GETTING THE DEAL THROUGH

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Japan

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1 Form

How may businesses combine?

The following forms of business combinations are available under Japanese law:
- share acquisition;
- business transfer;
- merger;
- share exchange;
- share transfer; and
- corporate split.

A share acquisition and a business transfer are straightforward sales and purchases of shares or a business of a company between the seller and the purchaser.

A merger is a transaction between two or more companies whereby those companies merge with each other such that one surviving company remains (absorption type merger) or one new company is formed (incorporation type merger). In a merger, in general, shares of the merged company are exchanged for the shares of the surviving company or the newly formed company.

A share exchange is a transaction between two companies whereby one company becomes the 100 per cent shareholder of the other company. In a share exchange, in general, shares of the acquired company are exchanged for the shares of the acquiring company, namely the new parent company.

A share transfer is a transaction whereby an existing company newly forms a parent company and becomes its wholly owned subsidiary, that is, the shares of the existing company are exchanged for the shares of a to-be-formed parent company. This allows an operating company to create and shift to a holding company governance structure. In addition, because two or more companies may jointly implement a 'share transfer' to create a holding company owning all the shares of those companies, a share transfer is often used as a means of business combination.

A corporate split is a transaction whereby one company splits out a segment of its business. The split-out business can be transferred to a company to be newly formed as a result of a corporate split (incorporation type split) or to an existing company (absorption type split). In general, shares of the company to which the split business is transferred are issued to the transferring company that splits out the business, or to the shareholders of such company.

Under the Company Law, not only stock companies (*kabushiki kaisha*), but other types of companies (eg, limited liability companies (*godo kaisha*)) may become parties to the above types of business combinations. However, because most M&A transactions in Japan occur between stock companies either as parties or as vehicles, the answers to the questions below also assume that only stock companies are involved, unless otherwise indicated.

In addition, the consideration that may be used for absorption type mergers, share exchanges, or absorption type splits has been expanded such that, in addition to shares of the acquiring or successor company noted above (eg, the surviving company in a merger, an acquiring company in a share exchange and a succeeding company in a corporate split), cash, bonds, stock options and other assets may be used as consideration in these business combination transactions.

2 Statutes and regulations

What are the main laws and regulations governing business combinations?

The most important law governing business combinations is the Company Law (Law No. 86 of 2005, as amended).

In addition, the following laws and regulations are important:
- the Commercial Registration Law (Law No. 125 of 1963, as amended);
- the Law Concerning Prohibition on Private Monopoly and Preservation of Fair Competition (Law No. 54 of 1947, as amended) (the Anti-monopoly Law);
- the Financial Instruments and Exchange Law (Law No. 25 of 1948, as amended) (the FIE Law); and
- the Foreign Exchange and Foreign Trade Law (Law No. 228 of 1949, as amended) (the FEFT Law).

3 Governing law

What law typically governs the transaction agreements?

Merger, share exchange, share transfer and corporate split are statutory arrangements provided by the Company Law, which is a part of Japanese law. Therefore, the agreements or other documents for those transactions must satisfy relevant requirements under Japanese law, and will be governed by Japanese law. Agreements for share acquisitions and business transfers may be governed by the laws of any jurisdiction selected by the parties; however, in the majority of cases, the agreements for those transactions are also governed by Japanese law.

4 Filings and fees

Which government or stock exchange filings are necessary in connection with a business combination? Are there stamp taxes or other government fees in connection with completing a business combination?

Anti-monopoly Law

Under the Anti-monopoly Law, subject to certain threshold requirements and exceptions, a company accepting a business transfer and a company implementing a merger or a corporate split must file a prior notification of such transaction with the Japan Fair Trade Commission, after which there is a 30-day waiting period. Further, under the Anti-monopoly Law, subject to certain threshold requirements and exceptions, if a company increases its shareholding in another Japanese company or a foreign company having at least one branch in Japan of a certain size, and the resulting shareholding ratio exceeds ownership thresholds of 10 per cent, 25 per cent or 50 per cent, such company must file an ex post facto report with the Japan Fair Trade Commission within 30 days from the date of such acquisition.

