DOING DEALS IN JAPAN REVISITED: AN UPDATED INTRODUCTORY GUIDE FOR U.S. PRACTITIONERS

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How times have changed since "Doing Deals in Japan" was first published in 2010![1] Japan still remains in the M&A spotlight, but from a new perspective. In 2010, Japanese companies had an insatiable appetite for purchasing American companies. The premise of the first edition of "Doing Deals in Japan," therefore, was to provide U.S. dealmakers with a basic understanding of Japanese M&A techniques in order to better advise Japanese clients through comparative analysis and to anticipate (and manage) deal "blind spots." While Japanese companies still have a healthy appetite for American companies, there has been a resurgence of the Japanese economy and inbound investment activity. Coupled with this pivot, recent changes to Japanese law have materially impacted Japanese M&A practices making descriptions in the first edition of "Doing Deals in Japan" either incomplete or no longer applicable. "Doing Deals in Japan Revisited" fills this void by providing a comprehensive one-stop update.

The Japanese economy is roaring back. Based on Japanese government reports, between fiscal years 2012 and 2015 real GDP grew from 520 to 529 trillion yen (ranking Japan as the third-largest economy in the world), annual corporate ordinary profits increased by 20 trillion yen, and unemployment declined from 4.3% to 3.4%. Inbound investment activity also experienced a similar strong growth trend. The net amount of inward forward direct investment in 2015 reached a record annual high of 24.5 trillion yen and Prime Minister Abe announced that he would use all his political power to increase foreign direct investment even further to 35 trillion yen by 2020. Needless to say, international investors are taking notice. Since January 2011 the Nikkei 225 has approximately doubled in value, and a 2015 UNCTAD report on world investment ranked Japan as the 13th most attractive destination for multinational companies over the 2015-2017 period. The United States continues to remain the single largest net investor into Japan, and there are no signs that this trend will end. With the wind blowing toward inbound investment (especially from the United States), a U.S. practitioner's basic understanding of Japanese M&A techniques is now more useful than ever.

There are many stark differences in the methods to acquire a Japanese company and the ways to transact business in Japan when compared to U.S. laws and practices. This article does not purport to explain all the variances between U.S. and Japanese M&A techniques and practices, but aims to highlight the principal differences in (1) corporate governance, (2) M&A acquisition methods, and (3) the application and enforcement of contractual rights.

Corporate Governance

Understanding the corporate governance structure of a Japanese company has multiple benefits. At a minimum, it enables purchasers of Japanese assets to better understand with whom they should negotiate, the powers and limitations of the Japanese negotiating team, and the overall corporate decision-making process. In addition, Japanese companies entering the U.S. market may use their corporate governance systems as the framework for analyzing the U.S. deal team and the level at which negotiations should take place, and U.S. counsel's prior understanding of these systems may prevent unnecessary confusion and time delays in completing the deal.

There are fundamental differences between the

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U.S. and Japanese corporate governance models. For example, the Revised Model Business Corporation Act and Delaware corporate law state that the business and affairs of every corporation should be managed under the direction of its board of directors.[2] The Companies Act of Japan ("Japan Companies Act"), however, does not necessarily require a board of directors-centered supervisory structure. The Japan Companies Act allocates a portion of the supervisory function to the company's shareholders and statutory auditor (*kansa-yaku*).[3] Consequently, a board's traditional supervisory function and role as a check on executive abuse of power normally found in the U.S. corporate governance model is typically absent in Japan. This difference in supervisory approach has influenced how the rights and responsibilities of directors and shareholders are apportioned under the Japan Companies Act.

Shareholder Rights

While shareholders in a Delaware company may cast their votes upon the election of directors, an amendment to the company's certificate of incorporation, the dissolution of the company, or a fundamental corporate change (such as a merger or a sale of all or substantially all of the company's assets), the Japan Companies Act provides shareholders (depending on their percentage ownership level) with a panoply of rights above those afforded to shareholders in a Delaware company, including the right to determine dividend payments, approve the sale of shares at a discounted price or involving a change in control, select the company's accounting firm, petition a court to dissolve the company, and establish the upper limit of the aggregate amount of compensation to be awarded to all directors.[4] Furthermore, the articles of incorporation of a Japanese company can be amended by only a shareholders' resolution (*i.e.*, the shareholders may propose an amendment to a company's articles without obtaining the board's approval).[5] Shareholders of Japanese companies, therefore, typically have vaster and deeper voting rights than shareholders in Delaware corporations.

Board of Directors

Weak director independence, limitations on who is capable of lawfully binding a company, and the absence of functioning board committees are the principal corporate governance differences when comparing U.S. and Japanese boards of directors.

Weak director independence. While a majority of the directors in U.S. public companies are usually independent directors and many U.S. private companies have independent board members, most board members of Japanese public and private companies concurrently serve as senior executives of the company. To address the lack of director independence at the public company board level, over the past few years the Japanese government has overhauled the director independence requirements under the Japan Companies Act and the Tokyo Stock Exchange has amended its listing maintenance rules as part of efforts to strengthen Japan's corporate governance under economic reforms sponsored by the Abe administration. As a result, Japan now has complicated and multilayered requirements for director independence that apply (and sometimes overlap) depending on such factors as the size of the company, whether the company is a reporting company, and whether the company's shares trade on a major stock exchange. While detailing the complexities of these various independence requirements is beyond the scope of this article, the introduction of the new director independence requirements has made little difference on board composition—while relatively more "independent directors" now serve on Japanese boards than in 2010, Japanese boards still remain dominated by company management.[6]

A continued lack of board independence is not limited to outlier Japanese companies. A report published by the Tokyo Stock Exchange on July 27, 2016, revealed that of the companies listed on the Tokyo Stock Exchange Section 1 (the premier stock exchange in Japan, reserved for the largest and most profitable

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companies), 97.1% had at least one independent director (up from 31.5% in 2010) and 79.7% had at least two independent directors (up from 12.9% in 2010). However, in 2016 (i) the average size of the boards of directors for companies listed on the Tokyo Stock Exchange Section 1 was 9.29 persons, and (ii) only 4.6% of all Tokyo Stock Exchange Section 1 listed companies had a board comprised of 50% or more independent directors. With independent directors having unmistakable minority representation on the boards of practically all of Japan's most prestigious and noteworthy companies, a conducive environment does not exist for Japanese boards to impartially check and monitor the activities of senior management.

Limited binding authority. The board of directors of a Japanese company must appoint one or more Representative Directors (*daihyō torishimari-yaku*) from among its directors to have the authority to represent the company (*i.e.*, execute contracts on behalf of the company). Historically, a Japanese company was required to appoint at least one individual who was a resident of Japan to serve as its Representative Director; however, this residency requirement was eliminated as of March 16, 2015. The name of each Representative Director is listed in the company's publicly available commercial registry in order to provide notice of such binding authority to third parties.

