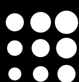
**Practice Guides**

# JAPAN M&A

**Second Edition**

Contributing Editor
Tatsuya Morita



LEXOLOGY
Getting the Deal Through

# JAPAN M&A

## Practice Guide

Second edition

Contributing Editor
Tatsuya Morita

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# Regulatory Issues and Hurdles for M&A in Japan

**Kosuke Hamaguchi and Ryohei Tanaka**[1]

## Introduction

When it comes to the regulatory regime in relation to M&A transactions in Japan, there are two major obstacles that foreign investors or acquirers should keep in mind: foreign investment control and merger control. Generally speaking, as the regulatory hurdles for M&A in Japan are not so stringent compared with many other jurisdictions, it would be advisable, in the early stages of the entire process, to meticulously identify the issues, assess their implications and prepare for scrutinised review by the government authority. This chapter discusses the legal framework and recent practical challenges in relation to these two issues.

## Legal framework of foreign investment control in Japan

The Foreign Exchange and Foreign Trade Act (FEFTA) is the primary Japanese legislation that governs foreign investment. Where a foreign investor either acquires shares of a non-listed Japanese company from a seller who is not a foreign investor or acquires a certain number of shares of a listed Japanese company whereby the shareholding ratio or voting ratio of such foreign investor after the share acquisition is at least 1 per cent, this acquisition generally falls under a regulated investment classification referred to as 'inward direct investment, etc' (inward direct investment) under the FEFTA. In addition, an acquisition by a foreign investor of businesses from a Japanese entity through a business transfer, demerger or merger constitutes an inward direct investment. The purchaser who carries out an inward direct investment would generally be required to file either a prior notice or an ex post facto report, subject to certain exemptions. In the case of an acquisition by a foreign investor of shares of a non-listed Japanese company where the seller is another foreign investor, such acquisition falls under another regulated investment classification referred to as a 'specified acquisition' and the purchaser would generally be required to file a prior notice if such non-listed company engages in certain categories of businesses.

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1 Kosuke Hamaguchi and Ryohei Tanaka are partners at Nagashima Ohno & Tsunematsu.



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In general, the Japanese government has been relatively lenient in terms of foreign investment control and has very rarely blocked transactions under the FEFTA. However, this trend is changing in response to the global trend toward tightening foreign investment control. We have seen a number of cases where the Japanese government has scrutinised an inward direct investment and imposed certain restrictions on a foreign investor under the current regime.

## Inward direct investment

### *Prior notice requirement*

If either (or both) of the following conditions are met, a foreign investor must file a prior notice before completion of an inward direct investment unless certain exemptions (as explained below) apply:

- the target company or any of its affiliates conducts any of the businesses designated by the Japanese government as requiring the filing of a prior notice (the Specified Businesses, a list of which is set forth below); or
- the 'foreign investor' is from a country or region that is not included in the list of approved countries and regions set forth in the FEFTA (ie, Iraq, North Korea, Somalia and Yemen).

The Specified Businesses are:

- businesses related to national security (eg, manufacturing activities or software development related to weapons, aircraft, satellites or rockets, or nuclear energy);
- businesses related to public infrastructure (eg, production and/or supply of electricity or gas, heat supply, telecommunications, broadcasting, water-related services and railways and passenger transport);
- business related to dataprocessing (eg, manufacturing activities with respect to data-processing-related equipment and parts, and development of data-processing-related software);
- businesses related to medical care (eg, manufacturing activities related to certain medical drugs for infectious diseases or specially controlled medical devices); and
- certain other regulated businesses (eg, businesses related to agriculture, forestry and fishing, petroleum, leather and leather goods manufacturing, air and marine transport, and security services).

