing the report, if the shareholding ratio increases or decreases by 1% or more, an amendment to the report must be filed within five business days from that increase or decrease. Financial institutions that trade securities regularly as part of their business and satisfy certain requirements under the FIEA are required to file the report only twice a month (the special report).

4.3 Hurdles to Stakebuilding

As described in **9.3 Common Defensive Measures**, some Japanese listed companies have adopted takeover defence measures that prevent an acquirer from acquiring shares in a company in excess of a certain threshold. The threshold is generally set between 15% and 30% (20% in most cases).

Further, as described in **6.2 Mandatory Offer Threshold**, an acquisition of shares of a listed company may be subject to the tender offer rules under the FIEA, which prohibit a bidder from acquiring more than one third of the voting rights of the target company through off-market trading or off-floor trading.

4.4 Dealings in Derivatives

Dealings in derivatives are allowed in Japan. A bidder may purchase derivatives regarding shares in a target company to build an economic stake in that target company or hedge risks regarding its shares in the target company.

4.5 Filing/Reporting Obligations

Equity derivatives may be subject to large-scale shareholding reporting obligations. Options pertaining to shares may trigger disclosure if, upon exercise, they would result in excess of a 5% shareholding. However, holding equity derivatives that are cash-settled and do not transfer the right to acquire shares would not be likely to trigger disclosure.

According to the relevant guidelines of the FSA, derivatives that transfer only economic profit/loss in relation to target shares, such as total return swaps, are generally not subject to disclosure. This being said, even holding such cash-settled equity derivatives may trigger disclosure, if a holder purchases long positions on the assumption that a dealer will acquire and hold matched shares to hedge its exposure.

4.6 Transparency

Shareholders intending to implement a tender offer must disclose in a tender offer registration statement in detail the method of acquisition of control or participation in the management of the target company, and its management policy and plans after the acquisition.

Shareholders, which are certain financial institutions, must disclose in a large-scale shareholding report their intention to make a proposal that would materially affect the issuer's business (including a proposal of an acquisition or disposition of material assets, a large amount of borrowings, an appointment or dismissal of a representative director, a material change of

board composition, or a merger, company split or any other business combination).

5. NEGOTIATION PHASE

5.1 Requirement to Disclose a Deal

If a target company is a listed company, it must disclose the deal when the board approves the contemplated transaction. Typically, this approval is given on the day that a definitive agreement is to be signed by the target company and the disclosure is made on the same day.

In general, there is no legal requirement to disclose the deal when the target company is first approached or when negotiations commence. If a non-binding letter of intent is signed by the target company, the deal is sometimes (but not very commonly) disclosed. In those cases where disclosure is made at an early stage, the purpose is often to allow the parties to discuss the deal openly with a wider group of relevant organisations or personnel.

For example, if the transaction might require the competition authorities to conduct third-party hearings, the parties may prefer to disclose the transaction sooner rather than later and to discuss the possibility of the transaction with the authorities in order to expedite the authorities' review.

5.2 Market Practice on Timing

Where there is a leak of information concerning a listed company that would have a material impact on investors' decisions, the TSE will make enquiries of the listed company and, if necessary, may require it to make timely and appropriate disclosure of the matter. The TSE may provide an alert to investors if it considers it necessary to do so when leaked information is unclear or otherwise requires the attention of investors to gain information of the relevant listed company or its shares.

5.3 Scope of Due Diligence

In a negotiated transaction, due diligence generally includes a comprehensive review of a target company's business, legal, financial/accounting and tax matters. The scope of due diligence may vary, depending on the size and nature of the deal or any time constraints in the parties' negotiations, and may be focused on material issues by setting a reasonable materiality threshold. The impact of the pandemic on the target company's business is also carefully reviewed by potential acquirers. Also seen are more virtual site visits instead of physical site visits.

Depending on the level of antitrust issues involved, the parties may be restricted from exchanging certain competitively sensitive information during due diligence so as to avoid so-called gun-jumping issues under the Anti-monopoly Act. In short, the parties must operate as separate and independent entities until the applicable waiting period under the Anti-monopoly Act has expired and therefore the parties must not engage in conduct that could facilitate unlawful co-ordination during that period.

5.4 Standstills or Exclusivity

In a friendly transaction, a standstill provision (which generally prohibits a potential acquirer from acquiring a target company's shares outside a negotiated transaction) is not very common in Japan.

However, even if there is no standstill provision (see **4. Stakebuilding**), in practice, those bidders acquiring the shares of the target company without the target company's prior consent have traditionally been viewed by Japanese listed companies as being unfriendly bidders. Therefore, any acquisition of shares in advance

of a negotiated transaction might jeopardise the friendly nature of the transaction.

