Japan – Overview of recent trends in M&A activity and relevant legal developments in Japan

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In 2013, M&A transactions in Japan significantly increased, and several large-scale and cross-border deals were completed. While it is not clear how the economic environment in Japan will proceed in 2014, it is expected that cross-border transactions will likely continue to increase due to the shrinking of the Japanese market. There have also been many legal developments, such as submission of the amendment bill of the Companies Act to the Diet and new court decisions that are expected to impact M&A practice in Japan.

Recent trends of M&A activity

Overview

According to the data published by Recof, an M&A advisory boutique firm in Japan, during 2013 there were 2,048 M&A deals in which at least one party was a Japanese company. This number grew by approximately 10.8% from the previous year, which marks the second consecutive year in which M&A deals increased.

The number of inbound M&A deals, in which Japanese companies are acquired by foreign companies, grew by approximately 33.0% and domestic M&A deals grew by approximately 14.7% in each case from the previous year. On the other hand, the number of outbound M&A deals, in which foreign companies are acquired by Japanese companies, slightly decreased by approximately 3.1%. However, the number of outbound M&A deal has remained at a high level in recent years and the geographic locations of the acquired companies were quite broad, ranging from North America and Europe to China and Southeast Asia.

It was generally reported that in 2013 the economic environment in Japan was much improved than in 2012 under the series of the economic policies adopted by the Abe LDP Administration, which are called "Abenomics." One example, which shows the favourable economic environment in 2013 in Japan, is that during 2013 the Nikkei Stock Average recovered to the level it achieved before the Lehman Brothers Collapse in 2008. Many consider the recovery to be one of the reasons for the increase in M&A transactions in Japan in 2013. On the other hand, since the beginning of 2014, the Nikkei Stock Average has fallen. In addition, the consumption tax rate will be scheduled to rise from 5% to 8% in April 2014. Therefore, it is unclear how the economic environment and trends in M&A activity in Japan will proceed in 2014.

Notable M&A deals in 2013

In 2013, several large-scale and cross-border deals were completed. For example, the business integration between Applied Materials, Inc. and Tokyo Electron Limited, both of which are among the largest companies in the world in the semiconductor and display manufacturing technology industry, attracted broad attention due to the deal size, which values the new combined company at approximately US$29bn (¥2.8 trillion), and the novel structure in which the holding company for both parties after the business integration was incorporated in the Netherlands. Other examples of large-scale and cross-border deals include (i) the acquisition of Sprint Nextel Corporation by SoftBank Corp for approximately US$21.6bn (¥1.8 trillion) in the telecom industry; (ii) the acquisition of Bank of Ayudhya Public Company Limited by the Bank of Tokyo-Mitsubishi UFJ, Ltd. for approximately Bt170.6bn (¥536.0bn) in the bank business; and (iii) the acquisition of Beam Inc. by Suntory Holdings Limited for approximately US$16bn in the liquor industry.

It is expected that the number of Japanese companies seeking to conduct business on a wider and more global scale through outbound M&A transactions continues to increase from now on because of social and economic conditions in Japan, mainly due to the shrinking of the market and the decline in the birth rate.

With respect to M&A deals in which both parties are Japanese companies, integrations between or among companies in the same industry or business continued to increase in 2013. Examples of these transactions include (i) the acquisition of the Peacock Store and the Daiei Inc. by AEON Co., Ltd. and the acquisition of the Nissen Holdings Co., Ltd. by Seven & i Holdings Co., Ltd. in the retail industry; (ii) the integration of system LSI businesses between Panasonic Corporation and Fujitu Limited in the electronics industry; and (iii) the acquisition of the

Honda Elesys Co., Ltd. by NIDEC Corporation in the electronic control units for automobiles industry.

