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Amendments to the Foreign Exchange and Foreign Trade Act of Japan (Part 1)

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I. Introduction

The Foreign Exchange and Foreign Trade Act (the "Act") obliges foreign investors contemplating to make certain inward direct investments or equivalent actions ("IDIs"), which target certain restricted businesses ("Restricted Businesses"), to submit a prior notification. Following the global trend of tightening scrutiny on foreign investments,[1] recently, there have been a series of amendments to the prior-notification requirement under the Act.

In May 2019, an amendment adding 20 types of businesses to the list of Restricted Businesses was published (the "May 2019 Amendment"). This amendment took effect on August 1, 2019. Subsequently, in September 2019, an amendment of the Cabinet Order on Inward Direct Investment (the "Cabinet Order") and the Order on Inward Direct Investment (the "Order") was published which expanded the scope of IDIs subject to the notification requirement by covering acquisitions of 10% or more of the total voting rights of a Japanese listed company and other similar activities ("September 2019 Amendment"). This September 2019 Amendment took effect on October 26, 2019.

In addition, the Diet passed a bill amending the Act on November 22, 2019 which included major changes to the prior-notification requirement under the Act ("2020 Amendment"). Since this bill included amendments relating to shareholder proposals, the 2020 Amendment is expected to take effect before the holding of most annual meetings of shareholders in June 2020.

This article features the May 2019 Amendment and September 2019 Amendment. The 2020 Amendment will be summarized in the next issue of the Oh-Ebashi Newsletter.

II. Summary of the Current Notification Requirement

Under the Act, a foreign investor who intends to make an IDI that may affect national security, public order, public safety or the smooth management of the economy of Japan must submit a prior notification.[2] IDIs that require prior notification are then reviewed by the Ministry of Finance and other ministries having jurisdiction over the relevant Restricted Business, and subjected to a statutory waiting period of 30 days (prohibition period).[3]

1. In the US, the Foreign Investment Risk Review Modernization Act of 2018, which took effect last February 2020, expanded the jurisdiction of the Committee on Foreign Investment in the United States (CFIUS) to address growing national security concerns over the foreign exploitation of certain investment structures. In the EU, EU regulations regarding a new framework of screening foreign direct investments entered into force in April 2019 and is scheduled to take effect after October 2020. This regulation will create a cooperation mechanism, which will enable member states and the European Commission to exchange information and raise concerns about specific investments.
2. The Act, art. 27, para. 1, and the Cabinet Order, art. 3, para. 2.

The waiting period can be extended up to 5 months,[4] but is usually shortened to 2 weeks[5] or less.

After performing the subject IDI transaction, in addition to prior notification, a post-transaction report is required. A post-transaction report must also be submitted for IDIs that do not require prior notification.

As a result of the review, if the Ministry of Finance and the relevant ministries find any concern from the viewpoint of national security, public order, public safety, or the smooth management of the economy of Japan, then they may request or order the foreign investor to change the terms of, or suspend, the IDI.[6] In addition, in the event of a failure to make the required notification, false statement in the notification, or non-compliance with an order of change or suspension, if an IDI involves a threat to national security, then the Ministry of Finance and the relevant ministries may order the disposal of shares or other appropriate remediation measures.[7]

III. May 2019 Amendment – Expansion of Restricted Businesses

Due to the increasing importance of securing cybersecurity and to avoid a security crisis in Japan, on May 27, 2019, an amendment was published adding 20 types of businesses to the list of the Restricted Businesses involving IDIs and specified acquisitions (the "Newly Added Businesses").

The Newly Added Businesses are divided into the following three categories:
(i) Manufacturing of information processing equipment and parts

- Integrated circuits
- Mobile and PHS phones
- Semiconductor memory media
- Radio communication equipment
- Optical and magnetic disks, magnetic tape
- Electronic computing devices
- Electronic circuit mounting boards
- Personal computers
- Wired communication equipment
- External memory devices

(ii) Software related to information processing

- Contract development of software
- Packaged software
- Built-in software

(iii) Information and communications services

- Regional telecommunications※
- Mobile telecommunications※
- Long-distance telecommunications※
- Information processing services
- Wired broadcast telephones
- Internet use support services※
- Miscellaneous fixed telecommunications※

※ The scope has been expanded.

