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PREFACE

The past year has seen the financial crisis continue to escalate. Financial markets have witnessed a number of events that have had global effects, from the collapse of Lehman Brothers in September 2008, to Iceland's banking crisis and the nationalisation of various financial institutions by several governments. The consensus is that the decision not to rescue Lehman was a mistake, although, to date, this appears to be an isolated – if serious – error by the authorities in response to the banking sector crisis. Other responses to these turbulent market conditions include the decision to reduce interest rates to historically unprecedented levels and massive fiscal stimulus in many countries. More controversially, several monetary authorities have implemented a 'quantitative easing' policy. Taken together, these efforts seem, at the moment anyway, to have averted a full-scale depression, but this has clearly been achieved at the price of huge public-sector deficits and substantial debt burdens for future generations.

The current debate centres around whether the next stage will be a continuing crisis, a return to 'normality' or, as seems more likely, a slow and anaemic recovery. In any case, many observers predict significantly higher levels of inflation than seen in recent years. Although some tentatively predict that a recovery from the financial crisis is on the horizon, the topic remains one of ferocious debate.

Some questioned whether the banking crisis would seriously affect the wider economy. The last year has proved beyond doubt that those who predicted a wider financial crisis were correct. The crisis in the real economy has much further to run and a significant increase in unemployment, particularly in Europe, regrettably seems inevitable.

M&A activity has reflected this crisis. Lending remains very constrained and the most significant activity has been in the financial sector, although property companies are also severely stressed. The less welcome development over the past year or so has been the steady stream of distressed corporate rescues, some by takeover. More optimistically, many are now commenting that, for those with cash, there are bargains to be had.

From the lawyers' perspective, the next stages are likely to be of great interest as the authorities take steps to rebuild confidence in financial institutions. The regulatory architecture will change significantly, although the final form is not yet obvious.

I again wish to thank all the contributors for their continued support and cooperation – and all the unnamed others who have helped to produce this book, which, given the current economic climate, should hopefully provide interesting reading.

Simon Robinson
Slaughter and May
London
August 2009

Chapter 32

JAPAN

*Hiroki Kodate and Risa Fukuda**

I OVERVIEW OF 2008/2009 M&A ACTIVITY

Owing to the changing Japanese and global economy and the financial crisis triggered by the subprime loan problems in the US, particularly following the collapse of Lehman Brothers in September 2008, the level of M&A activity involving Japanese companies was low in 2008 as compared with 2007, which witnessed a very high level of M&A activity. In particular, the presence of investment funds, both foreign and domestic, which have faced difficulty in raising funds, has been less notable. However, there were a number of outbound M&A transactions where Japanese companies acquired companies and businesses outside Japan involving large capital amounts. In addition, there were more M&A transactions driven with a view to restructuring or bailing out businesses.

The Japanese have commonly been said to be 'allergic' to M&A transactions that involve the sale and purchase of businesses. However, even at the time of the financial crisis, we see a decent volume of M&A transactions. M&A continues to become an important management strategy option for Japanese companies.

II GENERAL INTRODUCTION TO THE LEGISLATIVE M&A FRAMEWORK

In Japan, the Companies Act and the Financial Instruments and Exchange Act ('FIEA'), provide the fundamental statutory framework for M&A transactions. The Companies Act provides fundamental rules concerning companies and applies to both public and closed companies, whereas the FIEA makes provision for, among other things, public offers of securities, takeover bids and insider trading, and is an important source of rules regulating M&A transactions involving public companies. There have been amendments to the FIEA after it replaced the Securities and Exchange Act in 2007, and

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the amendments that may affect M&A transactions are described in Section III, *infra*. There are also other important laws such as the Antimonopoly Act in which Japan's merger control rules are contained (for the amendments on the Antimonopoly Act, please refer to Section IX). In relation to foreign investment in Japanese companies, the Foreign Trade and Foreign Exchange Act requires the approval of, or reporting to, relevant ministries in certain circumstances.