FEFT Law

Under the FEFT Law, a foreign investor may be required to file ex post facto reports with the competent minister(s) through the Bank of Japan, when it acquires shares of a Japanese company (see the question 14).

FIE Law

The FIE Law contains certain disclosure obligations relevant to business combinations, and the tender offer regulations, as well as insider trading regulations (which are important in practice but not covered by this chapter).

Under the FIE Law, if a party acquires 5 per cent or more of the shares of a publicly traded company (ie, a company listed on a stock exchange or registered for trading over the counter), such party is required to file a large shareholding report within five business days of the acquisition. An increase or decrease of 1 per cent or more in the shareholding ratio of the acquirer will trigger an obligation to file an amendment report. Please see the response to question 6. Also, it should be noted that the previous treatment under the Securities Exchange Law (the preceding law of the FIE Law) that no 'solicitation' takes place at the time of issuance of shares upon merger, etc was changed when the FIE Law became effective in summer 2007, and therefore, under the FIE Law, the issuance of shares, etc at the time of merger, etc requires additional disclosure. That is, the FIE Law requires prior submission of a securities registration statement in the event of a merger, share exchange, share transfer or corporate split where, in addition to the other requirements, the acquired company (the dissolving company in a merger, the company becoming a subsidiary in a share exchange and a share transfer, or a splitting company in a corporate split) of such business combination is subject to continuous disclosure requirements under the FIE Law, and the securities to be distributed as consideration are not subject to disclosure requirements under the FIE Law.

More importantly in the context of M&A transactions, tender offers are governed by the FIE Law. Under the FIE Law, a tender offer is mandatory for a purchase or purchases of shares of publicly traded companies or other companies that are otherwise subject to continuous disclosure requirements under the FIE Law, if, among others: after such purchases from more than 10 sellers via 'off market' transactions within a period of 61 days or less, the purchaser's shareholding is in excess of 5 per cent; after such purchases via 'off market' transactions or certain trade sale type market transactions, the purchaser's shareholding is in excess of one-third; or after a combination of 'off market' transactions or certain trade sale-type market transactions for shares in excess of 5 per cent in itself, and other acquisitions of shares (including subscription of newly issued shares), being implemented within a three-month period, the purchaser's shareholding increases by more than 10 per cent and is in excess of one-third in total. For the purpose of 'purchaser's' ownership percentage calculation, detailed rules are provided in the FIE Law, and shares owned by statutorily defined 'affiliates' are aggregated.

Where a tender offer is required, the purchaser must, at the time of commencing the tender offer, file a tender offer registration statement with the local financial bureau and make a public announcement, both in accordance with the applicable disclosure requirements under the FIE Law. The information to be disclosed includes the purchase price, the tender offer period (from 20 to 60 business days), the conditions to the tender offer, the outline of the business plan after the completion of the tender offer, the outline of purchaser, etc. Further, it should be noted that, if the purchaser intends to purchase two-thirds or more shares of the target company, such a purchaser is required to offer to purchase all the shares tendered.

Stamp duty and other governmental fees

No stamp duty or other governmental fee is imposed on a share acquisition agreement, share exchange agreement, or share transfer plan. A stamp duty of ¥40,000 is imposed on a merger agreement and a corporate split agreement (or corporate split plan). Stamp duty on a business transfer agreement varies depending on the price of the business being transferred; with the maximum amount being ¥600,000. A business combination often involves amendments to the company's commercial registration, which are subject to various registration taxes in amounts depending on the matters affected. There are no governmental fees charged for a tender offer.

5 Information to be disclosed

What information needs to be made public in a business combination? Does this depend on what type of structure is used?