In principle, if a foreign investor is required to file a prior notice, such investor will not be allowed to complete an inward direct investment until the passage of 30 days from the date the government authority receives the prior notice. However, in practice, such waiting period is typically reduced to two weeks for most filings. In some cases, the relevant authorities may further reduce the waiting period to five business days from the date of receipt of the prior notice. However, if the government authority determines that additional time is necessary to investigate, for instance, whether the investment impairs national security, disturbs the maintenance of public infrastructure or hinders the protection of public safety, or whether the investment has a significant adverse effect on the seamless management of the Japanese economy, it may extend the waiting period (often to four and occasionally up to five months), although such extensions are rare. In practice, the government authority implements a stringent review process with regard to investments involving the Core Businesses (as explained below) or those made from certain countries and regions such as China (although China is on the list of approved countries and



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regions as described above). In the case of such potentially sensitive inward direct investments, it would be advisable to undertake a pre-consultation process with the government authority before filing a prior notice to ensure the timely review by the government authority and gauge the likelihood of obtaining clearance. Once the waiting period has elapsed without objection by the relevant government authority, the foreign investor is allowed to complete the investment.

In the course of the review, the government authority may request a foreign investor or other parties to the investment to provide certain relevant information. In this case, the review process continues until the requested information has been provided and the government authority has assessed the information in order to make its determination. Such information requests can span various topics such as the identity and other basic information of the foreign investor, purposes and key terms of the potential investment, details of the concerned technology and businesses, and the information management system of the foreign investor. In practice, if the review is not expected to be completed until the expiry of the initial waiting period, the foreign investor is often encouraged to withdraw and refile the prior notice so that the government authority does not have to extend the waiting period. In addition, the government authority may request the foreign investor to wait to file the prior notice until the government authority feels comfortable with starting the waiting period. As a result of the review, the government authority may request the foreign investor to abide by certain conditions in order to allow it to proceed with the investment.

Under the FEFTA, a foreign investor who files a prior notice pertaining to an inward direct investment must also file a separate report upon the completion of the investment. Such foreign investor must file such report within 45 days from the date of the completion of the investment.

*Exemptions from prior notice obligation*

With respect to inward direct investment by way of share acquisition, a prior notice is not required as long as certain conditions are met. First, in the event that a foreign investor is a foreign financial institution that is regulated or supervised under Japanese laws and regulations or equivalent foreign laws (a Foreign Financial Institution), such foreign investor who intends to acquire shares of a listed company is exempted from filing a prior notice as long as it complies with the following requirements:

- the foreign investor or its affiliates will not become a director or statutory auditor of the target company;
- the foreign investor will not propose an agenda item regarding the transfer or cessation of any of the Specified Businesses; and
- the foreign investor will not have access to any information on non-public technology belonging to the Specified Businesses (collectively, the exemption requirements).

In addition, a foreign investor, whether a Foreign Financial Institution or otherwise, who intends to acquire shares of either a listed company or a non-listed company is entitled to exemption from the prior notice obligation as long as the foreign investor complies with the exemption requirements and the target company is not engaged in the limited categories of the Specified Businesses, including the following (collectively, the Core Businesses):

- businesses related to weapons, aircraft, satellites or rockets, or nuclear energy;
- certain types of cyber security-related services;



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- manufacturing activities related to certain medical drugs for infectious diseases or specially controlled medical devices;
- certain types of production and/or supply of electricity or gas;
- certain types of telecommunications services;
- certain types of water-related services;
- businesses related to railways; and
- businesses related to petroleum.

However, even if the target company is engaged in any of the Core Businesses, a prior notice is not required with respect to the acquisition of the shares of a listed company whereby the shareholding ratio or voting ratio of such foreign investor after the share acquisition is 1 per cent or more but less than 10 per cent, as long as the foreign investor complies with the exemption requirements and the following additional requirements: the foreign investor, with respect to any of the Core Businesses, will not participate or delegate someone to participate in the target company's board of directors or another important body that has authority to decide on important matters and will not make a written proposal to the target company's board of directors or such other body, or a member thereof, requesting that certain actions be taken before a specified deadline. Such exemption with respect to the Core Businesses is not applicable to the acquisition of shares of a non-listed company. A foreign investor who was sanctioned because of a violation of the FEFTA or is a certain government entity specified under the FEFTA is not allowed to benefit from the exemptions.

