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Contributing editor
Alan M Klein

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Getting The Deal Through

Publisher
Tom Barnes
tom.barnes@lbresearch.com

Subscriptions
Claire Bagnall
claire.bagnall@lbresearch.com

Senior business development manager
Adam Sargent
adam.sargent@gettingthedealthrough.com

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Alan M Klein
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Lexology Getting The Deal Through is delighted to publish the fourth edition of *Public M&A*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes a new chapter on Austria.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Alan M Klein of Simpson Thacher & Bartlett LLP, for his continued assistance with this volume.

LEXOLOGY
Getting The Deal Through

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Sho Awaya and Yushi Hegawa

Nagashima Ohno & Tsunematsu

STRUCTURES AND APPLICABLE LAW

Types of transaction

1 | How may publicly listed businesses combine?

Among various forms of business combinations available under Japanese law, the following methods are most commonly used:

- acquisition of outstanding shares through a tender offer (followed by a second-step squeeze-out process in case of an acquisition of full control);
- merger (simple merger or triangular merger);
- share exchange (simple share exchange or triangular share exchange);
- joint share transfer; and
- third-party allotment.

Acquisition of outstanding shares is a straightforward sale and purchase of shares of a public company between its shareholder (as seller) and the purchaser. Owing to mandatory tender offer requirements, acquisition of outstanding shares of a listed company that represent a controlling interest is generally required to be conducted through a tender offer. Cash consideration is commonly used in a tender offer in order to avoid unfavourable tax implications on the seller shareholders that result from payment of non-cash considerations (eg, shares of the acquiring company or another company in the cases of exchange offers). In addition, exchange offers (ie, use of the acquirer's shares as consideration in a tender offer) are rare due to certain onerous requirements under the Company Law (Law No. 86 of 2005, as amended) (the Company Law). Such onerous requirements under the Company Law include (1) the need for a special shareholder's approval of the acquirer for issuance of the shares (which will be used as consideration for the share acquisition) at a preferential price, which may be triggered owing to the price premium given to the seller, and (2) other requirements applicable to an in-kind contribution. Requirements applicable to an in-kind contribution consist of a mandatory investigation by a court-appointed inspector, and the potential exposure of the sellers and the acquirer's directors to a liability to indemnify the acquiring company for any substantial shortfalls in the value of the contributed asset (ie, shares of the target company) vis-à-vis the amount of such asset as determined by the acquiring company upon its decision to issue its shares in exchange for such in-kind contribution. While there are certain exemptions with respect to the requirement to go through an investigation by a court-appointed inspector, the risk of indemnification liability cannot be fully eliminated. Notably, an amendment to the Act on Strengthening Industrial Competitiveness (Law No. 98 of 2013, as amended) (the ASIC) was introduced in 2018 with an aim to provide acquirers with more flexibility in the use of share considerations with respect to takeovers of both public and private companies. The amended ASIC provides for a mechanism under which an acquiring company may apply for an approval of a 'business restructuring plan' by the Minister of Economy, Trade and Industry and other competent ministers. Once the business restructuring plan is approved, both the requirement for investigation by a court-appointed inspector and the statutory liability of sellers and the acquirer's directors to indemnify the acquiring company as discussed above will be exempted by operation of the ASIC. Further, the need for a special shareholders' approval of the acquiring company will also be exempted if the number of shares issued by the acquiring company as consideration is no more than 20 per cent of the outstanding shares, and no objection is made by shareholders holding voting rights above a certain threshold during a two-week window following a public announcement (or individual notifications to shareholders) of the share issuance by the acquiring company. Although we have not seen any acquisition of a Japanese publicly listed company using the special treatments under the amended ASIC as of February 2019, it is expected that the amended ASIC will stimulate the use of exchange offers in Japan.

