Impact of the New Financial Instruments and Exchange Law on M&As

Pursuant to comprehensive amendments to the *Securities and Exchange Law* in June 2006, the rules on tender offers and large shareholdings have been changed substantially. Sometime this summer, the *Securities and Exchange Law* will become the *Financial Instruments and Exchange Law* and will be restructured as a law on investment services that broadly regulates financial instruments and related services.

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On June 7 2006, two bills – one amending the *Securities and Exchange Law* and other financial laws, and the other aimed at abolishing or amending other related laws – were approved in the Japanese Diet. Pursuant to these two new laws, which were promulgated on June 14 2006, the *Securities and Exchange Law* (SEL) is to be extensively amended and will be known as the *Financial Instruments and Exchange Law* (FIEL) from its effective date sometime this summer.

The amendments to the SEL include the consolidation of other financial laws – such as the *Financial Futures Trading Law* and the *Law Concerning Foreign Securities Firms* – into the FIEL; broadening the scope of securities covered by the law; amending corporate disclosure requirements, the tender offer rule and the large shareholding reporting rule; and establishing harsher penalties. The amendment to the tender offer rule became effective December 13 2006 and the introduction of the corporate reorganization disclosure rule, which is scheduled to become effective this summer, are both likely to affect merger and acquisition (M&A) transactions in Japan.

Amendments to the tender offer rule

A tender offer is an offer to purchase or a solicitation of an offer to sell shares (including stock options and bonds with stock acquisition rights), made to the holders thereof and the purchase of tendered shares outside the securities markets. Under the SEL, in order to purchase shares of a public company (meaning any company that is required to file annual securities reports, and typically including Japanese listed companies) outside the securities markets in a quantity that will bring the purchaser's shareholding ratio to exceed one-third, and in certain other cases, such purchase must be made through a tender offer pursuant to the provisions of the SEL.

Pursuant to the amendment to the SEL that became effective on December 13 2006, the tender offer rule was amended as follows:

(i) The scope of share purchases for which a tender offer is required has been broadened;
(ii) target companies are now obligated to express their opinions on tender offers;
(iii) target companies are now entitled to ask questions of the bidder;
(iv) the tender offer period has been amended; and
(v) bidders are now obligated to purchase all tendered shares, if the shareholding ratio after purchase is expected to be two-thirds or more.

Broadened scope of share purchases requiring a tender offer

As mentioned above, under the SEL, a purchase of shares of any public company that will bring the purchaser's share in the target to exceed one-third, in principle, must be made through a tender offer. Under the SEL prior to the amendment, however, an exemption was available if the bidder acquired shares in the securities markets or subscribed newly issued shares. As a result, a bidder was able to hold more than one-third of the target company without making a tender offer by, for example, purchasing up to 32% of the target company's shares outside the securities markets and acquiring an additional 2% in the securities markets.

To close this loophole, the SEL was amended to require a tender offer if a bidder acquires more than 10% of the target's shares within three months – whether in the securities markets, outside

the markets, through the subscription of newly issued shares or any combination thereof – provided that more than 5% of the target's shares are acquired outside the securities markets or through a specific type of market transaction, or if no shares are acquired outside the securities markets and provided that the purchaser becomes the holder of more than one-third of the target's shares as a result of such acquisition (SEL Article 27-2, Clause 1, Item 4).

Accordingly, a company seeking to acquire shares of a target without making a tender offer needs to develop a detailed share purchase plan, taking into account not only purchases outside the securities markets but also purchases on the markets and acquisitions through the subscription of newly issued shares.

A target company's obligation to register its opinion

Prior to the amendment, the SEL provided that, if a tender offer target expressed its opinion on such offer during the tender offer period, it was required to file a position statement report. The target company had the discretion of whether or not to express its opinion. The amended SEL, however, requires the target to file a position statement report within 10 business days of the tender offer and to send a copy to the bidder, thereby obligating the target company to express its opinion (SEL Article 27-10, Clause 1). The information to be included in the report has also been broadened, and the target company must set forth not only its opinion on the tender offer (i.e., whether it agrees or objects to the offer) and a description of the procedures employed in reaching such opinion, but also the reasons underlying its opinion.