U.S. practitioners may incorrectly assume that persons holding a title that appears equivalent to a senior executive position would have the authority to legally obligate a Japanese company. This binding authority, however, is ordinarily non-existent. Many Japanese companies often refer to their highest level employees as "executive officers" (*shikkō yakuin*), and unless a special delegation has been made to such persons, then they ordinarily will not have the authority to enter into contracts on behalf of the company.[7] When transacting with a Japanese company, therefore, the deal team should be sensitive to the divergence between title and actual power, and U.S. practitioners should anticipate that Japanese clients may be skeptical if a vice president or line manager claims to have the authority to execute contracts on behalf of the company (and may seek a legal opinion to confirm such authority, as opposed to relying on a corporate secretary's certificate).

Absence of functioning board committees. Unlike Delaware corporate law, the Japan Companies Act does not permit a Japanese board to fully delegate its power and authority to a committee (even if the committee consists entirely of directors). When facing matters that require board approval, a Japanese company is actually required to hold a full board meeting or, if its articles of incorporation permit, pass a board resolution by way of unanimous written consent of its directors. The establishment of a special committee to negotiate with a purchaser in the M&A context is also currently uncommon in Japan. However, Japanese companies since the mid-2000s have with greater frequency established special committees to review the terms and conditions of a management buyout or to decide whether to implement anti-takeover defensive measures (primarily due to the recommendations made in reports published by study groups established by Japan's Ministry of Economy, Trade and Industry). Since these special committees do not have binding authority and typically cannot engage their own advisors, they are frequently viewed as simply an advisory committee to the board of directors.

M&A Acquisition Methods

While Japanese acquisition techniques vary depending on whether the target is publicly-traded or privately held, certain background principles cut across both public and private M&A transactions.

Background Principles

Formation of acquisition vehicle. A company not organized under Japanese law cannot merge or enter into a statutory corporate combination with a Japanese company. Establishing a new Japanese company could have negative tax implications for a purchaser if

assets must be transferred to the new Japanese subsidiary, and also may delay the deal's timetable and significantly raise transaction costs. In particular, unlike the ability to incorporate a Delaware company overnight, completing the registration of a newly-established Japanese company will normally take approximately one week after the necessary paperwork is submitted to the local registry. Using shelf companies is not common in Japan due to the inability to confirm that there are no prior "hidden" or contingent liabilities. Furthermore, although the stated capital (*shihon kin*) of a Japanese company technically can be one Japanese yen, many operating companies have a stated capital of approximately one million Japanese yen or more due to the local bias toward conducting business with financially strong and prestigious companies, and the stated capital is frequently viewed as an indicator of financial health.[8] The concept of shares with a par value no longer exists under the Japan Companies Act.

Choice of acquisition methods and tax considerations. Similar to a U.S. target, a Japanese target can be acquired through an asset sale (referred to locally in English as a business transfer), stock purchase or merger. While an asset acquisition may be the initial option if the purchaser wishes to acquire only a portion of the target's business or to potentially avoid the assumption of certain liabilities of the target, the choice of either a stock acquisition or a merger is the common acquisition method in Japan due to the seller being required to recognize the unrealized gain on the transferred assets and the purchaser not being able to inherit net operating losses and loss carryforwards from the seller.

For mergers and other corporate combinations involving Japanese companies, the target will be required to recognize a capital gain on its assets and goodwill, unless the several requirements outlined in the table below are met. The requirement that the purchaser use its shares as the sole consideration in order to obtain Japanese capital gains tax deferral is likely the main reason why mixed consideration (cash plus stock) is rarely used in Japan in the corporate combination context.

In Japanese stock purchase transactions, the target shareholders frequently will be subject to Japanese national and local income tax if the purchase price for their shares is greater than the book value. The target, on the other hand, is not required to recognize a capital gain on its assets or goodwill. In this respect, a stock purchase transaction offers tax advantages over a cash merger, and it is frequently used as the acquisition method for a cash deal.[9]

Capital gains or losses can be deferred at both the target and shareholder level in a qualifying merger or other qualifying form of corporate combination if the requirements below are satisfied:[10]

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Requirements	**Qualified Merger, Corporate Split, Share Exchange, Share Transfer or Contribution-in-Kind**		
	100% Relationship[a]	<100% but >50% Relationship[b]	<50% Relationship
Consideration	Only purchaser shares or shares of purchaser's direct parent who owns (and is expected to continue to own) all of purchaser's shares		
Employment	None	Approximately 80% of target's employees must be expected to continue to be employed *(Requirement applicable to the transferred business in a qualified corporate split or contribution-in-kind)*	
Business Continuity	None	Principal business of target must be expected to continue *(Requirement applicable to the transferred business in a qualified corporate split or contribution-in-kind)*	
Other	None	Principal assets and liabilities of the transferred business must be transferred to purchaser in a qualified corporate split or contribution-in-kind	● Mutual connection between the principal business of target and any business of purchaser *(Requirement applicable to the transferred business in a qualified corporate split or contribution-in-kind)* ● Target shareholders who are expected after the transaction to hold shares of purchaser (or the shares of its parent if used as the consideration) must, before the transaction, hold at least 80% of target's shares unless target has 50 or more shareholders ● Principal assets and liabilities of the transferred business must be transferred to purchaser in a qualified corporate split or contribution-in-kind ● Either of the following: (i) sales amount, number of employees or other similar characteristics of target's principal business or a related business of purchaser is no more than approximately five times greater than the size of that of the other; or (ii) at least one senior manager of target and purchaser before the transaction will be appointed a senior manager of purchaser after the transaction *(and in the case of a qualified share exchange or share transfer, none of target's senior management resign upon the closing or shortly thereafter)*

a: Target or purchaser must own directly or indirectly all of the shares issued by the other party, or all of the shares of both the target and purchaser must be directly or indirectly owned by the same individual or company. Such capital relationship must be expected to continue.

b: Target or purchaser must own directly or indirectly less than 100% but more than 50% of the shares of the other party; or less than 100% but more than 50% of the shares of both the target and purchaser must be directly or indirectly owned by the same individual or company. Such capital relationship must be expected to continue.

While the availability of a tax-free U.S. corporate acquisition often depends on the results of a "continuity of interest" analysis, Japanese tax law appears to require the continuity of corporate organization at the target company level as well as the target shareholders' continuity of investment. Generally speaking, therefore, an inverse relationship exists between the number of factors that must be satisfied and ownership percentage—as the target or acquiror's ownership percentage increases in the other party, the number of factors that must be satisfied to effect a tax-free qualified merger or other qualifying form of corporate combination decreases. It also goes without saying that the factors in the table above are vague and open to interpretation, so counsel should be instructed at an early stage if tax-free status is desired.

Public M&A Transactions

The two principal areas of difference when comparing U.S. and Japanese public M&A techniques are tender offer regulations and permissible defensive measures.

