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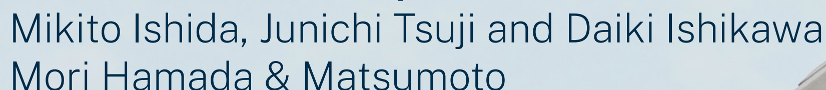

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JAPAN

Law and Practice

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MORI HAMADA & MATSUMOTO

1. Market Trends

1.1 Technology M&A Market

The technology M&A market in Japan has been relatively calm for the past 12 months. With that said, technology start-up companies continue to attract talents and investors in the Japanese market and the long-term trend remains strong. In addition, global investors began to show more interest in the Japanese market and investing into Japanese start-up companies. There may be multiple reasons for this attraction to Japan. The depreciation of the Japanese yen against other currencies has lowered the valuation of the Japanese start-up companies in other currencies, and increased tension between China and the United States has caused western investors to reconsider Japan as an attractive place of investment within Asia.

1.2 Key Trends

In 2023, we have seen some high-profile technology M&A deals especially in the semiconductor industry. In June 2023, Japan Investment Corporation, a Japanese government-sponsored fund, announced an acquisition of JSR Corporation, a manufacturer of semiconductor materials, for approximately JPY900 billion.

Tech companies continue to lead the start-up ecosystem in Japan and there have been 28 tech companies that went public during the first three quarters of 2023 (January to September), which means that the IT industry has supplied more IPO companies than any other industry areas during that period (the runner-up being the service industry with 17 IPOs).

On the other hand, the market environment for start-up financing in Japan gradually calmed down, and the authors have observed down-round financing in Japan much more often than what was seen just a few years ago.

Another hot topic for Japanese technology start-up companies in 2023 is the tax treatment of a certain employee stock option scheme called “trust-type stock options”. Because of its flexibility in allocating stock options to the current and future employees, it was adopted by many start-up companies in Japan, including those who had already gone public. However, the National Tax Agency of Japan recently clarified in May 2023 that income from this type of stock option should generally be taxed as a salary income rather than a capital gain, and some listed companies (mostly tech companies) incurred additional losses by changing their interpretation

of tax for the exercise of this trust-type stock option.

2. Establishing a New Company, Early-Stage Financing and Venture Capital Financing of a New Technology Company

2.1 Establishing a New Company

A start-up company starting a business in Japan or entrepreneurs residing in Japan would typically establish a new company in Japan and not in other jurisdictions. There are exceptions in certain areas, such as Web3-related businesses, for which the firm observes Japanese entrepreneurs establishing their companies in Singapore or Dubai.

A company can be established without difficulty in Japan and it normally takes less than a few weeks. A company must have a paid-in capital and payment of initial capital is required, but there is no minimum threshold and initial capital payment can even be JPY1.

2.2 Type of Entity

In Japan, joint-stock company (*kabushiki-kaisha*, or KK) and limited liability company (*godo-kaisha*, or GK) are the major types of entities used for incorporation, but nearly all of the start-up companies are established as a KK. Venture capital funds would normally not invest unless a start-up company is a KK, and companies must be a KK in order to be listed in the Japanese stock market. An investment limited partnership, which is a vehicle used by many venture capitalists in Japan, is prohibited from investing in GK under the law.

A KK must be formed by one or more "promoters" (*hokki-nin*), who make the initial arrangements for the incorporation procedure. And the promoter(s) must prepare the Articles of Incorporation (*teikan*) and have them notarised by a Japanese notary before filing for commercial registration of the company.

2.3 Early-Stage Financing

In Japan, there are a certain number of venture capitalists who focus on early-stage financing (seed investments). And the authors observe individual investors (angel investors) such as successful entrepreneurs who exited the previous start-up(s) that invest in and support entrepreneurs of younger generations. There is also an increasing number of accelerators in Japan who would provide educational programmes for entrepreneurs as well as seed money.

The documentation of early-stage financing would typically consist of an investment agreement (which mainly stipulates the process of share issuance and subscription) and shareholders agreement (which mainly stipulates governance of the company after the investment). However, similar to other jurisdictions, drafting such investment contracts requires certain costs and time. Therefore, an investment scheme called J-KISS (described in **2.5 Venture Capital Documentation**), which adopts the concept of convertible equities to the Japanese law context, was created and made available in Japan back in 2016, and has been used by an increasing number of start-ups and investors over the years, for the purpose of simplifying the documentation process.

2.4 Venture Capital

While the size and number of venture capitalists may be smaller than the US, there are many venture capital firms available in Japan. According to the website of the Japanese Venture Capital Association (JVCA), as of 30 September 2023,

there are 149 venture capital firms who are the VC members of the JVCA, and in additional to that, 118 companies join the JVCA as corporate venture capital (CVC) members.

We also have some government-sponsored funds that are active in the ecosystem. JIC (Japan Investment Corporation) directly invests in start-up companies, while SMRJ (Organisation for Small & Medium Enterprises and Regional Innovation, Japan) makes LP investments into Japanese venture capital funds.

With respect to the investment by foreign venture capital firms, language barriers have been an issue for a long time, but the authors have seen an increasing number of foreign venture capital firms investing into Japanese start-up companies in the past few years.

2.5 Venture Capital Documentation

In Japan, there is no standard venture capital documentation that is prevailing in the market to the extent similar to the ones provided by the National Venture Capital Association (NVCA) in the US. However, the Ministry of Economy, Trade and Industry (METI) has published certain guidance for start-up investment contracts, and recently in July 2023, the Japan Association of Corporate Directors announced a set of model investment contracts for start-up investments written in English.

In order to replicate the economics of the US west coast convertible equities, Coral Capital, one of the venture capital firms in Japan, announced a template called "J-KISS", which stands for Japanese version of KISS (Keep It Simple Security) created by 500 Global (formerly known as 500 Startups) in the US. J-KISS is a stock acquisition right that will be converted to preferred shares once a qualified financing event occurs in the future.