Target companies may question the bidder

Under the amended SEL, a tender offer target may pose questions to the bidder in its position statement report (SEL Article 27-10, Clause 2, Item 2). If such questions are raised, the bidder is required to file a response thereto within five business days of receiving the position statement report (SEL Article 27-10, Clause 11).

Accordingly, bidders must now make sufficient advance preparation to enable them to issue timely responses to questions from target companies.

Tender offer period amended

Under the SEL prior to amendment, the prescribed period of any tender offer was not less than 20 days and not more than 60 days. Under the amended SEL, however, the prescribed period has been revised to not less than 20 business days and not more than 60 business days. The change from a calendar day basis to a business day basis was made to ensure that, even if a tender offer is made during a holiday period, there will be sufficient time for the target company to defend against the tender offer and for the target's shareholders to consider whether or not to tender their shares.

> The amended SEL requires the target to file a position statement within 10 business days of the tender offer and to send a copy to the bidder.

If the tender offer period is less than 30 business days, the target company may demand an extension thereof to 30 business days in its position statement report, in which case the bidder is obligated to extend the period accordingly (SEL Article 27-10, Clauses 2 and 3).

Bidders must purchase all tendered shares

Under the SEL prior to amendment, a tender offer bidder was permitted, regardless of its expected shareholding ratio upon completion of the tender offer, to provide – as a condition of its tender offer – that, if the number of tendered shares exceeded the number of shares the bidder desired to purchase, the bidder would not purchase some or all of such excess. Under the amended SEL, however, a bidder that is expected to have a shareholding ratio in the target of two-thirds or more after the tender offer may not impose such a condition, and instead is required to extend its tender offer to all shares (including stock options and bonds with stock acquisition rights, as mentioned above) issued by the target company.

Corporate reorganization disclosure rule

Under the SEL, when a primary offering (a solicitation regarding the distribution of newly issued securities, typically to 50 or more persons) or a secondary distribution (a solicitation regarding the distribution of previously existing securities to 50 or more persons) is made, the issuer of the relevant securities is required to file a registration statement. The issuance or transfer of shares in the event of a merger, share exchange or other corporate reorganization, however, is not deemed to constitute either a primary offering or a secondary distribution. Accordingly, although any party to such a reorganization that is a public company is required to file an extraordinary report in a relatively simplified form, no registration of a share issuance or transfer is required under the SEL.

Currently, in the case of a merger, shares of the surviving company are issued or transferred to the shareholders of the merged company. In principle, delivery of other securities or cash as merger

consideration is not permitted. Beginning this May, however, a deregulation will become effective under which it will be possible to deliver securities other than shares or to deliver securities of another company as merger consideration, thereby making so-called triangular mergers possible.

Given this deregulation, Japanese legislators considered it necessary to require the disclosure of sufficient information regarding the consideration to be paid in connection with corporate reorganizations, to enable potential recipients to evaluate the proposed transactions appropriately. For this purpose, under the FIEL, the abovementioned registration requirement will also become applicable to corporate reorganizations.

This registration requirement for corporate reorganizations is in line with the registration requirement pursuant to Rule 145 under the *US Securities Act of 1933*, under which a registration statement is required to be filed with the US Securities and Exchange Commission prior to the submission, for the vote or consent of shareholders, of any plan or agreement for a merger or other business combination.

Corporate reorganization subject to registration

Under the FIEL, corporate reorganization is defined to include any merger, corporate split, share exchange or other reorganization of a company. The procedure for a corporate reorganization in which securities are to be newly issued as consideration is defined as a "corporate reorganization issuance procedure", and the procedure for a corporate reorganization in which previously existing securities are to be transferred as consideration is defined as a "corporate reorganization transfer procedure".

