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HANDLING PERSONAL INFORMATION IN JAPANESE M&A TRANSACTIONS

The handling of personal information in the M&A context presents unique and complex challenges from the very beginning of the acquisition process. During the pre-acquisition due diligence phase, a buyer may seek to access personal information concerning the employees of the target company to help evaluate the competitiveness of compensation packages, to plot the expected tenure of key employees, and to undertake financial modelling to support the acquisition purchase price. Post transaction, personal information concerning the target company's employees and customers may need to be used by the buyer in the ordinary course of business. A prudent buyer of a Japanese company should pay careful heed of how to appropriately handle and manage privacy issues from the very early stages of its acquisition discussions, as Japanese privacy laws are a complex web currently in a state of flux that can impact the entire acquisition cycle, and non-compliance can significantly damage the reputation of a business (and ultimately its profitability).

Before addressing Japanese privacy laws in the M&A context, this newsletter first provides a basic overview of current Japanese privacy laws.

Primer on Japanese Regulation of Personal Information

Japan's Act on the Protection of Personal Information (the "PIA") is the principal Japanese privacy statute that regulates the treatment and handling of personal information that a company receives and generates during the course of conducting its business. Depending on the industry in which a company operates, industry-wide regulations also may govern the handling of personal information (a survey of which is beyond the scope of this newsletter). Companies also can adopt internal rules or policies concerning the handling by an employee of personal information that exceed the requirements of the PIA.

The PIA does not regulate all non-public information held by a company. The ambit of the PIA is more limited. The PIA regulates the treatment of "Personal Information" held by a "Business Operator," which are terms of art and defined as follows:

- **Personal Information** is defined broadly and means information about a living individual that can identify the specific individual by name, date of birth or other similar information. Personal Information also includes information that on its face may not be Personal Information, but could identify the specific individual by referencing other individual defining information. For example, an Internet customer's registered user nickname (such as "sunrise1234") would not by itself necessarily identify the specific individual, but could qualify as Personal Information if such user's nickname and his/her actual name could be matched without using special software. It goes without saying that a person's name, personal identification number (*i.e.*, the soon to be released "My Number" in Japan), address, phone number and bank account details would qualify as "Personal Information" covered by the PIA, regardless of whether such information is business information that is publicly accessible on a firm's website.

- A **Business Operator** means an entity that handles, for its business, one or more databases that in the aggregate have contained Personal Information relating to more than 5,000 individuals at any time within the past six months. The 5,000 individual threshold encompasses Personal Information with respect to all individuals who interact with the company (*e.g.*, customers, employees, suppliers, business partners, etc.). Given the record retention policies of most Japanese companies, reaching the 5,000 threshold is not difficult.

Under the PIA, a Business Operator that receives Personal Information is required to maintain the confidentiality of such information and use such Personal Information only for the specified purpose(s) notified or announced to the subject individuals. Proper notification can be effected not only through direct written correspondence to the subject individual, but verbally as well. A sufficient announcement can be made by placing a "use statement" on a company's website.

A Business Operator is also generally prohibited from sharing Personal Information with a third-party unless (i) the receiver of the Personal Information is exempt from the meaning of a "third-party" under the PIA, or (ii) the individual to whom the Personal Information relates specifically consents to the disclosure, collection and use by a third-party (or category of third-parties) (a so-called "*consent scheme*"), or does not object to the Business Operator sharing the Personal Information with a third-party (or category of third-parties) (a so-called "*opt-out scheme*"). Under an opt-out scheme, prior to obtaining Personal Information, the Business Operator is required to notify or announce to the individual to whom the Personal Information relates about (i) the intention of the Business Operator to share Personal Information with a third-party (or category of third-parties), (ii) the items or categories of Personal Information that the Business Operator may share with a third-party, (iii) the method by which such Personal Information will be shared with the third-party (*e.g.*, publishing, providing online, or delivering by hand), and (iv) the cessation by the Business Operator of sharing such Personal Information upon the request of the individual to whom the Personal Information relates.