2.6 Change of Corporate Form or Migration

Typically, the majority of the start-up companies would be established as a KK, and they do not need to change their corporate form. On the other hand, if a start-up company is initially formed as a GK, it might be better for the company to convert into KK when it starts looking for equity financing from external investors, since the company will have much more chance to access the venture capital financing market by being a KK. Under the Companies Act of Japan, a GK can be converted to KK by undergoing a certain required process.

Some Japanese start-up companies that aim to penetrate into the US market in their business or who seek to receive investments from US investors decide to undergo the corporate inversion process and become a US company. On the other hand, some Japan-oriented start-ups that established their entity in the US go the opposite way and take corporate inversion to become a Japanese company, for reasons such as to be listed in the Japanese stock exchanges.

3. Initial Public Offering (IPO) as a Liquidity Event

3.1 IPO v Sale

The number of M&A sale processes for start-up companies is limited and taking a company public is still the primary way for Japanese start-up companies to achieve liquidity. However, the government is actively working to facilitate M&A sales for start-up companies. One solution they have implemented in 2023 is expanding the existing tax incentive for companies that invest

in start-ups to cover M&A deals. This means that companies which acquire more than half of the voting shares of start-up companies can, subject to satisfying certain conditions, deduct 25% of the acquisition cost from their taxable income.

It is worth noting that exploring a possible M&A exit opportunity while preparing for an initial public offering (a dual-track process) is not common in Japan, primarily due to limited M&A opportunities for start-up companies. However, there are a few publicly known transactions that underwent a dual-track process, such as an acquisition of Paidy Inc, a Japanese online deferred payment service provider, by PayPal Holdings, Inc, in 2021, and an acquisition of DFA Robotics by CHANGE, Inc, in 2022.

3.2 Choice of Listing

If a Japanese company decides to go public, it is more probable that it will choose to do so on a Japanese exchange market. Nonetheless, the number of companies looking to be listed on NASDAQ is on the rise. While the number is still relatively small, the shorter preparation period for an initial public offering (in Japan, the typical preparation period for an IPO is about three years) and the potential to approach a broader scope of investors are becoming increasingly attractive to these companies.

3.3 Impact of the Choice of Listing on Future M&A Transactions

It is not very common for Japanese companies to list on exchanges outside the US and Japan. Since the minority shareholder squeeze-outs are available in both jurisdictions, the choice of listing location does not have a huge impact on the feasibility of a potential future sale.

4. Sale as a Liquidity Event (Sale of a Privately Held Venture Capital-Financed Company)

4.1 Liquidity Event: Sale Process

The process of the sale would depend on the scheme and situation of the transaction. Having said that, if the sale of the company is chosen as a liquidity event, a company may want to opt for a bilateral negotiation with a selected buyer rather than an auction process. This is because it can be challenging to find enough potential buyers to run an auction process, particularly if there are not many opportunities for a trade sale. In addition, if you already have a relationship with a potential buyer or they have invested in your company, the management may be more inclined to work with them instead of seeking out new potential buyers.

4.2 Liquidity Event: Transaction Structure

When a privately held technology company is up for sale, it is typical for the sale to be structured as a stock purchase, even if there are multiple investors involved. A statutory merger is sometimes used for acquisitions, but it is not as widely used as it is in the US. The Companies Act requires certain procedures to be followed for a statutory merger, including disclosures and document maintenance. The merger agreement is also regulated under the Companies Act, which is not as flexible as a stock purchase agreement. In addition, if a merger is used, companies need to consider how it will affect their licences and government permissions that are necessary for operating the business, since the entity that was granted such licences or permissions may be dissolved.

The current trend is to sell the entire company rather than to sell only a controlling interest. While key management and employees may

be eligible to own equity in the company after the transaction, venture capital and other financial investors usually do not have the option to remain in the company thereafter.

4.3 Liquidity Event: Form of Consideration

The most common form of consideration for M&A transactions is cash. However, if the buyer is a public company, stock may be used as part or all of the consideration, depending on the nature and details of the deal. Cash is generally used for any type of M&A transaction, including statutory mergers and tender offers, but stock can also be utilised in these situations.

4.4 Liquidity Event: Certain Transaction Terms

When the founders of a company hold a significant portion of the shares and have been managing the business, they are expected to provide representations and warranties concerning various aspects of the company, such as the accuracy of financial statements, capitalisation, material contracts and assets, disputes and the environment, etc. In the event of any breach or inaccuracy of the representations and warranties, they are liable for indemnification.

On the other hand, VC investors argue to be held only accountable for their own fundamental representations and warranties, such as the holding of shares and good standing and should not be responsible for standing behind representations and warranties concerning the business.

In some cases, a portion of the consideration may be placed in escrow or held back to secure potential indemnity. However, some VC investors may seek to eliminate such a partial payment to avoid a decrease in their internal rate of return.

Representations and warranties insurance is gaining popularity in the Japanese M&A market. It is still not as popular in the US and Europe, but the number of insurance companies that underwrite such policies has been increasing in the past few years.

5. Spin-Offs

5.1 Trends: Spin-Offs

Spin-offs – separation of a business by distributing the shares of a new company which acquired the divested business – can be done by several schemes under the Companies Act, but typically includes setting up a new corporation and distribution in kind of that newco's shares to its shareholders. However, until 2017, both the divesting company and the shareholder levels would be taxed in a spin-off transaction, which made it unpopular in Japan.

Recently, in 2021, Toshiba Corporation, a major Japanese manufacturer of computers and electronic devices, announced its plan to divide its business into three main sectors, streamlined to two thereafter, to resolve the conglomerate discount by consummating a spin-off transaction. However, the shareholders denied the proposal at the shareholders meeting.

5.2 Tax Consequences

After 2017, if a spin-off meets the requirements for a tax-qualified spin-off, recognition of any capital gain or loss related to the transferred business will be deferred at the divesting company level. Additionally, recognition of the capital gain or loss of the shares to be distributed will be deferred at the shareholder level. The specific requirements for a tax-qualified spin-off depend on the structure of the spin-off, but generally include the following:

- shareholders of the divesting company must receive only shares issued by the spun-off company;
- no party may own more than 50% of the divesting company before the spin-off, and no party is expected to own more than 50% of the spun-off company after the spin-off; and
- the operation of the divested business must remain the same after the transaction in terms of assets, directors, and employees.

