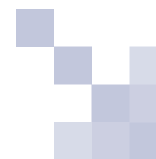
Japan



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MARKET AND REGULATION

1. Please give a brief overview of the public M&A market in your jurisdiction. (Has it been active? What were the big deals over the past year?)

The number of M&A deals, which was around 500 a year in the 1990s, substantially increased after 2000, and climbed to 2,725 in 2005 and 2,775 in 2006. The number of attempts for hostile bids is increasing, although almost all of them have gone to the wall. The number of management buyouts and share acquisitions by investment funds that can impact management of the target has also grown. This occurred against a backdrop of significant changes, including the reform of corporate law (since 1997), improvements to tax on corporate reorganisations (2001) and the amended industrial revitalisation law (2003).

The big deals over the past year include the:

- Acquisition of Vodafone by Softbank Group, in the telecommunication industry. The approximate value of this deal was JPY1,917 billion (about US$16 billion).
- Acquisition of Hanshin Electric Railway (Hanshin) by Hankyu Holdings, in the rail industry. This acquisition resulted from a recommended public offer after a considerable increase in shareholding in Hanshin by the so-called Murakami Fund. The approximate value of this deal was JPY374 billion (about US$3 billion).

2. What are the main means of obtaining control of a public company? (For example, public offer, legal merger, scheme of arrangement and so on.)

Stock purchase

Shares of a listed target company (target) can be purchased through the stock exchange or outside the stock exchange. This must be done by a public offer in some situations (*see Question 4*). This method does not require an agreement with the target's board, and therefore can be used for hostile bids. Needless to say, foreign companies also can use this method.

In addition, a proxy fight (where a group of shareholders is persuaded to join forces and gather enough shareholder proxies to win control of a company) can be used as a method of takeover.

Merger and stock-for-stock exchange

These methods require an agreement with the target's board, and therefore are only used for recommended bids.

Merger. A merger integrates two or more companies into one corporate entity (*Article 748, Corporate Law*).

The shareholders of the absorbed company are usually allotted shares in the absorbing company according to the merger ratio (which is based on multiple factors, including the corporate value of the absorbed company relative to that of the absorbing company).

Foreign companies cannot use this method under Japanese law to obtain control of a company.

Stock-for-stock exchange. This is where Company A becomes an absolute parent company of another company (Company B), by issuing new shares in itself in exchange for all of the shares in Company B (*Article 767, Corporate Law*).

Foreign companies cannot use this method under Japanese law to obtain control of a company.

However, by using a triangular merger (in which a subsidiary absorbs and merges with the target, and provides shares of its parent company to shareholders of the absorbed target), a subsidiary of a foreign company in Japan will be able to absorb a Japanese company by using its parent company's shares, when certain articles of the Corporate Law (*Articles 749.1(2) and 751.1(3)*) take effect (scheduled for May 2007). In addition, a stock-for-stock exchange, in which the parent company's shares are used for consideration, will be allowed when certain articles of the Corporate Law (*Articles 768.1(2) and 770.1(3)*) take effect.

Issue of new stocks and business transfer

Issue of new stocks. The acquiring company makes a subscription agreement with the target and receives new shares issued by the target (*Article 199, Corporate Law*).

There are potential problems, namely that minority shareholders remain and more funds are needed to obtain control of the target in an issue of new stocks than in a stock purchase. The issue of new stocks is available to foreign companies.

Issue of new stocks requires an agreement with the target's board, and therefore cannot be used in a hostile bid.

Business transfer. An acquiring company takes over part or parts of a business, composed of the target's integrated assets, em-

Country Q&A

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ployees, commercial rights, and so on (*Article 467, Corporate Law*). A business transfer is used when a company intends to pick selectively which assets and debts to acquire.

3. Are hostile bids allowed? If so, are they common? If they are not common, why not?

Hostile bids are allowed. They can be made by a stock purchase.

Until around 2000, hostile bids were not common. Part of the reason for this was deep-rooted cross-shareholding among Japanese companies and the resistance to hostile bids within Japanese society. However, after 2000, the number of hostile bids started to increase, mainly due to the dissolution of cross-shareholding among companies, and a decrease in the resistance to hostile bids or takeovers by foreign companies in Japanese society.

A representative example of a hostile bid in 2006 is that on Hokuetsu Paper Mills by Oji Paper. This case deserves special mention as it was a hostile bid by another large, traditional operating blue-chip company in the same trade, which has not been common in Japan. Other representative examples of hostile bids in 2006 are that on Origin Toshu by Don Quijote and that on Myojo Foods by Steel Partners Japan Strategic Fund. All of these have gone been unsuccessful, because of the appearance of white knights.

4. How are public takeovers and mergers regulated and by whom?

Regulation of public takeovers

Public takeovers are regulated by the Securities and Exchange Law. The title of the Securities and Exchange Law will be changed to the Financial Instruments and Exchange Law (FIEL) during 2007 and from then on public takeovers will be regulated by the FIEL. The contents of the regulations on public takeovers mentioned below are, at this stage, not planned to be affected.

