# Private Equity

*Contributing editor*
**Bill Curbow**

2019

GETTING THE DEAL THROUGH

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# Private Equity 2019

*Contributing editor*
**Bill Curbow**
**Simpson Thacher & Bartlett LLP**

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CONTENTS

**Global overview** 7
**Bill Curbow, Atif Azher, Peter Gilman, Fred de Albuquerque and Audra Cohen**
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## Fund Formation

**Australia** 10
**Adam Laura, Deborah Johns and Muhunthan Kanagaratnam**
Gilbert + Tobin

**Austria** 17
**Martin Abram and Clemens Philipp Schindler**
Schindler Rechtsanwälte GmbH

**Brazil** 24
**Carlos José Rolim de Mello, Alexandre Simões Pinto, Julio Antonio Nunes Queiroz, Bruno Sartori de Carvalho Barbosa, Patricia Eid, Vitor Arantes and Thais Martone**
Souza, Mello e Torres Sociedade de Advogados

**British Virgin Islands** 30
**Robert Varley and Rebecca Jack**
Appleby

**Canada** 37
**Andrae J Marrocco, Bruce Chapple and TE (Ted) Scott**
McMillan LLP

**Cayman Islands** 42
**Chris Humphries and James Smith**
Stuarts Walker Hersant Humphries

**China** 51
**Ping (Evan) Zhang**
Han Kun Law Offices

**Colombia** 58
**Jaime Trujillo**
Baker McKenzie

**Croatia** 64
**Branko Skerlev**
BMWC Law Firm

**Egypt** 69
**Nora Harb**
Thebes Consultancy

**Germany** 74
**Tarek Mardini and Sebastian Käpplinger**
P+P Pöllath + Partners

**Indonesia** 81
**Freddy Karyadi and Mahatma Hadhi**
Ali Budiardjo, Nugroho, Reksodiputro

**Israel** 87
**Miriam Haber, Rachel Arnin and Shemer Frenkel**
Raveh Haber & Co

**Italy** 92
**Dante Leone, Nicola Rapaccini and Barbara Braghiroli**
CP-DL Capolino-Perlingieri & Leone

**Japan** 99
**Makoto Igarashi and Yoshiharu Kawamata**
Nishimura & Asahi

**Korea** 105
**Je Won Lee and Kyu Seok Park**
Lee & Ko

**Luxembourg** 111
**Marc Meyers**
Loyens & Loeff Luxembourg Sàrl

**Saudi Arabia** 122
**Robert Eastwood and Omar Iqbal**
Legal Advisors Abdulaziz Alajlan & Partners in association with Baker & McKenzie Limited

**Spain** 127
**Carlos de Cárdenas, Alejandra Font, Víctor Doménech and Manuel García-Riestra**
Alter Legal

**Switzerland** 135
**Shelby R du Pasquier and Maria Chiriaeva**
Lenz & Staehelin

**United Kingdom** 142
**Richard Sultman, Jennifer Maskell, Catherine Taddeï, Beth Leggate and Hannah Esslemont**
Cleary Gottlieb Steen & Hamilton LLP

**United States** 153
**Thomas H Bell, Barrie B Covit, Peter H Gilman, Jason A Herman, Jonathan A Karen, Parker B Kelsey, Steven R Klar, Glenn R Sarno and Michael W Wolitzer**
Simpson Thacher & Bartlett LLP

## Transactions

**Australia** 165
**Rachael Bassil, Peter Cook, Deborah Johns, Muhunthan Kanagaratnam and Hanh Chau**
Gilbert + Tobin

**Austria** 173
**Florian Philipp Cvak and Clemens Philipp Schindler**
Schindler Rechtsanwälte GmbH

**Brazil** 180
**Carlos José Rolim de Mello, Alexandre Simões Pinto, Julio Antonio Nunes Queiroz, Bruno Sartori de Carvalho Barbosa, Patricia Eid, Vitor Arantes and Thais Martone**
Souza, Mello e Torres Sociedade de Advogados

**British Virgin Islands** 185
**Andrew Jowett and Rebecca Jack**
Appleby



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**Canada** 190
**Andrae J Marrocco, Brett Stewart and Georges Dubé**
McMillan LLP

