The Mergers & Acquisitions Review

Tenth Edition

Editor
Mark Zerdin

Law Business Research

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Mark Zerdin

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EDITOR'S PREFACE

The past year has seen a boom in dealmaking, with many markets reaching post-crisis peaks and some recording all-time highs. Mega-deals have been at the heart of the expanding market, with companies tapping into cash piles and cheap debt to fund transformational deals. Looking behind the headline figures, however, a number of factors suggest dealmaking may not continue to grow as rapidly as it has done recently.

In Europe, the European Central Bank was forced to start a programme of quantitative easing in the wake of consistently low growth, a full seven years after the Bank of England and the Federal Reserve undertook their programmes. US interest rates have also tightened for the first time since the financial crisis, contributing, according to some commentators, to the wobbly US markets that marked the start of 2016. Yet this uncertainty has now seemingly passed, and the Federal Reserve is contemplating raising rates further. Meanwhile, eurozone and UK interest rates look likely to remain low for some time to come due to continued slow growth and low inflation in the region. How the markets react to this bifurcation of monetary policy across the Atlantic will shape dealmaking in the year to come.

Elsewhere, there have been some concerns that falling commodities prices (particularly that of oil) have been driven by a fall in market confidence. However, it seems that this view is somewhat simplistic. It is more likely that prices have fallen due to excess capacity that built up to service Chinese industrialisation and somewhat weak growth figures. The recent uptick in prices should be seen as an indicator that perhaps the market overreacted and fundamentals remain strong.

Perhaps one of the biggest factors that poses a threat to dealmaking in 2016 is the political uncertainty affecting much of the world. In the UK, the first half of the year was clouded by the referendum on the UK's continued membership of the EU, and in the US, the presidential election result is likely to have a considerable impact on markets. It is hoped that the resolution of this uncertainty in the second half of the year will foster an environment in which markets can thrive.

I would like to thank the contributors for their support in producing the 10th edition of *The Mergers & Acquisitions Review*. I hope that the commentary in the following chapters will provide a richer understanding of the shape of the global markets, together with the challenges and opportunities facing market participants.

Mark Zerdin
Slaughter and May
London
August 2016

Chapter 30

JAPAN

Hiroki Kodate and Yuri Totsuka[1]

I OVERVIEW OF M&A ACTIVITY

Due to the changing Japanese and global economy, the level of M&A activity involving Japanese companies overall continued to be moderate throughout 2015. However, thanks to 'Abenomics', a set of measures introduced by Japanese Prime Minister Shinzo Abe after his December 2012 re-election to the post and designed to revive the sluggish economy with 'three arrows', a massive fiscal stimulus, more aggressive monetary easing from the Bank of Japan and structural reforms to boost Japan's competitiveness, Japanese stock has risen and the Japanese yen has weakened significantly since early 2013.

Thus far, this apparently has not had a significant effect on the overall M&A activity involving Japanese companies, but it has the potential to significantly alter the Japanese M&A landscape over the years.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

In Japan, the Companies Act and the Financial Instruments and Exchange Act (FIEA) provide the fundamental statutory framework for M&A transactions. The Companies Act provides fundamental rules concerning companies and applies to both public and closed companies, whereas the FIEA makes provision for, *inter alia*, public offers of securities, tender offers and insider trading, and is an important source of rules regulating M&A transactions involving public companies. There are also other important laws such as the Antimonopoly Act in which Japanese merger control rules are contained. In relation to foreign investment in Japanese companies, the Foreign Trade and Foreign Exchange Act requires the approval of, or reporting to, relevant ministries in certain circumstances.

1 Hiroki Kodate is a partner and Yuri Totsuka is an associate at Anderson Mōri & Tomotsune.

The listing rules promulgated by the Japanese stock exchanges provide for, *inter alia*, timely disclosure obligations, corporate governance codes and delisting requirements, which are also important for deals involving public companies.

Finally, a number of recent court cases have the potential to significantly affect the M&A framework of Japan. See Section V, *infra*.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Amended Companies Act of 2014 (Amendment Act)

In May 2015, the Amendment Act came into effect, following its promulgation in June 2014. The following briefly focuses on one major point that concerns M&A transactions.