If the target is a listed company, it is not always the case that the target company will grant exclusivity (ie, a commitment by the target company not to negotiate a similar deal with any other third party for a certain length of time) to a particular bidder. However, for example, a financially distressed target company may offer exclusivity to a potential sponsor with the aim of soliciting the sponsor to consider and negotiate the deal.

Exclusivity may also be agreed upon to bind the acquirer and the target company in the context of a business integration (such as a merger) of the two parties.

5.5 Definitive Agreements

It is permissible, but not very common, for an acquirer and a target company to document a tender offer in a definitive transaction agreement.

Procedurally, the target company will be required to disclose its opinion with regard to the contemplated tender offer, including the grounds and reasons for the opinion, the second-step process in a two-step acquisition structure and any policy or plans after the tender offer. Typically, the target company does not take any actions that would be inconsistent with the process outlined in its own disclosure, even if there is no such documentation between the acquirer and the target company (see **6.7 Types of Deal Security Measures**).

It is more common, however, immediately prior to the launch of a tender offer, for a buyer and principal shareholder of a target company to enter into an agreement where the shareholder agrees to tender its shares in the contemplated tender offer (see **6.11 Irrevocable Commitments**).

If the deal is structured as a statutory business combination, such as a merger, share exchange or company split, an agreement is entered into between the acquirer and the target company which includes terms that are required to be provided in accordance with the Companies Act (see **7.4 Transaction Documents**).

6. STRUCTURING

6.1 Length of Process for Acquisition/Sale

The length of the process for acquiring or selling a business can vary, depending on a number of factors, including the size and type of assets being acquired or sold, the type of target company (whether public or private), the level of due diligence required and the length of time needed to obtain required regulatory approvals. No particular delays or impediments to the deal-closing process occurred due to the governmental measures taken to address the COVID-19 pandemic.

Auctions

An auction will normally be structured as a two-phase process. In phase one, the seller will usually require the potential buyers to submit a non-binding indication of interest, typically addressing, among other things, the indicative offer price, proposed deal structure, possible conditions that the buyer may seek and necessary regulatory approvals.

In phase two, a few selected buyers will be given access to the data room for due diligence and will be required to submit their final bid, together with a mark-up of the draft transaction agreement circulated by the seller. After final bids are submitted, the seller will seek to negotiate and finalise the transaction agreement quickly so that the signing can occur as soon as practically possible. After the signing, the parties will seek any

applicable regulatory approvals or clearances for the transaction, such as antitrust clearance and any required prior notification under the FEFTA (see **2. Overview of Regulatory Field**).

Acquisitions

In an acquisition involving a tender offer, the tender offer period must be set between 20 and 60 business days. If the acquisition is effected through a two-step process, where the tender offer is followed by a second-step squeeze-out of the remaining minority shareholders who did not participate in the tender offer, the process of the second step will depend on the level of shareholding that the acquirer owns after the first-step tender offer.

If an acquirer owns 90% of the voting rights of a target company, the acquirer can complete the second step rather quickly (typically around one month) by exercising the Squeeze-out Right (see **6.10 Squeeze-Out Mechanisms**).

Where the acquirer is unable to achieve the 90% threshold in the first-step tender offer, the second step will usually take a few months. In those cases the second step will require the target company to convene a shareholders' meeting and to complete the court permission procedures (see **6.10 Squeeze-Out Mechanisms**).

6.2 Mandatory Offer Threshold

With respect to a listed company (and some other types of company), the FIEA provides specific requirements for a mandatory tender offer. Overall, the primary threshold for a mandatory tender offer is one third of the voting rights of a target company ("One-Third Rule"). Therefore, subject to certain limited exceptions, an acquirer must conduct a tender offer if the "total shareholding ratio" (*kabukentou shoyu wariai*) of the acquirer exceeds one third after the purchase and the purchase is made in off-market trading or off-floor trading (ie, trade-sale-type market trading). This means that an acquirer cannot obtain, for instance, a 40% stake of voting shares from the principal shareholder of a listed company through a private buy/sell transaction.

The total shareholding ratio is defined in detail in the FIEA and the calculation generally includes the aggregate voting rights of the target company held by the acquirer and certain special affiliated parties (*tokubetsu kankeisha*) of the acquirer (on an as exercised and as converted to common stock basis).

The one-third threshold for this purpose derives in part from the requirement under the Companies Act for a special resolution of the shareholders for certain important actions (ie, merger, amendment to the articles, dissolution), which requires approval by two thirds of the voting rights present at the relevant shareholders meeting. Therefore, ownership exceeding one third of the voting rights will effectively grant a shareholder a veto right over any special resolution of the shareholders at a shareholders meeting.

In addition to the One-Third Rule, there are a few other situations where a mandatory tender offer is required.