Merger is a transaction between two or more companies whereby such companies merge with each other resulting in either one of the companies surviving (absorption type merger) or one new company being formed (incorporation type merger). Generally, shares of the merged company are exchanged for the shares of the surviving company or the newly formed company. Unlike in certain jurisdictions, such as the United States, a 'reverse' triangular merger is not feasible under Japanese Law because the Company Law does not allow merging parties to convert or otherwise affect the shares held by the shareholders of the surviving company by operation of the merger. Although the form of merger consideration is not limited to shares of the acquiring company and the Company Law allows other forms of considerations including cash, bonds, share acquisition rights and other assets, shares of the acquiring company (or its parent) are typically used to avoid certain tax implications resulting from failing to meet the criteria of a tax-qualified merger. On the other hand, triangular merger is allowed, and practically not unprecedented.

Share exchange is a transaction defined and governed by the Company Law, whereby one company becomes the 100 per cent shareholder of the other company. As in the case of a merger, due to tax implications, shares of the acquired company are typically exchanged for the shares of the acquiring company or its parent company.

Share transfer is also a transaction defined and governed by the Company Law, whereby an existing company (or, in the case of a 'joint' share transfer, two or more companies) form a new parent company and become its wholly owned subsidiary. By operation of a share transfer, the shares of the existing company are exchanged for the shares of the to-be-formed parent company (or a combination of shares and bonds or share acquisition rights of such company). Accordingly, a joint share transfer allows the combining parties to combine under a new joint holding company while maintaining the corporate existence of the respective parties, which is a feature that gives comfort to parties in a 'merger of equals'.

Third-party allotment allows the purchaser to undertake newly issued shares (including treasury shares). This is another way to achieve a business combination, particularly if the acquirer intends to acquire not all but a substantial portion of the shares in the target company.

There are other types of business combinations generally available in Japan, including company splits and business transfers, but they are not suitable for acquisition or combination involving the entire businesses of a publicly listed company. Instead, they are frequently used to transfer a part of a company's businesses (or in a distressed situation). For this reason, this chapter will not cover company splits and business transfers, and will focus on the five types of business combinations mentioned above.

Statutes and regulations

2 What are the main laws and regulations governing business combinations and acquisitions of publicly listed companies?

The most important law governing business combinations is the Company Law.

In addition, the following laws and regulations are also relevant:

- the Financial Instruments and Exchange Law (Law No. 25 of 1948, as amended) (the FIE Law);
- 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 Foreign Exchange and Foreign Trade Law (Law No. 228 of 1949, as amended) (the FEFT Law); and
- the ASIC.

Cross-border transactions

3 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 will generally require a filing with the relevant ministries through the Bank of Japan under the FEFT Law (note that a foreign investor for the purposes of the FEFT Law includes a Japanese subsidiary or a branch of a foreign company). 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 is important to national security or other public interest (for example, military, aerospace, fishery, agriculture), prior notification must be filed.

It should also be noted that, in order to implement a merger, share exchange or share transfer, parties to these business transactions must be Japanese companies. However, triangular mergers or triangular share exchanges allow foreign companies to effect a merger in Japan through a Japanese subsidiary, whereby the shares of the foreign parent company are offered to the shareholders of the target company upon the merger or share exchange.

Sector-specific rules

4 Are companies in specific industries subject to additional regulations and statutes?

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

Transaction agreements

5 Are transaction agreements typically concluded when publicly listed companies are acquired? What law typically governs the agreements?

In a share acquisition through a tender offer, the acquiring party may, but is not required to, conclude an agreement with one or more sellers who agree to tender their shares in the tender offer. Although, in theory, parties are free to choose any law as the governing law of a transaction agreement, Japanese law is usually the governing law of these agreements. In some instances, particularly when the purpose of the tender offer is to form a capital alliance (ie, the target company remains public), the acquirer and the target company conclude a separate agreement that sets out the terms of the alliance as well as the target board's commitment to endorse the tender offer. In a buyout transaction, it is less common for the acquirer and the target company to enter into such agreement, although the acquiring company and the target's board usually negotiate the terms of the tender offer (in particular the tender offer price) and the acquiring company launches the tender offer only after confirming that the board of the target company resolved to endorse and recommend its shareholders to tender their shares in, the tender offer.