There are four categories of major disclosure requirements. The first is a public announcement required by the rules of the relevant stock exchange. The second, third and fourth are the filing of an extraordinary report, the filing of a large shareholding report, and the filing of a securities registration statement under the FIE Law. Regarding the details of such 'large shareholding report', see question 6. All information disclosed by these three means will become public information. The items required to be disclosed include the outline of parties, the outline of transactions, the reason for the transaction and the future prospects, etc. The details of such required disclosures differ according to the type of business combination.

6 Disclosure of substantial shareholdings

What are the disclosure requirements for owners of large shareholdings in a company? Are the requirements affected if the company is a party to a business combination?

Under the FIE Law, a party that becomes a 5 per cent or more shareholder of a publicly traded company is required to file a large shareholding report. In the report, such party must disclose its identity, as well as the number of shares it owns, the share acquisition and disposition history over the past 60 days, the purpose of acquisition, any material agreement relating to the shares (such as a security agreement), any financing source for acquisition funding and the identities of other cooperating shareholders. An increase or decrease of 1 per cent or more in the shareholding ratio will trigger an obligation to file an amendment report. The requirements are not affected even if the company is a party to a business combination.

In addition, the FIE Law requires a direct or indirect parent company of publicly traded companies to submit a report on its status within three months after the end of its fiscal year, except where such parent company itself is subject to the continuous disclosure obligations under the FIE Law. The report must contain information concerning its major shareholders, officers, and financial results, and shall be made public.

7 Duties of directors and controlling shareholders

What duties do the directors or managers of a company owe to the company's shareholders, creditors and other stakeholders in connection with a business combination? Do controlling shareholders have similar duties?

Under the Company Law, the directors of a company owe a fiduciary duty to the company. This duty must be distinguished from a duty to the shareholders as a matter of legal theory. The Company Law provides that the directors of a company must be liable to third parties (including shareholders and creditors) who suffer any damage due to wilful misconduct or gross negligence of such directors in the course of performance of their duties as directors.

Under Japanese law, duties of controlling shareholders are not recognised. However, the Company Law provides that if a materially unfair resolution is adopted at a general meeting of shareholders as a result of affirmative votes cast by one or more 'interested' shareholders, such resolution may be cancelled by legal action, which can be initiated by any shareholder, director or corporate auditor, etc.

8 Approval and appraisal rights

What approval rights do shareholders have over business combinations? Do shareholders have appraisal or similar rights in business combinations?

In 'share acquisitions', no such shareholder approval rights exist except that approval at a general meeting of shareholders is necessary for share acquisitions for some closed companies, if the articles of incorporation of such companies so provide. However, as a matter of course, each shareholder has a choice not to sell such shareholder's shares. Mergers, share exchanges, share transfers, corporate splits and business transfers (however, as for transferor, only in the case of transfer of all or a substantial part of its business to another company, or, as for transferee, acceptance of all the business of another company) must be approved by a super majority resolution with an affirmative vote of at least two-thirds of the votes at a general meeting of shareholders, where the shareholders present at such meeting hold at least a majority (which resolution requirements and quorum requirements can be modified by the articles of incorporation to the extent permitted under the Company Law) of the relevant voting rights. In small mergers, share exchanges and corporate splits below certain threshold requirements – as well as for shareholders' approval at a subsidiary in any of those business combinations, implemented with its 90 per cent or more parent company – this shareholders' approval is not required. Dissenting shareholders have appraisal rights (except for the shareholders of the acquired company in a small corporate split).

9 Hostile transactions

What are the special considerations for unsolicited (hostile) transactions?

In Japan, the number of hostile transactions is gradually increasing, but the number of those that have been successful is still very small, partly owing to the negative image associated with hostile transactions in the market. Since 2005, a number of listed companies have adopted anti-hostile-takeover plans ranging from poison pills to simple declarations by management that it will take anti-hostile-takeover measures whenever a hostile takeover is launched that is not in accord with the best interests of the company and its shareholders, and in 2007, the Supreme Court rendered a decision upholding the validity of the anti-hostile takeover plans using poison pills. It should also be noted that while the purchaser is not able to conduct a due diligence investigation of the target in the case of a hostile takeover, the disclosure of publicly traded companies in Japan is sometimes not necessarily sufficient.