Tender offer regulations. U.S. and Japanese tender offer regulations are closely aligned.[11] Nonetheless, principal differences exist. For example, generally speaking, Japanese tender offer rules are automatically triggered when a purchaser increases its beneficial ownership[12] in a Japanese reporting company above one-third through one or more "off-market transactions" or above 5% through transactions conducted "outside the market" with more than 10 persons during a rolling 60-day period.[13]

In addition, if a purchaser acquires more than 5% of the voting rights in a Japanese reporting company in one or a series of "off-market transactions" during a rolling three-month period, then generally speaking the purchaser may not acquire additional shares in any manner whatsoever that would increase by more than 10% its aggregate voting ownership level in the target over a three-month period (which ownership increase includes the transaction that brought the purchaser over the foregoing 5% ownership threshold) if as a result thereof its ownership level in the target would exceed one-third.[14]

Structuring the terms of a Japanese tender offer also can be more restrictive in comparison to options available under U.S. tender offer rules. For example, a purchaser can condition its tender offer only upon events specified by statute, such as the receipt of governmental approvals (but not the ability to obtain financing or the absence of a material adverse change), and a purchaser cannot withdraw its offer unless an event specified by Japanese securities laws occurs.[15] Furthermore, after the commencement of a tender offer (which occurs after the publication of the tender offer commencement notice), a purchaser may not decrease the tender offer price, decrease the number of shares to be purchased, shorten the tender offer period, decrease the minimum number of shares to be purchased, change the consideration of the tender offer, or change the withdrawal conditions listed in the tender offer documents. Also, if a purchaser intends to become an owner of no less than two-thirds of the voting rights in a Japanese reporting company, then it cannot launch a partial tender offer.

Other differences include:

- pre-commencement tender offer communications by the parties are not required to be filed with Japanese regulators;
- the purchaser is required to provide the Japanese regulator with evidence that it has ample funds to complete the offer at the proposed tender offer price (such as a bank statement that denotes it has sufficient funds);
- the equivalent of the "best price rule" under Japanese tender offer rules requires that the consideration offered to tendering shareholders through the tender offer be the same in form and amount, but such criteria normally does not require an examination of the arrangements

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entered into between the purchaser and the target's shareholders outside the tender offer, absent extreme circumstances (dispensing with the specific U.S. substantive standards applicable to employment compensation, severance, and other employee benefit arrangements with security holders of the target, and reducing the uncertainty that may exist with respect to commercial arrangements entered into between the purchaser and certain target shareholders at the time of the tender offer); and

- the initial and any subsequent tender offer period cannot in the aggregate extend beyond 60 business days from the commencement date.

Defensive measures. While unsolicited transactions are becoming more prevalent in Japan, the number of hostile acquisitions of Japanese companies pales in comparison to the United States.[16] Nonetheless, the May 2016 issue of *MARR* reports that as of March 31, 2016, 475 publicly-traded Japanese companies have adopted anti-takeover mechanisms (approximately 75 fewer companies than as of May 31, 2010), principally in the form of publishing notices that detail (1) the procedures that a purchaser should follow in order for the board (or shareholders) to consider an acquisition proposal, and (2) the potential defensive measures the company may take. This practice is called "advance warning" (*jizen keikoku*).[17] The use of U.S.-style "poison pills" in Japan remains rare.[18]

A series of cases decided in 2005 promoted the use of "advance warning" by Japanese publicly-traded companies. In the *Nippon Broadcasting* case, the Tokyo High Court articulated that, in the context of disputes over corporate control, unless the target succeeds in proving that the acquiror is an "abusive acquiror," then the court should award injunctive relief to stop the target from effecting anti-takeover mechanisms.[19] The Tokyo District Court, which had suggested in the *Nireco* case that the court will make a rebuttable presumption that a purchaser who violates the procedural provisions stipulated in the target's "advance warning" notice is an "abusive acquiror," held the following month in the *Japan Engineering Consultants* case that the target's board may require a hostile purchaser to present a business plan and allow the board sufficient time to examine its proposal in order for the target's shareholders to have sufficient time to decide whether the hostile purchaser or the current directors should manage the target.[20] If the purchaser declines to comply with these reasonable requests, then the court held that the board, to the extent permitted by law, may take reasonable anti-takeover measures against the purchaser.

Staggered boards rarely appear as a Japanese anti-takeover tactic because this mechanism normally is not helpful. While Delaware corporate law allows shareholders to remove directors sitting on a staggered board only for cause, Japanese corporate law allows the majority shareholders (or two-thirds majority, if the target's articles of incorporation so provides) to remove any director with or without cause at any time. Accordingly, a purchaser who acquires more than a majority of the outstanding voting interests in a Japanese target can gain control over the target's board. A raiding purchaser, however, may not be able to swiftly remove incumbent directors because the Japan Companies Act requires a company to actually hold a shareholders' meeting to adopt shareholder resolutions, unless all shareholders unanimously agree in writing to the matters being resolved (which unanimity requirement cannot be altered by the target's articles of incorporation).

Private M&A Transactions

The practices adopted by Japanese parties to undertake a local private business combination differ significantly from U.S. norms. It wouldn't be unprecedented in Japan for a large domestic transaction to be documented in a 30-page or shorter acquisition agreement. Although listing all of the differences be-

tween a U.S.-style versus a Japanese style private acquisition agreement would extend beyond the scope of this article, the following are some of the notable differences:[21]

- Similar to U.S. practices, representations and warranties covering the basic business operations of the target are common in domestic private transactions, as well as specially-tailored representations and warranties addressing matters uncovered during the due diligence process. However, detailed representations and warranties are normally not included for matters concerning employee benefits, environmental liabilities, specific items from the financial statements (*e.g.*, accounts payable, inventory, backlog, etc.), accounting practices, tax, or real property. Nevertheless, the inclusion of a "full-disclosure" representation and warranty remains a current market practice, especially since management interviews are a common source of information and a focal point of the due diligence exercise.

- The use of escrow agreements to hold-back a portion of the purchase price to settle indemnification claims and other post-closing obligations of the sellers only recently has been a realistic option in the local M&A scene due to the introduction of financially stable escrow agents offering the traditional services of an escrow agent at a reasonable price; however, the use of escrow arrangements is still infrequent. The use of representation and warranty insurance is virtually non-existent, but this hedge could gain traction as Japanese deal-makers become familiar with this policy in cross-border M&A transactions. Purchase price holdbacks and earn-outs are possible alternatives in the private acquisition context, but neither is currently widely used in Japan.

- While indemnification provisions with baskets and caps are common features in Japanese private acquisition agreements, it is uncommon for agreements to contain (1) carve-outs from the baskets and caps for certain representations and warranties and breaches of covenants, (2) double materiality scraps, (3) pro-"sandbagging" clauses, (4) a tax gross-up for indemnification payments (or claim off-sets for tax benefits resulting from the indemnification claim or insurance proceeds received), or (5) detailed procedures on how claims made by third-parties should be handled and controlled.

- Private acquisition agreements normally do not contain a separate section detailing how taxes of the target company incurred prior to the closing should be handled, and if such tax matters are addressed, reliance is often placed on a short indemnification clause holding the seller responsible for pre-closing tax obligations.

- The inclusion of a detailed definition for "material adverse effect" is uncommon and, if provided, the use of numerous exceptions to the definition is even less common.

- A fixed date is often inserted for the closing date, rather than a formula of a number of business days after the satisfaction of the conditions precedent, but a backstop date is often included in case the fixed closing date cannot be achieved. Japanese private acquisition agreements also normally contain comparatively more conditions precedent than U.S. private acquisition agreements, most notably by conditioning the sale on the absence of events having a material adverse effect (using an undefined term) and frequently a financing-out.

