THOMSON REUTERS
PRACTICAL LAW™

Memorandum of understanding (commercial) Q&A: Japan

by *Masaki Noda, Akihiko Izu and Satoshi Aizawa, Nishimura & Asahi*

This document is published by Practical Law and can be found at: **uk.practicallaw.com/w-023-4545**
To learn more about legal solutions from Thomson Reuters, go to **legal-solutions.co.uk**

This Q&A provides country-specific commentary on *Standard document, Memorandum of understanding (commercial): Cross-border*.

RESOURCE INFORMATION

RESOURCE ID
w-023-4545

RESOURCE TYPE
Country Q&A

STATUS
Law stated as at 30-Nov-2019

JURISDICTION
Japan

Memorandum of understanding

1. Are memoranda of understanding (MoUs) frequently put in place in your jurisdiction for a general commercial purpose?

Memoranda of understanding (MoUs) are commonly used in commercial transactions, particularly in the early phase of atypical or complex transactions, such as M&As and IP licence agreements with complex conditions.

As MoUs are used for countless types of transaction (M&As, as well as IP licences and distribution agreements), the content of each specific MoU largely depends on the ultimate purpose of the agreement.

Some will merely establish the parties' intentions to negotiate or discuss matters without including any concrete terms, while others will stipulate clear and concrete clauses that are almost the same as those to be provided in the final agreements.

Typical MoUs for IP licence agreements set out:

- The parties' objectives.
- The objective of the licence.
- Ownership and treatment of IP rights.
- Confidentiality.
- Exclusivity.
- General clauses such as:
  - cost;
  - dispute resolution; and
  - governing law.

As for the objective of the licence, some potential objectives will be provided if a definitive objective has yet to be determined when completing the MoU.

Concerning the provision of costs, MoUs typically stipulate what types of cost the parties will pay (such as legal fees), how those costs should be divided, and how they should be paid.

An MoU is sometimes referred to as a letter of intent (LoI) or term sheet (TS), and an MoU is normally not legally binding in Japan, even if it is described as an LoI or a TS (see *Question 2*). MoUs provide two primary benefits:

- Negotiation efficiency.
- Reduction of the risk of a sudden failure of the transaction.

Negotiation efficiency

In terms of negotiation efficiency, MoUs help the parties identify material points that need to be discussed and agreed before entering into the negotiation of definitive agreements. If the parties exchange draft final agreements without executing MoUs, they must bring attention to all negotiation points, including non-material matters, and negotiate those points; however, the parties sometimes fail to agree key negotiation points and the deal fails.

If, by executing MoUs, the parties can focus on the material points, they do not have to waste resources (both time and money) on negotiating non-material points before finding that there is no agreement on the deal.

Sudden failure risk reduction

MoUs provide a degree of commitment to reducing the possibility of unexpected deal failure, while still generally enabling either party to walk away from the deal before final agreements are signed without incurring any liability. In this sense, both parties can reasonably expect that they are likely to sign a definitive agreement if they have executed an MoU.

If either party is a Japanese listed company, that fact that they have signed an MoU may in some cases be publicly announced, depending on the terms of the MoU (it might be possible for the MoU to exclude any

announcement of the fact of the MoU's existence, but this will depend on the circumstances; for example, if the MoU does not contain any detailed terms relating to the transaction and only an agreement by the parties to commence negotiations, timely disclosure to the markets regarding its execution would not be necessary and could therefore be excluded). Since only a limited number of employees will usually be involved in a transaction due to confidentiality concerns, such an announcement allows the parties to involve more employees, facilitating adequate due diligence before execution of the definitive agreement.

In some cases where Japanese companies require thorough due diligence on Japanese listed companies (for example, a merger of equals between Japanese companies), they may prefer to execute MoUs to conduct thorough due diligence after announcing the signing of the MoU, but before executing the final agreement.

It may also be necessary to pay attention to the disclosure obligations under the applicable listed company disclosure rules. For example, listed companies may be required to disclose certain matters in a "timely" manner once they decide to conclude an MoU.

2. Would there be a presumption that an MoU is not legally binding in your jurisdiction?

Since an MoU is formed by mutual agreement, MoUs are legally binding under Japanese law unless otherwise agreed.

As the parties entering into an MoU will generally intend that most clauses not be legally binding, this intention should be clearly indicated in the MoU ; for example, a clause will often be included in an MoU to stipulate that, aside from certain clauses such as confidentiality and exclusivity, the MoU is not legally binding.

On the other hand, as it is not easy to change the terms of an MoU, especially after it is officially announced, the material terms (such as conditions precedent of a definitive agreement) are sometimes made legally binding in an MoU.

