

# The Corporate Counselor

- Insights into Japanese Corporate Law -

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## AMENDMENTS TO JAPAN'S FOREIGN DIRECT INVESTMENT LAW—POST- ACQUISITION ONGOING OBLIGATIONS

Effective June 7, 2020, Japan's foreign direct investment laws underwent a major overhaul. Generally speaking, the Japanese government revised its foreign direct investment laws (collectively, the "FDI Amendments") by (i) lowering the Japanese government approval threshold from 10% to a mere 1% for the acquisition of shares of publicly traded companies that engage in a wide range of business activities deemed critical to Japan, (ii) requiring Japanese government approval for an overseas investor to exercise certain shareholder rights (this aspect of the FDI Amendments being referred to as the "FDI Shareholder Rights Amendments"), (iii) expanding the scope of persons who must obtain the approval of the Japanese government for an inbound investment, and (iv) introducing exemptions that curtail aspects of the FDI Amendments to share purchases. The FDI Shareholder Rights Amendments are a game changer for investments into Japan in light of their reach. The Japanese government not only has a veto right over a proposed acquisition, but it now also subjects overseas investors to monitoring and reporting requirements throughout the investment cycle. Since the FDI Shareholder Rights Amendments apply retroactively, overseas investors also may no longer be able to effectively control their existing investments in Japan.

Our June newsletter addressed the ramifications of the FDI Amendments in relation to equity purchases of Japanese companies by overseas investors, and is available [here](#). This edition of the *Corporate Counselor* focuses on the contours of the FDI Shareholder Rights Amendments, and then proceeds to highlight issues that current and prospective overseas investors should consider through a question and answer format.

### FDI Shareholder Rights Amendments

**Key Definitions.** As the application of the FDI Shareholder Rights Amendments will depend on the business activities that the Japanese target company engages in and the persons proposing the matter to be

voted upon, it is essential to understand the following key terms:

- **"Closely Related Person"** is defined broadly and is more encompassing than what is commonly captured by the terms "affiliate" and "group." In general, when a Foreign Investor nominates a director candidate by itself, a Closely Related Person includes (i) a board member, employee, or member of a committee that has authority over the investment in the Designated Company at any of the Foreign Investor, the direct and second-generation subsidiaries, parent companies, and other "family" companies of the Foreign Investor (such as uncle/aunt companies, cousin companies and sister companies), (ii) a business partner of the Foreign Investor, (iii) persons who receive a substantial amount of financial rewards or other assets from the Foreign Investor, (iv) persons who have fallen under (i) through (iii) above over the past year, and (v) persons (or their Closely Related Persons) who have agreed with the Foreign Investor to jointly exercise voting rights. When used in relation to a state-owned enterprise, a Closely Related Person also includes members of the state's central government, local governments, government agencies, central bank and political parties. If a third party nominates a director candidate, then a narrower definition of "Closely Related Person" applies, which excludes the employees of the Foreign Investor and affiliated companies in (ii) through (iv) above.
- **"Designated Business Sector"** means any of the general business activities listed in [Annex I](#).
- **"Designated Company"** means a Japanese entity engaged in a Designated Business Sector.
- **"Foreign Investor"** means an individual or entity that is a non-resident of Japan, and a Japanese organized company for which 50% or more of the voting rights are directly or indirectly owned or controlled by a non-resident of Japan.

**Japanese Government Approval Requirements.** The FDI Shareholder Rights Amendments were adopted



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primarily to prevent the perceived outflow of technical information and the loss of business activities that involve Japanese national security, public order, or public safety. Accordingly, under the FDI Shareholder Rights Amendments a Foreign Investor must obtain the approval of the Ministry of Finance and the Japanese economic ministry overseeing the industry in which the Designated Company operates for the Foreign Investor to vote its shares (or to provide its written consent) for:

- the Foreign Investor or a Closely Related Person to serve as a director or corporate auditor of a Designated Company, if the nomination is made by the Foreign Investor or a third party; and
- the transfer or cessation of a Designated Business Sector by way of a business transfer, merger, demerger or share transfer, if the proposal is made by the Foreign Investor.

circumstances may change since the Foreign Investor acquired its interest in a Designated Company, so a Foreign Investor can undertake a proactive approach towards a Designated Company despite the conditions of the Blanket Exemption or the Regular Exemption so long as the Foreign Investor follows the requirements of the FDI Shareholder Rights Amendments (in particular, it makes the requisite filings and obtains the requisite approvals for a proposal subject to the FDI Shareholder Rights Amendments).

