

Japan



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Chapter 1: Introduction

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Japan has a population of around 126 million people and a GDP of around \$5tn. It is ranked 29th in the *Doing Business 2020* listing published by the World Bank. It also belongs in the top tier for various issues such as resolving insolvency, dealing with construction permits and obtaining electricity. Japan is also ranked 106th out of 190 countries for ease of starting a business.

Generally speaking, most industries in Japan are subject to certain levels of governmental regulations. These regulations are considered as one of several difficulties to confront foreign companies that look to invest and operate in Japan. They also make it difficult and burdensome for businesses to embark on innovative projects. The Japanese government has been simplifying regulations and administrative procedures relating to foreign companies and new businesses, but given Japan's *Doing Business* ranking, there is no doubt that a lot more needs to be done.

Japan is a civil law country, with a unitary rather than federal system of government. In addition to statutory codes, case law plays an important role in practice, even though court precedents (except for Supreme Court decisions) do not have legally binding authority. Moreover, although statutory codes are fundamental, government authorities have strong discretionary administrative powers to issue ordinances, orders and guidelines, which are regarded as important forms of administrative law. In recent years the government has been issuing guidelines in various circumstances; these guidelines function effectively as domestic soft law in Japan. Further, Japan tends to track regulations in Europe and the US and its regulations are mostly in line with global standards.

Japan is seen as one of the least corrupt countries in the world. However, in recent years there have been cases involving non-compliance with legal and ethical standards by Japanese companies, such as accounting fraud and falsification of quality standards.

Chapter 2: The business environment

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2.1 Government structure

Japan is a unitary, rather than a federal, state. In other words, the central government represents the country and has ultimate sovereignty. The role of the state is divided into three branches: legislative, judicial and administrative. The organs responsible for each branch are independent and mutually checking, in a system of checks and balances.

The separation of powers was recognised under the Constitution of the Empire of Japan (the 'Meiji Constitution'; the first modern constitution of Japan promulgated in 1889) before the Second World War, but because the Emperor had the right of absolute sovereignty ('The Emperor.... combining in

Himself the rights of sovereignty'), the separation of powers was insufficient under the Constitution of the Empire of Japan. The current Constitution of Japan (promulgated in 1946; during the occupation based on the Potsdam Declaration, it was enacted based on the draft of General Headquarters, the Supreme Commander for the Allied Powers through the process of constitutional amendment under the Meiji Constitution) clarifies the sovereignty of the people (Preamble and Article 1 of the Constitution). Under the current Constitution of Japan, the Emperor does not have authority concerning national administration as the symbol of Japan, and legislative power is vested in the Diet (Article 41 of the Constitution); executive power is vested in the Cabinet (Article 65 of the Constitution); and judicial power is vested in the courts (Article 76 of the Constitution). The Diet consists of two houses (bicameral legislature) and both houses (the House of Representatives and the House of Councillors) in Japan are composed of elected members.

The current Constitution of Japan adopts a parliamentary cabinet system (not a presidential system, but a system similar to that in the UK in this regard) based on the recognition of the separation of powers. The Diet can designate the Prime Minister (Article 67 of the Constitution) and pass a no-confidence resolution against the Cabinet (Article 69 of the Constitution), while the Cabinet has the right to dissolve the House of Representatives. The courts may conduct a constitutional review of laws; however, the courts may do so only in connection with a trial in an ordinary case in which the application of laws is at issue (using the US regime of standing and differing from the German constitutional court system).

Although Japan is not a federal state, the Constitution of Japan guarantees a system of local government (Articles 92–95 of the Constitution), and local governments, in addition to the central government, also engage in politics and administration in local areas. Local governments are divided into prefectures and municipalities. In accordance with the laws stipulated by the Diet, local governments are entrusted by the national government with some of the affairs carried out by the national government, and have responsibility for performing independent and comprehensive administration closely related to local residents (Articles 1–2, Paragraph 1 of the Local Autonomy Act). Local governments can enact ordinances (prefectural or municipal ordinance) within the scope of the law (Article 94 of the Constitution).

Matters relating to investment from foreign countries in Japan are essentially considered to be administrative matters for the national government and are regulated by acts determined by the Diet, or by cabinet orders (determined by the Cabinet) and ministerial ordinances (determined by the ministries) for the enforcement of the laws. However, with respect to certain matters (eg, in Comprehensive Special Zones), local government ordinances (prefectural or municipal ordinance) may be established in place of cabinet orders or ministerial ordinances.

2.2 Legal system

Since a series of political reforms modernising Japan in the Meiji Period (1868–1912), Japan has been a civil law country. The old Meiji Constitution promulgated in 1889 was enacted in accordance with the Constitution of Prussia (1850) in Germany, and the current Civil Code enforced in 1898 was enacted following the German and French Civil Codes. The current Penal Code, which came into effect in 1908, was also enacted after the complete revision of the former Penal Code, which

was enacted in 1882 based on the French Penal Code, with reference to the German Penal Code and other relevant laws. Japan adopts a codified law system in which all legal norms, such as the Constitution and laws, are enacted in written form. The current Constitution of Japan is the supreme law in the domestic legal order. Unlike in common law countries, precedents have no binding force and only *de facto* influence on similar cases.

The current Constitution of Japan was promulgated in 1946 under a strong American influence, and the Companies Act was also revised many times after the Second World War under the influence of US law, including major revisions in 1950 and 2005. The Act on Prohibition of Private Monopolization and Maintenance of Fair Trade was enacted in 1947, adopting US antitrust law as its model. The Financial Instruments and Exchange Act (formerly, the Securities and Exchange Act) was also enacted in 1948, subject to the influence of the Securities Exchange Act of the US. Thus, current Japanese law has been influenced not only by Continental law, but also by Anglo-American law.

The courts of justice exercise their powers independently of other organs (ie, the Diet and the Cabinet). The courts are passive organs that properly settle disputes and maintain legal order by interpreting and applying law to the disputes brought before them. Furthermore, under the current Constitution of Japan, administrative tribunals are not permitted final judicial power (Article 76 of the Constitution). The supreme judicial body is the Supreme Court. The Supreme Court, as the sole court of last resort, has jurisdiction over appeals and special appeals. In addition, the Supreme Court has the power to make rules on court proceedings and internal discipline, as well as the power to appoint lower court judges and review constitutionality.

Chapter 3: Business and corporate structures

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3.1 Common legal entities

Foreign individuals or entities may conduct business in Japan either directly or through a Japanese corporation or branch office. The three types of legal entities most commonly used by foreign investors in Japan are stock companies (*kabushiki kaisha* – KK), general partnership companies (*godo kaisha* – GK) and branch offices. Among them, the KK is the most common entity used to operate a business in Japan.

The liabilities of both a shareholder of a KK and a member of a GK are limited to the extent of the assets such a shareholder or member invested in the entity. In the case of a GK, only contributing members are allowed to be representative members and members in charge of the operation of the GK (an ‘Executive Member’) (this can include legal entities, such as a corporation, although a natural person must be appointed as a representative thereof). On the other hand, in a KK separation of ownership and management means that the owners of a business do not always execute the business of

the KK (in addition, legal entities are not entitled to become officers of a KK). In terms of the corporate structure, a GK is more flexible than a KK under the Companies Act in Japan. For example, members of a GK can decide the percentage of profit and loss distribution among them by mutual agreement between the members or in the GK's articles of incorporation, which means that the distribution ratio is not fixed based on their ownership percentages. Although both a KK's shareholders and a GK's members can make investments in kind, such as the contribution of intellectual property, a GK has an easier procedure for making investments in kind. However, unlike a KK, a GK is not permitted to be listed on a financial instruments exchange in Japan.

Other than the three popular types of legal entities described above, limited partnership companies and limited liability companies are also permitted under the Companies Act, and partnerships are permitted under the Civil Code. In addition, limited liability partnerships and investment limited partnerships are also permitted under the Limited Partnership Act and so on. These entities are used, as appropriate, for investment purposes.

3.2 Incorporation process

A KK or GK is legally formed upon registering its formation at the Legal Affairs Bureau with jurisdiction over the location of its head office. Such a registration requires preparing the articles of incorporation (in the case of a KK, the notarisation of its articles of incorporation by a notary public is also required), and subscription of shares for capital contribution, among other matters. The initial capital contribution to a KK or GK must be in assets such as cash. There is no minimum capital requirement, although such initial capital cannot be zero. Accordingly, a KK or GK can be incorporated with a capital of JPY 1.

In practice, it usually takes three weeks to one month to complete the registration, taking into account the time necessary for drafting the articles of incorporation (and notarisation in the case of a KK), verification of signature and purchase of a corporate seal, plus an additional week to complete the registration application at the Legal Affairs Bureau. This is quite slow by international standards. As such, the Japanese government plans to establish a new one-stop online incorporation system by April 2021.

Previously, at least one representative director must have been a resident of Japan. However, this restriction was removed in 2015.

Under the Foreign Exchange and Foreign Trade Act (FEFTA), incorporation by a foreign investor is generally considered as 'inward direct investments, etc', which will require a *post facto* report or, in exceptional cases, prior notification to the Ministry of Finance and other relevant ministers through the Bank of Japan. In 2019 the range of businesses subject to the prior notification requirement was expanded to address growing concerns about cybersecurity.

3.3 Ongoing reporting and disclosure obligations

The directors of a KK must submit or provide financial statements and business reports to annual shareholders' meetings, and the shareholders must approve such documents. A KK generally must give public notice (through the official gazette (*Kampō*), a daily newspaper or via an internet announcement)

of its balance sheet (or, for large companies as prescribed in the Companies Act, its balance sheet and profit and loss statement) promptly after the conclusion of the annual shareholders' meeting. At a GK, the members do not need to bear the obligations listed above. However, both types of companies must keep financial statements at their head office for a prescribed period. Shareholders of a KK and members of a GK may inspect or copy such financial statements at any time.

As described above, a KK or GK is formed by registering its incorporation. The main items included in such a registration are its trade name; head office location; business purpose; total number of shares issued (in the case of a KK); type and number of issued shares (in the case of a KK); amount of initial capital; and the names of the director(s), the representative director, and auditor(s) (in the case of a GK, the name of the representative member and the Executive Member); and if an Executive Member is a legal entity, then the name of a natural person who is to perform the duties of such a member ('Functional Manager'). Registration of the composition of shareholders or members is not required, and such information is not generally disclosed to the public. When any resolution is passed at a shareholders' meeting, members meeting or board of directors meeting regarding a change in one of the company's registered matters listed above, such a change must be filed with the Legal Affairs Bureau.

3.4 Management structures

The Companies Act allows the creation of the following corporate organisations within a KK: a shareholders' meeting, director, board of directors (consisting of at least three directors), executive officer (in the case of a company with three committees), statutory auditor, board of statutory auditors (consisting of at least three statutory auditors), committees (including a nominating committee, audit committee and compensation committee), accounting auditor and accounting adviser. All KKs are required to have a shareholders' meeting and one director. All other corporate organisations listed above are optional unless the company is: (1) a 'large company', which is defined under the Companies Act as a KK with stated capital of JPY 500m or more, or with aggregate debt of JPY 20bn or more; or (2) a 'public company', which is defined as a KK that does not restrict the transfer of all or part of its shares under its articles of incorporation.

