Japan

Takeover Guide

Contacts

Tatsuya Taniguchi
TMI Associates, Tokyo
ttaniguchi@tmi.gr.jp

Masanori Bito
TMI Associates, Tokyo
mbito@tmi.gr.jp

Contents

Page

INTRODUCTION 1
MANDATORY TENDER OFFERS 2
TENDER OFFER PROCESS 4
DUTIES OF TENDER OFFERORS AND TARGET COMPANIES 7
CODE OF CONDUCT FOR DIRECTORS 10
SQUEEZE-OUT PROCEDURE 11
ENFORCEMENT AND REGULATORS 12

INTRODUCTION

Tender offers

In Japan, tender offers are generally used in the acquisition of Japanese listed companies. This guide provides an overview of the regulatory environment for tender offers for shares listed on a Japanese stock exchange.

Although the acquisition of Japanese listed companies to make them wholly owned subsidiaries of the acquirer (takeover transactions) can be structured as reorganisations (eg, mergers or share exchanges) or squeeze-outs (eg, consolidation of shares), these methods require the approval of two-thirds or more of the votes of the shareholders present at the shareholders' meeting of the target company. To ensure transaction certainty, in practice, a tender offer is frequently utilised as the first step in takeover transactions.

Further, a partial tender offer may be implemented, in which portions of shares in a listed company are acquired. As mentioned below, there is a mandatory tender offer system, in which a bidder must make a tender offer when it intends to acquire shares through off-market trading or on-market off-floor trading that would result in holding more than one-third of the voting rights after such a transaction. Accordingly, a tender offer is also used in order to make a listed target company a consolidated subsidiary that remains listed. In practice, we have also seen discounted tender offer bids (TOBs) (tender offers whose acquire prices are below the market prices) such that only shares from major shareholders are acquired.

Although it is legally possible to use the shares of a tender offeror as consideration in a tender offer, this is rarely seen in practice. Instead, cash is used as consideration in most tender offers. This trend has been spurred by many different regulatory and tax reasons.

Applicable laws and regulations

Japanese laws and regulations relating to tender offers mainly consist of the Companies Act, the Financial Instruments and Exchange Act (the 'FIEA'), and stock exchange rules.

The FIEA regulates tender offers themselves, and the Companies Act regulates the subsequent reorganisations and squeeze-outs. If a target is a

listed company, the relevant stock exchange rules also apply, and the bidder and target must comply with various disclosure regulations, including timely disclosure rules under the relevant stock exchange rules, in addition to disclosure regulations under the FIEA.

MANDATORY TENDER OFFERS

Prior restraint

If an acquirer intends to acquire the shares of a listed company such that its voting right ratio would exceed a certain threshold after such a transaction, such an acquisition requires a tender offer. This type of prior restraint rule is unique to Japan when compared to the tender offer rules of other countries, which require a tender offer only after the consummation of an acquisition that has exceeded a certain threshold.

In principle, Japanese tender offer regulations regulate off-market trading,[1] but do not regulate the acquisition of newly issued shares, unless certain exceptions are present. The Companies Act, rather than the FIEA, applies to the acquisition of newly issued shares that result in a shareholder holding the majority of voting rights. Under the Companies Act, although the issuance of new shares is generally allowed only with the approval of the board of directors of the issuing company, if the shareholders owning ten per cent or more of the voting power of the issuing company dissent from such an acquisition, approval at the shareholders' meeting of the issuing company is required.

Threshold

An acquirer must make a tender offer if its voting rights ratio would exceed the following thresholds as a result of the acquisition of shares[2] in a company that is obliged to submit an annual securities report.[3] The voting rights ratio is

---

[1] The mandatory tender offer rule also applies to off-floor trading with respect to the one-third rule (see item 2 in the 'Threshold' section), and to off-floor trading and on-market trading with respect to the Competing Bids Rule (see item 4 in the 'Threshold' section).
[2] The mandatory tender offer rule applies not only to the acquisition of shares but also to the acquisition of certain convertible securities, including share acquisition rights (*shinkabu yoyakuken*) and bonds with share acquisition rights convertible into shares (*shinkabu yoyakuken tsuki shasai*).
[3] A listed company is a typical example of a company that must submit an annual securities report. In addition, companies that engage in offerings regulated under the

determined taking into account aggregation with any 'Persons in a Special Relationship'.[4,5] The most important rule in practice is the one-third rule.

