The Legal 500 & The In-House Lawyer
Comparative Legal Guide
Japan: Mergers & Acquisitions

This country-specific Q&A gives an overview of mergers and acquisition law, the transaction environment and process as well as any special situations that may occur in Japan.

It also covers market sectors, regulatory authorities, due diligence, deal protection, public disclosure, governing law, director duties and key influencing factors influencing M&A activity over the next two years.

This Q&A is part of the global guide to Mergers & Acquisitions. For a full list of jurisdictional Mergers & Acquisitions Q&As visit http://www.inhouselawyer.co.uk/index.php/practice-areas/mergers-acquisitions/

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1. What are the key rules/laws relevant to M&A and who are the key regulatory authorities?

The law with the most relevance to M&A in Japan is the Companies Act.
And, the following laws, rules and regulations are also important:

- The Financial Instrument and Exchange Act (the "FIEA");
- The Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (the "Anti-Monopoly Act"); and

- The Foreign Exchange and Foreign Trade Act (the “FEFTA”).

In addition to these laws, rules and regulations, there are specialized laws that regulate certain specific business segments such as banking, insurance and broadcasting.

The Legal Affairs Bureau, one of the local organizations of the Ministry of Justice, is responsible for the commercial registry of companies. The Financial Services Agency and the Japan Fair Trade Commission are the key regulatory authorities in the enforcement of the FIEA and the Anti-Monopoly Act, respectively, and there are other competent authorities tasked with supervising specific business segments.

Publicly traded or listed companies are also subject to the supervision of the relevant stock exchange on which their shares are listed in compliance with the applicable rules and regulations of such stock exchange.

2. What is the current state of the market?

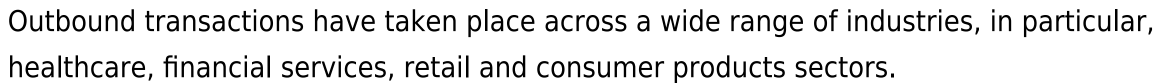
The number of M&A transactions by Japanese companies hit a record high in 2017 with steady growth since 2012, after experiencing a slowdown due to the global financial crisis in 2007 and 2008.

Outbound transactions are sustainable in terms of both the number and value of the deals as many Japanese companies are seeking opportunities for outbound transactions to expand their markets outside Japan.

Global private equity funds have shown a strong presence in recent large-scale transactions in Japan, such as the acquisitions of Calsonic, Hitachi Kokusai Electronics and Hitachi Koki by KKR, the acquisition of Toshiba Memory by a consortium led by Bain Capital, and the acquisition of Asatsu-DK by Bain Capital.

3. Which market sectors have been particularly active recently?

In the Japanese domestic market, investments in venture companies have increased. There has also been an increase in consolidations of Japanese regional banks, which is a recent phenomenon partly resulting from pressure by regulators.



Outbound transactions have taken place across a wide range of industries, in particular, healthcare, financial services, retail and consumer products sectors.

4. **What do you believe will be the three most significant factors influencing M&A activity over the next 2 years?**

First, it goes without saying, but the state of the Japanese economy will influence the Japanese M&A market. For example, because the Japanese market is shrinking in various industries due to the decline in Japan’s population, the recent trend of Japanese companies pursuing outbound transactions is expected to continue for the next few years.

Second, the adoption of corporate governance reforms in Japan may also have an impact on M&A activity. On-going corporate governance reforms are creating pressure on Japanese companies to improve their performance, and as a result, some Japanese companies may become more aggressive in pursuing M&A transactions.

Finally, the development of technology and innovation is expected to affect M&A activity. The development of technology and innovation is expected to not only facilitate an increase in M&A transactions involving venture companies and venture capital (especially in new fields such as artificial intelligence and financial technology (Fintech)), but also affect traditional business sectors. For instance, it would not be surprising to see advances in self- driving and electric vehicles facilitating reorganizations in the automobile sector.

5. **What are the key means of effecting the acquisition of a publicly traded company?**

The acquisition of control of a publicly traded company is most commonly achieved through a tender offer. If the acquirer desires to obtain complete control of the target company, a two-step process is commonly undertaken, consisting of a tender offer followed by a squeeze out, which is described in more detail in our response to Question 27 below.

6. What information relating to a target company will be publicly available and to what extent is a target company obliged to disclose diligence related information to a potential acquirer?

