MORI HAMADA & MATSUMOTO

Doing the best for our clients!

Mergers & Aquisitions
Capital Markets
Structured Finance
Banking
LBO Finance
Private Equity
Asset Management / Investment Trust / J-REIT

Venture Capital / Start-ups
Corporate Governance
Labor & Human Resources
Competition / Antitrust
Real Estate
Environment & Climate Change

Compliance
Financial Regulations
Other Regulations / Consumer Laws

Bankruptcy / Restructuring

Litigation / ADR
International Dispute Resolution
Criminal Defense

Intellectual Property / Entertainment
IT

Tax

China Practice
Asia Practice
EU Practice

Mori Hamada & Matsumoto is one of the largest full-service law firms based in Japan, offering legal expertise in a comprehensive range of practice areas.

Tokyo · Beijing · Shanghai

Marunouchi Park Building
2-6-1 Marunouchi, Chiyoda-ku, Tokyo 100-8222, Japan
Tel: 81 3 6212 8330 (PR) E-mail: mhm_info@mhmjapan.com

The Foreign Exchange and Foreign Trade Law

Seiji Akimoto of Mori Hamada & Matsumoto provides an overview of the law, its recent amendments and its effect on inward direct investment

In May 2008, the Japanese Ministry of Finance (MOF) and the Ministry of Economy, Trade and Industry (METI), acting pursuant to the Foreign Exchange and Foreign Trade Law (FEFT), ordered The Children's Investment Master Fund (TCI) to halt further acquisition of the shares of electric power wholesaler Electric Power Development (J-Power). Both MOF and METI based their rulings on the grounds that there was a possibility that, through TCI's further acquisition of J-Power's shares, the management of J-Power might be affected. This change in management could then affect the stable supply of electric power and Japan's nuclear and nuclear fuel cycle-related policies. The case appears to be the only instance in which Japanese authorities have issued an order prohibiting investment into a Japanese company. However, it is essential for foreign investors contemplating making an investment into a Japanese company (whether listed on a stock exchange or not) to have an understanding of the regulation regarding inward direct investments by foreign investors. Amendments to the Cabinet Order of the FEFT came into effect in 2007 and 2009 that may have significantly impacted foreign investors. As well as providing an overview of the regulation under FEFT, this article highlights a few key points of the amendments and offers some practical tips as well.

Regulation under FEFT

There are a number of rules and regulations that foreign investors need to be aware of when considering an investment into a Japanese company. These include tender offer regulation and the requirement to file a large shareholding report under the Financial Instrument and Exchange Act (FIEA) and a report regarding the acquisition of shares under the Anti-monopoly Act. There are also some industry-specific laws that limit foreign ownership of Japanese shares. In addition to these rules and regulations, the FEFT contains general regulations that are broadly applicable to investments into Japanese companies by foreign investors.

As a basic rule, the FEFT requires foreign investors purchasing shares in a Japanese company to make a filing when certain thresholds are crossed. Whether the filing is required before or after the transaction generally depends on the type of industry that the foreign investor is investing in.

Under the law, foreign investor means any one of the following who makes an inward direct investment, as defined in the FEFT:

(i) an individual who is a non-resident;

(ii) a juridical person (for example, corporation) or other organization (for example, a fund) established pursuant to foreign laws and regulations, or a juridical person or other organization with its principal office in a foreign state;

(iii) a corporation of which the ratio of the sum of the number of voting rights directly held by

"The FEFT provides different criteria for the filing requirement of reports with listed shares and non-listed shares"

> "The 2007 amendments were designed to tighten regulation, the 2009 amendments to encourage inward investment"

those listed in items (i) and (ii) and the number of voting rights specified by Cabinet Order as those indirectly held through other corporations to the number of voting rights of all shareholders of the corporation is 50% or more; and

(iv) a juridical person or other organization in which persons as listed in item (i) occupy the majority of either the officers (meaning directors or other persons equivalent thereto) or the officers having the power of representation.

