The Mergers & Acquisitions Review

Eleventh Edition

Editor
Mark Zerdin

The Law Reviews

THE MERGERS & ACQUISITIONS REVIEW

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Eleventh Edition

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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 2016. Thanks partly 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 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.

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*.

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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 the conditions of the sale. When the company gives such notice, the SCS is deemed to have made the demand to the 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 in Japan today, this provision is very commonly used by persons or entities who are categorised as SCSs. For a person or entity who has a shareholding of less than 90 per cent of the voting rights of all shareholders of a company, a squeeze-out by consolidating its shares (reverse stock split) is generally used as an 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 outside companies, and to 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 2016 rising to 79.7 per cent from 21.5 per cent (in 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 2016 increased to 97.1 per cent from 61.4 per cent (in 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 continue 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.

SoftBank Group Corp (SoftBank)/ARM Holdings plc (ARM)

In July 2016, SoftBank announced that SoftBank and ARM, a leading British chip designer, had agreed on the terms of a proposed acquisition of the entire shares of ARM by SoftBank through a court-sanctioned scheme of arrangement. In September 2016, SoftBank announced that the transaction had been completed with a total transaction value of approximately US$31 billion. This is the biggest ever purchase of a European technology company by a Japanese company.

Asahi Group Holdings, Ltd (Asahi)/Anheuser-Busch SA/NV (AB InBev)

In December 2016, Asahi announced that it had executed a share purchase agreement with AB InBev to acquire AB InBev's business in the Czech Republic, Slovak Republic, Poland, Hungary and Romania and other related assets that were owned by SABMiller plc prior to its merger with AB InBev. The total transaction amount is expected to be approximately €7.3 billion.

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

4 Tokyo Stock Exchange Inc, 2016. Appointment of Outside Directors by TSE-Listed Companies (Final Report): www.jpx.co.jp/news/1020/nlsgeu000001sndx-att/20160727-1.pdf.

ii Inbound transactions

Hon Hai Precision Industry Co, Ltd (Hon Hai), Foxconn Technology Group (Foxconn)/ Sharp Corporation (Sharp)

In February 2016, Sharp, a major electronics firm in Japan, announced that Sharp had accepted an acquisition plan proposed by Foxconn Technology Group (Foxconn), a leading Taiwanese multinational electronics contract manufacturing company. In March 2016, Foxconn and Sharp jointly announced that Sharp would issue new shares through third-party allotments in which the allottees were four companies affiliated with the Foxconn Technology Group, including Hon Hai. The acquisition was completed in August 2016 with a total transaction value of approximately US$3.8 billion.

Kohlberg Kravis Roberts & Co LP (KKR)/Calsonic Kansei Corporation (CK)

In November 2016, KKR, a leading global investment firm, and Nissan Motor Co, Ltd (Nissan) announced that CK Holdings Co, Ltd (offeror), an entity owned through investments controlled by KKR, intends to make a tender offer for all the existing shares of CK, a leading Japanese automotive components manufacturer. In connection with the tender offer, the offeror had entered into a tender agreement with Nissan, the lead shareholder in CK, to acquire in the tender, Nissan's approximate 41 per cent shareholding of CK's common shares. In March 2017, KKR and CK announced that the tender offer had been completed. As a result of the tender offer, the offeror had become the owner of 95.12 per cent of the existing common shares and had become a special controlling shareholder (SCS) as stipulated in the Amendment Act. For the purpose of making CK a wholly owned subsidiary of the offeror by acquiring all shares of CK, the offeror, as an SCS, demanded that all the remaining shareholders sell their shares to the offeror. The total transaction value is expected to be approximately US$4.5 billion.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

i Court decisions

In 2016 and 2017, 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.

Jupiter Telecommunications case

In July 2016, the Supreme Court of Japan issued a landmark judgment with respect to a petition for the determination of the stock acquisition price filed by shareholders of Jupiter Telecommunications Co, Ltd (J:COM), a Japanese CATV operation and telecommunication business company. In this judgment, the Supreme Court made it clear that where a petition for the determination of the stock acquisition price has been filed by a minority shareholder in connection with a cash-out transaction, the court should focus primarily on the fairness of the tender offer process; and if the process was fair, the court should respect the acquisition price determined by the offeror.

The typical scheme for the acquisition of all outstanding shares of a public company is usually a two-step process: the offeror initiates the tender offer, followed by a cash-out transaction. In *J:COM*, just as other usual cases at that time, after completion of the tender offer, the 'shares subject to call' methodology was used as a cash-out transaction in the second step.[5] In this arrangement, dissenting minority shareholders are granted a right to file a petition for the determination of the stock acquisition price. As the overall stock market had risen following on from the announcement of the tender offer to the acquisition, the shareholders of J:COM filed said petition, claiming that the price offered in the tender offer was too low for the acquisition price.