Prior to the May 2019 Amendment, with respect to the business of manufacturing information processing equipment and parts, or the software system engineering business, only those businesses which manufactured, or used the technology of, products with specifications subject to export control regulations fell into the category of Restricted Businesses. After the May 2019 Amendment, the businesses listed above as Newly Added Businesses became Restricted Businesses regardless of their product specifications. This resulted

3. The Act, art. 27, para. 2.
4. *Id.*, para. 3.
5. The Act, art. 27, para. 2, and the Order, art. 10, para. 2.
6. The Act, art. 27, paras. 5 and 10.
7. *Id.*, art. 29.

in doubling the number of companies engaged in Restricted Businesses. In particular, the second category of software related to information processing is now defined broadly, and includes businesses involved in the development of software other than game software.

As such, this amendment has affected venture capitalists and the startup companies they invested in. There have been cases where venture companies were unable to promptly arrange their capital because the foreign investor was required to make such prior notification. Thus, in scheduling financial arrangements involving foreign investors, it is important to take into account the time required for the preparation and drafting of the prior notification statement as well as the prohibition period.

IV. September 2019 Amendment – Expansion of IDIs

On September 26, 2019, an amendment of the Cabinet Order and the Order was published. The definition of an IDI was expanded. Prior to this September 2019 Amendment, IDIs mainly included the following acts:[8]

(i) acquisition from a non-foreign investor of any number of shares or equity in a non-listed company;[9]

(ii) transfer of shares or equity in a non-listed company held by a person prior to becoming a non-resident (limited to transfers from non-resident individuals to foreign investors);

(iii) acquisition of shares or equity in a listed company resulting in the acquirer and those specially affiliated therewith owning 10% or more of the shares of such listed company;

(iv) the giving of consent by persons holding at least one-third of all the voting rights of the shareholders in a company to a substantial modification of the business purposes of such company; and

(v) the lending of money in excess of 100 million yen to a Japanese corporation in a foreign currency, and for a term of more than one year.

Pursuant to the September 2019 Amendment, in addition to the acquisition of 10% or more of the shares in a listed company, acquisitions of 10% or more of the total voting rights of a Japanese listed company and other similar activities constitute IDIs. Specifically, the following activities were added to the definition of an IDI:[10]

(i) acquisition of 10% or more of the total voting rights of a listed company;

(ii) undertaking of proxy voting rights of shareholders in a listed company, which results in the proxy holding 10% or more of the total voting rights;

(iii) undertaking of proxy voting rights of shareholders other than a foreign investor in a non-listed company;

(iv) delegation by a non-resident individual to a foreign investor of voting rights of shares of a non-listed company held by the former prior to becoming a non-resident;

(v) discretionary investment in shares of a listed company (where the mandator cannot exercise the relevant rights due to the relevant entrustment), which results in the holding of 10% or more of the total voting rights; and

(vi) an agreement between foreign investors to jointly exercise voting rights of a listed company, resulting in such parties holding 10% or more of the total voting rights.

However, an “undertaking of proxy rights” (underscored above) is limited to instances where the agenda items of the meeting of the shareholders, where the proxy can

8. The Act, art. 26, and the Cabinet Order, art. 2, para. 9.
9. The acquisition of shares in a non-listed company from a foreign investor is called a "specified acquisition" and prior notification is required when the business of the target company includes a Restricted Business (the Act, art. 28, para. 1). Unlike in the case of an IDI, a post-transaction report is not required for a specified acquisition.
10. The Cabinet Order, art. 2, para. 9, items 3 to 7, and 11.

exercise the voting rights, include certain items that could enable the proxy to substantially control the target listed or non-listed company or materially affect the management thereof. These items include matters concerning the appointment, removal or shortening of the term of directors, amendment of the articles of incorporation to change the business purposes or to issue classified stocks, business transfer, dissolution, and merger.[11]

It should be noted that prior notification for these IDIs must be made, not before the time of the exercise of the voting rights, but before the time of the undertaking of proxy voting rights or the agreement to jointly exercise voting rights. This will materially affect the schedule of a shareholder proposal or proxy solicitation. Also, when shareholders agree to a joint exercise of voting rights in agreements such as a capital and business alliance agreement, prior notification must be made before entering into such agreement.

