PRACTICE GUIDES

Japan M&A

Contributing Editor
Tatsuya Morita

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Japan M&A

Practice Guide

Contributing Editor
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Due Diligence Coverage, Process and Issues for M&A in Japan

Shigeki Tatsuno, Tsunemichi Nakano, Chiharu Yuki and Shogo Tsunoda[1]

This chapter provides specific M&A issues to be investigated by the attorney representing the buyer in an M&A transaction in Japan. Conducting the appropriate diligence review is important as it helps the client to identify any material risks or issues which adversely affect the proposed transaction. In order to appropriately conduct the due diligence exercise, it is very important, at least from a legal perspective, to know the typical risks or issues, or tips to conduct efficient diligence, which could differ from country to country. We hope that this chapter will be of use to foreign companies and lawyers considering an M&A transaction in Japan.

The chapter is divided into three parts:

- first, we set out an overview of the role of Japanese legal adviser in the diligence review process, due diligence coverage in Japan and the principal methods used to acquire a target company in Japan;
- second, we consider in detail the main areas of legal due diligence in Japan, including organisation, stock, contracts, assets and liabilities, intellectual property, labour and employment matters, regulatory licence and compliance matters, as well as litigation and disputes; and
- third, we discuss other specific issues of legal due diligence in Japan such as the Gun-jumping Regulation and the Foreign Exchange and Foreign Trade Act.

Legal due diligence in Japan

Role of legal advisers in due diligence

In Japan, the due diligence review by the potential buyer (the buyer) generally involves investigating the target Japanese company (the target company) from legal, financial, tax and business perspectives. Depending on the nature and scope of the target company's business, the buyer may also include a diligence review of environment matters, information technology and human

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resources. Among these due diligences, a Japanese legal adviser (the Japanese legal adviser) mainly handles the legal due diligence under the laws of Japan.

In addition, when the target company has overseas subsidiaries, the buyer also needs to investigate whether the foreign subsidiaries have any material risks or issues that adversely affect the proposed transaction. Therefore, the Japanese legal adviser also organises the legal due diligence of foreign subsidiaries, which will be undertaken by local law firms. More specifically, the Japanese legal adviser serves as lead counsel, retains the local law firms that can provide the due diligence review of the target company's subsidiary located outside Japan and supervises the local firms' diligence from the view point of the target company and the relationship therewith.

Coverage of legal due diligence

The main areas of legal due diligence of the target company include organisation, stock, contracts, assets and liabilities, intellectual property, labour and employment matters, regulatory licence and compliance matters, litigation and disputes. Each area of diligence investigation under Japanese law is discussed under 'The main areas of due diligence'.

Differences in approach to legal due diligence

The approach to legal due diligence in Japan differs depending on the method used to acquire the target company. If the buyer is to acquire the target company, a straightforward and popular method in Japan, as in other jurisdictions, is to purchase shares in the target company by share acquisition through entering into an agreement with the seller. In addition to share acquisition, the Japanese Companies Act provides certain methods of acquiring the target company (or a certain business of the target company) including, among others, business transfer, company split (demerger), merger and share exchange. Under a share exchange scheme, the buyer normally issues its shares to the shareholders of the target company in exchange for the target company's shares.

Under share acquisition and share exchange, the buyer normally purchases all (or part in some cases of share acquisition) of the issued shares of the target company from its existing shareholders. A key difference between the two methods is that consideration for share acquisition in Japan is typically cash and consideration for a share exchange is typically shares of the buyer or buyer's parent company. The transfer of shares under these two methods only changes the composition of the shareholders and therefore does not directly affect the rights and obligations of the target company (eg, assets, liabilities, contracts and employees). As such, there is little need to investigate and analyse the procedures necessary for the succession of the rights and obligations of the target company.