5% Rule

If the total shareholding ratio of an acquirer exceeds 5% as a result of an off-market purchase. An exception applies to the 5% Rule if the acquirer has not purchased shares in off-market trading from more than ten sellers in aggregate during the 60 days before the day of the purchase on which the threshold is crossed (ie, during a 61-day period including the date of the threshold-crossing purchase).

Rapid Buy-Up Rule

If the total shareholding ratio of the acquirer exceeds one third as a result of the acquisition of shares within a three-month period,

whereby the acquirer accumulates more than a 10% shareholding through on-market trading, off-market trading and subscription of newly issued shares from the company, and that accumulation includes an accumulation of more than 5% through off-market and off-floor trading (ie, trade-sale-type market trading).

The Rapid Buy-Up Rule was introduced in 2006 with the primary aim of capturing a combination of on-market and off-market trading or a combination of off-market trading and new share issuances, which in each case would result in an acquirer holding more than a one-third total shareholding ratio. This effectively means that, for example, if an acquirer obtains 30% of the voting shares through off-market trading, it cannot then purchase additional shares during the next three-month period at market, off-market (including a tender offer) or otherwise that would result in its shareholding ratio exceeding one third.

Counter Tender Offer Rule

If, during the period in which there is an ongoing tender offer by a third party, an acquirer with an existing shareholding ratio of more than one third purchases more than a 5% additional shareholding. The Counter Tender Offer Rule effectively captures on-market trading, because off-market trading resulting in a total shareholding ratio exceeding one third will be subject to the One-Third Rule in any event.

6.3 Consideration

While cash is more commonly used as consideration in acquisitions, the type of consideration varies depending on the nature and structure of the acquisition. Earnouts can be used to bridge value gaps between the parties and we see an increase in the number of private deals using earnouts, particularly acquisitions of start up companies.

In a share purchase or business transfer, the consideration has been predominantly cash-only. However, the use of stock consideration may increase as a result of the introduction of the "share delivery" mechanism. The amended Companies Act that came into force on 1 March 2021 introduced a new "share delivery" mechanism whereby a Japanese stock company can acquire all or a part of the shares of a target company (which must also be a Japanese stock company) by delivering the acquiring company's shares to shareholders of the target company to make the target company its subsidiary. In a "share delivery", the acquiring company must prepare a share delivery plan and obtain special approval at its shareholders meeting (unless generally the aggregate book value of the consideration is not in excess of 20% of the net assets of the acquiring company). New tax rules that become effective as of 1 April 2021 have also resolved a taxation issue that now allows selling shareholders to defer taxation on capital gains. Specifically, deferral of capital gains taxes for selling shareholders will be possible as long as at least 80% of total consideration is comprised of the shares of the acquiring company (as opposed to cash or other consideration).

An exchange offer through which the acquirer offers its own securities as consideration in a tender offer is also legally permitted and, although no such deal has been announced to date, an exchange offer may be used in public deals that employ the newly introduced "share delivery" mechanism.

In a statutory business combination, such as a merger, share exchange or company split, stock is more commonly used as consideration, although cash or another consideration is legally permitted and it is often seen in the case of a company split.

Cash and Stock

A mix of cash and stock is not common in Japan. However, the newly introduced share delivery mechanism mentioned above allows a mix of cash and stock, and also allows the deferral of taxation for the selling shareholders if at least 80% of total consideration is comprised of stock of the acquiring company, with no more than a 20% cash component.

Separately, a cash tender offer followed by a second-step stock-for-stock merger or share exchange is often seen, and this structure also effectively provides the shareholders with the choice of cash or stock.

6.4 Common Conditions for a Takeover Offer

The FIEA strictly regulates tender offer conditions and permits the withdrawal of a tender offer only upon the occurrence of certain narrowly defined events. Those withdrawal events must also be specifically provided in the tender offer registration statement, and include:

- a decision by a target company to make a material change, such as a merger, reduction of capital stock split and issuance of new shares;
- the occurrence of a material event with respect to the target company, such as damage due to a natural disaster;
- the failure to obtain regulatory approvals; and
- the occurrence of a material event with respect to an acquirer, such as dissolution and bankruptcy.

A material change that would permit withdrawal must fit within one of the above narrowly defined withdrawal events; a broad MAC/MAE condition is not permitted. A financing condition is also not permitted and an acquirer must prepare, as part of the tender offer registration statement, a document evidencing pre-arranged financing on a firmly committed basis. If the pre-arranged financing is subject to conditions, the substance of these conditions is generally required to be described in the statement.

6.5 Minimum Acceptance Conditions

A minimum acceptance condition is permitted for a tender offer. Where a minimum acceptance condition is specified in the tender offer registration statement, an acquirer will not purchase any shares if the number of shares tendered is lower than that specified minimum number. If a minimum acceptance condition is set at the commencement of the tender offer, that minimum threshold may not be increased by the acquirer, but the acquirer may decrease or remove the condition.

