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This issue covers the following topics:

MERGER & ACQUISITIONS

Tokyo Stock Exchange Tightens Rules on MBOs and Controlling Shareholder Buyouts: Enhanced Disclosure and Minority Protection

I. Introduction

On July 22, 2025, the Tokyo Stock Exchange (the "**TSE**") introduced revisions to its Code of Corporate Conduct with respect to management buyouts ("**MBOs**") and controlling shareholder buyouts (the "**Code**") to strengthen fairness and transparency in such transactions. These changes impose enhanced disclosure obligations and procedural safeguards aimed at protecting minority shareholders in deals where company insiders or controlling shareholders seek to take a listed company private. This newsletter provides the context and motivations behind the revisions, as well as an overview of the revised Code.

II. Background: Value Pressures and the Rise of MBOs and Controlling Shareholder Buyouts in Japan

Japanese listed companies have been under increasing pressure to boost capital efficiency and share prices in recent years. In 2023, the TSE explicitly called on listed companies to pursue "management that takes into account capital costs and stock prices," signaling that chronically low valuations would no longer be ignored. This push reflects a broader governance shift toward medium- to long-term corporate value creation, and one consequence of these pressures has been a surge in going-private transactions, including MBOs and parent-subsidiary consolidations. At the heart of the revisions to the Code is a recognition of the inherent conflicts of interest and information asymmetry in MBOs and controlling shareholder buyouts. In such transactions, the party initiating the acquisition – whether it is incumbent management, the founding family, or a parent company – is an "insider" with greater knowledge of the target company's intrinsic value and prospects. They may have incentives to minimize the buyout price, to the detriment of outside minority shareholders. The July 2024 revisions to the Code seek to address the conflicts of interest and opacity in MBOs and controlling shareholder buyouts by requiring more rigorous process safeguards and transparency.

III. Scope of Transactions Covered

The following transactions (hereinafter referred to as the "**Target Transactions**") fall within the scope of the revised Code, but **only if** they are expected to result in the delisting of the target company (i.e., going private):

➢ **MBOs**: An MBO is defined as "[a] takeover bid from an officer of the target company (including takeover bids where the bidder is conducting the bid based on the request of an officer of the target company and has a common interest with said officer)" (Rule 441 of TSE's Securities Listing Regulations). In practice, an officer often partners with a private equity fund or sponsor to take the target company private, and such transactions fall under the definition even if the officer is not the direct offeror in the tender offer;

➢ **Buyouts by a Controlling Shareholder or other Related Company, etc.:** "Controlling shareholder" refers to a parent company or any person or entity that directly or indirectly holds a majority of the voting rights. It should be noted that the determination of a parent company is based not only on the ownership of a majority of voting rights (shareholding criterion) but also on the control criterion, namely whether the entity in substance controls the financial and business policies of another company. The revised Code also extended the scope to related companies (as defined in the Regulations on Terminology, Forms, and Preparation Methods of Financial Statements), which includes equity affiliates. The term "etc." encompasses cases that are substantively equivalent to an action by a parent company or other related company—for example, where a subsidiary of the parent company (a sister company of the target) or a parent or subsidiary of another related party acts as the tender offeror; and

➢ **Certain Transactions involving a Controlling Shareholder or other Related Company, etc.**: This includes, among others, squeeze-outs of minority shareholders conducted with the intention of retaining a controlling shareholder or other related company, etc. as shareholders of the target company[1].

Furthermore, the revised Code provides that, even in cases that do not fall under any of the above categories, where a controlling shareholder or other related company, etc. engages in a transaction such as making a re-investment in the purchaser after the purchaser has made the target company its wholly owned subsidiary, "it is expected that, depending on the nature of the transaction and the degree of structural conflicts of interest, the parties will consider implementing the procedures set forth in the Code of Corporate Conduct applicable to MBOs and similar transactions, treating them as equivalent to such transactions."