The Tokyo District Court held that the acquisition price should be determined based on the 'objective value' of the shares at the time of the second step cash-out transaction, and then adding a premium reflecting the expected increase in value through the cash-out transaction the portion of which the court deemed fair to allocate to minority shareholders. The Court also held that in determining 'objective value', it is fair to adjust the offer price upward, based on the overall stock market in this case. The Tokyo High Court maintained the same decision as the Tokyo District Court.

However, the Supreme Court reversed the lower court decisions that followed the traditional framework. The Supreme Court held that, if the tender offer was made in accordance with a process generally accepted to be fair, and the offeror has offered the same acquisition price as the first step tender offer for the second step cash-out transaction, then the court should approve that same price as fair value for the minority shares in the cash-out transaction as long as there are no exceptional circumstances.

As to what process needs to be followed to satisfy a 'process generally accepted as fair', in *J:COM*, the Supreme Court made references in its opinion to the fact that J:COM had obtained the opinion of an independent committee that it had set up, that the offeror had announced in the tender offer process that the acquisition price for the cash-out transaction in the second step would be the same price as the offer price, and that the offeror would acquire the minority shares at that price.

This new framework established by the Supreme Court decision is likely to increase foreseeability and certainty of total acquisition prices in buyouts. Further, the scope of this decision is likely to also cover other cash-out transactions, including those using the right of the SCS method. Notwithstanding the above, the scope of what would constitute a 'process generally accepted as fair' or 'exceptional circumstances' remains to be seen.

ii M&A transactions in Japan

JX Holdings Inc (JXHD)/TonenGeneral Sekiyu KK (TonenGeneral)

In December 2015, JXHD, a leading energy company in Japan, announced that JXHD and TonenGeneral, an oil company in Japan, entered into a memorandum of understanding in which they agreed on a business integration. JXHD is planning to use its 100 per cent subsidiary to acquire TonenGeneral under a scheme of triangular merger. In August 2016, JXHD and TonenGeneral announced that they had entered into a definitive agreement on the business integration. The deal amount of this acquisition is approximately US$6.2 billion. JXTG Holdings, Inc, the new integrated company, has become by far Japan's largest oil distributor.

5 Before the Amendment Act became effective, almost all cash-out transactions in the second step used the shares subject to the call methodology. Under the Amendment Act, it is common to use the right of an SCS to compulsorily acquire the shares of the target held by all other shareholders in the second step.

Canon Inc (Canon)/Toshiba Medical Systems Corporation (TMSC)

In March 2016, Canon announced that it had concluded a share transfer agreement with Toshiba Corporation (Toshiba) concerning the acquisition of shares of TMSC held by Toshiba. In December 2016, Canon announced that it had completed the acquisition of the shares and that TMSC is now a subsidiary of Canon. The deal amount of this acquisition is approximately US$5.9 billion.

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 (first-tier transaction), followed by a squeeze-out transaction for the remaining shareholders with the approval of the shareholders of the target at a shareholders' meeting or the approval of the board of directors (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. The 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 Amendments to the Ordinance for Enforcement of the Act on the Succession to Labour Contracts upon Company Split (Succession Act Ordinance)

The Succession Act Ordinance and the Guideline for Appropriate Implementation of Measures to be Taken by a Split Company or Succeeding Company Related to the Succession to Labour Contracts or Collective Agreements Executed by a Split Company (Succession Act Guideline) have recently been amended (effective as of 1 September 2016).

ii Succession of labour contracts upon a company split

With respect to the succession of labour contracts upon a company split, the individual consent of employees to be succeeded is not required, however, under the Act on the Succession to Labour Contracts upon a Company Split and other relevant laws and regulations. The split company must take the following measures to protect employees (among other matters): consult with a labour union or a person representing the majority of employees; conduct individual consultations with employees; and issue notices to the employees to be succeeded. The outline of these procedures has not been changed by the amendments. However, there are some changes to further promote the protection of employees (among other matters) as follows:

a under the amended Succession Act Ordinance, matters that need to be notified to employees have been broadened. The new provision stipulates that, if the labour contracts of relevant employees are to be succeeded, the successor company is required to notify the employee of the fact that the conditions of his or her employment will be maintained after succession so that the employees properly understand the succession procedure; and *b* under the amended Succession Act Guideline, a successor company is required to conduct individual consultations with employees who are not involved in the succeeded business but whose labour contracts will be succeeded upon the company split.

iii Establishment of Business Transfer Guideline

A guideline on the succession of labour contracts upon the transfer of a business and mergers, the Business Transfer Guideline, came into effect as of 1 September 2016. 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 Ministry of Health, Labour and Welfare has begun to recognise that a guideline is necessary to ensure the substantial consent of each employee and to enhance active communication between a company and its employees.

