Chapter 28

JAPAN

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I OVERVIEW OF M&A ACTIVITY

In view of the changing Japanese and global economy, the level of M&A activity involving Japanese companies overall continued to be moderate throughout 2017. Thanks partly to 'Abenomics', a set of measures introduced by Japanese Prime Minister Shinzo Abe after his re-election to the post in December 2012 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 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

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 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: see Section V.

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III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Amended Companies Act of 2014

The Amended Companies Act of 2014 (Amendment Act) came into effect in May 2015, 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 a 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 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 to be held, 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 Tax reform and amendment to Industrial Competitiveness Enhancement Act

The 2018 Tax Reform Bill was enacted in March 2018. This Bill and the amendment to the Industrial Competitiveness Enhancement Act (Enhancement Act) enacted in May 2018 are expected to facilitate M&A by the acquisition of shares using a company's own shares as consideration.

Special rules allowing deferral of recognition of capital gains derived from share transfer

The acquisition of shares using a company's own shares as consideration (i.e., a stock-for-stock acquisition) is not a popular scheme for a number of reasons, one of the main ones being tax issues arising from such a scheme. Under current tax rules, when a company (Acquirer) uses its own shares as consideration in a share acquisition to acquire another company (Target), the taxation of capital gains arising from the share transfer occurs when the acquisition takes effect. The 2018 Tax Reform Bill allows the shareholders of the Target to defer the taxation of capital gains derived from the share transfer if certain requirements are met. This tax deferral will be applied to a transaction that has been conducted in a manner which is certified as

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

a 'special business restructuring plan' pursuant to the Enhancement Act. The certification must be obtained during the period between the effective date of the Enhancement Act (no later than December 2018) and 31 March 2021. In order to be certified as 'special business restructuring plan,' the business restructuring is required to be a transaction that requires a certain large amount of funds for acquisition and falls under one of the following categories:

a developing new markets business (e.g., autonomous vehicle business and fintech);
b establishing value creation infrastructure business (e.g., platform business); or
c enhancing main business (e.g., conglomerate's restructuring).

iii Interim Proposal for Amendment to Companies Act – share delivery

In February 2018, the Ministry of Justice released an Interim Proposal for an Amendment to the Companies Act (Interim Proposal). With regard to M&A activity, the key topic that has been raised in the Interim Proposal is the proposed introduction of a new type of reorganisation, known as 'share delivery',[3] which is also expected to facilitate stock-for-stock acquisition.

Share delivery

As mentioned above, stock-for-stock acquisition schemes are rarely used. As well as the tax issue described above, such transactions also tend to encounter other hurdles related to the Companies Act. Under the current Companies Act, a subscription of shares in exchange for the Target's shares contributed in kind must be involved and, therefore, a partial acquisition is likely to face the following obstacles:

a an investigation of the Target's shares contributed in kind must be conducted by a court-appointed inspector, which has time and cost implications;
b shareholders of the Target and directors of the Acquirer may be obliged to compensate for the insufficiency of value of the shares contributed in kind.[4]

Such obstacles will not be applied to share delivery.

The Interim Proposal was available for public comment between 28 February 2018 and 13 April 2018. The Bill may be submitted to the Diet in 2019. For companies considering M&A transactions with Japanese companies, close attention must be paid to future trends in the amendments made to the Companies Act.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

i Outbound transactions

In view of 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 outlined below.

3 The Japanese term for share delivery is *kabushiki-kofu*.
4 For the acquisition of whole shares of a Target, the current Companies Act has a statutory reorganisation 'Share Exchange', in which the rules regarding contribution in kind will not be applied.

Takeda Pharmaceutical Company Limited/ARIAD Pharmaceuticals, Inc

In February 2017, Takeda Pharmaceutical Company Limited (Takeda), a leading Japanese pharmaceutical company, announced the completion of ARIAD Pharmaceuticals, Inc (ARIAD), a US oncology company for US$24 per share in cash. Takeda completed the acquisition through a tender offer and the subsequent merger of ARIAD with Kiku Merger Co, Inc, a wholly owned subsidiary of Takeda Pharmaceuticals USA. ARIAD is now an indirectly wholly owned subsidiary of Takeda. The total transaction value was approximately US$5.2 billion. Takeda believes this transaction will significantly enhance its global cancer treatment and research portfolio.