**Cayman Islands** 196
**Chris Humphries and James Smith**
Stuarts Walker Hersant Humphries

**China** 200
**Ping (Evan) Zhang**
Han Kun Law Offices

**Colombia** 207
**Jaime Trujillo**
Baker McKenzie

**Croatia** 213
**Branko Skerlev**
BMWC Law Firm

**Egypt** 218
**Aya Sabry and Nora Harb**
Thebes Consultancy

**Germany** 221
**Tim Kaufhold and Tobias Jäger**
P+P Pöllath+Partners

**India** 227
**Aakash Choubey and Sharad Moudgal**
Khaitan & Co

**Indonesia** 235
**Freddy Karyadi and Mahatma Hadhi**
Ali Budiardjo, Nugroho, Reksodiputro

**Italy** 241
**Giancarlo Capolino-Perlingieri and Maria Pia Carretta**
CP-DL Capolino-Perlingieri & Leone

**Japan** 247
**Asa Shinkawa and Masaki Noda**
Nishimura & Asahi

**Korea** 253
**Je Won Lee and Kyu Seok Park**
Lee & Ko

**Nigeria** 259
**Tamuno Atekebo, Eberechi Okoh, Omolayo Latunji and Oyeniyi Immanuel**
Streamsowers & Köhn

**Saudi Arabia** 264
**Omar Iqbal**
Legal Advisors Abdulaziz Alajlan & Partners
in association with Baker & McKenzie Limited

**Switzerland** 269
**Andreas Rötheli, Beat Kühni, Dominik Kaczmarczyk and Roman Graf**
Lenz & Staehelin

**Thailand** 276
**Jirapong Sriwat and Apinya Sarntikasem**
Nishimura & Asahi (Thailand) Co, Ltd

**Turkey** 282
**Noyan Turunç and Kerem Turunç**
TURUNÇ

**United Kingdom** 288
**David Billington, Michael Preston and Michael James**
Cleary Gottlieb Steen & Hamilton LLP

**United States** 295
**Bill Curbow, Atif Azher, Peter Gilman, Fred de Albuquerque and Jay Higdon**
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# Preface

## Private Equity 2019
Fifteenth edition

**Getting the Deal Through** is delighted to publish the fifteenth edition of *Private Equity*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

**Getting the Deal Through** provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on the British Virgin Islands, Canada, Colombia, Egypt and Thailand. The report is divided into two sections: the first deals with fund formation in 22 jurisdictions and the second deals with transactions in 23 jurisdictions.

**Getting the Deal Through** titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

**Getting the Deal Through** gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Bill Curbow of Simpson Thacher & Bartlett LLP, for his continued assistance with this volume

London
February 2019



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# Japan

**Asa Shinkawa and Masaki Noda**

**Nishimura & Asahi**

**1 Types of private equity transactions**

**What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?**

In Japan, there are several types of private equity fund-related transactions, such as going-private transactions of public companies by private equity funds, private investment in public equity and investment in non-listed companies. Among them, the most popular private equity transactions in Japan are going-private transactions of listed companies, paired with a squeeze-out of the remaining minority shareholders with some of the management of the company participating in the transaction. In addition, as is often the case with a private equity transaction, a private equity fund usually obtains financing through leveraged buyout (LBO) non-recourse loans to make investments with sufficient leverage.

To take a listed company private, a private equity fund may commence a tender offer with the shareholders of a listed company. However, in practice it is generally difficult to satisfy delisting conditions of securities exchanges in Japan with a tender offer, and accordingly private equity funds usually proceed with making the target company a wholly owned subsidiary by undertaking a transaction for squeezing out minority shareholders.

There are several schemes for squeezing out the shareholders of a listed company. For example, one of the simplest ones is a cash merger. Here, the private equity fund establishes a shell company in Japan acquiring shares through a tender offer, the target company merges into the shell company, and the shell company pays cash to the existing shareholders of the listed company as consideration for their shares in the merger. As all of the shareholders of the target company receive cash as consideration, they are squeezed out. However, a cash merger is not a common choice for a private equity fund's squeeze-out transaction because a cash merger forces the target company to realise capital gains and losses of its assets as of the date of the merger unless the shell company established by the private equity fund holds two-thirds or more of the issued and outstanding shares of the target company. Instead, the most common structure used by private equity funds for squeeze-out transactions is a combination of a tender offer and a subsequent minority squeeze-out of the remaining minority shareholders. Before the amendment to the Companies Act in Japan took effect on 1 May 2015, it was quite common to make use of a class of shares (shares subject to call) to squeeze out minority shareholders, however, after such an amendment, it has become a market practice to use a demand for sale of shares (demand for sale of shares), which was newly enacted under the amended Companies Act, when a shareholder holds 90 per cent or more of voting rights, and to use a reverse split of shares in other cases.