1. Five per cent rule: The acquirer must make a tender offer if it intends to: (i) acquire shares from ten or more persons within 60 days through off-market trading; and (ii) its voting rights ratio would exceed five per cent as a result of such an acquisition.

2. One-third rule: The acquirer must make a tender offer if it intends to: (i) acquire shares through off-market trading or on-market off-floor trading; and (ii) its voting rights ratio would exceed one-third as a result of such an acquisition.

3. Rapid acquisition rule: The acquirer must make a tender offer if: (i) it intends to acquire shares having greater than ten per cent of voting rights of the target within three months; (ii) the acquisition would include a transaction to obtain more than five per cent of voting rights through off-market trading or on-market off-floor market trading; and (iii) the voting right ratio would exceed one-third as a result of such an acquisition. This rule intends to prevent the evasion of the one-third rule by a combination of off-market trading, on-market trading and the acquisition of newly issued shares. For example, the acquirer could avoid the one-third rule if it acquired 32 per cent of voting rights through off-market trading or on-market off-floor trading, and then acquiring an additional two per cent of voting rights by on-market trading or the acquisition of newly issued shares, but such an acquisition would require a tender offer through this rapid acquisition test.

4. Competing bids rule: While a tender offer for shares by a third party is pending, the acquirer must make a tender offer if: (i) the acquirer already has

---

Japanese offering regulations or have a certain number of shareholders in Japan must submit an annual securities report.

[4] 'Persons in a Special Relationship' means persons who, with the acquirer, agree to jointly acquire or transfer shares, to jointly exercise voting rights, or to transfer or accept shares after the transaction. Persons or entities are also regarded as Persons in a Special Relationship if there exists a certain shareholder (in general with 20% or more of voting rights) or family relationship.

[5] The voting rights ratio is determined taking into account not only voting rights for shares that the acquirer and its Persons in a Special Relationship actually hold, but also cases in which they have authority to exercise voting rights or to invest the shares, and other similar cases.

more than one-third of the voting rights of the target; and (ii) the acquirer intends to further acquire more than five per cent of the voting rights of the target during the tender offer period.

TENDER OFFER PROCESS

Negotiations with the target company and individual shareholders

The usual first step in a tender offer process is negotiations between the tender offeror and the target company or its major shareholders. While a tender offeror may often kick off the negotiations, the target company, or its major shareholders, sometimes approach potential tender offerors to begin the bidding process.

Taking into account the code of conduct applicable to the directors of the target company (mentioned below), particularly where a tender offeror intends to conduct a subsequent squeeze-out transaction, the tender offeror usually negotiates the terms of a tender offer with the target company in advance.

Tender offerors usually launch tender offers only where they expect affirmative support from the target company. That being said, it is not common practice for tender offerors to enter into a contract with a target company that obligates the target company to affirmatively support the tender offer. On the other hand, recently, the number of tender offers without such affirmative support from the target company (unsolicited/hostile tender offers) has increased.

If the target company has major shareholders, tender offerors sometimes negotiate with its major shareholders and enter into a contract requiring them to tender their shares in a tender offer, prior to the commencement of the process, in an attempt to increase the odds of successful completion. However, a tender offeror may confront difficulties in enforcing the contract, and it may not be legally enforceable.

Acquisition prior to tender offer

The acquisition of shares of the target company by a tender offeror before the commencement of a tender offer is not common in a friendly deal, although it is not prohibited.

If the tender offeror acquires more than five per cent of the voting shares of the

target through off-market trading or off-floor trading, the tender offeror may be in violation of the Rapid Acquire Rule. Further, when a tender offeror's shareholding ratio[6] exceeds five per cent, the tender offeror must submit a large shareholding report within five business days from the date upon which the ratio exceeded five per cent, as well as, in principle, a change report each time the rate fluctuates by one per cent or more or a certain important item under the report changes. Accordingly, a tender offeror should take care to appropriately disclose its acquisition if it acquires shares of the target company.

