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# Corporate M&A 2023

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## **Japan: Trends & Developments**

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## Trends and Developments

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### Overview of the Landscape

The number of M&A deals involving Japanese companies in 2022 was 4,304, which is a 0.6% increase compared to 2021 (making the 2021 and 2022 numbers the highest on record for two consecutive years), while the total value was down by 31.6% to JPY11.4356 trillion. The decline in large-scale projects was conspicuous. The largest deal involving a Japanese company was the acquisition of Hitachi Transport System Ltd by KKR for JPY671.4 billion. Thus, in 2022, there were no deals exceeding JPY1 trillion and the number of deals with a value of JPY100 billion or more was only 21, showing a significant decline from 35 in 2021.

The total value of domestic transactions was up by 25.7% to JPY4.006 trillion, while the value of outbound transactions saw a significant drop by 51.7% and the value of inbound transactions was also down by 37.5%, in each case presumably because of the increased uncertainty of the global economy affected by the war in Ukraine. Based on only the number of deals, M&A deals (including equity participations and expansions of equity investments) involving startups accounted for over 40% of all M&A deals. The number of M&A transactions by foreign invest-

ment funds was the highest and accounted for 76.4% of all inbound transactions. In particular, the number of start-up investments by foreign investment funds has been soaring since 2021.

### Tender Offers and Anti-takeover Measures

The number of tender offers was on a sharply increasing trend in 2020 and 2021. There were 71 tender offers commenced in 2021, the most in a single year during the 12 years since 2009. This increased number, especially in 2021, was partly in response to the then upcoming reorganisation of the market segments of the Tokyo Stock Exchange to be implemented from April 2022. From April 2022, the market divisions of the Tokyo Stock Exchange were reorganised into three markets: prime market, standard market and growth market. Most significantly, the listing maintenance criteria for each market were made more stringent than the previous criteria. In anticipation of this, in 2021, a number of tender offers were made for delisting some listed companies that might potentially fail to meet the revised listing maintenance criteria. Further, against the backdrop of the heightened momentum for business restructuring triggered by the reorganisation of these market segments, there seemed to be an increase in moves by listed

companies to strengthen group management and dissolve parent-subsidary lists. In contrast, the number of tender offers commenced in 2022 significantly decreased to 59, partly because of dramatic changes to the market environment, including the global economic recession, high raw material prices, and the yen's depreciation, which appears to have made the desire for reorganisation by listed companies weaker.

Unsolicited tender offers have tended to be less common in Japan than in the US or the UK. However, many unsolicited tender offers were made in 2020 and 2021, with the number reaching a record high of eight and exceeding 10% of the total tender offers commenced in 2021. In the meantime, there was a growing number of cases in which the target company invoked anti-takeover measures against unsolicited takeovers in response to which the bidders sought injunctions against the target companies, which in turn saw the accumulation of a number of judicial precedents in this area. In 2022, this trend came to a halt and only one unsolicited tender offer was made. However, in light of the recent behaviour by activist shareholders (noted below), the decline in 2022 was likely a temporary one and unsolicited tender offers are expected to continue during and after 2023.

When an unsolicited acquirer emerges, it is common for the target company to dilute the voting right ratio of the acquirer by allocating to the pre-existing shareholders stock acquisition rights without contribution with a discriminative condition to exercise. This is done with the support of the shareholders at a general meeting of shareholders. While some of the recent judicial precedents allow an injunction to stop such allocation of stock acquisition rights, others do not, each taking into account various factors in the specific facts of each case. For example, in

2022, the court allowed an injunction to stop the allocation of such stock acquisition rights in the target company, Mitsuboshi Co Ltd.

In recent years, there have been several cases similar to the so-called wolf-packs in the US, where a number of investors acting together each purchase only a relatively small number of shares in small to medium-sized listed companies in a short period of time, mainly on the open share market, and thereby intentionally delay the submission of statements of large-volume holdings and/or changes thereto. This often results in large-scale acquisitions of shares in the target company being made before the market and target company management can become fully aware of the situation and places the management of the target under the influence of the new investors before the management can realise what has happened. In response to such behaviour of multiple investors, many defence counter-measures have been implemented in relation to not only the acquisition of shares exceeding a certain threshold by an individual acquirer but also such "joint activities" by multiple shareholders.

The Mitsuboshi case was the first one in Japan in which the validity of such "joint activities" and such counter-measures was contested in court and it attracted considerable public attention. The lesson learned from the Mitsuboshi case is that in order for defence measures against "joint actors" to be enforceable, the target company generally needs to establish objective criteria for the recognition of potential acquirers acting as "joint actors". Some companies have established such criteria in response to the Mitsuboshi case.