Typical procedural steps to squeeze out minority shareholders through a demand for sale of shares are as follows:

- a private equity fund establishes a shell company in Japan;
- the shell company commences a tender offer to acquire shares held by shareholders of the target company;
- if the shell company acquires 90 per cent or more of voting rights in a target company, after the settlement of the tender offer, the shell company held by the private equity fund requests that the remaining minority shareholders of the listed target company sell their shares and that the board of directors of the target company approve this request of share sale; and
- after an approval by the board of directors of the target company and other relevant procedures, mandatory sale of the shares in the target company takes place.

If the shell company does not acquire or hold 90 per cent or more of the voting rights in a target company, it is not entitled to squeeze out minority shareholders by this mandatory sale of shares provided under the Companies Act, however, in such cases, it has become common to use a reverse split of shares instead of the above-mentioned demand for sale of shares to squeeze out minority shareholders. To squeeze out minority shareholders using reverse split of shares, the private equity fund has to request that the listed target company hold a shareholders meeting to approve the reverse share split, the ratio of which is intentionally set at a very high level so that all the minority shareholders receive only a fraction of a share as consideration. Such fractional shares cannot actually be issued, but instead the aggregate shares are sold to a third party or can be repurchased by the target company, with court approval, and the cash consideration is proportionately distributed to the minority shareholders who were to receive those fractional shares, which effectively leads to a minority squeeze-out.

Under the Industrial Competitiveness Enhancement Act in Japan, which was amended as of 9 July 2018, the acquirer has an option to apply to relevant government ministries for approval of a business restructuring plan in order to lower the threshold from 90 per cent to two-thirds of the voting rights to use the above-mentioned demand for sale of shares. If the application under the Industrial Competitiveness Enhancement Act is approved, the acquirer may enjoy some other benefits; however, the business plan must be posted in a prescribed format on a publicly available website and the acquirer is required to provide annual updates to relevant ministries on whether the milestones set under the business restructuring plan are progressing according to schedule. We recommend consulting your adviser in order to gain an understanding of the pros and cons of such an application in your deal.

**2 Corporate governance rules**

**What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?**

Listed companies are subject to disclosure requirements and have to file annual securities reports that disclose company information such as financial information, governance-related information and business-related information. Listed companies are also required to disclose relevant information by filing semi-annual securities reports, quarterly securities reports and extraordinary reports in certain instances. If a target company satisfies some requirements after going private, such disclosure requirements are suspended and the company is not required to file such reports. If a target company remains a listed company after a private equity fund purchases some of its shares, then the target company will continue to be subject to the above disclosure requirements. In addition, if the major shareholder of the company listed on the Tokyo Stock Exchange has more than 50 per cent of the voting rights of the listed company, or makes the listed company an affiliate by the equity



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method, the listed company is required to disclose information on such shareholders, including financial information.

### 3 Issues facing public company boards

**What are some of the issues facing boards of directors of public companies considering entering into a going-private or other private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?**

As explained in question 1, a going-private transaction often includes a tender offer. Under the tender offer rules in Japan, in the event that a tender offer is launched, the board of directors of the target company would be required to express its opinion with respect to the tender offer. Directors of the target company must satisfy their fiduciary duties in considering the proposed tender offer and any other transaction related thereto, which is explained by a bidder in its registration statement of the tender offer.

Similarly, when a going-private transaction using a merger or any other corporate reorganisation structure or minority squeeze out, such as a Demand of Sale of Shares, is proposed to the target company, directors of the target company must satisfy their fiduciary duty in determining whether or not to proceed with the proposed transaction.

There is an issue of whether the directors of a target company would be subject to a duty to negotiate as high a price as possible or a duty to negotiate an increase in the price with a potential purchaser. So far, the majority view is that directors would not be subject to the aforementioned duty, although unless a proposed price is fair and reasonable, it is difficult for directors to support the proposed acquisition of shares.

It is quite common in Japan for the management of target companies to participate in private equity fund transactions to purchase all the shares of a listed company. In such a management buyout-type transaction, the directors who participate in the transaction with the private equity fund will face a conflict-of-interest issue. In the case of such a transaction, directors of the target company are at least subject to a duty to take appropriate measures to protect the interests of public shareholders. Under the Companies Act, directors who have special interests with respect to a transaction subject to a board resolution are prohibited from participating in the discussion and resolution at the board of directors meeting. Since the scope of 'special interest' in the statute is construed relatively narrowly, it is often the case in practice that directors who may not have 'special interests' but have personal economic interests aligned with the buyer abstain from deliberation and resolution at such a meeting. In addition, to protect the interests of public shareholders and ensure the fairness of the process, it is common practice to form a special independent committee to verify, among other things, whether negotiations between the buyer and the management of the company were properly conducted, and whether the agreed price is fair and reasonable. However, the members of such special independent committees in Japan are not necessarily independent directors of the company, because many listed companies do not have a sufficient number of independent directors to compose a special committee entirely of independent directors. Therefore, it is common to create an independent special committee that also includes one or more independent statutory auditors or independent experts such as attorneys, accountants or academics.