Under the Companies Act, shareholders have the right to request cash dividends when a company decides to make a distribution in kind. To qualify as a tax-qualified spin-off and exclude the possibility of distributing cash to shareholders, the divesting company must obtain special approval from the shareholders' meeting, which requires more than two-thirds of the shareholders' vote.

5.3 Spin-Off Followed by a Business Combination

Under the Companies Act, it would be technically possible to consummate a business combination immediately after a spin-off. However, a statutory merger requires at least one month's notice to creditors of merging companies and if the newly spun-off company is a public company, it would also take time to obtain approval from the shareholders, unless it meets certain requirements for mergers which would not require shareholders' approval.

As mentioned in **5.2 Tax Consequences**, a tax-qualified spin-off requires no one to be expected to own 50% or more of the spun-off company after the transaction. Therefore, if someone is expected to own 50% or more of the spun-off company through a business combination after the spin-off, such spin-off would not qualify as a tax-qualified spin-off.

5.4 Timing and Tax Authority Ruling

Technically, setting up a new company, separating a business and distributing the new company's shares can be done within a few months. However, assuming that a separating company is a listed company, it would be typical for the spun-off company to be listed in order for shareholders to have liquidity. Thus, separating companies must communicate with and obtain listing approval from the competent stock exchange to list the spun-off company soon after the spin-off. Also, at the separating company's end, they need to obtain shareholders' approval regarding distribution in kind and demerger (if any). Thus, typically, companies must prepare the spin-off from the preceding business year and it may take more than a year.

6. Acquisitions of Public (Exchange-Listed) Technology Companies

6.1 Stakebuilding

Stake Building

It is generally not considered customary to acquire a stake in a public company prior to making an offer. However, the decision to do so ultimately depends on the acquirer's strategy. Some acquirers may buy a certain amount of the target's shares before making an offer to exert some pressure on the target. However, in Japan, purchasing a certain amount of the target's shares as a toehold is often viewed as a hostile move.

Large Shareholding Reporting

Under the Financial Instrument and Exchange Act of Japan (FIEA), shareholders are required

to file a large shareholding report (*tairyo hoyuu houkoku sho*) with the relevant local finance bureau within five business days after their shareholding ratio in a listed company exceeds 5%. If the shareholding ratio subsequently increases or decreases by 1% or more, an amendment to the report must be filed within five business days. However, there is a special rule for financial institutions who regularly trade securities. Financial institutions are only required to file the report twice a month if the purpose of their investment does not include making a material change in the target's business or making material proposals, and their shareholding ratio does not exceed 10%.

Shareholders must provide various information in the report, including the purpose of the holding, material proposals, acquisition and disposal of shares within the past 60 days, source of financing, and material agreements related to the holding of shares. While there is no obligation for shareholders to make a proposal or state that they will not be making a proposal within a specified period of time (a "put up or shut up" requirement), if they change their purpose of the holding to propose certain matters, they must file an amendment report to reflect this change of purpose and specify the proposal in the report.

See **8.1 Significant Court Decisions or Legal Developments** for the ongoing discussion about the amendment of the rules.

6.2 Mandatory Offer

Under the FIEA, a tender offer is required for certain acquisitions of listed companies. There are two major rules that trigger a mandatory tender offer: the "One-Third Rule" and the "5% Rule".

In the case of the One-Third Rule, a mandatory tender offer is triggered when the shareholding ratio of an acquirer exceeds one-third of the target's voting rights after the transaction. This means that if an acquirer already owns more than 32.4% of the target's voting rights, even purchasing only 1% of the target's voting rights will require a tender offer. The One-Third Rule also applies even if an acquirer already owns more than one-third of the target's voting rights. However, generally speaking, a mandatory tender offer is not required when an acquirer's shareholding ratio exceeds one-third as a result of in-market transactions or new share allotment.

The 5% Rule triggers a mandatory tender offer if the total shareholding ratio of an acquirer exceeds 5% as a result of transactions outside of the market with more than ten people within 60 days. For instance, if an acquirer intends to purchase only 10% of voting shares from one large shareholder, a mandatory tender offer will not be required under the 5% Rule. However, the acquirer must consider if the One-Third Rule applies depending on the then shareholding ratio.

See **8.1 Significant Court Decisions or Legal Developments** for the ongoing discussion about the amendment of the rules.

6.3 Transaction Structures

The typical transaction structure for acquiring a public company involves conducting a tender offer first and then squeezing out the remaining minority shareholders. There are mainly two ways to conduct a squeeze-out, and which measure will be taken depends on the shareholding ratio of the acquirer after the tender offer.

Under the Companies Act, if an acquirer owns 90% or more of the voting shares of the target company after the tender offer, they can squeeze out minority shareholders by using the statu-

tory squeeze-out right (*kabushikitou uriwatashi seikyu*) without a resolution of the shareholders' meeting. On the other hand, if the acquirer owns less than 90% of the voting shares of the target company after the tender offer, they can use share consolidation (*kabushiki heigou*) to squeeze out minority shareholders with a special resolution of the shareholders' meeting which requires approval from two-thirds of the voting shares. Shareholders' interest less than one share as a result of share consolidation (known as "fractional shares") must be aggregated and sold for cash, and the cash proceeds from such sale must be distributed proportionately among the fractional shareholders. This mechanism enables the acquirer to squeeze out all the remaining shareholders by consolidating shares so that all the shareholders, except for the acquirer, hold less than one share.

Although an acquisition of a public company may be structured by a statutory merger, it is not very frequently seen in Japan.

6.4 Consideration and Minimum Price

When acquiring a public company in Japan, it is more common to use cash as a consideration for purchasing stocks. Although mergers are not commonly used to acquire public companies, cash can be used as a consideration in merger transactions as well.