Even if an MoU contains non-binding provisions, those provisions can provide clarity and help the parties confirm details that can be used as indicators in subsequent negotiations toward completion of the definitive agreement.

It should be noted that, even where an MoU clearly states that the parties are not legally bound, it is still possible that a party may be liable to the other party as a result of insincere negotiating behaviour when negotiations have proceeded to an advanced stage. While there are no clear criteria on what constitutes an "advanced stage", for example, in the Tokyo District Court case of *Sumitomo Trust Bank v. former UFJ Holdings (Tokyo District Court judgment of February 13 2006)*, discussed further at *Question 4*, it was mentioned that UFJ was liable for the damage incurred by Sumitomo because UFJ suddenly withdrew from the negotiations without any consultation or explanation after about two months of negotiating based on a non-binding MoU (see *Question 4* for the terms of the MoU).

3. What are the formalities required for the formation of contracts in a commercial context in your jurisdiction?

Under Japanese law, offer and acceptance are the requirements for a legally binding agreement; no consideration or documentation is required (*Tomohei Taniguchi, Kiyoshi Igarashi (2006) Shin-pan Chusyaku Minpou (13): Yuhikaku, pp. 393-394*).

Theoretically, MoUs can be made orally but, in practice, almost all MoUs are made in writing to provide evidential clarity on what the parties have agreed.

(In addition, since MoUs are binding unless otherwise agreed, it is usually clearly mentioned in MoUs that some clauses are legally non-binding (see *Question 2*)).

4. Would an obligation to negotiate in good faith be enforceable in your jurisdiction?

There is a general principle of good faith in Japanese law. This general principle has been considered in two cases which dealt with situations involving negotiations. While cases will turn on their individual facts, these decisions provide an indication of how such an obligation will be construed, and what level of damages may be available.

Sumitomo Trust Bank v UFJ Holdings

This issue was dealt with by the Tokyo District Court in *Sumitomo Trust Bank v former UFJ Holdings* (*Tokyo District Court judgment of February 13, 2006*), which related to damages.

In this case, Sumitomo and UFJ signed a non-binding MoU, regarding a business restructuring and business alliance between them.

The MoU provided, among other things, that:

- The parties should negotiate in good faith, execute another basic agreement (by a specified date) to provide more detailed terms and conditions of the business alliance, and conclude a definitive agreement as soon as practicable.
- The parties should negotiate in good faith in areas not covered by the MoU or where the MoU was unclear.
- The parties should not "directly or indirectly, provide any information or negotiate with a third party on any transaction that may conflict with the purposes of the MoU".

There was no provision for liquidated damages or penalties for any breach of the MoU.

UFJ withdrew from the MoU after starting negotiations towards a basic agreement with more detailed terms and conditions. It decided to merge with the Tokyo-Mitsubishi Group.

Sumitomo applied for a preliminary injunction, requesting that UFJ:

- Suspend negotiations with third parties other than Sumitomo.
- Not provide information on Sumitomo business alliance-related matters.

Later, Sumitomo also brought litigation against UFJ for indemnification and damages.

The court held that:

- The parties were obliged to negotiate in good faith under the MoU.
- A party would be liable for default under the MoU if it did not consult or negotiate to overcome issues that interfered with further negotiations between the parties and unilaterally rejected further negotiations for their business alliance.
- The scope of damages was limited to the damage that occurred from the expectation that the parties might execute a definitive agreement (that is, negotiation costs).

Tadao Ikeda v Yoshimasa Kakutani

There is also a Supreme Court judgment *Tadao Ikeda v Yoshimasa Kakutani (Supreme Court judgment of September 18 1984)*. This case did not involve an MoU, but involved negotiations to reach a sale and purchase agreement. After two months of negotiations, during which the property owner invested in and changed the property at the purchaser's request, the purchaser decided not to purchase the property.

The Tokyo District Court (upheld by the Tokyo High Court and the Supreme Court), held that:

- Parties who have started a transaction and have reached a "preparation-of-an-agreement" stage are in a closer relationship under the principle of good faith, which is different from the relationship between ordinary citizens.
- Irrespective of whether or not a contract was subsequently concluded, the parties are deemed to have a duty not to betray each other's trust and not to harm each other's property under the principle of good faith.
- If a party causes damage to the other in breach of the duty of good faith, that party will be liable under the principle of good faith even if the parties did not finally reach an agreement.