Given the recent increase in cases in which counterproposals were offered in public deals



and the considerable number of recent judicial decisions on injunctions against anti-takeover measures, the Ministry of Economy, Trade and Industry launched the Fair Acquisition Study Group in November 2022. The Study Group plans to examine the way that parties act in relation to unsolicited takeover proposals (the perspectives of the target company's board of directors and the acquirer(s) and the actions taken by both parties), and the ideal way that anti-takeover measures should be implemented. The Study Group aims to formulate and publish a Guideline by spring 2023 after compiling the results of its studies. It is expected that this Guideline, although not legally binding, will have a significant impact on future M&A practice in Japan.

On top of that, the Financial Services Agency announced in March 2023 that it will commence discussions on substantially reforming the regulations on tender offers and large-volume holding statements. If these discussions lead to actual reform, it will be the first time for reform in these areas since 2006. While the progress of such discussions is awaited, it is anticipated that, amongst others, the scope of application of the tender offer regulations will be amended to include the treatment of trading on the open share market.

## Shareholder Activism

Continuing the trend over the past few years, shareholder activism was active in 2022 as well. At annual general shareholders' meetings held in June 2022, shareholders made 330 proposals in 97 companies (compared to 187 proposals in 65 companies in the previous year). The number of companies making shareholder proposals was the highest ever, and shareholder proposals from institutional investors, including activist investors in particular, increased significantly.

For example, Silchester National made shareholder proposals to four regional banks. Interestingly, there were no shareholder proposals submitted by activist investors that were approved at annual general meetings of shareholders in June 2022, but there were cases in which activist investors withdrew their shareholder proposals in advance as a result of the company taking certain counter-measures in response to their proposals, such as the elimination of anti-takeover measures.

In another notable case, an activist investor conducted a campaign against a company proposal for the re-election of a director due to misconduct of the director, as a result of which the company withdrew the proposal. As disclosure by listed companies has improved in terms of both quality and quantity in recent years, there has been an increasing number of cases in which activist shareholders conduct public campaigns prior to annual general meetings of shareholders and publish detailed materials based on publicly available information. The above case is an example of this recent trend and a symbolic example of the expanding influence of activist investors in capital markets. Shareholder activism is expected to continue at annual general meetings of shareholders in June 2023.

## ESG

M&A deals aimed at realising sustainability, such as "de-carbonisation", are becoming more active, particularly among large enterprises. Tokyo Gas entered into a definitive agreement to sell its subsidiary, which owns interests in four Australian LNG projects, and Mitsui & Co invested in the holding company of Mainstream Renewable Power Ltd, an Irish renewable energy company that has been invested in by Aaker Horizons, a Norwegian clean energy investor, aiming to accelerate the reduction of GHG emis-

sions through improving its power generation portfolio.

Companies are increasingly aware that due consideration of sustainability, including ESG activities, is essential to achieving medium to long-term growth, and are reinforcing their efforts to address sustainability issues. The Corporate Governance Code issued by the Tokyo Stock Exchange, which was amended in June 2021, lays out a strong emphasis on initiatives to address sustainability-related issues. Several shareholder proposals related to ESG were made at annual general meetings of shareholders in June 2022. Market Forces, in collaboration with Kiko Network and other organisations, requested Sumitomo Mitsui Financial Group, Mitsubishi Corporation, TEPCO Holdings, and Chubu Electric Power Co Inc to amend their Articles of Incorporation to set and disclose short- and medium-term greenhouse gas emissions reduction targets consistent with the target of zero carbon emissions by 2050.

On 13 September 2022, the Government of Japan announced the Guidelines on Respecting Human Rights in Responsible Supply Chains. These Guidelines are soft law and not legally binding and follow the United Nation's Guiding Principles on Business and Human Rights, which are recognised as the most basic and most important international standards in the field of business and human rights. The Guidelines essentially re-emphasise established concepts such as the OECD Due Diligence Guidance for Responsible Business Conduct, which is recognised as an international standard for human rights due diligence.

However, being issued by the Japanese government, these Guidelines are expected to have a real impact in practice as under the Guidelines

all Japanese companies are strongly urged to undertake initiatives relating to “business and human rights”, in particular the implementation of human rights due diligence. In Europe, there has been notable progress on legislation that imposes mandatory human rights due diligence on corporations, such as the German Supply Chain Law which was enacted in January 2023. As there is a movement towards such legislation in Japan as well, developments in this area should be closely monitored.

## SPAC

From 2020 to 2021, there was a surge in SPAC listings and De-SPAC in the United States. New rules that permit the listing of SPACs were introduced in Singapore in September 2021 and in Hong Kong in January 2022. In Japan, it was decided that a SPAC listing system would be examined in the Growth-Strategic Implementation Plan approved by the Cabinet in June 2021. In October 2021, a study group was established in the Tokyo Stock Exchange, and in February 2022, the “Summary of Issues on Protecting Investors under SPAC Listing System” was published. According to this Summary, the points to be discussed in relation to protecting investors when introducing a SPAC listing system include:

- the target investor base of SPACs;
- disclosure of information on sponsors taking into account the structural conflicts of interest between SPAC sponsors and ordinary shareholders;
- listing requirements for SPAC and framework for liquidity, etc;
- measures to ensure proper governance in the course of De-SPAC; and
- process for confirmation of eligibility for listing of a company after De-SPAC.