**Exceptions.** Japanese government approval is not always required with respect to each proposal covered by the FDI Shareholder Rights Amendments. Rather, as summarized in *Table 1* whether Japanese government approval is required depends on the Foreign Investor’s share ownership level in the Designated Company, the public/private ownership status of the Designated Company, and the proposal being voted upon.

(Table 1)

	<b>Publicly Traded Designated Company</b>	<b>Privately Owned Designated Company</b>
<b>Director or Corporate Auditor Proposals</b>	Exempt if the Foreign Investor owns (i) less than 1% of the outstanding voting rights or (ii) 50% or more of the outstanding voting rights (so long as Japanese government approval was obtained when acquiring the 50% or more ownership stake)	Exempt if the Foreign Investor owns 50% or more of the outstanding voting rights (so long as Japanese government approval was obtained when acquiring the 50% or more ownership stake)
<b>Transfer or Cessation of Designated Business Sector Proposals</b>	Exempt if the Foreign Investor owns less than 1% of the outstanding voting rights	No exception

The definition of a Closely Related Person differs depending on whether the nomination is made by the Foreign Investor or a non-aligned third party, which adds a further complexity that may necessitate the assistance of legal counsel.

Covenants that a Foreign Investor made to the Japanese government to benefit from a “Blanket Exemption” or “Regular Exemption” (as defined in the FDI Amendments and discussed in our June newsletter) do not prevent a Foreign Investor from subsequently seeking to either place a member on the board of directors of a Designated Company or to transfer or cease a Designated Business Sector. The FDI Shareholder Rights Amendments recognize that

With respect to a publicly traded Designated Company, the FDI Shareholder Rights Amendments apply only if the Foreign Investor owns 1% or more of the outstanding voting rights of a publicly traded Designated Company. On the contrary, there is no similar ownership threshold requirement with respect to a privately owned Designated Company, so the FDI Shareholder Rights Amendments apply upon the Foreign Investor owning one or more voting rights of a Designated Company.

In addition, a Foreign Investor that owns 50% or more of the outstanding voting rights of a Designated Company (either publicly traded or privately owned) is not required to obtain Japanese government approval

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to nominate a board member or corporate auditor to a Designated Company, so long as the Foreign Investor obtained the prior approval of the Japanese government when it acquired its 50% or more voting rights interest in the Designated Company. Consequently, a Foreign Investor would not be able to benefit from this exemption if it acquired its interest in a Designated Company at a time when either no Japanese government approval for its share acquisition was required or only a post-acquisition notice filing was made with the Japanese government. For example, on July 15, 2020 the definition of Designated Business Sector was expanded to include all business activities relating to infectious disease medicines and certain medical devices. Consequently, Foreign Investors who previously purchased stakes in Japanese companies involved in the development of antibiotics and antiviral therapies and were not required to obtain Japanese government investment approval cannot now rely on any of the exceptions listed above to exempt the application of the FDI Shareholder Rights Amendments to their investment.

**Filings.** To vote on a proposal subject to the FDI Shareholder Rights Amendments, a Foreign Investor is required to submit an identical approval filing with the Ministry of Finance and the Japanese economic ministry overseeing the industry in which the Designated Company operates. The waiting period to review the approval filing is 30 days, so it is recommended to submit the filing no later than 30 days prior to the shareholder meeting at which the matter will be voted upon. The Japanese government announced during discussions to introduce the FDI Shareholder Rights Amendments that it would notify Foreign Investors of its clearance decision within five business days so long as the matter does not involve a national security concern, although Foreign Investors currently should expect a more lengthy Japanese government deliberation process given the nascent stage of the FDI Shareholder Rights Amendments (so filing as soon as possible is advisable).

The information required under the FDI Shareholder Rights Amendments filing form is basic; however, the Japanese government reserves the right to make supplemental information requests that can be time consuming to complete. A Foreign Investor is generally required to furnish: (i) the name and contact information of the Foreign Investor, (ii) basic information about the Designated Company, (iii) the ownership level in the Designated Company of the Foreign Investor and its Closely Related Persons, (iv)

basic information about the persons controlling the Foreign Investor, (v) information on the background and career of the person being nominated by the Foreign Investor and such person's relationship with the Foreign Investor (only with respect to a filing arising when the Foreign Investor or its Closely Related Person are nominated to serve as a director or corporate auditor), and (vi) an outline of the business transfer/cessation and background concerning the proposal (only with respect to a filing to obtain Japanese government approval for a Foreign Investor to make a proposal to transfer or cease a Designated Business Sector).

