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Doing Business In... 2021

Japan: Trends & Developments

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Trends and Developments

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M&A

Key developments in M&A law and regulation

As the amendment to the Companies Act, which was approved by the Japanese Diet in December 2019, came into effect on 1 March 2021, a new acquisition scheme called "Share Delivery" (*Kabushiki Kofu*) was introduced. Share Delivery allows a Japanese stock company to acquire the shares of another Japanese stock company using its own shares as consideration, making the target company its subsidiary. The tax law was also amended so that the shareholders of the target company are able to defer payment of any capital gains tax upon receipt of the acquiring company's shares. The combined consideration of cash and shares is also available as long as the value of the cash consideration does not exceed 20% of the total consideration value. Historically, there have been few share exchange offers in Japan compared to other countries, but these are expected to increase because of the introduction of Share Delivery, even though Share Delivery is practically available only between Japanese stock companies.

Another key development affecting M&A transactions is that, early in 2021, Japanese courts issued notable decisions on anti-hostile takeover defence measures. Under conventional M&A practice in Japan, the issuance of share options, without contribution, to all shareholders excluding the hostile tender offeror has generally been used as a poison pill. Pursuant to this, a considerable number of companies adopted an anti-hostile takeover plan, a so-called rights plan, in which such companies may issue share options by approval of the board when certain conditions are met.

In March 2021, Nippo Ltd. issued share options against a hostile takeover by Freesia Macross Co., Ltd. At first, the issuance of the share options was invalidated by the Nagoya District Court in late March 2021, but the appeals court held the issuance of the share options to be effective in an April 2021 decision (this case is still under review by the Supreme Court of Japan as of 31 May 2021). Similarly, in March 2021, Japan Asia Group Limited also tried to issue share options against a hostile takeover by City Index Eleventh Co., Ltd ("CI11"). In April, CI11's request for an injunction to suspend the issuance of share options was approved by the Tokyo District Court and the Tokyo High Court, and consequently, Japan Asia Group finally cancelled the issuance of the share options. In the case of Nippo Ltd., the Nagoya appeals court held Nippo's issuance of the share options to be valid because the share options were issued not only with Nippo's board approval, but the rights plan had also been consistently approved at Nippo's annual shareholders' meetings since 2019. By contrast, the decisions in the Japan Asia Group case denied the issuance of the share options because they were issued only through board approval, and was not approved at the shareholders' meeting. These new court precedents may thus suggest that a rights plan should be adopted with shareholders' approval obtained in advance, or, at least, the issuance of share options by board approval in emergency situations should be designed so that it can be cancelled by shareholders' resolution.

Recent trends in the M&A market

As mentioned above, there have been some recent court cases on anti-hostile takeover

measures. The reason for this is that the number of hostile takeovers has continued to increase in Japan since 2020, although almost all the M&A transactions in Japan are still friendly transactions. In particular, hostile takeovers have been announced not only by activist funds, but also by prominent listed companies. Recent examples include tender offers for:

- Ootoya Holdings Co., Ltd. by Colowide Co., Ltd., announced in July 2020;
- Shimachu Co., Ltd. by Nitori Holdings Co., Ltd., announced in October 2020;
- Tokyo Rope MFG Co., Ltd. by Nippon Steel Corporation, announced in January 2021;
- Nippo Ltd. by Freesia Macross Co., Ltd., announced in January 2021; and
- Japan Asia Group Limited by CI11, announced in April 2021.

Before Itochu Corporation's successful takeover of Descente Ltd. completed in March 2019, almost all hostile takeovers in Japan had failed. But recent hostile takeovers have been generally successful. In the tender offers referenced in the above examples, (i) to (iii) were successful, while (iv) and (v) were ongoing as of 31 May 2021. This trend may have resulted from the phenomenon that (i) cross-shareholdings among listed companies for business reasons have decreased following the amendments to the Corporate Governance Code announced by the Tokyo Stock Exchange in 2018, and (ii) the number of Japanese institutional investors employing the Stewardship Code is increasing and such investors have recently been inclined to accept better offers even though they are hostile.

Another trend is the increasing number of going-private transactions of listed subsidiaries. There were about 15 cases in 2020. Recent major examples of delisting of listed subsidiaries cover tender offers for:

- Sony Financial Holdings Inc. by Sony Group Corporation, announced in May 2020;
- NTT Docomo, Inc. by Nippon Telegraph and Telephone Corporation (NTT), announced in September 2020; and
- FamilyMart Co., Ltd. by Itochu Corporation, announced in July 2020.

