

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

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In 2012, M&A transactions in Japan, in particular outbound M&A transactions, significantly increased, and several notable deals were completed. While it is not clear how the economic environment in Japan is going to proceed in 2013 under the policies of the new government, it is expected that this trend will likely continue. There have also been various legal developments, such as revisions to laws and court decisions that are expected to impact the M&A practice in Japan.



Overview of recent trends in M&A activity

In 2012, there were 1,848 M&A deals, in which at least one party was a Japanese company. While the number of such M&A deals had been decreasing over the past five years through 2011, this number grew during 2012 according to the data published by Recof, an M&A advisory boutique firm in Japan.

In particular, the number of outbound M&A transactions, or the acquisition of foreign companies by Japanese companies, increased significantly in 2012, reaching a record-high and exceeding the bubble economy days in 1990. It has been noted that the reasons for this trend include the shrinking of the Japanese market along with the decline in the birth rate in Japan and continued rise in the value of the yen, among others. The geographic locations of the acquired companies were quite broad, ranging from North America and Europe to China and Southeast Asia.

Since the leadership in the Japanese government changed in December 2012, it is not clear how the economic environment in Japan is going to proceed in 2013 under the policies of the new government. However, it is expected that the number of Japanese companies seeking to conduct business on a wider and more global scale through outbound M&A transactions will continue to increase in 2013 because the social and economic conditions described above will likely continue to be in existence for a long period of time.

In contrast, the number of inbound M&A deals, in which Japanese companies were acquired by foreign companies, in 2012 decreased compared to 2011. Nevertheless, there were several notable deals; for example, the execution of the capital and business tie-up agreement between the Honhai group and Sharp Corporation (though the equity participation in Sharp by the Honhai group has not yet been completed since the terms and conditions of the transaction seem to be under negotiation in response

to the decline in Sharp's share prices), and the equity participation in Elpida Memory Inc., which is currently under the Japanese Corporate Reorganisation Proceedings (*Kaisyu-kose-tetuduki*), by Micron Technology Inc. In January 2013, much attention was given to the proposed, unsolicited acquisition by the Wuthelam group, a major paint maker in Singapore, of Nippon Paint Co., Ltd. In the future, it is highly likely that foreign companies, which are attracted to the advanced technology, reputable brand and sophisticated experts of Japanese companies, will attempt to acquire such Japanese companies.

With respect to M&A deals in which both parties are Japanese companies, integrations between or among companies in the same areas of business continued to increase. Examples of these transactions in recent years include the merger between Nippon Steel Corporation and Sumitomo Metal Industries, Ltd. in the steel industry, the acquisition of Kojima Co., Ltd. by BIC CAMERA INC. in the electronics retail business, and the acquisition of Calpis Co., Ltd. by Asahi Group Holdings, Ltd in the consumer beverages industry. Since it is generally said that there is an oversaturation of companies in the same industry or business area and these companies need to strengthen their business bases in order to survive in a highly competitive market, it is expected that mergers and business integrations between or among companies in the same business areas will continue to increase further.

While the hostile tender offer launched by PGM Holdings K.K. for the shares of Accordia Golf Co., Ltd. in 2012 attracted significant attention in the Japanese M&A market, this tender offer ultimately could not be completed because the total number of tendered shares did not meet the minimum threshold for the number of shares to be purchased. There are still only a few cases of unsolicited or hostile transactions in Japan, but the possibility that these transactions may increase in the future cannot be ruled out, because

many view that M&A transactions are necessary mechanisms by which Japanese companies can grow their businesses and survive in an increasingly competitive marketplace.

Legal developments

Tender offer by shares

In Japan, exchange tender offers, or tender offers in which the offeror's shares are given as consideration instead of cash, are not explicitly prohibited under the law. However, this type of tender offer has been difficult to conduct from a practical perspective due to several restrictions under the Companies Act.

On July 1, 2011, the revised Law on Special Measures for Industrial Revitalisation (the "LSMIR") was passed, under which certain regulations under the Companies Act would no longer be applicable to exchange tender offers. Pursuant to the LSMIR, the offeror in an exchange tender offer is able to acquire (i) less than all of the shares of the target company; (ii) shares of a foreign target company; or (iii) shares of a target company that objects to the tender offer; none of which are among the mechanisms that are permitted in a share exchange transaction (*kabushiki-kokan*) under the Companies Act. Therefore the revision to the LSMIR provides for new M&A methods for using shares as consideration, and therefore may contribute to the stimulation of the M&A market.

On the other hand, however, there still remain some barriers under Japanese tax laws that work to prevent exchange tender offers. The main barrier is the fact that tax deferrals for capital gains realised by the shareholders of the target company are not permitted with respect to exchange tender offer under the Japanese tax laws, even though tax deferrals for capital gains realised by the shareholders of the target company are permitted with respect to the share exchange transaction under certain conditions (i.e. *Tekikaku-kabushiki-kokan*). Due to this tax issue, there have not been any prominent exchange tender offer transactions since the revised LSMIR was passed in 2011. As described above, in order for exchange tender offers to contribute to the development of the M&A market, this tax issue will need to be resolved to allow for easier execution of exchange tender offers.