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If a Business Operator desires to substantially change or expand its use of Personal Information *(i.e.*, not share Personal Information with a third-party, but directly use Personal Information for additional purposes), then the Business Operator most likely would need to obtain the consent of the subject individuals to whom the Personal Information relates. The PIA does not permit the utilization of an opt-out scheme to substantially change or expand the use of Personal Information.

Whether a transaction is structured as a "*business succession*" or a "*stock acquisition*" is critical for purposes of analyzing the impact of the PIA on an M&A transaction. It is important, therefore, to distinguish upfront these acquisition types. A business succession is a form of acquisition pursuant to which a buyer directly acquires or assumes assets and liabilities of the target business. Business transfers/asset purchases and mergers are the most common forms of business succession arrangements. Unless the buyer itself will directly acquire or assume the assets and liabilities of the target company or the buyer has an existing operating company that can absorb such assets and liabilities, the buyer will form a special purchase company to acquire or assume the target assets and liabilities. As discussed later in this newsletter, the entity identified as the buyer under the PIA can expose an acquirer to an unexpected trap. A stock acquisition, on the other hand, is a form of acquisition pursuant to which the buyer directly acquires the stock of the target company from the selling shareholder(s) or subscribes for shares issued by the target company. The target company will become a subsidiary of the buyer depending on the amount of shares that the buyer acquires or the control that it can exercise over the target company.

The Japanese ministry that has regulatory authority with respect to the industry in which a Business Operator operates is tasked with the responsibility of overseeing and enforcing the PIA over its subject regulated companies. There is no private right to seek monetary damages under the PIA. Typically, a failure by a Business Operator to comply with the PIA may result in a public admonition by the regulator, which if the Business Operator fails to heed may lead to an order issued by the regulator to cure such violation. If the Business Operator fails to respond to such order, then the regulator could have:

- the Business Operator pay a penalty of up to JPY300,000; and

- the directors and/or employees of the Business Operator (as determined by the regulator) face imprisonment of up to six months or pay a penalty of up to JPY300,000.

While the monetary penalties for violating the PIA are relatively modest, the reputational damage that a Business Operator could suffer arising from a misappropriation of Personal Information most likely would have a much greater long-term negative impact on the Business Operator.

Pre-Acquisition: Application of the Japanese Privacy Statute to Due Diligence

Most information about a target company's employees and customers maintained by the target company would normally constitute Personal Information and would be subject to the strict confidentiality provisions of the PIA (so long as the target company is a Business Operator, which is often the case). Absent regulatory relief, therefore, a target company ordinarily would not be able to share such data with a prospective buyer or any of its affiliates before the conclusion of the acquisition, which could make it difficult for a prospective buyer to complete its financial modelling for the acquisition or for the prospective buyer to devise prior to the closing date its post-acquisition integration plans. However, guidance issued jointly by Japanese ministries provide an important exception to the sharing of Personal Information during the due diligence phase depending on the form of acquisition.

Transactions Structured as a Business Succession. Pursuant to a guideline issued jointly by Japan's Ministry of Economy, Trade and Industry and Japan's Ministry of Health, Labor and Welfare (the "Guideline"), sharing Personal Information with a prospective buyer during the due diligence phase in a business succession regardless of the category of persons to whom the Personal Information relates (*e.g.*, disclosure of Personal Information relating to a target company's employees, customers, suppliers, and lenders) even without obtaining the consent of the individual to whom the Personal Information relates and even without providing any notice to such individual is permissible so long as the target company and the prospective buyer enter into an agreement detailing how the Personal Information will be used by the prospective buyer, the way in which the Personal Information will be stored and safeguarded by the prospective buyer pending the completion or abandonment of the transaction, and the mechanics for how the Personal Information will be returned to the target company by the prospective buyer if the acquisition is not completed. As it is difficult to imagine a scenario where a target company would disclose Personal Information to a prospective buyer before executing a confidentiality agreement (which typically would cover the treatment, safeguarding and discarding of disclosed information), the foregoing documentation requirement under the Guideline should rarely arise as a stand-alone requirement.