*Ex post facto report*

If a foreign investor makes an inward direct investment that is not subject to a prior notice or is subject to any of the exemptions from the prior notice obligation, such foreign investor will generally be required to file an ex post facto report with the government authority. The filing of an ex post facto report is a relatively simple procedure that only requires the completion and submission of a short-form report within 45 days after the completion of the inward direct investment.

With respect to an acquisition by a foreign investor other than a Foreign Financial Institution of the shares of a listed company to which the exemptions from the prior notice obligation apply, such foreign investor needs to file an ex post facto report in the following circumstances:

- when its shareholding ratio or voting ratio reaches 1 per cent or more for the first time;
- when its shareholding ratio or voting ratio reaches 3 per cent or more for the first time; and
- for every share acquisition whereby the shareholding ratio or voting ratio of such foreign investor after the share acquisition is 10 per cent or more.

In case of an acquisition by a foreign investor of the shares of a listed company in other circumstances, the threshold of an ex-post fact report is 10 per cent.

With respect to an acquisition of the shares of a non-listed company that is not engaged in any of the Specified Businesses, a foreign investor is not required to file an ex-post fact report if the shareholding ratio or voting ratio of such foreign investor after the share acquisition is less than 10 per cent.



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*Corrective measures imposed by the Japanese government*

If, in the following scenarios, the government authority determines that the inward direct investment is likely to undermine national security, it may order the foreign investor that has conducted the inward direct investment to take corrective measures such as disposing of all or part of the acquired shares:

- the foreign investor conducted the inward direct investment without filing the required prior notice;
- the foreign investor conducted the inward direct investment before the waiting period had elapsed;
- the foreign investor made a false statement in the prior notice; or
- the foreign investor did not comply with, or violated, a government order.

### Specified acquisition

As discussed above, a specified acquisition is a transaction whereby a foreign investor acquires a certain number of shares of a non-listed company from another foreign investor. If the target company or any of its affiliates conducts any of the businesses designated as requiring the filing of a prior notice, the foreign investor must file a prior notice before acquiring the subject shares of such target company. The major categories of businesses subject to the prior notice requirement are provided separately from the Specified Businesses although some of them overlap. As is the case with an inward direct investment, a foreign investor may rely on the exemptions from the prior notice obligation in the case where a target company engages in businesses other than the Core Businesses. On the other hand, no exemption applies in the case of an acquisition of the shares of a non-listed company that conducts any of the Core Businesses.

The filing requirements and procedures, as well as the subsequent reporting requirements, are the same as those for an inward direct investment. Unlike an inward direct investment, an ex post facto report is not required for a specified acquisition.

Similar to an inward direct investment, the government authority has the authority to order a foreign investor who is in violation of the regulations to take corrective measures.

### Other regulated actions under the FEFTA

If a foreign investor intends to approve any of the following actions, a prior notice is required under the FEFTA:

1. substantive change in the business purpose of a domestic company, thereby expanding it to include any of the Specified Businesses, in the case where the voting ratio of a foreign investor is more than one-third of all voting rights;
2. an agenda item to appoint a foreign investor or its affiliated person as a director or statutory auditor of a domestic company that conducts any of the Specified Businesses; or
3. dispose of all or part of the businesses, merger, demerger, dispose of all or part of the shares in a subsidiary, dividend in kind, dissolution or close of the business, in each case, in relation to the Specified Businesses, if a relevant agenda item is proposed to a shareholders meeting by a foreign investor or through other shareholders.

