FINANCIER WORLDWIDE corporatefinanceintelligence

NAGASHIMA OHNO & TSUNEMATSU

WORLDWATCH

FOREIGN INVESTMENT

Changes to Japan's legal framework affecting foreign investors

www.financierworldwide.com

FW MAGAZINE

REPRINTED FROM

April 2010 Issue

JAPAN

Changes to Japan's legal framework affecting foreign investors

BY RYUJI SAKAI

When news of Lehman's financial woes was reported in Autumn 2008, there were very few economists or governmental officials who expected that this would severely disturb the Japanese economy. The notion generally then shared was that this was primarily an issue in America and the negative impact on the Japanese economy, if any, would be insignificant and only temporary. In fact, the then Minister of Finance commented that since Japanese financial institutions remain very sound, this is only a mosquito bite. As it turned out, however, it may be the Japanese economy that was most damaged by the Lehman shock and the ensuing turmoil. It is true that Japanese financial institutions were not derailed, but the Japanese economy depended too much on exports to overseas markets, especially America, for its ostensible recovery from the 'lost 20 years', and the Japanese manufacturing industry was unable to deal with the rapid shrinkage in demand in those markets. As a result, even the most formidable corporations in Japan reported a significant amount of losses, and symbolically, JAL, once the well-respected national flag carrier of Japan, applied for corporate reorganisation.

Nobody can predict with certainty how long it will take for the Japanese economy to pick up. For the last several years, the activities of investment in Japan have remained at a relatively low level. Many foreign businesses seem to view China or India as more attractive targets for making investments. However, Japan is still one of the largest markets in the world with a wealthy population of 140 million, and industries in Japan, particularly manufacturing industries with highly developed technologies, have huge potential. The slump of the Japanese economy as a whole should present good investment opportunities for foreign businesses via M&A transactions, joint ventures and other types of affiliations with Japanese companies that are suffering despite their potential.

Recent legal developments for investment in Japan

For foreign investors interested in making investments in Japan, a brief overview of the recent development of the legal framework relevant to such investments will be helpful.

Increased complexity of TOB regulations/stock exchange regulations

Stock acquisitions are implemented through a purchase of issued shares, new shares or a combination thereof. There have been very important regulatory changes that could significantly affect the planning of stock acquisitions of publicly traded Japanese companies.

First, compulsory take over bid ('TOB') requirements, which used to apply only to certain large scale 'off market' purchases of issued shares (typically those purchases from 11 or more sellers resulting in ownership of more than 5 percent of the target during a 61 day period or resulting in ownership of more than one-third of the target), have been amended to cover certain types of combinations of 'off market' purchases and other purchases during a three month period (new share purchases and/or market purchases) resulting in ownership of more than one-third of the target. In addition, if the ownership of the target is expected to reach two-thirds or more after the TOB, it is now required that the buyer offer to purchase 100 percent of the outstanding shares of the target in the TOB. As a result of a series of amendments over the last several years, including the above changes, the TOB regulations have now become extremely complex and contain a number of pitfalls. Further, it seems that the authorities are trying to require a TOB for a transaction that should not require a TOB from a literal reading of the applicable regulations (in the recent KDDI/JCOM deal, e.g., the authorities reportedly took the position that the proposed purchase of closely held intermediate holding companies, which in turn owned the shares of JCOM, a publicly traded company, should be carried out as a TOB for JCOM shares). This means that careful reading of the regulations and analysis of recent practice are very important in order to avoid an unexpected disaster in a given transaction.

Second, the stock exchange regulations have now imposed an important procedural requirement on the issuance of shares by a publicly traded company through a third party allotment. In the past, third party allotment transactions were rather loosely treated, and as long as the pricing was comparable to the then market price and the issuance was within the scope of the authorised share capital, the issuer's board of directors was able to authorise the issuance. However, after August 2009, for an issuance that will significantly dilute the ownership of the existing issued shares (e.g., dilution of 25 percent or more or a change of controlling shareholder), either a shareholders' resolution or the approval by an independent committee, e.g., is required.