Listed companies are required to make their annual and quarterly reports publicly available. Annual securities reports contain, among other things, (a) a narrative overview of the company and its business, (b) information concerning its material properties, (c) financial information and (d) other information of the company (e.g., information on its shareholders and officers).

On the other hand, the information on private companies that must be made publicly available is very limited. All Japanese companies (listed and private) are required to register certain fundamental information in their commercial registries, which are publicly available, such as the number of its authorized shares and issued shares, the names of its officers, any restrictions on share transfers, etc. Other than the information in their commercial registries or that is otherwise registered publicly, private companies are not required to make any other information publicly available.

Notably, the Japanese court system does not have a system or database that allows the public to search for pending court proceedings. Also, if a company registers its ownership of specific real estate or intellectual property, such ownership may be verified by reviewing the relevant registry; but, a person is not able to initiate a search on a system or database that would give such person a comprehensive listing of all real estate and intellectual properties owned by a specific company.

There is no legal obligation on a target company in Japan to disclose any specific diligence information to a potential acquirer. The target company has sole discretion as to what and how much diligence information it elects to disclose; however, target companies are usually cooperative when the transaction is amicable.

7. To what level of detail is due diligence customarily undertaken?

It is common for an acquirer to perform due diligence in an M&A transaction in Japan. The level of detail of such due diligence depends on various factors, including the size of the transaction, the nature of the target company’s business and the amount of time available for the diligence investigation.

8. What are the key decision-making organs of a target company and what approval rights do shareholders have?

The key decision-making organ of a target company is its board of directors. However, in relatively small transactions, a representative director, or an executive officer who is authorized by a representative director, may have the power to make decisions for the target company on such transactions.

Shareholder approval is required when a Japanese company desires to engage in or conduct certain transactions stipulated in its Articles of Incorporation or by law, e.g., a sale of a subsidiary, a business transfer or certain statutory corporate reorganizations such as a merger or a demerger (kaisha bunkatsu). Although, in each case, if the size of the transaction does not meet a certain threshold, shareholder approval may not be necessary.

9. What are the duties of the directors and controlling shareholders of a target company?

A director owes his or her company a duty of care and a duty of loyalty. Generally speaking, under the business judgement rule in Japan, directors have broad discretion in making business decisions. However, if there is a potential conflict of interest between the interests of a director and his or her company or its shareholders, such as in the case of a management buy-out, an acquisition of a minority stake by a parent company or a hostile takeover, it is generally understood that the business judgement rule does not apply in such situations. Having said so, there are only a few reported court cases in Japan that have dealt with decisions made by directors in the context of M&A transactions, and the courts have not yet established a clear standard to be applied to the decisions of directors under such circumstances.

For controlling shareholders, however, the Companies Act does not explicitly impose any general duties on controlling shareholders to their company or their fellow shareholders. In addition, there are no court decisions on the issue of a controlling shareholder’s duties. But, some scholars have suggested that controlling shareholders should owe fiduciary duties to their companies and their fellow shareholders; however, this view is not the prevailing one.

10. **Do employees/other stakeholders have any specific approval, consultation or other rights?**

In stock-transfer transactions, employees, creditors, business partners or other stakeholders do not have any statutory approval, consultation or other rights under the law. However, these stakeholders may have specific rights granted to them under relevant agreements.

On the other hand, some stakeholders may have specific approval, consultation or other rights in an asset-transfer transaction. Asset deals are often structured to include a contractual asset or business transfer component, a statutory demerger (kaisha bunkatsu) component or both. In the case of a contractual asset or business transfer, the designated contracts and other rights and obligations cannot be transferred without procuring the consent of the relevant counterparties. But, in the case of a statutory demerger, contracts and other rights and obligations specified in the agreement or plan concerning such demerger can be transferred without the necessity of procuring the consent of the relevant counterparties (although they may have specific rights under the contracts). The above notwithstanding, as part of the demerger process, the parties thereto are required by law to undertake certain statutory procedures to protect the interests of employees and creditors and to take certain measures when an employee or creditor raises an objection to the demerger.

11. **To what degree is conditionality an accepted market feature on acquisitions?**

Parties to an acquisition of stock or assets involving a private company are generally free to contract on whatever terms they may agree and are often made conditional upon satisfaction or waiver of various conditions. For example, most such agreements related to private companies contain conditions regarding the absence of any breach of representations and warranties and covenants, and, if applicable, the receipt of regulatory approvals. In addition, the parties often negotiate to include other conditions such as the absence of material adverse changes and the financing of the acquirer.