While not typical, stock (possibly in combination with cash) can be used as a consideration in both tender offers and mergers. If an acquirer intends to use its stock as consideration, the Companies Act provides options such as share exchange (*Kabushiki koukan*) and share delivery (*Kabushiki koufu*) in addition to a tender offer and a merger.

Share exchange is only applicable when an acquirer intends to acquire 100% ownership of the target company. To address this limitation, share delivery was newly introduced in 2021. Share delivery can be used by an acquirer who intends to make the target company its subsidiary, without necessarily acquiring 100% ownership, by using its stock (or cash or in combination) as consideration.

A tender offer does not have a minimum price requirement, and in some cases, it may be consummated at a price lower than the market price to acquire a bulk of shares from a certain major shareholder (known as a discounted tender offer).

Contingent value rights or other mechanisms to bridge value gaps are not commonly used in the acquisition, but it is considered possible to grant such rights as consideration. In the acquisition of private companies, earn-out mechanisms are sometimes utilised to bridge value gaps.

6.5 Common Conditions for a Takeover Offer/Tender Offer

In general, the conditions to revoke a tender offer are strictly limited to items enumerated under the FIEA, and a tender offeror may only withdraw its tender offer in very limited circumstances. These circumstances include merger and demerger of the target company and failure to obtain regulatory approval on the tender offer, among others.

If an acquirer does not intend to acquire 100% ownership of a target company, they can set a maximum acceptance amount up to two-thirds of the voting rights in the target. If more than the maximum acceptance amount of shares is tendered, the acquirer will be required to purchase only the maximum acceptance amount propor-

tionately from each shareholder who tendered their shares. The maximum acceptance amount cannot be two-thirds or more, and if an acquirer intends to acquire two-thirds or more of the voting rights of the target, they must purchase all the shares tendered.

The authors will discuss the minimum acceptance condition in **6.7 Minimum Acceptance Conditions**.

6.6 Deal Documentation

If a public target company has major or founding shareholders, it is common for acquirers to make agreements with them prior to the tender offer. These agreements typically include shareholders agreeing to tender their shares to the tender offer and not withdraw their tender, as well as other covenants.

If a shareholder is in a position of control within the public target company, such as the CEO, they may provide representations and warranties regarding the business of the target company. However, these representations and warranties are usually limited to material matters compared to those in acquisition of private companies.

It is uncommon for public target companies to enter into a transaction agreement with acquirers in connection with the tender offer, unless there are other transactions related to the tender offer, such as a business alliance or share allotment.

6.7 Minimum Acceptance Conditions

It is common for an acquirer to set a minimum acceptance condition when attempting to acquire 100% ownership of a target company. This is usually done to ensure that the acquirer holds two-thirds or more of the voting shares of the target after the tender offer, which is the minimum threshold to ensure that the acquirer has enough voting power to pass the shareholders' resolution to squeeze out minority shareholders in Japan. However, there is no specific restriction under the law and the minimum acceptance condition can be any amount. If the minimum acceptance condition is not met, the acquirer will not proceed with the tender offer.

6.8 Squeeze-Out Mechanisms

See **6.3 Transaction Structures**.

6.9 Requirement to Have Certain Funds/Financing to Launch a Takeover Offer

As part of the notification of the tender offer, tender offerors are required to submit supporting documents that demonstrate the existence of funds. Typically, this includes a certificate that indicates the balance of the bank account if the tender offeror is using its own cash, an equity commitment letter if using equity finance, and/or a debt commitment letter if using debt finance.

Withdrawing a tender offer is strictly restricted to ensure market stability. If a tender offeror fails to obtain the necessary funds, this is not considered a valid reason for withdrawal. As a result, the tender offeror must proceed with the tender offer even if they are unable to obtain the necessary funds.

6.10 Types of Deal Protection Measures

In the case of a tender offer, a target company itself is not a party to the transaction. As a result, it is uncommon for the target company to enter into a transactional agreement with the acquirer and grant deal protection measures. However, in situations where a transactional document is entered into by major shareholders and the acquirer, certain deal protection measures such as non-solicitation and no-talk provisions may be agreed upon through negotiations.

6.11 Additional Governance Rights

As discussed in **6.7 Minimum Acceptance Conditions**, acquirers often use a minimum acceptance condition to acquire 100% ownership and squeeze out minority shareholders. Thus, it is uncommon for the bidder to not achieve 100% ownership and still be granted governance rights by the target after the completion of the tender offer.

6.12 Irrevocable Commitments

In the case of a company with principal shareholders, it is common practice to obtain irrevocable commitments from these shareholders to tender their shares in a tender offer. These commitments are understood as a contractual obligation and thus even if the shareholders fail to tender their shares in violation of the agreement, their shares will not be considered tendered, but the shareholders will only be held liable for any damages incurred by the acquirer.

Whether or not shareholders have the right to tender their shares in a competing tender offer in the event of an announcement of a competing offer depends on the negotiations among parties. Some principal shareholders may only be allowed to tender their shares in the competing tender offer if the competing offer price is higher than the original offer price by a certain amount. However, in other cases, principal shareholders are still obligated to uphold the initial commitments even after the competing offer is announced.

6.13 Securities Regulator's or Stock Exchange Process

As per the Companies Act and the FIEA, it is not mandatory for tender offers to obtain approval from the Financial Services Agency (FSA) or stock exchange in order to launch a tender offer. However, in practice, the FSA must review the notification of the tender offer (*koukai kaitsuke todokede sho*), and the relevant stock exchange must review the press release of the target company. The review period varies depending on the nature of the deal and the workload of the FSA and stock exchange, but typically takes a few weeks.

It is important to note that the FSA and stock exchange do not approve the offer price or other terms of the tender offer. However, they may request to elaborate on the notification as to why such offer price and terms are fair to the shareholders.

In case a competing offer is announced, the original tender offeror has the right under the FIEA to extend the tender offer period up to the last day of the competing tender offer.

6.14 Timing of the Takeover Offer

It is common for tender offerors to announce the tender offer first and then seek regulatory approvals during the tender offer period. In general, the tender offer period can be extended up to 60 business days by the offeror. After obtaining the regulatory approval, the notification of tender offer must be amended to reflect the changes. If such an amendment occurs within ten business days from the end of the tender offer period, the tender offer period must be extended to have at least ten business days from the amendment. In such cases, the total tender offer period can be extended beyond 60 business days.