Introduction of competition law prior filing requirement for stock acquisitions

It seems to be a norm in many jurisdictions to require a prior filing, for competition law review purposes, for all types of business affiliations and integrations from asset acquisitions to mergers to stock acquisitions. Japan was an exception to this global norm until 2009 in that no prior filing was required for competition law purposes in the case of stock acquisitions. However, this is no longer the case. As of January this year, a legislative change was effected to require a prior filing even for stock acquisitions that satisfy certain thresholds in terms of their size, in addition to business acquisitions, mergers, etc., that were already subject to the prior filing requirement. If it is required, there will be a 30 day waiting period. In practice, it is strongly recommended to submit a draft filing document well in advance, and where substantive issues are expected to arise, a prior consultation with the authorities is a 'must'. This should be factored in when foreign investors make substantive investments in Japanese companies.

Direct regulation over foreign investment in Japan

The Japanese government has continued to implement 'deregulation' for foreign investment since the early 1980s. As a result, governmental approvals (more precisely, 'de facto' approvals through the requirement for prior filings and review of proposed transactions by the government) for equity investments in Japanese companies are needed for only a very few restricted business areas (e.g., ▸▸

This article first appeared in Financier Worldwide's *April 2010 Issue.*
© 2010 Financier Worldwide Limited. Permission to use this reprint has been granted by the publisher.
For further information on Financier Worldwide and its publications, please contact James Lowe on +44 (0)845 345 0456 or by email: james.lowe@financierworldwide.com

defence, aircraft, broadcasting, electricity, oil and gas, fishing, and agriculture). Until recently, the statutory language suggested that whether or not a proposed investment should require approval could be determined based on the businesses conducted by the target company, itself. However, as a result of a legislative change in 2007, it has become clear that this should be determined with reference to the businesses conducted by the target company and its subsidiaries. This approval requirement is applicable even to acquisitions of one share (in the case of privately held companies) and acquisitions resulting in 10 percent or more (in the case of publicly traded companies). Since the business profiles of a target company's subsidiaries are sometimes unclear, even in the case of publicly traded companies subject to various disclosure requirements, foreign investors should be aware of the possibility of an unexpected application of this approval requirement.

Conclusion

The recent developments outlined above are for illustration purposes only as there have been many other important changes to the legal framework in Japan (in particular, those related to publicly traded companies) that may affect investments in Japan by foreign investors. In addition, the Japanese government, now led by the Democratic Party, is planning further changes to the regulations of corporate governance of publicly traded companies. Foreign investors should duly consider the implications of these recent and future changes when they explore investment opportunities in Japan. Be prepared and take the opportunities. ■

Ryuji Sakai
Partner
Tokyo, Japan
T: +81 3 3511 6124
E: ryuji_sakai@noandt.com

Ryuji Sakai advises corporate and other clients, both domestic and foreign, on various corporate matters. Since 2000, M&A has become his core practice. He has also been participating in the governmental project for the translation of Japanese law into English since 2005.

Nagashima Ohno & Tsunematsu, established in 2000, is widely known as a leading law firm in Japan, and a foremost provider of international and commercial legal services. The firm represents domestic and foreign companies and organisations involved in every major industry sector and in every legal service area in Japan. The firm has structured and negotiated many of Japan's largest and most significant corporate and finance transactions, and has extensive litigation strength spanning key commercial areas, including intellectual property and taxation. The firm also has tremendous experience in the international arena, and has successfully negotiated many international transactions involving Japanese companies or Japanese assets. As of 1 March 2010, Nagashima Ohno & Tsunematsu comprises 353 lawyers (including 12 foreign-licensed lawyers). With one of the largest legal teams in the country, the firm brings a wealth of practical knowledge focused on the singular purpose of providing the highest quality of legal services to develop the optimum solution for any business problem or goal that its clients may have. Nagashima Ohno & Tsunematsu, with its knowledge and experience across a full range of practice areas, is always ready to assist its clients in any industry sector in constructing practical solutions to meet their business needs.