The role of a special committee in management buyout transactions in Japan varies from transaction to transaction. Some committees work as leaders of the transactions on behalf of the company itself and negotiate with the prospective purchaser themselves. Other committees work only as examiners and check whether, among other things, the price and other terms and negotiations by the management are appropriate.

### 4 Disclosure issues

**Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?**

The level of disclosure required for going-private transactions is not different from that required for other tender offer transactions. In the tender offer documents, the offeror has to disclose a great deal of information, including its reasons for the offered price, the purpose of the tender offer, the cap and threshold of the number of shares to be purchased, and funding information for the transaction. However, in the event of a management buyout transaction, disclosure of additional information is required. For example, in the event that the offeror obtained a valuation report or a fairness opinion with respect to the offer price, then such report or opinion is required to be attached to the tender offer registration statement and is disclosed to the public. However, obtaining such reports is not mandatory.

The tender offer rules also require that in the case of management buyout, the offeror must state the following:

- what measures have been taken for ensuring the fairness of a tender offer price, as well as details of the process discussing and deciding to launch a tender offer; and
- specific measures taken by the company for avoiding a conflict of interest.

Accordingly, it is common in practice to explain in detail, among other things, how the target company sets up a special committee, how the negotiations regarding the price have been developed, what discussions occurred at the special committee about the price and other terms of the proposed transactions, and why the special committee concluded that the proposed transaction is appropriate.

### 5 Timing considerations

**What are the timing considerations for negotiating and completing a going-private or other private equity transaction?**

It usually takes approximately four or five months from the launch of a tender offer until the completion of the squeeze-out of the remaining minority shareholders. In addition, it quite commonly takes a few months for a private equity fund and the target company or its major shareholders to negotiate and reach an agreement before the launch of the tender offer, which means that it usually takes more than six months from the beginning of negotiations until the completion of the transaction. As for a short breakdown of the above schedules, the tender offer rules require the provision of at least 20 business days as a tender offer period, and it usually takes five business days from the end of the tender offer period until settlement, which means that a typical tender offer takes more than a month from the launch of the tender offer until settlement. After settlement, the company must set a record date for the subsequent shareholders' meeting, and call for a shareholders' meeting to squeeze out minority shareholders. It typically takes approximately two months before a shareholders' meeting is held, because there are several procedures required for convening a shareholders' meeting, such as setting a record date, fixing the shareholders who have voting rights at the shareholders' meeting, and sending a notice for the shareholders' meeting. However, if the tender offeror succeeded in purchasing 90 per cent or more of the shares in the target company, the tender offeror may dispense with a shareholders meeting and squeeze out minority shareholders using a demand for sale of shares. If the acquirer plans to apply for an approval under the Industrial Competitiveness Enhancement Act, it is said to take approximately two months to obtain such approval.

When a private equity fund determines the timing of launching a tender offer, there are two points to note. First, in the event that a potential buyer comes into possession of non-public material information of the target company, unless the target company discloses such information to the public pursuant to a certain determined manner, the potential buyer cannot commence a tender offer under the insider trading rules. It is often the case that after the end of the fiscal year, during the course of accounting closing procedures, some facts will become apparent that will constitute non-public material information, however these facts are not sufficiently clear for the company to be able to make a public announcement in respect of them, in which case the buyer would need to wait until the time when the company is able to make a public announcement with respect to relevant material information. Accordingly, the initiation of tender offers immediately after the end of a fiscal year is usually avoided.

Second, private equity funds usually avoid initiating tender offers between the record date of an annual shareholders' meeting (ie,



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the final date of a fiscal year for most Japanese companies) and the annual shareholders' meeting, and usually avoid scheduling a tender offer period to include the date of an annual shareholders' meeting. Shareholders holding voting rights at shareholders' meeting may propose an increase of the amount of dividends if the company proposes an agenda of distribution of dividends for the annual shareholders' meeting. Even in the event that shareholders approve such an increase in dividends, under the tender offer rules in Japan, an offeror is not generally allowed to decrease a tender offer price owing to an increase in dividends after the launch of the tender offer. Therefore, some buyers do not want to initiate a tender offer from the record date of the shareholders' meeting until the date of the shareholders' meeting.

## 6 Dissenting shareholders' rights

**What rights do shareholders of a target have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?**

As explained in question 1, it is quite common for an acquirer to launch a tender offer and, after the successful completion of the tender offer, to obtain a super majority shareholders' approval of the targeted listed company to squeeze out minority shareholders.