7. Overview of Regulatory Requirements

7.1 Regulations Applicable to a Technology Company

When it comes to operating a business in the technology industry in Japan, it is important for companies to consider whether they need any specific licences or permissions related to their business. However, there are no general regulations that apply to all companies in this industry for setting up a new technology company and starting an operation.

Note that if a foreign investor wants to set up a technology company in Japan, they may need to file a notification with the relevant authority before or after setting up the company, depending on how the business of the company is categorised under the Foreign Exchange and Foreign Trade Act (FEFTA) in the context of Inward Direct Investment. For more information on this, refer to **7.3 Restrictions on Foreign Investments**.

7.2 Primary Securities Market Regulators

M&A transactions involving public companies in Japan are highly regulated by securities regulations under the FIEA, which is administered by the FSA. The FIEA covers a wide range of areas, including tender offers, public offerings, insider trading, and disclosures. Public companies are also required to adhere to the rules of the stock exchange they are listed on, such as the Tokyo Stock Exchange rule.

In addition, certain M&A transactions such as new stock issuance and statutory merger (but not for stock purchase) require corporate registry filing, regardless of whether the company is listed or unlisted. Corporate registry is overseen by the Ministry of Justice (MOJ), specifically the Legal Affairs Bureau.

For M&A transactions involving cross-border transactions, regulations under the FEFTA may be applicable (refer to **7.3 Restrictions on Foreign Investments** for more detailed information). The relevant ministries overseeing these regulations depend on the business of the target company, such as the Ministry of Finance (MOF) and the METI. Sometimes more than one ministry has overlapping jurisdiction over the same case.

It is also important to note that M&A transactions that substantially restrain competition may be subject to the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (the "Anti-monopoly Act"). These transactions are regulated by the Japan Fair Trade Commission (JFTC).

7.3 Restrictions on Foreign Investments

Pre-investment Notification

Under the FEFTA, in general, if foreign investors intend to acquire shares of a private company or 1% or more of shares or voting rights of a listed company in Japan (known as "Inward Direct Investment"), and such target company or its subsidiaries engage/s in the restricted business identified in the FEFTA, subject to certain exceptions, the foreign investors are required to file prior notification with the MOF and the competent ministries through the Bank of Japan (BOJ). Until 30 days after the receipt of the filing by the BOJ, the applicant must not consummate the transaction, but that period may be shortened if the transaction does not impair the national security or may be extended up to five months to conduct further investigation. If the transaction is considered to impair the national security, the MOF and the competent ministries may require the modification of the term of the transaction or cancellation of the transaction.

The scope of the restricted business was expanded in May 2019 and now includes computer development, software development and information services. Therefore, in many cases involving the investment in technology companies in Japan, this pre-investment filing requirement would be triggered, even if it involves a small investment acquiring only a limited amount of shares in the company.

Post-investment Notification

Foreign investors who were subject to pre-investment notification and completed a transaction after the waiting period must report the transaction's consummation to the MOF and competent ministries through the BOJ. Separately, even if the target company does not engage in any restricted business and therefore did not require pre-investment notification, foreign investors may still need to file a post-acquisition notification under the FEFTA.

7.4 National Security Review/Export Control

As mentioned in **7.3 Restrictions on Foreign Investments**, restrictions on foreign investments also function as a national security review.

In addition to the foreign investments regulation, the FEFTA also regulates export control. The FEFTA requires prior approval by the METI for an export of certain listed items (such as weapons) and provision of certain listed technologies (such as technologies related to weapon manufacturing) outside of Japan, regardless of the amount of consideration payment involved. Additionally, the FEFTA has a catch-all regulation provision that allows items and technologies not specifically listed under the act to be subject to approval by the METI if they can be used to develop or manufacture weapons.

7.5 Antitrust Regulations

Under the Anti-monopoly Act, certain M&A transactions are subject to a prior notification with the JFTC. If an acquirer intends to hold more than 20% or 50% of the voting rights in the target company, and an acquirer and its group companies have aggregated domestic sales of more than JPY20 billion and a target company group has aggregated domestic sales of more than JPY5 billion, prior notification obligation will be triggered.

After the JFTC accepts the notification, the parties generally cannot implement the transaction during the 30 calendar days that follow. This means that in practice, the notification must be filed at least 30 days prior to the contemplated closing date. Furthermore, it is customary to consult with the regulator in advance of filing to ensure that every entry is in order and the filing will be accepted on the filing date.

If it is obvious that the transaction will not substantially restrain the competition in a particular market, and the filing company requests to shorten the waiting period in writing, the waiting period may be shortened.

7.6 Labour Law Regulations

Since share purchase is the most customary method for the acquisition, labour law regulations do not have material impact in most of the transactions. However, labour laws take an important role in carve-out deals where the target company will be carved out from another company by way of company split or business transfer.

7.7 Currency Control/Central Bank Approval

There is not any particular currency control regulation (other than payment reporting which

is normally handled by banks) that applies to M&A transactions. However, as discussed in **7.3 Restrictions on Foreign Investments**, there is some pre-transaction and post-transaction reporting regulation regarding Inward Direct Investment via the Bank of Japan.

8. Recent Legal Developments

8.1 Significant Court Decisions or Legal Developments

The "Guidelines for Corporate Takeovers" were created by the METI in August 2023 in addition to the Fair M&A Guidelines published in June 2019. While the Fair M&A Guidelines mainly focused on M&A transactions that involved conflicts of interest (such as a management buy-out (MBO)), the Guidelines for Corporate Takeovers cover M&A transactions of public companies by share acquisitions among independent parties, including hostile transactions. The Guidelines provide best practice for the targets' boards and acquirers.

Additionally, the FSA established a working group to consider amending rules regarding tender offers and shareholding reporting obligations in June 2023. Discussions regarding tender offer regulations include expanding the scope of mandatory tender offers to cover in-market transactions and share allotments, as well as lowering the threshold for mandatory tender offers. Discussions on shareholding reporting obligations include clarifying the scope of material proposals that currently require specification but have ambiguity.