Japanese legal principles and cultural patterns may play a role in the differences between U.S. and Japanese contract drafting conventions. In particular, Japanese law does not have the U.S. equivalent of the parole evidence rule. As a result, the parties to a dispute

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normally can submit all applicable evidence to a court, even if a contract contains an integration clause that states the contract represents the entire understanding of the parties and supersedes all prior communications regarding the subject matter of the agreement.[22] Parties to an agreement in Japan, therefore, may naturally tend to feel that it is not important to memorialize all of the deal terms in a definitive set of transaction documents since external communications typically can be submitted to explain and supplement the provisions of a contract.

Japanese parties also may prefer to defer upfront detailed discussions over controversial and sensitive deal points because the parties frequently place great importance on preserving initial goodwill, and each side normally expects that post-closing differences will be reasonably resolved (regardless of what rights and privileges appear in the deal documentation). To support such sentiments, Japanese commercial agreements frequently contain a covenant that the parties shall decide through mutual consultation and good faith negotiations any matter that is not expressly provided in the agreement. Consequently, Japanese parties may feel that it is unnecessary for deal documentation to contain lengthy provisions delineating the various intricacies of the commercial arrangement and numerous deal-breaking scenarios because such sensitive matters can be subsequently worked out upon an analysis of the actual facts and the totality of the circumstances.

Squeezing Out Minority Shareholders

Similar to prevailing U.S. practices, a controlling shareholder of a Japanese company technically can utilize a cash-out merger to squeeze out the minority shareholders of the target. As discussed above, however, a cash-out merger would cause the target to incur a capital gains tax on its assets and goodwill. In order to avoid unnecessary tax leakage at the target level, the current common method for an acquiror to squeeze out minority shareholders is to use procedures that are afforded to a super-majority controlling shareholder.[23]

Super-majority shareholder squeeze-out. A cash squeeze out of the minority shareholders by a super-majority controlling shareholder has been available to acquirors only since 2015, and can be effected according to the following scheme:

- Once an acquiror achieves the status of being a "Special Controlling Shareholder" (as defined below) it is granted by operation of law with a conditional call option over all of the outstanding shares and other equity securities (*e.g.*, stock options and warrants) of the target company not owned by the Special Controlling Shareholder, other than any treasury shares held by the target company. The basic features of the conditional call option include: (i) it is created immediately upon an acquiror qualifying as a Special Controlling Shareholder, and no documentation needs to be prepared to issue the conditional call option to the Special Controlling Shareholder (since the conditional call option is created automatically by operation of law), (ii) it covers all of the outstanding shares and other equity securities of the target company (and is not with respect to only a portion or a class of securities, and it must be exercised in full), and (iii) there is no expiration date for the exercise of the conditional call option by the Special Controlling Shareholder. A "Special Controlling Shareholder" is defined as a person or entity that gains control of 90% or more (or a higher ownership threshold if stipulated in the target company's articles of incorporation) of the total voting rights in the target company, either alone or together with its wholly-owned subsidiary.

- To exercise the conditional call option, the Special Controlling Shareholder must (i) notify the target company's board of directors in writing of its intention to exercise the conditional call option and provide the relevant details concerning the conditional call option exercise (in particular, the proposed closing date for the

share purchase and the purchase price for the shares and other equity securities held by the minority shareholders—which consideration must be in the form of cash), and (ii) request that the board of directors of the target company accept the exercise of the call option by the Special Controlling Shareholder pursuant to such terms (which is why the call option is considered "conditional"). No direct communications between the Special Controlling Shareholder and the minority shareholders are required for the Special Controlling Shareholder to exercise its conditional call option, and the Special Controlling Shareholder cannot assign to a subsidiary (wholly-owned or otherwise) its rights under the conditional call option.

- The target company's board of directors is required to act on behalf of the minority shareholders to protect their interests and to inform them of the details of the conditional call option exercise by the Special Controlling Shareholder. If the target company's board of directors approves the call option exercise by the Special Controlling Shareholder, then the board must notify the minority shareholders in writing at least 20 calendar days prior to the proposed closing date for the share purchase.

It is a frequent Japanese practice in friendly transactions for an acquiror to enter into a take-private acquisition agreement with the target company prior to launching the first-step tender offer, which agreement typically stipulates the proposed consideration to be offered to the minority shareholders in the second-step squeeze out transaction. By agreeing upfront the consideration to be offered in the second-step squeeze out transaction (or the points to consider), it is not clear whether the consideration to be offered to the minority shareholders in a super-majority shareholder squeeze-out could ever be fixed at an amount less than the first-step tender offer price as the material details of the take-private acquisition agreement must be publicly disclosed and it would be an improper tender offer tactic to disclose that the minority shareholders will be squeezed out for a purchase price lower than the first-step tender offer price. However, in light of a recent Japan Supreme Court holding discussed below, transaction parties also can minimize the risk that an acquiror would need to pay the minority shareholders a price greater than the first-step tender offer price.

Remedies. Prior to amendments to the Japan Companies Act in 2014, exercising appraisal rights was essentially the sole remedy available to dissenting minority shareholders. However, in a super-majority shareholder squeeze-out process, minority shareholders who object to a decision by the target company's board of directors to accept the terms proposed by the Special Controlling Shareholder for the exercise of the call option can (i) exercise their appraisal rights and seek a court's determination of the fair value of their shares, (ii) seek an injunction to prevent the closing of the call option exercise, or (iii) file a lawsuit alleging a breach of fiduciary duties by the target company's directors arising from its improper approval of the exercise of the call option.[24]

Since the *Rex Holdings'* case, the judiciary's determination of "fair value" in appraisal proceedings has been one of the most widely debated topics in the Japan M&A scene given its vagaries and potential incentives to encourage appraisal proceedings by wily dissenting shareholders.[25] In the recent *Jupiter Telecommunications* appraisal proceeding, Japan's Supreme Court issued an opinion that will likely discourage appraisal arbitrage in Japan. In this case, Japan's Supreme Court held that if the tender offer is made in accordance with a process "generally accepted to be fair" and the bidder offers the same acquisition price that was paid following the first-step tender offer in the second-step cash squeeze-out transaction, then the judiciary, in principle, should approve that same price as the fair value for the cashed-out minority shares.[26] The Supreme Court's holding marked a dramatic

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change in court precedents (including its own verdict in the *Rex Holdings'* case and its progeny), where courts made their own valuation of fair price and frequently awarded dissenting shareholders an amount higher than the tender offer price that preceded the squeeze-out process. The *Jupiter Telecommunications* holding most likely will dissuade shareholders from initiating appraisal proceedings as a game tactic since the payment they will receive is likely to be the same as the tender offer price (so long as the transaction follows a fair process).[27]

Application and Enforcement of Contractual Rights

The inability to terminate certain contracts and the proclivity to resolve disputes outside of court are distinguishing factors of how contractual rights are honored and enforced in Japan.