The listing rules promulgated by the Japanese stock exchanges provide for, among other things, timely disclosure obligations and delisting requirements, which are also important for deals involving public companies. One of the major stock exchanges in Japan, the Tokyo Stock Exchange, has started revising its listing regulations to improve the current investment environment. Please refer to Section III, *infra*.

Lastly, a number of recent court cases have the potential to significantly impact the M&A frameworks, and these are described in detail in the later part of this chapter.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i An amendment to the Industrial Revitalisation Act

A law to partly amend the Act on Special Measures for Industrial Revitalisation ('the Industrial Revitalisation Act') has been promulgated on 30 April 2009 and has partially become effective as of the same date. The Industrial Revitalisation Act is aimed at industrial revitalisation to improve industrial productivity and provide a basis for sustainable economic development. One of the significant amendments made to the Industrial Revitalisation Act was the implementation of a measure for facilitating financing which came into effect as of 30 April 2009.

Recently, there appear to be large numbers of companies which can expect recovery of their business operations in the long run, but temporarily have incurred significant damage to their capital due to the global financial crisis. There is a widespread fear that such companies will have difficulty in funding their company unless they are able to secure funds in a timely manner. To facilitate the financing of such companies, the amendment extended the scope of loss covered by the Japan Finance Corporation ('JFC') as explained below. As the JFC is a public corporation wholly owned by the Japanese government, this amendment results in enhancing the capital strength of private sectors by utilising the public funds.

More specifically, the new amendment states that the JFC may cover part of the losses resulting from designated financial institutions (such as the Development Bank of Japan Inc, a bank wholly owned by the Japanese government) providing equity finance to business operators who had their restructuring plans authorised under the Industrial Revitalisation Act given that it is during a period of crisis recognised under a Cabinet ordinance. The Cabinet ordinance, which came into effect on 30 April 2009, designated the period between 31 April 2009 and 31 March 2010 as such period of crisis, due to the current financial turmoil.

There are certain requirements that must be met by a company to apply to receive funds from designated financial institutions under this system, which are approval of the restructuring plan under the Industrial Revitalisation Act and passing of an evaluation

by the designated financial institution. For obtaining the approval of the restructuring plan, (1) business conditions must have been aggravated due to financial turmoil inside and outside Japan; (2) there is a need not only for a loan but for equity finance due to the aggravated business conditions; (3) there will be a significant impact on the growth or expansion of the national economy, and (4) if funds are received from the designated financial institution, it will be able to receive funds in equity or apply for loans through private financial institutions.

Although requirement (3) above may seem to suggest that only major companies can use this system, it is hoped that the system may be applied in a flexible manner.

As an example of a recent approval of a restructuring plan under the Industrial Revitalisation Act, Elpida Memory, Inc, a manufacturer of dynamic random access memory has obtained approval on 30 June 2009.

ii Tokyo Stock Exchange's proposal regarding third-party allotments

Recently, the Tokyo Stock Exchange ('TSE') has taken action as a market provider to improve the environment for investors in Japanese securities markets. On 23 April 2009 the Advisory Group on Improvements to the TSE Listing System announced its proposal entitled 'Creating a Better Market Environment Where Investors Feel Secure' ('the Advisory Group Proposal') to the public. The Advisory Group Proposal mainly discusses how to build an investment environment in which investors feel secure and how to improve the system to facilitate communication between shareholders and listed companies. Following the announcement of this proposal, the TSE made public a proposal for improvement of the TSE listing system ('the Amendment Proposal') on 19 May 2009, and an amendment to the listing regulations is anticipated to follow in August 2009.

The Advisory Group Proposal focuses on third party allotments and reverse stock splits as two significant areas which require improvement for investors to feel secure. Here, we will focus on the discussion of third-party allotments, which are often seen as a means of acquiring a controlling stake in Japanese listed companies and thus which we believe will have a significant influence on M&A transactions.