9. Due Diligence/Data Privacy

9.1 Technology Company Due Diligence

In M&A transactions, target companies are expected to reveal certain information to potential buyers. This can include their articles of incorporation, financial statements, information about their shareholders, details about their major contracts and assets, and information related to compliance and disputes. For public companies, some of this information is already publicly available, so the scope of due diligence can be limited to high level issues.

It is important to note that target companies are not required to disclose the same information to every potential buyer. In fact, it is common for sensitive information to only be shared with a "clean team" of bidders who are not part of the related business department. This helps to avoid any violations of gun-jumping regulations.

During the legal due diligence process, it is common to conduct a public search for any intellectual property and to review any material licence agreements. However, a detailed technology due diligence is not typically part of the process.

9.2 Data Privacy

In general, the consent of the holder of the personal information is required if the personal information is to be shared with third parties. However, if the personal information is to be shared in connection with the merger, demerger and business transfer, it will not be regraded as sharing with the third parties and hence the consent of the holder of the personal information will not be required. However, this exception does not apply to stock purchase transactions, including tender offer, which is the most popular scheme of acquisition in Japan.

10. Disclosure

10.1 Making a Bid Public

When a publicly listed company decides to proceed with a tender offer, it is required to issue a press release regarding the offer. In the case of a friendly tender offer, the target company will typically announce its opinion on the offer on the same day that the offeror makes its press release. Under the FIEA, the tender offer officially begins when the offeror makes public notice of the offer. Typically, this public notice is made one business day after the decision to offer. On the same day as the public announcement, the offeror must file a tender offer registration document with a local financial bureau, which will then be made available online.

10.2 Prospectus Requirements

In a case when the stock of the acquirer that is a listed company is used as consideration, the acquirer is required to issue securities registration statements. The buyers' shares need not be listed on a specific exchange but as a practical matter, if such shares do not have sufficient liquidity, sellers rarely accept such an offer.

10.3 Producing Financial Statements

In a transaction involving a tender offer, the bidder is required to provide its financial statements in the tender offer registration statement, regardless of the type of consideration. These financial statements must be prepared according to certain accounting standards permitted under the Regulation for Terminology, Forms and Preparation of Financial Statements, including Japanese Generally Accepted Accounting Principles and International Financial Reporting Standards. However, if the offeror is a foreign entity and cannot provide financial statements in accordance with any of these, it may provide financial statements prepared using the generally accepted accounting principles of its home country, along with an explanation of any differences.

In cases where the filing of a securities registration statement is required, the acquirer must also disclose its financial statements in the registration statement.

10.4 Disclosure of Transaction Documents

In a tender offer registration document, the acquirer must disclose the material terms of the transactional documents related to the tender offer. This includes any agreements between the acquirer and major shareholders, where the material terms such as irrevocable commitment must be disclosed, but full disclosure of the documents is not required.

For business reorganisations, such as mergers, demergers, and share exchanges under the Companies Act, the full disclosure of statutory agreements, such as merger agreements, demerger agreements, or share exchange agreements, is required. However, in practice, parties typically enter into separate definitive agreements and keep the statutory agreement as simple as possible.

11. Duties of Directors

11.1 Principal Directors' Duties

Under the Companies Act, directors have a duty of care and a duty of loyalty towards the company. It is understood that these two duties are not separate, and that a duty of loyalty is included within the duty of care. The duty of care includes a duty to not compete and to avoid conflict of interest transactions.

In practice, when it comes to making business judgments, courts will not find a violation of the duty of care if the directors were not careless in recognising the relevant facts, and if both the decision-making process and the substance of the decision are not excessively unreasonable. This is known as the business judgment rule, which is generally applicable to decisions concerning M&A transactions.

11.2 Special or Ad Hoc Committees

In M&A transactions where there is a potential conflict of interest, such as an MBO or acquisition of 100% ownership by a controlling shareholder, target companies often establish a special committee to review the terms of the transaction. The board typically resolves beforehand that they will respect the decision of the special committee as much as possible, and they will not agree with the transaction if the special committee finds the terms and conditions to be unreasonable.

In practice, special committees have active discussion on terms and conditions of the transactions, especially the purchase price. The extent of their involvement in the negotiation varies depending on the nature of the transaction and the members of the special committee. In some cases, the special committee directly negotiates with the counterparty, while in many cases, they provide their opinions to the management during negotiations.

11.3 Board's Role

When a company receives a tender offer, its board must make a statement regarding the offer, indicating whether or not they agree with it and whether they recommend that shareholders tender their shares in the offer. Thus, in friendly tender offers, the offeror usually negotiates with the board or special committee to obtain a favourable opinion. If there is a special committee, the board is not expected to be actively involved in negotiations, but if there is no special committee, the board should be actively involved.

The business judgment rule generally applies to the board's decision in M&A transactions, so shareholders rarely challenge it in court. However, in the squeeze-out process (both in squeeze-out right type and share consolidation type), shareholders can exercise their appraisal right if they disagree with the consideration price offered by the acquirer. This allows them to contest the price and request a judicial review of the valuation. Therefore, acquirers should provide a well-documented and thorough explanation of their valuation and the justifications for the offered price to avoid the exercise of appraisal rights.

11.4 Independent Outside Advice

It is customary for directors of a target company to seek advice from financial, tax, and legal advisors when considering a tender offer or business combination. In some cases, especially in a large-size acquisition of 100% ownership by a controlling shareholder, the special committee may have its own advisors as well.

In M&A deals involving public companies, a valuation report is almost always obtained from an independent outside financial adviser. Obtaining a fairness opinion has not been prevalent in Japan. However, since the Fair M&A guideline supported the effectiveness of the fairness opinion subject to certain conditions, the number of cases obtaining the fairness opinion is increasing, especially in MBO transactions and acquisition of 100% ownership by a controlling shareholder.