On the other hand, mergers, share exchanges and joint share transfers are arrangements strictly governed by the Company Law. The Company Law requires the parties to such arrangement to conclude an agreement (or, in the case of a joint share transfer, a plan of share transfer) that satisfies relevant requirements under the Company Law. For this purpose, it is not uncommon for parties to enter into a simple agreement, with provisions limited to those that are statutorily required, alongside a separate agreement with more detailed terms and conditions regarding the combination (such as reps and warranties). Because the terms of these arrangements are subject to the requirements under the Company Law, they are governed by Japanese law.

In case of a third-party allotment, the acquiring party and the target company typically conclude an agreement governing the transaction. Because the Company Law governs the allotment process, such agreement is usually governed by Japanese law.

FILINGS AND DISCLOSURE

Filings and fees

6 Which government or stock exchange filings are necessary in connection with a business combination or acquisition of a public company? Are there stamp taxes or other government fees in connection with completing these transactions?

Financial Instruments and Exchange Law

Tender Offer Regulations

The Financial Instruments and Exchange Law (the FIE Law) provides certain requirements specific to tender offers as well as disclosure requirements relevant to tender offers, acquisition and holding of block shares, and business combinations. It also provides for insider trading regulations, which are important in practice but are not covered by this chapter.

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), provided that such purchase meets certain criteria and does not fall under any of the statutory exemptions. Without going into the complex details of each of such criteria and exemptions as provided under the FIE Law and pertinent regulations, a mandatory tender offer is typically required if any of the following criteria is met:

- as a result of purchases from more than 10 sellers via off-market transactions within a period of 61 days or less, the 'percentage

ownership' of the purchaser (ie, percentage of voting rights held by the purchaser and certain associated persons) in the target company will exceed 5 per cent;
- as a result of purchases from any number of sellers via off-market transactions or certain trade sale-type market transactions, the percentage ownership of the purchaser in the target company will exceed one-third; or
- as a result of a combination of (1) off-market transactions or certain trade sale-type market transactions involving shares in the target company representing 5 per cent of the total voting rights, and (2) other acquisitions of shares (including subscription of newly issued shares), to be implemented within a three-month period from each other, the voting rights of the purchaser in the target company will increase by more than 10 per cent, and the percentage ownership of the purchaser will exceed one-third of the total voting rights.

Detailed rules are provided in the FIE Law for the purpose of determining the 'percentage ownership' of the purchaser, wherein the shares owned by 'special associated persons' as statutorily defined – such as subsidiaries and any third party who has entered into a voting agreement with the purchaser – are aggregated with shares directly held by the purchaser. The purchaser is generally allowed to set a cap on the percentage of shares that it will acquire as a result of the tender offer (which means that if the number of shares tendered exceeds the cap, the tendered shares will be purchased on a pro-rata basis); however, if the purchaser intends to purchase shares representing two-thirds or more of the total voting rights of the target company, it is required to purchase all the shares tendered (ie, no cap is allowed).

It is also worth noting that it is not permissible to close an off-market purchase that triggers the above-mentioned criteria and then launch a subsequent tender offer; instead, the acquirer must implement the first off-market purchase through a tender offer in such case.

Where a tender offer is required, the purchaser (ie, the offeror) 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. Information to be disclosed includes the purchase price, the tender offer period (from 20 to 60 business days), conditions to the tender offer, the outline of the business plan after the completion of the tender offer, the general information of the purchaser, etc, and the sources of the funds to finance the tender offer. The target company is also required to file a report on its opinion on the tender offer in response to a tender offer.

Filings for issuance of shares

The FIE Law requires public companies to file a securities registration statement or a shelf registration statement in order to implement a primary or secondary offering of its shares in Japan. Therefore, such filing is required to implement a third-party allotment except where no offering activity takes place in Japan.