In Japan, it is said that since there is oversaturation of companies in the same industry or business area, many companies are competing despite the shrinking size of the market. It is expected that in order to survive in the highly competitive market situation these companies will need to strengthen their business bases through mergers between or among companies in the same business areas. Therefore, it is expected that the number of such M&A deals will continue to increase in the future.

In addition, much attention has been given to the proposed acquisition of Japanese companies by foreign entities. One example is the proposal of acquisition provided by the Wuthelam group, a major paint maker in Singapore, to Nippon Paint Co., Ltd. Another example is the business proposal by Third Point LLC to Sony Corporation to spin-off and list the entertainment business of Sony Corporation. Both cases did not result in unsolicited or hostile take-over attempts.

However, the possibility that these transactions may increase in the future cannot be ruled out and in some of them unsolicited or hostile take-overs may be attempted because foreign companies, which are attracted to the brand, advanced technology and sophisticated expertise of Japanese companies, may aim to acquire Japanese companies with such resources.

Legal development

Revisions of the Companies Act

An amendment bill of the Companies Act was submitted to the Diet on November 29, 2013. The amendment bill is under Diet deliberations now, and is expected to be adopted in this regular Diet session. The effective date of the revised Companies Act is not clear yet, but is expected to be April or May in 2015.

The amendment is composed mainly of revisions to the corporate governance system, but also includes the following important revisions that have the potential to impact M&A practice in Japan.

Revising the rules on third-party allotment of new shares. Under the current Companies Act, third-party allotments of new shares are required to be approved only by a resolution of the board of directors, but not by a resolution of the shareholders' meeting unless the amount to be paid for the subscribed shares is particularly favourable to the subscribers.

As to this point, some cases in which large-scale third-party allotments of new shares were made to new shareholders and the largest shareholder was altered without a resolution of a shareholders' meeting have faced severe criticism from cross-border institutional investors as unfair issuances of new shares.

Therefore, under the revised Companies Act, a third-party allotment of new shares that results in the replacement of the controlling shareholder is expected to be subject to a resolution of a shareholders' meeting under certain conditions. To be more precise, a company willing to conduct such a third-party allotment of new shares shall provide a notice to shareholders or public notice. If shareholders who hold 10% or more voting rights of the company notify the company that they are opposed to the third-party allotment of new shares within two weeks from the date of such notice to shareholders or public notice provided by the company, the third-party allotment of new shares is required to be approved by a resolution of a shareholders' meeting.

Revising the rules on transfer of the shares of a subsidiary. Under the current Companies Act, the transfer of the shares of a subsidiary is not required to be approved by a resolution of the shareholders' meeting, but the assignment of a significant part of the business must be approved by a special resolution of a shareholders' meeting.

In order to resolve this imbalance under the current Companies Act, under the revised Companies Act, the transfer of the shares of a subsidiary will be required to be approved by a special resolution of a shareholders' meeting if the book value of such shares is more than 20% of the total asset value of the transferring company or if, following the transfer, the transferring company will not be the parent company of a company of which shares are transferred.

Revising the rules on cash squeeze-outs and introducing a new cash-out method. Although under the current Companies Act, a company is able to conduct a squeeze-out of minority shareholders with cash using a particular class of shares, the procedures for doing so are complex and time-consuming. For example, the special resolution of a shareholders' meeting is required for revisions of the articles of incorporation.

Under the revised Companies Act, special controlling shareholders, who have 90% or more voting rights of the target company, will have rights to purchase the remaining shares from other shareholders. This procedure will require the resolution of the board of directors, but not a resolution of a shareholders' meeting of the target company.

Therefore, it is expected that the amendment will simplify the procedures for cash squeeze-outs.

It is worth noting that the other shareholders, who

object to the sale price proposed by the special controlling shareholder, may file a petition to the court for a determination of a fair sale price.

Revising the rules on company splits. Many professors of the Companies Act have stated that the current rules on company splits are not sufficient to protect the rights and benefits of the creditors of the splitting company. In addition, many lawsuits and important court precedents related to this issue have arisen in recent years.