It is quite uncommon in Japan for dissenting shareholders to seek for an injunctive order to suspend a tender offer, as it is practically very difficult to satisfy the requirements applicable to such an action.

Other possible methods for dissenting shareholders to challenge going-private transactions are to bring a damages claim against directors of the targeted listed company; to bring an action to challenge the validity of the shareholders' resolution to enter into a squeeze-out transaction; or to exercise a shareholder's appraisal right and challenge the squeeze-out price.

In the event that shareholders suffer economic loss as a result of a going-private transaction of a listed company, those shareholders may initiate litigation against the directors of the target listed company who assented to the going-private transaction to recover damages for loss arising from any breach of the directors' fiduciary duties. However, directors in general are protected by a business judgment rule in Japan and it is not easy for shareholders to prevail in such litigation against directors. For example, there is a case holding in connection with a management buyout transaction where directors faced an allegation of conflict of interest. The court found that the directors had breached their fiduciary duty, however, the plaintiff had failed to demonstrate causation between the breach and the alleged economic loss, therefore the plaintiff was not entitled to recover damages. This clearly shows that it is not easy for shareholders to recover damages by claiming directors have breached their fiduciary duties.

The most commonly used avenue by dissenting shareholders in going-private transactions in Japan is the exercise of a shareholder appraisal right. For example, the Companies Act provides appraisal rights to a shareholder who opposes a squeeze-out using a reverse share split or a demand for sale of shares. By exercising appraisal rights, dissenting shareholders may require an issuing company to repurchase its shares at a fair value. The law also requires the issuing company to pay interest on the appraisal value of shares at a rate equal to 6 per cent per annum, payable on the period from the date of closing of the going-private transaction in connection with minority squeeze out under a demand for sale of shares or the date of 60 days after the effective date of reverse share split to the date of payment for the relevant shares. Dissenting shareholders who exercise appraisal rights may negotiate the price of the shares to be repurchased by the company, however, if dissenting shareholders and the issuing company fail to reach an agreement, such dissenting shareholders may make a petition to a court to decide the price for the shares to be purchased by the company.

As the said appraisal rights are the most commonly used remedy for dissenting shareholders, an acquirer's protection from dissenting shareholders mainly relates to how they can prove the price the acquirer proposed is fair. As a practical step, it is commonly said that without convincing, legitimate grounds, management should avoid amending financial results and forecasts at a time close to the announcement of a tender offer in a management buyout transaction so that management can avoid the appearance of manipulating the market price to make their tender offer more attractive.

## 7 Purchase agreements

**What notable purchase agreement provisions are specific to private equity transactions?**

If there is a shareholder (or shareholders) with a large stake in the target company, it is common that the buyer will enter into a purchase agreement with such shareholder or shareholders. The provisions of such purchase agreements are similar to those used in other agreements for acquiring investment interests. However, when shares are acquired through a tender offer, in light of restrictions under the tender offer rules, various unique features are observed in tender offer purchase agreements. Firstly, unlike in the United States and other jurisdictions around the world where offerors are permitted to condition their obligations to settle a tender offer on their receipt of expected financing proceeds, in Japan the tender offer rules restrict the withdrawal of a tender offer to cases permitted under the law, and the tender offer rules have been widely interpreted as prohibiting a financing-out of tender offers. Accordingly, a tender offeror cannot withdraw a tender offer even if it fails to borrow money from banks for the tender offer. Secondly, the tender offer rules in Japan limit the remedies for breach of representation and warranties made by a shareholder. For example, a tender offeror may not walk away from a tender offer even if the offeror discovers a breach of representations and warranties, unless such a breach falls within a category of events of withdrawal that the tender offer rules specifically provide for. In addition, some argue that the tender offer rules do not allow indemnification by a shareholder of the target company, even if the shareholder gives representations and warranties in an agreement and then breaches them.

In transactions by a private equity fund for an acquisition of shares of a listed company without a tender offer, purchase agreements do not generally differ from purchase agreements used in transactions for the acquisition of investment interests in non-listed target companies, although in such cases sellers tend to refuse wide-ranging representations and warranties, because the target company operates independently from sellers.