There is no filing fee to obtain Japanese government approval under the FDI Shareholder Rights Amendments, and the filing is not publicly available. The Ministry of Finance and the Japanese economic ministry overseeing the industry in which the Designated Company operates will issue a joint opinion, so a Foreign Investor will not face a split decision. The Foreign Investor will be notified of the Japanese government's decision, but not the underlying rationale for the decision.

**Sanctions.** Failure to comply with a Japanese government approval requirement under the FDI Shareholder Rights Amendments can lead to members of the Foreign Investor's management team being subject to imprisonment for up to three years and/or the Foreign Investor being required to pay a monetary penalty of up to JPY1,000,000 (however, if the transaction value for the violative act exceeds JPY1,000,000, then the monetary fine can be increased to up to three-times the amount of the transaction value). As it is not clear how a value can be calculated with respect to a matter subject to the FDI Shareholder Rights Amendments, it is conceivable that there may not be sufficient grounds to apply the three-times multiplier.

## Frequently Asked Questions

### A. Matters relating to a proposal for the Foreign Investor or its Closely Related Person to serve as a director or corporate auditor

*Do the FDI Shareholder Rights Amendments apply to Foreign Investors who purchased shares in a Designated Company prior to the adoption of the FDI Shareholder Rights Amendments?*

Yes. The FDI Shareholder Rights Amendments apply

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to all shareholdings of Foreign Investors in a Designated Company regardless of the acquisition date, and even if after the date the Foreign Investor acquired its shares (i) the subject Japanese company became a Designated Company due to a change in its business operations or (ii) a legislative change expands the scope of what constitutes a Designated Business Sector.

*Do the FDI Shareholder Rights Amendments apply if a Foreign Shareholder has the right to appoint a non-voting observer to the Board of Directors of a Designated Company?*

No. The FDI Shareholder Rights Amendments apply to director appointments at a Designated Company. Persons who have non-voting rights or observer roles would not be characterized as directors of a Japanese company and are normally not appointed by a vote at a shareholders' meeting, so the FDI Shareholder Rights Amendments would not apply to these appointments.

*Do the FDI Shareholder Rights Amendments apply if a director or corporate auditor nomination is made by a third party not on behalf of the Foreign Investor?*

Yes. The FDI Shareholder Rights Amendments apply even if the nomination for a Foreign Investor or its Closely Related Person to serve as a director or corporate auditor is made by a third party not coordinating with the Foreign Investor (which third party may even include the Designated Company). Since it could create undue hardship for a Foreign Investor when a non-aligned third party nominates a Foreign Investor's Closely Related Person to serve as a director or corporate auditor, the definition of Closely Related Person is more limited in this context. For example, the definition of a Closely Related Person in such situation does not include the employees of the Foreign Investor and its affiliates, the business partners of the Foreign Investor, or persons who received a substantial amount of financial rewards or assets from the Foreign Investor. However, if a third party is making a nomination on behalf of or in coordination with the Foreign Investor, then the foregoing carve-outs would not apply and the definition of a Closely Related Person would be the same as if the Foreign Investor was directly making the nomination. The assistance of legal counsel is often required to make this determination given the complexities of the definition of Closely Related Person.

*If a Foreign Investor makes a filing under the FDI*

*Shareholder Rights Amendments for its Closely Related Person to serve as a director or corporate auditor, is the Foreign Investor required to make another approval filing when such person's term expires and is re-nominated by the Foreign Investor for election?*

Yes. Even if a Foreign Investor has obtained Japanese government approval under the FDI Shareholder Rights Amendments for its Closely Related Person to serve as a director or corporate auditor, such approval is not ever-green and is valid only for the nominee's term of office until re-election. Thereafter, a Foreign Investor is required to submit another approval filing with the Japanese government if it decides to nominate a Closely Related Person to serve as a director or corporate auditor of a Designated Company (even if the Foreign Investor nominates the same person previously approved by the Japanese government).