With respect to (2) and (3), if a target domestic company is a listed company, a prior notice is not necessary if a foreign investor holds less than 1 per cent of the voting rights. The government authority reviews those actions as set out in (2) and (3) solely for the purposes of preventing leak



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of technology information or loss of certain business activities in relation to national security. The government authority is expected to issue a decision granting clearance within five business days if no concern is identified from a national security perspective.

This category of the prior notice is required separately from, and in addition to, the one required for a share acquisition. Contrary to a share acquisition, no exemption from the prior notice obligation applies to this category.

### Foreign investment control under industry-specific regulations

In addition to the FEFTA, share acquisition by a foreign person or entity is also subject to industry-specific regulations.

For example, a licensed domestic air carrier must not be a foreign person or entity or a corporation where a foreign person or entity is a representative of, or constitutes one-third or more of the officers or holds one-third or more of all of the voting rights of, such domestic air carrier. If a licensed domestic air carrier violates this rule, its licence will be revoked by the relevant government authority. In this regard, a licensed domestic air carrier, when requested by a foreign person or entity to register the shares acquired by such person or entity in the shareholder registry of the air carrier, may refuse such request if it would result in the revocation of its licence in accordance with the rule mentioned above. Similar regulations apply in the fields of freight forwarding, radio stations or broadcasting (in the case of broadcasting the threshold with respect to the proportion of officers that can be foreign persons or entities or voting rights that can be held by such persons or entities is one-fifth rather than one-third).

There are other regulations on share acquisition regarding the financial industry. Namely, a person who holds more than 5 per cent of the voting rights of a bank or insurance company (including a holding company that has a bank or insurance company as a subsidiary) is required to submit a notification to the Commissioner of the Financial Services Agency. In addition, a person whose voting rights ratio is expected to reach or exceed the major shareholder threshold (meaning 20 per cent or, if such person is expected to have a material influence over the financial and commercial decisions of the target, 15 per cent) must obtain the prior approval of the Commissioner of the Financial Services Agency. There are also other regulations in connection with M&A transactions in the financial industry, and therefore parties carrying out such transactions need to exercise caution regarding the details of the requisite process and regulatory requirements.

## Legal framework of merger control in Japan

The Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947, as amended) (the Antimonopoly Act) prohibits those mergers that may result in substantial restraint of competition in any particular field of trade and provides filing requirements for certain mergers. The Japan Fair Trade Commission (JFTC) is the sole authority that reviews merger control filings. The Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combination (the Merger Guidelines) published by the JFTC describe an analytical framework used by the JFTC in its merger control review. In addition, the Policies Concerning Procedures of Review of Business Combination (the Review Policies) published by the JFTC set forth the JFTC's merger review procedures.



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## Triggers and thresholds

*Triggers*

The Antimonopoly Act takes a formalistic approach rather than using the concept of control to determine whether a transaction triggers a notification requirement. The following transactions are prohibited if they result in substantial restraint of competition:

- share acquisitions;
- joint share transfers (*kyodo-kabushiki-iten*);
- appointment of interlocking directorships;
- mergers;
- company splits (*kaisha-bunkatsu*);
- transfers of all or a significant part of the business;
- transfers of all or a significant part of the business's fixed assets;
- leases of all or a significant part of the business;
- delegations of management regarding all or a significant part of the business; and
- contractual arrangements to share business profits and losses.

Among the types of transactions listed above, share acquisitions (only if the voting rights ratio held by the acquiring company group in a target company exceeds either 20 per cent or 50 per cent as a result of the share acquisition), joint share transfers, mergers, company splits, transfers of all or a significant part of the business and transfers of all or a significant part of the business's fixed assets are subject to prior notification requirements if certain thresholds are met. There are no filing requirements for other types of transactions, such as the appointment of interlocking directorships.

*Thresholds*

Different jurisdictional thresholds apply depending on the categories of the transaction structure, which are defined based on the Japanese Companies Act. As a result, in some cases it is not clear which category a given foreign transaction would fall under. Moreover, even for a transaction that could be understood as an acquisition of a business as a whole, the JFTC takes a formalistic approach by breaking down the transaction by structure to determine the transaction categories and the number of notifications required. For example, a global transaction could be recognised as a combination of multiple share acquisitions and business transfers.