## 8 Participation of target company management

**How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity acquirer should discuss management participation following the completion of a going-private transaction?**

It is quite common for a private equity fund to provide some of the management of the target company and key employees with an opportunity to enter into an equity-based incentive plan, such as an opportunity to acquire a minority stake or stock options or to participate in an employee stock ownership plan in the target company after the closing. However, such equity-based incentive plans should be carefully structured as it is possible for the target company to become ineligible for release from its obligation to file a securities report. In addition, if a private equity fund commits in advance to providing the management of the target company with an opportunity to participate in such an equity-based incentive plan after the closing of the transaction, it means that such management will have the above-mentioned conflict of interest because of their future interest in the company. For this reason, it is often the case that private equity funds make a commitment to provide an incentive plan after minority shareholders are squeezed out.

## 9 Tax issues

**What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?**

One of the major tax issues in relation to minority squeeze-out transactions is a possible capital gains tax on the assets of the target company. As stated in question 1, depending upon the structure of the squeeze-out, it is possible to realise a capital gain on assets held by the target



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company. However, it is possible to avoid such tax if one utilises the reverse share split structure explained above or a demand for sale of shares newly provided in the amendment of the Companies Act as described in the answer to question 1.

As to the deductibility of interest, interest is deductible even if such interest is for subordinated loans; however, a company issuing preferred stock cannot deduct the amount of preferred dividends even if the preferred stock is very close in nature to a subordinated loan.

With respect to tax issues related to executive compensation, golden parachutes are not common in Japan and therefore there is no special tax treatment for such a payment, but if the retirement allowance amount is excessive, then the Tax Code does not allow a company to include such excessive amount in its general expenses. Tax treatment for stock options depends on if the issued stock options are tax-qualified or not. If the stock option is tax-qualified, a tax is imposed only when the shares obtained by exercising the stock options are sold. However, if the stock options are not tax-qualified, the holders of such stock options may be taxed as follows:

- when such options are issued;
- when the holder exercises such stock options; and
- when the shares obtained by exercising the stock options are sold.

In general, share acquisitions cannot be classified as asset acquisitions under the Japanese Tax Code.

## 10 Debt financing structures

**What types of debt financing are typically used to fund going-private or other private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?**

In private equity transactions, the most commonly used types of debt in Japan are LBO loans as syndicated loans, and they are usually made with term loans for the share purchase price and revolving credit for the target company's working capital. The terms and conditions of the existing debt should be carefully checked to see if a transaction made by a private equity fund triggers any provision, such as early redemption in the case of a change of ownership. There is no specific financial assistance rule in connection with a target company's support for others to purchase the shares of the company. However, if a shell company established by a private equity fund holds shares in a target company, until the completion of the squeeze-out of minority shareholders, the target company would be prohibited from providing financial benefits to such shareholder in connection with an exercise of shareholders' rights. In addition if, after the settlement of a tender offer, the offeror holds a majority of the shares in the target company, the granting of any security interest on the assets held by the target company for the LBO lenders is not normally done until after the squeeze-out of minority shareholders, because of the fiduciary duty of the target company directors to the shareholders, including minority shareholders.

## 11 Debt and equity financing provisions

**What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements for private equity transactions? What other documents typically set out the financing arrangements?**

For debt financing such as LBO loans, the following are commonly provided terms:

- conditions precedent regarding the TOB matters including the completion of the TOB procedure;
- mandatory repayment regarding the excess cash flow;
- early redemption in the event of default; and
- financial and performance covenants in connection with the business activities of the target company.

In the event that a private equity fund finances through mezzanines such as a preferred stock, the payment structure would be one of the most important terms, and an inter-creditor agreement between senior lenders and mezzanine investors would also be made.

Where a tender offeror plans to raise funds from a third-party funds provider in the form of a loan or an equity capital contribution, a commitment letter, certifying that the funds provider is prepared to provide an agreed amount of money to the tender offeror, must be executed by the funds provider and attached to the tender offer registration statement unless the funds provider has or will have already injected the relevant cash into the offeror's account before the launch of the tender offer (in which case, the offeror can attach a bank account balance statement). It is common for a private equity fund to negotiate with the loan provider in respect of detailed terms of the definitive loan agreement during the tender offer period and enter into a definitive loan agreement after the tender offer period before the settlement of the tender offer.

## 12 Fraudulent conveyance and other bankruptcy issues

**Do private equity transactions involving debt financing raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?**

If a shell company established by a private equity fund sources most of the funds used to purchase a target company through a loan and subsequently merges with the target company, then it is possible that such a merger may be detrimental to the existing creditors of the target company. Existing creditors may state their objection to the merger and receive payment or reasonable security if there is a risk of harm to existing creditors owing to such merger. However, even if the target company gets into financial trouble following the merger because of the high leverage, it would be hard for creditors to the pre-merger target company to invalidate the merger.