Also, in the improbable scenario that the securities to be distributed as consideration for a merger, share exchange or share transfer are not subject to disclosure requirements under the FIE Law, the FIE Law requires prior submission of a securities registration statement if the target company in a merger, share exchange or share transfer transaction is a listed company.

Other disclosure regulations

Apart from the regulations discussed above, the FIE Law also provides for other disclosure requirements. If a party acquires more than 5 per cent of the shares of a publicly traded company (namely, 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 purchaser will trigger an obligation to file an amendment report. Further, the FIE Law requires filing of an extraordinary report in the event, inter alia, a listed company or any other company subject to continuous disclosure requirements under the FIE Law (which may be the acquiring company or the target company) decides to:
- implement a merger, share exchange or share transfer;
- engage in, or upon the occurrence of, an event that results in a change in its parent company or major shareholder with 10 per cent or more voting rights, or its major subsidiary that meets certain quantitative thresholds; or
- acquire a subsidiary for a consideration (including fees and expenses pertaining to such acquisition) exceeding a threshold amount determined based on the purchasing company's net asset.

Disclosure requirements under the rules of the Tokyo Stock Exchange also require timely disclosure (ie, a press release) in each of such situations.

Law Concerning Prohibition on Private Monopoly and Preservation of Fair Competition

Under the Law Concerning Prohibition on Private Monopoly and Preservation of Fair Competition (the Anti-monopoly Law), subject to certain exceptions, if a company acquires shares (including by share purchase or by share exchange) in another Japanese or foreign company which, together with its subsidiaries, meets a certain amount of sales in Japan, and after the acquisition, the percentage ownership of the company crosses the voting right threshold of 20 per cent or 50 per cent, such company must file a prior notification with the Japan Fair Trade Commission (JFTC).

Further, under the Anti-monopoly Law, subject to certain threshold requirements and exceptions, a company implementing a merger or companies jointly implementing a share transfer must file a prior notification of such transaction with the JFTC.

If a filing is required, there is a 30-day waiting period (which may be terminated earlier by discretion of the JFTC upon petition by the filing party).

Foreign Exchange and Foreign Trade Law

Under the Foreign Exchange and Foreign Trade Law (the FEFT Law), a foreign investor may be required to file either a prior notification or an ex post facto report with the competent ministers through the Bank of Japan when it acquires shares of a Japanese company. In the event a prior notification is required, there is a 30-day waiting period (which is normally terminated within two-weeks or less after receipt of such notification, but could be extended to up to five months if the competent ministers deems necessary to investigate the notified transaction).

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. A business combination often involves amendments to the company's commercial registration, which are subject to various registration taxes, the amounts of which depend on the matters affected. For example, when new shares (as opposed to treasury shares) are issued by the target company in a third party allotment, amendment to the commercial registration to reflect the incidental increase in its stated capital will require a registration tax of an amount equivalent to 0.7 per cent of the increase in the amount of stated capital. There are no governmental fees charged for a tender offer; however, note that a substantial amount of fees are charged by the tender offer agent (typically an investment bank), which is required to be engaged by the tender offeror under the FIE Law.

Information to be disclosed

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

There are five categories of relevant, major disclosure requirements. The first is a public announcement required by the rules of the relevant stock exchange. The second to the fifth are the filing of an extraordinary report, the filing of a large shareholding report, the filing of a tender offer registration statement (for a tender offer), and the filing of a securities registration statement (for a third-party allotment or share-consideration merger, share exchange or joint share transfer) under the FIE Law. Details of the 'large shareholding report' can be found in 'Disclosure of substantial shareholdings'. All information disclosed by these means will become public information. The items required to be disclosed include an outline of parties, the outline of transactions, the reason for the transaction and the future prospects. Details of these required disclosures differ according to the type of business combination or acquisition.