Business transfer involves the individual transfer of bundle of rights and obligations as well as contractual status of parties to the contracts, which constitutes a business of the target company to another entity. During this process, the buyer acquires the rights and obligations of the target company that are identified in the business transfer agreement. Because the rights and obligations are transferred individually pursuant to general law principles, certain succession procedures may be required to succeed the contractual status of parties to the contracts as well as the rights and obligations of the target company accordingly (eg, obtaining prior written consent from, or providing notice to, counterparties to the contracts).

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A company split or merger is a reorganisation procedure pursuant to the Japanese Companies Act and involves transferring the business as a whole of the target company comprehensively to another entity; the difference between them is that under a company split, certain scope of a company specified by a party is transferred whereas the entire company is transferred under a merger. Unlike a business transfer scheme, all of the relevant rights and obligations are transferred comprehensively (ie, automatically) without any succession procedure or transfer requirements (eg, for consent or notice) unless otherwise provided for in individual contracts or in laws and regulations for regulatory permits.

In this chapter, we focus mainly on legal due diligence for the purpose of acquiring all the shares in a target company through share acquisition unless otherwise provided (for example, under 'Matters to be noted for transactions involving business transfer or company split', we discuss some of the issues that commonly affect M&A transactions involving a business transfer or company split).

Details of legal due diligence in Japan

The main areas of due diligence

Organisation

The first step of the due diligence with respect to the target company's organisation is to review the contents of its company register. A certified copy of the company register is available to the public at the local branch of the Legal Affairs Bureau for the area in which the target company has its principal business office.

Another fundamental document that a buyer acquiring a Japanese company needs to review is the articles of incorporation. Under the laws of Japan, Japanese stock companies are required to have articles of incorporation. Although some of the necessary items that are required to be included in the articles of incorporation overlap with the company register, in practice, Japanese stock companies may stipulate in the articles of incorporation further items related to the organisation and operation of the company (eg, quorum, requirements for resolutions, matters for resolutions of shareholders' meetings and board of directors' meetings, definition of the fiscal year, tenures, powers of directors and auditors, and procedures related to paying out dividends).

The table sets out the statutory contents of the company register and articles of incorporation, plus voluntary items that are typically included in the articles of incorporation.[2]

2 Article 911, paragraph 3 of the Companies Act.

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Contents of company register and articles of incorporation

	Company register	Articles of incorporation
Company's business purpose	√	√
Trade name	√	√
Location of head office and branch office	√	√
Amount of stated capital (capital requirement)	√	
Total number of shares issuable by a Japanese stock company	√	√
Details of class of shares (eg, priority of dividend of surplus, priority of distribution of residual assets)	√	√
Total number of issued shares, classes of shares and number of shares in each class	√	
Names of directors	√	
Name and address of representative director	√	
Organisational structure in the company (there should be at minimum a shareholders' meeting and a director in a Japanese stock company)	√	√
Provisions for transfer of shares (if the transfer requires the approval of the company)	√	√
The way the company provides public notices	√	√
Quorum, requirements for resolutions, matters for resolutions of shareholders' meetings and board of directors' meetings		√
Timing, procedures, method of resolutions of shareholders' meetings and board of directors' meetings		√
Definition of the fiscal year		√ (V)†
Number of directors and auditors		√ (V)†
Tenure of directors and auditors		√
Powers of directors and auditors		√ (V)†
Procedures related to paying out dividends		√
		†(V) – voluntary item

Although the company register and the articles of incorporation provide fundamental information regarding the target company, the information is not comprehensive. The buyer needs to further request necessary information from the target company (or the seller) with respect to its organisation so that the buyer can conduct the necessary diligence. For example, it is recommended that the buyer request from the target company (or the seller):

- the shareholder register, as the names of the shareholders of the target company are not included in the company register; and
- the minutes of shareholders' meetings and board of directors' meetings to investigate what has been discussed at these meetings.

Stock

In an M&A transaction involving share acquisition, it is important to confirm through the due diligence whether the seller validly holds all of the shares in the target company, by tracing the history of the shareholders since the incorporation of the target company. In order to conduct

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such diligence, it is necessary to understand two aspects of the laws of Japan in relation to share acquisition and incorporators.