## 13 Shareholders' agreements and shareholder rights

**What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms or other equity co-investors? Are there any statutory or other legal protections for minority shareholders?**

The key provisions in shareholders' agreements for private equity transactions are not substantially different from those for other transactions. Namely, it is quite common to place transfer restrictions on the shares in the shareholders' agreements, including rights of first offer or refusal, tag-along rights and drag-along rights, a right to appoint directors, and veto rights. However, if a portfolio company continues to list its shares on a stock exchange, a shareholder owning more than 5 per cent of the voting rights is required to disclose its shareholding and some agreements, such as ones to jointly exercise voting rights with other shareholders or to set a first refusal right on the shares pursuant to the large shareholding reporting system.

As statutory legal protection for minority shareholders, the Companies Act requires votes by two-thirds of the voting rights present at the shareholders' meeting in connection with fundamental matters such as mergers, demergers, transfers of a significant part of business and amendments of articles of incorporation, which means that a minority shareholder holding more than one-third of issued shares has a veto right under the Companies Act.

## 14 Acquisitions of controlling stakes

**Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?**

When a private equity fund purchases shares of a listed company, it must comply with the Japanese tender offer rules. The rules are quite complicated and we cannot provide a full description of the tender offer rules here owing to space limitations. However, we recommend consultation with Japanese counsel regarding this point prior to initiating a transaction.

One of the key points to be aware of is that a mandatory tender offer is triggered upon acquisition of more than one-third of the voting shares in the listed target company. An acquirer cannot purchase more than one-third of the voting shares of a listed target company through a method other than a tender offer or purchase on the market. As a result, even if a major shareholder holding more than one third of the voting



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shares would like to sell its shares to a private equity fund, the private equity fund has to commence a tender offer and provide other shareholders with the opportunity to tender for the shares.

Another major point to be aware of is the regulation under the tender offer rules for setting a cap. An acquirer may generally set a cap on a tender offer, and if the number of shares tendered in the offer exceeds the cap provided by the offeror, then the tender offeror must purchase the applied shares on a pro rata basis. However, an acquirer cannot set a cap if the acquisition through the tender offer could result in the offeror's shareholding exceeding two-thirds of the voting shares. Even if an acquirer would like to set the cap at, for example, 70 or 80 per cent, such a cap is not allowed, and the acquirer is required to purchase all shares tendered if it sets a cap above the threshold. The Japanese tender offer rules allow the tender offeror to set a minimum threshold for a tender offer (ie, if the number of tendered shares is less than the threshold, the tender offeror is not required to purchase any shares). As two-thirds of the voting rights present at the shareholders' meeting are necessary to approve a reverse share split to squeeze out minority shareholders, tender offerors sometimes set the minimum threshold of a tender offer at two-thirds of the voting rights.

### 15 Exit strategies

**What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity acquirer?**

In the event that a private equity fund pursues an IPO exit of portfolio companies purchased through a management buyout transaction, Tokyo Stock Exchange states in its booklet that more detailed scrutiny of such companies should be made than that of other non-management buyout companies. In such cases, the stock exchange will additionally check whether the price offered at the time of the management buyout was fair, whether the purpose of the management buyout was rational and the extent to which the business plan made for the management buyout was achieved.

If the target company is not listed and is wholly owned by a private equity fund (and its related parties), there would be little restriction on a private equity firm's ability to sell its stake in the target company to a third party, except for the lock-up stated in question 16 and restrictions under the articles of incorporation of the target company or a shareholders' agreement, if any.

Private equity funds generally resist providing a long-term post-closing indemnification for breach of representations and warranties or covenants and negotiate hard to limit the period for such an indemnification. There are cases where private equity funds agreed to set up an escrow holding part of a purchase price for a limited period (eg, six months) as a sole recourse that the buyer may have after the closing, but such an arrangement has not yet developed to become 'market practice'. In Japan, it has so far not been common at least for the sale of Japanese companies to use transaction insurance, which allows a buyer to recover its damages owing to a breach of representations and warranties by a seller.

### 16 Portfolio company IPOs

**What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?**

During the review process made by a stock exchange in Japan, the stock exchange generally requests that an agreement between a shareholder and the target company be terminated at the time of filing an application for listing, because listing rules require a newly listed company to treat every shareholder equally. Accordingly, a major shareholder of a portfolio company, including a private equity fund itself, cannot hold special rights such as board appointment rights or veto rights after the IPO.

Japanese law does not have a concept of registration rights as used in the United States, because in the event that a company completes an IPO and applies for listing of its shares, it is required that the company list all shares in the class subject to the listing as well as any new shares in such class when issued. There are cases where a target company will provide a shareholder with a right to file a registration statement upon the request of the shareholder, but such an agreement would need to be terminated at the time of filing an IPO application as explained above.