If a party intends to purchase shares of public companies (including listed companies, over-the-counter (OTC) companies, and also other companies that must submit annual security reports), this must be made by public offer in the following cases (with several exceptions):

- The purchase is made outside the Stock Exchange Market (including the OTC security market) and the aggregate voting rights held by a buyer and any affiliated persons (as defined in the Securities and Exchange Law) divided by the total voting rights of the target (Total Voting Ratio) after the purchase, exceeds 5% (except where the aggregate number of sellers in the contemplated share purchase and sellers of shares to the buyer outside of the Stock Exchange Market within 60 days before the day the purchase is made (Total Sellers) is ten or less) (*Article 27-2.1 (1), Securities and Exchange Law*).

- The purchase is made outside the Stock Exchange Market (including the OTC market), the number of Total Sellers is ten or less and the Total Voting Ratio exceeds one-third after the purchase (*Article 27-2.1 (2), Securities and Exchange Law*).

- The Total Voting Ratio exceeds one-third after the purchase, and the purchase is made by the certain methods of purchase prescribed by the Prime Minister (including purchasing through ToSTNeT of the Tokyo Stock Exchange and certain off-floor trading methods) (*Article 27-2.1 (3), Securities and Exchange Law*).

- Within three months:
  - over 5% of the voting shares are purchased outside the Stock Exchange Market (including the OTC security market) or by the certain methods of purchase prescribed by the Prime Minister mentioned above;
  - in total, over 10% of the voting shares are obtained through purchase (including purchases described in the preceding bullet point) or issuance of new shares; and
  - the Total Voting Ratio exceeds one-third after the purchase or the issuance. (*Article 27-2.1 (4), Securities and Exchange Law.*)

- During the period in which another party's public offer is made, a party, whose Total Voting Ratio before the purchase exceeds one-third, purchases over 5% of the voting shares (*Article 27-2.1 (5), Securities and Exchange Law*).

- Other certain cases set out in a cabinet order (*Article 27-2.1 (6), Securities and Exchange Law*).

There is no institution in Japan that corresponds to the Takeover Panel in the UK. The Financial Services Agency supervises the securities markets (*see box, The regulatory authority*).

Regulation of mergers

Mergers are regulated by the Corporate Law. The following are required for a merger:

- Conclusion of a merger agreement (*Article 748, Corporate Law*).

- Advance disclosure of certain documents, including the merger agreement (*Articles 782 and 794, Corporate Law*).

- Approval of the shareholders' meetings of the merging companies (*Articles 783 and 795, Corporate Law*).

- Procedures to protect creditors (*Articles 789 and 799, Corporate Law*).

- Registration of a merger (*Article 750, Corporate Law*).

- Disclosure of certain matters after the merger (*Articles 791 and 801, Corporate Law*).

Under the FIEL (when executed), where shares are issued or delivered through a corporate reorganisation (including merger) that satisfies certain conditions, the issuer of the shares is obliged to make disclosure upon issuance or delivery of the shares (by submitting a security registration statement) and after that to make the continuous disclosure prescribed in the FIEL if the disclosure (*Article 4.1 and 24.1 (3), FIEL*):

- Is made concerning shares of the target of the reorganisation.

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- Would not otherwise be made concerning shares which will be issued or delivered to shareholders of the target through the reorganisation.

PRE-BID

5. What due diligence enquiries does a bidder generally make before making a recommended bid and a hostile bid? What information is in the public domain?

Recommended bid

A bidder undertakes business, accounting and legal due diligence. It receives various information and documents as agreed between the bidder and the target (for example, important contracts, licences and approvals, and documents about contingent liabilities), and information and documents in the public domain.

Hostile bid

In general, a bidder's due diligence is based on information in the public domain.

Public domain

There are several different sources of public information:

The Commercial Register. This contains the following information on all companies (*Article 911.3, Corporate Law*):

- A company's purpose.
- The trade name.
- The amount of stated capital.
- The total number of issued shares, and the classes and the number of them.
- The contents and number of each class of shares. If a transfer of shares requires the approval of the company, the provisions for such transfer from the articles of incorporation (articles).
- The organisation of bodies of the company.
- The names of the directors.
- The way the company gives public notices and other information.

Accounts. The following are publicly available:

- The target's balance sheet. Balance sheets of a joint stock company (*kabushiki kaisha*) are made public through a public notice or its website (*Article 440, Corporate Law*).
- Income statements for a large company (a company with a capital of JPY500 million (about US$4.2 million) or more, or liabilities of JPY20 billion (about US$168 million) or more) (*Article 440, Corporate Law*).

Annual and semi-annual securities reports. These are filed by listed companies and OTC companies. They contain the following information (*Articles 24 and 24-5.1, Securities and Exchange Law*):

- An outline of the company, including changes in major business indices, the history of the company, structure of the business, status of the related companies, and status of employees.
- The condition of the business, including outline of business results, production, order and sales, problems which must be resolved, risk factors, and material contracts.
- The company's facilities, including an outline of investment, the condition of principal facilities, and plans for installation or removal.
- A descriptions of the company, such as information about shares (including the total number of shares, changes in the number of issued shares and the capital, type of shareholders and major shareholders), dividend policy, directors and officers, and corporate governance.
- Accounting conditions.

It is also possible to obtain information about defence measures against hostile bids from annual and semi-annual securities reports concerning the fiscal year that ends on or after 13 December 2006.

In addition, the articles are attached to the annual securities report, and can be inspected by anyone.