There had previously been a unique phenomenon in Japan where major listed companies had a tendency to hold the listing status of some of their subsidiaries to maintain their reputation. However, the Tokyo Stock Exchange announced its plan to review the listing classifications in February 2020, which will take effect in April 2022. Also, in June 2019, the Ministry of Economy, Trade and Industry issued the Fair M&A Guidelines, updating the prior MBO Guidelines issued in 2007, to ensure fairness not only in MBOs but also in acquisitions of a controlled company by a controlling shareholder. The expected review of the listing classifications caused major Japanese listed companies to initiate the delisting of their listed subsidiaries, while the Fair M&A Guidelines provided safe harbour rules for going-private transactions.

Regulations on Foreign Investments

Foreign direct investments triggering prior-notification requirements

About one year has passed since the amended regulations on foreign direct investments (FDIs) in Japan under the Foreign Exchange and Foreign Trade Act (FEFTA) have taken effect. Under the FEFTA, when a foreign investor carries out an FDI targeting a Japanese company (the "Target Company"), and the Target Company and its subsidiaries conduct businesses relating to certain "Designated Business Sectors" that may have an impact on Japan's national security, public order or public safety, then the foreign investor is required to file a prior notification before implementing such FDI. During the past

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year, cases that went through the prior-notification examination process have accumulated.

With regard to FDIs conducted through stock purchases, a prior notification is not required if the foreign investor complies with certain conditions. For example, the regular exemption conditions available to general non-Japanese investors (excluding state-owned enterprises) planning to invest in a Target Company conducting business in Designated Business Sectors (excluding certain specific core Designated Business Sectors) include:

- the foreign investor and its closely related persons will not become directors or corporate auditors in the Target Company;
- the foreign investor will not make proposals at shareholders' meetings for the transfer or disposition of the Target Company's business activities relating to the Designated Business Sectors; and
- the foreign investor will not access non-public information about the Target Company's technologies relating to the business in the Designated Business Sectors.

Notably, the threshold for the prior-notification requirement for stock purchases in a listed company was lowered from 10% to 1%, while even a single stock purchase in an unlisted company is enough to trigger this notification requirement.

If a foreign investor plans to purchase 1% or more shares in a listed Target Company (or a single share in an unlisted company), which conducts business in Designated Business Sectors, and such investor is unable to comply with the exemption conditions enumerated above, then such investor is required to file a prior notification with the Japanese government via the Bank of Japan in order to obtain regulatory clearance.

In March 2021, a subsidiary of the Chinese information technology company Tencent obtained a 3.65% stake in the online retailing and wireless carrier giant Rakuten Inc. without filing a prior notification. They explained that the deal was a purely financial investment that is exempt from prior notification. However, since Rakuten's business involves a significant amount of personal information and Tencent is one of the representative companies entangled in the economic battle between China and the United States, it was reported that, for national security reasons, Japanese and US authorities will be monitoring if the foreign investor will commit any illegalities as a result of the investment, including accessing non-public information of Rakuten that is one of the conditions for the exemption explained above.

Outline of the prior-notification examination process

A foreign investor who files a prior notification must observe a statutory waiting period of 30 days from the date of the filing. During this period, the Ministry of Finance (MOF) and the relevant ministries will examine the contemplated investment. This period is often shortened to two weeks if the authorities do not need to scrutinise the investment. However, if they find the necessity to carefully scrutinise the investment for possible risks to national security, etc, then the waiting period may be extended for up to five months from the date of the filing.

The authorities may give recommendations to the foreign investor and, if the investor does not observe the recommendation, order the suspension or amendment of the investment. In addition, if the foreign investor fails to comply with the prior-notification requirement, or the waiting period or the order of the suspension or amendment, then the authorities may order the disposal of any acquired shares or impose any other remedial measures they deem appropriate.

Criminal punishment is also stipulated for these violations.

Practical implementation of the prior-notification examination process

Factors that the authorities consider in the examination process are publicly available on the MOF's website (in Japanese). The authorities, taking into account these factors, evaluate whether the intended investment poses any risk to national security, etc, mainly from the perspective of the following:

- the attributes of the foreign investor;
- the attributes of the Target Company; and
- the purpose and effect of the contemplated investment.

In the process of the examination, in practice, the authorities send certain questionnaires to the foreign investor in order to obtain information regarding the above factors. Depending on the answers received from the investor, further questions may be asked. Frequent or typical matters included in the questionnaires include:

- matters concerning the investor or affecting the business policies of the investor; and
- matters concerning the notified investment.

Generally, relevant documents are also requested, including capital relationship diagrams of the investor group, schematic diagrams of the entire investment and related contracts, and summaries.