As to lock-up restrictions, under the listing rules of the Tokyo Stock Exchange, any existing shareholders who were allotted shares within a one-year period prior to the effective date of an IPO must hold (ie, must not transfer or dispose of) such shares until six months after the effective date of the IPO or one year after the effective date of such allotment of shares, whichever comes later. More importantly, from the perspective of private equity funds, it is common practice in Japan for underwriters of the IPO to require major shareholders of the company to abstain from selling the remaining shares of the company for 180 days after the date of the IPO, when they believe such restriction is necessary in light of market circumstances. After these lock-up periods, shareholders are allowed to sell their shares in the market.

Subject to the above-mentioned lock-up restrictions, following an IPO, all shareholders, not limited to private equity sponsors, may sell their shares in the market. Of course, such sales are subject to market conditions. Shareholders may also choose to sell their shares pursuant to a secondary distribution of securities after the securities registration statement filed by the portfolio company comes into effect. In some cases, major shareholders negotiate with and sell their shares to a purchaser who intends to buy a large portion of the shares; however, note that in Japan such a transfer may be subject to the tender offer rule, as explained in question 14.

### Update and trends

Amendment to the Industrial Competitiveness Enhancement Act in Japan took effect as of 9 July 2018. If a business restructuring plan of a buyer is approved under the Industrial Competitiveness Enhancement Act, the threshold for a demand for sale of shares is lowered as explained in question 1. In relation to a private equity fund's squeeze-out transactions, another possible benefit is that large shareholders other than the acquirer may survive without being squeezed out if such large shareholders form a consortium with the acquirer in an application under the Industrial Competitiveness Enhancement Act. However, as an application under the Industrial Competitiveness Enhancement Act entails some burdens, it is recommended to consult a legal adviser to check if it would be advisable to do so.

In addition, while the Ministry of Economy, Trade and Industry in Japan (METI) once issued a guideline with regards to fair practice in management buyout transactions, it was reported that METI started discussions to amend or supplement the guideline. As this amendment or supplement could have some impact on squeeze-out transactions of private equity funds, it is important to watch out for possible changes.

### 17 Target companies and industries

**What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in industry focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?**

Previously, it was sometimes said that private equity funds tended to choose companies in industries with relatively stable cash flows, such as the food or beverage industry, because it is relatively easy to agree with loan providers if the target company expects stable cash inflow. However, for recent going-private transactions, the industries are fairly diverse, and we cannot say that there are many going-private transactions focused on a specific industry. There are not many industry-specific regulations that block private equity fund transactions; however, there are some industry-related laws, such as the Broadcast Act, which may restrict private equity transactions.



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### 18 Cross-border transactions

**What are the issues unique to structuring and financing a cross-border going-private or other private equity transaction?**

Investments by foreign companies in Japanese companies that participate in restricted industries, such as power generation, broadcasting, agriculture, natural resources, nuclear-related industries and transport, require advanced approval under the Foreign Exchange and Foreign Trade Act. Whether an acquisition of a company by a foreign entity is allowed depends upon various factors such as the nature of business of the target company, what percentage of the shares the purchaser intends to purchase, and the purchaser's plans after the acquisition. There are not many cases publicly discussed regarding whether a foreign entity's specific purchase of shares in a restricted industry will be approved or not. One example of a public case, however, is the Children's Investment Fund's plan to purchase more than 10 per cent of shares in Electric Power Development Co Ltd, which was not approved by the relevant government authority.

### 19 Club and group deals

**What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?**

In club or group deals, shareholders have to provide for many matters, such as governance structure, board appointment rights, veto rights, dividend policy, pre-emptive rights and restrictions on the sale of shares, including transfer restrictions, rights of first refusal, tag-along rights and drag-along rights. However, these issues do not depend upon whether one or all of the shareholders are a private equity fund or not, and there are no specific considerations for a club or group deal where a private equity fund participates.

### 20 Issues related to certainty of closing

**What are the key issues that arise between a seller and a private equity acquirer related to certainty of closing? How are these issues typically resolved?**

In private equity fund buyer transactions without a tender offer, conditions precedent for closing are likely to be negotiated extensively by the relevant parties. However, sellers and a private equity fund purchaser do not usually negotiate so hard on conditions precedent in transactions where a private equity fund plans to acquire shares through a tender offer because, as mentioned in question 7, the Japanese tender offer rules essentially do not allow the setting of conditions on withdrawing a tender offer that is not provided for by law. There are other mechanisms to assure a closing, such as a termination fee arrangement; however, such an arrangement is not common in Japanese private equity transactions.

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