Consider the case of a triangular merger in which Company B is merged into Company A, with shares of Company C transferred to Company B's shareholders in exchange for their shares of Company B, and Company A being the survivor. If shares of Company C are newly issued and delivered to Company B's shareholders, such merger will be treated as including a corporate reorganization issuance procedure. If previously existing shares of Company C are transferred to Company B's shareholders, the merger will be treated as including a corporate reorganization transfer procedure.

The FIEL treats a corporate reorganization issuance as a primary offering and a corporate reorganization transfer as a secondary distribution. Accordingly, if the securities to be utilized as consideration are issued or transferred to 50 or more persons (i.e., the target company in the reorganization, Company B, has 50 or more shareholders) in a corporate reorganization issuance procedure or a corporate reorganization transfer procedure, the issuer of the securities to be used as consideration (Company C) will be required to comply with the registration requirement (FIEL Article 4, Clause 1).

Exemptions from the registration requirement

If (i) the information on the shares of the target company of the reorganization is not disclosed, or (ii) the information on the securities utilized as consideration has been disclosed, the abovementioned registration requirement will not apply (FIEL Article 4, Clause 1, Item 2). Information on shares or other securities is deemed to have been disclosed if a previous registration has been made of such shares or other securities, or if the issuer thereof has filed an annual securities report for its most recent fiscal year. In the example above, if Company B is not a listed company and no primary offering or secondary distribution of Company B's securities has been made, or if Company C had previously filed a registration statement or an annual securities report for its most recent fiscal year, Company C would not be subject to the registration requirement.

On the other hand, if the shares of the target company have already been disclosed and the securities to be utilized as consideration have not, the exemption mentioned above will not apply. Therefore, if a domestic or foreign company, the shares of which are not listed in Japan, seeks to merge (with itself as the survivor) with a company listed in Japan, the company seeking such merger will need to determine whether or not filing a registration statement is necessary.

Registration statement

The registration of a corporate reorganization issuance or a corporate reorganization transfer must be completed by filing a registration statement with the director of the competent local finance bureau. Such filing must be made before the agreement and other documents relating to the relevant corporate reorganization have been made available to shareholders for inspection. Shareholders of the target company may not acquire securities as consideration until the registration becomes effective (FIEL Article 15, Clause 1). Generally, such registration will become effective 15 days following the filing of the registration statement (FIEL Article 8).

A registration statement must contain information on the relevant corporate reorganization issuance procedure or corporate reorganization transfer procedure and the corporate data of the issuer of the securities to be delivered as consideration in the corporate reorganization. Although the form the registration statement must take is to be prescribed in a cabinet ordinance not yet issued at press time, it is expected that detailed corporate information will be required.

Continuous disclosure requirement

Under the FIEL, any company that files a registration statement for a corporate reorganization will thereafter be required to file regular annual securities reports with the required corporate information. In the event, however, that the company is a foreign company, it may, in lieu of an annual securities report, file another similar disclosure document in English that has already been released outside Japan.

Effect on M&As

In accordance with the amendments to the SEL and the enactment of the FIEL, detailed disclosures will be required in more M&A transactions. Following the deregulation of merger considerations scheduled for this May, M&A transaction structures will enjoy a significant increase in flexibility. However, any company contemplating a merger or acquisition will need, in evaluating the possible structures, to take into consideration whether registration will be required under the SEL/FIEL and, if registration is necessary, will also need to take into consideration the time and cost thereof.

About the author

Kazuhiro Yoshii is a partner with Anderson Mōri & Tomotsune. His principal areas of practice are securities law and corporate law, including capital market and M&A transactions. He is admitted to practice in Japan (the Dai-Ichi Tokyo Bar Association) and the State of New York. Mr. Yoshii earned a Bachelor of Laws degree (LL.B.) from the University of Tokyo in 1997 and a Master of Laws degree (LL.M.) from the University of California at Berkeley, School of Law, in 2005. He was associated with the New York office of Shearman & Sterling from 2005 to 2006. Mr. Yoshii is a native speaker of Japanese and is fluent in English.