Japanese listed companies, or 'public companies' as defined in the Japanese Companies Act, are permitted to issue shares and allocate such shares to specific third parties without shareholder approval (i.e., by a board resolution) provided that the number of shares issued are within the number of shares authorised to be issued and that such issuance will not be considered as a favourable issuance (i.e., an issuance of share at a particularly favourable price). While this system allows listed companies to efficiently raise necessary funds, from the perspective of existing shareholders, there are concerns about the dilution of voting rights and the threat of a change of control. From this point of view, the Advisory Group Proposal suggests important factors for listed companies to consider and these have been reflected in the Amendment Proposal.

Response to dilution and management's selection of shareholders

The Advisory Group Proposal suggests that a third-party allotment that results in a dilution exceeding 300 per cent should result in the taking of measures such as delisting, except in cases where the interest of the shareholders will not be damaged. Based on this

suggestion, the Amendment Proposal suggested a delisting. The Advisory Group Proposal also suggests that a third party allotment which results in a dilution of 25 per cent or more shall require an opinion by a party independent from the management (such as the outside director or the independent committee) to be provided regarding the necessity and the adequateness of such third-party allotment, or an opportunity for the shareholders to express their opinions at a shareholders' meeting. The Amendment Proposal has excluded cases under extreme emergency such as in the cases where the cash flow of the company has rapidly deteriorated and following the procedure will be difficult.

Issues concerning allocated parties

The Advisory Group Proposal discusses the banning of certain inappropriate parties from undertaking third-party allotments and the Amendment Proposal suggests that whenever the party to whom the company allots the shares is not one of the listed companies or members of the TSE, the company should submit to the TSE a confirmation form stating that such third party is not related to organised crime organisations or other antisocial forces. The Amendment Proposal has also proposed the delisting of companies where the controlling shareholder has changed as a result of the third-party allotment and it is likely that, within three years from such change, the soundness of transactions with the controlling shareholders will be damaged and it would be difficult to ensure protection of shareholders and investors' interest.

Cases in which the application of the category of favourable issuance is unclear

Under the Companies Act, a special resolution of a shareholders' meeting is required where the amount to be paid in a third-party allotment is considered to be particularly favourable ('favourable issuance'). However, since there is no precise measure to decide whether it is a favourable issuance, the Advisory Group Proposal stated that action should be taken such as disclosing the basis of the calculations of the amount to be paid in and where the discount ratio exceeds 10 per cent, depending on the calculation method, disclosing opinions on legality by parties such as statutory auditors. The Amendment Proposal calls for the disclosure and explanation of the basis for calculation of the issue price, and the submission of an opinion of parties such as the statutory auditor when the stock exchange requires such opinion.

Third-party allotments without proper financing

The Advisory Group Proposal states that listed companies should confirm the funding of the allocating party and disclose the result of such confirmation, as there are increasing cases where announced third-party allotments are cancelled, and these can confuse the market or damage market credibility. The Amendment Proposal has stated a similar requirement.

As explained above, the Amendment Proposal is likely to have a material impact on companies allocating a significant number of shares using third-party allotments.

iii Amendment to the FIEA

In December 2008, the FIEA was amended in relation to administrative monetary penalties. From the viewpoint of M&A transactions, there were important amendments

such as those imposing administrative monetary penalties for failure to submit documents in relation to takeover bids required under the FIEA. Also, administrative monetary penalties will be imposed when a holder of shares in a listed company does not submit a large-holding report in a timely manner. Generally, when a person holds more than 5 per cent of a listed company's shares or when there is a 1 per cent or greater increase or decrease in the shareholding, reports are required under the FIEA. In addition, important amendments include the amendment to raise the amount of administrative monetary penalties imposed on insider trading.

iv Court decisions

Please refer to Section V for full details on court decisions that can be considered significant cases affecting M&A transactions in Japan.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

As seen from last year there continue to be large-scale outbound M&A transactions where Japanese companies acquire businesses outside of Japan for high values.

