Watch your step

Yoshinori Ono and Masataka Sato of Nishimura & Asahi explain how to avoid the pitfalls of acquiring a Japanese public company

In late January 2010, a Japanese enterprise announced that it intended to acquire a 37.8% interest in a Japanese listed company that was held by a US holding company (on behalf of a US enterprise). This was noteworthy because Japanese law with respect to tender offer regulations, under the Financial Instruments and Exchange Act (FIEA), requires that an acquisition of over one-third of the shares of a company that is listed (or that must otherwise file securities reports) must be made through a tender offer.

In this case, since the acquirer intended to acquire the shares of the target by acquiring the US holding company from its parent US enterprise, the literal language of the FIEA does not seem to require a tender offer for the acquisition. However, the Financial Services Agency (FSA) has generally been thought to be concerned about this potential loophole in the tender offer regulations.

It was not surprising when, on February 12 2010, the acquirer announced that following consultations with, and instructions from, the FSA, it would decrease the number of shares which it intended to acquire to 31.1% of the target company. According to the press, the FSA also indicated to the acquirer that its initial plan may have violated the tender offer regulations.

On February 15, the FSA published a revised edition of its Q&A about tender offers, which provide a general interpretation of the tender offer regulations. According to the Q&A, although the acquisition of an asset managing company which holds over one-third of shares of a listed Japanese company (or a company that is otherwise required to file securities reports in Japan) is not strictly the same as directly acquiring the shares of such a company and a literal reading of the FIEA could lead one to argue that tender offer regulations do not apply to the former, a tender offer must be made for such an acquisition if the transaction is deemed to be substantively an acquisition of the shares of the target company.

This is after taking into consideration the value of assets held by the asset managing company other than the shares of the target company and the true extent of the business operations conducted by the asset managing company.

As this case illustrates, investors should exercise due care when acquiring a Japanese listed enterprise or otherwise engaging in M&A transactions in Japan.

> "An acquisition of over one-third of the shares of a company that is listed (or that must otherwise file securities reports) must be made through a tender offer"

Wholly-owned subsidiaries

Tender offer and squeeze-out

A typical structure used by a foreign investor to acquire a Japanese listed company (target company) as a wholly-owned subsidiary is to: establish an overseas or Japanese SPC for the acquisition; cause the

SPC to conduct a tender offer for the target company; and conduct a squeeze-out after acquiring two-thirds of the shares of the target company by making a cash payment to shareholders of the target company who did not respond to the tender offer.

If two-thirds or more of the target company's shares are acquired through a tender offer, the remaining shares of the target company may be acquired by (i) a cash-out of minority shareholders through cash merger or cash share exchange; or (ii) a cash-out of minority shareholders by converting their shares into shares that are convertible by the company. The latter method is now generally used for squeeze-out transactions in Japan since it is more tax efficient.

Triangular merger/share exchange

Generally in Japan, acquirers purchase the shares using cash when acquiring shares through a tender offer followed by a squeeze-out of minor shareholders remaining after a tender offer. However, under Japanese law, it is also possible to acquire shares of a Japanese enterprise using shares of another company as consideration.

The transactions in which shares are used as consideration are: (i) a triangular merger, where a foreign enterprise (foreign parent company) establishes a subsidiary in Japan (Japanese subsidiary) to be the surviving company, and shares of the foreign parent company are given as consideration to the shareholders of the target company; and (ii) a triangular share exchange, where shares of the parent of the acquirer are given as consideration to the target's shareholders in exchange for their shares of the target.

"In practice the acquirer often consults with the JFTC before making the prior notification"

Although the shares of the foreign parent company that are given to the shareholders of the target company are not required to be listed on the Japanese market under Japanese law, if the target company is a Japanese listed company, shareholders of the target company may not wish to receive shares of the foreign enterprise that are not listed on the Japanese market.

They may, therefore, oppose receiving them at the shareholders meeting of the target company. In addition, there is also the practical issue of delivering the shares of the foreign parent company to the shareholders of the target company in Japan, and managing them.