Terminating Contracts

The principle of "freedom of contract" generally governs the interpretation of termination clauses under Japanese law, so the parties to an agreement generally have the right to end their contractual relationship in accordance with the terms of the arrangement. However, in the employment context or if a commercial agreement is characterized as a "continuous contract," then the ability to unilaterally terminate such arrangement in Japan is restricted.

The foregoing could have a critical impact on the valuation of a target if the purchaser mistakenly assumes that after the acquisition it can readily reduce the target's workforce and terminate all unfavorable "continuous contracts" simply by complying with an agreement's termination provisions.

Employment arrangements. Unlike many jurisdictions in the United States, an employer in Japan cannot terminate an employee without good cause. Even if an employment contract stipulates that an employer may terminate the employment relationship for any reason or no reason, such provision normally will be held unenforceable as an unlawful attempt to bypass Japanese labor laws. The threshold for "good cause" in Japan is extremely high in comparison to most U.S. standards. Article 16 of Japan's Labor Contracts Act stipulates that the termination of an employee in Japan is invalid unless there is "objective good reason" for the termination and it is "acceptable in light of socially accepted standards." The foregoing standard is not defined or explained by Japanese statutes, which has given Japanese courts great latitude to determine when this standard is satisfied.

Japanese courts, taking into consideration the lifetime employment system established in the Japanese business community, require employers to meet extremely high burdens of proof to support the existence of "objective good reason," even if the employment agreement or the company's work rules permit a lower threshold. To demonstrate an "objective good reason," an employer normally would need to show that (1) the employee committed a severe breach of the company's work rules or other rules relating to employment, (2) the employee lacks competence or the necessary business skills, or (3) the survival of the subject company's business requires that headcount be reduced.[28] Even if the employer succeeds in showing an "objective good reason," the court will not permit the termination unless it is persuaded that the termination is "acceptable in light of socially accepted standards."[29] In each instance, direct and substantial evidence must be submitted to convince a judge to accept the dismissal, and it is often especially difficult to convince a Japanese court that poor performance alone should warrant employment termination. Accordingly, a company in Japan will normally negotiate a severance package with the affected employees, which calls for the employer to pay several months' wages (or more) as a separation payment in exchange for the employee's voluntary resignation. A company's Representative Director(s) and most likely its directors who hold executive authority do not benefit from the pro-employee provisions of Japanese labor laws.

Due to the significant restraints on terminating employees, employers in Japan often enter into fixed-term employment contracts. Japanese law generally permits fixed-term employment contracts of up to three years in length. The fixed-term employment contract will generally terminate at the end of the stated term, but can be renewed by the parties. Whether or not the employment contract is renewable, and the criteria for renewal, must be stated in the agreement. While a fixed-term employment agreement may prove useful to an employer in Japan who is uncertain about its future employment needs, if a fixed-term agreement is renewed repeatedly, the relationship with the employee may be deemed to be similar to a regular employment relationship and it will be more difficult for the employer not to renew the employment contract.[30]

Distribution, franchise and supply agreements. A "continuous contract" is generally understood in Japan as a contract under which a party is required to perform a duty continuously by virtue of the nature of the duty (*i.e.*, the duration of the agreement does not directly dictate whether an agreement is considered continuous, but the underlying type of obligation and whether such obligation by its nature should be performed continuously are the determining factors). Many Japanese lower court precedents treat distribution agreements, franchise agreements and supply contracts as "continuous contracts" due to the ongoing and long-term requirement of one party to supply and the other party to purchase the subject matter of the particular contract. If a commercial agreement is characterized as a "continuous contract," a Japanese court is likely to require a "justifiable and unavoidable reason" in order to allow the unilateral termination of such agreement.[31] Japanese courts place a high burden on a party seeking to terminate a "continuous contract" (even if the agreement permits unilateral termination) because the non-terminating party typically will make business decisions relying on the expected long duration of the agreement (and Japanese courts believe that such reasonable expectations should be protected). Accordingly, a one-sided cancellation right is normally voided. If a "continuous contract" is terminated without a justifiable and unavoidable reason, then the terminating party may be required to pay damages to the non-terminating party (the type and calculation of which is determined by Japanese courts on a case-by-case basis, but is rarely *de minimis*), or the termination can be enjoined until the passage of a sufficient wind-down period (as determined by the court).

Enforcing Contractual Rights

In comparison to the United States, civil litigation is not frequently used as a method to settle disputes in Japan. A U.S. purchaser entering the Japanese market that hastily uses or threatens the use of litigation to settle disputes may find its reputation tarnished and blacklisted from the local deal community.

There are a number of cultural, structural and procedural reasons that support the lack of civil litigation in the commercial context in Japan, including:

- Japanese hold a cultural preference for informal mechanisms to resolve disputes as opposed to formal litigation, as illustrated by the above with respect to the proclivity to include covenants in commercial agreements that the parties should consult and undergo good faith negotiations to resolve matters not contained in the agreement.
- Japan has relatively few lawyers per capita in comparison to the United States. For every 245 Americans there is one lawyer, while in Japan there is one lawyer for every 3,257 Japanese.[32] The dearth of lawyers in Japan inherently limits the amount of litigation that can be brought and may even discourage parties from initiating litigation due to the perceived lack of adequate resources.
- Commercial parties may view Japanese judges

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with skepticism (jury trials do not exist in civil trials in Japan) because (1) most judges turn to this profession immediately after graduating from Japan's Legal Training and Research Institute, so commercial parties may be reluctant to have matters decided by a judge who has little (or no) business experience, and (2) some judges apply their own concept of fairness when deciding matters without particular reliance on the facts at hand or court precedents (other than decisions by the Supreme Court of Japan) and since it is difficult for plaintiffs to "forum shop" under the Japanese judicial system, commercial parties may prefer to settle matters pursuant to their own framework of justice.

- There is little "discovery" prior to the commencement of a trial (so pre-trial maneuvering through costly depositions or document demands do not generally exist). In addition, damages are normally prescribed by statute and Japanese courts are not allowed to grant punitive damages (so adversaries may be more inclined to settle their disputes before trial since damage awards can be more accurately estimated, thereby allowing the parties to better gauge their exposure when crafting settlements terms).

The lack of civil litigation in Japan is not due to arbitration or mediation serving as the preferred dispute resolution method. In comparison to civil litigation, commercial arbitration and mediation are actually even less frequently used in Japan as a way to settle either domestic or international disputes. During the fiscal year ended March 31, 2016, the Japan Commercial Arbitration Association (the Japanese counterpart of the American Arbitration Association) handled only 47 arbitration cases (21 new cases and 26 cases carried forward), and no mediation cases.

Conclusion

Many Japanese companies have a reputation of priding themselves on their native business practices and scorning outside influences. However, the attitude of "this simply isn't the way we do it in Japan" may soon change. The increased pace of foreign direct investment into Japan should not only benefit the local economy, but also could impact how business is conducted in Japan. A common consequence of foreign direct investment is the transfer of technology and business practices by the overseas parent company to its Japan operations, and allowing the Japan operations to exploit the parent company's global network and resources. Even though Japan is one of the most advanced economies in the world, Japanese companies nonetheless also can benefit by adopting certain best practices developed elsewhere. The convergence of increased local competition arising from greater foreign direct investment and the world spotlight turning to Japan in light of the 2020 Summer Olympics in Tokyo could provide the requisite spark for Japanese businesses to discard outdated practices and implement deep changes. Should this occur and Japanese companies increase their profitability, then a multiplier effect for change may follow because Japanese companies would become even more attractive candidates for foreign direct investment.