Trends and Developments

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Mori Hamada & Matsumoto is one of the largest full-service Tokyo-headquartered international law firms, with more than 700 lawyers, including more than 150 foreign lawyers. Its corporate M&A team consists of approximately 200 lawyers. The firm has offices in Tokyo, Osaka, Nagoya, Fukuoka, Takamatsu, and Sapporo and international branch offices in Singapore, Shanghai, Beijing, Bangkok (Chandler MHM Limited), Yangon (Myanmar Legal MHM Limited), Ho Chi Minh City, Hanoi, Jakarta (ATD Law), and New York. The firm's M&A practice handles mergers, acquisitions, restructurings, and corporate alliances in a wide variety of industries and sectors, including domestic and cross-border transactions; listed company, private equity, and venture capital transactions; friendly and unsolicited transactions; going-private transactions; MBOs; acquisition finance; and takeover strategies. Mori Hamada & Matsumoto also has a strong TMT practice group which regularly provides advice on issues involving technology businesses including data protection, IP, IT, and financial, mobility, and telecommunication regulations.

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MORI HAMADA & MATSUMOTO

The Latest in Japanese Tech M&A

Despite the worldwide decline in M&A deals in 2023, M&A activities in Japan remain strong. According to RECOF, while the total number of deals was down by 10.8% from the same period of the year in 2022 which hit a record-high number of transactions in Japan's M&A history, the total value of general M&A transactions in the first ten months of 2023 grew 12.8% to JPY10.5734 trillion. It is anticipated that the number of transactions will continue to grow towards the end of the year. In particular, outbound transactions which grew 3.9% in number and 60.0% in value from last year seem to be the main driver of the increase. In-in transactions also stay strong, which are down by 12.6% in number but have a 79.6% increase in value. Inbounds seem to be relatively weak, recording both a 19.6% decrease in number and a 73.8% decrease in value.

Technology M&A is one of the main areas driving the current trends. Two going-private deals involving Toshiba, a leading electronics and infrastructure conglomerate, and JSR, a semiconductor materials manufacturer, are the top two 2023 Japanese M&A deals in value to date. Larger technology companies continue to sell their non-core businesses through carve-out deals, and private equity funds are active in seeking opportunities to invest in such carved-out businesses. The acquisition of technology start-ups through trade sales is still not a strong trend in Japan, but the firm has seen some remarkable cases where up-and-coming tech ventures were selected to become a part of larger, sometimes global, strategic buyers.

Factors driving M&A activities

Low growth rate of Japan's economy

The low growth rate of the domestic economy, especially after the end of COVID-19, urges companies to enter growing overseas markets through acquisitions. While large-sized, public companies have been the main players in outbound transactions, mid-sized and private enterprises are becoming more active in seeking investment opportunities abroad despite the challenge in procuring funds in foreign currency due to the current low exchange rate of the Japanese yen.

Aging population

The rapidly aging population of Japan is causing a decrease in consumer confidence in the domestic market, which not only is another factor driving companies to seek opportunities in foreign markets but also justifies business integration between players in the same industry. Currently, a decreasing workforce is causing a severe lack of manpower in some industries, and M&A transactions are used to procure manpower or to optimise the allocation of the workforce among different business units.

Low interest rate

Unlike the increase in interest rates in the US and Europe in response to rapid inflation, Japan's interest rate is still kept extremely low by the Bank of Japan, the country's central bank. This provides a favourable environment for the procurement of funds for acquisitions by strategic and financial investors. The difference in interest rates between Japan and other countries led to the exchange rate of the Japanese yen dropping to a record low level and makes the total value of Japanese companies look considerably low if converted to a dollar or euro value. This may potentially be a factor that could attract more inbound transactions in the near future although, as explained above, inbound transactions do not seem to have been bolstered so far.

Policy of Tokyo Stock Exchange

In March 2023, the Tokyo Stock Exchange (TSE) made a surprising move when it requested listed companies to take "actions to implement management that is conscious of the cost of capital and stock price". The announcement included a strong request for companies with less than one price-to-book-value ratio (PBR) to establish and implement roadmaps to improve their PBR. The management of such low-PBR listed companies is now under strong pressure to consider various strategic options to strengthen their companies' profitability and optimise the cost of capital, which should include realising growth through M&A transactions. The TSE's request may also result in an increase in management buyouts by urging certain companies to temporarily put themselves in a more flexible management environment in order to improve their capital efficiency.

Continuing trends of shareholder activism

The shareholder activism continues to grow in 2023. Indeed, the activist shareholders played a significant role in both the Toshiba and JSR deals. Together with the request from the TSE, presence of activists and growing acceptance of activism by other shareholders will urge the companies to consider decisive strategic options including M&A transactions to improve capital efficiency.

Environmental, social and governance (ESG)

As the issue of sustainability has been brought to the centre of attention nation-wide, the government, investors and consumers expect companies to take concrete actions toward achieving sustainability in their businesses. The 2021 amendment to the Corporate Governance Code by TSE also requested listed companies to implement and disclose policies addressing sustainability issues.

Japanese companies are active in transforming their businesses into environmentally sustainable ones. Companies that historically heavily relied on fossil fuels such as energy companies and trading houses are trying to "de-carbonise" their businesses by making enormous investments in renewable energy projects inside and outside of Japan. While the Japanese car industry was relatively slow in electrifying its product line-ups, major Japanese car manufacturers, Toyota, Nissan and Honda, together with their suppliers, have recently been investing trillions of yen in developing new technologies and securing supplies of essential parts and components including batteries for their battery EVs. Also, the electrification of vehicles is leading to new types of collaboration between mobility and electronics industries. Sony Honda Mobility which was established in 2022 as a 50/50 joint venture between Sony and Honda is a good example of this new movement.