During 2008, a number of major outbound investments involved Japanese parties.

i Mitsubishi UFJ Financial Group Inc/Morgan Stanley

Mitsubishi UFJ Financial Group, Inc. ('MUFG'), Japan's top financial group obtained shares of US global financial services firm Morgan Stanley, in October 2008 for an aggregate purchase price of $9 billion. MUFG obtained the shares in the form of preferred stocks and obtained a 21 per cent ownership interest on a fully-diluted basis. Further to such acquisition, MUFG has announced in May 2009 that it will swap part of its preferred shares and obtain common shares in Morgan Stanley's new share offering so as to maintain over 20 per cent ownership.

ii Takeda Pharmaceuticals/Millennium Pharmaceuticals

In April 2008, Takeda Pharmaceutical Company Limited ('Takeda'), a leading research-based global company in Japan mainly focusing on pharmaceuticals announced that it will acquire shares of Millennium Pharmaceuticals, Inc ('Millennium'), a leading biopharmaceutical company in the United States, through a tender offer for approximately $8.8 billion. It completed the acquisition of shares in May 2008, and with a subsequent merger of a wholly-owned subsidiary of Takeda into Millennium, Millennium became a wholly owned subsidiary of Takeda.

iii Nomura/Lehman Brothers

One of the major impacts of the financial turmoil arising from the subprime loan crisis was the bankruptcy of Lehman Brothers Holding Inc ('Lehman Brothers'), a global financial services firm in September 2008. Nomura Holdings Inc ('Nomura"), a leading financial services group in Japan, announced it would take over Lehman Brothers' franchise in the Asia-Pacific region, including Japan and Australia in September 2008

following an announcement to take over Lehman Brothers' equities and investment operations in Europe and the Middle East.

It can be observed that the financial crisis has resulted in more foreign outbound investments, particularly in Japan's banking and financial sector.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

In 2008/2009, there were a number of notable court cases in Japan which may impact future M&A transactions. In this section, we discuss two major cases regarding takeover bids, one of the major procedures in the context of M&A deals utilised in Japan. Under the FIEA, an investor who intends to obtain more than one-third of the total voting rights of the shareholders of a listed company is generally required to do so by the method of a public takeover bid.

i Rex Holdings

On 29 May 2009, the Supreme Court of Japan upheld a High Court decision in relation to the 'fair price' to be paid to minority shareholders in a squeeze-out following the management buyout of Rex Holdings Co, Ltd ('Rex'). This was the first ruling by the Supreme Court in respect of what is determined to be the fair price. Although certain facts were very specific to the case, this ruling should become a noteworthy case for structuring future squeeze-outs in Japan.

Rex, a Japanese convenience store and a restaurant chain holder, which was a listed company, had announced a takeover bid in the form of an MBO by Rex's management, sponsored by an investment fund in November 2006. The takeover bid had resulted in acquisition of 91.5 per cent of the shares in Rex and the management proceeded to squeeze out the minority shareholders by way of compulsory acquisition of their shares under the Companies Act. The price of such shares was determined to be ¥230,000 per share, equal to the actual takeover bid price per share, to which certain of the minority shareholders objected and filed a petition with the court to determine the fair price, a right stipulated in the Companies Act.

The minority shareholders alleged that ¥230,000 did not reflect the fair price of the shares and one of the major reasons for this claim was the disclosure of certain information provided in an August 2006 press release, three months prior to the announcement of the takeover bid. The press release stated that the company had recorded large losses and revised down its earlier business forecast, and the minority shareholders argued that this resulted in the major decline in the market share price immediately afterwards. Accordingly the minority shareholders alleged that the takeover bid price which reflected the average price of the shares only for one month prior to the announcement of the takeover bid was exceptionally low and did not reflect the fair price.

The Tokyo District Court ruled that ¥230,000, which was the same price as the takeover bid price calculated by taking the average of the market share price for one month prior to the announcement of the takeover bid plus a premium of 13.9 per cent was a fair price. However, the Tokyo High Court did not support such view and ruled that the fair price should be calculated by taking the average of the six-month period

before the takeover bid announcement, which is 'the value of the shares acquired at the time of the squeeze out' ('the objective price'), with an additional 20 per cent premium as 'the expectation of a rise in the share price in the future' which the shareholder should have obtained ('the expectation value'). Based on this calculation, the Tokyo High Court determined that the fair price should be a total of ¥336,966 per share, significantly higher than the takeover bid price. It should be noted that the Tokyo District Court also was of the view that the fair price should be the objective price of the shares, determined based on their value up until the takeover bid announcement plus the expectation value, but the calculation of such components significantly differed in the two rulings.