Although it is not common in a friendly deal for a tender offeror to acquire shares in a target company prior to the commencement of the tender offer, in practice, even in a friendly deal, some acquirers acquire one share unit prior to the commencement of the tender offer, and use that holding to inspect the shareholders record of the target so that they may directly solicit the shareholders.

A tender offeror must disclose the status of the share transactions of the target company by itself and by Persons in a Special Relationship for a period of 60 days before the commencement of the tender offer in a tender offer statement, which is discussed in more detail below.

Governmental approvals

Tender offer regulations do not require a tender offeror to obtain prior approval, authorisation or clearance from any governmental entity for the acquisition of shares under antitrust or competition laws, the foreign exchange and foreign trade act or any other laws before the commencement of the tender offer. If the tender offeror fails to obtain governmental approvals by the end of the tender offer period, it can withdraw the tender offer.

In practice, however, we see many tender offerors obtain all applicable governmental approvals before the commencement of a tender offer. If not, they generally at least set a timeline for obtaining the applicable governmental approvals prior to the end of the tender offer period.

When it is expected that it will take a long time to obtain governmental

---

[6] Strictly speaking, the definitions of shareholding ratio under the tender offer rule and large shareholding report are not exactly the same.

approvals, or it is practically impossible to start the procedures for obtaining governmental approvals before public announcements of the tender offers are made, some tender offerors will nevertheless prepare for the commencement of tender offers and make public announcements before obtaining the applicable governmental approvals. These announcements lay out all details of the proposed tender offer, including the tender offer prices and plans to launch subject to obtaining the applicable governmental approvals ('Prior Notice Tender Offers'). In practice, we have not seen any situation in which a tender offer has not been launched where all applicable governmental approvals were obtained after a public announcement of a Prior Notice Tender Offer.

Pre-consultation with authorities

Prior to the commencement of a tender offer, in practice, a tender offeror usually submits a draft of the tender offer statement to the Kanto Local Finance Bureau for its review. Generally, this process begins about three weeks before the commencement of the tender offer, and the Kanto Local Finance Bureau comments on the details of the draft.

In the case of a friendly tender offer, the target company also submits a draft of a press release to the stock exchanges for their review, as required by the timely disclosure rules for the stock exchanges. The target company is required to initiate this process at least ten days before the commencement of the tender offer.

Response to information leakage

Under the applicable stock exchange rules, if information about a tender offer is leaked by the press before the commencement of the tender offer, the target company is required to issue a press release, in a timely manner, regarding the information leakage. Because information leakage may have a material impact on the market price of the target company, many target companies implement thorough information management systems and make preparations in advance to deal with possible information leakage. On the other hand, information leakage does not force the tender offeror to take actions, such as commencing the tender offer.

Commencement and termination of tender offers

In the event of a friendly deal, a tender offer is usually launched on the business day following the day of the press release required by the timely disclosure rules, other than for Prior Notice Tender Offers. On the commencement day, the tender offeror must make a public notice of the commencement of the tender offer and submit a tender offer statement.

The period of a tender offer must be at least 20 business days and a maximum of 60 business days under the FIEA. However, in case that the target company is expected to become a wholly owned subsidiary after the tender offer, to allow the shareholders to sufficiently consider their tenders and ensure that other bidders have opportunities to seek their own tender offers, it is considered appropriate to set this period to 30 business days or more. Therefore, it is a common practice for this period to be 30 business days or more, in such cases.

On the business day following the day when the tender period ends, the tender offeror must disclose the result of the tender offer, including whether the tender offer was successfully completed and the number of tenders, by submitting a tender offer report. The listed target company must also issue a press release in a timely manner as to the result of the tender offer.

Squeeze-out

If a tender offeror intends to make the target company its wholly owned subsidiary, the tender offeror must indicate the details of its intention to do so in the tender offer statement. It will carry out squeeze-out proceedings following the successful completion of the tender offer. It usually takes approximately one month for squeeze-out proceedings to be completed where approval by the shareholders' meeting of the target company is not required (ie, the tender offeror holding 90 per cent or more of the voting rights of the target company) and it usually takes at least approximately three months where approval by the shareholders' meeting of the target company is required.