Extraordinary Report. A company that must file an annual securities report must also file with the Prime Minister without delay an extraordinary report if it intends to make a public offering or secondary offering in a foreign country, or if required under Cabinet Office regulations (*Article 24-5.4, Securities and Exchange Law*). Cases in Cabinet Office regulations include:

- A change of the main shareholder.
- A disaster affecting the company.
- A determination on making agreements about, for example, a stock-for-stock exchange, corporate demerger, merger and business transfer.

These are made public through the Extraordinary Report (*Article 25, Securities and Exchange Law*).

Timely disclosure. Disclosure regulations of the stock exchange or a securities dealers' association require that listed companies and OTC companies must make timely disclosure of information to investors that may impact on their investment decisions. Information that must be disclosed includes (*Tokyo Stock Exchange, Rules on Timely Disclosure of Corporate Information by Issuers of Listed Securities*):

- Certain items determined by the company or its subsidiaries. This includes a reduction of capital, a stock-for-stock exchange, a stock transfer, a corporate demerger or merger, and a business transfer and dissolution.

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- Certain facts affecting the company or its subsidiaries. This includes damages caused by a disaster or damages that have occurred in business operations, a change of the main shareholder and any event that may cause de-listing.

- Account settlement by the company or its subsidiaries.

6. Are there any rules as to maintaining secrecy until the bid is made?

There are no rules as to maintaining secrecy until the bid is made. However, in recommended bids, the parties often conclude confidential agreements, obliging them to keep matters confidential.

7. Is it common to obtain a memorandum of understanding or undertaking from key shareholders to sell their shares? If so, are there any disclosure requirements or other restrictions on the nature or terms of the agreement?

Bidders often obtain a memorandum of understanding or undertaking from key shareholders to sell their shares (or to apply for a public offer).

A party must disclose certain matters when an "organ of administrative decision", including a board, decides to make a public offer, or makes another important decision about, for example, its management, operation or assets (*Stock Exchange Rules*).

Accordingly, a party may be required to disclose that it has entered into a memorandum of understanding and/or certain elements of the agreement (*see Question 12*).

8. If the bidder decides to build a stake in the target before announcing the bid, what disclosure requirements, restrictions or timetables apply? Are there any circumstances in which shareholdings of associates could be aggregated for these purposes?

Disclosure requirements

A holder of securities (issued by a listed company, including an OTC company) whose shareholding is larger than 5% (Large Shareholder) must:

- File a large shareholding report within five days from the day on which it became a Large Shareholder (*Article 27-23, Securities and Exchange Law*).

- Send without delay a copy of the report to the company that issued the shares and the stock exchange or securities dealers association (*Article 27-27, Securities and Exchange Law*).

- File an amended report if its shareholding has increased or decreased by 1% or more (*Article 27-25, Securities and Exchange Law*).

The number of shares held by the bidder and joint shareholders are aggregated, to calculate this shareholding for filing a large shareholding report (*Article 27-23.4 to 6, Securities and Exchange Law*). An entity is a joint shareholder if it either:

- Has agreed with the bidder that purchases shares to jointly acquire or transfer those shares, or to jointly exercise voting rights or other rights.

- Is in a relationship of share ownership, kinship or other special relationship with the bidder that purchases the shares, as set out in a cabinet order.

Regulations

Shareholders having 3% or more of the voting rights or issued shares can demand to inspect or copy the accounting books and materials (*Article 433, Corporate Law*). These shareholders fall into the category of a corporate insider.

If a corporate insider becomes aware of a material fact about the listed company when exercising its inspection rights, the corporate insider cannot purchase, sell, assign or acquire for value any security of the listed company, until the material fact has been made public (*Article 166.1(2), Securities and Exchange Law*).

In addition, if a shareholder is a principal shareholder (holding 10% or more of the voting rights) of a listed company, the following apply:

- If a principal shareholder purchases or sells securities of certain issuers, it must file with the Prime Minister a report of this, no later than the fifteenth day of the month after the purchase or sale (*Article 163.1, Securities and Exchange Law*).

- A listed company can demand a principal shareholder to surrender to it any profit that the principal shareholder has made for its own account by selling, within six months of purchase, a security of the listed company (or by purchasing such a security within six months of sale) (*Article 164.1, Securities and Exchange Law*).

- Principal shareholders of a listed company cannot execute a short sale of shares exceeding the amount of shares it owns (*Article 165, Securities and Exchange Law*).

9. If the board of the target company recommends a bid, is it common to have a formal agreement between the bidder and target? If so, what are the main issues that are likely to be covered in the agreement? To what extent can a target board agree not to solicit or recommend other offers?

It is not necessarily common to have a formal agreement between the bidder and target. This may be because all agreements between a bidder and a target must be disclosed in the registration statement of a public offer (*see Question 12*) (*Article 12 and Form No. 2, Cabinet Office Regulation Concerning Disclosure in a Public Offer by Entities Other Than the Issuer*).

Under the Securities and Exchange Law, the target must, pursuant to Cabinet Office regulations, file with the Prime Minister a

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document stating its position about the public offer and other matters provided in Cabinet Office regulations (known as a Position Report) within ten business days from the date of the public notice of the start of a public offer (*Article 27-10. 1, Securities and Exchange Law*).

Therefore, if an agreement is made between the bidder and the target, the agreement can include provisions obliging the target to express its approval of the public offer.