The Tokyo High Court's decision stated that it cannot be denied that in the accounting process, there was an intention to manipulate the share price with the downward revision to its earlier business forecast stated above. Accordingly, the Tokyo High Court calculated the price based on the six-month period which includes the period before the press release. On the other hand, the Tokyo District Court stated that the downward revision to Rex's business forecast was not done with an intention to manipulate the price. Therefore, the Tokyo District Court only looked at the one-month period a while after the press release.

The Tokyo High Court's decision made clear that the court has considerable discretion in assessing the expectation value, namely the premium when there is no evidence submitted to justify the appropriateness of the price by means of valuation reports or business plans from Rex. The court simply referred to the value of premiums paid in recent MBOs to determine the '20 per cent' premium. The court also ruled that in this case where there were no valuation reports for calculating the share price or no business reports submitted, or no chance given to a third party (other than the intended party to conduct the MBO) to perform a due diligence, the fact that 95.1 per cent of the shareholders have accepted the takeover bid at the given price and that there were no other parties to counter-launch a takeover bid, does not constitute reasonable grounds to assume that the price is appropriate. The Supreme Court upheld the High Court decision.

The Supreme Court decision does not indicate that the calculation used in this decision should unanimously apply to all MBO cases. It is yet to be seen how this Supreme Court decision will affect future squeeze-out transactions as the facts such as the press release containing the downgrading revision of the operating prospects and no valuation reports or business plans being submitted were specific to the case.

ii Murakami Fund

One of the most noteworthy news items in Japan a number of years ago was the hostile takeover of Nippon Broadcasting System Inc ('NBS'), a Japanese radio broadcasting company, by an internet firm, Livedoor Co ('Livedoor'). In relation to this takeover, the Tokyo District Court ruled in July 2007 that Yoshiaki Murakami, a well-known fund manager and head of the investment advisory firm MAC Asset Management committed insider trading by using information on the takeover obtained from Livedoor to trade in shares of NBS. The Tokyo High Court in February 2009 upheld this decision. The main issue of this case was whether Murakami obtained information from Livedoor of its intention to buy a controlling bloc of NBS shares and traded in them after the Livedoor 'determined' that it would do so. Under the Securities and Exchange Act (the

predecessor of the FIEA), it would have been a violation of the law if Murakami had proceeded with the trading of shares after such point of 'determination' knowing of Livedoor's intention but before Livedoor had made such intention public.

The Tokyo District Court and the Tokyo High Court ruled differently as to how the point of 'determination' should be decided, although in conclusion, both courts ruled that Murakami violated the law by proceeding with the trading of shares while being aware of Livedoor's intention after the point of determination. The Tokyo District Court had decided that the point of determination was earlier than the point decided by the Tokyo High Court, by ruling that only in cases where there is no possibility of the shares actually being bought will it not constitute a determination. Meanwhile, as long as there is a possibility that shares will be bought, the probability or level of certainty will not affect the time of determination. The Tokyo High Court on the other hand, ruled that the point of determination should be decided by taking into consideration several factors and that the probability of occurrence will be one factor to be considered. In addition, the Tokyo High Court ruled that the determination should have a certain degree of concreteness and should be 'genuinely' intended, and as such the determination should have a 'reasonable possibility of actual fulfilment'.

Murakami has appealed and the decision of the Supreme Court is keenly awaited.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Leveraged buyouts have become more common in Japan in recent years. Banks operating in Japan extend loans to acquisition vehicles funded partly by equity so that these vehicles may make a takeover bid for all of the issued shares in a Japanese listed target (the first-tier transaction), followed by a squeeze-out transaction with the approval of shareholders of the target at a shareholders' meeting (the second-tier transaction). Extension of loans is often made in the form of syndicated loans which involve a number of banks in the case of large-scale buyouts. In the context of the financial crisis, trends are that banks more carefully decide whether to make loans and the same is true of equity providers such as funds.