The Interim Report published by the Financial System Council's "Market System Working Group" in June 2022 states that "it is appropriate to continue to collect information on overseas trends, etc. regarding SPAC system, and to continue to verify the significance and necessity of its introduction in Japan, while considering the characteristics of Japan's market and issues for protecting investors". There seems to have been no significant progress on this matter for the past year, but it is an area to keep a close watch on going forward.

## Economic Security Promotion Law

Countries have been actively responding to the tight supply of semiconductors and medical supplies due to the COVID-19 pandemic. The war in Ukraine highlighted anew issues such as the worsening impact of contingencies on the global supply chain and the importance of defensive measures against cyber attacks. In light of such situation, the Act for the Promotion of Ensuring National Security through Integrated Implementation of Economic Measures (the "Act") was enacted on 11 May 2022. The Act provides for the following:

- a system for providing subsidies to private companies for the stable supply of "specified important goods" designated by the government for the purpose of strengthening supply chains;
- a system for prior examination of plans for the introduction of certain important facilities and entrustment of maintenance, etc for businesses that provide important social infrastructure that is likely to harm the safety of the state and the people if their functions cease to function;
- a system for supporting the development of cutting-edge important technologies; and

- a system for non-disclosure of patent applications for inventions which are likely to harm the safety of the state and the people if disclosed.

It is expected that each system will be enforced in stages within six months to two years from the date of promulgation of the Act.

Foreign companies may therefore be affected if they seek to acquire a Japanese company that is subject to the systems under the Act. For example, if a foreign company contemplates acquiring (i) a Japanese company that is a certified supplier of specific important goods, (ii) a Japanese company that supplies important facilities to specified social infrastructure business operators, or (iii) a Japanese company that is provided with government subsidies for the development of specified important technology, a key question will be whether such Japanese company can carry out its business activities after the closing of the transaction in the same manner as before the transaction.

More specifically, whether the Japanese target can continue to receive support for securing the supply of the specified important goods and for the development of the specified important technology, and/or whether it can continue to deliver important equipment to specified social infrastructure business operators will all become matters requiring serious consideration. Although it is difficult to provide general exhaustive answers as to what is required for the Japanese target to clear these specific issues and what the impact on the transaction might potentially be if a foreign company seeks to become a parent of a Japanese company subject to the Act, it would be advisable for a foreign company to assess the impact of the Act when contem-

plating an M&A deal targeting a Japanese company subject to the Act.

## Spin-Offs

The inadequate optimisation of business portfolios has for many years been described as a major cause of the lower profit margins of Japanese companies with diversified and large-scale businesses compared to equivalent Western organisations. In this context, it has been expected that spin-offs would be utilised as one of the measures for Japanese companies to tackle business reorganisations and optimise their business portfolios. Nevertheless, even after 2017, when a tax reform was introduced that aimed to utilise spin-offs (taxation of capital gains on a spun-out company and taxation of deemed dividends on shareholders were allowed to be deferred under certain conditions), there has been only one spin-off actually implemented (by Koshidaka Holdings Co Ltd in 2019) utilising this tax reform.

In February 2022, Toshiba announced a policy of spinning off its device business as a newly listed company through a method of share distribution and splitting the company into two segments in order for its infrastructure services business and its device business to be operated independently. However, at the Toshiba general meeting of shareholders in March 2022, the company's proposal in relation to the spin-off was rejected, which resulted in Toshiba suspending its strategic reorganisation by way of spin-off.

When large enterprises spin off a division, there is also typically a need to maintain a capital relationship between the original enterprise and the spun-off entity. This is partly because (i) a spun-off subsidiary often needs to continue to use the brands and internal systems of the former parent; and (ii) it is important, especially for manufacturers, to maintain the trust and business dealings with their customers, which therefore means it may be easier for spun-out divisions to proceed with the business separation by gradually reducing the capital relationship with their former parent. In this regard, it has been lamented that in the case of a “partial spin-off” in which part of the subsidiary's shares remain held by the former parent, the above-mentioned tax reform cannot be applied and, therefore, the lack of availability of this tax reform is a hurdle to enterprises that seek to spin off a part of their business portfolios.

In response to such criticism, the Japanese government has approved a special measure to defer taxation on shareholders in the case of a partial spin-off that leaves a part of the equity interest in the subsidiary (less than 20%) held by the former parent company. However, this special measure has only been approved with a time limit of one year commencing from 1 April 2023. While it remains unknown whether such special measure will be made permanent, for Japanese companies, partial spin-offs will continue to be one of the main potential methods of restructuring and optimising the business portfolios of their corporate groups.



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