The Companies Act also provides for three corporate governance systems for a KK (mainly for large companies): (1) company with a board of statutory auditors; (2) company with three committees as described above (each committee must consist of at least three directors and the majority of the members of each committee must be outside directors); and (3) company with an audit and supervisory committee consisting of at least three directors who are elected as audit and supervisory committee members at a shareholders' meeting (the majority of the members of such a committee must be outside directors).

Of the systems described above, very small KKs often choose simply to have one or more directors. In the case of a small or medium-sized KK, a board of directors and one or more statutory auditors is typical. Large companies typically choose one of the following three patterns: (1) board of directors, board of statutory auditors and accounting auditor; (2) board of directors, three committees and accounting auditor; or (3) board of directors, audit and supervisory committee, and accounting auditor.

In the case of a company with three committees, a (representative) executive officer elected by the board of directors executes the business of the company. In the case of companies other than companies with three committees, a representative director elected by the board of directors (in the case of a company without a board of directors, such a representative director is elected at a shareholders' meeting) executes the business of the company.

In the case of a GK, members of the GK execute the business of the GK unless otherwise provided for in the articles of incorporation. If a member who executes the business is provided for in the articles of incorporation, only such a member (ie, an Executive Member) can execute the business of the GK. Since the name of any representative member and Executive Member is disclosed in the registration, if a member wishes not to have his/her name disclosed in the registration, then the GK has to provide for Executive Member(s) in its articles of incorporation. Each Executive Member represents the GK, unless one or more representative members are appointed in the articles of incorporation (or by and from such a member in accordance with a process provided for in the provisions of the articles of incorporation). If an Executive Member is a legal entity, then such a legal entity must appoint a natural person who is to perform the duties of such member (ie, a functional manager).

3.5 Director, officer and shareholder liability

In the case of a KK, directors, statutory auditors, accounting auditors, accounting advisers and executive officers owe the duty of care of a good manager to the company in carrying out their duties. In the case of a GK, members in charge of the operation owe the same duty. If they cause damage to the company in breach of such a duty, they are personally liable for such damage. However, if their decisions in carrying out the business of the company satisfy the standards under the business judgement rule, they will not be held liable. If the company fails to pursue such personal liability, a shareholder or member of such a company may file a derivative lawsuit against such a person on behalf of the company.

A KK may enter into a contract with directors (other than representative directors and directors in charge of the operation of the company), statutory auditors, accounting auditors and accounting advisers establishing a cap on their liability (such a cap must be at least in the amount provided for in the Companies Act). In addition, a KK may exempt the personal liability of directors (including representative directors and directors in charge of the operation of the company), statutory auditors, accounting auditors, accounting advisers and executive officers (exceeding an amount provided for by Companies Act) by a resolution of a shareholders' meeting or a resolution of the board of directors in case the articles of incorporation of the company contain a provision that such persons' personal liability for damage to the company may be exempted by a resolution of the board of directors. In order to exempt all the personal liability for damages to the company, the consent of all shareholders is required.

In the case of a GK, it is interpreted that the articles of incorporation may have a provision that all personal liability for damage to the company is exempted, or a provision regarding the process and requirements for the exemption from personal liability for damage to the company.

With respect to a shareholder or a member who is not in charge of the operation of the business of a company, there is no statutory law or court case that clearly mentions that it owes any duty to other shareholders or members.

Chapter 4: Takeovers (friendly M&A)

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4.1 Overview

In Japan, while we have started to see some hostile takeovers in the capital markets, most M&A transactions involving the acquisition of listed target companies are friendly transactions, where the management of target companies agrees to the acquisition proposed by the buyers.

The Financial Instruments and Exchange Act (Act No 25 of 13 April 1948, as amended, or the FIEA) and the cabinet order, the cabinet office orders and several regulations promulgated thereunder set forth the rules of and process for takeover transactions. The Financial Services Agency (FSA) is the responsible regulator for takeovers, and the Kanto Local Finance Bureau is the delegated contact point for both bidders and target companies. Stock exchanges impose their own disclosure rules on listed companies. This chapter focuses on the rules of Tokyo Stock Exchange (TSE).

4.2 Summary of regulations

4.2.1 Mandatory tender offer

The FIEA requires a buyer to commence a tender offer in any of the following cases:

1. a buyer acquires shares or other securities issued by a listed company (the ‘Securities’), and as a consequence the voting rights the buyer owns exceed five per cent of the total voting rights, except in the case where the buyer acquires Securities within 61 days from ten shareholders or less;
2. a buyer acquires Securities, and as a consequence the voting rights the buyer owns exceed one-third of the total voting rights;
3. a shareholder who already holds more than 50 per cent of the voting rights of the target company acquires Securities of the target, and as a consequence, the voting rights the shareholder owns do not exceed two-thirds of the total voting rights, except in the case where the shareholder acquires Securities within 61 days from ten shareholders or less;
4. a buyer acquires Securities, and as a consequence the voting rights the buyer owns become two-thirds or more of the total voting rights;
5. (i) a buyer acquires Securities representing more than ten per cent of the voting rights in any form (including acquisition of newly issued shares) within three months, (ii) which includes acquisition of Securities representing more than five per cent of the voting rights through off-market trading or through off-auction trading, and (iii) as a consequence, the voting rights the buyer owns exceed one-third of the total voting rights; or

6. a tender offer is in process, and a shareholder who already holds more than one-third of the total voting rights acquires Securities representing more than five per cent of the voting rights during the offer period.

A tender offer is not required if all the Securities are acquired through in-market transactions (except for (1), transactions through off-auction trading, such as the electronic trading network system offered by the TSE will not be excluded).

Voting rights held by certain affiliates and other persons with whom a buyer has agreed to purchase, sell or exercise voting rights in concert with are counted together when applying the triggering thresholds under the mandatory tender offer rule.

Virtually all transactions in which a buyer contemplates acquiring more than one-third of voting rights of a listed company through off-market transactions will trigger the mandatory tender offer requirement.

Violation of the mandatory tender offer rule can result in a criminal fine of up to JPY 5m and/or imprisonment up to five years; and an administrative penalty amounting to 25 per cent of the aggregate purchase price of the acquisition can also be imposed.

4.2.2 Tender offer process

OVERVIEW

In a friendly takeover deal the buyer usually conducts due diligence on the target company, then discusses and negotiates the terms of the acquisition with the management of the target before launching a tender offer. The negotiation process is subsequently required to be described in the disclosure documents for the tender offer. If there are one or more major shareholders of the target company, it is not uncommon that the buyer and those major shareholders enter into a tender and support agreement, under which the major shareholder(s) agree to tender shares through the tender offer process. Normally, the major shareholder(s) only agree to provide very limited representations and warranties and to make very limited covenants. Once the buyer and the target company reach an agreement on the terms, they prepare the required disclosure documents, consult with the FSA through the competent Kanto Local Finance Bureau and the TSE, and make formal decisions to commence the tender offer. In a typical tender offer, the following disclosures are required for the buyer and the target company.

DISCLOSURE BY TENDER OFFERORS

A buyer who commences a tender offer (the 'Tender Offeror') is required to: (1) make a Public Notice for Commencing Tender Offer (*kokai kaitsuke kaishi kokoku*); and (2) file a Tender Offer Notification (*kokai kaitsuke todokedesho*), both through the online disclosure system operated by the FSA (Electronic Disclosure for Investors' NETwork or EDINET). Practically, these are filed and disclosed through EDINET on the next business day when the Tender Offeror makes its decision to commence the tender offer. If the Tender Offeror is a listed company, it is also required to issue a press release on the day it decides to commence the tender offer. In addition, the Tender Offeror must deliver a (3) Tender Offer Statement (*kokai kaitsuke setsumeisho*) to each shareholder who

tenders its shares, concurrently with or prior to such tender. The contents of a Public Notice for Commencing Tender Offer, a Tender Offer Notification and a Tender Offer Statement (and press release, if any) are almost identical; they set forth the material terms of the tender offer, including the purpose of the tender offer, tender offer price, tender offer period and number of shares to be purchased.

Any time there is a change to any of the material matters set out in a Tender Offer Notification (typically, a change in the tender offer price, the tender offer period or expiration of the waiting period under competition law), a Tender Offeror must file an amendment of the Tender Offer Notification.

When the tender offer is complete, the Tender Offeror must: (1) make a public notice to announce the result of the tender offer; and (2) file a Tender Offer Report (*kokai kaitsuke hokokusho*), both on the next day after the last day of the tender offer period, through EDINET, to announce the result of the tender offer, including the number of tendered shares. If the Tender Offeror is a listed company, it is also required to issue a press release. In addition, the Tender Offeror needs to file a Report of Possession of Large Volume (*tairyo hoyu hokokusho*) (a report required for holders of Securities representing more than five per cent of a listed company's outstanding shares), and if the target company becomes a subsidiary of the Tender Offeror, make some other filings, which may include a Status Report of the Parent Company (*oyakaisyatou jokyo hokokusho*) and Extraordinary Report (*rinji hokokusho*).

DISCLOSURE BY TARGET COMPANIES

When a tender offer is commenced, the target company is required to file a Position Statement (*iken hyomei hokokusho*) through EDINET within ten business days after the Public Notice for Commencing Tender Offer is published, and issue a press release to express its opinion on the announced tender offer. In these documents the target company expresses its opinion with respect to the tender offer, and the grounds and reasons thereof. In a friendly takeover transaction the target company usually holds a board meeting on the same day a tender offer is announced, and the board adopts a resolution to determine its opinion on the announced tender offer and files the Position Statement on the same day. In a friendly takeover transaction, the target company normally assents to the tender offer and its board of directors recommends that the shareholders tender their shares. If the tender offer price is lower than the market price (typically in the case where the buyer contemplates acquiring shares held by major shareholder(s) (or a parent company) only), the board of the target company typically assents to the tender offer, but leaves the shareholders to decide whether or not to tender their shares.

Upon the successful completion of a tender offer, the target company is required to file an Extraordinary Report through EDINET announcing the change of its major shareholder(s) (or parent company), and issue press releases depending on the result of the tender offer.

LANGUAGE OF DISCLOSURE DOCUMENTS

All required filings and announcements, including the Public Notice for Commencing Tender Offer and Tender Offer Notification, need to be prepared in Japanese. The disclosure documents available

on EDINET are in Japanese only. Some Tender Offerors and target companies voluntarily prepare and disclose English translations of their press releases, but such translations are not mandatory.

4.3 Some features of tender offers in Japan

4.3.1 *Ceiling of purchased shares/obligation to purchase all shares*

A Tender Offeror is not allowed to set an upper limit on the purchased shares if the voting rights to be held by the Tender Offeror after the successful completion of the tender offer will become two-thirds or more of the total voting rights. When a tender offer crosses this threshold, the Tender Offeror needs to solicit a tender from all shareholders and must purchase all tendered shares. In other words, the Tender Offeror may set an upper limit on the purchased shares so long as it does not cross this two-thirds threshold. For example, the Tender Offeror may set an upper limit on the purchased shares so that the total voting rights it will hold after the tender offer will become 51 per cent, and keep the target company listed on a stock exchange after the successful completion of the tender offer.