Recent developments in laws relating to Technology M&A

Guidelines for Corporate Takeovers

In August 2023, the Ministry of Economy, Trade and Industry (METI) published the "Guidelines for Corporate Takeovers – Enhancing Corporate Value and Securing Shareholders' Interests" (the "Guidelines") as the result of discussions at its Fair Acquisition Study Group which was launched in 2022. The Guidelines contemplate setting best practices for management members and boards of directors of publicly listed companies in responding to and considering takeover offers, including unsolicited offers, by:

- establishing three principles that must be respected in considering takeover offers, namely:
  - (a) enhancement of corporate value and shareholders' common interests;

(b) respecting shareholders' intent; and
(c) ensuring transparency;

- setting a code of conduct for the company's management and board of directors in responding to takeover offers;
- emphasising the importance of transparency of the takeover proposals for both acquirer and the target company; and
- setting a framework for companies in establishing takeover response policies and countermeasures.

One of the key messages of the Guidelines is the need for directors and management members of public companies to consider bona fide takeover offers sincerely and place a stronger emphasis on shareholders' intent and common interest when considering proposals. Remarkably, the Guidelines urge company management to seriously consider an offer even where the company did not solicit the offer, with METI recognising the rapid increase in unsolicited takeover efforts in Japan, considering that unsolicited or hostile takeovers were not common until the 2020s. While the Guidelines are not mandatory, they are expected to form the standards for directors in dealing with takeover proposals and courts are likely to refer to them when scrutinising whether directors fulfilled their fiduciary duties. The Guidelines have already started affecting the conduct of Japanese technology M&A players – for example, NIDEC, which manufactures electric motors, made an unsolicited takeover proposal to Takisawa, a machine tool maker, in July 2023 in accordance with the process recommended in the Guidelines, although only a draft thereof was published by METI at that time. Takisawa's board eventually accepted NIDEC's offer.

Upcoming reform to tender offer and large shareholding disclosure regulations

The Financial Services Agency commenced discussions to reform the regulations on tender offers and disclosure requirements for large shareholdings, including applying mandatory tender offer rules to the acquisition of shares of a listed company by trading in the share market and revising large shareholding disclosure rules to enhance transparency in the acquisition of a significant number of voting rights of listed companies. If the discussions lead to actual reforms of the tender offer and large shareholding regulations, that development will significantly affect public M&As.

Foreign investment regulations

Given the recent geopolitical situations surrounding Japan, including economic decoupling with China and Russia, Japan has been reinforcing government scrutiny over foreign investments. In 2020, the Japanese government broadened the scope of transactions which require notification to regulators by lowering the threshold for the acquisition of listed shares from 10% to 1% and increasing the type of actions that need notification (including appointment of a director). Since 2019, it has also been expanding the scope of businesses in which an acquisition by a foreign investor would require prior notification to the regulators. The expanded list of such businesses includes, among others, certain types of IT and software businesses, semiconductor-related businesses, telecommunication businesses, and healthcare-related businesses. According to the statistics released by the Ministry of Finance in June 2023, more than 60% of the prior notifications made in fiscal year 2022 were for cybersecurity-related businesses (ie, information technology, software and semiconductor).

The requirement for prior notification does not only affect the timeline of transactions, but may also affect deal certainty. While there has only been one case in history where the Japanese government blocked an M&A transaction using foreign investment regulations, the author understands that there have been cases where the transactions were voluntarily withdrawn due to conditions imposed by regulators before giving clearance to the transactions.

Economic Security Promotion Act

In May 2022, Japan enacted the Act on the Promotion of National Security through Integrated Economic Measures (the Economic Security Promotion Act). The law introduced a screening system for the instalment or operation of critical facilities by businesses designated by the government as critical infrastructure businesses (ie, electricity, gas, crude oil, water, railroads, freight forwarding, ocean freight, aviation, airports, telecommunications, broadcasting, postal services, financial services, and credit card businesses). A foreign acquirer of a critical infrastructure business in Japan must consider whether the screening system could be a barrier in operating the target business after the transaction, as the regulator may take into account the nationality and other attributes of the foreign acquirer in considering whether to allow or block the acquisition.

The Economic Security Promotion Act also provides that the government supports (i) the stable supply of materials that are critical to the economic security of Japan, such as semiconductors, batteries, and cloud programs, and (ii) the development of advanced technologies. The increasing importance of economic safety and the support programmes being implemented by the Japanese government will affect a company's investment to strengthen its supply chain for these critical materials and technologies. The effect can already be seen from recently announced projects for building new large-sized semiconductor fabrications in Japan, one of which is under construction in Kumamoto by a joint venture between TSMC, a Taiwanese semiconductor manufacturer, and Sony. Another one is being planned in Hokkaido, which will be undertaken by Rapidus, a new company funded by the Japanese government and eight major Japanese companies. The advanced technologies identified by the government also include technologies to utilise outer space such as using a constellation of small satellites.

Growing calls to regulate artificial intelligence

Japan's legal environment is considered by developers to be friendly to the development of artificial intelligence (AI). The 2018 amendment to the Copyright Act introduced a new exemption from copyright infringement which enabled the utilisation of copyrighted work for the purpose of analysing information for AI development. Compared to recent moves in Europe and the US to regulate the development and usage of AI, Japan is slow in implementing comprehensive regulations relating to the development of AI technologies. However, as the chair of the G7, Japan co-ordinated the international guiding principles for developers of advanced AI systems released in October 2023, and the contents of the guidelines for the development and utilisation of generative AI in Japan to implement the guiding principles are currently under discussion. Close attention should continue to be paid to future legal developments in this area.

Business and human rights

When the Japanese government issued "the Guidelines on Respecting Human Rights in Responsible Supply Chains" in September 2022, "business and human rights" had already

become an important topic in Japan just like in many other countries. Companies are ever more aware of the need for human rights due diligence and to pay due attention to human rights issues when making decisions in M&A transactions.

Conclusion

The current strong trend of M&A in Japan is likely to continue in the near future as some of the factors driving such trend have roots in the long-term circumstances affecting Japanese society. Also, as far as can be expected at this moment, the macroeconomic situation in Japan will not drastically change. The recent reforms to the regulations or guiding principles for M&A transactions will definitely affect M&A practices in general. At the same time, regulations affecting the technology sectors continue to develop in response to rapid changes in geopolitical and social situations and the emergence of new technologies like generative AI that may change modern human life in its entirety.

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