By contrast, it should be noted that the withdrawal of a tender offer bid on a listed company is only permitted under the fairly limited circumstances enumerated in the FIEA, such as the decision of the target company to implement anti-takeover measures

or the suspension of the target company’s business. In practice, there have been almost no cases where a tender offer bid has been withdrawn after its commencement.

12. What steps can an acquirer of a target company take to secure deal exclusivity?

Deal exclusivity is typically only found in transactions in which the controlling shareholders of the target company are involved in the marketing and sales process and when the acquirer is able to successfully negotiate a grant of deal exclusivity from the controlling shareholders.

If the controlling shareholders of the target company are not involved in the marketing and sales process, the acquirer will need to negotiate with the target company to obtain deal exclusivity. It is more difficult and less common for the acquirer to receive deal exclusivity in such case, because there is concern among directors that granting deal exclusivity may result in the breach of their duties to the target company.

13. What other deal protection and costs coverage mechanisms are most frequently used by acquirers?

In transactions in which the controlling shareholders of the target company are involved in the process to market and sell the company, the acquirer will typically enter into a definitive agreement directly with such controlling shareholder. The controlling shareholders, in such definitive agreements, may negotiate and include certain deal-protection mechanisms that restrict the ability of the controlling shareholder to terminate the agreement or to shop for or accept a better deal.

On the contrary, if the controlling shareholders of the target company are not involved in the process to market and sell the company, the acquirer will typically enter into a definitive agreement directly with the target company. However, in the context of a tender offer bid, it is not always easy for the acquirer to enter into a definitive agreement with the target company because of the duties owed by the directors of the target company. Even in the case where the target company agrees to enter into an agreement with the acquirer, which will bind the board of directors of the target company to support the transaction, the target company frequently insists on including a “fiduciary out” provision. In such case, it is common for the acquirer to try to negotiate

for a reasonable break-up fee in the definitive agreement to provide the acquirer with a certain degree of deal protection.

14. Which forms of consideration are most commonly used?

Cash is the most commonly used form of consideration in both public and private deals.

Non-cash forms of consideration are much less frequently used; but, shares are used as a form of consideration in a share exchange, which is a type of statutory corporate reorganizations by which an acquirer acquires all the shares of a target company from its shareholders. It is also possible for an acquirer (including a foreign company) to establish a Japanese subsidiary and to cause such subsidiary to conduct a merger or share exchange in exchange for the shares of such acquirer (so-called triangular mergers or triangular share exchanges). However, in practice, the use of such triangular merger or triangular share exchange transactions is not common in Japan.

15. At what ownership levels by an acquirer is public disclosure required (whether acquiring a target company as a whole or a minority stake)?

When the shareholding ratio of the shares held by an acquirer exceeds 5%, such acquirer must file a large shareholding report with the relevant Local Finance Bureau, which includes the following information: purpose of the shareholding, changes in the shareholding during the last 60 days, source of funding used for the acquisition of the shares and any material agreement relating to the shares.

16. At what stage of negotiation is public disclosure required or customary?

Under the Stock Exchange Rules, a listed company must disclose material information when certain decisions are made by the company in connection with an M&A transaction. Similarly, under the FIEA, a company that is obliged to submit an annual securities report must submit an extraordinary report when certain material decisions are made in connection with an M&A transaction.

In practice, companies try to avoid making a decision in an M&A transaction that would trigger any such disclosure obligation until the parties enter into a definitive agreement with respect to such transaction.

17. Is there any maximum time period for negotiations or due diligence?

There are no limitations (maximum or minimum) under the laws of Japan on the amount of time the parties can take for negotiations and due diligence. Practically speaking, when one party has more bargaining power in a transaction (e.g., the seller in an auction), that party will sometimes unilaterally set the schedule for negotiation and due diligence for the transaction.

18. Are there any circumstances where a minimum price may be set for the shares in a target company?

There are no requirements under the laws of Japan that mandate when a certain minimum price be set for the shares in a target company.