4.3.2 *Tender offer at a discounted price*

A Tender Offeror may propose a tender offer price lower than the current market price. This is done when the Tender Offeror contemplates acquiring shares held by major shareholder(s) (or a parent company of the target) only.

4.3.3 *Cash-out transactions*

In May 2015 a new process for the cash-out of minority shareholders was introduced, and this process now enables a shareholder owning 90 per cent or more of the voting rights of the target company compulsorily to acquire the shares of the target held by other shareholders upon the approval of the board of directors of the target (the ‘Call Option by Special Controlling Shareholder’; *kabushikitou uriwatashi seikyu*). This allows the buyer to avoid calling a shareholders’ meeting of the target and seeking court approval for a payment to minority shareholders. Since this method was introduced, most cash-out transactions have relied on this approach so that if a Tender Offeror successfully acquires 90 per cent or more of the voting rights through its tender offer, and if the aggregate voting rights after the tender offer do not reach 90 per cent, a cash-out transaction is sought by conducting a reverse stock split. The major difference between relying on a Call Option by Special Controlling Shareholder and a reverse stock split is the need to call for a shareholders’ meeting of the target company in the latter case. Therefore, a reverse stock split scheme takes more time to complete the cash-out transaction.

4.3.4 *Foreseeability and certainty on acquisition price*

In 2016 the Supreme Court held that if the tender offer was made in accordance with a process ‘generally accepted to be fair’, and the Tender Offeror has offered the same acquisition price paid following the first-step tender offer in the second-step cash-out transaction, then the court should approve that same price as the fair value of the minority shares in the cash-out transaction. A court will therefore primarily review the fairness of the process, and will uphold the acquisition price proposed by the Tender Offeror, if the Tender Offeror has followed a fair process and proposes the

same cash-out price as the offer price in the preceding tender offer. While the process that needs to be followed in order to satisfy the ‘process generally accepted as fair’ standard remains open, this Supreme Court decision has nevertheless provided greater foreseeability and certainty on the acquisition price to be paid by the Tender Offeror.

4.3.5 Fair M&A Guidelines

Unlike in some other jurisdictions, such as the US, under Japanese law there is no common understanding of how the ‘duty of loyalty’ concept should be interpreted, nor is it clear how conflict-of-interest transactions should be disciplined in general. On 28 June 2019 the Ministry of Economy, Trade and Industry issued the Fair M&A Guidelines, updating the MBO Guidelines issued in 2007. The Fair M&A Guidelines primarily focus on management buyouts (MBOs) and the acquisition of a controlled company by a controlling shareholder, where issues with respect to structural conflicts of interest and information asymmetries typically exist, aiming to provide a guideline to a fair process in those circumstances.

Among other things, the Fair M&A Guidelines suggest the adoption of some or all of following methods to avoid conflict of interest issues between the buyer (management of the target company) and other general shareholders of the target company (in the case of MBO transactions) or between a controlling shareholder and other general shareholders (in the case of the acquisition of a controlled company by a controlling shareholder): (1) establishment of an independent special committee at the target company; (2) obtaining advice from independent expert advisers (eg, obtaining legal advice from an independent legal adviser and obtaining a share valuation report from an independent share valuation institution); (3) ensuring opportunities for other acquirers to make proposals (market check); (4) enhancing the provision of information to general shareholders so as to improve the process transparency; (5) eliminating coerciveness (eg, avoiding adopting a scheme in which dissenting shareholders will not have an appraisal right, or conducting the cash-out transaction without delay); and (6) establishing a ‘majority-of-minority condition’ for the proposed transaction.

The common practice is to adopt the concepts described in (1)–(5) in a tender offer process. A ‘minority of majority condition’, however, is still uncommon in Japan, and the Fair M&A Guidelines admit that this condition may not always work to avoid conflict of interest issues. As noted, the Fair M&A Guidelines are an update of the MBO Guidelines, and those previously issued guidelines have been respected by the Japanese courts. The measures proposed in the Fair M&A Guidelines are expected also to be respected by the courts, and are considered to provide guidelines of what would be considered a ‘generally accepted to be fair’ process in a tender offer process.

Chapter 5: Foreign investment

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5.1 Foreign investment control/restriction

5.1.1 Foreign Exchange and Foreign Trade Act

The restrictions on investment by foreign investors are governed by the Foreign Exchange and Foreign Trade Act (FEFTA). If a foreign investor intends to make an inward direct investment, such as: the acquisition of a company's shares or equity interests from a resident; consent to a substantial change to the business purpose of the investee company; the acquisition of long-term loans or bonds in excess of JPY 100m; or acceptance of proxy exercise of voting rights, the person must submit a prior notification or report after the fact.

Due to the revision of the FEFTA in January 1992, most inward direct investment became a matter that should be reported after the fact based on the principle of freedom of investment. The *ex post facto* report must be submitted to the MoF and the minister having jurisdiction over the business via the Bank of Japan in a prescribed form by the fifteenth day of the month following the month that includes the date of the transaction or act.

Prior notification is required if the foreign investor's nationality or country of residence is: (1) a country not listed in the published list of countries; (2) the business objective of the investment destination is a business with prior notification (weapons, aircraft, nuclear power, space related, manufacturing of general-purpose products that can be used for military purposes, cybersecurity-related, electricity and gas, heat supply, telecommunications business, broadcasting business, water supply, railways, passenger transportation, manufacturing of biological products, maintenance business, agriculture, forestry and fisheries, petroleum, leather-related, air transportation, shipping etc); or (3) certain actions performed by persons concerned with Iran.

Actions requiring prior notification may not be performed until 30 days (it is usually shortened to two weeks, and for certain cases, such as a capital increase of a wholly owned subsidiary, efforts are made to shorten it to four business days) have elapsed after the prior notification. Prior notification must be made to the MoF and the minister having jurisdiction over the business via the Bank of Japan in a prescribed form from six months prior to the intended act. If, as a result of the examination, the MoF and the minister having jurisdiction over the business find that there is an issue, they may recommend the foreign investors change the content of the transaction or discontinue it. In addition, if prior notification has been provided, an execution report must be submitted to the MoF and the minister having jurisdiction over the business via the Bank of Japan in a prescribed form within 30 days.

5.1.2 Overview of red flag issues that foreign investors should note

As of March 2020 foreign investors are required to submit prior notification when acquiring shares of unlisted companies in businesses covered by prior notification. However, for listed companies

they are required to submit prior notification only if the acquisition is more than ten per cent of the listed companies' shares. In October 2019, however, a bill to reduce this ratio to one per cent was approved by the Cabinet and came into effect in the spring of 2020. The explanation given is that portfolio investments and other investments that do not pose a risk to national security, and so on are exempted from prior notification, and a system of exempting prior notification has been introduced by Cabinet Order and public notice, but there is a possibility that it will have a significant practical impact. Furthermore, in the revised bill, the consent of a foreign investor or a person closely related thereto to appoint the position of an officer or consent to the transfer or abolition of a significant business is regarded as inward direct investment and so on, which may have a significant practical impact.

5.1.3 Specific limitations on investment in real estate

Under the Act on Foreign Nationals' Rights in Relation to Land, there are provisions to prohibit or impose conditions or restrictions on the acquisition of land rights by foreigners or foreign corporations in areas necessary for national defence, but no applicable Cabinet Order has been enacted. Accordingly, in Japan there are no limitations on the acquisition of real estate by foreign investors, and even foreigners can acquire full ownership of real estate, and buy and sell it freely.

However, under the FEFTA, when a non-resident acquires real estate in Japan, the person is required to report to the MoF via the Bank of Japan within 20 days after the acquisition (however, reporting is not required in certain cases, such as for residential use or for non-profit business purposes).

In addition, if the payment for real estate (in cases exceeding JPY 30m) is made between a resident and a non-resident, the resident is required to submit a report on the receipt of the payment to the MoF through a bank and so on within ten days from the transaction.

5.2 Foreign exchange control

In Japan foreign exchange control has been abolished, except for transactions with countries subject to economic sanctions, due to the revision of the FEFTA in April 1998. Foreign exchange operations have been liberalised through the liberalisation of domestic and overseas capital transactions and the abolition of the authorised foreign exchange banking system. Therefore, there are no particular issues with foreign exchange control.

However, when a foreign investor conducts a capital increase and it falls under the category of inward direct investment, it may be necessary to submit a prior notification or an *ex post facto* report.

In addition, if a transaction payment equal to JPY 30m or more is made between a resident and a non-resident, a report must be submitted to the MoF through a bank and so on within ten days of the transaction.

5.3 Applicable tax incentive or grants

5.3.1 Overview of tax incentives

Japan's corporate tax rate is one of the highest in the world, and while it has always been pointed out in Japan and abroad that tax incentives are necessary as an incentive to invest in Japan, there are no specific tax incentives for foreign investors that apply to Japan as a whole, and in addition to certain tax incentives under special laws, the use of special economic zones has been introduced, and local governments have established their own tax incentives. Details can be obtained from the websites of INVEST JAPAN FDI Promotion and Japan External Trade Organisation (navigation system for investing in Japan's local regions).

5.3.2 Tax system to strengthen local regions

If the head office functions of a Japanese branch or research institute are 'opened and expanded' in a local city other than the Tokyo metropolitan area by direct investment in Japan, or if a foreign company with head office functions in Tokyo's 23 wards 'relocates' the head office functions from Tokyo's 23 wards to a local city other than the Tokyo metropolitan area, it may receive preferential tax treatment under the tax system to strengthen local regions (certain requirements must be met).

5.3.3 Special economic zones

There are three special zones: National Strategic Special Zones, Comprehensive Special Zones and Special Zones for Reconstruction.

Ten districts have been recognised as National Strategic Special Zones, and more than 300 projects have been recognised. Special tax measures have been implemented in the National Strategic Special Zones, including tax breaks for promoting capital investment and income tax deductions.

Corporate taxes have been reduced in the special zones to enhance international competitiveness.

In the Special Zones for Reconstruction, special tax measures, such as special depreciation of capital investment, are available when business operators engage in projects that contribute to securing employment opportunities, make capital investment or employ disaster victims in industrial cluster zones for reconstruction.

5.3.4 Measures taken by local governments

Some local governments have introduced measures to reduce or exempt corporate citizenship tax for foreign investors when they start up businesses in Japan. However, only a few local governments have established such tax incentives, and many only provide rent subsidies or partial subsidies for the establishment of bases. In addition, the applicable conditions and the amount of subsidies for each industry are different.

Chapter 6: Restructuring and insolvency

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6.1 General overview

In Japan, when a debtor company faces financial difficulty and aims to revitalise itself, it would usually first consider an out-of-court debt-restructuring arrangement with its creditor banks ('out-of-court workout' or *shiteki seiri*). In an out-of-court workout, the target creditors are usually limited to lender banks, and other claims (such as trade claims) will be paid in full outside the process. On top of that, the debtor's workout is kept confidential between the debtor and the banks, and hence the value of the business will not be impaired by the workout. This is why the out-of-court workout is usually the first method of choice for debt restructuring.