100% Ownership

In a 100% acquisition deal, the minimum acceptance condition is traditionally set such that the voting rights held by an acquirer after the tender offer will reach two thirds of a target company's voting rights on a fully diluted basis. The ownership of two thirds of the voting rights of the target company will ensure that the acquirer will be able to pass a special resolution of the shareholders at a shareholders' meeting (eg, merger, amendment to the articles, dissolution). The acquirer will then proceed to the second step of the acquisition to squeeze out any remaining shareholders who did not tender their shares in the tender offer (see **6.10 Squeeze-Out Mechanisms**).

More recently, minimum acceptance conditions are sometimes set below the two thirds threshold to increase the likelihood of a successful tender offer. One of the reasons for this trend is that passive index funds that hold the target shares normally do not tender shares in a tender offer, but do vote in favour of the second step squeeze out (where a shareholder resolution is required).

Partial Ownership

If an acquirer does not seek 100% ownership of a target company, the minimum acceptance condition is typically set such that the voting rights held by the acquirer after the tender offer will be a majority of the voting rights of the target company on a fully diluted basis. The majority ownership will allow the acquirer to pass an ordinary resolution of the shareholders at a shareholders' meeting. The primary purpose of a deal of this type is typically to allow the shares of the target company to continue to be listed on a stock exchange.

In addition, the acquirer may also set a maximum number of shares to be purchased by the acquirer, provided that the total shareholding ratio of the acquirer after the tender offer will remain less than two thirds. If the number of shares tendered exceeds that maximum number, the acquirer must purchase the tendered shares on a pro rata basis. If, for instance, a bidder sets both a minimum and maximum at the level of a simple majority, a majority acquisition can be achieved without purchasing all shares tendered.

6.6 Requirement to Obtain Financing

In a statutory business combination, there are no specific limitations on conditions. However, in practice, the conditions in a business combination among listed companies are typically quite limited, such as necessary shareholder approval and regulatory approvals and clearances. A financing condition is not commonly used in a business combination because, as explained in **6.3 Consideration**, stock is more commonly used.

6.7 Types of Deal Security Measures

In a tender offer, as explained in **5.5 Definitive Agreements**, it is permissible but not very common for an acquirer and a target company to document a tender offer in a definitive transaction agreement. Hence, it is usually not practical for an acquirer to seek deal security measures, such as break-up fees or match rights, with the target company. However, as has been recently seen in an increasing number of competing offers in the market, more acquirers may be seeking deal security measures going forward. One example is the acquisition of Unizo Holdings, a then-public real estate company, in 2019-20, where multiple competing bids were proposed. The target agreed to a 1% break-up fee with both the bidder sponsored by Fortress Investment and the employment buyout bidder sponsored by Loan Star.

It is more common for a buyer and principal shareholder of a target company to enter into an agreement where the shareholder agrees to tender its shares in the contemplated tender offer (see **6.11 Irrevocable Commitments**). The irrevocable commitments often include certain deal security measures such as non-solicitation provisions. Non-solicitation provisions and force-the-vote provisions (or a like) are also often seen in a statutory business combination.

With regard to the pandemic, the parties in private deals are carefully negotiating MAC/MAE provisions, including a more detailed definition of what constitutes a material adverse change/effect. In respect of the interim covenant to run the target's business in the ordinary course, the sellers recently tend to negotiate so that reasonable actions taken in response to or in connection with the COVID-19 pandemic would not constitute a breach of the interim covenant.

6.8 Additional Governance Rights

If an acquirer does not seek 100% ownership of a target company, the acquirer may seek certain contractual protections, such as the right to designate members of a company's board of directors, veto rights over certain material matters, and information rights to receive periodic financial information and business reports.

However, if the target company is a listed company, such protections may be quite limited because the target company will not be likely to accept such protections of the acquirer from a corporate governance standpoint.

6.9 Voting by Proxy

In certain circumstances, shareholders can vote by proxy. See **6.10 Squeeze-Out Mechanisms**.

6.10 Squeeze-Out Mechanisms

In a tender offer for 100% of a listed company, the remaining shareholders who did not tender their shares in a successful tender offer will generally be squeezed out through a second-step squeeze-out mechanism. In practice, if an acquirer owns 90% of the voting rights of a target company after the first-step tender offer (thereby becoming a special controlling shareholder), the acquirer will usually complete the second step by exercising a statutory right to force the other shareholders to sell their shares to the special controlling shareholder (the "Squeeze-Out Right").