Disclosure of substantial shareholdings

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

Under the FIE Law, a party that becomes a more than 5 per cent shareholder of a public company (based on the number of shares rather than voting rights) 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 for 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. In addition, in case of sales of a material number of shares that results in (1) a shareholding that is less than one half of the maximum shareholding percentage during the preceding 60-day period and (2) a decrease in shareholding of more than 5 per cent compared to the maximum shareholding percentage, disclosure of the identity of the purchaser and the amount of consideration is required. An increase or decrease of one 1 per cent or more in the shareholding ratio triggers an obligation to file an amendment report.

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 of the end of its fiscal year, except where the 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.

DIRECTORS' AND SHAREHOLDERS' DUTIES AND RIGHTS

Duties of directors and controlling shareholders

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

Under the Company Law, directors of a company (whether public or non-public) owe a fiduciary duty to the company. While this duty has historically been distinguished from a duty owed to the shareholders, the academia suggests that directors' duties include a duty to achieve fairness among shareholders in a situation where interests of the shareholders conflict among themselves (which is typically seen in a management buyout (MBO) situation), and recent court decisions related to MBOs affirm that directors may be liable to shareholders if a director pursues its own or a third party's interest in an MBO or fails to prevent other directors from carrying out such conduct. The Company Law also provides that the directors of a company shall be liable to third parties (including shareholders and creditors) who suffer any damage owing to wilful misconduct or gross negligence of such directors in the course of performing 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.

Approval and appraisal rights

10 What approval rights do shareholders have over business combinations or sales of a public company? Do shareholders have appraisal or similar rights in these transactions?

No shareholder approval is required in case of acquisition of shares in a public company through a tender offer. As a matter of course, each shareholder has the choice not to sell its shares (although it may be eventually squeezed out).

Mergers, share exchanges, and share transfers must be approved by a super-majority resolution of the relevant parties. In small mergers or share exchanges, which fall below certain threshold requirements, shareholders' approval is not required. Also, if one of the parties to a merger or share exchange is a parent with 90 per cent or more voting rights of another party to such merger or share exchange (ie, a short-form merger), shareholder approval at the subsidiary party level is not required. Dissenting shareholders have appraisal rights, except for (1) shareholders of a company whose shareholder approval is not required because it qualifies as a small merger, and (2) the parent entity in case of a short-form merger.

Under the Company Law, a third-party allotment does not require a shareholder approval unless the allotment is made at a preferential price (in which case a super-majority resolution at the target's shareholders meeting is required). However, the rules of the Tokyo Stock Exchange require that, in the event the number of new shares to be issued by a listed company is equal to or more than 25 per cent of the number of outstanding shares, such company must either (1) obtain an opinion from an independent person (such as a third-party committee, outside director or outside statutory auditor) regarding the necessity and adequacy of the offering, or (2) obtain a shareholder approval. In addition, an amendment to the Company Law that came into effect in 2015 introduced a new requirement that, in the event of a third party allotment that results in creating a controlling shareholder (ie, a shareholder holding, directly or indirectly through its subsidiaries, a majority of the entire voting rights), a simple majority shareholder approval at the company's shareholders' meeting would be required if shareholders holding 10 per cent or more of the total voting rights provide the company with a notice of objection during a two-week window following disclosure of the plan of the third-party allotment.

COMPLETING THE TRANSACTION

Hostile transactions

11 What are the special considerations for unsolicited transactions for public companies?

In Japan, the number of hostile transactions is gradually increasing, but the number of those which succeeded remains very small, partly owing to the negative perception 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 accordance with the best interests of the company and its shareholders. 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 acquirer is not able to conduct a due diligence investigation of the target in the case of a hostile takeover, disclosure of publicly traded companies in Japan is sometimes not necessarily sufficient compared to other jurisdictions such as the United States (for example, contents of material agreements are normally not disclosed).

Break-up fees – frustration of additional bidders

12 Which types of break-up and reverse break-up fees are allowed? What are the limitations on a public 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. 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. Also, the decision of a target company's directors to agree to an unreasonably high break-up fee may constitute a breach of their fiduciary duty. In practice, however, break-up fees and reverse break-up fees are unusual in the context of mergers and acquisitions involving a Japanese public company as the target. Some deals do involve certain deal protection mechanisms, but typically the parties agree to no-talk or no-shop clauses with a simple fiduciary out exception without any break-up fees.