Accordingly, although it is not a statutory requirement, in order to conduct a triangular merger or a triangular share exchange using shares of a foreign parent company as consideration, it may be necessary to have the shares of the foreign parent company listed on the Japanese market.

Foreign investment regulations

Foreign Exchange and Foreign Trade Act

Under the Foreign Exchange and Foreign Trade Act (FEFTA), in order to acquire 10% or more of the shares of a company listed in Japan or to acquire shares or an interest in an unlisted company from a party other than a foreign investor, prior notification must be provided to the Japanese government if the target company engages in regulated business:

(i) business related to national security (manufacture of arms, aircraft, satellites, nuclear reactors, nuclear power generators or similar items);

(ii) business related to public order or public safety (manufacture of narcotics, security service or sim-

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ilar areas); or

(iii) business the nation of Japan treats as outside the scope of free trade (agriculture, forestry and fisheries, mining, oil, or manufacturing of leather and leather products).

The prior notification must be provided three months before the acquisition of the shares of the target company. As a general rule, the foreign investor may not acquire the shares of the target company until the expiration of 30 days (the waiting period) from the day that the notification is accepted.

The waiting period will be shortened so long as the transaction is not deemed to interfere with Japan's national security or national interests. However, the period may be extended up to five months if it is determined that an examination of whether or not inward direct investment pertaining to the notification has any impact on Japan's national security or national interests.

For the purposes of FEFTA, foreign investors are not limited to non-residents or foreign juridical persons, and include Japanese legal entities with non-residents or foreign entities as shareholders who hold fifty percent (50%) or more of the shares of the entity, and Japanese legal entities whose majority directors are comprised of non-residents.

Accordingly, as prior notification regulations under FEFTA apply if a foreign investor establishes a Japanese subsidiary and the Japanese subsidiary acquires the target company's shares, it is necessary to confirm the substance of business of the target company in advance.

In addition to cases where the target company conducts Regulated Business, prior notification must also be made if the target company's subsidiary conducts such business. Accordingly, it is also necessary to confirm in advance the substance of business of the target company's subsidiary in addition to that of the target company.

It must be noted that, as the waiting period is calculated from the day that the prior notification is accepted, should there be any defect in this document and the prior notification is not accepted, the waiting period will not commence.

As a general rule, upon acquiring shares of a company engaging in business other than regulated business subject to the above prior notification, a designated report must be submitted within 15 days from the acquisition date of the shares of the target company.

Investment regulation

In addition to FEFTA, some Acts also restrict acquisitions of certain shareholding thresholds of Japanese legal entities which are engaged in certain regulated business (for example airlines, telecommunication, and broadcasting companies) by a non-resident or a foreign legal person.

Accordingly, before acquiring the target company, it is also necessary to confirm the substance of the particular regulations that affect the specific business that is conducted by the target company in addition to FEFTA, and confirm whether or not there are any applicable restrictions on acquisitions by foreign investors.

Antimonopoly Act

Criteria for prior notification

The Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade of Japan (Antimonopoly Act) requires that a prior notification to the Japan Fair Trade Commission (JFTC) be filed before commencing a share acquisition transaction if certain criteria apply. The criteria are comprised of tests related to the number of voting rights subject to acquisition and tests related to domestic sales of the acquirer and the target company; the prior notification is required where both criteria are met.

A transaction which involves the acquisition of voting rights which exceed 20% or 50% of the target company's voting rights upon share acquisition may be subject to prior notification.

When calculating the number of voting rights, the acquirer must include not only the number of voting rights to be held by the acquirer after completion of the share acquisition transaction, but also the number of voting rights held by the acquirer's parent company (including grandparent companies and great-grandparent companies) and subsidiaries of the parent company and the acquirer (including grandchild companies and great-grandchild companies) – together a company group.

An acquirer must make a prior notification to the JFTC regarding its share acquisition if:

(i) the transaction will result in more than 20% or more than 50% of the target company's voting rights being held;

(ii) total sales in Japan (domestic sales) of the acquirer and the company group to which the acquirer belongs exceed ¥20 billion; and

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(iii) the domestic sales of the target company and its subsidiary exceed ¥5 billion.

