Private mergers and acquisitions in Japan: overview

Keita Tokura, Anderson Mori & Tomotsune

global.practicallaw.com/3-551-4026

CORPORATE ENTITIES AND ACQUISITION METHODS

1. What are the main corporate entities commonly involved in private acquisitions?

The stock corporation (*kabushiki kaisha*) (KK) is the most common form of corporate entity in Japan. A KK can be used flexibly for various sized firms, from a small private company with a sole shareholder to a public company with a large number of shareholders. Almost all Japanese business enterprises listed on stock exchanges use the KK structure.

A limited liability corporation (*godo kaisha*) (GK) is far less commonly used than the KK, but is still sometimes used as an acquisition vehicle in both public and private acquisition deals. A GK is usually suitable for a relatively small-sized company, in which all equity owners participate in management level decision-making of the company. In a KK, ownership and management of the company are structurally separate.

2. Are there any restrictions under corporate law on the transfer of shares in a private company? Are there any restrictions on acquisitions by foreign buyers?

Restrictions on share transfer

Shares in a KK are freely transferable unless the articles of incorporation of the KK (articles) require the approval of the company for share transfers.

This restriction is very commonly found in the articles of private companies. The articles may stipulate that approval must be obtained through a shareholders' resolution, board resolution (if the company has a board of directors) or by the decision of another organisational body of the company.

A buyer in private acquisitions often needs to obtain the approval of the target for the contemplated acquisition of shares. In many cases, the buyer will require such approval to be one of the conditions precedent under the share purchase agreement.

If the target does not approve the contemplated transfer, or if the selling shareholder (or the buyer) requests for the target to do so, the target must either designate an alternative buyer to purchase the shares or buyback the shares itself (*Companies Act (Act No. 86 of 2005)*). The prices of the shares in such scenarios are determined in consultation between the selling shareholder and the alternative buyer (that is, the buyer designated by the company or the company itself). Either party is entitled to file a petition to request that the court determine the price, within a limited period of time.

Foreign ownership restrictions

An acquisition of shares in a Japanese company by a foreign buyer, which is defined as Direct Inbound Investment ("*tainai-chokusetsu-toushi*"), is subject to notification or reporting requirements under the Foreign Exchange and Foreign Trade Act (FEFTA).

If the target engages in certain sensitive business activities (such as manufacturing weapons, operating power plants, and agriculture), a foreign buyer must file a prior notification with the relevant regulatory authority and comply with the required waiting period (which is 30 calendar days, by default).

In addition to the regulations under the FEFTA, there are also several industry or entity-specific foreign ownership restrictions in areas such as radio, broadcasting, cargo forwarding and air transportation.

A May 2019 amendment to the FEFTA expands the scope of business activities for which prior notification is required. The amendment applies to transactions executed after September 2019 and covers, for example:

- Manufacturing integrated circuits, semiconductor memory devices or computers.
- Certain software businesses (any business that develops application software (except gaming software) is likely to fall within this category).
- Provision of information processing support services and certain internet-based support.

Another amendment to the FEFTA that is expected to come into effect in 2020 expands the scope of Direct Inbound Investment. This amendment lowers the threshold at which notification or report of share acquisitions in listed companies is required from 10% to 1%. Further, certain post-deal notification or reporting requirements will also be added to cover such cases where:

- A foreign buyer takes a role as an officer of the target company.
- The principal business of the target is abolished or transferred after an acquisition by a foreign buyer.

Because the scope of foreign investment regulations under the FEFTA is expanding, a foreign company that intends to acquire or invest in a Japanese company must carefully consider and analyse the necessary notification requirements and other relevant proceedings.

3. What are the most common ways to acquire a private company? What are the main advantages and disadvantages of a share purchase (as opposed to an asset purchase)?

Share purchases: advantages/asset purchases: disadvantages

Share purchases are generally the most common way to acquire a private company for the following reasons:

- The procedures for share purchases are usually simpler than those for asset purchases.
- Since the target as a corporate entity remains intact in share purchases, governmental licences and other permits necessary for the target's business can usually be preserved as is.
- Share purchases do not involve assignment of contracts to which the target is a party and consent is not required from creditors, employees or other contract counterparties, unless there is a specific change of control provision in the contracts.

Share purchases: disadvantages/asset purchases: advantages

Asset purchases in private acquisitions are usually in the form of a business transfer (*jigyou jouto*) or a company split (*kaisha bunkatsu*).

In share purchases, the buyer cannot cherry pick the assets and liabilities of the target. In asset purchases by way of business transfer or company split, the buyer can specify the assets to be purchased and liabilities to be assumed.

Business transfer. This is a contractual arrangement between the buyer and the target, by which the target transfers all or part of its business to the buyer. A business usually consists of specific assets, liabilities, contracts, employees and other rights and obligations of the target. Therefore, a business transfer is a bundle of assignments of various assets, liabilities, contracts and employees. It requires individual consents from creditors, employees or other contract counterparties.

Company split. This is a special transaction permitted under the Companies Act. The target carves out certain parts of its business and transfers them to a separate Japanese company (such as a KK or a GK) by operation of law.

There are two types of company split:

- **Absorption-type split.** The target transfers the carved-out business to an existing company.
- **Formation-type split.** The target transfers the carved-out business to its wholly-owned subsidiary, which is newly created by operation of law as part of the transfer.

Business transfer versus company split. A company split has an advantage over a business transfer in that all the assets, liabilities, contracts and employees that constitute a business are transferred to the buyer by operation of law without the need for consents of creditors or other contract counterparties (universal succession). However, the creditors are given an opportunity to raise objections to the contemplated company split within a statutory creditor protection period of at least one month. Moreover, the buyer still needs to obtain individual consents of creditors or other contract counterparties if the relevant contract specifically prohibits the contemplated transfer of business.