DUTIES OF TENDER OFFERORS AND TARGET COMPANIES

Disclosure regulation

A tender offeror must make a public notice of the commencement of a tender offer on the date of the commencement of the tender offer. The tender offeror

must submit the tender offer statement through the Electronic Disclosure for Investors' Network ('EDINET'), which is managed by the Financial Service Agency in Japan. The tender offeror must register for EDINET in advance. The public notice and the tender offer statement will be publicly disclosed via EDINET.

The terms of the tender offer, including the acquisition price, number of shares planned to acquire, including the maximum or minimum limit, the period and qualitative items, such as the purpose of the tender offer, are set forth in the public notice and the tender offer statement.

Equal opportunities

The tender offer price must be the same for all shareholders who tender their shares.[7] If a tender offeror has a maximum limit to the number it will acquire, it must acquire tendered shares on a pro rata basis.

Prohibiting acquisition outside of a tender offer

Generally, a tender offeror, its Persons in a Special Relationship and its agents must not acquire the target company's shares outside of the tender offer during the tender offer period.

Change to the terms of acquisition for a tender offer

In principle, after the commencement of a tender offer, a tender offeror may not change the terms of the tender offer to disadvantage the tendering shareholders. Prohibited changes include lowering the acquire price, reducing the number of shares to acquire and shortening the period.

If the tender offeror changes certain terms of the tender offer and the period has less than ten business days remaining, the tender offeror must extend the period to the expiration of ten business days from the change.

Withdrawal of a tender offer

In principle, after the commencement of a tender offer, a tender offeror may not withdraw the tender offer. Exceptions are extremely limited and allowed under circumstances listed under the FIEA, and in the event that withdrawal is

---

[7] However, a tender offeror may set different prices on different classes of shares or share acquisition rights if these prices are substantially equal.

allowed, a tender offeror wishing to withdraw must submit a withdrawal report by disclosing that it will effect a tender offer withdrawal, the reasons and other details on both its tender offer notice and tender offer statement.

Maximum or minimum limit for the number of shares to be acquired

A tender offeror may put a maximum or minimum limit on the number of shares to be acquired. If the tendered shares exceed the maximum limit, the tender offeror must acquire such shares on a pro rata basis. If the tender offeror sets a minimum limit, no tendered shares will be acquired if the number of tendered shares does not meet the minimum.

On the other hand, a tender offeror may not set a maximum limit that enables the tender offeror to hold two-thirds or more of the voting rights following the tender offer. In this situation, the tender offeror must make a bid for the entire class of shares and certain other equitable securities.

Rules for the acquisition price

While the acquisition price in a tender offer must be the same for all tendering shareholders, there are no other limitations with respect to the acquisition price. If a tender offeror intends to make the target company its wholly owned subsidiary, the tender offeror usually adds a premium to the acquisition price. Usually this premium price is greater than the prevailing market price, but a tender offer whose acquisition price is below the market price is also allowed, called a 'discounted TOB'. In practice, discounted TOBs are used for some partial tender offers, mainly from a specific major shareholder.

Rules for the target company

The target company must submit a position statement and clarify its position on the tender offer within ten business days from the date of the public notice of the commencement of the tender offer. This position statement generally includes: (1) support or non-support with respect to the tender offer; and (2) a recommendation or opposition for shareholders to tender their shares. As to both (1) and (2), the target company may take a neutral position, or withhold and defer its position. The target company may change its position during the period of the tender offer, and if that happens, the target company must submit an amendment to the position statement.

A listed target company must issue a press release regarding the commencement, and its position, of the tender offer, pursuant to the timely disclosure rules. In practice, the contents of the press release are nearly identical to those of the position statement.

If the tender offer period is less than 30 business days, the target company may require the tender offeror to extend the period to 30 business days.

The target company may ask the tender offeror questions in its position statement. In such a case, the offeror must submit a document stating its response to the questions, or, if it declines to respond, the reasons why, within five business days from the date when the offeror receives a copy of the position statement.

The target company's position statements and tender offeror's responses are publicly disclosed on EDINET.