To calculate the domestic sales of the target company, it is sufficient to add the domestic sales of the target company and subsidiaries of the target company. However, when calculating the domestic sales of the acquirer, not only the domestic sales of the subsidiary of the acquirer but also those of the company group to which the acquire belongs (including the parent company of the acquirer) must be included.

Here, domestic sales are the total value of transactions by which products or services are provided to Japan directly or indirectly from a foreign country; this is not limited to the value of the transactions conducted by the foreign enterprise through its Japanese subsidiary or office.

Accordingly, even where a Japanese subsidiary is newly established to acquire the shares of the target company, if the foreign parent company and the subsidiaries of the foreign parent company directly or indirectly provide products or services to Japan, the value of such transactions shall be included when determining whether domestic sales exceed ¥20 billion.

“The acquisition of voting rights which exceed 20% or 50% of the target company’s voting rights … may be subject to prior notification”

Applicant

Where the above prior notification is required under the Antimonopoly Act, the acquirer must provide a prior notification. Accordingly, where a foreign investor establishes a subsidiary and causes the subsidiary to acquire shares of the target company and where the above criteria on prior notification are triggered, the subsidiary which acts as the acquirer must provide the prior notification.

On the other hand, where a foreign investor establishes a partnership or a limited partnership and causes the partnership or the limited partnership to acquire the shares of the target company, the company which controls decisions regarding the finances and the business of the partnership or the limited partnership is obliged to provide the prior notification rather than the partnership or the limited partnership (which is acting as the acquirer).

Waiting period

An acquirer which provides a prior notification under the Antimonopoly Act may not acquire shares of the target company for 30 days following the day that the notification is accepted by the JFTC (although the waiting period may be shortened at the discretion of the JFTC).

If the JFTC determines that the share acquisition is problematic in light of the Antimonopoly Act and issues a cease-and-desist order regarding the share acquisition, within the review period it will provide notice of its determination to the acquirer which filed the prior notification. As a general rule, the review period shall be the same as the above 30-day waiting period.

However, if the JFTC asks the acquirer to submit reports, information, or other materials during the 30-day waiting period, then the review period will be extended up to the later of 120 days from the date that the JFTC accepts the prior notification, and 90 days from the date of receipt of all requested reports and other items.

Prior consultation with the JFTC

As mentioned above, as a general rule, the prior notification review period under the Antimonopoly Act is 30 days following the day that the notification is accepted but the review period will be extended if the JFTC asks the acquirer to submit materials or other items.

Since an extension of the review period has a material impact on the acquirer’s acquisition schedule, in practice the acquirer often consults with the JFTC before making the prior notification and provides the prior notification after it confirms that no issues will arise in relation to the Antimonopoly Act. The JFTC has published guidelines for such prior consultations.

At the outset of a prior consultation, the acquirer submits materials indicating the substance of the transaction according to the prior consultation guidelines and the JFTC examines whether additional materials are necessary to commence its review. As a general rule, within 20 days from the acquirer’s submission of the materials, the JFTC will either notify the acquirer to the effect that it has determined that no additional materials are necessary, or present the acquirer a written list of additional materials to submit.

The JFTC will commence its review on the day it notifies the acquirer that no additional materials are necessary or the day it receives the additional materials that are requested. As a general rule, the JFTC will notify the acquirer within 30 days that the transaction does not present any Antimonopoly Act issues or that a further detailed review (secondary review) is necessary.

As the JFTC will conduct a hearing with third parties which have business relationships with the target company during a secondary review, the acquirer must make a public announcement describing the substance of the share acquisition transaction. After the acquirer has made such a public announcement about the deal, the JFTC will make a public announcement that it will conduct a secondary investigation in relation to the deal.

Where a secondary review is necessary, the JFTC will require the acquirer to submit additional materials as necessary for the secondary review, and, as a general rule, within 90 days from the submission of the materials necessary for the secondary review, the JFTC will provide an answer as to whether there are any Antimonopoly Act issues and will make a public announcement setting forth the substance of its answer to the secondary review.