Upon exercising the Squeeze-Out Right, dissenting shareholders will have the right to exercise appraisal rights. In addition, if the exercise of that right would violate law or the company's articles of incorporation, or the consideration is grossly improper, the dissenting shareholders will have a right to seek an injunction.

In cases where the acquirer is unable to achieve the 90% threshold in the first-step tender offer, it may still implement the second-step squeeze-out through other means, typically the so-called share cancellation scheme (by way of use of a stock combination), to the extent that the acquirer holds two thirds of the voting rights of the target company (ie, the threshold to pass a special resolution at the target company's shareholders meeting). In the share cancellation scheme, a target company will implement a share cancellation in which the ratio of the stock combination is set so that the shares held by each minority shareholder will become less than one full share of the target company.

The share cancellation scheme normally takes a few months, as the process requires the target company to convene a shareholders' meeting and to complete certain court permission procedures for the sale of fractional interests held by minority shareholders. In the shareholders' meeting, the acquirer can vote by proxy.

6.11 Irrevocable Commitments

If there is a principal shareholder of a target company, it is relatively common for an acquirer to obtain an irrevocable commitment from the principal shareholder to tender its shares in the target company in the contemplated tender offer. The commitment will be made in a written agreement (*oubo keiyaku*), which is negotiated prior to the announcement of the transaction by the parties. Where such a commitment exists, material terms of the commitment are disclosed in the tender offer registration statement.

Whether this type of commitment agreement includes a clause that would permit the principal shareholder to refuse to tender in the event that a competing bid is made by a third party at an offer price higher than the tender offer price varies, depending on the type of principal shareholder (eg, a founder, senior management, a private company, a listed company) and other factors. This is a matter of negotiation and may be incorporated in the commitment, particularly if the deal did not involve an auction process or proactive market check and the principal shareholder is interested only in the financial aspects of the transaction.

7. DISCLOSURE

7.1 Making a Bid Public

If an acquisition is made by a tender offer to the shareholders of a listed company, a bidder must publicly announce the bid at the beginning of the tender offer by:

- a press release;
- public notice of the tender offer; and
- a tender offer registration statement.

Bullet points two and three are required pursuant to the FIEA and are to be made or filed on the tender offer commencement date. As the press release in item is only required by the stock exchange regulations, if the bidder is not a listed company, the bidder is not required to issue a press release, although the target listed company is required to issue a press release immediately after it has formed an opinion (regarding its endorsement or not) of the tender offer.

If a bidder's press release is required, it is usually made one business day before the tender offer commencement date (simultaneously with the target company's press release unless the bid is unsolicited). However, in certain exceptional situations, a bid is publicly announced by the bidder and the target company in advance of the commencement of the tender offer, such as when earlier public disclosure would be required to obtain merger clearance in certain jurisdictions.

7.2 Type of Disclosure Required

When an acquisition is made by a statutory business combination (ie, merger, corporate split, share exchange or share transfer) or share delivery mechanism, whereby an acquirer's shares are issued as consideration, the filing of a security registration statement by the acquirer is required if there are at least 50 shareholders of a target company and the target company is a reporting company under the FIEA, and no security registration statement has already been filed in relation to the same class of shares as the shares to be issued upon such a statutory business combination or a share delivery mechanism.

For example, if a foreign purchaser acquires a Japanese listed company by way of a triangular merger and issues the shares of the foreign purchaser as consideration of the merger, the foreign purchaser will be required to file a security registration statement unless it has already become a reporting company in Japan under the FIEA.

7.3 Producing Financial Statements

For a tender offer, the bidder must disclose in the tender offer registration statement its financial statements, prepared in accordance with Japanese Generally Accepted Accounting Principles (GAAP) for the latest fiscal year, together with any quarterly or half-year financial statement after the date of the most recent full-year financial statement.

If the bidder is a foreign entity, it may provide financial statements prepared in accordance with the generally accepted accounting principles of its home country, with explanatory notes as necessary, to explain certain differences with Japanese GAAP, in lieu of Japanese GAAP financial statements.

When a business combination requires the filing of a security registration statement, the offeror must disclose, in the security registration statement, its financial statements for the last two fiscal years, together with any quarterly updates, prepared in accordance with Japanese GAAP.

However, a foreign offeror may produce financial statements prepared in accordance with the accounting standards of its home country or

any other country in each case with the specific approval from the Minister for Financial Services of Japan.

7.4 Transaction Documents

Disclosure of transaction documents in full is not required for a tender offer. If there are any agreements between the bidder and a target company or its officers in relation to the tender offer itself or a disposal of material assets after the tender offer, the material terms of such agreements must be described in the tender offer registration statement.

For a business combination, the Companies Act requires parties to the business combination to prepare an agreement providing for statutorily required matters. A statutorily required agreement such as a merger agreement, share exchange agreement or company split agreement must be disclosed in full. However, in practice, such an agreement only addresses the matters required by law and is thus very short.