In practice, when the authorities recognise that the intended investment poses concerns to national security, etc, they terminate the examination and recommend to the foreign investor to include certain compliance requirements in the notification form in order to avoid the issuance of an order of suspension or amendment of the investment. The details of the compliance requirements are generally proposed to the investor by the authorities taking into consideration the information stated in the notification form and the answers to the questionnaires. These compliance requirements may be very similar to the regular exemption conditions mentioned above. If the investor withdraws the original notification and refiles a new notification containing the compliance requirements that the investor has agreed to, the waiting period could be shortened to four business days from the acceptance date.

Labour and Employment

Influence of COVID-19

Teleworking

The COVID-19 pandemic continues to spread in Japan as the country experiences a fourth wave of increasing infections at the time of writing. To prevent the spread of infection, many companies have adopted teleworking as a new work style. For its part, the government has attempted to promote and encourage teleworking to make it common practice, and has amended the related guidelines on 25 March 2021.

These guidelines illustrate the government's interpretation of some legal points, as well as set forth aspirational conduct when teleworking is implemented; for example, how working hours and maintaining workers' health during the course of teleworking should be managed. Generally, employers should administer and record the working hours of each employee under the labour laws and take due care not to harm the workers' health due to the working environment, including long working hours. The Labour Standards Act (LSA) currently allows employers to adopt an "off-site deemed working hours system", but its requirements are strict and narrowly construed. The amended guidelines provide an interpretation that enables employers to adopt a system that is broader than usual.

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Shutdowns and subsidies

The pandemic has caused a huge decrease in the business needs in some industries. Many companies were forced to shut down, in whole or in part, occasionally due to the state of emergency declarations made by the government. Under the LSA, if a leave of absence is taken due to reasons attributable to the employer, a leave allowance of 60% of the average wage must still be paid to the employee. Even if the leave is due to the influence of COVID-19, it is interpreted as a cause attributable to the employer unless force majeure is found, such as when the leave is due to the government's request. The provision of subsidies by the government has been extended until the end of June 2021; however, it is not clear up to when the provision of subsidies will be extended.

Secondments

One of the ways by which employers are trying to survive the current circumstances is by utilising secondments. Secondments fall under "labour supply", which is defined and regulated by the Employment Security Law under Japanese Law. Before COVID-19, the Ministry of Health, Labour and Welfare (MHLW) allowed secondments under certain limited purposes, such as for personnel exchanges within a corporate group. Recently, the MHLW provided new guidelines and clarified its policy of allowing more lenient, repetitive secondments in order to maintain employment. Companies with a surplus labour force may second their employees to companies seeking labour, which arrangement is endorsed by the guidelines.

Freelance guideline

In Japan, the freelance work style has been rapidly expanding, and this further expanded during the COVID-19 pandemic. The government has stated that it is necessary that an environment be created where individuals who so desire can choose to do freelance work. On 26 March 2021, under the joint names of several administrative agencies, including the MHLW, the "Guidelines for creating an environment where people can work with peace of mind as freelancers" were issued. The guidelines focus on protecting freelancers from the exploitative conduct of their clients, as well as provide the criteria for determining when labour legislation should be applied. Although the guidelines do not mention any social security, such as a workers' accident compensation insurance system and/or an employment insurance system, as a safety net, the government recently began to consider including freelancers under the workers' accident compensation insurance system. There are currently no moves pertaining to applying employment insurance or a minimum wage to freelancers.

Three Supreme Court cases on equal pay for equal work

In Japan, the number of non-regular workers has been increasing in the past 30 years, and their poor working conditions and treatment have become a social problem. Non-regular workers include fixed-term and part-time workers. The Labour Contract Act (LCA) was amended in 2012 to improve the treatment of non-regular workers. Article 20 of the LCA was adopted by Article 8 of the Act on Improvement of Personnel Management and Conversion of Employment Status for Part-Time Workers and Fixed-Term Workers, and these articles prohibit employers from setting an unreasonable disparity in the treatment of regular versus non-regular workers.

On 13 and 15 October 2020, three Supreme Court cases were rendered in this regard. The Supreme Court promulgated labour principles regarding the differentiation between regular and non-regular workers in the giving of retirement allowances (Metro Commerce case; Third Small Court), bonuses (Osaka Medical and Dental University case; Third Small Court), and

various allowances and treatments (Japan Post case; First Small Court). Although all of them are case judgments, it is noteworthy that the Supreme Court endorsed the differentiation in basic salaries, bonuses and retirement allowances between regular and non-regular workers if the reason for such differentiation is to secure proficient human resources. This principle sanctions the more generous treatment of regular employees if the purpose of such treatment is to allow the employer to secure and retain competent workers. When this theory is applied, even if there is a considerable difference in treatment between regular and non-regular employees, such difference would not be considered unreasonable. Thus, the Supreme Court judged that the disparity in the treatments under both the Metro Commerce case and the Osaka Medical and Dental University case was not unreasonable.