10 Break-up fees – frustration of additional bidders

Which types of break-up and reverse break-up fees are allowed? What are the limitations on a company's ability to protect deals from third-party bidders?

Break-up fees and reverse break-up fees provided in the definitive agreements are generally enforceable in Japan, as long as the amount of the fee is reasonable in view of the costs and damage to the parties. If the amount of the break-up fee or the reverse break-up fee is unreasonably high, there is a possibility that a court might hold that the arrangement is against the public interest and declare it null and void. To our knowledge, break-up fee arrangements have recently tended to be adopted more often than in the past, while reverse break-up fee arrangements have not yet been very popular in Japan. Break-up fee arrangements could also be viewed as a means to back away from the deal, should a more favourable opportunity be presented by a third party bidder. In particular, these aspects of break-up fee arrangements may become important for publicly traded companies in the future.

Break-up fee arrangements for exclusive negotiation obligations contained in a letter of intent or memorandum of understanding are also generally enforceable but, in practice, are normally limited to the recovery of costs and expenses. It should be noted that Japanese courts recently denied a request for injunctive relief based on a letter of intent with binding exclusive negotiation provisions by stating that monetary compensation should be sufficient.

In addition, the target company in an M&A transaction should generally avoid offering its assets as collateral to secure acquisition finance for the acquirer in view of the interests of minority shareholders unless and until the target company becomes 100 per cent owned by the acquirer as a result of the transaction.

11 Government influence

Other than through relevant competition (antitrust) regulations, or in specific industries in which business combinations are regulated, may government agencies influence or restrict the completion of business combinations including for reasons of national security?

Other than in the two cases mentioned in the question and the possible intervention with cross-boarder transactions under the FETL Law (which is based on national security as well as other concerns), there are no means for governmental agencies in Japan to influence or restrict the completion of business combinations. It should be noted, however, that in many cases business combinations require commercial registration with the competent legal affairs bureau. Parties wishing to implement atypical business combinations may encounter objections from the officials of the legal affairs bureau when registering such atypical business combinations and should therefore consult with the legal affairs bureau in advance.

12 Conditional offers

What conditions to a tender offer, exchange offer or other form of business combination are allowed? In a cash acquisition, may the financing be conditional?

Conditions to a tender offer are statutorily limited to the following: if the number of shares tendered is less than a specified minimum number, no purchase of shares will be made; if the number of shares tendered exceeds a specified maximum number (if such specified maximum number is set, it must be less than two-thirds), purchase of shares will be on a pro-rata basis; and a tender offer can be withdrawn upon occurrence of 'material adverse change' – events that are statutorily defined.

Financing can be conditional upon successful completion of the tender offer. However, such financing must be on a firm commitment basis and thus a tender offer cannot be conditioned upon the financing.

Business combinations other than in the form of a tender offer can generally be subject to agreed upon conditions. However, in practice, business combinations via merger, share exchange, share transfer, or corporate split, etc, between publicly traded companies, are rarely subject to many conditions other than necessary shareholder approval, regulatory approval or competition law clearance.

13 Minority squeeze-out

May minority stockholders be squeezed out? If so, what steps must be taken and what is the time frame for the process?