VII EMPLOYMENT LAW

In the Japanese labour and employment law area, there was little significant movement for the year 2008. The Labour Standards Act was recently amended for the purpose of maintaining workers' health and achieving a work-life balance by limiting long working hours. This amendment will become effective on 1 April 2010. One of the amendments includes the increase in the overtime work compensation rate which will be increased from 25 per cent to 50 per cent when the employee works over a certain limit. Generally, when conducting legal due diligence for M&A transactions, the cost of unpaid overtime work compensation is one of the contingent liabilities that need to be considered. From this point of view, the amount of unpaid compensation in respect of overtime work may become a larger contingent liability in the future due to this amendment. However,

in terms of proceeding with M&A transactions in Japan, it can be concluded that there were no relevant major changes to employment law in 2008.

VIII TAX LAW

During 2008 and the first half of 2009, in the area of tax law, there were no great changes affecting M&A transactions in Japan. However, it should be noted that the 2009 amendment to the Japanese tax law includes amendments regarding investments in Japan. These amendments will facilitate offshore investors to invest through funds such as venture capital funds and corporate restructuring funds in shares of Japanese companies. They are intended to enhance such investments as well as to enable foreign investors to utilise such investment funds. Specifically, this tax reform implements a special treatment regarding Direct Permanent Establishment Taxation as below.

Before these amendments, a foreign investor who was a partner of an investment business limited partnership ('IBLP') established under Japanese law (often utilised as a format of investment funds) was deemed to have a permanent establishment in Japan, whenever at least one of the partners of the IBLP had a permanent establishment in Japan and was conducting the business of the IBLP in Japan. When one has a permanent establishment in Japan, this means that such person will be taxed for capital gains in Japan. These amendments allow a non-Japanese resident individual partner or a foreign corporate partner of an IBLP having a business base in Japan investing in shares of Japanese companies to be deemed not to have a permanent establishment in Japan under certain conditions. Certain requirements for the above to apply include, that (1) the investor is a limited partner of the IBLP, (2) the investor is not involved in the business of the partnership, (3) the investor holds less than 25 per cent of the partnership assets, (4) the investor does not have a special relationship with general partners (who have unlimited liability operating the partnership business), and (5) the investor does not have a permanent establishment in Japan other than the one related to the partnership business.

IX COMPETITION LAW

On 10 June 2009, an act to amend the Antimonopoly Act was promulgated which will come into effect within one year. A similar bill was submitted to the Japanese Diet last year, but it was abandoned without deliberation. The new bill was submitted in February 2009 with substantially the same content as the previous bill. Among the important issues of this amendment, one that will significantly affect M&A transactions is the requirement of pre-notification for business combinations involving share acquisitions as has long been the case with other types of business combinations. A share acquisition will require a prior notification to be submitted if the shareholding ratio after the transaction rises above 20 per cent or 50 per cent. In addition, the acquirer will not be able to acquire the relevant shares until the expiration of a 30-day waiting period from the day such prior notification has been accepted by the Japan Fair Trade Commission ('JFTC'). Another noteworthy part of this amendment is the change in the notification threshold for business combinations that are share acquisitions, mergers, corporate splits and business

transfers. For example, the notification threshold will be based on 'domestic sales' rather than 'total assets' which was the measure used before the amendment. In calculating the amount of 'domestic sales', it should be carefully noted that this measure will apply not only to domestic companies but also to foreign companies. Although the details of domestic sales are to be decided by the regulations of the JFTC, it is anticipated that this will include the sales amount accrued through direct importing to Japan, even without any presence in Japan such as having a branch office or subsidiary in Japan.

X OUTLOOK

The pace of M&A activity in Japan has significantly slowed down since the latter half of 2008. It remains to be seen how long the stagnation of the financial markets and the resultant low-level activity of M&A transactions will continue.

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