The creditors of the splitting company may not exercise their credit upon successor companies after the company splits if the credits are not included in the splitting assets under the current Companies Act.

Under the revised Companies Act, the rights and benefits of the creditors of the splitting company will be better protected. To be more precise, if the splitting company conducts the company split with the knowledge that the split is harmful to the creditors of the company, the creditors may exercise their credit upon the successor companies.

Revisions to insider trading regulations

In 2013, there were two important revisions to insider trading regulations concerning M&A transactions.

Scope of regulations in M&A transactions. Firstly, a revision was implemented concerning the scope of application of the regulations to the transfer of shares in M&A transactions.

Under the past regulations, the transfer of shares in a merger or corporate split was not subject to the insider trading regulations, while share transfers in a business transfer were subject to such regulations.

Under the revised regulations, the transfer of shares in a merger or corporate split, as well as in a business transfer, is subject to the insider trading regulations.

On the other hand, transactions in which there may be little potential for insider trading are exempt from insider trading regulation regardless of the methods of such transactions.

In short, the revised regulations allows businesses to be more neutral in selecting the method or type of the transaction in light of the insider trading regulations.

Insider trading regulations concerning Tender Offers. Secondly, insider trading regulations concerning Tender Offers were revised. The two main points of this revision, which was published in June 2013 and will be enforced beginning on April 1, 2014, are as follows:

- *Extension of the range of "Person Concerned with Tender Offeror"*: In recent years, the frequency of insider trading by officers and employees of a company which is the target of a tender offer, or persons who receive insider information from them, has increased.

  Under the new regulations, if officers or employees of the target company come to know the relevant fact in the course of their work or business, they become a "Person Concerned with Tender Offeror" to whom insider trading regulations are applied. In addition, persons who receive insider information from officers or employees of the target company are also subject to insider trading regulations.
- *Exemption applied to persons who receive insider information from a Person Concerned with Tender Offeror*: Under the past regulations, if an entity (X) which makes a decision to launch a tender offer tells another entity (Y), a possible tender offeror, any information or fact concerning the launch of the tender offer by X before publication, then Y is subject to insider trading regulations and unable to launch a tender offer for the same company. The regulations effectively limit unreasonably competitive tender offers.

  Under the revised regulations, Y may not be subject to the regulations and could launch a tender offer in the following two cases: (i) when Y publicises such information or fact concerning X's launch of a tender offer by a Tender Offer Notification or (ii) six months after Y receives the information or fact from X.

  However, the exemption shall apply to only to information or a fact concerning other entity's launch of a tender offer. Therefore, an entity that receives insider information concerning the business or other matters of a target company from an entity that makes a decision to launch a tender offer, shall not launch its own tender offer for such target company.

Court decisions

In 2013, there were several important court decisions which are expected to affect M&A practice in Japan.

Court decisions concerning representation and warranty clauses are particularly important. In the past, it was not necessarily usual for a party to an M&A transaction in Japan to file a suit against the other party for indemnity due to a breach of a representation and warranty clause. However, in recent years, the number of lawsuits concerning M&A transactions has been increasing.

Court decisions in cases where a buyer knows or is able to know of any breach of representation and warranty by sellers are divided into two types. Some court decisions have said that there is no need to give a remedy to such a buyer and dismissed such buyer's claim for indemnification. Other court

decisions have said that a seller who made representations and warranties shall take on risk of liability for breach even if the buyer knows of a breach of one of the seller's representation and warranty clauses and have allowed the buyer's claim for indemnities.

Although it is still not clear how court decisions will proceed in the future, it is necessary to monitor the future development of court decisions with regard to representation and warranty clauses. Furthermore, it is important to pay attention to the risk that a buyer's claim for indemnity will not be allowed in Japan in accordance with the wording of the agreement if a buyer knows or should know of the seller's breach of a representation and warranty clause.

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