IV. New Disclosure and Procedural Requirements Under the Revised Code

The following are the major changes introduced under the revised Code:

➢ **Independent Special Committee and Opinion**: When making a decision regarding a Target Transaction, the target company's board must form a special committee of independent members (comprised of outside directors, outside auditors, and/or external experts) and obtain from this committee an opinion stating that the transaction is fair to minority shareholders. This marks a shift from the old standard, which only required a board to obtain an opinion that the transaction was "not disadvantageous to minority shareholders." This change addresses cases where a special committee deemed a transaction "not disadvantageous" to minority shareholders merely because it offered an exit at a premium to market price, despite concerns over price fairness. To ensure that any increase in corporate value is fairly shared with minority shareholders, the standard was revised to require an opinion that the transaction is "fair to minority shareholders." However, special committees in most cases appear to have examined transactions from this very perspective even

[1] Specifically, this includes squeeze-outs carried out as the second step of a two-step acquisition following the implementation of a tender offer by management, a controlling shareholder, or other related parties, as well as squeeze-outs conducted by a controlling shareholder or other related parties without implementing a tender offer. On the other hand, if a person other than a controlling shareholder or other related company conducts a tender offer and, as a result of the offer, newly falls within the category of a controlling shareholder or other related company, and subsequently carries out a squeeze-out as part of the same series of transactions, such a squeeze-out will fall outside the scope of the revised Code.

before the revised Code, and, based on such analysis, concluded that they were "not disadvantageous" to minority shareholders. Accordingly, the practical impact of this change is expected to be limited.

➢ **Stricter and "Necessary & Sufficient" Timely Disclosure**: The revised Code imposes a heightened timely disclosure obligation once the Target Transaction is approved by the board. Companies are now required to provide "necessary and sufficient" information to investors at the time of the deal announcement. Key disclosures include the full content of the special committee's opinion (rather than a summary under the old standard)[2] and the key assumptions and financial forecasts underlying the valuation. For example, in addition to describing the specific valuation methodology, if a discounted cash flow (DCF) method is adopted, disclosure is expected to include, among other things, (i) the actual numbers from the financial forecasts used as the basis for the valuation; (ii) the source and identity of the party preparing those forecasts; (iii) basic assumptions of the financial forecasts (e.g., if the financial forecasts differ materially from the ones publicly announced prior to the Target Transaction, the reasons for such deviation), (iv) whether the financial forecasts anticipate a material increase or decrease in free cash flow, the factors underlying such changes; (v) whether the financial forecasts assume the implementation of the Target Transaction; (vi) the specific discount rate applied; and (vii) the method of calculating the terminal value and the numerical parameters used in that calculation.

V. Conclusion

As the revisions have only recently taken effect, the practical expectations for the level of detail—for example, the specific granularity required by the TSE regarding key assumptions and financial forecasts underlying the valuation—are likely to become clearer as more transactions subject to the new rules are announced and market practice develops.

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[2] However, if the opinion contains confidential business information, it is permitted to withhold such portions from disclosure to a reasonable extent.

FINANCE / RESTRUCTURING AND INSOLVENCY

The New Act on Security Interests by Assignment

Significant Changes to Security Interests over Movables and Receivables: Impact on Priority and Perfection Rules

I. Introduction

The Act on Contracts for Security Interest by Assignment and Retention of Title (the "Act"), enacted on May 30, 2025, and promulgated on June 6, 2025, is expected to take effect by 2027 (within two years and six months from its promulgation date). The Act introduces significant changes to the legal framework for "security interests by assignment" (jou-to tanpo) over movables and receivables in Japan. This newsletter highlights three key aspects of the Act that are anticipated to substantially impact practice: (1) the express recognition of the ability to create subordinate (junior) security interests by assignment; (2) the new rule subordinating perfection by constructive transfer with retention of possession (sen-yu kaitei; hereinafter "Constructive Transfer") to other methods; and (3) a transitional measure that preserves the priority of pre-enactment Constructive Transfer.

II. Key Features of the Act

(i) Express Recognition of Subordinate Security Interests by Assignment

Under the previous legal framework, creating subordinate (junior) security interests by assignment was rarely utilized in practice. This was partly due to a lack of clarity as to the possibility of effectively establishing multiple security interests, given that security interests by assignment, unlike statutory security interests, were based solely on the form of an assignment. Although the Japanese Supreme Court's decision of July 20, 2006 (Minshu Vol. 60, No. 6, p. 2499), included an explanation that appeared to recognize this possibility, the statement was not part of the binding holding. This created significant practical uncertainty concerning the effectiveness of junior security interests by assignment and their relation to senior interests, discouraging their use.