Buyout by a special controlling shareholder

The Amendment Act has a new provision that allows a special controlling shareholder (SCS) – a person who holds at least 90 per cent of the voting rights of all shareholders of a company – to demand that all other shareholders of the company sell their shares to the SCS.[2]

An SCS who intends to make such demand is first required to notify the company about the conditions of the sale, including the amount of money to be paid to selling shareholders, and the date on which the SCS will acquire the shares. If the company consents to the conditions, it must give notice to the selling shareholders no later than 20 days prior to the acquisition date, stating, *inter alia*, the details of the SCS and conditions of the sale. When the company gives such notice, the SCS is deemed to have made the demand to other shareholders for the sale of their shares, and the SCS will acquire all of the shares on the date of acquisition.

For an SCS who intends to carry out a cash out of the remaining shareholders, this new rule will speed up the process as it does not require a shareholders' meeting, unlike general cash-out techniques that were used under the former Companies Act. Therefore, it was expected that this new rule is likely to be used in practice.

In M&A transactions these days in Japan, this provision is very commonly used by persons or entities who are categorised as SCS. For a person or entity who has a shareholding of less than 90 per cent of the voting rights of all shareholders of the company, a squeeze-out by consolidating its shares (reverse stock split) is generally used as a M&A scheme.

ii Corporate Governance Code (Code)

In June 2015, the Code set forth by Tokyo Stock Exchange (TSE) came into effect. The Code establishes fundamental principles for effective corporate governance, which include a structure for transparent, fair and decisive decision-making by listed companies in Japan, with due attention to the needs and perspectives of shareholders and also customers, employees and local communities. Under the Code, listed companies are required to comply with each principle, or otherwise provide a proper explanation of their reasons for non-compliance in a corporate governance report (comply or explain approach). The following briefly reviews one specific point regarding M&A transactions.

2 The Amendment Act provides that these new cash-out rules also apply to share options.

Appointment of independent directors

Principle 4.8 of the Code states that listed companies should appoint at least two independent directors,[3] who are expected to monitor the management from the outside of companies, and fulfil their roles and responsibilities with the aim of contributing to the sustainable growth of companies and increasing corporate value over the mid to long-term.

Many companies have responded quickly to these changes, with the ratio of first section listed companies with two or more independent directors in 2015 rising to 48.4 per cent from 21.5 per cent (2014) according to a survey of the TSE based on corporate government reports submitted by listed companies.[4] In addition, the ratio of first section companies with at least one independent director in 2015 increased to 87.0 per cent from 61.4 per cent (2014) according to the same survey.

Considering the expected role of independent directors, they are required to be active when a company intends to undertake management buyouts, M&A transactions or other transactions where fairness is especially required.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

i Outbound transactions

Due to the increasing recognition of the importance of overseas operations among Japanese companies, there continues to be large-scale outbound M&A transactions in which Japanese companies are acquiring high-value businesses outside Japan. Last year's notable examples are as follows.

Tokio Marine & Nichido Fire Insurance Co, Ltd/HCC Insurance Holdings, Inc

In June 2015, Tokio Marine Holdings, Inc (TMHD) and HCC Insurance Holdings, Inc (HCC) announced that they had entered into a definitive agreement under which TMHD, a leading insurance group in Japan, would acquire all outstanding shares of HCC, a US insurance company comprising property and casualty, accident and health and other specialty insurance businesses, for US$78.00 in cash per share, through TMHD's wholly-owned subsidiary, Tokio Marine & Nichido Fire Insurance Co, Ltd. The acquisition was completed with a total transaction value of approximately US$7.5 billion. TMHD aims to enhance Tokio Marine's operations in the US, the largest insurance market in the world and internationally by this acquisition.

Japan Tobacco Inc – Reynolds American Inc (Natural American Spirit business)

In September 2015, Japan Tobacco Inc (JT), a leading tobacco maker in Japan, announced that it had agreed with Reynolds American Inc (Reynolds) that JT would acquire business related to the Natural American Spirit brand of tobacco outside the US, including the trademark rights of the brand related to the tobacco sales business outside the US and all the shares of the nine subsidiaries of Reynolds outside the US that sell the brand of tobacco products. The

3 Independent director: an outside director that is designated as an independent director under the TSE listing rules.

4 Tokyo Stock Exchange Inc, 2015. Appointment of Outside Directors by TSE-Listed Companies (Final Report): www.jpx.co.jp/english/news/1020/20150729-01.html.

acquisition was completed in January 2016 with a total transaction value of approximately US$5 billion. JT aims to expand its brand portfolio and enhance its competitiveness as well as accelerate the growth of the above brand.

ii Inbound transactions

Comcast Corp/USJ Co, Ltd

In September 2015, Comcast Corp (Comcast), a US cable television company, announced that it had agreed to acquire 51 per cent of the shares of USJ Co Ltd (USJ), a leisure and entertainment company in Japan, for approximately US$4.8 billion, through Comcast's wholly-owned subsidiary, NBC Universal, LLC.