First, in the case of a private company, the approval of the general meeting of shareholders (or the board of directors if the company has a board of directors) is required for the transfer of shares.[3] In addition, in the case of a share certificate-issuing company, the transfer of shares is not effective unless the share certificates are delivered to the transferee.[4] Therefore, in order to confirm that the transferee validly holds the shares through the proper transfer procedure, it is necessary to investigate that a resolution approving the share acquisition has been passed at a general meeting of shareholders (or the board of directors) of the private company, and that the transferee has received share certificates in the share certificate-issuing company. This can typically be confirmed through reviewing relevant minutes of shareholders' meetings or board meetings.

Second, before the 1990 amendment to the Commercial Code (which was the main law governing Japanese companies until the Companies Act took effect in 2006), Japanese companies were required to set up at least seven incorporators for incorporation, therefore relatives or friends of the incorporators or employees of a company sometimes became nominal shareholders, especially in the company established by family members. Since bona fide shareholders (who are not nominal shareholders) validly hold shares in Japanese companies under the laws of Japan, the buyer needs to carefully analyse who the bona fide shareholders of the target company are (if the company was incorporated before the 1990 amendment to the Commercial Code, as the Commercial Code is still effective for the purpose of analysing the legality of relevant corporate actions when the Code was in effect), taking into account who paid for stock, who receives dividends for stock, who are involved in the management of the target company, among other factors.

Contracts

Under the due diligence for the purpose of conducting a transaction that involves change of control of the target company, it is important to confirm whether the change of control provisions are included, especially in contracts that are material for the business of the target company. For example, certain contracts executed by the target company may contain change-of-control provisions allowing the counterparties of the target company to terminate the contracts when a significant change occurs in the composition of the shareholders of the target company. In this case, the consent of the counterparties regarding transfer of shares must be obtained. In this regard, it should be noted that contracts entered into by and among Japanese companies are occasionally written in a quite simple form lacking sufficient provisions, and often include abstract and broad language, among other things, in the change-of-control provisions. Thus the buyer must carefully analyse whether the transaction triggers events described in change-of-control clauses of material contracts entered into by the target company.

The buyer also needs to identify in the due diligence process whether material contracts have a non-assignment provision, which does not permit assignment of all or part of rights and obligations under a contract, or specifies that consent is required for doing so. Since there is no uniform interpretation under Japanese law as to whether succession under a company split constitutes an assignment to any third party all or part of its rights or obligations under such

3 Article 139, paragraph 1 of the Companies Act.

4 Article 128, paragraph 1 of the Companies Act.

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provision, it is important to carefully consider the non-assignment provision in the transaction involving company split.

Furthermore, in Japan, there are many cases in relatively small companies where oral promises that are agreed upon without a written contract or documents (such as purchase order or order receipt), which make the diligence review of contracts quite difficult. In addition, even when written contracts exist, certain terms and conditions of the contract between the target company and its business partners are often not elaborated in detail. In this case, it is necessary to analyse them according to the principles under the Civil Code and the Commercial Code.

Moreover, in Japan, there are often strong business ties between affiliated companies, especially when they are owned by an individual owner. If the target company has transactions with its parent company or other affiliated companies, including companies owned by the owner's family members or relatives, it is necessary to confirm whether the transactions are conducted at arm's length, and to analyse the necessity of contract modification or termination before the transactions are completed.

Finally, the buyer also needs to investigate in the due diligence process whether there are any contracts that adversely affect the operation of the business after the acquisition is completed. Examples of such contracts typically include those that contain non-compete provisions.

Assets and debts

If the target company leases buildings, generally speaking, the lessee is protected under Japanese law and there is a risk that the target company may not be able to evict the lessee even after the agreed lease period has expired. For instance, if the target company conducts a retailing business such as supermarket business, the target company rents a suitable building from its owner to operate a supermarket, then subleases a portion of the building to another retailer (eg, a flower shop operated by another company inside the supermarket). In this case, there is a risk that the target company may not be able to evict the lessee (eg, another retailer) at will as the Japanese law is quite lessee-friendly in terms of renewal of building lease contracts.