In this regard, directors of a company are obliged to take the care of a good manager and owe a duty of loyalty to the company (*Article 330 and 355, Corporate Law and Article 644, Civil Law*). Therefore, the board can agree not to solicit or recommend other offers provided that is in compliance with the duty. So, if target makes an agreement with the bidder, from the viewpoint of target's directors it is advisable to establish provisions in the agreement which allow the target to gain release from the agreement if a third party makes a better offer for target and it is determined that target's directors would violate their duties if they do not recommend the offer from the third party (so-called fiduciary-out provisions).

10. Is it common on a recommended bid for the target to agree a break fee if the bid is not successful? If so, please explain the circumstances in which the fee is likely to be payable and any restrictions on the size of the payment.

It is not common on a recommended bid for the target to agree to a break fee if the bid is not successful. One reason for this is probably that the target is not the central player in a public offer and cannot control whether or not a bid succeeds.

On the other hand, it is possible to make an arrangement in which the target pays a break fee to the bidder if the target withdraws its support for the bid after another offer from a third party.

11. Is committed funding required before announcing an offer?

Committed funding is required before announcing an offer subject to the following:

- A bidder must disclose information about funding in the registration statement of a public offer (*see Question 12*) (*Article 12 and Form No. 2, Cabinet Office Regulations Concerning Disclosure in a Public Offer by Entities Other Than the Issuer*).
- A bidder must also file a document indicating that it has the necessary funds, including its bank balance in relation to the offer. This is attached to the registration statement (*Article 13.1.(7), Cabinet Office Regulations Concerning Disclosure in a Public Offer by Entities Other Than the Issuer*).

However, guarantees by financial institutions and joint liability of financial advisers are not required in Japan.

ANNOUNCING AND MAKING THE OFFER

12. Please explain how (and when) the bid is made public (highlighting any relevant regulatory requirements) and set out brief details of the offer timetable. (Consider both recommended and hostile bids.) Is the timetable altered if there is a competing bid?

Timely disclosure based on stock exchange regulations

If the applicant making a public offer is a listed company, it must disclose the following immediately after the board or other decision-making body decides to make a public offer (*Tokyo Stock Exchange regulations, Article 2.1(1)(s), Rules on Timely Disclosure of Corporate Information by Issuer of Listed Security and Chapter 2(1)(a), section 24(2) of the Timely Disclosure Guidebook*):

- Purpose of the purchase.
- Description of the target.
- Public offer period.
- The purchase price.
- Grounds for calculating the purchase price.
- Number of shares to be purchased and other information concerning the public offer.

Public notice of the start of a public offer

If an entity must purchase shares by a public offer (*see Question 4*), it must serve a public notice of the (*Article 27-3.1, Securities and Exchange Law and Article 9-3, Cabinet Order for Enforcement of the Securities and Exchange Law (COESEL)*):

- Purpose of the public offer.
- Purchase price.
- Number of shares to be purchased.
- Public offer period.
- Any other matters in Cabinet Office regulations.

A bidder, as a general rule, cannot, after it has served a public notice of the start of a public offer, withdraw the offer or cancel the contract for the offer. However, shareholders who accepted the offer can cancel a contract made in connection with it at any time during the offer period (*Articles 27-11.1 and 27-12.1, Securities and Exchange Law*).

Filing of public offer registration statement

An entity who has served a public notice (*see above, Public notice of the start of a public offer*) must, according to Cabinet Office regulations, on the same day as the public notice of the start of the public offer, file with the Prime Minister a registration statement of a public offer, stating:

- The offer conditions (including the grounds for calculating the purchase price).

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- If the bidder concludes an agreement in which the bidder agrees to purchase the shares that is the target of the public offer by a method other than the public offer after the day of the public notice of the start of a public offer, the contents of the agreement.
- The purpose of the offer. (If there is a prospect of de-listing, it is also required to disclose this prospect and its reasons.)
- Matters concerning the bidder.
- Any other matters in Cabinet Office regulations.

It must also attach any document specified in Cabinet Office regulations (*Article 27-3.2, Securities and Exchange Law*).

A bidder must, immediately after filing a registration statement of a public offer, send a copy of the registration statement to the issuing company and a stock exchange or securities dealer's association (*Article 27-3.4, Securities and Exchange Law*). A registration statement of a public offer is made public at the Local Finance Bureau and a stock exchange or securities dealers association (*Article 27-14, Securities and Exchange Law*).

Preparing and delivering a public offer circular

A public bidder must prepare a public offer circular containing matters required in a registration statement of public offer (*see above, Filing of public offer registration statement*), and other matters prescribed in Cabinet Office regulations (*see Question 14*). A public bidder must deliver, according to Cabinet Office regulations, a public offer circular to any person who intends to sell shares (*Article 27-9, Securities and Exchange Law*).

Public offer period

The bidder must determine the period during which the shareholders' acceptances must be filed. The period must be between 20 and 60 business days from the public notice of the start of the public offer (*see above, Public notice of the start of a public offer*) (*Article 27-2.2, Securities and Exchange Law and Article 8. 1, COESEL*).

During the offer period, a public bidder, as a general rule, cannot, other than by a public offer, purchase target shares (*Article 27-5, Securities and Exchange Law*).