Seven & i Holdings Co, Ltd/Sunoco LP

In January 2018, 7-Eleven, Inc (7-Eleven), a wholly owned subsidiary of Seven & i Holdings Co, Ltd, a leading Japanese company in the convenience-retailing industry, announced that it had completed the acquisition of 1,030 stores owned by Sunoco LP (Sunoco), a US limited partnership that distributes motor fuel and operates convenience stores and retail fuel sites. In the asset purchase agreement entered into between 7-Eleven and Sunoco in April 2017, approximately 1,100 Sunoco stores were supposed to be acquired by 7-Eleven for approximately US$3.3 billion; however, the Federal Trade Commission (FTC) ruled that the proposed transaction would harm competition in local markets. The parties and the FTC were subsequently able to arrive at a consent agreement under which the acquisition could proceed. Under this agreement, 7-Eleven was required to sell 26 retail fuel outlets to Sunoco and Sunoco was further required to retain 33 fuel outlets that 7-Eleven otherwise would have acquired.

ii Inbound transactions

Toshiba Memory Corporation/K K Pangea

In September 2017, Toshiba Corporation (Toshiba) announced that it had approved the sale of Toshiba Memory Corporation (TMC), a wholly owned subsidiary of Toshiba, to K K Pangea (Pangea), a special-purpose acquisition company formed and controlled by a Bain Capital Private Equity, LP-led consortium (including its affiliates, Bain Capital) and entered into a share purchase agreement with Pangea. The acquisition was completed in June 2018 with a total transaction value of approximately US$18 billion. The completion of the acquisition had been delayed by a prolonged review by the Chinese antitrust authority. The Bain consortium includes Hoya Corporation, a Japanese medical technology company; SK hynix, Inc, a South Korean chip maker; Apple Inc; Dell Technologies Capital; Seagate Technology plc; and Kingston Technology Corporation. Toshiba has reinvested in Pangea and accordingly acquired approximately 40.2 per cent of the voting rights in Pangea. With Toshiba and Hoya's investments, Japan-based companies will hold more than 50 per cent of the voting rights in Pangea.

USJ Co, Ltd/Comcast Corporation

Comcast Corporation (Comcast), a US-based technology and media company, announced in February 2017 that it had agreed to purchase (from Goldman Sachs, MBK Partners and others) 49 per cent of stocks in USJ Co, Ltd (USJ), a Japanese leisure company that operates a theme park, Universal Studios Japan, for US$2.3 billion. Upon completion of the deal, Comcast, which already owns 51 per cent of stocks in USJ, will become the sole owner of USJ.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

i Court decisions

There were a number of notable court cases in 2016 and 2017 that may affect future M&A transactions. As an example, 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 when 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.

A 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 the announcement of the tender offer to the acquisition, the shareholders of J:COM filed a petition, claiming that the price offered in the tender offer was too low for the acquisition price.

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, 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 upwards, based on the overall stock market in this case.

Tokyo High Court maintained the same decision as the District Court.

However, the Supreme Court reversed the lower courts' 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 regards the process that 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

5 Before the Amendment Act became effective, almost all cash-out transactions in the second step used the 'shares subject to 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.

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 foregoing, the scope of what would constitute a 'process generally accepted as fair' or 'exceptional circumstances' remains to be seen.

ii M&A transactions

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 a memorandum of understanding in which they agreed on a business integration. JXHD used 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 was approximately US$6.2 billion. JXTG Holdings, Inc, the new integrated company, has become by far Japan's largest oil distributor.

Canon Inc/Toshiba Medical Systems Corporation

Canon Inc (Canon) announced in March 2016 that it had concluded a share transfer agreement with Toshiba concerning the acquisition of shares held by Toshiba in Toshiba Medical Systems Corporation (TMSC). In December 2016, Canon then 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 was 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 the issued shares (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 Section III.i regarding the Amendment Act's introduction of the new cash-out rule). LBOs are also often used 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

The Ordinance for Enforcement of the Act on the Succession to Labour Contracts upon Company Split (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 been amended, with effect from 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 Company Split and other relevant laws and regulations, the split company must take the following measures to protect employees (among other matters): (1) consult with a labour union or a person representing the majority of employees; (2) conduct individual consultations with employees; and (3) issue notices to the employees. 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 on 1 September 2016. Because, unlike with a merger, the consent of each employee is required for 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 any 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 take into account 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

The importance of the 2018 Tax Reform Bill in M&A transactions has been discussed in Section III.ii. In this section, we illustrate the new rules concerning tax-free spin-offs, one of the notable changes in the 2017 Tax Reform Bill enacted in March 2017, 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 Bill 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) wishes 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 form a new entity (newco) from the target business, 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 the public shareholders 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: (1) 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; (2) about 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 (3) following 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 wishes 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 the public shareholders of the transferor in a proportion that reflects the number of shares held by the public shareholders in the transferor company.

Under the new rules, the above structure will be tax-qualified, subject to certain conditions, including the following matters: (1) 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; (2) about 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 (3) at least one of the directors on the board of directors of the subco prior to completion of the spin-off should remain after completion of the spin-off.

As illustrated above, the 2017 Tax Reform Bill 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 are likely to result in an increase in the popularity of this type of business restructuring. However, 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 those 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 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.

Since this series of actions was considered by the JFTC 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 carry out such actions in the future, and had 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, if 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

Thanks to the 'Abenomics' measures, Japanese stock remains high and the 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.

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

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