Article 7 of the Act directly addresses this issue by expressly providing for the creation of multiple security interests by assignment over the same property. The Act further clarifies the enforcement methods for security interests by assignment, thereby making the effect and treatment of junior security interests by assignment more concrete. This statutory clarification enhances legal certainty, particularly for subordinated financing arrangements like mezzanine finance. For instance, in mezzanine finance, where both senior and mezzanine lenders secure positions against the same movables or receivables, the Act now explicitly enables the establishment of such subordinated security interests, providing mezzanine lenders with greater predictability regarding their security's effectiveness, enforcement, and priority.

(ii) Subordination of Perfection by Constructive Transfer

In practice, security interests by assignment over movables in Japan have traditionally been perfected either through non-physical transfer of possession, i.e., by Constructive Transfer, or by registration under the Act on Special Provisions, etc. of the Civil Code Concerning the Perfection Requirements for the Assignment of Movables and Claims. Constructive Transfer refers to a situation where the original possessor (the assignor) retains physical possession of the relevant asset but manifests the intent to possess same on behalf of the assignee. This method has been criticized for its inherent lack of external publicity, as there is no physical transfer of possession. The assignor retaining physical possession makes it difficult for subsequent creditors to ascertain the existence and priority of security interests by assignment, causing uncertainty for third parties compared to perfection by registration.

Article 36 of the Act introduces a significant change: a security interest by assignment perfected by Constructive Transfer is now expressly subordinated to other security interests perfected by other

methods, such as registration. This subordination rule means that a subsequent creditor who perfects its security interests by assignment by registration will have priority, even if another security interest was previously perfected by Constructive Transfer. In practice, this allows a lender creating a new security interest by assignment to easily confirm prior security interests by assignment with superior priority simply by checking the registration, thereby enhancing transactional safety and clarity. It is important to note, however, that the Constructive Transfer subordination rule does not apply to true sales. Therefore, lenders must continue to verify whether a true sale has occurred in transactions involving Constructive Transfer.

Furthermore, the subordination of Constructive Transfer promotes the use of registration, which offers greater publicity and thus greater clarity as a method of perfection. While there has been a tendency in Japan to avoid registration as a perfection method of security interests by assignment due to reputational concerns (i.e., publicizing that a borrower's financial condition has deteriorated to the point of needing financing secured by movables or receivables), the new Constructive Transfer subordination rule may alter this mindset. This change significantly enhances the transparency, clarity, and reliability of security interests for financial institutions and other market participants.

(iii) Transitional Measure for Pre-Enactment Constructive Transfer

Upon its effective date, the Act will apply to security agreements executed and security interests by assignment established prior to its enforcement. The introduction of the subordination rule for Constructive Transfer could have thus resulted in a sudden loss of priority for pre-enactment security interests perfected by this method. Such a change risks undermining the value of existing collateral, triggering financial covenant breaches, and causing a cascade of legal and commercial issues for lenders and borrowers alike. To mitigate these concerns, Supplementary Article 5 of the Act includes a transitional measure. This provision allows holders of security interests by assignment perfected by Constructive Transfer before the Act's enforcement to preserve their original priority by registering their security interest by assignment either prior to the Act's effective date or within a two-year window thereafter. If registration is completed within this period, the security interest's priority will be determined based on the original date of Constructive Transfer, rather than the registration date.

In practice, given the new Constructive Transfer subordination rule, financial institutions and other secured parties should promptly review their portfolios to identify any security interests by assignment perfected solely by this method. It is advisable to prepare the necessary documentation and coordinate with borrowers to complete the registration process within the transitional period. Borrowers should also be aware that registration may require joint applications and additional information, and their loan agreements might need review for related provisions concerning fees or information obligations.

III. Conclusion

The Act marks a significant shift in the legal landscape for security interests by assignment over movables and receivables in Japan. All parties should review their existing security portfolios to identify interests by assignment perfected solely by Constructive Transfer and take steps to register them within the stipulated timeframe. For new transactions, parties should consider using registration for perfection rather than Constructive Transfer, as the practical advantages of the latter have largely been eliminated due to its inherent lack of clarity and transparency compared to registration.

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