If there is a competing bid during the offer period, it is possible to extend the public offer period until the final day of the competing public offer period (*Article 13.(2), COESEL*). If the public offer period stated in the public notice of the start of a public offer is fewer than 30 days, the target can require that the public offer period be extended to 30 days (*Article 27-10. 3, Securities and Exchange Law and Article 9-3. 6, COESEL*).

Expressing its position on the bid by the target

The target must file with the Prime Minister a document stating its position and other matters in Cabinet Office regulations (Position Report) within ten business days from the date of the public notice of the start of a public offer (*Article 27-10.1, Securities and Exchange Law*).

The target can pose questions to the bidder in the Position Report. In this case, the bidder must file with the Prime Minister a document stating the response to the questions and other matters in Cabinet Office regulations within five business days from the date of receiving the Position Report (*Article 27-10. 2 and 11, Securities and Exchange Law*).

Public notice of effects of a public offer

The bidder must serve a public notice or make a public announcement of the number of shares applied for in the public offer and other matters prescribed in Cabinet Office regulations, on the day after the last day of the offer period (*Article 27-13.1, Securities and Exchange Law*).

In addition, the bidder must file with the Prime Minister a document reporting the content of this public notice or public announcement and other matters prescribed in Cabinet Office regulations on the date of the public notice or public announcement (*Article 27-13.2, Securities and Exchange Law*).

Delivery and other procedures for settlement of the purchase

A notice containing matters set out in Cabinet Office regulations, including the number of shares to be acquired by the bidder and others, must be sent without delay to an accepting shareholder after the end of the offer period.

In addition, delivery and other procedures for settlement must be carried out without delay after the end of the public offer period (*Article 27-2.5, Securities and Exchange Law and Article 8.5, COESEL*).

These procedures and timetables apply regardless of whether a bid is recommended or hostile.

13. What conditions are usually attached to a takeover offer (in particular, is there a regulatory requirement that a certain percentage of the target's shares must be offered/bid)? Can an offer be made subject to the satisfaction of pre-conditions (and, if so, are there any restrictions on the content of these pre-conditions)?

A bidder must offer the same terms and conditions to all shareholders (uniform price and proportional distribution) (*Article 27-2.3, Securities and Exchange Law*). Conditions usually attached to a takeover offer are as follows:

- A public bidder will not purchase:
  - any of the shares tendered by the shareholders, if the number of shares for sale is smaller than the number it originally planned to purchase (*Article 27-13.4, Securities and Exchange Law*); or
  - part or any of the tendered shares exceeding the number of shares it originally planned to purchase (*Article 27-13.4, Securities and Exchange Law*). (However, if the Total Voting Ratio becomes two-thirds or more after the purchase, the bidder must make a mandatory offer for all shares (*see Question 16*)).
- A public offer can be withdrawn if an important change takes place in the business or property of the target, or

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if another event seriously hinders execution of the offer. This can only apply in situations set out in a cabinet order, including where (*Article 27-11.1, Securities and Exchange Law and Article 14, COESEL*):

- the target's decision-making body decides to carry out certain actions, including petitioning for bankruptcy, civil rehabilitation, corporate reorganisation or imposing or sustaining certain defence measures against hostile bids;
- situations arise in relation to the target, including filing of a petition to suspend its business;
- a necessary permission from a government body is not obtained before the last day of the offer period, or where bankruptcy or other changes set out in a cabinet order take place in relation to the bidder.

Preconditions attached to the public offer are limited to the conditions stated above.

Incidentally, the bidder, as a general rule, is not allowed to make changes to the offer conditions which are disadvantageous to applicants for the offer. However, the bidder is allowed to reduce the purchase price within certain limitations where the target splits shares or makes a free issue of shares or share warrants, if the bidder clearly states it in advance in the public notice of the start of a public offer and the public offer registration statement. This is because, in these cases, the value of shares falls and, were a reduction of the purchase price not allowed, the bidder would suffer unexpected and unreasonable damages (*Article 27-6.1, Securities and Exchange Law and Article 13.1, COESEL*).

14. What documents do the target's shareholders receive on a recommended and hostile bid? (Please briefly describe their purpose and main terms, and which party has responsibility for each document.)

Shareholders who intend to accept a public offer and sell their shares are entitled to receive a public offer circular (*see Question 12, Preparing and delivering a public offer circular*) from the bidder (*Article 27-9, Securities and Exchange Law*).

A public offer circular aims to ensure proper allocation of consideration in a public offer, and that shareholders have sufficient information to make investment decisions. It is based on information in the registration statement of a public offer and is a means of direct disclosure.

The main terms required in a public offer circular are:

- The registration statement of the offer, excluding the name of any financial institution from which the public bidder is borrowing money.
- A statement that the offer is subject to section 2-2(1) of the Securities and Exchange Law.
- A statement that the offer circular has been made according to Article 27-9 of the Securities and Exchange Law (*Article 24, Cabinet Office Regulation concerning Disclosure in a Public Offer by Entities other than the Issuer*).

The bidder must produce the public offer circular. If it contains a material misstatement or is not delivered, the bidder is subject to a penalty (*Article 197-2(8) and 200(9), Securities and Exchange Law*).

15. Are there any requirements for a target's board to inform or consult its employees about the offer?

There are no requirements for a target's board to inform or consult its employees about the offer.