Combination of share purchase and company split. It is common for a transaction to adopt a two-layered structure:

- The target company conducts a formation-type split, to carve out certain parts of its business and transfer them to its wholly-owned subsidiary.
- The buyer purchases the shares in the subsidiary from the seller (that is, the target).

4. Are sales of companies by auction common? Briefly outline the procedure and regulations that apply.

Sales of companies by auction are quite common, especially where private equity houses attempt to exit by way of a trade sale. The mechanism and procedure for such an auction vary from sale to sale, but normally do not deviate significantly from practices in other major jurisdictions.

The selling shareholder(s) and the target company in auction sales may be subject to regulations on offer of sale or solicitation of offer to purchase (*uridashi*) under the Financial Instruments and Exchange Act.

PRELIMINARY AGREEMENTS

5. What preliminary agreements are commonly made between the buyer and the seller before contract?

Letters of intent

A letter of intent is commonly made in private acquisition deals. It is often intended not to be legally binding, except for certain clauses such as confidentiality and exclusivity.

If the parties intend to have a non-legally binding letter of intent, the letter should specifically provide for this intention, otherwise a court may find the letter legally binding based on the factual circumstances.

The issues typically covered in a letter of intent include:

- The basic terms of the transaction (transaction structure, schedule, price range often subject to due diligence, and other agreed terms).
- Confidentiality.
- Exclusivity (*see below, Exclusivity agreements*).
- Co-operation with the buyer's due diligence.
- Costs and expenses.
- Legally binding effect.
- Governing law and jurisdiction.

If a party to the transaction is a listed company, it is often an issue as to whether the timely disclosure obligation under the rules of the relevant stock exchange (press release) is triggered by execution of the letter of intent. There is no clear-cut rule but, normally, the more detailed the terms agreed (especially if they have legally binding effect), the more likely it is that disclosure is required.

Exclusivity agreements

An exclusivity agreement (or lockout agreement) is an agreement between a seller and a buyer, under which the seller agrees not to seek or accept other offers for a specified period. Typically, a letter of intent has an exclusivity clause that is intended to be legally binding.

Depending on the specific circumstances, the exclusivity period can be a week, 30 days, 90 days, or another agreed period.

The remedy available for a breach by a seller of an exclusivity agreement has not been clearly established in Japan. However, it is generally very difficult for the buyer to establish the requirements for injunctive relief. In addition, monetary damages might be limited to reimbursement of actual out-of-pocket expenses

incurred by the buyer, such as the costs of due diligence (that is, not including expectation damages, such as lost profits) (*Sumitomo Trust & Banking v UFJ Holdings (Supreme Court Decision, 30 August 2004, and Tokyo District Court Judgment, 13 February 2006)*).

Non-disclosure agreements

A non-disclosure agreement (or confidentiality agreement) is commonly executed by the parties at an early stage of negotiation, typically before execution of a letter of intent. There are no legal formalities for a non-disclosure agreement to be legally binding.

For a breach of a non-disclosure obligation, the non-breaching party can seek monetary damages. The buyer can also obtain an injunctive order from the court, if it can establish that the injunctive relief is necessary (for example, where monetary damages are not sufficient to protect the buyer's interests).

ASSET SALES

6. Are any assets or liabilities automatically transferred in an asset sale that cannot be excluded from the purchase?

In general, there are no assets or liabilities that must be automatically transferred in asset purchases (as a business transfer or company split).

The parties can specify the assets and liabilities to be included in a purchase (*see Question 3*). Therefore, as long as the parties can reach an agreement, any asset, liability, employee, contract, or tax liability can be excluded from the purchase.

An exception is the special regulation concerning the transfer of employees in a company split under the Act on the Succession to Labour Contracts on Company Split (Labour Contracts Succession Act) (*see Question 31*).

Further, if the seller company becomes financially insolvent or if the asset purchase otherwise causes detriment to the seller company's creditors, the asset purchase can be subject to various actions, for instance:

- Revocation by the creditors on the ground of fraudulent conveyance, under the Civil Code.
- Disaffirmance of the transaction by the administrator, under the Bankruptcy Act.

7. Do creditors have to be notified or their consent obtained to the transfer in an asset sale?

Consents of the relevant creditors are necessary in a business transfer (*see Question 3*).

In a company split, unless the relevant contract specifically prohibits transfer of liabilities or obligations, the relevant creditor's consent is not necessary. However, the creditors can raise objections to the contemplated company split within a statutory creditor protection period of at least one month (*see Question 3*). If a creditor raises an objection during this protection period, the company must make full payment, provide security or entrust property to a trust company, unless the company can establish that the proposed company split is unlikely to cause any harm to the creditor.

In addition, certain groups of employees and the labour union must be notified in writing (*see Question 31*).

SHARE SALES

8. What common conditions precedent are typically included in a share sale agreement?

Common conditions precedent to the buyer's obligation to complete under a share purchase agreement include:

- Bring-down conditions (such as no (material) breach by the seller of the representations and warranties as of the closing date, or no (material) breach by the seller of the pre-closing covenants).
- Third party consents (including waivers relating to triggered change of control clauses in the relevant contracts).
- Execution of ancillary agreements (for example, transitional service agreement).
- Governmental approvals (including clearance from competition authorities).
- The target company's approval of the contemplated transfer (*see Question 2*).
- No material adverse change.

In leveraged buyout deals, financing-out conditions (that the buyer has obtained the necessary external acquisition finance) are one of the most heavily negotiated closing conditions between a buyer and a seller. From the seller's perspective, a financing-out condition significantly threatens deal deliverability. The buyer, without the financing-out condition, risks breaching the share purchase agreement if it fails to obtain acquisition finance.