ENDNOTES:

[1]Stephen D. Bohrer and Akio Hoshi, "Doing Deals in Japan: An Introductory Guide for U.S. Practitioners," *The M&A Lawyer*, 2010, 14(9), at 14-26.

[2] *See* Section 8.01(b) of the Revised Model Business Corporation Act and Section 141(a) of the Delaware General Corporation Law.

[3]Depending on the size of the company (measured by the amount of its stated capital and total liabilities) and whether the company's shares are publicly traded or subject to a statutory right of first refusal exercisable by the company (which would be typical for a privately-held company), there are approximately 40 permissible corporate governance structures available under the Japan Companies Act. In practice, however, an overwhelming majority of Japanese companies have adopted a single corporate governance form of a *kabushiki kaisha* (the practical equivalent of a corporation in the United States) that has a board of direc-

tors and statutory auditors. Generally speaking, a statutory auditor is tasked with the responsibility of (i) monitoring the performance of directors to confirm that they are in compliance with applicable laws, regulations and the company's articles of incorporation, and properly executing their duties owed to the company, and (ii) overseeing and reviewing the audit of the company's financial statements by its external accounting firm (a privately-held company, if it does not appoint an external accounting firm, can limit the responsibility of its statutory auditor to an audit of the company's financial statements). In comparison to the U.S. corporate governance model, the function of a statutory auditor is similar to that of an independent director who also serves on the company's audit committee. The critical difference is that a statutory auditor does not have a vote in the meetings of the board of directors. For ease of comprehension, in this article we focus on the predominant Japanese corporate governance structure of a *kabushiki kaisha* with a board of directors and statutory auditors.

[4]Unlike the "Say-on-Pay" votes in the United States, shareholder resolutions on executive compensation in Japan are legally binding. Normally, the board of directors decides how to allocate compensation among directors within the aggregate amount approved by shareholders. It is well known that executives at Japanese companies are paid much less than their U.S. counterparts, and performance-based compensation normally constitutes only a small portion of their compensation packages. A scholarly work suggests a link between governance structure and the levels and forms of executive compensation. *See* Robert J. Jackson & Curtis J. Milhaupt, *Corporate Governance and Executive Compensation: Evidence from Japan*, 2014 Colum. Bus. L. Rev. 111.

[5]Unlike U.S. corporations, Japanese companies only have articles of incorporation, which is often a relatively short document in length. The provisions that would typically appear in a U.S. company's bylaws can be found in a Japanese company's board regulations or are statutorily prescribed under the Japan Companies Act.

[6]An "independent director" is defined as an "outside director" who is not likely to have a conflict of interest with the company's public shareholders (with conflict of interest not precisely defined, but left to be determined subjectively on a case-by-case basis). An "outside director" is any person who serves as a director, other than (i) a present or former executive or employee of the subject company and its subsidiaries (unless ten years have passed since his/her resignation, in which case, such person can qualify as an "outside director"), (ii) a controlling shareholder or a present director, executive officer or employee of the subject company's parent, (iii) a present executive or employee of a sister company to the subject company, or (iv) a spouse or relative within a second degree of kinship to a director, executive officer or key employee of the subject company.

[7]In the case of a *kabushiki kaisha* that has a board of directors and three statutory committees (*shimei-iinkai tō secchi kaisha*), the authority of its executive officers is essentially equivalent to that held by executive officers in U.S. corporations, and they directly owe fiduciary duties to the company. They are called *shikkō-yaku* (not *shikkō yakuin*) in Japanese and are distinguished from employees. Even in a *shimei-iinkai tō secchi kaisha*, however, corporate binding authority is normally reserved to the Representative Officer(s). As of August 1, 2016, only approximately sixty listed companies had adopted this corporate governance structure in Japan.

[8]Under the Japan Companies Act, at least one-half of the sum paid to a company in connection with a new share issuance must be allocated to the company's stated capital account, with the balance allocated to the company's capital surplus account (*shihon jōyo kin*). A registration tax equal to the greater of 0.7% of the stated capital amount or 150,000 yen (for a newly established company) and 30,000 yen (when an existing company allots new shares) is payable, so companies with a large stated capital account will have paid a relatively higher registration tax in comparison to less "prestigious" companies that have a smaller stated capital amount. The allocation between a company's stated capital account and capital surplus account does not have an impact on the amount available for dividend payments, and Japanese companies are not required to pay the equivalent of a Delaware annual franchise tax.

[9]We are aware of only a few transactions where non-Japanese purchasers chose a tender offer as an acquisition method in a stock deal, but those transactions were made prior to the introduction of a triangular merger to Japanese corporate law (which became effective in 2007). A non-Japanese purchaser, nevertheless, may consider a stock tender offer as an acquisition method if the home jurisdiction of the purchaser prohibits the purchaser from performing a triangular merger under Japanese law or the purchaser wishes to make a hostile takeover bid with stock as the consideration.

[10]A corporate split (*kaisha bunkatsu*), share ex-

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change (*kabushiki kōkan*), and share transfer (*kabushiki-iten*) are forms of business combinations prescribed under the Japan Companies Act. Under a (i) corporate split, the assets and liabilities of a contributor's business are assumed by either a newly established company (in exchange for its shares) or an existing company (in exchange for its shares, cash and/or other property) by operation of law, (ii) share exchange, the target is converted into a wholly-owned subsidiary of the acquiring company by operation of law and remains a separate legal entity (in this respect, it is identical to a reverse triangular merger under Delaware corporate law), and (iii) share transfer, all outstanding shares of the subject company (or companies) are transferred to a newly incorporated company, and such newco issues shares on a proportional basis to the shareholders of the subject company (or companies). Tax considerations and the ultimate ownership structure frequently drive the selection of the form of business combination. For more information about corporate splits, *see* Stephen D. Bohrer and Tatsuya Tanigawa, "Everything You Always Wanted to Know About Corporate Splits in Japan (But Were Afraid to Ask)," *The M&A Lawyer*, 2016, 20(7), at 17-27.

[11]Japanese tender offer rules are applicable to a company that is subject to the periodic reporting requirement under the Financial Instruments and Exchange Act of Japan (which is substantially identical to the periodic reporting requirement under the U.S. Securities Exchange Act of 1934 ("U.S. Exchange Act")). As an initial step, a prudent purchaser should examine whether Japanese mandatory tender offer rules will apply before acquiring shares in a Japanese reporting company.

[12]Ownership level is calculated on a diluted voting power basis and includes the voting interests held by "specially-related persons" (*tokubetsu kankeisha*) of the purchaser (similar to the "group" concept under Section 13(d) of the U.S. Exchange Act).

