IN-HOUSE VIEW

Japan M&A

TRANSACTION STRUCTURES FOR PUBLIC COMPANY M&A IN JAPAN

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The *In-House View: Japan M&A* provides an up-to-date analysis of the legal framework, opportunities, challenges and risks that arise in connection with M&A transactions in Japan – a jurisdiction that often follows global trends but has specific laws, regulations, business practices and culture.

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Transaction Structures for Public Company M&A in Japan

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Introduction

In this chapter, we describe M&A transaction structures in Japan, focusing on the M&A structure of public companies.

The most fundamental law in Japan governing M&A transactions is the Companies Act. The Companies Act provides several structures for M&A, specifically, (1) transfers of shares; (2) business transfers; (3) statutory corporate reorganisations, including mergers, company splits, share exchanges, share transfers and partial share exchanges and (4) issuances of new shares to buyers by way of third-party allotments.

The most typical M&A transaction structure, whether for acquiring public companies or private companies, is transfer of shares. In the case of transfers of shares in private companies, the articles of incorporation of the target company typically require that any transfer of shares must be subject to board approval. Thus, the transfer of the shares is subject to the approval of the board of directors of the target company. In contrast, in the case of transfers of shares in public companies, the approval of the board of directors of the target company is not required. However, certain types of acquisitions of listed shares are subject to tender offer regulations. The tender offer requirements are statutorily provided under the Financial Instruments and Exchange Act (the FIEA) and its subordinate regulations. There are various types of acquisitions that trigger a mandatory tender offer, but the most important consideration is when a buyer purchases shares in a listed company and, as a result of the purchase, the buyer's voting rights in such target company will exceed one-third of the total voting rights through one or a series of off-market transactions. The offeror can set an upper limit and lower limit on the number of shares to be acquired in the tender offer; however, the offer cannot be capped if the offeror's voting rights after the tender offer will reach two-thirds or more of the total voting rights. The tender offer period must be at least 20 business days and may last up to 60 business days. The offer price must be equal for all offerees. All of the tender offer conditions need to be provided at the time of the launch of the tender offer.

In the past few years, much progress has been made with respect to the transfers of shares in public companies in Japan, due in part to the following events:

- the Companies Act was amended in 2014 to change the provisions regarding squeeze-out methods, which became effective in 2015;
- the Stewardship Code was introduced by the Financial Services Agency (FSA) in 2014, and revised in 2017 and 2020;
- the Corporate Governance Code was introduced by the Tokyo Stock Exchange (TSE) in 2015, and revised in 2018 and 2021;
- the Guidelines on Fair M&A were published by the Japanese government in 2019 (the 2019 Guidelines), which cover management buy-out transactions relating to public companies and acquisitions of a controlled public company by the controlling shareholder; and
- the Guidelines for Corporate Takeovers were published by the Japanese government in 2023 (the 2023 Guidelines), which cover, among other things, a code of conduct

for directors of a target company and other related parties in transactions in which a buyer acquires control of a listed company by acquiring its shares.

In addition, possibly the most important development will be the amendments to the rules regarding tender offers through an amendment of the FIEA, which were passed by the Diet in May 2024 and are expected to come into effect by 2026, based on a report published by the Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council, which was established by the FSA, in December 2023 (the 2023 Report).[1] The major items of the amendments are as follows:

- mandatory application of a tender offer for the acquisition of shares that exceed a certain threshold (ie, 30 per cent), even in market trades; and
- lowering the one-third threshold mentioned above to 30 per cent in line with that of other countries.

Further, the FSA issued the 'Notes on the Disclosure of the Tender Offer' (the TO Disclosure Guidelines) in October 2024. The guidelines put together existing disclosure practices regarding the disclosure of tender offers and provide guidance on unclear disclosure issues.

In the following sections of this article, with reference to the contents of the amendment of the Companies Act, and the codes and guidelines mentioned above, we describe the important recent developments on the following M&A structures for acquiring public companies: going private transactions, partial acquisition of a public company and acquisition of a public company without consent.