Break-up fee arrangements for exclusive negotiation obligations contained in a letter of intent or memorandum of understanding (ie, agreements concluded at a premature stage of the negotiation towards a definitive agreement) are also generally enforceable, though such arrangements are normally limited to the recovery of costs and expenses. It should be noted that there is a high-profile transaction case where the Japanese courts denied a request for injunctive relief based on a letter of intent with binding exclusive negotiation provisions on the ground that monetary compensation may be sufficient remedy.

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.

Government influence

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

Other than in the two cases mentioned in the question and possible intervention in cross-border transactions under the FEFT Law (which is based on national security as well as other concerns), governmental agencies in Japan have no means of restricting 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.

Conditional offers

14 What conditions to a tender offer, exchange offer, merger, plan or scheme of arrangement or other form of business combination are allowed? In a cash transaction, may the financing be conditional? Can the commencement of a tender offer or exchange offer for a public company be subject to conditions?

Conditions to settling a tender offer are statutorily limited to the following: (1) if the number of shares tendered is less than a specified minimum number, no purchase of shares will be made; (2) 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 (3) a tender offer can be withdrawn upon occurrence of a 'material adverse change', which is 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 availability of financing.

It is permissible to publicly disclose a plan to commence a tender offer for a public company subject to satisfaction of certain conditions. However, in order to avoid violating restrictions on 'spreading of rumours' and 'market manipulation' under the Financial Instruments and Exchange Law, the conditions are generally limited to those that are reasonably necessary before commencing a tender offer, such as the obtaining of competition law clearances.

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, joint share transfer or third-party allotment involving publicly traded companies, are rarely subject to many conditions other than necessary shareholder approval, regulatory approval including competition law clearance and closing of agreed-upon ancillary transactions.

Financing

15 If a buyer needs to obtain financing for a transaction involving a public company, how is this dealt with in the transaction documents? What are the typical obligations of the seller to assist in the buyer's financing?

In the event the purchaser in a tender offer needs to obtain financing, it is necessary to attach a document to the tender offer registration statement evidencing a firm commitment by a lender to finance the transaction. Such document should include substantial conditions precedent to the drawdown of the loan, as well as the representations and warranties if they are referred to in such conditions. Because the law does not allow a tender offer to be made conditional on the availability of financing, in theory, it is possible for the buyer to default if a condition precedent to the drawdown of the loan is not satisfied.

There is no specific rule on how to deal with the financing for business combinations other than in the form of a tender offer; parties enjoy a wide discretion in this regard.

Further, there is no typical obligation on the seller to assist in the buyer's financing.

Minority squeeze-out

16 | May minority stockholders of a public company be squeezed out? If so, what steps must be taken and what is the time frame for the process?

Under the Company Law, acquirers are allowed to squeeze out minority shareholders of a public company. While there are a number of options available under the Company Law for implementing a squeeze-out transaction using cash as the consideration, the most common approach is a two-step transaction consisting of (1) a front-end tender offer and (2) a back-end squeeze-out process (most commonly by way of either a 'share consolidation' or a 'demand for sale of share, etc'). Although it is legally permissible to complete a cash-out transaction without launching a tender offer by way of a straightforward cash-out merger or cash-out share exchange, a merger or share exchange is rarely used in a cash-out because of tax implications.

Under a two-step approach, the back-end squeeze-out process is most commonly implemented by way of a share consolidation. Through a share consolidation, a considerable number of shares of the target company will be consolidated into one share, leaving all shareholders other than the acquirers with only a fraction of a single share (ie, less than one share). Subsequent to a tax reform in 2017, cash merger has become another practical option that may be used instead of a share consolidation.