It is possible to create a reverse break-up fee arrangement, under which the buyer pays a certain amount to the seller to walk away from the deal if the necessary acquisition financing is not obtained. However, currently this arrangement does not seem to be particularly common in practice.

SELLER'S TITLE AND LIABILITY

9. Are there any terms implied by law as to the seller's title to the shares in a share sale? Is any specific wording necessary and do buyers normally impose a higher standard than is implied by law?

There are no specific terms implied by Japanese law as to the seller's title to the shares in a share sale.

Under the Civil Code, a seller's fundamental obligation in a sale and purchase agreement is to transfer good title to the object of the sale and purchase transaction.

Therefore, unless otherwise agreed in the sale and purchase agreement, if the seller fails to transfer to the buyer a good title to the shares, the buyer may be entitled to demand full performance of the seller's obligation, to claim monetary damages or to terminate the contract under the Civil Code.

However, in many cases the share purchase agreement provides that the buyer is only entitled to remedies provided in the agreement (for example, indemnity and termination rights), excluding the above statutory remedies. These contractual remedies may or may not be more preferable for the buyer than the statutory remedies.

In general, no specific form or wording is required to draft provisions for contractual remedies.

In the case of a sale of shares in a company that is a share-certificate-issuing company, if the seller is in possession of the

share certificate representing the shares to be sold, the seller is presumed to be the lawful title owner of the shares.

Importantly, even if the possessor of the share certificate is not the lawful title owner of the shares, a bona fide buyer (meaning a buyer without knowledge of or who is not grossly negligent in not knowing of the defective title of the possessor) who received delivery of the share certificate from the possessor may be deemed to have lawfully acquired full title (*Companies Act*).

10. Can a seller and its advisers be liable for pre-contractual misrepresentation, misleading statements or similar matters?

Seller

If a seller or its agent provides a false explanation to the buyer which induces the buyer to enter into the contract, the seller or its agent can be liable under the Civil Code for providing the false explanation.

Advisers

See above, *Seller*.

MAIN DOCUMENTS

11. What are the main documents in an acquisition and who generally prepares the first draft?

The main document in a share purchase is the share purchase agreement.

In asset purchases, the main document in a business transfer is a business transfer agreement and in company splits, a company split agreement is the main document.

In both a share purchase and an asset purchase, the main document is usually drafted by the buyer, except in an auction sale, where the seller usually produces the first draft.

In addition:

- In company splits, parties sometimes prepare a company split agreement that is as simple as possible, to reflect only the matters required under the Companies Act. They then enter into a separate side agreement, which sets out the detailed terms of the asset purchase and any other terms outside of the company split agreement.
- In business transfers, parties typically execute discrete sale and purchase agreements with respect to certain assets to be transferred (for example, real estate and intellectual property) separately from the master business transfer agreement, to assist with the registration of the transfers with the relevant authorities.

ACQUISITION AGREEMENTS

12. What are the main substantive clauses in an acquisition agreement?

A share purchase agreement typically includes:

- Definitions.
- Agreement of purchase and sale:
  - number of shares to be purchased;
  - closing mechanism; and
  - purchase price.
- Pre-closing and post-closing purchase price adjustments.
- Conditions precedent.
- Representations and warranties.
- Pre-closing covenants, including:
  - the seller's obligation to run the target in ordinary course; and
  - the seller's obligation to cause no leakage.
- Indemnity.
- Termination.
- Post-closing covenants, including the seller's non-competition obligation.
- Miscellaneous provisions, including:
  - confidentiality;
  - public announcement;
  - no assignment;
  - costs and expenses;
  - notices;
  - entire agreement;
  - language; and
  - governing law and jurisdiction.

The basic structure of an asset purchase agreement is not significantly different from that of a share purchase agreement, as set out above. However, an asset purchase agreement needs to provide a list of assets, liabilities, employees, and other rights and obligations to be transferred. Also, it is common for the buyer in an asset purchase to require that the seller obtain consents of the relevant creditors or other contract counterparties, which are necessary for the relevant liability or contract to be transferred.

For material contracts, the necessary consents are usually included as conditions precedent. Otherwise, the parties can also agree that any liability or contract in respect of which necessary consent is not obtained will be excluded from the transfer (often subject to a purchase price adjustment mechanism).

13. Can a share purchase agreement provide for a foreign governing law? If so, are there any provisions of national law that would still automatically apply?

A share purchase agreement can provide for a foreign governing law but this is rare in practice.

Even if the governing law of a share purchase agreement is not Japanese law, the transfer of lawful and valid title to the shares of a target incorporated under the Companies Act (the closing mechanism) remains governed by the Companies Act.

WARRANTIES AND INDEMNITIES

14. Are seller warranties/indemnities typically included in acquisition agreements and what main areas do they cover?

In Japanese practice, a warranty claim is structured as one of the heads of indemnity claim provided for in a share purchase agreement. The seller is liable for the damages incurred by the buyer as a result of its representations and warranties being untrue or incorrect (there is no strict conceptual distinction between

representations and warranties in Japan). This seller's liability is usually structured as part of the seller's indemnity obligation.

Therefore, the seller's representations and warranties, and indemnity obligation in respect of its representations and warranties being untrue or incorrect, are typically included in acquisition agreements.

The main areas that representations and warranties typically cover are the following.

Matters in respect of the seller. These are:

- Authority and due execution.
- Necessary internal procedures completed.
- Binding effect and enforceability of the acquisition agreement.
- No violation of laws.
- Required governmental permissions obtained.
- No insolvency.

Matters in respect of the shares (in share purchases). These are:

- Lawful and valid title to the shares.
- No encumbrances or other limitations.