Going-private transactions

Overview of two-step acquisition structure

In going-private transactions, namely buyouts of public Japanese companies, it is common to conduct a two-step acquisition. A tender offer is made during the first phase and the back-end squeeze-out of the remaining minority shareholders follows in the second phase.

In the preceding tender offer, a buyer or a purchase vehicle established by a substantial buyer becomes the tender offeror and discloses information in accordance with the FIEA. The main disclosure documents are the public notice of the commencement of the tender offer, the tender offer statement filed by the tender offeror, and the position statement filed by the target company. All disclosure documents will be subject to review by the Kanto Local Finance Bureau. If a tender offeror intends to acquire more than one-third[2] of the total voting rights of a listed company, it must make a tender offer. In going-private transactions, the tender offeror will initiate a tender offer aiming for two-thirds or more of the total voting rights without setting a cap on the number of shares to be purchased in the tender offer.

When conducting a going-private transaction, it is usual to take measures to ensure the fairness of the tender offer in respect of the public shareholders of the target company and eliminate the coercive nature of the tender offer. Specifically:

1.

in many cases, the tender offer statement sets out that the tender offeror intends to conduct a back-end squeeze-out at an amount equal to the tender offer price if the tender offer is completed successfully; and

2. a tender offer period of 30 business days or more is provided.

If the transaction falls under a management buyout (ie, the current management invests all or part of the funds needed to acquire the target company's shares on the assumption of a going concern (MBO)), the transaction is expected to comply with the 2019 Guidelines.-[3] In most cases, if a going-private transaction constitutes an MBO, in addition to taking the procedures in items (1) and (2) above, the target company will establish a 'special committee' that is independent from the management, in accordance with the 2019 Guidelines. The special committee is expected to examine and determine the merits of the buyout, the appropriateness of the terms of the transaction, and the fairness of the procedures from the perspective of the interests of the public shareholders in the target company.

Tender offer agreement

If the target company has major shareholders, a tender offer agreement is often concluded between the tender offeror and the major shareholders, whereby they agree that if the tender offeror initiates a tender offer for the target company's shares under certain conditions, the major shareholders will tender their shares and will not withdraw the tender. If there are no such major shareholders, a tender offer agreement will be entered into between the tender offeror and the target company, providing conditions to commence the tender offer. According to the TO Disclosure Guidelines, if a tender offer agreement is entered into, the main terms and conditions of the agreement must be stated in the tender offer statement.

A tender offer agreement with major shareholders generally includes the obligation to commence a tender offer and the conditions precedent for this commencement, the obligation of the major shareholders to tender their shares and not to withdraw the tender, representations and warranties, and covenants. A tender offer agreement with the target company generally covers certain representations and warranties by each party, conditions to commence the tender offer, and certain covenants of the target company, including the obligation not to solicit or negotiate competing bids. For this obligation, fiduciary-out clauses are generally provided as exceptions (eg, if the competing offer price exceeds the offer price of the tender offeror and other conditions are met, the target company may terminate the tender offer agreement), and break-up fees will also occasionally be provided in case the target company terminates the tender offer agreement through to the fiduciary-out clause.

Practice of pre-announcement

In recent years, large buyout deals in Japan have been increasingly required to obtain certain clearances before closing under various regulations, such as merger control regulations, regulations relating to the Committee on Foreign Investment in the United States and other investment regulations in several jurisdictions. However, it may take between several months and more than a year to obtain these clearances after the parties have reached an agreement for the buyout and filings are made with the relevant authorities. In these cases, to protect the public shareholders of the target company, the Japanese financial authorities will request that the buyer commence the tender offer only after the clearances are expected to be obtained. To address this concern, the general practice is to make a timely disclosure, wherein the target company 'makes a pre-announcement' that the parties have already agreed on the buyout and that the tender offer will commence once the necessary clearances are expected to be obtained and other conditions are met.