The Company Law authorises the use of straightforward squeeze-outs of minority shareholders, through cash-out mergers, cash-out share exchanges, etc. These squeeze-out transactions, including those with cash-out features, generally require both board approval and super-majority shareholders approval (two-thirds or more) of the companies concerned (the shareholders approval is not required at the target company, if the acquiring company already owns 90 per cent or more of the target company and at the acquiring company depending on the significance of the transaction). In the case of a publicly traded company, it normally takes at least several weeks to call a shareholders meeting. In addition, in certain cases, including mergers, creditor protection procedures require the observance of a one-month waiting period. In practice, the tender offer process often precedes a squeeze-out transaction in order to accomplish the share ownership of the target company required to implement the desired squeeze-out. One important caveat is that such squeeze-out transactions must be implemented on fair and commercially reasonable terms, otherwise the transactions may be challenged by minority shareholders through an attempt to cancel the required shareholders' approval, etc. In addition, the 'cash-out'-type mergers or share exchanges authorised by the Company Law cannot be used where a substantial premium is paid because of tax reasons, as discussed in the response to question 16. As an alternative, it is suggested in practice to use a recapitalisation-type transaction whereby the minority shareholders will effectively be squeezed out in cash. This alternative transaction also requires 'super majority' shareholder approval of the target company, but the 90 per cent ownership waiver for this shareholders approval is not available.

14 Cross-border transactions

How are cross-border transactions structured? Do specific laws and regulations apply to cross-border transactions?

Business combinations resulting in a foreign investor holding 10 per cent or more of the shares of a Japanese publicly traded company or any shares of other Japanese companies will generally require a filing with the relevant ministries through the Bank of Japan under the FEFT Law. This filing is on an ex post facto basis in most cases. However, where the target company is engaged in a certain category of business that raises a concern for national security or other public interest (eg, military, aerospace, fishery, agriculture), prior notification must be filed, and with respect to protected business areas among such categories (eg, fishery, agriculture) the prior filing requirement functions as a de facto ban.

It should be noted that in order to implement a merger, corporate split, share exchange or share transfer, parties to these business transactions must be Japanese companies. However, triangular mergers are expected to allow foreign companies to effect a merger in Japan through a subsidiary, whereby the shares of the foreign parent company are offered to the shareholders of the target company upon the merger. A business transfer requires the purchaser foreign company to have either a subsidiary or a branch in Japan. In contrast, in the case of a share acquisition, a foreign company may directly acquire the shares of a Japanese company. A foreign investor for purposes of the FEFT Law includes a subsidiary or a branch of a foreign company.

15 Waiting or notification periods

Other than competition laws, what are the relevant waiting or notification periods for completing business combinations? Are companies in specific industries subject to additional regulations and statutes?

Parties to a merger and certain other types of business combination transactions that involve transfer of debts – including corporate splits – must undertake a creditor protection procedure, which generally involves public and individual notice requirements and observance of a one-month waiting period. The parties may not consummate these transactions until the expiration of such waiting period.

Business combinations involving target companies in regulated industries (eg, banks, securities firms, insurance companies and broadcasting companies) are subject to certain regulatory approval processes under the relevant industry-specific laws and regulations.

16 Tax issues

What are the basic tax issues involved in business combinations?

Straightforward share acquisitions (including by tender offer) and business transfers are taxable transactions and the seller will be subject to income taxation for any gains. Also, in the case of business transfers, the seller must pay consumption taxes (Japanese VAT at the rate of 5 per cent). However, if the seller of shares is not a resident of Japan, an exemption may be available depending on the acquired percentage ownership or the applicable tax treaty. Other business combination transactions (ie, merger, corporate split, share exchange, and share transfer) can be implemented without income taxation at the time of the transaction (in substance, tax deferral) if such transactions satisfy the requirements for tax-qualified restructuring. Broadly speaking, such a transaction may satisfy the requirements for 'tax-qualified restructuring' if no consideration other than shares of the party taking over the business (including the shares of the parent company in the case of triangular mergers) is paid out (ie, cash-out for squeeze-out will disqualify the transaction), and:

- it is implemented between a parent and a wholly owned subsidiary or between wholly owned subsidiaries;
- it is implemented between a parent and a subsidiary or between subsidiaries, where 80 per cent or more of the employees continue to be engaged in the business concerned and the primary businesses are continued; or
- it is implemented to do a 'joint operation', where: the businesses of the parties are related to each other, 80 per cent or more of the employees continue to be engaged in the business concerned and the primary businesses are continued; the ratio of the size of the businesses of the parties is within a range of 1 to 5 or the key management members remain the same; and with certain exceptions, where the ownership structure resulting from the transaction is expected to continue within the applicable parameters.