Matters in respect of the target. These are:

- Due incorporation and existence.
- Share capital structure.
- Group company structure.
- Financial statements and no undisclosed liabilities.
- Assets and debts.
- Material contracts.
- Employees and pensions.
- Tax.
- Compliance and governmental permissions.
- IP and IT.
- Environment.
- Litigation and other disputes.
- Insurance.
- Information/full disclosure.

The scope of these representations and warranties and the areas covered will depend heavily on the circumstances of each acquisition.

15. What are the main limitations on warranties?

Limitations on warranties

Representations and warranties are often subject to limitations such as seller's knowledge and/or materiality qualifications.

Limitations on the seller's indemnity obligation in respect of its representations and warranties being untrue or incorrect typically include:

- Maximum amount (or cap) on indemnity claims.
- Minimum amount on indemnity claims (a *de minimis* exception).
- Exclusion of indirect, consequential or contingent damages.
- Time limitation on indemnity claims.
- Procedural limitation on indemnity claims.

Qualifying warranties by disclosure

Representations and warranties are usually qualified by disclosure, which is usually made by the seller either in a separate disclosure letter or in a disclosure schedule as an attachment to the share purchase agreement.

The Tokyo District Court, in its leading judgment of 17 January 2006, set a general principle that a buyer is not entitled to claim under an indemnity for the seller's breach of representations and warranties if the buyer, at the time of execution of the share purchase agreement, had actual knowledge of the breach or was grossly negligent in not knowing of the breach. However, there have been no established guidelines as to the extent of factual information relating to the seller's breach that would cause the buyer to be deemed to have actual knowledge, or of the actions necessary for the buyer to avoid being deemed grossly negligent. The Tokyo District Court's judgment above found that the buyer did not have actual knowledge and was not grossly negligent.

16. What are the remedies for breach of a warranty? What are the time limits for bringing claims under warranties?

Remedies

Remedies for breach by the seller of a representation and warranty are normally provided in the share purchase agreement, excluding the statutory remedies that may be available to the buyer (*see Question 9*).

Typical remedies for the buyer are:

- If the conditions precedent include no material breach by the seller of the representations and warranties as of the closing date, the buyer can choose not to close the transaction if there is material breach of the representations and warranties.
- Monetary damages.
- Termination (it is usually stipulated that termination after closing is not possible).

Time limits for claims under warranties

Time limits on indemnity claims are usually provided in the share purchase agreement. The length of this time limit depends on each deal and on each item.

Longer time limits (or no time limits) are sometimes separately set for indemnity claims for a breach of certain fundamental representations and warranties, such as the seller's lawful and valid title to the shares. In particular, for representations and warranties relating to the target's tax liabilities, the parties sometimes take into account the statute of limitation on tax claims by the tax authorities (five to seven years).

CONSIDERATION AND ACQUISITION FINANCING

17. What forms of consideration are commonly offered in a share sale?

Forms of consideration

The most common form of consideration in a share sale is cash.

Share consideration.

Under the existing Companies Act, an M&A deal with share consideration is typically structured in one of two ways:

- **Share exchange (*kabushiki koukan*).** This is commonly used in share-for-share private acquisitions with the aim of acquiring

100% of the shares in the target company. Like a merger and company split (*see Question 3*), a share exchange is a special form of transaction permitted under the Companies Act. In a typical share exchange:

- the buyer and the target (not the selling shareholders) enter into a share exchange agreement.
- the share exchange takes effect after certain procedures are completed in accordance with the Companies Act (for example, shareholder resolutions of both the buyer and the target have been obtained, each with at least two-thirds approval).
- according to the share exchange agreement, the buyer compulsorily acquires all the outstanding shares in the target. In return, the existing shareholders of the target receive the buyer's shares as consideration. In this case, no inspection by a court-appointed inspector is required.

- A foreign company buyer is not allowed to conduct a share exchange directly with a Japanese target. However, the foreign buyer can use its own shares as consideration in a triangular share exchange, for instance by establishing a new KK as an acquisition vehicle which becomes a party to the share exchange agreement with the target.
- **Contribution in kind.** The buyer's own shares are not commonly used as consideration in a bilateral share purchase. One reason for this is that the Companies Act requires an inspection by a court-appointed, independent inspector, of the buyer's share issuing procedures in respect of the shares to be issued and exchanged for the target's shares. The inspection procedure may be time consuming, depending on the nature and complexity of the deal, and can take several months. The inspection requirements can be avoided if the share issue falls under any of the exceptions under the Companies Act, which include any of the following:
  - the number of shares issued by the buyer as consideration for the acquisition is no more than 10% of the total issued shares of the buyer.
  - the total issue price (value of the shares in the target) does not exceed JPY5 million.
  - the buyer has obtained a certificate from an attorney-at-law, certified public accountant or tax accountant qualified in Japan, certifying the value of the shares in the target.

To promote M&A deals by way of share consideration, the Industrial Competitiveness Enhancement Act (ICEA) was amended in 2018. There was also an amendment to the Companies Act on 11 December 2019, to introduce a "share delivery" mechanism (*kabushiki-koufu*). The amendment will take effect in 2021.

M&A with share consideration under ICEA. The amendment to the ICEA was enforced in July 2018 and expands the scope of exceptions in the Companies Act intended to promote the use of share consideration in mergers and acquisitions. Exemption from the inspection requirement was not available for private M&As before 2018, but it is now available for them after the amendment under certain conditions.

Establishment of share delivery. The new amendment to the Companies Act will establish the share delivery mechanism. This mechanism is similar to the share exchange mechanism in that it will allow a share-for-share transaction. However, unlike the share exchange, the share delivery mechanism will offer a method of acquiring less-than-100% shares of the target company by using the buyer's shares as consideration.