Insider trading regulations

The revised insider trading regulations under the Financial Instruments and Exchange Act (*kinyu-shohin-torihiki-hou*) (the "FIEA") were published in September 2012. Under the past regulations, whether a transaction was subject to the insider trading regulations depended on the scheme of the transaction; for example the transfer of shares in a business transfer transaction is subject to the insider trading regulations, but the

transfer of shares in a merger or corporate split is not. Under the revised insider trading regulations, the transfer of shares in a merger or corporate split as well as in a business transfer is subject to the insider trading regulations, while transactions in which there may be little potential for insider trading are exempt from insider trading regulation regardless of the specifics of such transactions. In short, the new insider trading regulations allows businesses to be more neutral in selecting the method or type of the transaction.

On December 25, 2012, the working group of the Financial System Council of the Financial System Agency of Japan published a report on the revisions to the insider trading regulations. In the report, the working group noted that it would be favourable for the Japanese M&A practice if the current insider trading regulations are reduced in order to resolve some practical issues with regard to tender offer procedures. At this stage it is unclear whether the proposal by the working group will ultimately lead to the revision of the FIEA, but the possibility of revision should be noted in considering the future trends of the M&A practice.

Outline of revisions in the Companies Act

The Legislative Council (*hosei-singikai*) of the Ministry of Justice published the Outline (*Yoko-an*) of the Companies Act (the "Outline") on August 1, 2012, and the draft law of the revised Companies Act, which is based on the Outline, is expected to be submitted to the Diet in the near future. While it is worth noting mainly how the corporate governance system will be revised, the Outline also includes the following important proposed revisions concerning M&A transactions:

- i. Revising the rules on third-party allotment of new shares: A third-party allotment of new shares that results in the replacement of the controlling shareholder is expected to be subject to the resolution of a shareholders' meeting under certain conditions. Presently, such third-party allotments of new shares are only required to be approved by the resolution of the board of directors under the current Companies Act.
- ii. Revising the rules on transfer of the shares of a subsidiary: The transfer of the shares of a subsidiary is expected to be subject to the special resolution of a shareholders' meeting under certain conditions. The current Companies Act authorises such transfers by the resolution of the board of directors.
- iii. Revising the rules on cash squeeze-outs and introducing a new cash-out method: Although under the current Companies Act, a company is able to conduct a squeeze-out of minority shareholders with cash using a particular class of shares, the procedures for doing so are complex and time-

consuming. For example, the resolution of a shareholders' meeting is required. The Outline is expected to simplify the procedures for squeeze-outs, such as by only requiring the resolution of the board of directors, not a resolution of a shareholders' meeting.

- iv. Revising the rules on company splits: Many have complained that the current rules on company splits are not sufficient to adequately protect the rights and benefits of the creditors of the splitting company, and many lawsuits and important court precedents related to this issue have arisen in recent years. Under the revised Companies Act, the rights and benefits of the creditors of the splitting company are expected to be better protected.

Antimonopoly regulations

More than a year has passed since the Japan Fair Trade Commission (the "JFTC") implemented new business combination investigation procedures on July 1, 2011, which were based on the new Policies Concerning Procedures of Review of Business Combination (the "New Policies"). Over the past few years, the JFTC conducted investigations of large cases in Japan, which were closely watched overseas, including, for example (i) the merger between Nippon Steel Corporation ("NSC") and Sumitomo Metal Industries, Ltd. ("SMI"), which was publicly announced on December 14, 2011 following the results of the investigation; and (ii) the integration of the Tokyo Stock Exchange Group, Inc. ("TSE Group") and the Osaka Securities Exchange Co., Ltd. ("OSE").

These cases demonstrate that the parties involved and their attorneys can expedite the investigation process by being well-prepared, providing a full picture of the major potential issues in a well-organized manner from a strategic perspective and focusing their attention on those issues at an early stage of the investigation, although these factors do not necessarily always apply since the strategy for each case will depend on the type and scale of the case. As more companies in the same business area integrate, as mentioned above, Japanese companies and the JFTC will gain more experience and become more efficient

and speedy with respect to the process of investigating M&A transactions, depending on the type and scale of the transaction.

While ancillary to Japanese legal issues, it should be noted that in recent years several M&A transactions in Japan were subject to the investigation procedures of the relevant Chinese authority, and the transaction schedule was significantly affected as a result of such procedures.

Court decisions

In 2012, there were many important court decisions, which are expected to affect the M&A practice in Japan with respect to the following, for example, (i) the framework for calculating the "fair value" of shares when a shareholder makes a Share Purchase Demand (*kabusiki-kaitori-seikyu*) under the Companies Act or when minority shareholders are squeezed out under a management buy-out and other going-private transactions; (ii) the preservation of the rights of the creditors of a splitting company when a corporate split is conducted under certain processes and conditions by which the creditors are harmed; and (iii) the interpretation of representations and warranties clauses under M&A transaction agreements.

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