For example, article 26, Paragraph 1 of the Act on Land and Building Leases (the Act on Leases) stipulates that in cases where a period has been prescribed for a building lease, when, from between one year to six months prior to the expiration of said period, the parties fail to notify the other party to the effect that the lease shall not be renewed, it shall be deemed that the contract has been renewed with conditions identical to those of the existing contract, provided that said period is not prescribed.

Further, article 28 of the Act on Leases states that the non-renewal notice set forth in article 26, paragraph 1 of the Act on Leases may not be given, and a request to terminate a building lease may not be made, unless it is found that there are justifiable grounds for doing so. When determining the justifiable grounds, the following factors are considered:

- the circumstances pertaining to the necessity of using the buildings on the part of lessor and the lessee (including the sub-lessee);
- the history of the building lease contract;
- the conditions of the building's use;
- the current state of the building; and
- in cases where the lessor has offered payment to the lessee as a condition for surrendering the buildings, the consideration of such offer.

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Based on the above factors, it is necessary to conduct a detailed fact-finding investigation to analyse whether there are justifiable grounds and that the tenant can be evicted. However, it is usually very difficult to prove that justifiable grounds exist.

Intellectual property

Similar to the diligence review in other jurisdictions, it is important to analyse whether the target company actually owns the intellectual property that the target company claims to own or is important to its business. Careful attention needs to be paid especially for a jointly owned patent as, under the laws of Japan, if the target company jointly owns a patent right with a third party, exercising such patent right is more restricted than exercising the solely owned patent. For example, under the Patent Act, where a patent right is jointly owned, although each of the joint owners of the patent right may work[5] the patented invention without the consent of the other joint owners,[6] unless otherwise agreed upon by a contract, no joint owners of a patent right may:

- assign or establish a right of pledge on his or her own share of the patent right;[7] or
- grant an exclusive licence or non-exclusive licence to the patent right to any third party without the consent of all other joint owners.[8]

In the case of an invention of a product, a subcontractor of one of the joint owners of the patent right may work the patented invention without the consent of all other joint owners, if such subcontractor acts solely for such joint owner and manufactures the product under the control and supervision of such joint owner.

During the due diligence review with regard to intellectual property, it is also important to confirm whether the target company has paid reasonable compensation for an employee invention. Under the Patent Act, if an employee creates an invention that falls within the scope of the business of the employer and was achieved by acts categorised as a present or past duty performed by the employee for the employer (the employee invention), the employer will automatically own the employee invention from the time the employee invention was created if, and only if, the employer entered into an agreement or stipulated in its rules of employment in advance that the employer will own the employee invention. If the employer owns the employee invention, the employee will have the right to claim reasonable compensation for such employee invention, which could adversely affect the cash flow and valuation of such company.

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5 Working of an invention in the Patent Act means the following acts:
   1 in the case of an invention of a product (including a computer program, etc, the same shall apply hereinafter), producing, using, assigning, etc (assigning and leasing and, where the product is a computer program, etc, including providing through an electric telecommunication line, the same shall apply hereinafter), exporting or importing, or offering for assignment, etc (including displaying for the purpose of assignment, etc, the same shall apply hereinafter) thereof;
   2 in the case of an invention of a process, the use thereof; and
   3 in the case of an invention of a process for producing a product, in addition to the action as provided in the preceding item, acts of using, assigning, etc, exporting or importing, or offering for assignment, etc the product produced by the process.

6 Article 73, paragraph 2 of the Patent Act.

7 Article 73, paragraph 1 of the Patent Act.

8 Article 73, paragraph 3 of the Patent Act.

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If the employer pays reasonable compensation in accordance with its rules of employment, the employer does not have to give any additional benefit. Therefore it is necessary to confirm whether the rules of employment that contain the provisions relating to compensation for the employee invention are reasonable and whether the employer (ie, the target company) has actually paid reasonable compensation in accordance with such rules.