Factors in choice of consideration

Factors to be considered in choosing consideration are:

- **Availability of funds.** A buyer that does not have sufficient funds in a cash share purchase will need to obtain some form of financing.
- **Dilution.** In a share-for-share acquisition, depending on the relative sizes of the buyer and the target, the buyer may be required to issue a large number of new shares. This could significantly dilute the ownership of the existing shareholders. For procedures for the issue of new shares, see *Question 18*.
- **Seller's preference.** Especially in auction sales, sellers usually prefer immediately available cash to the buyer's shares or other form of consideration. On the other hand, in general, if sellers wish to continue investing in the combined business after the sale, they may require the buyer's shares to form part of the consideration. In this case, the level of liquidity of the buyer's shares (for example, whether listed on a stock exchange, and trading volume in the market) is relevant.

18. If a buyer listed in your jurisdiction raises cash to fund an acquisition by an issue of shares, how is the issue typically structured? What consents and regulatory approvals are likely to be required?

Structure

If the buyer has common stock listed on a stock exchange in Japan, an issue of new shares for acquisition financing has typically been structured as either:

- A public offering of new common stock.
- A third-party allotment (that is offering securities to selected investors) of new common stock, or sometimes convertible bonds convertible into common stock.

A rights offering (free allotment of stock acquisition rights to existing shareholders) is becoming increasingly common in Japan.

Consents and approvals

Under the Companies Act, a listed company can issue common stock (or convertible bonds) by a resolution of the board of directors (without a shareholders' resolution) if both the following requirements are met:

- The issue price of common stock or stock acquisition rights (attached to the convertible bonds) is not particularly favourable to an allottee.
- The number of newly issued shares is within that authorised in the company's articles.

In addition, under the rules of the Tokyo Stock Exchange (except for in special circumstances provided for by those rules) if a listed company conducts a third-party allotment of shares or stock acquisition rights resulting in a 25% or more equity dilution or a change in control of the company, it must obtain either:

- An approval by a shareholders' resolution.
- An opinion by a person independent from the company's management in connection with the necessity and reasonableness of the third-party allotment.

Furthermore, the 2014 Amendment to the Companies Act provides that in the case where new shares are issued by a public company which results in a change of control (that is, where the allotee will hold a majority of the voting rights of all shareholders of the company), the issuing company must both:

- Give prior notice to existing shareholders or make a public announcement of the same.
- Except in very limited circumstances, if shareholders holding 10% or more of the voting rights of all shareholders give a notice

opposing the issue, pass an ordinary resolution at a shareholders' meeting approving the allotment of shares, within a specified period.

Requirements for a prospectus

If a listed company issues listed common stock or a convertible bond (which is convertible into common stock), the company must file a securities registration statement with the regulatory authority, unless the total issue price is less than JPY100 million.

If the company must file the statement, and statutory exceptions do not apply, the company must prepare and deliver a prospectus to the subscribing investors. The content of a prospectus is substantially similar to the securities registration statement.

19. Can a company give financial assistance to a potential buyer of shares in that company?

In general, there are no specific regulations preventing the target from giving financial assistance to a potential buyer of shares in the target.

However, the fiduciary duties of the target's directors should be considered in determining whether such financial assistance is permitted. It is possible that the directors could be seen to breach their fiduciary duties if they provide financial assistance to a potential buyer (for example, by issuing guarantees or providing security over the target's assets in favour of the buyer) and in so doing prejudice the interests of the existing shareholders. Further, the target is prohibited from providing property benefits to any person in connection with the person's exercise of rights as a shareholder of the target (*Article 120, Companies Act*).

In light of the above, in leveraged buyout transactions, the target often only provides guarantees or securities over its assets in favour of the buyer after the buyer has acquired all of the outstanding shares in the target.

SIGNING AND CLOSING

20. What documents are commonly produced and executed at signing and closing meetings in a private company share sale?

Signing

In a private company share sale, the share purchase agreement is usually the document that is executed at signing. The ancillary agreements, such as a shareholders' agreement and a transitional service agreement, are often attached as schedules to the share purchase agreement.

In a private asset sale, the asset purchase agreement (either a business transfer agreement or a company split agreement) is usually the document that is executed at signing.

Closing

In a private company share sale, the documents that are normally produced and executed at closing meetings include:

- Share certificates, if the target is a share-certificate-issuing company.
- Share transfer forms, for the buyer to request a change in the shareholders' register of the target.
- Ancillary agreements, such as the shareholders' agreement and transitional service agreement.

In a private asset sale, documents required to register the transfer of assets that require registration (for example, real estate and certain intellectual property) are usually produced and executed at closing.

21. Do different types of document have different legal formalities? What are the formalities for the execution of documents by companies incorporated in your jurisdiction?

Under Japanese law, there are certain limited instances where specific legal formalities for execution are required (for example, a guarantee contract must be in writing). However, documents executed in private acquisitions do not usually have specific legal formalities.

There are no specific requirements for execution by Japanese companies, except for certain corporate documents that must be prepared in a form suitable for making an application to change the company's commercial registration purposes, which might be required in connection with the private acquisition (for example, a change in directors of the target on closing).

For the agreement to be legally binding and enforceable, as long as a duly authorised representative of a company affixes his signature or the company seal, no other formalities, such as witnesses or notarisation, are required. While it is a business custom in Japan to use a registered company seal (*daihyou in*), the use of such a seal is not a legal requirement for the execution of a legally binding and enforceable agreement.

22. What are the formalities for the execution of documents by foreign companies?

There are no specific formalities required for the execution of documents by foreign companies under Japanese laws.

23. Are digital signatures binding and enforceable as evidence of execution?

Digital signatures are generally binding and can be used as evidence of execution.

24. What formalities are required to transfer title to shares in a private limited company?

In a share-certificate-issuing company, delivery of the relevant share certificates from the seller to the buyer is the condition for the transfer to take effect.