Back-end squeeze-out: squeeze-out right v consolidation of shares

The back-end squeeze-out generally employs either an exercise of the squeeze-out right or a consolidation of shares. The squeeze-out right was introduced in the 2014 amendment to the Companies Act and allows a buyer to demand that all other shareholders of the target company sell to the buyer all their shares in the target company when the buyer holds 90 per cent or more of all the voting rights in the target company. On the other hand, the back-end squeeze-out by consolidation of shares is a method whereby the target company conducts the consolidation of shares using an extreme consolidation ratio so that the shares of the target company held by the minority shareholders other than the buyer are reduced to fractions of less than one share, and then, following the statutory procedures under the Companies Act, and with court approval, the target company sells the whole-number portion of the shares that is the sum of these fractions and delivers a cash-out to the minority shareholders in exchange for their equity portions.

In contrast to the consolidation of shares, the exercise of the squeeze-out right does not require a resolution at a general shareholders' meeting of the target company. It can be carried out by a resolution of the board of directors and does not require a statutory cash-out procedure for fractional shares. In practice, it takes several months for a listed company to hold a general meeting of shareholders, and the statutory cash-out procedures for fractional shares require court approval. Therefore, the exercise of the squeeze-out right allows for a quicker cash-out compared with the consolidation of shares.

Before the 2014 amendments to the Companies Act, the consolidation of shares was not used as a cash-out scheme because it did not provide the minority shareholders with legal protections such as the dissenting shareholders' right to demand the purchase of their shares and injunctive relief. However, after the amendment, these protections were introduced. As a result, the consolidation of shares is now widely used as a back-end squeeze-out method. The greatest advantage of the consolidation of shares over the exercise of the squeeze-out right is that it does not require the acquisition of 90 per cent or more of the total voting rights of the target company in the first-phase tender offer. The consolidation of shares requires approval through a special resolution of the target company's shareholders, but such special resolution can be obtained once the buyer secures two-thirds,[4] not 90 per cent, of the total voting rights of the target company.

Considering the above, in practice, although the minimum number of shares to be purchased in the first-phase tender offer is set at two-thirds of the total voting rights of the target company, if the tender offeror succeeds in acquiring 90 per cent or more of the total voting rights, it often chooses to exercise the squeeze-out right as the scheme for a back-end squeeze-out. On the other hand, if the number of shares purchased is less than 90 per cent, the consolidation of shares is often chosen.

Code of conduct for directors of target company

Japanese lower courts have issued several rulings on the fiduciary duties of directors of a target company in an MBO going through a two-step acquisition, but these precedents are somewhat ambiguous as a code of conduct for directors of a target company when they are involved in corporate acquisitions. However, the Japanese government issued the 2023 Guidelines in August 2023, providing a clearer code of conduct for directors. When directors of a target company receive an acquisition proposal, the 2023 Guidelines suggest that the directors should promptly submit or report the matter to the board of directors so that the board will give 'sincere consideration' to a 'bona fide offer.' In determining whether the acquisition proposal is a 'bona fide offer,' the board will consider whether (1) the proposal is specific, (2) its purpose is legitimate and (3) the proposal is feasible. When the board of directors decides to reach an agreement on the acquisition, the board should make reasonable efforts to aim for the best available transaction terms for the shareholders. In light of this, if the board makes an exceptional decision to endorse a proposal that is considered to enhance corporate value but is not sufficiently priced, the board should fully explain the reasonableness of its decision.

Regarding the process of a two-step acquisition, on 1 July 2016, the Supreme Court of Japan ruled that if the major shareholders of a target company jointly set up a tender offer and conduct a two-step takeover with a squeeze-out, even in such transaction with a structural conflict of interest, if the tender offer was made through procedures generally recognised as fair to eliminate the conflict of interest and a subsequent back-end squeeze-out was made at the same amount as the tender offer price, the price determined between the parties shall generally be respected. However, in a decision by the Tokyo District Court on 23 March 2023, the court recognised the dissenting shareholders' request for purchase of their shares at an amount larger than the tender offer price, because the squeeze-out, which was made at an amount equal to the tender offer price under the above Supreme Court decision, was not determined through fair procedures (the *Family Mart* case). Family Mart, the target company, established a special committee following the 2019 Guidelines, which examined whether the tender offer price was appropriate. The special committee had been advised by an outside valuation adviser of a certain range that would constitute an appropriate share value. However, when the buyer offered an amount lower than the suggested range, to which Family Mart's management agreed, the special committee accepted this offer without providing any particular explanation of the reasonableness of the decision. Considering this fact, the court concluded that the special committee could not be considered to have sufficiently fulfilled its role as a body tasked with eliminating arbitrariness in the decision-making process of the target company from an independent standpoint.