16. Is there a requirement to make a mandatory offer? If so, when does it arise?

If a party intends to purchase shares of public companies, this must be done by a public offer in certain cases (*see Question 4*) (*Article 27-2.1, Securities and Exchange Law*).

Additionally, if the Total Voting Ratio becomes two-thirds or more after the purchase, the bidder must make a mandatory offer for all shares (all types of voting shares) in the target and must purchase all shares for which it receives acceptances (*Article 27-13.4, Securities and Exchange Law and Article 14-2-2 and 8.5(3), COESEL*).

CONSIDERATION

17. What form of consideration is commonly offered on a public takeover?

Generally, only money is commonly offered on a public takeover.

Legally, there is no special regulation of the form of consideration, so shares (including a bidder's own stock) can be used as consideration. However there seems to have been no public offers in which shares were used as consideration. The main reason for this is probably that shareholders cannot benefit from tax credits in a public offer (unlike, for example, a stock-for-stock exchange).

If a bidder uses its own shares as consideration, continuous disclosure by the bidder is required under the Securities and Exchange Law. Foreign companies have difficulty with the time and cost of continuous disclosure in Japanese, although continuous disclosure in English has begun to be allowed under certain conditions since 2005 (*Article 24.8 and 24-5.7, Securities and Exchange Law*).

If the bidder is a Japanese company, regulations of an in-kind capital contribution (*Article 207, Corporate Law*) and the issue of new shares to non-shareholders at a favourable issue price apply (*Article 199.3 and 201.1, Corporate Law*). Therefore, it is difficult for Japanese companies to use shares as consideration in takeover bids.

18. Are there any regulations that provide for a minimum level of consideration? If so, please give details.

There are no regulations that provide for a minimum level of consideration.

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19. Are there additional restrictions or requirements on the consideration that a foreign bidder can offer to shareholders? If so, please give details.

There are no additional restrictions or requirements on the consideration that a foreign bidder can offer to shareholders.

POST-BID

20. Can a bidder compulsorily purchase the shares of remaining minority shareholders? If so, please give details.

It is expected that after May 2007, in merger and stock-for-stock exchanges, an absorbing company or a company that will be a 100% parent company after the stock-for-stock exchange, will be permitted to use not only its shares but also all kinds of assets (including money) as a consideration for shares of the absorbed company or the company that will be a wholly-owned subsidiary after the stock-for-stock exchange (*Article 749.1(2) and 768.1(2), Corporate Law, effective in May 2007*). Therefore, after May 2007, a bidder can obtain the shares of remaining minority shareholders by using a merger or stock-for-stock exchange. In this case, the absorbed company or the company that will be a wholly-owned subsidiary after the stock-for-stock exchange must disclose in advance a document stating the suitability of such consideration (*Article 782.1, Corporate Law and Articles 182.(1) and 184.(1), Enforcement Regulation of Corporate Law*).

21. If a bidder fails to obtain control of the target, are there any restrictions on it launching a new offer or buying shares in the target?

There are no restrictions on a bidder launching a new offer or buying shares in the target if a bidder fails to obtain control of the target by a public offer.

22. What action is required to de-list a company?

The company must undertake a transaction that satisfies the criteria for de-listing.

A stock-for-stock exchange or stock transfer can be used to de-list a company. If these cannot be used, the company can decrease the number of shareholders or increase the shareholding of the majority shareholders by purchasing its shares.

On the Tokyo Stock Exchange, companies are de-listed in any of the following ways (*Article 2.1(2), Criteria for De-listing of Stock of the Tokyo Stock Exchange*):

- The number of shareholders falls below a certain number and does not return to that number within a year. (The number is 400, if the number of listed shares is below 10,000.)
- A particular shareholding (the total shareholding of the top ten shareholders, officers and the company itself) exceeds 75% of all listed shares of the company, and does not fall to, or below, 75% within a year.
- A particular shareholding exceeds 90% of all listed shares of the company, and the company does not submit a document concerning a public issue, secondary offering, or separate sale of shares with a quantity limit designated by the stock exchange, by the date it designates.

TARGET'S RESPONSE

23. What actions can a target's board take to defend a hostile bid (pre- and post-bid)?

Pre-bid

A target's board can take the following actions, depending on the situation:

- Rights plan using share purchase warrants (with discriminatory conditions, where only certain shareholders can execute the warrant and so on). This defence can be made by a resolution of a shareholders' meeting or a board meeting. In addition, it can be structured so that:
  - the company simply notifies in advance the possibility of using this defence, and after a bid is made the company allots warrants to its shareholders; or
  - the company issues warrants to a trust bank (or special purpose company that entrusts the warrants to a trust bank), and the warrants are managed in a trust account. After a bid is made, the company can provide the warrants to shareholders (the trust bank distributes the warrants to shareholders). It is possible to issue warrants allowing the issuing company to compulsorily exchange the warrants for shares without the warrantholders' consent, and in this way the issuing company can defend against hostile bids rapidly and certainly without execution of warrants by warrantholders (*Article 236.1(7), Corporate Law*).
- Issuing shares that in effect can veto the approval of a merger or election or removal of directors (by requiring a resolution of a shareholders meeting of the holders of such class of shares on such matters) (*Article 108.1(8), Corporate Law*), or issuing shares with multiple voting rights to an amicable third party in advance (*Article 108.1(3), Corporate Law*).
- By amending the articles, the company is able to restrict the requirement to have shareholder meeting approval of a merger or the removal of directors. In particular, the company can require approval of over two-thirds of the attending voting shares (the default requirement is approval of at least two-thirds of them) and/or approval by a certain number of shareholders, regardless of the number of shares held by such shareholders (*Article 309.2, Corporate Law*).