The entity that is considered the "buyer" under the PIA is critical for assessing the availability of the Guideline to a proposed due diligence exercise. Under the PIA (and, therefore, the application of the Guideline), the buyer is considered the entity that will directly acquire or assume the assets and liabilities of the target company. The foregoing meaning of a buyer can lead to an unexpected trap when an acquirer will form a special purpose company to acquire or assume the assets and liabilities of the target company because the special purpose company will be considered the buyer under the PIA even though representatives of the special purpose company's parent and its affiliates will be leading the due diligence investigation in such scenario (and as a matter of fact, may need to lead the due diligence exercise as the special purpose company may not be formed until shortly before the closing of the transaction). Local counsel should be contacted early on to consider ways to overcome this conundrum, as exemptions under the PIA could apply to the case at hand or suitable masking procedures could be employed to assure that information cannot be used to identify a specific individual.

The Guideline applies either before or after the execution of a definitive business succession agreement for the purpose of enabling a prospective buyer to complete its due diligence review over the target company. The Guideline also does not differentiate between the types of Personal Information that can be shared during the due diligence phase in a business succession. However, Japan's Ministry of Health, Labor and Welfare has issued a guideline focusing on Personal Information relating to employees, under which the Ministry emphasizes the sensitivity of employee Personal Information. Further, while this guideline does not distinguish between the handling of an employee's salary and an employee's medical condition (even if the employee suffers from a debilitating or sensitive ailment), the Ministry of Health, Labor and Welfare issued a circular focusing on employee health information pursuant to which the Ministry cautioned that the handling of employee health information and medical conditions should receive careful treatment. As no illustrative steps are provided as to what constitutes careful treatment in the M&A context, local counsel should be contacted to advise on current best practices.

Transactions Structured as a Stock Acquisition. The Guideline applies only with respect to an acquisition structured as a business succession. Thus, a consent-scheme or an opt-out scheme would need to be implemented in order to share Personal Information with a prospective buyer during the due diligence phase in the context of a stock acquisition. Seeking consent or an opt-out from employees or other third-parties to share Personal Information with a prospective buyer during the due diligence phase is normally inadvisable because the deal team often desires to maintain strict confidentiality over the potential transaction until a definitive agreement is executed in order to reduce inter-lopper risk and limit any damage to the target company's reputation if the transaction is subsequently abandoned. Fortunately, a relatively easy fix exists to share information with a prospective buyer during the due diligence phase in the stock acquisition context – the name, address and other information of the person should be masked so pieces of shared information cannot be used to identify a specific individual.

Post-Acquisition: Treatment of Acquired Personal Information

Similar to the pre-acquisition context, the treatment post-acquisition of acquired Personal Information under the PIA depends on the form of the acquisition.

Transactions Structured as a Business Succession. Under the PIA, a buyer that has acquired a Business Operator through a business succession can use the acquired Personal Information (not only the information shared during due diligence phase) without obtaining the consent of the individual to which the Personal Information relates, so long as (i) the buyer uses the Personal Information consistent with the way the target company legitimately used the Personal Information prior to the acquisition, and (ii) the buyer notifies or announces the subject individuals of the specified purposes for which the buyer will use the Personal Information (which announcement/notification can mimic the most recent disclosure made by the target company). Unlike in the pre-acquisition context for acquisitions structured as a business succession (where the buyer and the receiver of Personal Information during the due diligence phase may not be the same person), in the post-acquisition context such possible distinction should not exist because the buyer and holder of the assumed assets and liabilities ordinarily will be the same person.

If the buyer desires to use the Personal Information for a different purpose or in a different manner, then the buyer must obtain the consent of the subject individuals. For example, if a buyer will utilize employee Personal Information to assist with business financial modeling or the development of an internal employee payroll system, then no employee consent should be required for such uses by the buyer. However, if the buyer wants to provide employee Personal Information to its parent company so that the parent company can undertake marketing activities towards the subject employees, then the buyer would need to receive the consent of the relevant employees prior to sharing such employee Personal Information with the parent company.

Transactions Structured as a Stock Acquisition. Since the target company (and not the buyer) ordinarily remains the holder of its Personal Information after the completion of a stock acquisition, no post-acquisition steps pursuant to the PIA would need to be taken by the target company with respect to its continued use of the Personal Information it holds, so long as the target company will use such Personal Information consistent with the way it legitimately used the Personal Information prior to the acquisition. If the target company would like to share the Personal Information that it holds with a third party or use such information for a different purpose, then depending on the facts and circumstances, the target company many need to receive the consent of the individuals to whom the Personal Information relates.