In a non-share-certificate-issuing company, shares can be transferred through an agreement between the seller and the buyer.

In both cases, for the buyer to perfect title to the shares, the transfer must be duly recorded in the target's shareholders' register.

TAX

25. What transfer taxes are payable on a share sale and an asset sale? What are the applicable rates?

Share sale

No transfer taxes (stamp duty or registration tax) are payable on a sale of shares.

Asset sale

Asset sale transactions are usually subject to various taxes, including the following:

- Stamp duty on certain taxable documents, including a business transfer agreement, company split agreement, and agreements executed in Japan regarding the transfer of real property and certain other assets. The amount of stamp duty is either a flat rate or a rate which is based on contract. In either case, the maximum amount of stamp duty is JPY600,000.
- Real property acquisition tax is imposed on the acquisition of land or buildings. Subject to various exemptions and reductions, the tax rate is generally up to 4% of the value of the acquired land or buildings, as assessed by the relevant local government.
- Registration tax is imposed on, among other things, the acquisition of real estate and certain intellectual property (for example, trade marks).

26. What are the main transfer tax exemptions and reliefs in a share sale and an asset sale? Are there any common ways used to mitigate tax liability?

Share sale

Not applicable (*see Question 25*).

Asset sale

There are certain exemptions and reductions available for transfer taxes. For instance, transfer of real property by way of a qualifying company split (*see Question 3*) which meets certain criteria is not subject to real property acquisition tax.

27. What corporate taxes are payable on a share sale and an asset sale? What are the applicable rates?

Generally, corporate tax is potentially payable on the capital gains of a corporate seller (shareholder) in a sale of shares, and on gains of the target in a sale of assets (both business transfers and company splits).

The effective corporate tax rate (including relevant local tax) in Tokyo for the fiscal year commencing on 1 April 2020 (in certain cases) is 30.62%.

In a sale of shares by way of a share exchange (*see Question 17*) scenario, certain assets of the target (such as real property) are subject to corporate tax as if those assets were sold at fair market value by the target, unless the share exchange meets the requirements for a tax-qualified share exchange (*see Question 28*). In contrast, in a straightforward share sale and purchase transaction between the seller and the buyer, target assets are not subject to corporate tax as a result of the sale.

28. What are the main corporate tax exemptions and reliefs in a share sale and an asset sale? Are there any common ways used to mitigate tax liability?

Share sale

Corporate tax on capital gains of a corporate seller can be deferred if the acquisition is made in the form of a tax-qualified share exchange (*see Question 17*).

Corporate tax on the target in a share exchange is exempted if the share exchange meets the requirements for a tax-qualified share exchange.

A straightforward sale and purchase of shares in the target in exchange for shares in the buyer is also a taxable transaction and the corporate seller will be liable to pay corporate tax on any gains made (without being entitled to tax deferral). In this regard, a tax reform enforced in 2018, together with the amendment to the Industrial Competitiveness Enhancement Act, will permit tax deferral treatment to sellers in certain cases, where the sale is made in exchange for stock of a buyer pursuant to a "special business restructuring plan" which has been submitted to, and authorised by, the competent minister(s) of Japan under the Industrial Competitiveness Enhancement Act.

Under the 2020 tax reform, income tax deductions will be accepted for investments in certain start-up companies. Specifically, after 1 April 2020, certain investments in companies within ten years after incorporation result in an income tax deduction equivalent to 25% of the share purchase price.

Asset sale

The target is, in principle, subject to corporate tax on gains from an asset sale (in both a business transfer and a company split). However, in a company split, taxation is deferred if the company split meets the requirements for a tax-qualified company split.

29. Are other taxes potentially payable on a share sale and an asset sale?

If the buyer is to issue new shares for acquisition financing, registration tax is imposed on the increased stated capital. The applicable tax rate is generally 0.7%.

The company must allocate at least half the amount paid by the allottee to stated capital. For instance, if the company receives JPY100 million in exchange for the newly issued shares and allocates half the amount to stated capital (JPY50million), the amount of registration tax is JPY350,000.

Consumption tax applies to domestic transactions, including a sale of certain taxable assets located or registered in Japan. A transfer of assets through a company split is not subject to consumption tax. However, a transfer of assets through a business transfer is generally subject to consumption tax.

As of 1 October 2019, the aggregate consumption tax rate is 10% (national consumption tax rate of 7.8% and local consumption tax rate of 2.2%).

30. Are companies in the same group able to surrender losses to each other for tax purposes? For example, can interest expenses incurred by a bid vehicle incorporated in your country be set off against profits of the target before tax?

Losses can be surrendered between entities if the entities are in the same corporate group under the consolidated tax system. The consolidated tax system applies to a group of Japanese companies, where a Japanese ultimate parent company directly or indirectly owns 100% of the shares of Japanese subsidiaries.

EMPLOYEES

31. Are there obligations to inform or consult employees or their representatives or obtain employee consent to a share sale or asset sale?

Asset sale

In general, there are no legal obligations to inform or consult employees or their representatives or to obtain employees' consent

to an asset sale in the form of business transfer, unless a collective agreement (or other forms of agreement) between the company and a labour union specifically obliges the company to do so. However, guidelines implemented by the Ministry of Health, Labour and Welfare (MHLW) in September 2016 provide certain guidance which companies are advised to follow in dealing with its employees in the context of a business transfer.

Consultation. Under the guidelines, the company is advised to provide the employees subject to transfer with sufficient explanations on the matters, such as the overall situation relating to the business transfer and the overview and working conditions of the transferee company, and hold a consultation with each such employee so that the employee can make an informed judgment on whether to consent to the proposed transfer.