In many cases, the parties to a business combination enter into another agreement to provide in detail the terms of the business combination, in which case, only the material terms of such an agreement need be disclosed in the security registration statement (if the filing of the security registration statement is required as previously discussed) and the press release pursuant to the stock exchange regulations (if the party is a listed company).

8. DUTIES OF DIRECTORS

8.1 Principal Directors' Duties

Under the Companies Act, as a general principle, directors owe a duty of care as a good manager, and a duty of loyalty to the company and, indirectly, to the shareholders of the company.

Except for violations of law or situations involving a conflict of interest, the business judgment rule generally applies in determining whether directors have breached their duties. Under the business judgment rule in Japan, directors are not held accountable for their decisions unless the directors were careless and failed to recognise relevant facts in making their decisions or the process of the decision-making or the substance of the decisions was particularly unreasonable or inappropriate.

There have not been many judicial precedents addressing directors' duties in M&A transactions, although, however, as far as M&A transactions without any conflict of interests are concerned, it is understood by M&A practitioners that the business judgment rule generally applies to directors in M&A transactions and there are a few judicial precedents confirming such understanding.

8.2 Special or Ad Hoc Committees

Use of an independent ad hoc special committee in M&A transactions involving conflicts of interest has become common in Japan. In almost all cases of management buyouts, and in many recent going private transactions by a controlling shareholder for cash consideration, boards of directors of the target company have established an ad hoc special committee to review the transaction. Even where there is no inherent conflict of interest, a listed target company will sometimes establish a special committee to review the deal terms more carefully.

In recognition of the importance of ensuring fair procedures in M&A transactions, the Fair M&A Guidelines emphasise the role of special committees and provide detailed guidelines including the composition of the special committees. The Fair M&A Guidelines explicitly state that outside directors who owe fiduciary duties to the company are the most suitable persons to serve

as members of the special committees. In practice, we have also more frequently seen outside directors as members of special committees.

While the involvement of special committees in negotiations of transaction terms was limited in the past, the Fair M&A Guidelines state that it would be desirable that the special committees should be actively involved in negotiations on transaction terms, either directly or indirectly, through expressing their views to the project team members who are in charge of the negotiations rather than simply reviewing the transaction terms when they are agreed. As such, special committees are expected to play a more active role in negotiations.

8.3 Business Judgement Rule

As noted, in M&A transactions without any conflicts of interests, the business judgment rule generally applies to directors' decisions. Therefore, as long as directors of an acquirer make reasonable, informed business decisions based on sufficient information, including obtaining advice of experts and information obtained through due diligence, the courts would normally defer to the judgment of the board of directors. The Supreme Court in 2010 held in the Apaman Shop Holding case that the business judgment rule applies to the directors of an acquirer that conducted a share exchange with a private company.

8.4 Independent Outside Advice

It is common for directors of a company in an M&A transaction to obtain financial, tax and legal advice from outside experts. Obtaining a valuation report from an independent outside financial adviser is recognised as a prerequisite to ensure fairness and transparency.

In practice, a valuation report is obtained by a target company in almost all tender offers and by both parties in many statutory business combinations such as mergers. In some cases, in addition to the valuation report, directors obtain a fairness opinion from an outside financial adviser, but this is not a prerequisite.

8.5 Conflicts of Interest

In appraisal proceedings to determine the fair value of shares of the target company, the courts generally respect the transaction terms including the valuation agreed upon by the parties if the transaction is an arms' length transaction between unaffiliated parties, and if procedures that generally considered fair have been taken, such that the shareholders have approved the transaction after full disclosure of all material relevant information. However, if the transaction involves conflicts of interest of directors or controlling shareholders, the courts will also consider whether adequate measures have been taken to eliminate arbitrary decisions and the effect of conflicts of interest.

In 2013, the Tokyo High Court held in a breach of fiduciary duty claim with respect to a management buyout that the directors must perform their fiduciary duties to ensure that fair value is transferred among the shareholders, and to disclose adequate information necessary to ensure informed decision-making by the shareholders to determine whether to tender their shares in a tender offer.

Views are divided as to whether this court holding imposes a stricter standard of review or merely clarifies duties of directors in management buyouts. It is also not clear if this court holding applies only to management buyouts, or if it extends to transactions involving conflicts of interests or to any transactions in which disputes can arise regarding transfer of value among shareholders. In any event, the courts normally closely look into whether adequate measures to eliminate arbitrary decisions and the effect of conflicts of interest have been taken in transac-

tions that involve conflicts of interest of directors or controlling shareholders.