[13]A transaction conducted "outside the market" means a purchase and sale that does not clear through a stock exchange (*i.e.*, a transaction privately negotiated directly between the purchaser and the seller of the shares) or a proprietary trading system meeting statutory requirements. An "off-market transaction" means a purchase and sale that (i) does not clear through a stock exchange or (ii) clears through a non-auction trading system run by a stock exchange, such as the Tokyo Stock Exchange Trading Network System (commonly referred to as "ToSTNeT"), unless the transaction falls under a statutory exception.

[14]The intention behind this extremely complicated rule is to require a purchaser who has acquired more than 5% of the outstanding voting rights of a Japanese reporting company in "off-market transactions" to wait three months before commencing further target share acquisitions. The Japanese government enacted this "speed bump" requirement in 2006 in response to a public outcry against the rapid accumulation by M&A Consulting (also known as the Murakami Fund) of shares in Hanshin Electronic Railway in "off-market transactions." Except for the ten-day cooling off period under Rules 13d-1(e)(2) and 13d-1(f)(2) of the U.S. Exchange Act, U.S. tender offer rules do not have a similar stop-and-wait rule.

[15]Pursuant to Article 14, Paragraph 1 of the Enforcement Order of the Financial Instruments and Exchange Act, a purchaser can withdraw its offer if the target or its subsidiary determines to undertake certain actions or experiences certain events, including: (i) a statutory corporate combination, (ii) a corporate dissolution, (iii) the filing of a petition for bankruptcy, (iv) a decrease in its stated capital, (v) the sale or discontinuance of all or part of its business, (vi) the delisting of its shares, (vii) a stock split, (viii) the allotment of shares or share purchase warrants with or without consideration, (ix) a sale or other disposal of material assets, (x) the incurrence of a significant amount of indebtedness, (xi) the issuance of an injunctive order to stop its principal business, (xii) the revocation of a principal business license, (xiii) the discontinuity of business with a major customer or supplier, (xiv) the loss of a material asset due to a *force majeure* event, or (xv) the occurrence of any other event or circumstance that is equivalent to the matters above and specified by the purchaser (a so-called "catch-all" provision). Most of the foregoing events and actions are subject to numerical thresholds. Japan's Financial Services Agency has very narrowly interpreted the "catch-all" provision. On August 2, 2012, the agency published an official statement indicating that the following events would be captured by the "catch-all" provision: (a) the target company pays dividends after the commencement of the tender offer, (b) the target company's disclosure documents include false statements or material omissions, or (c) a material contract of the target company is terminated due to events that occur after the commencement of the tender offer. Noticeably absent is the ability of a purchaser to withdraw its offer upon the occurrence of any event or circumstance that would cause a reasonable purchaser to withdraw its offer. As a result, a purchaser launching a tender offer in Japan is generally required to assume the consequences of unforeseeable events during the pendency of a tender offer.

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[16]According to the Thomson One database, during the period from January 1, 2005 through February 28, 2017, there were only 15 hostile offers in Japan, none of which resulted in the hostile offeror succeeding in gaining a majority ownership in the voting rights of the target.

[17]According to the data provided in the May 2016 issue of *MARR*, 472 Japanese companies have adopted "advance warning" procedures as of March 31, 2016.

[18]The *Bull-dog Sauce* case (Saikō Saibansho [Sup. Ct.] August 7, 2007, Hei 19 (kyo) no 30, 61 Saikō Saibansho minji hanreishū [Minshū] 2215 (Japan)) is widely known in Japan as the only case where a poison pill, which was adopted by the target after the purchaser had commenced its hostile takeover bid, was intentionally triggered. One may think that, in light of the *Bull-dog Sauce* case, Japanese corporate law would allow the target to adopt a poison pill after the emergence of a hostile purchaser. Bull-dog's pill, however, was far from the typical "poison pill" when compared to those adopted in the United States. Under the Bull-dog pill (which was approved by approximately 83.4% of the outstanding voting rights in Bull-dog), all shareholders (including Steel Partners) would receive three share purchase warrants per share. However, Steel Partners was required to exchange its warrants for cash, while other shareholders were required to exchange their warrants for Bull-dog's newly-issued shares. As a result, Steel Partners' share ownership level in Bull-dog reportedly decreased from 10.52% to 2.86%, but it received a cash payment of approximately $26.1 million. In essence, Bull-dog's exercise of its pill was a partial cash-out of an existing shareholder. For fiscal 2006, Bull-dog reported a net profit of only approximately $6 million, making the large cash payment to Steel Partners rather remarkable under the circumstances. The *Nihon Keizai Shinbun* newspaper reported on July 3, 2007, that an investment banker referred to the Bull-dog poison pill as the "honey pill."

[19]In the *Nippon Broadcasting* case, the court enjoined the issuance of new share purchase warrants to a friendly third party. *See* Tōkyō Kōtō Saibansho [Tokyo High Ct.] March 23, 2005, Hei 17 (ra) no. 429, 58 Kōtō saibansho minji hanreishū [Kōminshū] 39 (Japan).

[20]*See* Tōkyō Chihō Saibansho [Tokyo Dist. Ct.] June 1, 2005, Hei 17 (yo) no. 20050, 1186 Hanrei Taimuzu [Hanta] 274 (Japan), and Tōkyō Chihō Saibansho [Tokyo Dist. Ct.] July 29, 2005, Hei 17 (yo) no. 20080, 1909 Hanrei Jihō [Hanji] 87 (Japan).

[21]The Japan Federation of Bar Associations has not published a model acquisition agreement and there is no equivalent in Japan of the American Bar Association's "Deal Points Study," so the matters addressed in this section reflect the observations of the authors with respect to small-to-mid cap domestic private M&A transactions.

[22]We note that in the cross-border context, Japanese courts may respect an integration clause if the parties knew or should reasonably have known the significance of the provision. *See, e.g.*, Tōkyō Chihō Saibansho [Tokyo Dist. Ct.] Dec. 13, 1995, Shō 63 (wa) no. 16921, 938 Hanrei Taimuzu [Hanta] 160 (Japan) (although the agreement was governed by Japanese law, the plaintiff was advised by a New York-licensed lawyer and the defendant's general counsel and corporate secretary was a New York-licensed lawyer, and therefore, the parties should have been fully capable of understanding the meaning of the integration clause), and Tōkyō Chihō Saibansho [Tokyo Dist. Ct.] Dec. 25, 2006, Hei 18 (wa) no. 1710, 1964 Hanrei Jihō [Hanji] 106 (Japan) (court referred to the integration clause in a definitive license agreement as a reason to deny the introduction of a most favored nations clause allegedly agreed prior to the execution of the license agreement).

[23]Prior to the introduction of super-majority shareholder squeeze-out, virtually all recent cash-out transactions were made using the "shares subject to call" (*zenbu-shutoku-jōkōtsuki-syurui-kabushiki*) squeeze out method. However, the use of the super-majority shareholder squeeze-out is becoming the preferred choice of squeeze-out technique by acquirors, with acquirors utilizing this technique over target companies listed on the Tokyo Stock Exchange in approximately 30 transactions since July 2015. For details of the shares subject to call squeeze out method, *see* Bohrer & Hoshi, *supra* note 1, at 20-21.