The transferor company should also make endeavours to obtain the understanding and co-operation of the employees with respect to the business transfer. In particular, the company is advised to commence consultations with the labour union representing the majority of the employees, or a representative of the majority of the employees if there is no labour union, before the consultation with the employees described above.

In a company split (*see Question 3*), the Labour Contracts Succession Act and its related regulations provide that:

- If an employee who is primarily engaged in the business to be transferred is excluded from the employees to be transferred under the company split agreement (or plan, as applicable), the employee can raise an objection and the employee will be automatically transferred to the successor company (the buyer).
- If an employee who is not primarily engaged in the business to be transferred is included in the employees to be transferred, the employee can similarly raise an objection and the employee will be automatically excluded from the transfer (that is, he can stay with the transferor company (the seller).

Notice. The company must give the employees who fall into the above categories written notice of certain matters relating to the company split. Further, if the target has entered into a collective agreement with a labour union, the company must notify the labour union in writing of certain matters relating to the company split.

The deadline for the notice to the employees and the labour union is the day prior to two weeks before the date of the shareholders' meeting (if a shareholders' resolution is required for the company split).

Consultation. The company has an obligation to make endeavours to obtain the understanding and co-operation of the employees with respect to the company split (*Labour Contracts Succession Act*). In particular, the company must hold discussions at each of its places of business with the labour union representing the majority of the employees, or a representative of the majority of the employees if there is no labour union. In addition, the company is required by the Commercial Code to consult with each employee who is engaged in the business to be transferred or who is not engaged in the business to be transferred but is included in the group of employees to be transferred.

Share sale

In general, there are no obligations to inform or consult employees or their representatives, or to obtain employees' consent to a share sale, unless a collective agreement (or other form of agreement) between the company and a labour union specifically obliges the company to do so.

32. What protection do employees have against dismissal in the context of a share or asset sale? Are employees automatically transferred to the buyer in a business sale?

Asset sale

In general, employees have no specific protections against dismissal in an asset sale. Therefore, the general rules governing dismissals of employees apply.

Dismissal of an employee is strictly regulated. The Labour Contract Act provides that a dismissal is invalid as an abuse of right of the employer if it lacks objectively reasonable grounds and is not considered appropriate in light of the norms of general society. In particular, precedents set by the court provide that the company must establish the following four points for a reduction to be valid:

- Necessity for reduction.
- Effort to avoid reduction.
- Reasonableness of selection of the employees to be dismissed.
- Appropriateness of procedures for reduction.

In a company split, the Ministry of Health, Labour and Welfare's guidelines clearly provide that the employer cannot dismiss an employee solely because that employee has raised an objection under the Labour Contracts Succession Act (*see Question 31*).

In a business transfer, the guidelines implemented by the Ministry of Health, Labour and Welfare in September 2016 reinforce the existing principles relating to employee dismissal under the Labour Contracts Act. That is, if a dismissal lacks objectively reasonable grounds and is not considered appropriate in light of the norms of general society, any such dismissal is invalid. For example, where an employee subject to transfer is dismissed by the transferor company only on the basis that the employee does not consent to the transfer, the dismissal would not usually meet those criteria.

Share sale

Employees do not have specific protections against dismissal in a share sale. Therefore, the general rules governing dismissals of employees apply (*see above, Asset sale*).

Transfer on a business sale

No employees are automatically transferred in a business sale as a business transfer. For the company to transfer an employment agreement to the buyer, it must obtain individual consent from the relevant employees (*see Question 6 and Question 31*).

However, in a company split, employees who are primarily engaged in the business to be transferred cannot be excluded from the transfer if they so request by raising the objection (*see Question 31*).

PENSIONS

33. Do employees commonly participate in private pension schemes established by their employer? If an employee is transferred as part of a business acquisition, is the transferee obliged to honour existing pension rights or provide equivalent rights?

Private pension schemes

Employees commonly participate in private pension schemes established by their employer, in addition to the mandatory public pension schemes.

Pensions on a business transfer

A pension plan is not split automatically as a result of a business transfer or a company split.

However, in a company split, working conditions, which may include pension plans, must be maintained in principle with respect to employees transferred to the buyer. However, splitting the existing pension plans of the seller or establishing a new pension plan for the buyer may involve complex procedures, and be subject to various requirements under the laws and regulations.

In this context, guidelines published by the Ministry of Health, Labour and Welfare provide that the transferor company (the seller) should reasonably resolve any issues about pension rights of the transferred employees, through providing necessary information to, and consultations with, the employees.

Here, a buyer's decision not to honour existing pension rights or not to provide equivalent rights may constitute amendments to the rules of the working conditions of the employees. Importantly, amendments to the rules of the working conditions that are unfavourable to the employees can only be made after appropriate procedures have been undertaken, and the amendments must be reasonable in light of:

- The level of detriment incurred by the employees.
- The need for the amendments.
- The appropriateness of the amended conditions.
- The status of negotiations with a labour union.
- Other circumstances relating to the amendments.

COMPETITION/ANTI-TRUST ISSUES

34. Outline the regulatory competition law framework that can apply to private acquisitions.

Triggering events/thresholds

Under the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Anti-Monopoly Act), specified forms of business combination, including a share purchase and an asset purchase (business transfer and company split), trigger the requirement for prior notification to the Japan Fair Trade Commission (JFTC) (*www.jftc.go.jp/en*) if all of the thresholds for the relevant structure (set out below) are met.

In a share purchase:

- The aggregate domestic turnover of the corporate group to which the buyer belongs exceeds JPY20 billion; and
- The aggregate domestic turnover of the target and its subsidiaries exceeds JPY5 billion; and
- As a result of the acquisition, the corporate group's holding ratio of voting rights in the target exceeds 20% or 50%.