Practical application

Although cases will need to be considered on an individual basis, these decisions indicate that

- If negotiations are unduly cancelled during the intended negotiating period, it is possible that the parties will be liable for (limited) damages (while the damages are limited to a certain extent, they are not limited only to negotiation costs: some other expenses may be included).
- A party to an MoU which takes no action towards the execution of a definitive agreement may be liable for (limited) damages.

While the decision in *Sumitomo* related to an MoU which contained an explicit obligation to negotiate in good faith, as also provided for in *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 2.1*, it is reasonable to expect that, even where an MoU did not contain a explicit good faith obligation, the court would decide a similar case in the same way based on the general contractual obligation to act in good faith.

While specific performance is not available in relation to the duty to negotiate in good faith, a party who breaches this duty will be liable for damages if the breach causes any damage to the other party.

5. What period would obligations of confidentiality typically endure under an MoU in your jurisdiction?

Although there is no statutory limitation on the confidentiality period, the period of the confidentiality obligation, including the survival period, is usually limited to one to five years in Japanese MoUs; it is our experience that a longer obligation is likely to be seen as too burdensome for the parties, whereas a limited, relatively short period will be seen as more reasonable. The period is agreed between the parties to an MoU, taking into consideration:

- The scale or complexity of the transaction.
- The timescale in which the value of the information will become obsolete.

In cases where an MoU has not clearly defined a period of confidentiality, it is likely that the period will be determined based on a "reasonable interpretation" of the parties' intentions, considering the above factors, as this is the common practice of the Japanese courts.

6. Are there any limitations on the use of non-solicitation restrictions in your jurisdiction?

It is quite common to provide, even at the MoU stage of a transaction, for non-solicitation of any director, officer or employee of the other party.

In MoUs governed by Japanese law it is not common to provide for non-solicitation of customers or clients using confidential information obtained during the negotiation of the MoU or the subsequent negotiation for final agreements, as this can potentially lead to an issue in terms of anti-trust regulation.

However, the authors believe that non-solicitation of customers or clients can be provided for in MoUs, as long as the duration is limited appropriately to suit the particular transaction. If the duration is too long, the Japan Fair Trade Commission might require the parties to take corrective action. Further, such an overly lengthy duration may be void where it is deemed to be against public policy.

It is also common to provide an exception to non-solicitation of employees if the employee's response is to a general recruitment offer made by the other party, rather than to an offer specifically made to that employee (a general offer could include a posting of the job vacancy on the company's own website). This would not constitute targeted headhunting as a result of information-gathering during the negotiation of the agreement, and therefore would be seen as irrelevant to the non-solicitation obligation.

The duration of any non-solicitation obligation is usually two years or less, and it is not common to provide longer-term non-solicitation obligations for directors, officers or employees under Japanese MoUs. It is thought that an overly lengthy non-solicitation obligation will cause the parties to the agreement to incur an undue burden, and will therefore be considered unreasonable by the courts.

7. Would it be standard practice to include a provision like *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 6.4* (providing an express remedy for breach a non-solicitation restriction) in your jurisdiction? What other remedies might be available to a party in the event of a breach? Would *paragraph 6.4* potentially prevent recovery?

It is common to provide for non-solicitation of any director, officer or employee of the other party (see *Question 6*); however, it is not common to stipulate liquidated damages for a breach of the non-solicitation, as provided for in *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 6.4*.

To prevent the breach of non-solicitation obligations by the other, a party may wish to initiate a petition for a preliminary injunction. It is not however easy to be granted a preliminary injunctive order from the Japanese courts because of the difficulty in demonstrating *prima facie*:

- The necessity for an injunction (that is, that the injunction is necessary to avoid any substantial detriment or imminent danger that would occur to the obligee regarding the rights in dispute).
- The existence of rights to be protected, (in other words, the types of right that may have been or will be breached must be clearly proved).

For example, in *Sumitomo Trust Bank v former UFJ Holdings(August 30, 2004)*, which dealt with injunctions, the Supreme Court rejected the appeal in connection with an application for a preliminary injunction due to lack of necessity (the petitioner was unable to make a prima facie case for such necessity) (see *Question 8*).

Indemnification is the most common remedy for a breach of a non-solicitation obligation. As it is not easy to prove the amount of loss caused by the breach, it makes sense to provide for liquidated damages, as in *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 6.4*.

However, this is not a common provision in Japan.

8. Are there any limitations on the use of exclusivity or lock-out provisions in your jurisdiction?

Exclusivity provisions are commonly included in Japanese MoUs. Where an exclusivity provision is stipulated in an MoU, the parties usually agree that this clause is legally binding (see *Question 2*).

However, parties are likely to be limited to a remedy of damages, rather than injunction, for any breach of exclusivity provisions.