However, if such an arrangement is found to be difficult because, for example, one or more banks opposes the plan, or the speed of deterioration of the business or cash liquidity is so fast that the debtor does not have enough time to go through the workout process, the company will likely need to consider filing with the court a petition for civil rehabilitation proceedings (*minji saisei*) or corporate reorganisation proceedings (*kaisha kosei*).

If the company intends to liquidate, a petition for bankruptcy proceedings (*hasan*) or special liquidation proceedings (*tokubetsu seisan*) is available. Bankruptcy proceedings also commence in civil cases where rehabilitation proceedings or corporate reorganisation proceedings fail.

6.2 Out-of-court workout

An out-of-court workout usually initiates with a debtor's notice, which requests the banks to stand still; that is, refraining from collecting claims, setting off or exercising security interests. The debtor then proposes a restructuring plan to the banks, which lays out the terms and conditions of rescheduling or discharging its debts. If the banks find the debtor's restructuring plan fair, economically reasonable and feasible, the banks usually consent to the plan. This consent must be unanimous. Therefore, if one of the banks opposes the plan, even though all the other banks agree, the debt-rescheduling plan or debt-discharge plan will not become effective and the company is likely to need to file for civil rehabilitation or corporate reorganisation proceedings.

In Japan there are several laws and statutes that facilitate systematised out-of-court workout proceedings, such as the Turnaround ADR scheme and the SME Rehabilitation Support Association scheme. In particular, the Turnaround ADR is the most important and is sometimes utilised by listed companies.

6.3 Court insolvency proceedings

As discussed above, in Japan there are four types of in-court insolvency proceedings. Civil rehabilitation and corporate reorganisation are proceedings for the revitalisation of the debtor's business,

while bankruptcy and special liquidation are proceedings for the liquidation and winding-up of the debtor company.

The debtor company can file for corporate reorganisation or civil rehabilitation when there is a possibility of the debtor falling into a situation of: (1) excessive debts (ie, insolvency on a balance-sheet basis); (2) general and continuous inability to pay its debts when they become due (ie, insolvency on a cash-flow basis); or (3) significant hindrance to the continued operation of business if it pays its debts when they become due.

The debtor company can file bankruptcy proceedings when it is in a situation of: (1) excessive debts; or (2) general and continuous inability to pay its debts when they become due.

6.3.1 Corporate reorganisation proceedings

Corporate reorganisation proceedings are only available to KKs, and are typically used for large and complex insolvency cases, such as the Japan Airline case.

Under corporate reorganisation proceedings:

- a trustee is always appointed by the court and the right to operate the company's business and dispose of the company's assets solely belongs to that trustee; and
- security interest will no longer be exercisable during the proceeding.

The trustee will formulate a reorganisation plan and propose it to secured creditors and ordinary unsecured creditors. The plan comes into effect if it is approved: (1) by unsecured creditors holding a simple majority of the aggregate unsecured claim amount; and (2) by secured creditors holding either two-thirds or more (if the plan only reschedules the secured claims) or three-fourths or more (if the plan discharges the secured claims) of the aggregate secured claim amount and is then subsequently confirmed by the court. The secured and unsecured creditors will be paid in accordance with the plan. The value of the secured claim will be determined by an amicable settlement between the trustee and the secured creditor if one can be reached, or by a claim assessment procedure in court.

6.3.2 Civil rehabilitation proceedings

Civil rehabilitation proceedings are available to companies of any size and type, as well as individuals.

Under civil rehabilitation proceedings, as a general rule:

- a trustee is not appointed, and the debtor keeps the right to operate the company's business and dispose of the company's assets as the debtor-in-possession under supervision by a court-appointed supervisor and the court itself (certain important matters, such as the transfer of assets, must be conducted only with the consent of the supervisor, or permission of the court); and
- security interests are exercisable during the proceeding unless an order temporarily to suspend exercise is issued by the court.

The debtor-in-possession will formulate the rehabilitation plan and propose it to ordinary unsecured creditors. The plan comes into effect if approved: (1) by a simple majority of the headcount of the

ordinary unsecured creditors (by headcount); and (2) by ordinary unsecured creditors holding half or more of the aggregate claimed amount of ordinary debt and is then subsequently confirmed by the court; the confirmation order becomes final and non-appealable. The ordinary unsecured creditors will be paid in accordance with the plan. Secured creditors will be paid in accordance with an amicable settlement with the debtor if one can be reached, or by exercising their security interest.

6.3.3 Bankruptcy proceedings

Bankruptcy proceedings are available to companies of any size and type, as well as individuals.

Under bankruptcy proceedings:

- a trustee is always appointed by the court and the right to dispose of the company's assets belongs solely to the trustee; and
- security interests are exercisable during the proceeding.

Chapter 7: Employment, industrial relations, and work health and safety

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7.1 Employees' rights and protection

The principal sources of employment law and regulations in Japan are: (1) the Labour Standards Act (Act No 49, 1947) (LSA), which lays down the basic principles that govern employment relationships and the minimum standards of employment conditions; and (2) the Labour Contract Act (Act No 129, 2007) (LCA), which also regulates individual employment relationships. As a general rule, Japanese employment laws apply to all employees in Japan, regardless of their nationality, and are very protective of employees.

7.1.1 Working hours regulations

The maximum statutory working hours is 40 hours per week and eight hours per day, and at least one day per week must be provided as a statutory non-working day or rest day, subject to exceptions under the LCA, namely the flextime system, irregular working hours system, discretionary working hour system and advanced professionals system.

Under the flextime system, employees have flexible starting and finishing times of work, and working hours per day, but their designated working hours per month should be fixed (eg, 177 hours). The employer may also designate a core time range when all employees are required to work.

For work with peak and off-peak periods, employers often introduce the irregular working hours system. Under this system, as long as the average working hours do not exceed 40 hours per week

over a certain period (one week/one month/one year), no overtime pay is required to be paid to employees who work more than the statutory maximum working hours.

As to the discretionary working hours system, it can be either the expert type, or the planning or proposal type under the LCA. The requirements to apply this system are strict, and for the introduction of the planning or proposal type system the employer must establish a labour-management committee to adopt this system by a vote of at least four-fifths of its members. Thus, this system may only be used for a limited number of employees. On 1 April 2019 the advanced professionals system was introduced as a new exception to the discretionary working hours system. However, only a limited number of companies have adopted this system because it only applies to employees with specific job descriptions and advanced vocational skills with a certain annual income (eg, no less than JPY 10,750,000), and the labour-management committee must adopt it by a vote of at least two-thirds of its members.

7.1.2 Overtime agreement

To ask employees to work more than the maximum working hours or on rest days, the employer must: (1) enter into a labour-management agreement that permits such overtime work (the ‘Overtime Agreement’) with a representative majority of employees; and (2) submit such agreement to the labour standards inspection office. In principle, under this agreement, overtime limits should be 45 hours per month and 360 hours per year, except as otherwise specified therein. A breach of these limits shall be subject to criminal penalties, except for cases where an Overtime Agreement has been established for temporary and special situations.

In any event, overtime working hours should not exceed 720 hours per year, even in such exceptional cases, and within such a 720-hour limit, the following limits also apply: (1) the overtime working hours should not exceed 80 hours per two or six months on average (including rest days); (2) the overtime working hours should be less than 100 hours per month (including rest days); and (3) the overtime working hours should not exceed 45 hours per month more than six times (the principal limitation).

7.1.3 Overtime work compensation

Employers must pay extra compensation for work performed in excess of the maximum working hours and work performed on rest days (collectively, ‘Overtime Work Compensation’). In addition, employers must pay extra compensation for work performed between 2200 and 0500 (‘Late Night Work Compensation’). The minimum rates of Overtime Work Compensation and Late Night Work Compensation under the LSA are summarised below.

Type of work	Applicable work	Minimum hourly rate
Overtime work	Over eight hours per day or 40 hours per week	125% of the normal base hourly wage
Rest day work	On a rest day	135% of the normal base hourly wage
Late night work	Between 2200 and 0500	125% of the normal base hourly wage

The hourly rates are to be combined if any two of the above types of work overlap. For example, an hour of Overtime Work and Late Night Work should be compensated at 150 per cent of the normal base hourly wage.

The current statute of limitations for wages including Overtime Work Compensation under the LSA is two years. However, a bill to initially extend such a period to three years, and then later to five years, was submitted to the ordinary Diet in 2020 and took effect on 1 April 2020.

7.1.4 Annual paid leave

An employee who has continuously worked for six months and has worked for at least 80 per cent of the total number of working days is entitled to receive annual paid leave. The minimum number of days to be granted as annual paid leave in accordance with Article 39 of the LSA is in proportion to the length of service, as shown in the table below:

Years of service	6 months	1 year, 6 months	2 years, 6 months	3 years, 6 months	4 years, 6 months	5 years, 6 months	6 years, 6 months
Days of annual paid leave	10	11	12	14	16	18	20

Unused paid leave may be carried over until the next year only since the current statute of limitations for rights is two years. An employer is not required to provide paid sick leave in addition to the above annual paid leave.

7.1.5 Termination of the employment contract

The LSA, LCA and case law require employers to have objectively ‘reasonable grounds’ for dismissing employees. In the absence thereof, a dismissal would not be considered appropriate in general societal terms, and it will be treated as an abuse of the employer’s right and declared invalid.

All possible grounds for such a dismissal must be clearly provided in the rules of employment or an employment agreement for the dismissal of an employee to be valid. Unlike an ordinary dismissal, a disciplinary dismissal involves a disciplinary action of the employer and is considered to be the most severe method of dismissal. It can be justified only when, for example, an employee has committed a crime or a very serious ethical breach, or was unreasonably absent from work.

Under the LSA, in dismissing an employee, an employer must provide at least 30 days’ advance notice or pay the average wage for a period of not less than 30 days in lieu of notice (except for disciplinary dismissal cases with the prior approval of the relevant authority). The employer may reduce the 30-day notice period by paying the average wage for each day reduced.

Since courts tend to review the ‘reasonable grounds’ very narrowly, and the employer has the burden of proof, it is hard to dismiss employees validly in Japan. The law also does not allow an employer to terminate the employment unilaterally by paying some severance allowance. Thus, most employers attempt to execute a separation agreement with the employee, often including the payment of a severance allowance, to terminate the employment in a fast and amicable manner. There is no statutorily mandated severance pay, and the amount thereof is influenced by the expectation of the

employee. However, it is generally calculated to reflect the years of service, amount of remuneration and so on. The amount is also affected by the size and particular industry of the employer.

The discussions above apply to redundancy. Courts uphold a redundancy as a dismissal due to reorganisation (*seiri kaiko*) only where the employer can demonstrate the following requirements: (1) the redundancy is necessary to accomplish a reasonable management action; (2) the employer has made all possible efforts to avoid dismissal of the employees; (3) the terminated employees were chosen based on an appropriate selection criteria; and (4) the employer has provided a sufficient explanation and offered the employees an opportunity to discuss the matter – something akin to due process. Redundancy measures that are taken based only on a slowdown in business activity or a temporary economic downturn to increase profits (as opposed to saving the company) would be considered an abuse of the right of the employer.