In a business transfer, both:

- The aggregate domestic turnover of the corporate group to which the acquiring company belongs exceeds JPY20 billion; and
- The domestic turnover generated from the business/asset to be transferred exceeds JPY3 billion.

In a company split (in case of an absorption-type split of the entire business of a company), both:

- The aggregate domestic turnover of the corporate group to which one of the parties belongs exceeds JPY20 billion; and
- The aggregate domestic turnover of the corporate group to which any of the other parties belongs exceeds JPY5 billion.

Corporate group is defined under the Anti-Monopoly Act as a group consisting of the company in question, its ultimate parent company, and all subsidiaries of the ultimate parent company.

Notification and regulatory authorities

If a transaction meets the applicable thresholds, the buyer (in a company split, both the seller company and the buyer company) must file a notification to the JFTC.

The notifying party is prohibited from closing the transaction before the expiration of the waiting period, which is 30 calendar days after the JFTC's due acceptance of the notification. On written request by the notifying party, the JFTC can shorten the waiting period if it is clear that the contemplated transaction would not cause any issues under the Anti-Monopoly Act.

Within the 30-day waiting period, the JFTC can issue a request to the notifying party to submit additional reports, information and/or materials. If the JFTC issues this request, the waiting period is extended to the later of 120 calendar days after the JFTC's due acceptance of the notification, or 90 calendar days after the JFTC has received all the requested information.

Before the expiry of the relevant waiting period, the JFTC is required either to issue a cease-and-desist order to prohibit the transaction or to clear the transaction, with or without conditions.

Substantive test

The JFTC has issued detailed guidelines on its review of business combinations (Merger Guideline). According to the Merger Guideline, the JFTC will first define a relevant geographical and product market in its substantive analysis. In defining the relevant market, generally the JFTC uses the small but significant and non-transitory increase in price (SSNIP) test, to analyse whether a product or service is interchangeable or substitutable by the consumer.

The Merger Guideline provides that, in horizontal combination cases, the JFTC typically takes into account the following factors in determining whether the transaction restricts competition significantly in the defined relevant market:

- Parties' position in the market and competitors' position.
- Competitive pressure from imports.
- New entries.
- Competitive pressure from neighbouring markets.
- Competitive pressure from customers.
- Overall business power of the parties.
- Efficiency brought by the contemplated business combination.
- Financial and business situations of the parties.

ENVIRONMENT

35. Who is liable for clean-up of contaminated land? In what circumstances can a buyer inherit and a seller retain liability in an asset sale and a share sale?

General

Under the Soil Contamination Countermeasures Act (SCCA), the owner, manager or occupier of contaminated land (landholder) can be subject to an order by the local government to take measures for clean-up of the land, if the land is designated by the local government as an area that requires action.

Land is designated as an area that requires action if the local government determines that both:

- The level of hazardous substances present in the land exceeds the limits permitted by applicable laws and regulations; and
- The land can be harmful to human health based on the statutory standards.

However, if the local government concludes that the landholder is not a person or entity that has contaminated the land, and certain other conditions are met, the local government will issue an order against the person who caused the contamination (polluter) requiring it to take measures to clean up the land.

If a landholder who is not a polluter takes measures to clean up the contaminated land according to the orders of the local government, the landholder can recover from the polluter the costs it incurred in the clean-up of the land.

Asset sale

If the buyer acquired the land as part of an asset sale, it may be subject to a clean-up order by the local government under the SCCA, if the land is designated as an area that requires action. If the buyer has taken clean-up measures according to the order, the buyer can recover from the seller the costs it incurred in the clean-up under the SCCA.

Regardless of the SCCA, the buyer may be entitled to recover the damage caused by the contamination under the asset purchase agreement, or based on the statutory warranty against concealed defects under the Civil Code.

Share sale

If the contaminated land is owned by the target, the target may be ordered by the local government to take measures to clean up the contaminated land if the land is designated as an area that requires action. Neither the seller nor the buyer of the shares in the target is directly liable for such contamination under the SCCA.

The buyer may be entitled to recover the damage caused by the contamination under the share purchase agreement (as a breach by the seller of its representations and warranties, if provided).

Practical Law **Contributor profile**

Keita Tokura, Partner

Anderson Mori & Tomotsune

T +8 136 775 1144
F +8 136 775 2144
E

keita.tokura@amt-law.com

Professional qualifications. Japan, attorney-at-law; New York, attorney-at-law

Areas of practice. Corporate governance; mergers and acquisitions; information technology.

Recent transactions (private transactions only)

- Advised a Taiwanese company on an acquisition of a Japanese tech company (2019).
- Advised a US pharmaceutical company on its private sale of certain business to a Japanese pharmaceutical company (2019).
- Advised a US-based private equity fund on acquisitions of various Japanese companies (2019).
- Advised founders of a Japanese asset management company on their private sale of the company to a Chinese company (2018).
- Advised founders of a Japanese technology start-up company on their private sale of the company to an Israeli company (2017).
- Advised a subsidiary of a NYSE-listed US company on a private acquisition of a local distributor company in Japan (2017).
- Advised a NYSE-listed US company on a private acquisition of a local distributor company in Japan (2017).
- Advised a TSE-listed Japanese company on a private sale of its subsidiary to a French company (2016).

Languages. Japanese, English

Professional associations/memberships. Dai-ni Tokyo Bar Association.

Publications

- *Private mergers and acquisitions in Japan: overview (Practical Law, 2018).*
- *Mergers & Acquisitions, second edition (Japan Chapter) (Thomson Reuters, 2016).*
- *NYSE: Corporate Governance Guide (Japan Chapter) (2014).*
- Laws and regulations in UK relating to minority shareholder squeeze-out and its suggestions to design a new system in Japan, *Commercial Law Review (Junkan Shoji Houmu), No. 1970, 1971 (2012).*