When a buyer conducts a going-private transaction constituting an MBO, a target company is expected to follow the 2023 Guidelines and implement the measures recommended by the 2019 Guidelines, including establishing a special committee in the target company. However, considering the *Family Mart* case, it is not sufficient to merely establish a special committee. The special committee must fulfil its role in a truly independent manner, without pandering to the acquiring party and the target company.

Partial acquisition of public company

While the securities regulations of major European countries forbid partial acquisitions of a listed company and mandate a tender offer with no upper limit to provide minority shareholders with an opportunity to sell their shares at a fair price, the FIEA generally allows a tender offer with an upper limit based on the understanding that a strict restriction on partial acquisition could discourage desirable M&As. However, it has been pointed out that a partial tender offer could be coercive when the contemplated acquisition potentially reduces corporate value because the minority shareholders are pressured to accept the offer in order not to be the mouse left in a tiny room with a large elephant (the buyer). Apart from the coercion issue, shareholders who wish to sell their shares may not have the opportunity to sell all of their shares through the tender offer when it has an upper limit.

With those problems in mind, the ongoing amendments to the FIEA based on the 2023 Report are expected to require a buyer to make further disclosures in addition to the rules applicable to the first step in a two-step acquisition described above. Such additional disclosures would include the buyer's plan to address the conflict of interests issue between the buyer and minority shareholders after the partial acquisition, and the measures the buyer plans to take when a certain number of shareholders oppose the acquisition (for example, obtaining a resolution at a general shareholders' meeting to confirm the majority opinion).

Acquisition of public company without consent

Recent developments on acquisitions without consent

After some court decisions on takeover response policies (a 'poison pill'), in favour of the management of target companies in the early 2000s, many Japanese listed companies introduced and maintained poison pill policies. Under these circumstances, a hostile takeover was almost considered a taboo for strategic investors in the Japanese capital market. A hostile takeover was something that only extremely aggressive activists could dream of, and it was mostly a pipe dream without the support of institutional investors such as Japanese banks and insurance companies who had long played the role of guardians of target companies.

Now that (1) the Corporate Governance Code takes a very negative position on anti-takeover measures with the view that such measures function to entrench the current management, (2) the Corporate Governance Code and the Stewardship Code in concert urge institutional investors to sell their shares of Japanese listed companies if they do not have legitimate reasons to continue holding them, and (3) the 2023 Guidelines emphasise that desirable acquisitions, whether they are friendly or hostile to the management of the target companies, will increase corporate values, the acquisition of Japanese listed companies without the consent of their management is no longer considered a taboo, even for strategic investors including traditional Japanese companies.

Following an unsuccessful preliminary discussion among the executives of both companies in early 2023, Nidec Corporation, a Japanese electric motor giant, in July 2023, made a pre-announcement that it would initiate a two-step acquisition of Takisawa Machine Tool Co, Ltd (Takisawa), which was then listed on the TSE, without the consent of their board of directors, proposing a very generous price. Although the 2023 Guidelines were not finalised at this time,[5] both companies declared in their respective releases that they would fully comply with the draft 2023 Guidelines. After questions and answers regarding the potential increase in corporate value were exchanged, all of which were disclosed, the board members of Takisawa finally endorsed the offer, admitting that the acquisition would increase their corporate value and provide a very attractive exit opportunity for their shareholders. Takisawa did not invoke the countermeasures that were reserved in their already-introduced takeover response policies. In December 2023, Dai-ichi Life Holdings, Inc (Dai-ichi), one of the largest insurers in Japan, surprised the capital market with the announcement that it would buy Benefit One Inc (Benefit One), a then-listed employee benefits provider. It was surprising because the announcement was made in the middle of a takeover bid against Benefit One by M3, Inc (M3), a medical-related services provider, which the board members of Benefit One had endorsed. The tender offer price of Dai-ichi was higher than the offer by M3. In the end, Benefit One withdrew their consent to M3's offer and endorsed Dai-ichi's counteroffer. Several attempts at unsolicited takeovers initiated in 2024 have either failed or are still ongoing.