7.2 Statutory contributions and minimum wage

An employer must participate in four kinds of insurance system: workers' accident compensation insurance, employment insurance, health insurance and nursing care insurance, and employee's pension insurance. All employees who meet certain criteria shall be covered by such insurance systems. In general, the employer pays the insurance premiums by deducting the portion payable by employees from their wages, and paying them to the relevant authorities together with the portion payable by the employer.

No employer can hire an employee for less than the legal minimum wage under the Minimum Wage Act. The minimum hourly wage is determined based on the region and industry. If two different minimum wage amounts apply to an employee, the employee is entitled to the higher amount. Tokyo has the highest minimum wage of JPY 1,013 as of 1 October 2019.

7.3 Work permits

A foreigner who wishes to work in Japan must obtain the appropriate visa and work permit (collectively, the 'work visa') under the Immigration Control and Refugee Recognition Act (ICA). Until recently, work visas only covered work that required a high level of professional knowledge or skill. Therefore, in principle, it was not possible for foreigners to engage in manual labour under work visas, unless they were granted work visas based on their family status, had trainee visas or were part-time workers on student or dependent visas. The latest major amendment to the Immigration Control and Refugee Recognition Act in April 2019 created a new status of residence called a 'Specified Skilled Worker'. To cope with current labour shortages, this amendment now allows the entry of relatively unskilled labour from foreign countries to work for Japanese companies, though still limited to certain industries (eg, healthcare, construction, agriculture, food services and shipbuilding).

Chapter 8: Tax law

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8.1 Taxes applicable to individuals

Income tax, local inhabitant tax and special reconstruction income tax are listed as taxes applicable to employees.

Under the Income Tax Act, salary earned by employees is classified as salary income. The amount of salary income is calculated by deducting the amount of salary income deduction from the amount of salary revenue. The amount of salary income deduction increases in accordance with the amount of salary revenue, but is capped at JPY 1.95m. The amount of gross income is calculated by offsetting losses arising from certain categories of income against the amount of salary income and other certain income, and the amount of taxable income is calculated by deducting income deductions, such as the basic deduction from the amount of gross income. The amount of income tax is calculated by multiplying the amount of taxable income by the applicable tax rate. The Income Tax Act adopts progressive rates, with the maximum tax rate being 45 per cent.

The amount of income tax for a calendar year is fixed by filing a tax return and must be paid by 15 March of the following calendar year, in principle. However, as to salary, withholding income tax is withheld from salaries when it is paid by the employer and the difference between the income tax to be paid and the amount of WHT is settled by way of a year-end adjustment made by the employer who pays the salary. Accordingly, employees who receive only salary income generally do not need to file a tax return.

In addition to income tax, a special reconstruction income tax is imposed at the rate of 2.1 per cent of the basis amount of income tax from 2013 through 2037.

Furthermore, salary income received by employees residing in Japan is subject to local inhabitant tax. It is usual for local inhabitant tax to be withheld from salary payments.

Under the Income Tax Act, salary paid to non-residents is subject to WHT in Japan at the rate of 20.42 per cent only if and to the extent that such a salary is paid for services performed in Japan. Non-residents without a permanent establishment in Japan generally are not required to file an income tax return for such salary. Such WHT may be exempt under a tax treaty.

8.2 Taxes applicable to businesses

8.2.1 Corporation tax

TAXATION ON DOMESTIC CORPORATIONS

Domestic corporations are required to pay corporation tax on their income for each business year. The applicable tax rate depends on the type and size of corporation; however, it is 23.2 per cent,

in principle. Such income is calculated by deducting the amount of deductible expenses from the amount of gross profits. The amount of deductible expenses and the gross profits are to be calculated in accordance with generally accepted accounting principles (GAAP) unless otherwise stipulated under exceptional provisions of Japanese law.

Most of such exceptional provisions are stipulated so as to deny the deduction of expenses recorded under GAAP for the purpose of corporation tax. For example, certain expenses, such as remuneration for officers, appraisal losses on assets, depreciation expenses or allowances recorded under GAAP are deducted for corporation tax purposes only to the extent of a limited amount or if they satisfy certain requirements specified under such provisions. On the contrary, there are some exceptional provisions that stipulate that certain types of revenue under GAAP are not included in gross profits for corporation tax purposes. For example, dividends received from an entity's subsidiaries, etc, are included in revenue under GAAP; however, all or part of such dividends may not need to be included in gross profits depending on the shareholding ratio and so on for corporation tax purposes.

Capital transactions, which are transactions that cause an increase or decrease in the amount of stated capital and so on of a corporation, and the distribution of profits or surplus conducted by a corporation do not cause taxation on such a corporation. In the case where a corporation that files a final return form shows any net operating loss that arose in a business year starting within ten years prior to the first day of each of its business years, the amount equivalent to such a loss may be included in deductible expenses to the extent of 50 per cent of the income before such an inclusion (100 per cent for SMEs), when calculating the amount of income for each relevant business year.

Corporations should file a tax return and pay their corporation tax within two months from the date following the final day of each business year, in principle; however, such a deadline may be extended in certain cases.

The amount of income and corporation tax is to be calculated by each respective corporation, in principle. As an exception, subject to the approval of its consolidated tax return, the consolidated income of corporations is calculated by aggregating the income of a corporation and that of each of its perfectly controlled subsidiaries, and the amount of corporation tax is calculated based on such consolidated income. Even when such a consolidated tax return is not adopted, a group taxation system applies and certain transactions conducted between group companies may benefit from the deferral of capital gains and losses. Note that there will be an overhaul of the consolidated tax return system that will come into effect on 1 April 2022.

There is no general anti-avoidance rule (GAAR) under Japanese tax law; however, there are comprehensive rules to deny tax avoidance that are applied to closely held corporations, corporation reorganisations and consolidated tax returns.

FOREIGN CORPORATIONS

Under the Corporation Tax Act, foreign corporations are obliged to pay Japanese corporation tax only on income sourced in Japan. The scope of income sourced in Japan subject to corporation tax depends on whether the foreign corporation has a permanent establishment and the type of

permanent establishment. Certain categories of income sourced in Japan are subject to withholding income tax.

8.2.2 *Systems to prevent international tax avoidance*

There are various systems for preventing international tax avoidance under the Corporation Tax Act and the Act on Special Measures Concerning Taxation. For example, Japan has controlled foreign corporation rules by which the income of certain overseas corporations is included in the income of their large Japanese corporation shareholders. Japan also has thin capitalisation rules and earnings stripping rules, which prohibit the deduction of certain interest. Under Japanese law, the transfer pricing rule applies to transactions conducted with overseas affiliates of Japanese corporations.

8.2.3 *Other taxes applicable to businesses*

Some other taxes are imposed based on the income of a corporation, such as local corporation tax and corporation special business tax (which are national taxes) and corporation business tax and corporation inhabitant tax (which are local taxes).

If the transactions are conducted in Japan for consideration as a business, consumption tax and local consumption tax will be imposed on transactions at the rate of ten per cent in total in principle.

8.3 Other taxes

It is necessary to pay attention to stamp tax, registration tax, real estate acquisition tax, office tax and excise tax when conducting business in Japan.

Chapter 9: Intellectual property

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9.1 Patents

9.1.1 *Patentable subject matter*

Under Japanese law, patentable subject matter encompasses ‘inventions’, which is defined under Article 2, paragraph 1 of the Patent Act as ‘significant creations of technical ideas utilizing the laws of nature’. Inventions can be classified into three categories: ‘inventions of products’, ‘inventions of processes’ and ‘inventions of processes for producing products’. A patent may be granted for business methods that are combined with computer systems or other devices. Methods of medical treatment and diagnosis for human illnesses are not patentable. The mere discovery of microorganisms that occur naturally, or components thereof, such as a DNA sequence or a protein, is not a patentable invention. However, if the microorganism or its component is artificially isolated from its natural source or has mutated, and is demonstrated to meet the utility requirement, such a discovery can be a patentable invention.

9.1.2 Requirements for inventions to be eligible for patents

To be eligible for a patent, an invention must meet the novelty requirement and the ‘inventive step’ requirement (the latter is equivalent to the ‘obviousness’ requirement in certain other jurisdictions).

To meet the novelty requirement, an invention cannot be identical to another invention that has been publicly known, publicly implemented, or described in a publication in Japan or in a foreign country prior to the filing or relevant priority date of the patent application. Further, the invention must not be identical to: (1) an invention of others and described in any part (claims, specifications or drawings) of a patent application that was filed by another person in Japan earlier and was subsequently published (‘laid open’); and (2) an invention that was described in the claims of an issued patent previously filed by the same applicant in Japan.

To meet the inventive step requirement, an invention cannot be something that could have been made easily by a person ordinarily skilled in the art based on other inventions that were publicly known, publicly implemented, or described in a publication in Japan or in a foreign country prior to the filing of the patent application.

9.1.3 Ownership of patents

The inventor has the right to obtain a patent for the invention and such a right can be transferred. For an invention created by an employee during the course of employment, the right to obtain a patent may be assigned to the employer or even automatically vested in the employer in accordance with employment rules set by the employer, and the employer may file the patent application as the applicant. In the case of multiple inventors, the right to file a patent application is held jointly by all of them, and the patent application needs to be filed by all of them together. The transfer of ownership of an issued patent becomes effective when such a transfer is recorded with the Japan Patent Office (JPO).

9.1.4 Duration of patent rights

A patent expires 20 years after the filing date of the patent application. For pharmaceutical and agrochemical patents, a patent term extension is available for up to five years upon request by the patentee if the patentee or a licensee thereof receives marketing approval for the patented drug or pesticide from the relevant Japanese authority.

9.1.5 Remedies for patent infringement

If a patent is infringed, the patentee may seek an injunction against the infringer. A permanent injunction is available almost automatically if the court finds the patent valid and infringed. A request to destroy the infringing products can be made together with a claim for an injunction. A preliminary injunction is also available through summary proceedings and may be granted if the court finds a *prima facie* case of infringement, and that the patentee is likely to suffer irreparable harm without the preliminary injunctive relief.

In addition, under the Patent Act of Japan, a patentee may seek compensation for damages caused by infringement, based on the following three theories:

1. the patentee's lost profits;
2. the profits of the accused infringer; and/or
3. reasonable royalties.

Punitive damages are not allowed in Japan for patent infringement, even in cases of wilful infringement.

9.2 Trademarks

9.2.1 *Scope of trademarks*

Under the Trademark Act of Japan a 'trademark' is defined as 'any character(s), figure(s), sign(s), three-dimensional shape(s) or any colour(s), or any combination thereof, sounds or other marks provided by a Cabinet Order' and needs to be recognisable by human perception. In particular, 'motion marks', 'holograms', 'colours without profiles', 'position marks' and 'sound marks' can be protected in addition to traditional text and graphic trademarks.