V. Conclusion

As stated above, in addition to the May 2019 Amendment and September 2019 Amendment, the Diet passed the 2020 Amendment in November 2019 introducing major changes in the prior-notification requirement of IDIs. These changes mainly include (i) an expansion of the definition of an IDI, and (ii) establishment of a prior-notification exemption system. Since the details of the 2020 Amendment are to be added to the Cabinet Order and the Order, and provided in other public notices, it is important for market players and foreign investors to pay attention to announcements thereon.

11. The Cabinet Order, art. 2, para. 11, and the Order, art. 2, para. 5.

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New Rules on Shareholders' Meetings under the Amended Companies Act of 2019

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I. Introduction

On December 4, 2019, the Japanese Diet approved the bill to amend the Japanese Companies Act of 2005 (as amended, the "Amended Companies Act"). The amendments to the Companies Act mainly intend to improve corporate governance, covering: (a) shareholders' meetings; (b) directors; and (c) other matters such as the establishment of an assistant bond administrator system and the introduction of a new M&A measure called share delivery (*kabushiki kofu*). This article will only focus on providing a brief overview of the new rules on shareholders' meetings.

II. New Rules on Shareholders' Meetings

(i) "Notice and Access" System for Shareholders' Meeting Materials

The Amended Companies Act introduced the Japanese version of the "notice and access" system for materials for shareholders' meetings, the main purpose of which is to enable shareholders to access such materials more quickly. Under the current Companies Act, companies must provide printed copies of the materials for shareholders' meetings including the reference documents, voting forms, financial statements and business reports, unless such companies have obtained the consent of each shareholder to provide such documents in electronic form. The amendment introduced a new system whereby such materials can be uploaded onto a website and shareholders are notified in writing of the website address. This electronic provision system will be compulsory for listed companies and their articles of incorporation will be deemed to include a provision allowing for the electronic provision system as of the date the Amended Companies Act is enacted. For non-listed companies, however, although they have the option to provide materials or information via the Internet or through paper documents, their articles of incorporation must first allow them to use the electronic provision system. Thus, non-listed companies must amend their articles of incorporation if they want to provide meeting materials or information electronically.

Once the electronic provision system is introduced, companies must upload the information at least three weeks prior to a shareholders' meeting. (The current rule only requires companies to send documents at least two weeks prior to the meeting.) However, companies must still send a paper-based notice to convene the meeting and inform them of the website address, the date and place of the meeting, etc. This notice is typically short (1 to 2 pages long), and must be sent at least two weeks prior to the shareholders' meeting.

The Amended Companies Act provides a safeguard for shareholders who have difficulty accessing the Internet. If they wish, shareholders can request companies for the delivery of the materials in paper-based format. Upon such request, companies must send the notice to convene as well as a printed copy of the materials at least two weeks prior to the shareholders' meeting. Shareholders must make such request by the date set by the company (usually about three months before the dateof the

meeting). It is noteworthy that once a shareholder requests for paper-based meeting materials, such preference will remain effective unless withdrawn by the shareholder. Thus, the number of shareholders to whom companies must provide printed documents may increase cumulatively every year. To deal with such situation, the Amended Companies Act allows companies to send a notice to their shareholders to end the system of providing paper-based materials after the lapse of one year from the day of the request. If the shareholder does not object thereto, then the company may cease to provide written documents to such shareholder.

(ii) Limitation on Proposals by Shareholders

Another new provision enables companies to limit the number of proposals that shareholders can submit for approval in a shareholders' meeting. Under the current Companies Act, there is no limit to the number of proposals that a shareholder can submit. Thus, there have been some recent examples of shareholders abusing this right by submitting too many proposals. The Amended Companies Act now limits to ten the number of proposals that a shareholder of a company with a board of directors may submit.

The draft bill of the government also included a provision that would have enabled companies to reject a proposal by a shareholder if its contents were defamatory or inappropriate. However, this draft provision was not passed by the Diet because it would have been difficult for a company to decide fairly whether a shareholder had abused such right to make a proposal based on the contents thereof, and the company might have limited such right arbitrarily.

III. Schedule

Most of the provisions of the Amended Companies Act are scheduled to be enacted within one year and six months from December 4, 2019, as decided by a Cabinet Order. We expect the enactment to take place in late 2020 or early 2021. However, some amendments, including that relating to the electronic provision system for shareholders' meeting materials, are scheduled to be enacted within three years and six months from December 4, 2019, which we expect to take place in 2022 or 2023. Thus, listed companies, which are obligated to provide shareholders' meeting materials via the website, will have relatively enough time to prepare for the new system.

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