If, as a result of the front-end tender offer, the acquirer and its wholly owned subsidiaries successfully acquire shares representing 90 per cent or more of the total voting rights in the target company, the acquirer usually uses a 'demand for sale of share, etc', which is a fast-track procedure introduced by an amendment to the Company Law, which came into effect on 1 May 2015.

In case of a share consolidation, it normally takes at least three to four weeks for a public company to call a shareholders' meeting after settlement of the tender offer. Also, the effective date of the share consolidation is usually set at a date that is about a month after the date of the shareholders' meeting in order to complete the delisting procedure of the stock exchange. After the effective date of the share consolidation, on which date all minority shareholders will be squeezed out, and subject to obtaining a court approval, either the acquirer or the target company pay cash consideration to the minority shareholders that have been squeezed out in exchange for the fractions of a share left in the hand of such minority shareholders. The amount of consideration paid will be calculated using the tender offer price of the front-end tender offer. A cash-merger also requires a shareholder approval, and it also requires a creditor protection process.

When a 'demand for sale of share, etc' is available, the acquirer is allowed to forcefully purchase all shares held by the minority shareholders without any shareholder approval; this purchase may be implemented with the target company's board approval and notification to the minority shareholders. Absent the need for convening a shareholders' meeting, this process allows the acquirer to complete the squeeze out in approximately 40 days (during which the target company will completes the delisting procedure of the stock exchange) following the settlement of the front-end tender offer.

It should also be noted that a 'demand for sale of share, etc' and a cash merger entitle the acquirer to forcefully purchase all share acquisition rights (ie, stock options) issued by the target company. On the other hand, share acquisition rights cannot be forcefully purchased in the event share consolidation is used as the back-end squeeze-out process and it will require case-by-case consideration on how to deal with such outstanding share acquisition rights.

Waiting or notification periods

17 | Other than as set forth in the competition laws, what are the relevant waiting or notification periods for completing business combinations or acquisitions involving public companies?

Certain waiting periods apply if pre-acquisition filings are required under the Anti-monopoly Law or the FEFT Law. Further, parties to a merger (and certain other types of business combination transactions that involve transfer of debts) 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 this waiting period. Also, a third-party allotment cannot be consummated until the lapse of a 15-day waiting period following the filing of a securities registration statement (or any amendment thereto). Such waiting period may be shortened to seven days in certain circumstances where the issuer has continued to file its securities report for a year or more.

OTHER CONSIDERATIONS

Tax issues

18 | What are the basic tax issues involved in business combinations or acquisitions involving public companies?

Straightforward share acquisitions (including by tender offer) are taxable transactions and the seller will be subject to income taxation for any gains. Sellers are not entitled to tax deferral even if the purchaser's shares are offered as consideration for such acquisition. It has been considered that this is the primary reason why exchange offer is almost unprecedented in Japan, and the Tax Reform in 2018 (as discussed below), combined with the amendment to the Act on Strengthening Industrial Competitiveness (ASIC), is expected to open a practical pathway to the use of exchange offers. If the seller of shares of a Japanese company in share acquisitions is not a resident of Japan, it could be subject to Japanese income taxation for the capital gains; however, an exemption may be available depending on the percentage of its historical ownership of the shares and the number of shares sold or the applicable tax treaty.

Statutory business combination transactions often used in combinations or acquisitions of a public company (namely, merger, share exchange and joint share transfer) can be implemented without income taxation at the time of the transaction (in substance, tax deferral) if these 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 a parent company owning the entire shares of the purchasing company in the case of triangular mergers) is paid out (accordingly, 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 by the surviving entity (in case of a merger), or the wholly owned subsidiary (in case of a share exchange or joint share transfer) (such entities respectively, the surviving entity) or its successor entity if a tax-qualified merger is planned to be consummated by the surviving entity after the business combination; or
- it is implemented to perform 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 by the surviving entity or its successor entity if a tax-qualified merger is planned to be consummated by the surviving entity after the business combination;
- the ratio of the size of the businesses of the parties is within a range of 1:5 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.