Labour and employment

Among various issues related to labour and employment aspect of Japanese companies, the issue of unpaid wages such as overtime allowance is one of the most commonly seen issues that require careful investigation. It is also one of the typical reasons for potential liability for companies in Japan, which could turn out to be a significant amount, since overtime work has been quite common practice in Japan. Therefore the buyer is strongly recommended to investigate whether the target company has any unpaid wages through the due diligence review. There are two particular aspects of unpaid wages in Japan, as follows.

Under the Labour Standards Law, a working hour (for employees in Japanese companies) is set at eight hours a day and 40 hours a week, and there must be one non-working day a week.[9] For any overtime work outside this period and any work during holidays, the employer is obliged to pay extra wages.[10] In addition, if an employee had to work during late-night or early-morning hours (ie, from 10pm to 5am), the employer is obliged to pay extra wages.[11] Thus, it is important to manage and calculate the precise number of working hours for employees, including the number of hours for their overtime work, to precisely assess the financial risk. If the target company does not have a good system to track employees' working hours (eg, employees merely record their working hours on their own), the target company is likely to be obliged to pay out a certain amount of unpaid wages, which could sometimes be significant.

On the other hand, if an employee of the target company is objectively classified as a manager or supervisor, he or she is exempted from some of the provisions of the Labour Standards Law concerning working hours, overtime work and work during holidays.[12] In such cases, employers are not obliged to pay managers or supervisors extra wages for overtime or work during holidays (although they are obliged to pay extra wages for late-night or early-morning work).

However, although Japanese companies typically nominate a large number of managers or supervisors among their employees, there are strict requirements as to whether such employees actually can be treated as managers or supervisors under Japanese laws and regulations. These factors include whether he or she:

- is in an integrated position with management with respect to the determination of working conditions and other labour management;
- has important duties and responsibilities that require him or her to operate beyond the framework of regulations regarding working hours, overtime and work during holidays; and

9 Article 32 and 33, and article 35, paragraph 1 of the Labour Standards Law.

10 Article 37, paragraph 1 of the Labour Standards Law, and the Cabinet Ordinance concerning Minimum Rate of Wages for Overtime Work and Work on Holidays under article 37, paragraph 1 of the Labour Standards Law.

11 Article 37, paragraph 4 of the Labour Standards Law.

12 Article 41, item 2 of the Labour Standards Law.

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- is in a position where his or her actual working conditions do not conform to regulations regarding working hours.

A comprehensive judgement should be made based on the job description, responsibility and authority, working conditions and compensation package. If the target company inappropriately determined that a certain employee was a supervisor or manager, he or she will be deemed an employee fully entitled to extra wages for overtime or work on holidays as well as late-night or early-morning work and the target company is likely to be obliged to pay unpaid wages for the overtime work of the employee concerned.

Regulatory licence or permit and compliance

In M&A transactions in Japan, due diligence with respect to the regulatory licence or permit owned by the target company requires confirmation of the necessary procedure to maintain such licence or permit post-transaction. This item is especially important in a business transfer or company split, either of which is used to carve out a business of companies, and careful confirmation as to whether such licence or permit can be transferred from the target to the buyer is necessary in such cases. Generally speaking, while under a business transfer scheme the regulatory licences or permits held by the target company may not be transferred and therefore the transferee (or the buyer) would ordinarily have to obtain such licences or permits, under company split scheme certain licences or permits may be transferred to the transferee (or the buyer). In this section, we discuss aspects of the Act on Securing Quality, Efficacy and Safety of Products including Pharmaceuticals and Medical Devices (the PMD Act) that allow the transfer of certain regulatory licences or permits but not others in the pharmaceutical industry.