Contractual Overrides to the Japanese Privacy Statute

Complying with the PIA does not eliminate the need to comply with contractually agreed upon confidentiality obligations. For example, an individual may have entered into a consulting agreement with the target company and wants his/her identity not to be disclosed (perhaps due to the industry in which the target company operates or the services being rendered) and, accordingly, has included a covenant in the arrangement that prohibits the target company from revealing to third-parties the consultant's name or the fact that the consultant entered into the agreement. While an exception under the PIA could permit the target company to disclose the details of the consulting agreement to a prospective buyer during the due diligence phase, such disclosure would breach the terms of the confidentiality agreement, and PIA compliance would not serve as a shield against liability from the confidentiality obligations agreed under the consulting agreement.

In order to identify and manage the elaborate array of issues that can arise from the disclosure of Personal Information in an M&A transaction, a seller may wish to involve legal counsel as early as possible in the process. If the target company

breaches its privacy obligations during the sale process, such breach could lead to a lost opportunity for the seller if the buyer is able to terminate its acquisition agreement due to this material development, or lead to a transfer of wealth from the seller if the buyer is able to make a post-closing indemnification claim. Prompt legal involvement would allow counsel to (i) identify early on target company agreements and databases that contain Personal Information in order to avoid inadvertent missteps, and (ii) develop disclosure guidelines and best practices to help shield the target company from breaches of the PIA, regulatory guidelines that cover the industry in which the target business operates, and contractual obligations.

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On May 21, 2015, Japan's House of Representatives passed amendments to the PIA (the "PIA Amendments") in an effort to (i) provide Business Operators with clearer guidelines for the protection and utilization of Personal Information, and (ii) promote the use of so-called "anonymized data." On August 28, 2015, Japan's House of Councilors approved the PIA Amendments, and the PIA Amendments were formally adopted into law on September 3, 2015. The PIA Amendments are slated to become effective within approximately two years. No precise effective date for the PIA Amendments can be cited at this stage because the Prime Minister's Cabinet and a "Personal Information Protection Committee" (a committee to be formed under the auspices of the Japanese Government) need to promulgate various detailed rules and regulations to implement the broad ambitions of the PIA Amendments. Although the specific impact of the PIA Amendments is uncertain at this time, given its broad mandate there is no doubt that the PIA Amendments as a whole will significantly change the handling and treatment of Personal Information under Japanese law, including the ability to disclose Personal Information to certain prospective buyers during the due diligence phase.

After the PIA Amendments become effective, an overseas buyer may not be able to rely on the due diligence exception as currently available under the PIA. As explained above, sharing Personal Information with a prospective buyer in good faith anticipation of a potential business succession will normally be permissible even without obtaining the consent of the person to whom the Personal Information relates and even without providing such person with any notice. The foregoing applies regardless of the location of the buyer. However, after the PIA Amendments become effective, a buyer located outside of Japan cannot receive Personal Information without the consent of the person to whom the Personal Information relates unless:

- the buyer is located in a country to be designated by the Personal Information Protection Committee as a jurisdiction that has rules and regulations concerning the protection of personal information that are at least as protective (from the perspective of the individual to whom the Personal Information relates) as the rules and regulations of Japan; or

- the buyer has established an effective system to monitor and protect Personal Information equivalent to the standards to be prescribed by the Personal Information Protection Committee.

Given the very early implementation stage of the PIA Amendments and that the Personal Information Protection Committee has not yet even been formed, it is difficult to predict the contours of the above-exceptions or whether a permissible alternative would exist for an advisor located in Japan (such as legal counsel) to receive the Personal Information and digest the data in a due diligence report or otherwise "mask" the Personal Information prior to transferring the data outside of Japan.

The next couple of years should be very exciting times for persons dealing with Japanese data privacy rules as the details of the PIA Amendments become better known, though potentially stressful as well to practitioners during this period due to the great uncertainties pending the completion of rulemaking!