The transaction structures of an acquisition without consent are essentially the same as those of acquisition with consent, which have already been explained above. Therefore, we provide descriptions of issues typical of an acquisition without consent below.

Open-market purchase

When a target listed company is not friendly to a buyer, the buyer need not initiate a tender offer as long as the buyer purchases the shares in the open market, because the current FIEA mandates a tender offer only when a buyer purchases the shares outside of the market. The rationale for this policy was based on the myth that open-market transactions are transparent and fair.

However, in recent years, there have been some cases where investors took controlling shares of companies through open-market transactions with very limited information disclosed to the target companies and the market.[6] Regarding such cases, the 2023 Report pointed out that the sufficient time and information that should have been provided in such transactions resulting in a change in control were not provided to shareholders. Therefore, the FIEA is expected to expand the scope of mandatory tender offers to include open-market transactions, which will be one of the most fundamental amendments to the FIEA in decades.

Toehold and wolf pack strategy

Especially for a buyer who is not reluctant to acquire without consent, purchasing a small number of the target company's shares in advance (a 'toehold') is strategically important to increase the likelihood of a successful tender offer to follow. The advantage of a toehold is maximised when a group of buyers take a 'wolf pack' strategy. Under the FIEA, a person who holds more than 5 per cent of the shares of a listed company on a beneficial ownership basis must report this holding in accordance with the large shareholding reporting rules, which are the equivalent of the US Schedule 13D/G filing rules. However, if each of the several buyers purchases less than 5 per cent, but they act in concert and purchase more than 5 per cent in total (wolf pack strategy), it is arguable and unclear whether they need to abide by the reporting obligation.

Amid mounting tensions between pro-shareholder proponents and pro-management proponents, the Japanese government seems to be pursuing a middle way. While the 2023 Guidelines concluded that pre-acquisition purchases have a significance positive impact in advancing acquisitions and should not be negatively regarded, the FIEA is expected to broaden the definition of a deemed joint holder to include entities that have the same directors/offices in common and are in a close financial relationship with each other. More importantly, in the 2023 Report, the working group mentioned above urged regulators to enforce the large shareholding reporting rules more actively and strictly. FSA imposed levies in August 2024 on individuals and an entity who reportedly took a 'wolf pack' strategy in their attempt to acquire Mitsuboshi Co, Ltd since they did not file a large shareholding report in a timely manner and reported smaller shares than they actually held.

Disclosure of beneficial owner

Under existing laws in Japan, a buyer need not disclose its beneficial owner or owners except under the large shareholding reporting rules. Companies that are concerned about potential acquisition often retain a service provider to discover the beneficial owners behind those listed in the shareholder registry. But in many cases, beneficial owners remain opaque. This has made discussion with beneficial owners difficult and made it easier to pursue the wolf pack strategy.

The 2023 Report proposes to amend the relevant rules so that institutional investors are legally obligated to disclose the holding status of beneficial owners if requested by the target company. This reform could change the landscape of hostile takeovers for 'submarine-type' buyers by making it difficult to remain anonymous.

Pre-announcement as a bona fide offer

Theoretically, any buyer can initiate a tender offer against a target company without its consent. However, in practice, most buyers who fail to agree with the management of the target company, or who do not expect to reach an agreement behind the scenes, make a public pre-announcement to solicit consent from the board of directors of the target company in the hope that shareholders and other stakeholders will put pressures on the board members in favor of the offer.

For the past few years, some pre-announcements in hostile takeover cases were problematic in that the stock price in the market skyrocketed even though the grounds for the proposed price and the business plan after the acquisition were very unclear, and in the worst cases, the tender offers never materialised after causing the stock price to become unreasonably unstable. On the other hand, in some such cases, the management of the target companies were quickly able to simply reject the offer as not constituting a bona fide offer.