In practice, acquirers often choose to proceed with a prior consultation procedure when conducting a transaction that requires a prior notification. The best practice is to submit sufficient materials at the initial stage in order to avoid the JFTC's secondary review and to promptly obtain clearance from the JFTC.

Where the JFTC determines a secondary review is necessary, the substance of the share acquisition transaction must be made public. However, an acquirer who does not wish a transaction to be made public may apply to withdraw its application for a prior consultation upon receiving notice that a secondary review would be required, or may discontinue the prior consultation by not making a public announcement about the transaction.

Tender offer regulations

In order to acquire shares of a company that is listed in Japan (or that must otherwise file securities reports), an acquirer must determine whether or not the acquisition will be subject to tender offer regulations.

As the FIEA sets forth various conditions which trigger a requirement to make a tender offer, it is necessary to examine whether tender offer regulations apply in light of the entire structure of a contemplated transaction. If the acquirer intends to acquire more than one-third of the shares of the target company, a tender offer is mandatory even if more than this number of shares could be obtained from a single shareholder.

As such, a tender offer will be implemented if the transaction is purported to acquire the shares of a listed company in Japan to make the company the acquirer's wholly-owned subsidiary. In addition, if a foreign investor intends to acquire the shares of a Japanese target company to make the company its wholly-owned subsidiary, the foreign investor must conduct a procedure to squeeze out the shareholders who did not respond to the tender offer.

As a general rule, it is necessary to obtain a special resolution of the shareholders meeting of the target company by two-thirds of the total number of voting rights of the shareholders attending the shareholders meeting in order to implement such squeeze-out procedures. Therefore, the acquirer needs to implement the tender offer purporting to acquire shares in the number equal to a number not less than two-thirds of the target company.

When conducting a tender offer, the acquirer must make a public notice that indicates its commencement to make the tender offer. The tender offer commences when this public notice is made. The acquirer must submit a tender offer registration statement to the Kanto Local Financial Bureau on the day of the public notice of the tender offer.

The target company of the tender offer is obliged to submit a position statement within 10 business days from the public notice of commencement of the tender offer. Generally, in the case of a friendly takeover, the target company will submit a position statement indicating that it agrees to the acquirer's tender offer on the same day as the public notice of the tender offer and the submission of the tender offer registration statement.

Then the acquirer will submit a tender offer report indicating the results of the tender offer on the day following the final day of the tender offer period.

The tender offer period must be not less than 20 and not more than 60 business days. The introduction of the prior notification system under the Antimonopoly Act where the acquirer must make a prior notification regarding the share acquisition has thus affected the scheduling of tender offer periods in Japan.

If a prior notification is necessary, as a general rule, the acquirer will be subject to a 30-day waiting period. Such a period must have expired before the final day of the tender offer period. In addition, if prior consultation with the JFTC is not held and the review period expires without any prior notice of a cease-and-desist order from the JFTC, it is necessary to submit an amendment report to the tender offer registration statement.

In such case, the tender offer period must be extended by the 10 business days following the submission of such amendment report. On the other hand, if a clearance from the JFTC has been obtained through a prior consultation to the effect that no Antimonopoly Act issue exists and such is indicated in the tender offer registration statement, no amendment report needs to be submitted because of the expiration of the review period during the tender offer period.

An acquirer may fix the minimum and the maximum number of shares subject to acquisition. However, if the number of voting rights held by the acquirer after the tender offer is two-thirds or more of the voting rights of the target company, the acquirer must purchase all shares offered in the tender offer.

If the target company issues several classes of shares, it is possible to limit the tender offer to a specific class of shares. However, if the number of voting rights held by the acquirer after the tender offer is two-thirds or more of the voting rights of the target company, then as a general rule the tender offer may not be limited to a specific class of shares, and the acquirer must solicit a tender offer application for all classes of shares issued by the target company. If the acquirer is required to solicit all classes, the solicitation for multiple classes of shares must be conducted by a single tender offer.