*Can the FDI Shareholder Rights Amendments apply if a nominee of the Foreign Investor or its Closely Related Person is nominated on-the-spot at a shareholders' meeting?*

Maybe, depending on who makes the on-the-spot proposal. The FDI Shareholder Rights Amendments acknowledge that compliance is not necessary if an on-the-spot nomination is made by a third party not acting on behalf of or in coordination with the Foreign Investor.

*If a vacancy arises on a board of directors due to the resignation or death of a director, can the remaining directors appoint a designee of a Foreign Investor or its Closely Related Person to fill the vacancy without complying with the FDI Shareholder Rights Amendments?*

No. Unlike other jurisdictions, Japanese corporate law does not allow a board to unilaterally fill vacancies. In Japan, a departing director can be replaced only upon the vote and approval of the company's shareholders (in which case, the FDI Shareholder Rights Amendments could apply depending on who nominates the person to fill the board vacancy).

*What filings under the FDI Shareholder Rights Amendments are required when a joint venture company conducting business in a Designated Business Sector is formed by two Foreign Investors, where Investor A owns 60% of the joint venture*

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*company and Investor B owns 40% of the joint venture company and each Foreign Investor sends its Closely Related Person to serve on the board of directors of the joint venture company based on director nomination rights in a shareholders' agreement?*

Although it may appear to be counter-intuitive, only Investor B is required to make a filing under the FDI Shareholder Rights Amendments. Investor B is required to obtain Japanese government approval (i) to have its nominee serve as a director of the joint venture company and (ii) to vote its shares for the appointment of Investor A's nominee to serve as a director (because Investors A and B have agreed to jointly exercise their voting rights under the shareholders' agreement). Investor A is not required to make any filings under the FDI Shareholder Rights Amendments for either its nominee or Investor B's nominee to serve as directors of the joint venture company so long as Investor A obtained the prior approval of the Japanese government when it acquired its shares in the joint venture company (since it owns a majority of the joint venture company and can benefit from an exception discussed above).

#### **B. Matters relating to a proposal for the transfer or cessation of a Designated Business Sector**

*Do the FDI Shareholder Rights Amendments apply if a director nominated by a Foreign Investor (either alone or as part of a special transaction sub-committee of the board) proposes the sale or cessation of a Designated Business Sector, which initiative is subsequently adopted by the Designated Company's full board of directors?*

No. If the sale or cessation of the subject Designated Business Sector does not require the approval of the Designated Company's shareholders, then the FDI Shareholder Rights Amendments would not apply.

*If a shareholder proposal to sell or cease a Designated Business Sector is made by a shareholder or the Designated Company at the request of a Foreign Investor, would the FDI Shareholder Rights Amendments apply?*

Yes, if made by another shareholder, but no if made by the Designated Company. The FDI Shareholder Rights Amendments in relation to proposing a transfer or cessation of a Designated Business Sector apply if the proposal is made by the Foreign Investor directly or through another shareholder on its behalf.

Therefore, if a Foreign Investor lobbies another shareholder to transfer or cease a Designated Business Sector and such person makes the transfer/cessation proposal to the Designated Company's shareholders, then the Foreign Investor would be subject to the FDI Shareholder Rights Amendments since it will be deemed to have submitted the proposal at the shareholders' meeting. On the other hand, if a Foreign Investor through its director nominee or through other communications convinces a Designated Company to make a proposal to its shareholders for the sale or cessation of a Designated Business Sector, then the prior notification would not be required for the Foreign Investor to exercise its voting rights for the proposal. The foregoing creates a potentially broad loophole that could be subject to abuse, so legal counsel should be consulted in advance if a Foreign Investor plans to rely on an indirect Designated Company proposal approach.

*Do the FDI Shareholder Rights Amendments apply to a Foreign Investor who has provided a "foreign financial institution" or a Japanese asset manager voting and investment discretion over its shares in a Designated Company?*

It depends on the nature of the grant. If the Foreign Investor has provided the "foreign financial institution" or Japanese asset manager with full discretion to invest/sell the shares of the Designated Company and exercise all shareholder rights, then the FDI Shareholder Rights Amendments would not apply over the Designated Company shares owned by the Foreign Investor while such delegation is effective. However, if the Foreign Investor reserves or revokes any right with respect to the investment/sale of the shares or the exercise of shareholder rights in the Designated Company, then the FDI Shareholder Rights Amendments would apply over the shares owned by the Foreign Investor (unless an exception discussed above applies).