9. DEFENSIVE MEASURES

9.1 Hostile Tender Offers

Hostile tender offers have been permitted but historically not common in Japan. However, there have been a number of hostile tender offers conducted by both strategic and financial buyers in the last few years.

The background to this shift may be a decrease in the stable shareholders that have historically been reluctant to tender their shares in a hostile tender offer, which in turn is a result of the Japanese government's policy to decrease cross-shareholdings, as implemented through the adoption of Japan's Corporate Governance Code and enhancement of disclosure regarding the cross-shareholdings in annual security reports.

9.2 Directors' Use of Defensive Measures

Defensive Measures Implemented by Directors Only

With respect to defensive measures that do not dilute shareholdings, the court has held that directors may take reasonable defensive measures to ensure necessary information and a reasonable period for shareholders to consider whether the shareholders should entrust the management of a company to incumbent directors or an acquirer (Nihon Gijutsu Kaihatsu case in 2005).

Where there is a contest for control of a company, defensive measures by way of issuing stock options to a particular third party or allotting poison pill type stock options to all shareholders that dilute an acquiring shareholder are generally not permitted to be implemented without shareholder approval if the primary purpose is maintaining or ensuring incumbent management's control of a company, unless the defensive measures are justified in the context of protecting the interests of shareholders as a whole (Nippon Broadcasting case in 2005; Japan Asia Group case in 2021).

Defensive Measures Implemented upon Resolution of Shareholders

In a case involving defensive measures implemented by resolution of the target's shareholders in accordance with the target's articles of incorporation, the Supreme Court held that it was permissible under the equitable doctrine for the target to allot stock options to all shareholders that are only exercisable by shareholders other than the hostile acquirer, and that are callable by the target for new shares for all shareholders other than the hostile acquirer, as long as such allotment is necessary and reasonable to protect the common interests of shareholders from the probable damages to be caused by the bidder (Bull-Dog Sauce case in 2007).

Defensive Measures Implemented by Directors with Shareholder Approval

The court has upheld poison pill type defensive measures involving an allotment of stock options implemented by the board of directors that was subject to subsequent approval of shareholders (ie, the defensive measures would be cancelled if voted down at the shareholders meeting) (Fuji Kosan case in 2021). In this case, the defensive measures were implemented to enable shareholders to determine whether the takeover would harm corporate value and the common interests of shareholders of the target company.

In a case involving a takeover attempt through the accumulation of shares in on-market transactions, the court upheld poison pill type defensive measures involving an allotment of stock options implemented by the board of directors

and later approved at a shareholders meeting by a majority of shareholders present at the shareholders meeting excluding the acquirer and the directors of the target company and their related parties (a "majority of minority" resolution). In this case, the court held that in consideration of the coerciveness of a takeover through on-market transactions, the "majority of minority" resolution should be sufficient to see whether the company's shareholders approve the defensive measures to be implemented (Tokyo Kikai Seisakusho case in 2021).

As to the pre-warning type of defensive measures (see **9.3 Common Defensive Measures**) that have been approved at a shareholders meeting before a tender offer is commenced, the court upheld the implementation thereof (ie, the allotment of stock options) by resolution of the board of directors (without a shareholder resolution) where the acquirer did not comply with the procedures set out in the defensive measures (Nippo case in 2021).

9.3 Common Defensive Measures

The most common hostile takeover defensive measures adopted by Japanese listed companies before a hostile acquirer emerges are the pre-warning type of defensive measures. A company sets and publicly discloses (warns) a procedure with which a would-be acquirer has to comply before starting an acquisition. Under the procedure, the acquirer has to provide the board of directors with information regarding the acquirer and its acquisition plan, and ensure the directors have time to consider the plan and prepare alternatives, and for shareholders to consider which plan is in shareholders' interests.

If the company determines based on a recommendation of an independent committee established by the board that the bidder has not complied with the procedures set by the company, or that the proposed acquisition would cause clear harm to the corporate value and common interests of shareholders, it would allot stock options to all shareholders without contribution that are only exercisable by, or callable for new shares by the company with respect to, those shareholders other than the acquirer, resulting in a dilution of the shareholding ratio of the acquirer.

In most cases, it is provided that the board of directors may also confirm shareholders' intentions concerning an allotment of such options by convening a shareholders' meeting.

However, the number of companies adopting these types of measures has been decreasing due to opposition by institutional investors. While 567 listed companies had adopted the measures as of 2009, 270 listed companies have adopted the measures as of 2021.

9.4 Directors' Duties

As discussed in **8. Duties of Directors**, directors have a duty of care as a good manager and a duty of loyalty to a company, and the business judgment rule is generally available for directors' decisions in Japan. Laws and court precedents do not clearly provide that an intermediate or heightened level of review apply to directors' decisions where they implement defensive measures.