[24]Japan's business community has widely shared the view that directors owe fiduciary duties towards the company's stakeholders as a whole, including the company's employees, and not solely to the company's shareholders (a fiduciary duty approach similar to a "benefit corporation" in the United States, though not directly formalized under the Japan Companies Act). However, the Tokyo High Court recently held, in dictum, that the fiduciary duties of directors include ensuring that the company's public shareholders receive fair consideration in connection with a management buyout transaction. *See* Tōkyō Chihō Saibansho [Tokyo High Ct.] April 17, 2013, Hei 23 (ne) no. 2230, 2190 Hanrei Jihō [Hanji] 96 (Japan). Many commentators in Japan cite this pivotal case as a new

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view that directors owe fiduciary duties directly to the company's shareholders. Japanese fiduciary duty analysis is currently in a state of flux pending guidance from Japan's Supreme Court.

[25]*See* SAIKŌ SAIBANSHO [Sup. Ct.] May 29, 2009, Hei 20 (ku) no. 1037 & Hei 20 (kyo) no. 48, 1326 KIN'YŪ SHOJI HANREI [KINHAN] 35 (Japan). In the *Rex Holdings'* case, the Supreme Court dismissed the target company's appeal from the Tokyo High Court's decision, which awarded dissenting shareholders in a management buyout transaction an amount approximately 1.5 times higher than the first-step tender offer price. Justice Tahara stated in his concurring opinion that the "fair value" owed to the dissenting shareholders should be equal to the target's share price but for the transaction (the "objective share value" for the subject securities), plus a "premium" (which is offered as compensation to the departing shareholders for the value that is expected to be created by the management buyout transaction). Justice Tahara's concept of "fair value" has been utilized by numerous Japanese lower courts in appraisal cases, but vastly different economic inputs have been considered by these courts to reach "fair value," leading to great outcome uncertainty and legal debate. For example, (i) to establish "objective share value," lower courts have examined the average market price of the target company's securities anywhere from one month to one year preceding the announcement of the takeover transaction and some courts have even made an upward adjustment to the average market price of the target company's securities in order to reflect the rapid increase of share prices in Japan between the announcement of the transaction and the effective date of the squeeze-out transaction, which took place after the introduction of *Abenomics,* by way of a regression analysis between the prices of the target company's securities and those of a share index, and (ii) to fix the "premium" amount, lower courts have applied a percentage ranging from 20% to 43% or a half of the difference between the DCF valuation made by a third party appraiser and the "objective share value." Furthermore, some courts, in order to reach a conclusion that the tender offer price was equal to the "fair value," held that the premium was equal to the difference between the tender offer price and the "objective share value."

[26] *See* SAIKŌ SAIBANSHO [Sup. Ct.] July 1, 2016, Hei 28 (kyo) no. 4 to 20, 1497 KIN'YŪ SHŌJI HANREI [KINHAN] 8 (Japan). There are currently no mandated steps that should be undertaken to demonstrate that the tender offer process is "generally accepted to be fair." In the *Jupiter Telecommunications* case, the Supreme Court did note as favorable facts that (i) the target set up an independent committee and obtained its opinion on the transaction, (ii) the target retained its own legal counsel and financial advisor, and (iii) the bidder announced in the tender offer process that the squeeze-out price would be the same price as in the first-step tender offer.

[27]The Japan Companies Act was amended in 2014 to permit a target company to make a tentative payment to dissenting shareholders for an amount the target company considers to be fair. By paying this amount (which often will equal the price paid in the first step tender offer), Japan's statutory 6% interest obligation on unpaid share consideration will accrue only on the ultimate amount that a court awards in excess of the consideration already paid to the dissenting shareholder. In light of the *Jupiter Telecommunications* holding, there most likely will be little incentive for shareholders in Japan to object to a transaction simply to collect a high interest payment award.

[28]For the third factor, Japanese courts typically consider: (i) whether the reduction of headcount is needed in light of the company's financial performance, (ii) whether the company has made a reasonable good-faith effort to avoid the termination through other means, such as trying to change the employee's work-position or second the employee to other companies, (iii) whether the selection of the terminated employees was made based on fair and reasonable standards, and (iv) whether the company has undertaken good-faith discussions with the affected employees and labor unions.

[29]When assessing whether a termination meets "socially accepted standards," a Japanese court would consider various factors, including: (i) the significance of the reason for the termination, (ii) the process leading to the termination, (iii) the terminated employee's performance, (iv) the severity of the employee's poor conduct, (v) the remorse shown by the terminated employee, (vi) the existence of measures taken by the employer to avoid the termination, and (vii) the lack of alternative measures available to the employer (*e.g.*, easier work or more suitable work for the affected employee).

[30]In 2012, Japan's Labor Contracts Act was amended to provide a new Article 18 that also requires employers to provide a fixed-term contract employee with employment for an indefinite term not subject to automatic termination at the end of the contract term upon the request of the employee if the employee has worked for more than five years on two or more fixed term agreements and there has been no break in

employment of six months or longer.

[31]Japan's Supreme Court has not provided any specific rule to determine what constitutes a "justifiable and unavoidable reason," but the factors that Japanese lower courts have considered when determining the existence of a "justifiable and unavoidable reason" include the following: (i) the non-terminating party committed a prior breach of the "continuous contract;" (ii) trust between parties has been destroyed; (iii) the non-terminating party faces severe financial difficulties that make it difficult to perform its obligations under the "continuous contract" (*i.e.*, as a result, the terminating party makes an anticipatory repudiation of the "continuous contract"); (iv) a material change in circumstances has occurred; (v) the length, term, and subject matter of the "continuous contract" in question (*i.e.*, whether the goods/services are unique or can be sourced from several other suppliers); (vi) the number of times the "continuous contract" has been renewed and the manner in which the renewals were granted (*i.e.*, renewed automatically or after negotiations); (vii) the reason(s) for terminating the "continuous contract;" (viii) the amount of damages the non-terminating party will suffer due to the termination of the "continuous contract;" (ix) the costs incurred by the non-terminating party in order to continuously fulfill its obligations under the "continuous contract" (*e.g.*, capital expenditures, employees hired, advertising expense, etc); and (x) the amount of prior notice offered before the termination takes effect. However, in the case of international distribution agreements, having the laws of a country other than Japan as the governing law of a contract and requiring disputes be resolved outside of Japan could avoid the application of the "continuous contract" theory and dissuade a Japanese court from asserting jurisdiction based on public policy grounds (even if the obligations under the subject contract will be performed in Japan). *See* TŌKYŌ KŌTŌ SAIBANSHO [Tokyo High Ct.] August 28, 2007, Hei 19 (yo) no. 20047, 1272 HANREI TAIMUZU [HANTA] 282 (Japan).

[32]As of December 31, 2015, the United States had 322,060,152 inhabitants (according to the survey of the U.S. Census Bureau) and 1,315,561 lawyers as of December 31, 2015 (based on data published by the American Bar Association). As of January 1, 2017, Japan had 126,860,000 inhabitants (according to the survey of the Statistics Bureau of Japan's Ministry of Internal Affairs and Communications) and 38,954 lawyers as of January 1, 2017 (based on data published by the Japan Federation of Bar Associations and excluding judges and public prosecutors).

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