Vinci and ORIX /New Kansai International Airport

In December 2015, VINCI Airports SAS (VINCI), an airport concession holder and operator in France, and ORIX Corporation (ORIX), a leading integrated financial service group in Japan, announced that they had established Kansai Airports to manage the Kansai and Osaka International Airports Concession, and at the same time, Kansai Airports had signed a contract with New Kansai International Airport Company for the operation of the Kansai and Osaka international airports. The transaction volume was approximately US$13.6 billion.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

i Court decisions

In 2015 and 2016, there were a number of notable court cases in Japan that may affect future M&A transactions. In this section, we discuss a case regarding a petition for the determination of the stock acquisition price in the context of squeezing out the remaining shareholders in a going-private transaction.

Toho Real Estate case

In March 2016, the Tokyo High Court issued a judgment on a petition for the determination of the stock acquisition price filed by shareholders of Toho Real Estate Co, Ltd, a Japanese real estate company. The acquisition of the shares by Toho Real Estate was based on a shareholder resolution regarding the acquisition of common shares that are subject to being wholly called, which was made after a takeover bid from Toho Co, Ltd, the parent company of Toho Real Estate. Unlike the Tokyo District Court in the first trial, the Tokyo High Court held that an adjustment of the stock price according to fluctuations in the market price was unnecessary.

The Tokyo District Court held that when determining the acquisition price, the objective value of the relevant stock that the shareholder could have enjoyed without the acquisition, and also the expected increased value following the acquisition (to the extent that existing shareholders should enjoy it) shall be taken into consideration. In addition, the Court held that the objective value of the relevant stock in this case should be determined based on the market stock price predicted by applying the volatility rate of the closing prices on TOPIX and the TSE Real Estate Index for the period from the announcement date to the acquisition date; and that the average of such predicted prices for a one-month period

dating back from the acquisition date should be used, to exclude or decrease the influence of incidental factors. This judgment is particularly noteworthy, because the adjustment was calculated based on a regression analytical method.

On the other hand, the Tokyo High Court denied such adjustment because, in this case, as the acquisition price was determined in accordance with fair procedures, the agreement between the parties should be respected; the fluctuations in the market price for the period from the announcement date to the acquisition date were not at all rare or unusual; and such adjustment significantly impaired the parties' predictions.

ii M&A transactions in Japan

JX Holdings Inc/TonenGeneral Sekiyu KK

In December 2015, JX Holdings Inc (JXHD), a leading energy company in Japan, announced that JXHD and TonenGeneral Sekiyu KK (TonenGeneral), an oil company in Japan, entered into an MOU in which they agreed on a business integration. JXHD is planning to cause its 100 per cent subsidiary to acquire TonenGeneral by a scheme of triangular merger. The deal amount of this acquisition is approximately US$6.156 million.

Sumitomo Mitsui Finance and Leasing/GE Japan GK

In December 2015, Sumitomo Mitsui Finance and Leasing Company, Limited (SMFL) announced that it had agreed to acquire General Electric Company's (GE) leasing business in Japan (equipment and asset leasing business, small-ticket leasing business and automotive leasing business) by acquiring GE Japan GK, a finance and leasing company owned by GE Ireland Usd Holdings Unlimited Company, a subsidiary of GE. The deal amount of this acquisition is approximately US$4.755 million. SMFL will be the second-largest leasing company in Japan.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Leveraged buyouts (LBOs) have become more common in Japan in recent years. Banks operating in Japan extend loans to acquisition vehicles funded partly by equity so that these vehicles may make a tender offer over a Japanese-listed target to acquire all of the issued shares in it (the first-tier transaction), followed by a squeeze-out transaction for the remaining shareholders with the approval of shareholders of the target at a shareholders' meeting or the approval of the board of directors (the second-tier transaction; see above regarding the Amendment Act's introduction of the new cash-out rule). LBOs are also often utilised in the context of private acquisitions. Extension of loans is often made in the form of syndicated loans, which involve a number of banks in the case of large-scale buyouts.