Although the term "Inward Direct Investment" covers a broad variety of transactions (including establishing a branch office in Japan and loaning money to an entity with its principal office in Japan), this article focuses on acquisitions of listed and non-listed shares in Japanese companies by foreign investors.

Post-transaction filing requirement

If the target company's business is not within the businesses that require a pre-transaction filing as discussed below, if a foreign investor acquires shares of a listed company in Japan, and because of this, the investor directly or indirectly holds in aggregate 10% or more of the issued shares of the relevant company, the foreign investor is required to report (through the Bank of Japan) the acquisition to the Finance Minister and other relevant Ministers by the 15th day of a month following the month in which such acquisition was made. This date was introduced as part of amendments to the rules under FEFT in 2009. Before the amendment, the report had to be made within 15 days from the date on which an inward direct investment was made.

When calculating the number of shares held, those shares that are held by entities that have a "special relationship" with the foreign investor will be aggregated. Entities that have a special relationship with the foreign investor include controlling entities, controlled entities and entities under the common control with the foreign investors. The precise definition of special relationship is relatively complicated, and it would be advisable for foreign investors to carefully examine the scope of "special relationship" before making investments, especially if the foreign investor is a fund with number of sister funds.

If the target company's business is not within the businesses that require pre-transaction filing, if a foreign investor acquires shares of a non-listed company in Japan from any individuals or entities other than foreign investors, and as a result of such acquisition the foreign investor directly or indirectly holds in aggregate 10% or more of the issued shares of the relevant company, it is required to report (through the Bank of Japan) the acquisition to the relevant Ministers by the 15th day of a month following the month in which such acquisition was made. Again, shares that are held by entities that have a special relationship with the foreign investor will be aggregated in calculating the number of shares held.

Although the filing requirements regarding the acquisition of listed shares and non-listed shares appear quite similar, they are different. An acquisition of shares in a non-listed company by one foreign investor to another is not treated as an Inward Direct Investment, regardless of the number of the shares to be acquired. Thus, the requirement to file an Inward Direct Investment Report after the transaction is not applicable in such a case. However, a Capital Transaction Report will be required if one of the foreign investors is a resident and the other is a non-resident

For example, transferring 100% of the issued shares of a non-listed company in Japan from a US private equity fund to a UK private equity fund is not an Inward Direct Investment. But if a foreign investor acquires 10% or more of the issued shares in a listed company in Japan from another foreign investor, it does constitute an Inward Direct Investment and the acquiror needs to file an Inward Direct Investment Report in accordance with the FEFT.

The form of the report for post-transaction filing is fairly simple, and the items needed to be stipulated in the report are limited. These

About the author

Seiji Akimoto is an attorney with Mori Hamada & Matsumoto. His areas of practice include corporate, private equity and M&A, with particular focus on cross-border transactions. Seiji was admitted to the Bar in 2002 in Japan and in 2009 in New York. He graduated from the University of Tokyo (LLB, 1999) and the University of Chicago Law School (LLM, 2009). He worked at Kirkland & Ellis LLP from 2008 to 2009.

Contact information

Seiji Akimoto
Mori Hamada & Matsumoto

Marunouchi Park Building
2-6-1 Marunouchi, Chiyoda-ku
Tokyo 100-8222, Japan
Tel: +81 3 5220 1818
Fax: +81 3 5220 1718
Email:
seiji.akimoto@mhmjapan.com
Web: www.mhmjapan.com

include the number of shares acquired, the purchase price and the shareholding ratio in the target company, but they do not include the purpose of the investment or names of the shareholders or investors of the foreign investor. In addition, the filed reports are not publicly available. The reports can be submitted by hand but are generally sent to the Bank of Japan by mail. Electric filing (for example, EDINET) is not available.

Pre-transaction filing requirements

Pre-transaction filing requirements apply to investments into companies in Japan engaged in certain businesses (telecommunications, broadcasting, electricity, gas or oil. See TCI case discussed above). As discussed below, the list of businesses that require pre-transaction filing was expanded in 2007.