9.2.2 *Ownership of trademarks*

Any Japanese individual or legal entity, any foreign individual domiciled or residing in Japan and any foreign legal entity having a place of business in Japan may apply for trademark registration in Japan, provided that such an individual or entity uses or intends to use a trademark on its goods or in its services in connection with its business. This also applies to individuals or legal entities from a country that allows Japanese nationals to register their trademarks in that country, provided that such foreign individuals or entities have a representative in respect of the said trademark in Japan.

9.2.3 *Duration of trademark rights*

The term of protection for a registered trademark is ten years from the date of the registration, and is renewable. An owner of a trademark shall submit a request for renewal to the JPO within six months prior to the expiry date of the trademark. After the expiry of the trademark, the owner may still file a request for renewal within six months from the date of expiry. No proof of use is required for renewal. However, if a registered trademark has not been used in Japan by the owner or its licensee for three consecutive years, any person may file a request for a trial for rescission of such a trademark registration. As a defence against such requests, the trademark owner needs to submit proof of use, such as copies of catalogues, advertisements, publications, websites, and trade documents bearing the trademarks and showing the dates of such materials.

9.2.4 Remedies for trademark infringement

Permanent injunctions and monetary relief are available through a primary civil action on the merits. In addition, a preliminary injunction is available through summary proceedings. As to monetary relief, the amount of damages is limited to actual damages, and punitive damages are not allowed in Japan, even in cases of wilful infringement.

The amount of damages is usually determined by:

1. the trademark owner's lost profits;
2. the profits of the accused infringer; and/or
3. reasonable royalties.

To obtain a permanent injunction in a lawsuit on the merits, the trademark owner does not have to establish any fact other than an ongoing infringement or a threat of infringement. For preliminary injunction, the trademark owner must additionally establish that it is likely to suffer irreparable harm without a preliminary injunction.

9.3 Copyright

9.3.1 Copyrightable subject matter

Under the Copyright Act of Japan, copyrightable subject matter encompasses 'works of authorship', which is defined as 'productions in which ideas or emotions are expressed in a creative way in the literary, scientific, artistic, or musical domains'. Letters, diaries and other kinds of confidential writings can also be protected by copyright. In court precedents, typeface designs (fonts) are held outside the scope of works of authorship under the definition above and are therefore not copyrightable.

9.3.2 Ownership of copyrights

In principle, the author of a work of authorship holds the copyright. The term 'author' is defined in the Copyright Act as 'a person who creates a work of authorship'. If a work is created by employees of a legal entity during the course of employment and at the employer's initiative and is to be published under the name of the employer, the legal entity is regarded as the author of the work, unless the employment contract or employment rules in force at the time of creation provide otherwise. As for the author of a motion picture, the Copyright Act provides that 'the authorship of a cinematographic work shall be attributed to those who, by taking charge of producing, directing, filming, and art direction, have contributed to the creation of that work as a whole, excluding authors of novels, scenarios, music, or other works adapted or reproduced in that work'. If a work is jointly created by several persons and consists of inseparable contributions, the work is regarded as a joint work, and the copyright in the work is jointly owned and must be exercised jointly by all the authors.

9.3.3 Author's moral rights

The author of a work of authorship also has the following moral rights: the right to make a work public; the right to claim authorship; and the right to maintain the integrity of his/her work. A moral right is exclusively personal to the author and is not alienable. Although, in general, a moral right ceases to exist when the author dies, the publisher of a work is prohibited from infringing the author's moral rights not only during the author's lifetime, but also after the author's death.

9.3.4 Duration of copyright

Copyright protection begins at the time the work is created and continues for 70 years following the death of the author (for a jointly created work, for 70 years after the death of the last surviving co-author). The duration of copyright for a work whose author is a legal entity or other corporate body is 70 years from the time the work was first made public, or, if the work was not made public within 70 years following its creation, 70 years from its creation.

The duration of a copyright for a cinematographic work (regardless of whether its author is a corporation or an individual) is either 70 years from the time the work was first made public, or, if the work was not made public within 70 years from its creation, 70 years from its creation.

9.3.5 Remedies for copyright infringement

When an author's moral rights or copyrights are infringed or are likely to be infringed, the author may seek an injunction against such an infringement. The plaintiff in an infringement action may demand the destruction of the infringing objects and any equipment or instruments used solely for committing the infringement, and may demand any other measures necessary for the discontinuance or prevention of the infringement.

For monetary damages, the Copyright Act provides three presumptive theories of damages:

1. the copyright owner's lost profits;
2. the profits of the accused infringer; and/or
3. reasonable royalties.

9.4 Designs

9.4.1 Subject matter of design rights

Under the Design Act of Japan, a protectable 'design' is defined as 'a shape, pattern, or color or any combination thereof in an article (including part of an article) which produces an aesthetic impression on the sense of sight'. It should be noted that designs registrable under the Design Law can be protected concurrently by copyright if they also constitute 'works of authorship' under the Copyright Act.

9.4.2 Ownership of design rights

Under the Design Act of Japan, any person who has created a design may file an application for design registration. The right to obtain design registration is assignable. The rules governing employees' inventions under the Patent Act are also applicable to designs created during the course of employment.

9.4.3 Duration of design rights

For a design right for which the application was filed on or before 31 March 2020, the duration is 20 years from the date of registration. For a design right for which the application is filed on or after 1 April 2020, the duration is 25 years from the date of application.

9.4.4 Remedies for design right infringement

The Design Act of Japan provides three types of civil remedies for design right infringement: injunction, damages and measures to restore the plaintiff's business reputation.

Similar to other types of intellectual property, the Design Act provides three presumptive theories of damages:

1. the design right owner's lost profits;
2. the profits of the accused infringer; and/or
3. reasonable royalties.

9.5 Other

9.5.1 Utility model rights

Utility model rights protect 'devices', and are defined under Article 2(1) of the Utility Model Act as 'the creation of technical ideas utilizing natural laws'. Compared with utility patents under the Patent Act as explained above, which requires a 'significant' creation of technical ideas, utility model registration does not have to meet such a high standard.

Since a utility model right is established by registration without an examination of substantive requirements, the right holder is required to obtain from the JPO a technical appraisal report of the utility model and deliver the report to an alleged infringer together with a warning before the right holder can institute an infringement action, pursuant to Article 29-2 of the Utility Model Act. The right holder may seek compensation for damages and injunction against infringement of a registered utility model right.

The duration of a utility model right is ten years from the date of application.

9.5.2 Integrated circuit layout design utilisation rights

The Act on the Circuit Layout of Semiconductor Integrated Circuits establishes layout design utilisation rights to protect the layout design of semiconductor integrated circuits. Under the act,

a person who has created a layout design, or his/her heir or successor is eligible for the registration of a layout design utilisation right. If there are two or more creators, they shall jointly apply for a registration of the right. The right holder of a layout design utilisation right may seek compensation for damages and injunctive relief against infringers.

The duration of a layout design utilisation right is ten years from the date of registration.

9.5.3 Breeder's rights

The Plant Variety Protection and Seed Act establishes breeder's rights. The subject matter of breeder's rights encompasses plant 'varieties', which means a group of plants that can: (1) be distinguished from other groups of plants by the expressions of at least one of the important characteristics of the plant; and (2) be propagated while maintaining all its expressions of the characteristics. The breeder's right becomes effective upon registration of the variety. Under the act, any person who has created a plant variety meeting the following requirements may obtain a registration for the variety: (1) the variety is clearly distinguishable, by expression of at least one of the important characteristics, from any other variety the existence of which is a matter of common knowledge in Japan or in any foreign state at the time of the filing of the application for registration; (2) all the plants under the variety at the same propagation stage are sufficiently similar in all their expressions of the characteristics; and (3) all the expressions of the characteristics of the variety remain unchanged after repeated propagation.

The holder of a breeder's right has an exclusive right to exploit, in the course of business, the registered variety and any other varieties that are not clearly distinguishable from the registered variety by the expressions of the characteristics.

The duration of a breeder's right is 25 years from the date of variety registration.

9.5.4 Act for Prevention of Unfair Competition

The Act for Prevention of Unfair Competition provides protection for: (1) unregistered trademarks; (2) configuration of goods; (3) trade secrets; (4) certain types of data; and (5) domain names. Although the act does not establish any statutory intellectual property rights, it prohibits unfair competition that would infringe others' business interest in (1) – (4). As for civil remedies, the act provides both monetary damages and injunctive relief.

Chapter 10: Financing

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10.1 Licensing requirements for banks, etc

10.1.1 Banking Act

An entity that intends to engage in ‘banking business’ is required to obtain a licence from the Prime Minister in accordance with the Banking Act. The Banking Act defines ‘banking business’ as the operation of a business conducting any of the following activities:

- acceptance of deposits together with lending funds or discounting bills; or
- fund transfers for customers

In order to obtain a banking business licence, the applicant must be a stock company having a board of directors, a board or a committee of company auditors and an accounting auditor. The stated capital of the applicant must not be less than JPY 2bn. In addition, the applicant must satisfy other licence requirements, such as securing qualified directors experienced in banking business and establishing a system necessary for the proper execution of the banking business. The FSA of Japan (JFSA) supervises banks.

If a foreign bank wishes to engage in banking business in Japan, it is required to specify a single branch in Japan that serves as the principal base of the foreign bank’s banking business in Japan, and it must obtain a banking licence from the Prime Minister. The branch is supervised by the JFSA.

10.1.2 Money Lending Business Act

The act of lending money as a business does not fall under banking business but generally falls under ‘money lending business’ under the Money Lending Business Act (MLBA). An entity that intends to engage in money lending business is required to establish a business office or other office in Japan and to register with the Prime Minister or prefectural governor. In order to complete such a registration, the applicant must satisfy the registration requirements, such as securing persons with at least three years’ experience in loan business, as well as a registered chief of money lending operations; having net assets of at least JPY 50m; and establishing a system necessary for the proper execution of money lending business. Money lending business operators are subject to supervision by the JFSA and the relevant prefectural government.

10.1.3 Applicability of the Civil Code, etc to money lending business

A loan agreement is subject to the Civil Code, and the content of a contract may be freely determined by agreement between the lender and the borrower under the principle of the freedom of contract. However, the Interest Rate Restriction Act stipulates the maximum rates (15 – 20 per cent of the amount of the loan’s principal). If the interest rate exceeds the maximum rate, the amount in excess is void. The Act Regulating the Receipt of Contributions, the Receipt of Deposits, and Interest Rates

also stipulates the maximum rate (20 per cent of the amount of the loan's principal). If the operator of a loan business exceeds the maximum rate, such a person (including the representative, an agent or employee if the person is a juridical person) is subject to criminal punishment. Further, if a borrower is an individual who is not categorised as a business operator, the Consumer Contract Act applies, and any one-sided contract clause that impairs the interests of consumers is void.

10.2 Requirements for issuing bonds

10.2.1 Companies Act

Bonds issued in Japan include public bonds, such as government bonds and municipal bonds, and private bonds, such as straight bonds, convertible bonds and financial bonds issued by financial institutions under special laws. The issuance of corporate bonds is one of the primary financing methods used by stock companies.