However, in a tender offer transaction, the acquirer must offer the same price per share to all shareholders of the target company. Also, in the two-step process described in our response to Question 5 above, it is common for the price per share to be paid in the squeeze-out to the minority shareholders who did not accept the tender offer to be set equal to the tender offer price.

19. Is it possible for target companies to provide financial assistance?

There is no general prohibition under the laws of Japan on target companies providing financial assistance to acquirers. However, if there are minority shareholders of the target company when financing is made, providing financial assistance to an acquirer would be considered to be for the benefit of the majority shareholders only, which would raise the issue of breach of duties of the directors of the target company. Accordingly, the provision of a guarantee or the grant of a security interest by the target company is usually suspended until target company becomes wholly-owned by the acquirer.

20. Which governing law is customarily used on acquisitions?

In share transfer or business transfer agreements, the parties to an acquisition are free to select the laws of a jurisdiction other than Japan to be the governing law for such agreements. However, the laws of Japan have been selected by most parties to be the governing law in such agreements, because the effects of the Companies Act cannot be completely eliminated from such agreements. Certain matters, e.g., the validity of the share transfer, are determined in accordance with Japanese law, regardless of what law is chosen as the governing law in the agreement.

On the other hand, an agreement concerning a statutory corporate reorganization, such as a merger agreement, a demerger agreement, and a share exchange (kabushiki koukan) agreement, must satisfy the requirements provided in the Companies Act and such requirements must be governed by Japanese law.

21. What public-facing documentation must a buyer produce in connection with the acquisition of a listed company?

As we describe in more detail in our response to Question 25 below, an acquirer may be required to make a tender offer bid when acquiring the shares of a listed company. A tender offer is commenced by the tender offeror when it posts a public notice followed by its filing of a tender offer registration statement. In response, the target company must file its position statements. All these documents are available to the public on EDINET (Electronic Disclosure for Investors' NETwork), an electronic corporate disclosure system under the FIEA. The material portions of these documents are also disclosed in the press releases of the acquirer and the target company.

In addition, as we described in more detail in our response to Question 15 above, when an acquirer acquires more than 5% of the total outstanding shares of a listed company, the acquirer needs to prepare and file a large shareholding report.

In the case where an acquirer acquires a listed company by way of a statutory corporate reorganization (including the acquisition of only part of the businesses or assets of such listed company), the acquirer must prepare certain documents setting out certain information concerning such corporate restructuring and must make such documents available for inspection by the shareholders and creditors of each party.

22. What formalities are required in order to document a transfer of shares, including any local transfer taxes or duties?

For a private company, in addition to a share transfer agreement between the parties, if the target company is a company that issues share certificates (the Companies Act allows private companies to choose whether they will issue share certificates or not), the seller must deliver the relevant share certificates to the acquirer. Further, regardless of whether or not the target company issues share certificates, the shareholder registry must be updated in order for the acquirer to perfect the share transfer. The Articles of Incorporation of private companies usually contain a provision that requires the approval of the board of directors or the shareholders for a share transfer. In such case, a resolution must be approved at a board of directors' meeting or shareholders' meeting, as applicable, and the minutes to record such resolution must be prepared.

For a public company, the transfer of shares of a listed company will become effective when the share transfer is recorded in the account of the acquirer at the relevant account management institutions (typically, the relevant securities companies).

No transfer taxes or duties are imposed on the transfer of shares of public or private companies in Japan.

23. Are hostile acquisitions a common feature?

Hostile acquisitions are very rare in Japan. The few attempted hostile acquisitions made in the past mostly ended in failure.

24. What protections do directors of a target company have against a hostile approach?

Many listed companies have adopted pre-warning types of anti-hostile takeover plans. These companies have adopted and disclosed rules that potential acquirers need to follow when they desire to acquire shares of such company in excess of a certain percentage, and that warn that if the acquirers do not comply with such rules, the company will take defensive measures. The intention of these rules is to secure the time and an opportunity for its shareholders to obtain sufficient information from the potential acquirer and to carefully consider its proposal. In addition, in many cases, pre-warning

types of anti-hostile takeover plans allow the target company to take defensive measures against acquisitions that are determined by it to have the potential to cause clear harm to its corporate values even if the acquirer complies with the rules. Notwithstanding the above, it is not necessarily clear under what situations a target company will be allowed to take defensive measures under a pre-warning type of anti-hostile takeover plan.