*Acquiror A and Target B are both US companies/Foreign Investors. Target B has a wholly-owned Japanese Subsidiary C that conducts business in a Designated Business Sector. Acquiror A will acquire Target B. Will Acquiror A need to comply with the FDI Shareholder Rights Amendments post-acquisition?*

Possibly, though admittedly astonishing. It is helpful to initially analyze this question from the first step acquisition of Target B. Japanese foreign direct

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investment laws require a prior screening only for an acquisition of shares of a Japanese company. Therefore, Japanese foreign direct investment laws should not apply with respect to Acquiror A's acquisition of Target B if the transaction is structured as either a share purchase or a reverse triangular merger because under either of these transaction forms there will be no change in the direct shareholder of Japanese Subsidiary C. Post-acquisition, Target B would be in principle the entity needing to comply with the FDI Shareholder Rights Amendments, but Target B would be exempt if it obtained Japanese government approval when it acquired its ownership stake in Japanese Subsidiary C. Furthermore, Acquiror A also would be required to comply with the FDI Shareholder Rights Amendments if Acquiror A has and exercises its right to instruct the voting of shares for its nominees or its Closely Related Person to serve as a director or corporate auditor of Japanese Subsidiary C despite Japanese Subsidiary C being a wholly-owned subsidiary because Acquiror A did not obtain Japanese government approval to acquire its 50% or more ownership stake in Japanese Subsidiary C. In addition, Acquiror A would be required to comply with the FDI Shareholder Rights Amendments if Acquiror A has and exercises its right to instruct the voting of shares for its proposal to transfer or cease a Designated Business Sector from Japanese Subsidiary C because this compliance aspect of the FDI Shareholder Rights Amendments applies regardless of Acquiror A's ownership level in Japanese Subsidiary C.

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The FDI Shareholder Rights Amendments will have a disproportional impact on Foreign Investors who purchase a minority interest in a Designated Company.

Foreign Investors can benefit from a "Regular Exemption" (as defined in the FDI Amendments and discussed in our June newsletter) to avoid the requirement to obtain Japanese government approval for purchases of shares of a Designated Company if the Foreign Investor agrees with the Japanese government that (i) they (along with their Closely Related Persons) will not become board members of the Designated Company, and (ii) they will not propose at a shareholders' meeting the transfer or disposition of business activities undertaken in relation to a Designated Business Sector. Consequently, Foreign Investors making acquisitions in this context will know upfront the limitations on their shareholder rights and can price such restrictions into their investment model.

Foreign Investors who acquire shares in a Designated Company not in reliance on the Regular Exemption ordinarily will not enter into agreements with the Japanese government at the time of the investment to curtail their shareholder rights. As a result, such Foreign Investors will be subject to the discretion of the Japanese government post-investment each time a filing is made pursuant to the FDI Shareholder Rights Amendments. Given the uncertainties of how the Japanese government may decide each application, a Foreign Investor may wish to include remedies in its acquisition documentation (presumably in a shareholders agreement) that would be available to the Foreign Investor if the exercise of its shareholder rights are denied by the Japanese government under the rubric of the FDI Shareholder Rights Amendments or the Japanese government provides its approval subject to conditions that the Foreign Investor reasonably finds unacceptable.

Japanese foreign direct investment laws are complex and constantly evolving. We believe that we are uniquely qualified to field questions in this area, and we would be happy to assist.

**Annex I**  
**Business Activities Subject to the FDI Shareholder Rights Amendments**

<b>Designated Business Sectors*</b>
Weapons
Aircraft ( <i>i.e., the manufacturer of aircraft and rockets, and the parts thereof</i> )
Nuclear facilities
Space
Infectious disease medicines and “Specially Controlled Medical Devices”
Dual-use technologies ( <i>i.e., manufacturers, engineering service providers and software developers who deal with products and technologies that are subject to Japanese export control regulation</i> )
Cybersecurity
Electricity
Gas
Telecommunications
Water supply
Railways
Oil
Heat supply
Broadcasting
Public transportation
Biological chemicals
Security services
Agriculture, forestry and fisheries
Leather manufacture
Air transportation ( <i>i.e., air transportation service providers, such as Japan Airlines</i> )
Maritime transportation

\* This Annex I should not be considered comprehensive as it provides only a summary of the Designated Business Sectors.