Under the PMD Act, a person who conducts a marketing business of pharmaceuticals in Japan must obtain a marketing licence for pharmaceuticals (marketing business licence).[13] In addition, when the holder of a marketing licence for pharmaceuticals intends to market a particular pharmaceutical item in Japan, the holder must receive marketing approval for such pharmaceutical item individually.[14] On the other hand, a person who conducts a manufacturing business of pharmaceuticals in Japan must obtain a manufacturing licence for each manufacturing facility of pharmaceuticals (manufacturing business licence).[15]

Under the PMD Act, when a person holding marketing approval for a pharmaceutical item transfers the marketing business of such pharmaceutical item (along with the marketing materials for such pharmaceutical item) through business transfer or company split, the transferee (or the buyer) will be able to inherit the marketing approval for such pharmaceutical item,[16] provided that the transferee (or the buyer) files a statement of the transfer with the Pharmaceuticals and Medical Devices Agency around one month prior to the transfer. However, neither the marketing business licence nor the manufacturing business licence can be transferred under the PMD Act through a business transfer or company split, and therefore the transferee (or the buyer) must hold or obtain the necessary marketing business licence or manufacturing business licence.

13 Article 12, paragraph 1 of the PMD Act.

14 Article 14, paragraph 1 of the PMD Act.

15 Article 13, paragraphs 1 and 2 of the PMD Act.

16 Article 14-8 of the PMD Act.

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Litigation and disputes

The number of litigation cases in Japan is fewer than in other countries. It is, however, still important to investigate whether the target company has any ongoing litigation cases to which the target company is a party. In addition, the average trial period for civil cases among Japanese companies is usually long, and sometimes judgment will be rendered after expiry of the indemnity clause set in the definitive agreements. Therefore, the buyer should consider using special indemnity clauses in the definitive agreement of the transaction (eg, with the higher cap amount and the indefinite indemnity period) with respect to ongoing civil cases to which the target company is a party. In addition, the buyer should also identify disputes and other claims that have not led to litigation.

Matters to be noted for transactions involving business transfer or company split

For transactions involving business transfer or company split to carve out a certain business, it is important to consider whether rights transferred from the target company (ie, contracts, assets, intellectual property, systems, employees and insurance) are both necessary and sufficient for the operation of the transferred business after the succession. If they are not sufficient, stand-alone issues may arise.

In the event that certain rights or agreements are also necessary for the target company's business operations and will not be transferred to the buyer, it may be necessary that the target company and the buyer enter into transition service agreements, preferably at the same time as the definitive agreements of the transaction are concluded or when the transaction is completed at the latest, so that the buyer may continue to receive necessary services after the transaction is completed (ie, to resolve the stand-alone issues). For example, the transition service agreement stipulates that the target company may license its patents, trademarks, copyrights and know-how to the buyer after the transaction is completed. For another instance, if raw material supplier agreements are necessary for both the target company and the buyer but cannot be transferred to the buyer for a legal reason or economic reason, the transition service agreement may stipulate that the target company buys from the supplier a certain amount of raw materials necessary for its business and the transferred business and resell such raw materials to the buyer on a back-to-back basis (ie, at the same price purchased from the supplier) after the transaction is completed. Accordingly, from the due diligence perspective, it is important to investigate and identify possible stand-alone issues that need to be covered under the transition services agreements.

One of the most important issues in a transaction involving a company split is the succession of employees under the Act on the Succession to Labour Contracts upon Company Split. When a company is split, the splitting company is required follow certain procedures in order to protect the affected employees. For example, pursuant to the Act, the splitting company is required to give written notices to employees who are primarily engaged in the business to be succeeded and are included in the succession. Such notices must also be given to trade unions. Furthermore, the following employees must be given the opportunity to object to such inclusion or exclusion:

1. those who are primarily engaged in the business to be succeeded but are excluded from the succession; and
2. those who are not primarily engaged in the business to be succeeded but are included in the succession.

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In the case of (1), the employees are entitled to be included in the succession, and in the case of (2), the employees are entitled to not be included in the succession. For the above purposes, it is important to properly determine during the diligence review whether the employees are mainly engaged in the business to be succeeded.