Regardless of whether a target company has adopted such an anti-hostile takeover plan, in the tender offer process, the target company has the right to submit questions in its position statements to the potential acquirer, and the potential acquirer must respond (or explain its reason for not responding) within 5 business days. Also, there are other defensive measures available, for example, the acquisition of shares by a white knight. But, directors should be cautious in implementing such measures to avoid breaching their duties to the company.

25. Are there circumstances where a buyer may have to make a mandatory or compulsory offer for a target company?

The tender offer rules under the laws of Japan are very complicated, but unless any of the exemptions (e.g., exercise of stock options, transactions within a group, acquisition by a parent) apply, if the target company is a corporation or other entity that is obliged to submit an annual securities report, a tender offer is typically required in the following instances:

(i) a purchase of shares outside of any stock exchange market from more than ten (10) sellers within a sixty-one (61)–day period and where, as a result of such purchases, the shareholding ratio of the acquirer exceeds five percent (5%);

(ii) a purchase of shares outside of any stock exchange market where, as a result of such purchase, the shareholding ratio of the acquirer exceeds one-third (1/3); or

(iii) a purchase of shares in excess of ten percent (10%) of the total voting rights of the target company during a three (3)-month period by way of purchases of shares or by way of the acquisition of newly issued shares (but only if such acquisition is in excess of ten percent (10%), which includes purchases of more than five percent (5%) of the

shares made outside of the stock exchange market or through off-hour trading), and where, as a result of such purchases, the shareholding ratio of the acquirer exceeds one-third (1/3).

If the acquirer seeks to acquire two-thirds (2/3) or more of the voting rights of the target company, the acquirer is not permitted to set an upper limit and is required to acquire all tendered securities.

26. If an acquirer does not obtain full control of a target company, what rights do minority shareholders enjoy?

Minority shareholders continue to enjoy full rights as shareholders, such as voting rights and rights to receive distributions of dividends.

In addition to those rights held by every shareholder, minority shareholders also enjoy so-called “minority shareholder rights” which include, inter alia, the following:

- a right to bring an action to confirm the non-existence or nullifications of certain corporate actions (e.g., issuances of shares and certain statutory corporate reorganizations such as merger);
- a right to bring an action to confirm the non-existence or nullifications of a resolution of a shareholders meeting;
- a right to bring an action to rescind a resolution of a shareholders meeting;
- a right to bring an action to demand that the company cease certain corporate actions (e.g., issuances of shares and certain statutory corporate reorganizations such as merger);
- a right to request the disclosure of the shareholder registry, the minutes of a shareholders’ meeting or a board of directors’ meeting or the financial statements of the company;
- a right to bring a shareholder’s derivative suit against the officers of the company;
- a right to demand that a director cease an action that is in violation of law or regulation or the articles of incorporation of the company;
- a right to require that the directors include an agenda item proposed by the shareholder in the agenda of a shareholders’ meeting;

- a right to request that the directors convene a shareholders’ meeting; and
- a right to require that the court appoint an inspector to investigate the procedures for convening a shareholders’ meeting and adopting resolutions thereat.

27. Is a mechanism available to compulsorily acquire minority stakes?

If the acquirer holds 90% or more of the total voting rights of the target company as a result of a tender offer or otherwise, the acquirer has a statutory call option right by which the acquirer can require all of the minority shareholders to sell their shares to the acquirer without needing to pass a resolution at a shareholders’ meeting.

If a majority shareholder owns less than 90% of the total outstanding shares of the target company, the acquirer can still make the target company a wholly-owned subsidiary if a resolution is passed by super-majority vote (requiring two-thirds or more affirmative votes) at a shareholders’ meeting of the target company. There are a variety of methods for squeezing-out minority shareholders. The most prevalent method is to use a reverse share split, which reduces the number of shares of the target company by a ratio that results in all of the minority shareholders owning less than one share, at which point they cease to be shareholders in the target company. The same result can also be achieved by a cash-out merger or share exchange between the majority shareholder and the target company, but the tax implications of such cash-out merger or share exchange used to create a major barrier to the use of them for squeeze-outs. However, as a result of recent tax reforms, a cash-out merger or share exchange between the majority shareholder and the target company has become more tax efficient when the majority shareholder holds two-thirds or more of the total issued and outstanding shares of the target company. As such, it is anticipated that the cash-out merger or share exchange structure will be widely used for the squeeze-out process moving forward.