Update and trends

Due to the subprime loan issue and the credit crisis, acquisitions by private equity funds have substantially decreased, while transactions involving distressed companies have increased. This trend is expected to become more prominent in the near future. Concerning the regulatory framework governing business combinations, we expect the amendment to the Anti-monopoly Law to be enacted soon. After this amendment, prior notification to the Japan Fair Trade Commission will be required even in the case of an acquisition of shares in a Japanese company (see question 4 concerning the current requirement in the case of the acquisition of shares under the Anti-monopoly Law).

In the case of a 'tax-qualified' business combination, neither the seller company nor the target company is subject to income taxation at the time of the transaction and their tax bases for the relevant shares or assets remain intact after the transaction (thus, tax deferral) and in general the shareholders of the parties are not subject to income taxation (also, tax deferral). However, a cash-out transaction is not tax qualified, meaning that even the target company must recognise taxable gains, if any, from the transaction because its assets (including goodwill associated with the business) must be either deemed to have been sold or revalued on a mark-to-market-value basis for tax purposes. The onerous nature of the tax treatment of cash-out transactions would effectively deny the use of cash-out mergers or cash-out share exchanges, etc, where a substantial premium is involved because a premium normally represents the value of goodwill.

Incidentally, a business transfer could also be tax-qualified in a narrow path, where, for example, the consideration is comprised entirely of the shares of the purchaser company and the above requirements for tax-qualified transactions are satisfied.

17 Labour and employee benefits

What is the basic regulatory framework governing labour and employee benefits in a business combination?

In general, employment relationships and relevant employee benefits at Japanese companies are primarily regulated by the internal rules (Work Rules) established by the employer company and the applicable statutory provisions. It is rare that a detailed employment contract is signed.

In the case of share acquisitions, share exchanges and share transfers, since there is no change in the status of the employer company, employment relationships and employee benefits will remain unchanged after the transaction.

In the case of mergers and corporate splits, the employment relationships and employee benefits will automatically be transferred to the surviving or succeeding company. Therefore, the Work Rules and employment benefits of the merged or transferring company will continue to apply to the ex-employees of the merged or transferring company, even after the merger or corporate split, unless appropriate arrangements for integration are made. In connection with a corporate split, it should be noted that the employees primarily engaged in the transferred business are entitled to transfer to the succeeding company even if they are excluded from the scope of transfer in the relevant documents, and the employees not primarily engaged in the transferred business are entitled to remain with the transferring company even if they are included in the scope of transfer in the relevant documents.

In the case of business transfers, the transfer of employment relationships is not automatic and such transfer of employment relationships requires agreement between the parties to the business transfer and the consent of the relevant employees. The parties can agree that the purchaser will accept only those employees who consented to the application of the current Work Rules and employment benefits of the purchaser.

18 Restructuring, bankruptcy or receivership

What are the special considerations for business combinations involving a target company that is in bankruptcy or receivership or engaged in a similar restructuring?

In the context of insolvency proceedings, acquirers should be careful in setting the timing of an acquisition (whether before the adoption of a restructuring plan or as a part of the plan) and identifying the party having authority to approve the acquisition (administrator, trustee, supervisor or court). It should also be noted that if the transaction is of the type in which an administrator or trustee is appointed in statutory insolvency proceedings, the transaction will have to be implemented on an 'as is' basis without any meaningful representations or warranties regarding the quality of the business. If the restructuring is under way as a private collective settlement outside the realm of statutory insolvency proceedings, the purchaser should possibly expect a difficult negotiation with the banks and other creditors.

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