VII EMPLOYMENT LAW

i Guideline on the succession of labour contracts upon the transfer of a business

The Ministry of Health, Labour and Welfare (MHLW) is planning to set out a guideline on the succession of labour contracts upon the transfer of a business. Since, unlike upon a merger, the consent of each employee is required for such succession upon the transfer of business, it was not regarded as important to set out the statutory regulation for the protection of employees in such a case. However, a transfer of business often has severe

effects on employment and the conditions of employment, and can also cause conflicts in connection with the succession or interruption of labour contracts. Thus, the MHLW has begun to recognise that a guideline is necessary to ensure the substantial consent of each employee and enhance the active communication between a company and its employees.

Although the proposed guideline is not a binding rule, it recommends that companies pay attention to items including that the consent of each employee is required upon the succession of a labour contract; that the information provided by companies should explain adequately about the transfer of business and an outline of the assignee of business; and that the consent of each employee is also required for any amendment to the conditions of employment. The proposed guideline has not yet been established; however, because it was drafted based on some recent court cases and trends in labour issues, companies should prepare for the enactment of the guideline.

VIII TAX LAW

The following is a review of two court cases regarding a catch-all anti-avoidance rule concerning corporate reorganisations.

i Yahoo! case

In April 2011, Yahoo! Japan Corporation (Yahoo! Japan) filed a lawsuit in the Tokyo District Court to challenge an administrative decision of the Tokyo Regional Tax Bureau (TRTB), in which it applied Article 132-2 of the Corporate Tax Act (CTA), a catch-all anti-avoidance rule concerning corporate reorganisations (the catch-all rule).

In February 2009, Yahoo! Japan purchased from its parent company SoftBank IDC Solutions Kabushiki Kaisha (IDC), which had net operating losses (NOLs). This purchase was followed by a merger of IDC into Yahoo! Japan a month later, and Yahoo! Japan, in its 2009 tax return, deducted the NOLs that it had succeeded from IDC. Following this deduction, the TRTB concluded that the real reason behind the merger was tax avoidance, disallowed the deduction of the NOLs, and determined that Yahoo! Japan owed a tax liability of an estimated ¥26.5 billion. In March 2014, the Tokyo District Court dismissed Yahoo! Japan's claim. Yahoo! Japan appealed, but the Tokyo High Court also dismissed Yahoo! Japan's claim in November 2014, basically for the same reasons that the Tokyo District Court had indicated. Finally, Yahoo! Japan appealed to the Supreme Court, but in February 2016, it also dismissed Yahoo! Japan's claim.

This is considered to be the first case where the catch-all rule has been applied since it was added to the CTA in 2001 along with provisions that introduced tax-free corporate reorganisations. Under the catch-all rule, regardless of the type of corporate reorganisation and accounting treatment for tax purposes, a district director of a regional tax office may challenge the tax benefits sought by a corporation that was a party to a merger, corporate divisive reorganisation, in-kind incorporation, in-kind distribution, share exchange or transfer of shares (each a 'corporate reorganisation'); and assess taxable income, losses and amount of tax liabilities of such corporation. The district director can exercise the above authorities when it is found that the burden of corporate tax is 'unjustifiably lightened' by a corporate reorganisation.

With respect to the phrase 'unjustifiably lightened', the Supreme Court stated that acts to be subject to the catch-all rule are abuses of the tax system relating to reorganisation (reorganisation tax system) as a way of tax avoidance. The Supreme Court also stated that a

relevant act falls under such abuse if such relevant act has the intention of tax avoidance and is considered to be deviating from the intent and purpose of the provision of the reorganisation tax system. In determining whether an act is an abuse of the tax system, a court will consider (1) whether the relevant act is deemed unnatural because of its unusual procedure or scheme, or its form, which does not match the reality; and (2) the existence of a reasonable business purpose or other events for the relevant act other than tax avoidance. According to the above framework, the Supreme Court concluded that the relevant acquisition shall be subject to the catch-all rule.

While the Tokyo District Court and the Tokyo High Court stated that even if it is found that each stage of a corporate reorganisation had a business purpose, the phrase 'unjustifiably lightened' will apply if the reorganisation as a whole was clearly contrary to the intent and purpose of the reorganisation tax system, it is considered that the Supreme Court does not intend the same, which is interpretation more favourable for corporations than that found under the Tokyo District Court and the Tokyo High Court framework.

ii IBM case

The issue in this case was also the catch-all rule. IBM Japan, Ltd (IBM Japan) had acquired its treasury shares from IBM AP Holdings (Holdings), which caused a ¥400 billion loss for Holdings. Following the acquisition, Holdings and IBM Japan adopted a consolidated tax payment system, and consequently a loss carry forward had been deducted from the income subject to taxation that IBM Japan gains. The TRTB applied the catch-all rule to this case and denied the deduction. IBM Japan filed a lawsuit to challenge the administrative decision, and won its case both in the Tokyo District Court and the Tokyo High Court. The nation appealed to the Supreme Court, but the final appeal was rejected.