Share acquisition

Prior notification is required for a share acquisition if all of the following thresholds are met:

- as a result of the share acquisition, the voting rights ratio held by an acquiring company group in a target company exceeds either 20 per cent or 50 per cent;
- the total Japanese turnover generated by the acquiring company group for the last fiscal year exceeds ¥20 billion; and
- the total Japanese turnover generated by the target company and its subsidiaries for the last fiscal year exceeds ¥5 billion.



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### Joint share transfers

A joint share transfer is a type of transaction under the Japanese Companies Act in which two or more companies establish a new common holding company. Prior notification is required for a joint share transfer if all of the following thresholds are met:

- the total Japanese turnover generated for the last fiscal year by one of the company groups participating in the joint share transfer exceeds ¥20 billion; and
- the total Japanese turnover generated for the last fiscal year by one of the other company groups participating in the joint share transfer exceeds ¥5 billion.

### Merger

Prior notification is required for a merger if all of the following thresholds are met:

- the total Japanese turnover generated for the last fiscal year by one of the company groups participating in the merger exceeds ¥20 billion; and
- the total Japanese turnover generated for the last fiscal year by one of the other company groups participating in the merger exceeds ¥5 billion.

### Incorporation-type company split

Prior notification is required for an incorporation-type company split if any of the following thresholds are met:

- the total Japanese turnover generated for the last fiscal year by one of the company groups splitting all of its business exceeds ¥20 billion and the total Japanese turnover generated for the last fiscal year by the other company group splitting all of its business exceeds ¥5 billion;
- the total Japanese turnover generated for the last fiscal year by one of the company groups splitting all of its business exceeds ¥20 billion and the Japanese turnover generated from the corresponding business for the last fiscal year exceeds ¥3 billion if the other company group splits a substantial part of its business;
- the total Japanese turnover generated for the last fiscal year by one of the company groups splitting all of its business exceeds ¥5 billion and the Japanese turnover generated from the corresponding business for the last fiscal year exceeds ¥10 billion if the other company group splits a substantial part of its business; or
- the Japanese turnover generated from the corresponding business for the last fiscal year exceeds ¥10 billion if one of the company groups splits a substantial part of its business and the Japanese turnover generated from the corresponding business for the last fiscal year exceeds ¥3 billion if the other company group splits all or a part of its business.

### Absorption-type company split

Prior notification is required for an absorption-type company split if any of the following thresholds are met:

- the total Japanese turnover generated for the last fiscal year by the company group splitting all of its business exceeds ¥20 billion and the total Japanese turnover generated for the last fiscal year by the absorbing company group exceeds ¥5 billion;
- the total Japanese turnover generated for the last fiscal year by the company group splitting all of its business exceeds ¥5 billion and the total Japanese turnover generated for the last fiscal year by the absorbing company group exceeds ¥20 billion;



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- the Japanese turnover generated from the corresponding business for the last fiscal year exceeds ¥10 billion if the company splits a substantial part of its business and the total Japanese turnover generated for the last fiscal year by the absorbing company group exceeds ¥5 billion; or
- the Japanese turnover generated from the corresponding business for the last fiscal year exceeds ¥3 billion if the group splits a substantial part of its business and the total Japanese turnover generated for the last fiscal year by the absorbing company group exceeds ¥20 billion.

#### Business transfer or business asset transfer

Prior notification is required for a business transfer or business asset transfer if the following thresholds are met:

- the total Japanese turnover generated by the transferee's company group for the last fiscal year exceeds ¥20 billion; and
- the transaction involves any of the following:
  - acquiring all of the business of a company that generated total Japanese sales of more than ¥3 billion for the last fiscal year;
  - acquiring a substantial part of the business of a company, and the part of the business to be transferred generated a Japanese turnover for the last fiscal year of more than ¥3 billion; or
  - acquiring all or a substantial part of the business assets of a company, and the business assets to be transferred generated a Japanese turnover for the last fiscal year of more than ¥3 billion.