Other specific issues of legal due diligence in Japan

Gun-jumping Regulation

In M&A transactions where prior notification to competition authorities is required, it is commonly considered that the parties to the transaction are prohibited from virtually achieving a substantial integration of businesses before the review by competition authorities is completed (the Gun-jumping Regulation). Therefore, until the review by competition authorities is completed, the parties to the transaction must refrain from conducting activities that can be deemed as virtually achieving a substantial integration of businesses.

In cross-border M&A, taking into the account the market on a global basis, it is quite possible that the seller and the buyer are judged to be in mutually competitive relationship, and the Gun-jumping Regulation may also become an issue when the buyer owns a subsidiary that is in a competitive relationship with the seller. Therefore, prior to the closing of the M&A transaction, the parties to the transaction should take reasonable care not to restrict competition between themselves due to information exchange between the parties.

The following are examples of sensitive information that may become a significant means of competition for present or future business activities and require reasonable care owing to confidentiality obligations or other requirements (sensitive information):

- present and future sales price by customer or product;
- specific future marketing strategies and plans;
- specific information about present and future research and development;
- profit and loss by product (eg, manufacturing costs, costs of raw materials, sales expenses, general administrative expenses and profits);
- purchase price for major raw materials and other terms by product;
- production and sales volume by product;
- production capacity by product;
- sales forecasts; and
- trade volume, sales price and trade terms with each customer.

In some cases, the parties to the transaction must limit the recipients and the disclosure methods when exchanging materials containing sensitive information. In such cases, the recipients of the sensitive information should be limited to external advisers (including lawyers, financial advisers and accountants) and the clean teams (consisting of directors, officers and employees of the parties who are specifically appointed to be clean team members because they are not in a position to use sensitive information to affect competition among the parties, eg, those who are not decision-makers, those who do not hold management positions or members of the sales and procurement department), all of whom shall be subject to a confidentiality obligation.

As for disclosure methods, when materials containing sensitive information are disclosed to the clean teams, they should only be able to view such information as is necessary for the purpose of discussing the M&A transaction. In addition, when material containing sensitive information is disclosed, the material should clearly indicate any high confidentiality of information

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by marking it strictly confidential. Last, the parties to the transaction must take the appropriate measures to prevent sensitive information from being leaked to anyone outside the clean teams.

Foreign Exchange and Foreign Trade Act

Under the Foreign Exchange and Foreign Trade Act, which governs foreign investments, when a foreign investor acquires more than a certain percentage of shares or voting rights in a Japanese company engaged in certain designated industries (discussed below), the investor is required to submit prior notification to the minister having jurisdiction over the business and the Minister of Finance. In particular, the foreign investor must submit prior notification at least 30 days before making the investment in each of the following cases:

- a foreign investor acquiring 1 per cent or more of the shares or voting rights of a listed company (the threshold has been lowered from 10 to 1 per cent in accordance with the 2020 reform of the Foreign Exchange and Foreign Trade Act);
- a foreign investor acquiring any shares or equity in an unlisted company; or
- a foreign investor acquiring a business from a domestic corporation engaged in a designated industry, through business transfer, an absorption-type company split or merger.

Importantly, upon its review of notification, the Minister of Finance or the competent minister may recommend a change to the transaction structure or cancellation of the foreign investment. In addition, because the investment cannot be made until prior notification has been submitted and reviewed by the competent authorities, this has significant impact on the transaction schedule and structure. Therefore it is important to consider during the due diligence review whether the investment falls within designated industries, including aircraft, weaponry, nuclear power, space development, energy, leather goods and information processing.

It is necessary to determine whether an investment falls under a designated industry by reviewing its actual business activities as well as the business purpose in the articles of incorporation of the target company. Therefore, during the due diligence review, it is important not only to confirm whether the designated industry is listed in the business purpose in the articles of incorporation, but also to confirm whether the target company actually operates its business in the designated industry.

Exemptions to prior notification have not been described in detail in this chapter.

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Appendix 1

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