In the case of a 'tax-qualified' merger, share exchange or joint share transfer, neither the target company nor its shareholders (ie, the sellers) are 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). 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.

Under the 'group-based corporate taxation' regime, business combination or other transactions taking place between a parent and a wholly owned subsidiary or between wholly owned subsidiaries (both Japanese companies) can in general be implemented without income taxation at the time of the transaction (in substance, tax deferral), regardless of whether the transaction is a statutory business combination or is a tax-qualified restructuring as mentioned above.

The 2017 Tax Reform has adopted some significant changes to the rules mentioned above relating to the tax-free reorganisation. Among other items, a cash-out merger or share exchange will qualify as a tax-free reorganisation (hence no immediate taxation upon the target company), if the buyer already owns at least two-thirds of the shares of the target company (ie, one-third of the shareholders may be cashed out). Also, certain squeeze-out transactions will be captured by the tax-free reorganisation rules; so the target company will be subject to income taxation as a result of the squeeze-out unless certain key requirements for the tax-free reorganisation are met. Further, a spin-off transaction (where a Japanese company will distribute the shares of its wholly owned subsidiary to its shareholders on a pro rata basis) will also be designated as a tax-free reorganisation.

The 2018 Tax Reform provided for a tax deferral treatment to sellers in certain qualifying exchange offers. The exchange offer must be conducted in accordance with a 'plan of special business restructuring,' which must be approved by the competent minister under the ASIC. It should be noted, however, that, among various other conditions, an acquirer that is a non-Japanese company cannot use the tax deferral treatment, since the 'plan of special business restructuring' may only be approved when a Japanese joint stock company plans to use its own shares as the sole consideration for acquiring controlling interests in a target entity.

The 2019 Tax Reform is expected to effectively expand the scope of tax-qualified triangular mergers and other business combinations, by designating as a qualifying share consideration shares of an indirect parent company, in addition to shares of the direct parent company, owning the entire shares of the acquiring company.

Labour and employee benefits

19 What is the basic regulatory framework governing labour and employee benefits in a business combination or acquisition involving a public company?

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, 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 company will continue to apply to the ex-employees of the merged company, even after the merger, unless appropriate arrangements for integration are made.

Restructuring, bankruptcy or receivership

20 What are the special considerations for business combinations or acquisitions 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 warranties or indemnities 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 acquirer should possibly expect a difficult negotiation with the banks or other major creditors.

Anti-corruption and sanctions

21 What are the anti-corruption, anti-bribery and economic sanctions considerations in connection with business combinations with, or acquisitions of, a public company?

Bribery of officials is generally prohibited under Japanese law, but this prohibition is not specific to bribery made in connection with business combinations or acquisitions. That is, bribery of foreign public officials with regard to an international commercial transaction for the purpose of gaining illicit profits is prohibited under the Unfair Competition Prevention Act, and individuals who commit this bribery are subject to imprisonment of up to five years or criminal fines of up to ¥5 million or both, and legal persons whose representative, agent, employee or other servant commit this bribery are also subject to criminal fines of up to ¥300 million. Further, bribery of domestic public officials with regard to the officials' duty is prohibited under the Criminal Code, and those who commit this bribery are subject to imprisonment of up to three years or criminal fines of up to ¥2.5 million or both.

UPDATE AND TRENDS

Key developments

22 What are the current trends in public mergers and acquisitions in your jurisdiction? What can we expect in the near future? Are there current proposals to change the regulatory or statutory framework governing M&A or the financial sector in a way that could affect business combinations with, or acquisitions of, a public company?

No updates at this time.

Coronavirus

23 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

No updates at this time.

NAGASHIMA OHNO & TSUNEMATSU

Sho Awaya
sho_awaya@noandt.com

Yushi Hegawa
yushi_hegawa@noandt.com

JP Tower, 2-7-2 Marunouchi
Chiyoda-ku
Tokyo 100-7036
Japan
Tel: +81 3 6889 7000
Fax: +81 3 6889 8000
www.noandt.com

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