The Tokyo District Court held that whether the burden of corporate tax is 'unjustifiably lightened' shall be determined by whether the relevant act of corporation is deemed economically unreasonable. The Tokyo High Court adopted a framework similar to the Tokyo District Court; furthermore, the Tokyo High Court stated that if the relevant act is different from transactions that are normally conducted between independent and equal parties who have no special relationship, it is considered to be economically unreasonable.

Because the courts did not find that IBM conducted the acquisition to avoid taxation without any justifiable business purpose, as the nation had asserted, the Tokyo District Court and the Tokyo High Court concluded that it shall not be subject to the catch-all rule. The Supreme Court seems to have rejected the appeal, since it concluded that there were no issues to be argued relating to the interpretation of the law.

IX COMPETITION LAW

i Oji/Chuetsu case

In May 2015, the Japan Fair Trade Commission (JFTC) announced a result of its review of the acquisition by Oji Holdings Corporation (Oji) of additional shares in Chuetsu Pulp & Paper Co, Ltd (Chuetsu). Oji and Chuetsu are both Japanese companies that engage in manufacturing and selling paper and pulp products. Oji, one of the two largest paper manufacturing groups in Japan, held nearly 10 per cent of the shares in Chuetsu, and proposed to acquire additional shares in Chuetsu to obtain 20.9 per cent of its voting rights (acquisition).

Upon receiving notification of the proposed acquisition, the JFTC reviewed the acquisition and reached the conclusion that, given the undertakings proposed by Oji and Chuetsu, competition in any particular field of trade was unlikely to be substantially restrained.

Initially, the JFTC concluded that there would be 'joint relationship' (a relationship in which two or more companies operate a business in a united form, whether fully or partially by shareholding, merger or other transaction) between the parties, because as a result of the acquisition, Oji would have the highest ratio of voting rights in Chuetsu. Oji responded by arguing that the joint relationship would not be strong because the acquisition was not aimed at controlling Chuetsu's management. However, the JFTC held that because the acquisition was aimed at including Chuetsu in the Oji group by causing Chuetsu to become an affiliated company and the parties had a plan of business partnership, the possibility of a joint relationship was not weak.

Secondly, the JFTC held that, with respect to at least six products, the acquisition would create a situation where the combined group and other competitors could easily coordinate their conduct and thereby restrain competition in the relevant markets. This was because, among other factors:

a in the relevant market, there are limited competitors or the market shares of a few players are highly concentrated;
b each manufacturer has limited excess supply power generally;
c paper manufacturers are able to obtain price information of their competitors from their distributors;
d demand fluctuations in the relevant market are limited and the relevant industry is less innovative; and
e paper manufacturers tend to raise their price simultaneously.

Notwithstanding the above, the undertakings proposed by Oji and Chuetsu (such as an undertaking that the parties each will independently operate the business relating to the six products) satisfied the JFTC and allowed it to conclude that the acquisition would not substantially restrain competition.

X OUTLOOK

Due to Abenomics, Japanese stock remains high and the Japanese yen continues to be relatively weak. It remains to be seen how long these trends will continue and how much they will eventually affect the level of activity of M&A transactions involving Japanese companies.

Appendix 1

ABOUT THE AUTHORS

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Hiroki Kodate is a partner at Anderson Mōri & Tomotsune, and is principally involved in the fields of corporate and commercial law, with an emphasis on M&A and corporate governance. In addition to his experience at Anderson Mōri & Tomotsune, he has served as an attorney at the Civil Affairs Bureau of the Ministry of Justice of Japan (2002 to 2005), where he was engaged in the modernisation of Japanese corporate law. He also worked at Slaughter and May in London from 2000 to 2001.

Mr Kodate received his LLM from Harvard Law School (2000) and his LLB from the University of Tokyo (1994).

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Yuri Totsuka is an associate at Anderson Mōri & Tomotsune, and her practice areas include corporate law and M&A. She received her JD degree from Waseda University (2014). She is a member of the Daini Tokyo Bar Association in Japan (since 2015). She speaks Japanese and English.

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