Since the 2023 Report suggested that FSA prepare new guidelines setting forth disclosure rules on the pre-announcement of tender offers, FSA issued the TO Disclosure Guidelines in 2024. For now, below are the points that a pre-announcement should reportedly cover.

- a written offer, not an oral one;
- the name of the offeror (there is no anonymity);

- offered price and key transaction terms, and reasoning therefor;
- evidence of financing, such as a bank's commitment letter;
- conditions precedent to start the tender offer;
- expected timeline of the tender offer;
- management strategy after the acquisition;
- track record of M&As; and
- follow-on announcements as things unfold.

The TO Disclosure Guidelines clarify that the Kanto Local Finance Bureau will accept a review of the pre-announcement documents, if the buyer so desires.

Consideration by the board of directors

Previously, the management of a target company would generally cite the retention of employees and corporate culture when it opposed a hostile takeover. It was not unusual for a target company to endorse a lower-priced offer by a friendly bidder, such as a white knight.

However, the 2023 Guidelines articulate that 'corporate value' is a quantitative concept and further asserts that the management of the target company should not make the concept of corporate value unclear by emphasising qualitative value, which is difficult to measure, nor should the 'corporate value' concept be used as a tool for management to defend themselves. The 2023 Guidelines also state that the purchase price and other transaction terms should be seriously examined, and if an increase in corporate value can be reasonably expected from the acquisition proposal, as suggested by a purchase price that is considerably higher than the historical stock price, each director and the board of directors should give the proposal due consideration. As discussed above, the 2023 Guidelines warn that when the management of the target company endorses a proposal that is considered to be conducive to enhancing corporate value but is not sufficiently priced, this endorsement should be exceptional and the board of directors should fully explain the reasonableness of its decision.

As a result, it is now understood that an acquisition offer without consent cannot be easily rejected if the proposed price is significantly higher than the stock price in the market or the tender offer price agreed upon between the target company and a friendly bidder.

Special committee

As explained above, the 2019 Guidelines recommend that the target company establish a special committee in case of an MBO and buyout by controlling shareholders. Under the 2019 Guidelines, a special committee seems unnecessary when a buyer with no meaningful equity stake proposes acquisition of the target company without consent.

However, the 2023 Guidelines find establishing a special committee useful in the following context:

- when the appropriateness of the transaction terms is considered particularly important to the interests of shareholders because the proposal includes a cash-out;

- when considering takeover response policies or countermeasures; and
- other cases where accountability to the market is considered high (eg, when there are multiple publicly known acquisition proposals)

As a result, under the 2023 Guidelines, it is understood that a special committee is practically necessary even when a buyer proposing an acquisition without consent holds no shares of the target company. A special committee was established in the *Takisawa* case and the *Benefit One* case discussed above.

Conclusion

As discussed above, there have been many important developments in recent years in relation to the transfers of shares in public companies. In addition, further developments are expected in the near future because a revision of the rules regarding tender offers is scheduled as early as this year. Therefore, it is necessary to continue to pay attention to further developments in this area.

Endnotes

1 The English translation of the 2023 Report is available at the following URL: https://www.fsa.go.jp/en/refer/councils/singie_kinyu/20240130/01.pdf. ^ Back to section

2 As discussed above, this threshold is expected to be decreased to 30 per cent by an amendment to the FIEA. ^ Back to section

3 The TSE is planning to amend the Code of Corporate Conduct on Matters to be Observed Pertaining to Disclosure of MBO, etc. in 2025 to strengthen disclose for shareholders to be squeezed out. ^ Back to section

4 More precisely, it is two-thirds of the voting rights present at the general meeting. ^ Back to section

5 A semi-final draft was available at the website of METI. ^ Back to section

6 In the *Tokyo Kikai Seisakusho* case in 2021, an acquiring group obtained around 40 per cent of the outstanding shares through open-market transactions within around three months. ^ Back to section

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