In practice, listed companies cannot introduce defence measures if the Exchange believes that they unreasonably restrict the rights of shareholders or exercise of these rights (*Criteria for De-listing of Stock of the Tokyo Stock Exchange*). The company will be de-listed if it introduces such a measure and does not remedy the

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situation in six months. The types of defence measure which are effectively prohibited to listed companies include:

- Introduction of a rights plan, where the execution price is much lower than the market price and is given to shareholders as of the date of the introduction.
- Introduction of a rights plan, which the company cannot abolish and has no choice but to execute, even if the change of over half of the directors of the company has been resolved.
- A resolution or determination of an issuing class of shares with, in effect, power of veto (in other words, a resolution of a shareholders meeting of the holders of such class of shares is required) on important matters including election or removal of over half of directors.

Post-bid

The following measures are considered defence measures but almost all of them have legal concerns and their effects are limited:

- **A significant increase in dividends.** This decreases the incentive of a bidder to obtain control of the target by removing liquid assets.
- **Reduction of capital or fund reserves with compensation.** This has a similar effect as a significant increase in dividends.
- **Issuing new shares to an amicable third party.** This aims to increase the funds required to obtain control of the target, by increasing the number of shares issued.
- **Merger.** This increases the funds required to obtain control of the target by increasing the number of shares issued.
- **Forming a joint holding company with an amicable company by stock transfer, or acquiring such a company by stock-for-stock exchange.** This increases the funds required to obtain control of the target (or its successor company), by increasing the number of shares issued.

TAX

24. Are any transfer duties payable on the sale of shares in a company that is incorporated and/or listed in your jurisdiction? Can payment of transfer duties be avoided?

Transfer tax is not payable on the sale of shares in a company incorporated in Japan.

(Income tax or corporate tax and local tax calculated on capital gain (sale price minus acquisition cost) is imposed on the seller.)

OTHER REGULATORY RESTRICTIONS

25. Are any other regulatory approvals required, such as merger control and banking? If so, what is the effect of obtaining these approvals on the public offer timetable (for example, do the approvals delay the bid process, at what point in the timetable are they sought and so on)?

Merger control

Mergers, business acquisitions and share acquisitions that will substantially restrain competition in a particular market are prohibited under the Anti-monopoly Act (AMA). The AMA is enforced by the Japan Fair Trade Commission (JFTC). The JFTC sets out guidelines detailing which mergers, business acquisitions or share acquisitions are considered to substantially restrain competition in a particular market (Guidelines to Application of the Anti-monopoly Act Concerning Review of Business Combination (2004)).

If mergers, business acquisitions or share acquisitions are judged to restrain competition in such a manner, the JFTC can order the entity concerned to dispose of all or a part of its stock, to transfer a part of its business, or to take any other measure necessary to remedy the situation (*Article 17-2, AMA*).

Regarding mergers and business acquisitions which meet certain thresholds, the parties concerned must file a pre-merger notification or a pre-acquisition notification with JFTC, and the parties cannot close the transaction until the lapse of the 30-day waiting period from the date of JFTC's accepting the notification (*Articles 15 and 16, AMA*).

Regarding share acquisitions which meet certain thresholds, the company must submit a post-facto report on such shareholding within 30 days from the date of the share acquisition (*Article 10, AMA*).

In a public offer, if it meets the above thresholds and the submission is necessary, the bidder must submit this post-facto report within 30 days from the date of settlement of the purchase. If the share acquisition is viewed as substantially restraining competition in a particular market, the JFTC may order the bidder to dispose of all or a part of its stock. Therefore, a bidder intending to make a public offer that may impact on competition will, when appropriate, consult with the JFTC, and confirm that the share acquisition by the public offer will not be judged as substantially restraining competition, before issuing a public notice at the start of a public offer.

Since 2004, the JFTC's Guidelines have adopted HHI (Herfindahl-Hirschman Index), in addition to the market shares, as the thresholds to judge whether mergers, business acquisitions or share acquisitions substantially restrain competition in a particular market. The JFTC is now planning to replace the market shares with HHI as the main thresholds, for the purpose of simplification.

Regulation of bank shareholders

An entity that intends to hold more than a certain percentage (generally 20%) of voting rights in a bank must obtain the approval of the Commissioner of the FSA (*Article 2.9, 52-9.1 and 59.1, Banking Law*).

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Approval must be obtained by, at the latest, settlement of the purchase (*see Question 12*). If it does not do this, the entity is subject to administrative fines (*Article 65(14), Banking Law*).

It takes at least one month (or two months for banks designated by the Minister of the FSA) from the application to obtain approval (*Article 40, Enforcement Regulations of the Banking Law*). Therefore, for practical reasons, it is necessary to consult with the FSA before issuing the public notice of the start of a public offer (*see Question 12*), and to apply for approval in the early stages.