The Business Transfer Guideline stipulates that companies that intend to obtain the consent of employees are required to pay attention to the principle that the consent of each employee is required upon the succession of a labour contract, and to adequately explain the transfer of business and provide an outline of the assignee of the business. In addition, the Business Transfer Guideline provides some guidance in connection with the procedures to engage with labour unions and collective bargaining.

VIII TAX LAW

In March 2017, the 2017 tax reform bill was enacted. This section illustrates the new rules concerning tax-free spin-offs, one of the notable changes in the 2017 tax reforms that are most relevant to M&As.

Under the former rules, the scope of spin-offs (i.e., restructuring schemes for business carve-outs) that qualify as tax-free reorganisations was narrowly defined. To be categorised as a tax-qualified company split, for example, the transferor and the acquirer had to be related parties. In contrast, the 2017 tax reform provides two key alternatives for spinning-off a business with tax deferability for capital gains, losses and dividends, making it easier for Japanese companies (especially public companies) to restructure businesses.

i Carve-out by a company split of a target business to a new company

When a listed company (transferor) desires to carve-out a target business for the purpose of restructuring its businesses, the transferor may use the company split under the Companies Act to split the target business off into a new entity (newco), whereby the shares of the newco will be distributed to all the public shareholders of the transferor in a proportion that reflects the number of shares held by such public shareholder in the transferor company as a payment in kind (split-off type of company split).

Under the new rules, the above structure will be tax-qualified subject to certain conditions. The conditions include the following: the transferor should not have a controlling shareholder prior to the spin-off, nor should the newco have a controlling shareholder upon completion of the spin-off; approximately 80 per cent or more of the employees engaged in the target business should be employed by the newco after completion of the spin-off; and following the completion of the spin-off, the board of directors of the newco shall include a director who is an officer or employee of the transferor.

ii Carve-out of a subsidiary by a distribution of a subsidiary's shares

The second alternative is in relation to the carve-out of an existing subsidiary by a distribution of shares in that subsidiary. When a transferor desires to carve-out a target business engaged in by a wholly owned subsidiary of the transferor (subco), the transferor may use a distribution in kind of the subco's shares to all of the public shareholders of the transferor in a proportion that reflects the number of shares held by such public shareholder in the transferor company.

Under the new rules, the above structure will be tax-qualified subject to certain conditions, including the following matters: the transferor should not have a controlling shareholder prior to the distribution in kind, nor should the subco have a controlling shareholder upon completion of the distribution in kind; approximately 80 per cent or more of the employees employed by the subco should remain employed by the subco after completion of the spin-off; and at least one of the directors on the board of directors of the subco prior to completion of the spin-off should remain after the completion of the spin-off.

As illustrated above, the 2017 tax reform provides more flexibility for companies (in particular for public companies) in separating or disposing of non-core business. By expanding the tax-qualified spin-off options, the new rules will likely result in an increase in the popularity of such business restructurings. However, it is worth noting that the conditions that need to be met to qualify as a tax-free spin-off are still considered to be strict.

IX COMPETITION LAW

In June 2016, the Japan Fair Trade Commission (JFTC) announced the result of its review of the proposed acquisition by Canon of shares in TMSC held by Toshiba, concluding that it would not have the effect of restraining competition in any particular field of trade. However, in the same announcement, the JFTC also issued a caution[6] pointing out that the scheme of the acquisition could violate the Antimonopoly Act.

Before submission of the notification to the JFTC, Canon acquired, *inter alia*, share options whose underlying shares were common shares of TMSC, and, as consideration for such share options, etc., Canon in effect made a payment to Toshiba of an amount equal to the value of the underlying common shares. Further, a third party had participated in owning the voting shares of TMSC until Canon exercised the share options.

This series of actions had been considered to be likely to give rise to the formation of a joint type of relationship[7] between Canon and TMSC through the above-mentioned third party, resulting in part of a structure premised on Canon ultimately acquiring the voting shares of TMSC, which the JFTC stated was subject to approval being obtained as a business combination review under the Antimonopoly Act.

6 The JFTC issues a 'caution' when it does not find sufficient evidence to support the existence of illegal conduct but finds that such a conduct may lead to a possible violation.

7 'Joint type of relationship' means the relationship among two or more companies where they operate a business in a united form, whether fully or partially, by shareholding, merger or other transaction.

Since this series of actions was considered by the JTFC to be likely to lead to an activity that could violate the provisions of Article 10(2) of the Antimonopoly Act, and this had been undertaken before Canon made a notification to the JFTC, which the JFTC stated was inconsistent with the purpose of the prior notification system, the JFTC had cautioned Canon not to conduct such actions in the future and had also urged Toshiba, which engaged in the implementation of the above structure, not to engage in activity in the future that may be inconsistent with the purport of the prior notification system.

Therefore, in the future, where companies planning a business combination need to adopt a structure such as that described above, they shall be requested to make a notification to the JFTC prior to implementing any part of such a structure.

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

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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.

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