Under the Companies Act, if a stock company intends to issue corporate bonds, it must determine the subscription requirements, such as the total amount, amount of each bond, interest rate, method and due date of redemption, method and due date of interest payments, and other matters relating to the bonds and specified in the Companies Act. In the case of a stock company with a board of directors, such a decision is generally made by the board of directors, but the board of directors may delegate such a decision to an individual director if the board of directors determines the total amount and certain other matters regarding the bonds prescribed in the Companies Act. A third party must be appointed as a bond manager unless: (1) the amount of each bond is JPY 100m or more; or (2) the number obtained by dividing the total amount of the class of bonds to be issued by the minimum amount of each bond of the class is less than 50. A bond manager is a person who receives payments, preserves rights of claims and otherwise manages bonds on behalf of bondholders. In cases where a bond manager is not required, a fiscal agent is generally appointed to handle the payment process on behalf of the issuing company. Bondholders' meetings may be convened to make resolutions on matters in relation to the interests of the bondholders, but in practice there are not many cases of holding bondholders' meetings due to the large administrative burden.

10.2.2 Financial Instruments and Exchange Act

A corporate bond falls under the definition of 'Securities' in the Financial Instruments and Exchange Act (FIEA), and such Securities are subject to disclosure requirements in accordance with the FIEA. Offerings of corporate bonds may not be made without filing a Securities Registration Statement (SRS) with the competent local finance bureau, unless exempted from the registration requirements. An SRS describes, in detail, the content of the Securities (securities information) and the business outline, financial status and so on of the issuer (corporate information) and is made available for public inspection. In addition, the issuer is required to prepare a prospectus containing almost the same content as the SRS and must deliver it to investors. Further, the issuer is subject to ongoing disclosure obligations and must file an annual securities report and so on. These disclosure requirements only apply to public offerings and do

not apply to private placements. There are three types of private placements: (1) private placement to qualified institutional investors; (2) private placement to professional investors; and (3) private placement to a small number of investors. The concept of ‘private placement to professional investors’ was introduced in 2008, aiming at creating a new professional market. A professional investor as defined in the FIEA means any of the qualified institutional investors, the government of Japan, the Bank of Japan and certain other investors considered able properly to manage risk arising from financial transactions based on their knowledge and experience, as well as the status of assets specified in the FIEA.

10.3 Requirements for issuing stocks

10.3.1 Companies Act

The Companies Act governs the procedures for issuing new shares. Under the Companies Act, the issuance of new shares is broadly divided into ‘allotment to shareholders’ and ‘other than allotment to shareholders’. An ‘allotment to shareholders’ grants all existing shareholders the right to receive an allotment of shares in proportion to the number of shares they hold. This method is generally used for private companies where shareholders are interested in maintaining their shareholding ratio. On the other hand, ‘other than allotment to shareholders’ is classified into ‘public offerings’, where shares are issued to many and unspecified investors, and ‘third-party share issuance’, where shares are issued to specific investors. A ‘public offering’ is generally used to raise funds for listed companies or companies seeking IPOs of their shares. An ‘allocation to third parties’ is often used not only for raising funds but also for strengthening business relationships with underwriters or for bailing out companies facing financial difficulties.

In the issuance of shares, a stock company needs to determine the subscription requirements in accordance with the Companies Act. For example, for a third-party share issuance by a public company, a resolution of the board of directors is generally required unless such an issuance can be classified as an issuance favourable to underwriters. However, where shares are issued at a particularly favourable price, such an issuance requires a special resolution of a shareholders’ meeting. The term ‘a particularly favourable amount’ means an amount particularly low compared with ‘the fair amount to be paid’, and the term ‘fair amount to be paid’ means the market value of shares; in other words, the latest market price of shares for listed companies. According to the Guidelines for Handling of Third-Party Share Issuance of the Japan Securities Dealers Association, as it is assumed that an issuance of new shares at ten per cent or less discount is not an advantageous issuance, in practice the amount to be paid will be the price discounted by less than ten per cent of the market price.

10.3.2 FIEA

Shares fall under the definition of ‘Securities’ in the FIEA and therefore the disclosure regulations under the FIEA apply. The framework of disclosure regulations is essentially the same as that for corporate bonds.

10.4 Other financings

10.4.1 Crowdfunding

Crowdfunding is a fundraising method whereby an entity that needs money raises funds from an unspecified number of investors through an internet platform. In 2014 a small-amount investment-type crowdfunding system was introduced in Japan to promote the supply of risk money. The ‘small-amount’ here means that the total offering amount is less than JPY 100m and the investment amount per person is less than JPY 500,000. Under the FIEA, the market entry requirements that apply to a business operator handling a public offering or private placement of unlisted stocks or funds were relaxed, while new requirements were imposed on them. The new requirements include the duty to disclose appropriate information through the internet and the duty to conduct due diligence on the business of venture companies.

10.4.2 Peer-to-peer lending

Peer-to-peer lending is categorised as social lending. Under this system, an unspecified number of investors lends money to SME or individual seeking funds through an online platform. In a typical scheme, a business operator collects contributions in a silent partnership (*tokumei kumiai*) from investors and lends money to a person seeking funds by using such contributions. Such a business operator is required to register as a money lending business operator under the MLBA. In addition, such a business operator is required to register as a Type II financial instruments business for soliciting contributions in a silent partnership, which falls under the concept of ‘deemed securities’ as defined in the FIEA.

Chapter 11: Privacy laws and data protection

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The Act on the Protection of Personal Information (APPI) is the main data protection legislation in Japan and imposes legal obligations on private business operators who handle personal information (each is a ‘Handling Operator’). Replace with: The amendments to APPI were enacted in June 2020, and most clauses will take effect by June 2022.

Another important law is the Act on the Use of Numbers to Identify a Specific Individual in the Administrative Procedure (the ‘My Number Act’), which stipulates special rules for what is known in Japan as My Number, a 12-digit individual number assigned to each resident of Japan.

The Personal Information Protection Commission (PPC) is the primary regulator responsible for the APPI and the My Number Act, and publishes guidelines for the handling of personal information.

In order to understand the restrictions under the APPI, it is important to distinguish between three terms: personal information, personal data and retained personal data.

Personal information means information about living individuals that: (1) can identify specific individuals; or (2) contains an individual identification code as defined by the APPI.

Personal data means personal information contained in a personal information database, which is a collection of information (which includes personal information) that is systematically organised to enable a computer or other means to search for particular personal information.

Retained personal data means personal data that a Handling Operator has the authority to disclose, correct, add or delete content from; and discontinue the use of, erase or discontinue its provision to a third party, excluding personal data that is scheduled to be deleted within six months (note that the anticipated amendment of the APPI is likely to remove this six-month qualification) and certain other limited personal data.

The Handling Operator has various obligations under the APPI, including the following:

- It must specify and make known to the data subject the purpose of collecting that subject's personal information.
- It cannot use personal information for any other specified purpose without the consent of the data subject.
- It must establish appropriate safeguards to protect personal data.
- It must manage employees and data-handling service providers on their handling of personal data.
- It cannot transfer personal data to another entity without the opt-in consent of the data subject, unless it falls under an exception under the APPI. Exceptions include instances when the transfer is required by law or is necessary to perform governmental duties; to protect the life, body or property of a person; or to improve public health. Other major exceptions include the delegation of the handling of personal data to another entity; joint use of personal data with another entity; business succession resulting from a merger or other legal reasons; or filing of a notification of opt-out consent with the PPC. Note that the anticipated amendment of the APPI may change the opt-out scheme.
- It must keep a record of the provision of personal data to a third party.
- It cannot transfer personal data to countries that do not have sufficient data protection safeguards without the consent of the data subject. The data subject's consent to overseas data transfers is not necessary only if: (1) the foreign country is designated by the PPC as a country with a data protection regime with a level of protection equivalent to that of Japan (only member countries of the European Economic Area and the UK have been designated to date); or (2) the recipient has a data protection system that meets the standards prescribed by the PPC. Please note that the APPI has no general data localisation requirements for personal information.
- It must make certain mandatory elements accessible to data subjects and respond to data subjects' requests (to disclose, correct, add or delete content from; and discontinue the use of, erase or discontinue its provision to a third party) regarding retained personal data.

- It must endeavour to notify the PPC of data breaches, and the APPI recommends that it notify data subjects of data breaches. Note that notification to the PPC and data subjects may become legal obligations under the anticipated amendment of the APPI.
- It must endeavour to keep personal data accurate and to erase personal data without delay when it becomes unnecessary to use it.

An outline of the sanctions for violations of the APPI is as follows:

- The PPC may require a Handling Operator to report or submit materials regarding its handling of personal information, and may enter a Handling Operator's offices or other places to investigate, make enquiries and check records or other documents (Article 40).
- The PPC may provide guidance or advice to a Handling Operator (Article 41).
- The PPC may recommend that a Handling Operator cease a violation and take other necessary measures to correct the violation (Article 42.1).
- The PPC may order a Handling Operator to take necessary measures to implement the PPC's recommendations and to rectify certain violations of the APPI (Articles 42.2 and 42.3).
- If a Handling Operator breaches an order of the PPC that is issued as part of an administrative sanction (note that 'order' does not include guidance, advice or a recommendation from the PPC), it may be subject to imprisonment of up to six months or a fine of up to JPY 300,000. If the breach is committed by an employee of an entity, that entity will be subject to a fine of up to JPY 300,000. Note that the anticipated amendment of the APPI may toughen the penalties. Especially in the case of a corporate body violating an order of the PPC, the penalty will be a fine of up to JPY 100m.

Chapter 12: Competition law

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12.1 Relevant legislation

The Anti-Monopoly Act (AMA) is the fundamental legislation of Japan's antitrust legal framework. It was enacted in 1947 and is sometimes called 'Japan's Economic Constitution'.

The AMA covers multiple areas of antitrust practice, such as cartel issues, merger filings, abuse of monopoly and unfair trade practices. However, given that the language of the AMA provisions is ambiguous, businesses are strongly advised to refer to the Japan Fair Trade Commission (JFTC) enforcement policies and guidelines and case law for further guidance.

Other statutes and rules relating to antitrust rules are:

- General Designation of Unfair Trade Practices, which identifies 16 categories of unfair trade practices in accordance with the framework of the AMA;

- Act against Delay in the Payment of Subcontract Proceeds, which regulates the abuse of a superior bargaining position by large companies;
- Unfair Competition Prevention Act, which regulates some kinds of unfair trade practices, such as trade secrets; and
- Act against Unjustifiable Premiums and Misleading Representations, which regulates unfair trade practices especially relevant to consumer transactions.

12.2 Relevant authorities

The principal authority charged with the enforcement of the AMA is the JFTC. The JFTC is headquartered in Tokyo and has over 800 officials. It consists of a chairperson and four commissioners. It also has a Secretariat, which handles policy-making; an Economic Affairs Bureau, which handles merger reviews and various general enforcement of the AMA; and an Investigation Bureau, which handles specific investigations of the alleged violation of the AMA.

