

Japan

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Triangular mergers and cash-out mergers will be allowed

This deregulation will allow a foreign company to make a Japanese company its subsidiary relatively easily by way of a ‘triangular merger.’ More specifically, a foreign company could use a wholly owned subsidiary in Japan (which would acquire shares in the foreign company), which then would in turn become the surviving company under a merger agreement with the dissolved company (another Japanese company). As consideration

for the merger, the surviving company would deliver shares in the foreign company to the shareholders of the dissolved company.

Further, where consideration for a merger is limited to cash, i.e. a ‘cash-out merger,’ the reforms will be especially useful in transforming a subsidiary into a wholly owned subsidiary. However, this deregulation does not confirm the legality of unfair or extreme squeezing out in the absence of justifiable business purposes.

Value of consideration for a merger will still be scrutinized

Since any form of consideration should have the same value as the shares in the surviving company (the only form of consideration at present), consideration should represent the positive synergistic effects arising from the merger in order to appropriately compensate the shareholders of the dissolved company. However, it would be extremely difficult to correctly calculate this. From a practical viewpoint, a detailed description, as required in the Proposed Outlines, coupled with legitimate reasons is essential.

This deregulation will not create a new method of hostile takeover

The deregulation in the Proposed Outlines is only related to consideration for mergers. Since a merger agreement generally needs to be approved by the shareholders of a dissolved company holding two-thirds of the total voting rights held by the shareholders present, the proposed deregulation will not create any new method of hostile takeover. Rather, the ability to perform a triangular merger or cash-out merger would likely act as incentives to hostile takeover bids.

Endnote

Please note that after finalizing this article, a news article was released, suggesting that it is likely that the deregulation as to consideration for mergers will become effective in 2007.

Proposed Deregulation of Consideration for Mergers Under the New Corporation Act of Japan



Yusuke Nakano

The *Proposed Outlines Regarding Modernization of Corporate Legislation* adopted on December 8 2004 (Proposed Outlines), suggest deregulation of consideration for mergers. If the *Corporation Act* (tentative name) reflecting the Proposed Outlines passes the Diet in the ongoing session, it could become effective in April 2006. Should this reform be instituted, it would have a significant impact on M&As in Japan. In this article, I briefly introduce the proposed deregulation of consideration for mergers.

Currently, under the *Commercial Code*, consideration for a merger (offered by the surviving company to shareholders of the dissolved company) is limited to shares in the surviving company. This regulation attempts to (i) control the “squeezing out” of minority shareholders; and (ii) protect the financial interests of said minorities. On the other hand, if certain requirements are met, the 2003 amendment to the *Industrial Revitalization Act* allows cash or shares in another company to be used as consideration for a merger. In this sense, the principle in the *Commercial Code* is not sacrosanct.

Recently, however, the chorus of calls from the business community, which have demanded the use of more types of consideration in merger proceedings, has been growing. In response, the Proposed Outlines stipulate the following:

“In case of merger ... the surviving company will be able to deliver cash or other assets to shareholders in the dissolved company ... instead of delivering shares in the surviving company.

N.B. In addition to a document describing the reason for the allotment of consideration to shareholders ... of the dissolved company, a document must also be disclosed which describes the reason why such consideration is appropriate.”

The following are my comments on the relevant portion of the Proposed Outlines.