If a foreign investor plans to acquire shares of a listed company in Japan engaged in a regulated business, and as a result would directly or indirectly hold in aggregate 10% or more of the issued shares of the company, a prior notification must be submitted to the relevant Ministers within six months before the scheduled acquisition. Before the rule under the FEFT was amended in 2009, a prior notification had to be submitted to the Finance Minister and the other relevant Ministers within three months before the scheduled acquisition

A foreign investor who has given prior notification cannot complete a direct domestic investment for 30 days, from the day of receiving the notice by the relevant Ministers. In practice, this period is normally shortened to two weeks. Shares that are held by entities that have a special relationship with the foreign investor will be aggregated in the same way as they are in the post-transaction filing requirement.

If a foreign investor acquires shares of a non-listed company in Japan engaged in the regulated businesses from any individuals or entities other than foreign investors, it must submit a prior notice to the relevant Ministers within six months before the acquisition. The number of the shares to be acquired is not an issue here; purchasing one share will trigger the pre-transaction filing requirement. The 30-day waiting period (generally shortened to two weeks) is also applicable.

Extending the waiting period

Where the relevant Ministers have received prior notice, they can extend the period in which inward direct investment pertaining to the notice is prohibited up to five months from the acceptance of the notice if they find it necessary to examine whether the proposed inward direct investment will fall under certain types of inward direct investments listed in the FEFT. These investments include those that are likely to impair national security, disturb public order, hinder public safety or adversely effect the smooth management of the Japanese economy. The relevant Ministers may also order the foreign investor to change the content of its inward direct investment or to discontinue it under certain circumstances.

Although the consequences of the prior notification can be significant, its form is fairly simple. Items to be provided in the notification include: (i) purpose of acquisition, (ii) means of participation in management in connection with acquisition, (iii) business plan after acquisition and (iv) treatment of business falling under business type subject to prior notification. As in the post-transaction filing requirement, the filed reports are not publicly available. The reports can also be submitted by hand but are generally sent to the Bank of Japan by mail. Electric filing, such as EDINET, is not available.

Amendments in 2007 and 2009

The rules under the FEFT regarding inward direct investment were amended in 2007 and 2009. The 2007 amendments were designed to tighten regulation under the FEFT, while the 2009 amendments were made to encourage inward investments by foreign investors. From a foreign investor's point of view, the 2007 amendments have had a more significant impact. According to a press release by the METI, the purpose of the 2007 amendments was to prevent the outflow of important technology related to weapons of mass destruction and the resulting damage to Japan's defence production and technology infrastructure.

The list of businesses that require prior notification was expanded to cover:

(i) industries manufacturing dual use items relating to weapons of mass destruction;

(ii) industries manufacturing highly sensitive general-purpose items relating to conventional weapons; and

(iii) industries manufacturing materials, accessories or equipment specially designed for the production of arms or aircraft (including the software business related to programs specially designed for use in arms and/or satellites).

In cases in which regulated businesses are conducted by a consolidated subsidiary, inward direct investment to the parent company that controls such subsidiary has been added to the scope of the regulations. Because of this, foreign investors need to examine the subsidiaries' type of business as well as the business of the target company itself before making an investment.

According to a press release from the MOF and other Ministries, the purpose of the 2009 amendments to the rules under the FEFT was to reduce the clerical burden on foreign investors and to encourage inward direct investments. These amendments include extension of the reporting period as mentioned above.

Practical tips

Japanese companies list the businesses they are engaged with in their articles of incorporation. Foreign investors also may discover a target's business by looking at its corporate register, which is publicly available. The Bank of Japan, however, has indicated that whether a company engages in a regulated business should be determined not only by its stated business but also by a company's actual operations. Foreign investors need to carefully examine both a company's reported and observable activities in order to assess whether a company is engaged in a regulated business.

The number of issued shares (including the amount of treasury stock) of Japanese companies is publicly available information, so those who acquire shares may easily know if a planned investment will exceed the applicable threshold by dividing the number of the shares they intend to acquire by the number of issued shares.