Regulation of insurance companies' shareholders

Regulations similar to those imposed on banks are imposed on shareholders of insurance companies (*Article 271-10.1, Insurance Business Law*) (*see above, Regulation of bank shareholders*).

26. Are there restrictions on foreign ownership of shares (generally and/or in specific sectors)? If so, what approvals are required for foreign ownership and from whom are they obtained?

If a foreign company intends to obtain 10% or more of the shares in a company operating in certain regulated industries, it must give prior notification to the Minister of Finance and the Minister in charge of the relevant industry (*Article 26.2.(3) and 27, Foreign Exchange and Foreign Trade Control Law*). Such industries include aircraft, weapons, atomic energy, and space development.

The foreign company cannot generally invest until 30 days (this can be extended to up to five months by the relevant Ministers) after the date on which the notification was received. The Minister of Finance and Minister in charge of the relevant industry can alter the scope of the investment or suspend it on national security grounds (*Article 27, Foreign Exchange and Foreign Trade Control Law and Article 3, Cabinet Order Concerning Direct Inward Investment*).

In relation to the Nippon Telegraph and Telephone Corporation (NTT), broadcasting companies and air transport companies, there are specific regulations regarding the ownership of shares by foreign entities.

The NTT Law provides that foreign entities cannot hold one-third or more of voting rights in NTT (*Article 6, Nippon Telegraph and Telephone Corporation Law*).

Under the Radio Law, a radio station licence (which is necessary for broadcasting) cannot be granted to a company where the voting rights of foreign entities of the company reach or exceed one-fifth. Accordingly, a broadcasting company can refuse to register shares held by foreign entities in these circumstances (*Article 52-8, Broadcast Law*).

Under the Aviation Law, approval of the Minister of Land, Infrastructure and Transport Ministry (which is necessary for air transport business) cannot be granted to a company where the voting rights of foreign entities of the company reach or exceed one-third (*Article 4.1 and 101, Aviation Law*). Accordingly, an air transport company can refuse to register shares held by foreign entities in these circumstances (*Article 120-2, Aviation Law*).

THE REGULATORY AUTHORITY

Financial Services Agency

Head. Mr Hirofumi Gomi (Commissioner)

Address. The Central Common Government Offices
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T +81 3 3506 6000 (main switchboard)
F +81 3 3506 6266 (Corporate Accounting and Disclosure Division, Planning and Co-ordination Bureau)
E *nal-09@fsa.go.jp* (Corporate Accounting and Disclosure Division, Planning and Co-ordination Bureau)
W *www.fsa.go.jp/en/index.html*

Main area of responsibility.

- The planning of the securities markets system.
- Collecting, analysing and investigating materials and information concerning securities transactions.
- Supervising securities companies.

Contact for queries. Corporate Accounting and Disclosure Division, Planning and Co-ordination Bureau.

Obtaining information. See website above.

27. Are there any restrictions on repatriation of profits or exchange control rules for foreign companies? If so, please give details.

If there is a repatriation of profits over JPY30 million (about US$252,000), a report on payment or receipt of payment must be submitted after the event (*Article 55, Foreign Exchange and Foreign Trade Control Law, Article 18-4.1, Cabinet Order concerning Foreign Exchange and Foreign Trade and Article 1, Ministerial Order concerning Report of Foreign Exchange and Foreign Trade*).

The department to which the report must be submitted and the time limits for this, vary, depending on the methods of payment and so on. It is therefore advisable for an entity to contact and consult with the Bank of Japan on a case-by-case basis.

28. Following the announcement of the offer, are there any restrictions or disclosure requirements imposed on persons (whether or not parties to the bid or their associates) who deal in securities of the parties to the bid?

During a public offer period, a bidder, generally, cannot purchase target shares by ways other than a public offer (*Article 27-5, Securities and Exchange Law*) (*see Question 12*). As a restriction on third parties, during the period in which another party's

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public offer is made, if a party, whose Total Voting Ratio before the purchase exceeds one-third, intends to purchase over 5% of the voting shares, it must through a public offer (*see Question 4, Regulation of public takeovers*).

REFORM

29. Please summarise any proposals for the reform of takeover regulation in your jurisdiction.

Tender-offer regulations were considerably amended in 2006. No further amendment is definitively planned at this stage, although several possible changes are being discussed. These proposals include:

- Bringing the purchase of shares on the Stock Exchange Market within the scope of purchases obliging a public offer. The result would be that, if a party obtains a certain threshold percentage of voting shares within a certain period, and the Total Voting Ratio exceeds one-third after obtaining such shares, the party must obtain the shares by way of a public offer. This proposal is intended to protect minority shareholders from the sudden and unexpected appearance of a controlling shareholder.
- In cases where the number of Total Sellers is at or below a certain number, to remove the requirement that the purchase be made via a public offer, regardless of the purchaser's Total Voting Ratio after the purchase (*see Question 4, Regulation of public takeovers*). This proposal is intended to make corporate acquisitions easier, and is based on the theory that, in cases fitting such circumstances, the sellers of the shares generally have sufficient information to make an informed decision as to whether to sell and there is little need to have the bidder go to the trouble of putting together a public offer.

PRACTICAL LAW COMPANY

As long as I give reasonable notice I can always terminate our contract, can't I?

☐ True

☐ False

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Answer: False
You must look at what the contract says about termination. There's no automatic right to terminate on reasonable notice.

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