On the other hand, in the case of Japan Post, the Supreme Court stated that, regarding peripheral, incidental allowances and other treatments, if the objectives and purposes thereof also apply to non-regular employees in light of the purposes of such allowances and treatments, then differentiating between regular and non-regular workers will be deemed unreasonable.

Personal Information Protection

Enforcement

In March 2021, it was reported that the personal information of the users of LINE, a leading social networking service provider in Japan, was being stored in foreign countries, including China, and that there were issues with the processing of the information. In response, the Personal Information Protection Commission (PPC) requested LINE to report the relevant facts and conducted on-site inspections. As a result of this, the PPC issued an interim release in April 2021 announcing that it had provided guidance to LINE due to the latter's problems in managing its processors, while stating that there were no major issues with the international transfers.

Recent amendments of the APPI

The Act on the Protection of Personal Information (APPI) is currently in the middle of one of the most extensive amendments since its enactment in 2003, with two amendments passed by the Diet in 2020 and 2021 awaiting implementation.

Latest update on the 2020 Amendment

The APPI amendments in 2020 added many new provisions. At present, the Cabinet Order and the Enforcement Rule have been enacted, and the draft of the PPC Guidelines was published in May 2021 and is currently open to public comment.

The amendments aim to reinforce personal information protection, including the following:

- strengthening the data subject's rights;
- regulation of certain information related to cookies;
- mandatory reporting of certain data breaches to the PPC; and
- strengthening rules on cross-border transfers.

In addition, it introduces a new concept of "pseudonymised data" to facilitate the use of data. The amendments will take effect on 1 April 2022.

2021 Amendment

Other than the 2020 Amendment, another amendment was enacted in May 2021. This amendment changes the entire personal information protection system in Japan. Currently, the APPI applies only to the private sphere, and the PPC oversees only that sector. In contrast, two laws, the Act on the Protection of Personal Information Held by Administrative Organs (APPIHAO) and the Act on the Protection of Personal Information Held by Incorporated

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Administrative Agencies, etc (APPI-IAA), control the national public institutions. Furthermore, the local governments' processing of personal information is regulated by their respective personal information protection ordinances. There is no independent supervisory authority for these public sectors.

The 2021 amendment of the APPI aims to integrate the rules for these public areas into the APPI. As a result, the private sector entities and most public sector entities will be subject to the amended APPI and supervised by the PPC.

This amendment is anticipated to facilitate the flow of data between the public and private sectors. The government also intends to negotiate with the EU to expand the latter's adequacy decision with respect to Japan. Currently, the decision only covers the private sector.

Since the amendment will primarily integrate the rules for the public sector into the APPI, it will have less impact on private businesses than on public entities. However, certain companies, such as those conducting joint research with a university, may be affected.

The integration of the APPIHAO and the APPI-IAA will take effect in 2022, and the integration of the local government ordinances will take effect in 2023.

Regulation of digital platforms

On 1 February 2021, the Act on Enhancing Transparency and Fairness of Specified Digital Platforms came into effect. On 1 April 2021, the Ministry of Economy, Trade and Industry (METI) designated five online mall and app store operators – including Amazon, Apple and Google – as providers of specified digital platforms. The Act imposes several obligations on them, including disclosing the terms and conditions of transactions and submitting reports to the METI every year.

Currently, the government plans to apply the Act to online advertising platform providers. It will amend the Government Order on the Act to expand it in autumn 2021. Furthermore, at the same time, the Ministry of Internal Affairs and Communications will also provide guidelines for the processing of personal data in the context of online advertising by amending the Guidelines for Protection of Personal Information in the Telecommunications Business.

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Oh-Ebashi LPC & Partners is a full-service law firm with over 140 attorneys, and with its main offices in Tokyo and Osaka. It was originally established in Osaka in 1981 and now has an equivalently sized operation in Tokyo. Oh-Ebashi was the first Japanese law firm to open an office in China. Together with its Nagoya Office, Oh-Ebashi currently has offices in four locations. Oh-Ebashi has been providing its clients with the best legal advice and solutions for decades, and is committed to consistently exceeding the clients' expectations and being their ideal legal partner. The legal practice at Oh-Ebashi covers a broad range of fields, including corporate/M&A, risk management and compliance, intellectual property, life sciences, restructuring/insolvency, competition and antitrust/consumer protection, dispute resolution, finance and insurance, employment law, administration/regulatory law, tax law, international practice, Chinese/Asian practice, private practice, and pro bono practice.

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