#### Value of transaction test

On 17 December 2019 the JFTC revised the Review Policies. Under the new policies, the JFTC encourages parties to consult the JFTC even if the transaction does not meet the above turnover thresholds if the value of the transaction exceeds ¥40 billion and falls under any of the following:

- the target company has a business base of operations or research and development facility in Japan;
- the target company is conducting marketing activities in relation to Japanese customers, including setting up a Japanese language webpage or preparing Japanese language leaflets; or
- the target company generated Japanese sales of more than ¥100 million.

### Duration and timetables

Notification is compulsory if the thresholds are met. There is no deadline for notification, provided that the transaction is not implemented before the lapse of the 30-day waiting period.

There is no clear rule as to the stage in the transaction timetable at which the JFTC will accept the notification. However, the outline of the transaction structure must be clear and the acquiring entity must be established and identified, as the filing form that needs to be used is different depending on the transaction category and the filing must be made by each acquiring company. Other than the above, in general, the JFTC will accept the notification if the parties can show a good faith intention to close the transaction. A copy of the definitive agreement is generally required to be submitted to the JFTC together with the notification as a supplemental



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document. Parties may, however, file on the basis of a less formal agreement such as a letter of intent or memorandum of understanding.

Once the notification is duly accepted by the JFTC, the JFTC will issue an acceptance notice setting out the case number and the date of the acceptance of the notification. The 30-day waiting period starts from the date of the acceptance of the notification (Phase I). Upon request from the parties, the JFTC may, at its sole discretion, shorten the 30-day waiting period and issue a decision granting clearance.

Within 30 days from the acceptance of the filing, the JFTC needs to decide whether to clear the transaction or move to Phase II. If the JFTC does not issue an information request (defined below) during Phase I, the transaction is deemed to have been cleared. In practice, pre-notification discussions are typically held between the JFTC and the relevant parties in relatively complex cases.

If the JFTC issues a formal request to one or more parties to the transaction to submit additional materials or information (information request) during Phase I, the review will move to Phase II. The JFTC will have until the later of 120 days from the date of the acceptance of the notification or 90 days from the date when the parties have completed their response to the information request to decide whether to clear or prohibit the transaction. Once the review moves to Phase II, the transaction is disclosed on the JFTC's website for public comment. In general, it takes at least two to three months for the parties to submit complete responses to the information request. In practice, parties often purposely do not complete their responses to the information request to give themselves more flexibility in terms of timing.

### Public announcements

The notification itself will not be made public. If the merger review proceeds to Phase II, the transaction will be made public on the JFTC's website for public comment. Additionally, if the merger review is completed after Phase II, the detailed competition analysis conducted by the JFTC will be made public.

Moreover, the JFTC makes public, on a quarterly basis, a list of the transactions that it has cleared. In addition, every June, the JFTC makes public a list of selected merger cases with summaries of its competition assessment. The merger parties are given a chance to review a draft summary prepared by the JFTC to make sure that the summary does not contain any business secrets that the merger parties do not wish to be disclosed to the public.



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# Appendix 1

## About the Authors

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Nagashima Ohno & Tsunematsu

Kosuke Hamaguchi's practice mainly involves public and private M&A transactions and corporate governance. Based upon his experiences overseas, he represents international companies in numerous cross-border projects. In particular, he is recognised for his expertise in strategic M&A transactions and alliances. He also regularly advises clients on corporate governance, activism and takeover defence matters. He is deeply experienced in assisting international clients on doing businesses in Japan by means of, among other things, joint ventures, distributorship arrangement and other corporate transactions. His experience spans multiple industries, including manufacturing, industrials, consumer and retail, and fashion.

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