Sumitomo Trust Bank v former UFJ Holdings is the leading case on the validity and expiration of exclusivity in MoUs, as well as possible remedies where there is a breach of exclusivity (see *Question 4*).

Sumitomo filed a petition for preliminary injunction to suspend the negotiations between UFJ and Mitsubishi, claiming that UFJ's negotiations with Mitsubishi were in breach of the exclusivity provided in the MoU between UFJ and Sumitomo. The Tokyo District Court granted an injunction, but the Tokyo High Court and Supreme Court reversed the decision, citing various factors such as that:

- The nature and scope of the damages could be satisfied by compensation.
- Sumitomo and UFJ were unlikely to reach a final agreement on their business alliance based on the MoU.
- Sumitomo's petition for preliminary injunction covered a long period, and the damage to UFJ from an injunction would have been considerable.

The Supreme Court held that exclusivity in MoUs expires if the parties are not likely to enter into a final agreement, even if they continue to negotiate with each other and the MoU clearly provides for exclusivity.

Generally speaking, the period of exclusivity is fully dependent on how long the parties need to negotiate to reach a definitive agreement; the more complicated the matter, the longer the exclusivity period. For complicated matters like M&A transactions, it is quite common to provide for one to six months' exclusivity.

It is worth noting that it is becoming more difficult to make a *prima facie* case showing the necessity of a preliminary injunction when the exclusivity period is unnecessarily long. The Supreme Court in the UFJ case found that Sumitomo's requirement of a long period of suspension of discussions with, or non-provision of information to, third parties was a negative factor.

Where the term of exclusivity is relatively long, the parties sometimes consider including exceptions to exclusivity, such as fiduciary out clauses (which permit the board to change its recommendation for the signed deal and terminate the merger agreement if failing to do so would breach its duty to obtain maximum value for shareholders), so that one party can pursue other more beneficial opportunities if it may find during the exclusivity period.

Fiduciary out clauses, often accompanied with break-up fees, are becoming more common in final agreements between Japanese companies.

However, it is less frequent to find this type of clause included as an exception to exclusivity in an MoU. This is likely due to the fact that, in many cases, the term of exclusivity in MoUs is not very long compared to the exclusivity in final agreements. Another possible reason is that not all MoUs are disclosed, while most final agreements of listed companies are disclosed, and third parties may recognise the deal and want to approach the relevant party.

9. Would it be standard practice to include an indemnity to cover breach of exclusivity like *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 7.7* in an MoU in your jurisdiction?

As mentioned in *Question 8*, the Supreme Court in its decision in the UFJ case set a high hurdle to overcome for specific performance to suspend negotiations with third parties and to enjoin the other party from providing relevant information, including due diligence information, to third parties. This is why indemnity or compensatory damages would be the more usual remedy.

Some MoUs include indemnity provisions for breach of exclusivity like *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 7.7*, but it is not standard practice in Japan to provide for a cost reimbursement indemnity clause where there is a breach of exclusivity. This is partly because there is no established practice to determine the amount of these liquidated damages. As mentioned in *Question 8*, the Supreme Court in the UFJ case held that the parties were not obliged to execute a definitive agreement, and therefore the profit that was expected to be earned as a result of executing a definitive agreement was not included in the damages for the breach of exclusivity under the MoU.

The breaching party was liable only for damages caused by betraying the expectation of the other party that it would enter into a final agreement. However, the amount of those damages was not clear.

As a result, it is not easy for a party to an MoU to prove the amount of damages it sustained following the breach of an MoU exclusivity provision. Fixed-amount liquidated damage clauses are therefore useful, as the parties will not need to prove the amount of damages in any subsequent litigation, although it is also not easy to agree on fixed amounts for liquidated damages. While there is no specific legal restriction or precondition on liquidated damages in order for them to be enforceable and fully recoverable, if the agreed amount is too large, there is a risk that the courts may hold this provision to be invalid due to being against public policy.

However, as the Supreme Court in *Sumitomo Trust Bank v former UFJ Holdings* (see *Question 4* and *Question 8*) held that liquidated damages could be deemed to amount to the reimbursement of costs incurred for the matter, the parties often agree to an indemnity covering the costs incurred for the matter, sometimes together with a relatively low amount of fixed liquidated damages.