9.5 Directors' Ability to "Just Say No"

While there is no case law in Japan addressing the "Just Say No" defence, there is no per se rule that prohibits directors from simply refusing to negotiate and rejecting outright a hostile takeover attempt. However, the directors are required to make such decision in compliance with their fiduciary duties, and they are also under pressure from shareholders, including shareholder activists and institutional investors.

10. LITIGATION

10.1 Frequency of Litigation

In general, it is not very common in Japan for shareholders or other stakeholders in a company to bring litigation against the company or its directors in connection with M&A transactions. Under Japanese law, it is not easy for stakeholders to enjoin in advance the consummation of any type of M&A transaction because the grounds for an injunction are generally limited to a violation of law or the company's articles of incorporation. The general view is that a violation by directors of their duties of care and loyalty is not deemed a violation of law.

The exception is that shareholders may seek injunctive relief against: the issuance of stock or stock options by the company pursuant to the Companies Act based on certain grounds, including that the issuance is unjust; and a short-form merger or exercise of the Squeeze-out Right, based on the grounds that the consideration is grossly improper.

10.2 Stage of Deal

Shareholders are more likely to bring legal action in connection with M&A transactions involving conflicts of interest, such as MBOs or squeeze-out transactions conducted by a controlling shareholder, after the transactions are completed. The most common litigation in Japan is litigation with respect to appraisal rights of shareholders. Moreover, shareholders sometimes file a suit against directors or corporate auditors of a target company for recovery of monetary damages suffered as a result of the violation of their duties of care and loyalty.

10.3 "Broken-Deal" Disputes

In early 2020, some pending Japanese M&A transactions that were negotiated before the COVID-19 crisis were suspended or cancelled as a consequence of the pandemic. However, there has been no reported important court decision with respect to M&A transactions dealing with the triggering of MAC clauses, or breaches of pre-closing covenants or representations and warranties, as a result of the pandemic.

11. ACTIVISM

11.1 Shareholder Activism

Although public shareholders have not historically had much influence on the management of companies in Japan because of cross-shareholdings, according to a recent survey, Japan is now second behind the USA as the country most targeted by public campaigns conducted by shareholder activists. Since the introduction of Japan's Corporate Governance Code in 2015 and Stewardship Code in 2014, there has been a significant change in the environment surrounding the corporate governance of Japanese listed companies and the mindset of their management.

11.2 Aims of Activists

After the issuance in 2020 of the Practical Guidelines for Business Transformation by the Ministry of Economy, Trade and Industry, which discusses issues concerning business portfolios and business transformations of Japanese companies, there has been a gradual increase in the number of demands by activists against Japanese listed companies for going private transactions or divestitures or spin-offs of non-core or unprofitable businesses.

As discussed in **11.3 Interference with Completion**, activists are engaging in so-called bumpitrage with respect to M&A transactions. Activists exercise their appraisal rights as dissenting shareholders with respect to M&A transactions and file a petition to the court for a determination of the fair price for the relevant shares after the completion of the transaction.

11.3 Interference with Completion

The amount of bumpitrage has recently increased in Japan. With respect to tender offers conducted as the first step of a squeeze-out transaction, or transactions requiring a shareholder resolution (such as a merger or share exchange), activists occasionally advocate, through a press release or other media, that the purchase price is lower than fair value and/or increase their shares in a target company or launch a counter tender offer. However, it is not easy under Japanese law for activists to obtain injunctive relief from a court prior to the completion of a transaction.

If the market price of target company shares hovers at a level higher than the offer price as a result of the involvement of shareholder activists, uncertainty as to the completion of a transaction may increase, and an acquirer may be required to pay more than it had planned to consummate the transaction and, in the worst case, the transaction may fail. There has recently been an increase in tender offers that failed because the market price was continuously higher than the tender offer price until the end of the tender offer period.

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Mori Hamada & Matsumoto has a corporate M&A team that consists of approximately 200 attorneys. The firm has offices in Tokyo, Osaka, Nagoya, Fukuoka and Takamatsu, and international branch offices in Singapore, Shanghai, Beijing, Bangkok (Chandler MHM Limited), Yangon (Myanmar Legal MHM Limited), Ho Chi Minh City and Hanoi. The firm's M&A practice handles mergers, acquisitions, restructurings and corporate alliances in a wide variety of industries and sectors, including domestic and cross-border transactions (inbound and outbound); listed company, private equity and venture capital transactions; friendly and hostile transactions; going-private transactions; MBOs; acquisition finance; and takeover strategies. The firm has been particularly active in cross-border transactions between Japan and South and South-East Asian countries. The firm's M&A team liaises with other key practice areas for M&A transactions involving distressed or insolvent companies, as well as M&A-related litigation and arbitration.

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