The other major authorities tasked with enforcing antitrust laws and policies are:

- Public Prosecutor's Office (PPO), which investigates and prosecutes criminal violations after receiving the JFTC's criminal complaint;
- Ministry of Economy, Industry and Trade, which handles competition policy from an industrial policy perspective;
- Consumer Affairs Agency, which handles enforcement and policy-making for unfair trade practices regarding consumer transactions, such as misleading advertisements; and
- courts, which handle private antitrust cases, appeals against the JFTC's administrative actions and criminal prosecutions by the PPO.

12.3 General enforcement trends

The majority of the targets of the JFTC's enforcement consists of companies in Japan. However, the JFTC is increasing its investigation of foreign companies, especially in merger control cases. The JFTC sometimes makes high-profile investigations of foreign companies or their Japan subsidiaries.

In private practice around five large Japanese law firms that are all headquartered in Tokyo typically handle large merger control cases and government investigations. At the same time, a couple of boutique law firms focus on antitrust and consumer protection affairs. Some international law firms have antitrust teams that include Japanese qualified attorneys working at their Tokyo offices.

Apart from law firms, a couple of world-renowned economic consulting firms with offices in Tokyo are also active in the practice. Economic analysis is becoming increasingly important in high-profile cases, especially in merger reviews. The JFTC has some in-house economists as well, who are often seconded from academic institutions and private practice.

12.4 Cartel cases

12.4.1 General trends

In the early half of the 2010s enforcement actions against cartels and bid rigging were quite active. By contrast, the number of cartel investigations in the last couple of years has been moderate.

12.4.2 Prohibition

The AMA prohibits ‘unreasonable restraint of trade’, which includes collusive activities such as cartels and bid rigging. However, the prohibition requires that there is a ‘substantial restraint on competition’ in the relevant market. Thus, cartels and bid rigging are not per se illegal in Japan.

12.4.3 Enforcement

Cartel activities can be both administrative and criminal violations in Japan. The JFTC, however, usually first pursues an administrative case and imposes administrative sanctions. A criminal investigation commences only after the JFTC’s accusation to the PPO.

The issuance of a cease-and-desist order is the most common administrative sanction. This order directs the cessation of specific conduct by cartel participants. Typically, it also imposes an obligation to establish or improve a participant’s compliance system to prevent future antitrust violations.

Another common administrative sanction is an administrative surcharge, which amounts to ‘monetary fines’ in other major jurisdictions. The JFTC has no discretion on the amount of the surcharge as it is automatically calculated as the multiple of the following factors: (1) the volume of commerce affected by the cartel for three years before cessation of the violation; (2) fixed percentage (manufacturer: ten per cent; retailer: three per cent; and wholesaler: two per cent); and (3) aggravating and mitigating factors.

Cartels and bid rigging are also subject to criminal fines and imprisonment. Moreover, cartel participants are often debarred from various public procurements.

12.4.4 Leniency programme

A leniency programme is available in Japan and has been vigorously used since its introduction in 2006. The benefits for the first applicant are huge as it can receive full immunity from both the administrative surcharge and criminal prosecution. Employees are also entitled to immunity from personal criminal liability. There are certain, though lesser, benefits for subsequent applicants who can receive a reduction of the administrative surcharge (ie, they cannot receive immunity from criminal liability).

12.5 Merger controls

12.5.1 General trends

The number of filings each year in Japan is around 300. While there are two phases in the merger control regime, most cases were cleared during Phase I. The average period for merger review after the submission of the official application is two to three weeks. However, for difficult or complex cases, the entire review period may last several months to over a year.

12.5.2 Fundamental factors of merger control

The AMA requires the filing of a mandatory merger notification under threat of sanctions. The reporting party is required to make the notification at least 30 days prior to a filing event. Non-notifiable transactions may be reviewed if there are substantive concerns. The types of transactions caught in the notice requirement are broad, including share acquisition, statutory merger, statutory demerger (ie, corporate split), and assets or business transfer. The two fundamental thresholds for notification are relevant to the consolidated turnover in Japan (CTJ) of the following parties:

- acquirer/one participating party: CTJ > JPY 20bn; and
- target/other party: CTJ > JPY 5bn (JPY 3bn for assets or business transfer).

12.5.3 Enforcement and sanctions

The failure to notify may be penalised by criminal fines of less than JPY 2m. In actual practice, however, there have been no sanctioned cases to date. Nonetheless, the JFTC, from time to time, requests a written explanation for a failure to notify.

The JFTC may open an investigation on a non-reporting transaction if it believes that the deal may raise a substantial competition concern. Thus, to avoid unnecessary friction with the JFTC, the parties may make a voluntary merger filing if there is a possible substantial competition issue in the transaction.

12.6 Other areas of antitrust law

Aforementioned, in addition to cartels and merger control, the AMA also regulates the abuse of monopolies and unfair trade practices. Although those fields are relatively remote for foreign businesses, some regulations, such as prohibitions against retail price maintenance, abuse of a superior bargaining position, trade with restrictive terms and exclusive dealings, may be critical for foreign businesses that wish to conduct business in Japan.

Chapter 13: Dispute resolution

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13.1 Judicial courts

13.1.1 Structure

Since Japan is not a federal state, all judicial courts are integrated into one nationwide court system. The Constitution of Japan anticipates lower courts in addition to the Supreme Court, but it is silent on the number of instances. According to the Code of Civil Procedure (CCJ), in most civil cases there are three instances: a regional court as the first instance, a high court as the second instance, and the Supreme Court as the third and last instance. Since the grounds for appeal to the Supreme Court are very limited (eg, on the grounds that a judgment contains a misinterpretation of the Constitution or any other violation of the Constitution), realistically, for most cases, it is a two-instance system. Among others, factual assertions and fact-finding can be made only in the first two instances.

Japanese law belongs to the Roman law system, and this also applies to procedural law such as the CCJ. The current CCJ of 1996 continued many legal concepts from the initial CCJ of 1890, the first draft of which was prepared by a German jurist, Eduard Hermann Robert Techow. Accordingly, the German influence on the Japanese CCJ is still strong.

13.1.2 Court practice

There is a widespread myth that Japanese people do not like court cases. This is somewhat accurate, especially in comparison with the US, where there is much litigation. However, the reason is not only because of the Japanese culture, in which people do not like open confrontation, but also because the courts do not necessarily function quickly and in a cost-effective manner. Some scholars use the term ‘20 per cent justice’, which implies that only 20 per cent of Japanese citizens receive adequate judicial services. In fact, according to *Doing Business 2019* published by the World Bank, Japan is ranked as low as No 52 among the 190 countries in the category ‘Enforcing Contracts’.¹ A frequently asked question for business lawyers in many jurisdictions is whether a lawsuit is advisable or not, and most often the answer is negative if a lawsuit can reasonably be avoided due to various jurisdiction-specific reasons. The following factors should be considered before initiating a lawsuit in Japan:

- overloaded judges: in 2018 the courts accepted 1,552,708 new civil (and administrative) cases, while there were only 2,782 judges in all Japan; this roughly means 558 new civil cases per judge, in addition to criminal and family law cases;

¹ See www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf accessed 13 May 2020

- longer court proceedings: according to a report prepared by the Supreme Court, in 2018 the first instance took nine months on average, and the second instance took 5.7 months on average;²
- settlements: the parties are frequently encouraged, recommended or expected by the judge to make a settlement rather than waiting for a verdict;
- relatively weak fact-finding: Japanese law does not have a discovery system like in the US, and Japanese judges have a tendency not to exercise the judge's right in fact-finding aggressively; judges are vested by the CCJ with the power to issue an order to a party to submit written evidence under his possession, but this power is rarely exercised; and, on another note, perjury is a crime, but it is extremely rare that a witness is indicted due to his/her false testimony;
- relatively conservative fact-finding: Japanese courts tend to impose a high burden of proof, and tend to be careful in admitting the causal relationship and in calculating the damage to be awarded;
- inefficient procedure: the submission of briefs or evidence via the internet has not yet been allowed, and there are many occasions in which the lawyer must appear before the court in person, which results in additional time and legal fees; and
- legal fees: although the lawyer's fees tend not to be as high as those in some Western countries, in a contractual dispute each party shall bear its own lawyer's fee, which is a big problem for foreign parties in particular because its legal fee will be increased by an expensive translation cost.

Some recent trends may make Japanese courts more attractive. For example:

- Intellectual Property High Courts were established in 2005. The Constitution of Japan prohibits the establishment of special courts outside the court hierarchy, with the Supreme Court at the top. The Intellectual Property High Courts are constitutional because they are integrated into the existing court hierarchy.
- In March 2018 the Cabinet Secretariat announced its plan to introduce IT into court procedures in three phases. Phase 1 began the following year, and a web meeting system has been introduced in some courts. From 2020 the arrangement of issues can be made at some courts in Tokyo, Osaka and several other major cities using a cloud service. Japanese courts had not necessarily been enthusiastic about the introduction of IT, but the coronavirus pandemic may accelerate the reform process.

13.2 Alternative dispute resolution

A non-binding conciliation (*chōtei*) is commonly used in family law or for labour law cases. A special type of conciliation was conducted by the Conflict Resolution Center for Nuclear Damages, established based on the Act on Compensation for Nuclear Damage, in a systematic and concentrated manner to offer a special conciliation service to cope with the largest civil law disputes in Japanese judicial history as a result of the nuclear power plant accident in Fukushima in 2011. By the end of July 2012 only about

² See www.courts.go.jp/toukei_siryou/siryo/hokoku_08/index.html accessed 13 May 2020.

20 claims for damages related to the nuclear accident had been submitted to judicial courts, while 3,398 applications had been received by the Conflict Resolution Center for Nuclear Damages.

The inclusion of an arbitration (*ch sai*) clause in cross border transactions is increasing. However, the actual number of arbitration cases is still limited. Since the arbitration language of most cases is English, and considering the high language barrier in Japan, if something goes wrong with some of these agreements and arbitrations start one after another at some point in the future, it will be a big challenge for the Japanese parties.

13.2.1 Enforcement of foreign judgments/arbitration awards in Japan

Japan is one of the more than 150 signatories to the New York Convention, so the enforcement of an arbitration award is not complicated.

Enforcement in Japan of a judgment by a foreign judicial court is not simple: Article 118 of the CCJ sets forth that a final and binding judgment rendered by a foreign court shall be effective only where it meets all the following requirements: (1) the jurisdiction of the foreign court is recognised under laws or regulations, or conventions or treaties; (2) the defendant has been served (excluding being served by the publication or any other means similar thereto) with a summons or order necessary for the commencement of the suit, or has appeared without being so served; (3) the content of the judgment and the court proceedings are not contrary to public policy in Japan; and (4) a mutual guarantee exists.

Among these conditions, (4) refers to reciprocity; for example, it is considered that there is reciprocity between Japan and Germany, while there is no reciprocity between Japan and China. In the US reciprocity depends on the state. As regards (3), one example that cannot be enforced in Japan due to *ordre public* violation is a US judgment that orders the paying of punitive damages. Furthermore, there is a tendency for this condition to be abused by Japanese defendants by prolonging the execution procedure through arguing that the foreign judgment violates public order in Japan, with the hidden intention of making a settlement at a lower amount.