10. Does the law of your jurisdiction dictate which governing law and jurisdiction will apply to an MoU?

Jurisdiction

Japanese law does not specify a governing jurisdiction for MoUs relating to Japan, and the parties to MoUs may choose courts in jurisdictions other than Japan as the exclusive jurisdiction for dispute resolution so long as:

- The relevant case is not exclusive to the Japanese courts (for example, claims for preliminary injunction are exclusive to the Japanese courts if the disputed subject matter is located in Japan (*Civil Provisional Remedies Act, Article 6,12(1)*)).
- The designated foreign courts have jurisdiction over the relevant case under the applicable foreign regulations, to avoid a situation where the designated foreign court has no jurisdiction under the applicable laws and the parties cannot bring lawsuits anywhere.
- The agreement on the exclusive jurisdiction is not significantly unreasonable or against Japanese public policy (for example, an agreement that the plaintiff could file a claim with any court was invalid (*Tokyo High Court decision of February 13, 2004*)).

Oral agreements are not sufficient, and the applicable Japanese law (*Code of Civil Procedure, Article 3-7(2)*) requires that the agreement regarding jurisdiction should be made in writing.

In MoUs between Japanese companies, the parties often agree that the following will have jurisdiction:

- A specific court in Japan (such as the Tokyo District Court).
- The court where the defendant is headquartered.

In MoUs for cross-border transactions, Japanese courts are still in many cases chosen as the exclusive jurisdiction for dispute resolution, especially if a Japanese company is the target. However, as Japanese court procedure is public and is conducted in Japanese, parties to cross-border matters sometimes agree to arbitration in Japan or third countries such as Singapore and Hong Kong for dispute resolution.

As Japan is one of the signatories to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the parties may easily enforce foreign arbitral awards in Japan with an execution judgment by Japanese courts.

Governing law

Under Japanese law, it is not compulsory for MoUs relating to Japan to be governed by Japanese law, and the parties may freely choose the governing law.

In cross-border transactions, parties generally agree that MoUs are governed by any relevant laws (usually, the laws of the jurisdictions to which the parties or the target companies belong):

- For MoUs between Japanese parties, the MoU will usually be governed by Japanese law.
- For MoUs relating to M&A deals between Japanese and non-Japanese parties, the MoU will usually have as its governing law that of the target company.

11. Are there any clauses in *Standard document, Memorandum of understanding (commercial): Cross-border* that would be ineffective or not standard practice in your jurisdiction?

As discussed in *Question 6* and *Question 7*, it is not common to provide for non-solicitation of customers or clients in MoUs, as provided for in *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 6.2(b)*.

However, we believe that provisions on non-solicitation of customers or clients are effective as long as:

- The solicitation of customers or clients in question is made using confidential information obtained during the negotiations for the MoU or the subsequent definitive agreement.
- The duration for non-solicitation is appropriately limited in connection with the relevant case.

As also discussed in *Question 7*, it is not standard practice in Japan to provide liquidated damages for a breach of non-solicitation of employees (as in *paragraph 6.4* of the Standard document) while it is common to prohibit solicitation of employees as provided in paragraph *6.2(a)* of the Standard document.

As for exclusivity, it is not uncommon in Japan to provide for exclusivity in MoUs as in *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 7.4*. However, as mentioned in *Question 9*, it is less common to provide indemnity clauses requiring reimbursement of the costs incurred, as in *Standard document, Memorandum of understanding (commercial): Cross-border: paragraph 7.7*.

12. Are there any other clauses that it would be usual to see in an MoU and / or that are standard practice in your jurisdiction?

MoUs relating to Japanese M&A transactions sometimes provide for a few more clauses, so that the parties can make it clear that they are on the same page in reaching a final agreement. These might include:

- Envisaged structures.
- Tentatively agreed valuations.
- Timelines, including milestones.
- The due diligence process.

13. Would the United Kingdom's departure from the European Union (Brexit) raise any issues that should be considered by the parties or affect the drafting of *Standard document, Memorandum of understanding (commercial): Cross-border* in your jurisdiction, especially for transactions or matters that present a connection to the UK (for example, because one of the parties is a UK-incorporated entity or has assets or carries on business in the UK).

We do not expect any significant impact to be caused by Brexit on MoUs, even those between Japanese and British companies. However, taxation- or licence-related matters would have to be considered in the case of any MoU relevant to the United Kingdom.

Contributor details

Masaki Noda, Partner

Nishimura & Asahi

T + 81-3-6250-6422

E m_noda@jurists.co.jp

Areas of practice: Corporate/M&A.

Akihiko Izu, Associate

Nishimura & Asahi

T + 81-3-6250-6746

E a_izu@jurists.co.jp

Areas of practice: Corporate/M&A.

Satoshi Aizawa, Associate

Nishimura & Asahi

T + 81-3-6250-7439

E s_aizawa@jurists.co.jp

Areas of practice: Corporate/M&A.