CODE OF CONDUCT FOR DIRECTORS

Duty of directors in the target company

In the phase of the tender offer and subsequent squeeze-out, as a part of the duty of care and duty of loyalty of directors towards the target company under the Companies Act, the directors of the target company have certain duties relating to the fairness of the acquisition price, which may be called the 'duty to transfer fair corporate value' or 'duty to consider the interests of shareholders', depending on the circumstances.

Fairness ensuring measures

To avoid conflicts of interest in takeover transactions, it is common that the directors of a target company take certain measures to ensure fairness. Transactions where these types of measures are implemented in practice include takeovers by a controlling shareholder and management buyouts ('MBOs').

The 'Fair M&A Guidelines', published by the Ministry of Economy, Trade and Industry ('METI') in July 2019, has an important role with respect to fairness-ensuring measures. We have seen most parties to a conflict of interest transaction adhere to these measures, including the establishment of a special committee and retaining of independent advisers, including legal and financial

advisers. That said, some measures mentioned in the guidelines are not always adopted depending on the circumstances of the deal, such as active market checks and majority of minority conditions.

Takeover defence

We have seen some target companies take takeover defence measures if the board of directors of the target company oppose the tender offer. For example, a target company may implement a rights plan if it has one in place. A typical rights plan requires a tender offeror who intends to acquire 20 per cent or more of the voting rights to comply with certain procedural rules, and if the tender offeror does not comply with them, the rights plan authorises the target to implement takeover defence measures with discriminatory terms against the tender offeror. Also, we have seen some target companies (without any rights plan being introduced prior to the commencement of the tender offer) newly introduce and implement a rights plan, or another takeover defence measure, after the commencement of the tender offer.

In the *Bull-Dog Sauce* case, the Supreme Court of Japan held in 2008 that a valid rights plan requires that: (1) it is likely that the takeover by a certain shareholder will damage the target company's corporate value and the interests of general shareholders, as the takeover will make it difficult for the target company to continue and develop its business; and (2) the contents of the rights plan are not unreasonable.

The number of cases involving takeover defence measures in Japan has increased since around 2019. Although there are neither definite precedents nor concrete views on this matter yet, given the *Bull-Dog Sauce* case, we have recently seen many cases in which shareholders' meetings of the target companies have approved the introduction and/or implementation of rights plans in view of requirement (1) mentioned above.

SQUEEZE-OUT PROCEDURE

If a tender offeror intends to make the target company its wholly owned subsidiary, the tender offeror will initiate squeeze-out procedures after the completion of the tender offer. Methods for squeeze-out procedures include: (1) a demand for share cash-out; (2) a consolidation of shares; (3) a process involving shares subject to a class-wide call; and (4) a share exchange.

Recently, the trend is to demand share cash-out or a consolidation of shares to be used if the consideration is cash, and share exchange if the consideration is shares.

If a tender offeror holds 90 per cent or more of all voting rights in the target company after the tender offer, the tender offeror can easily squeeze out minority shareholders without needing any approval of the shareholders' meeting of the target company, either through a demand for share cash-out or a share exchange in a summary form, provided that these methods result in only one shareholder in the target company immediately following the squeeze-out procedure, with exceptions for the tender offeror's wholly owned subsidiaries in the case of a demand for share cash-out.

On the other hand, if a tender offeror holds less than 90 per cent of all voting rights in the target company after the tender offer, a squeeze-out procedure, through the method of consolidation of shares, a process involving shares subject to a class-wide call, and a share exchange in an ordinary form, is subject to approval by two-thirds or more of the votes of shareholders present at the shareholders' meeting of the target company.

If a tender offeror intends to make the target company its wholly owned subsidiary, the tender offeror must disclose at the commencement of the tender offer that: (1) the tender offeror plans to conduct a squeeze-out procedure; and (2) the consideration amount of the squeeze-out procedure will be substantially the same as that of the tender offer.

To protect minority shareholders in a squeeze-out procedure, dissenting shareholders may be entitled to file appraisal proceedings, seek an injunction of the squeeze-out, or seek revocation of a resolution at the shareholders' meeting for the squeeze-out procedure. Although it might be theoretically possible that minority shareholders seek an injunction on the tender offer itself, they rarely do so in practice, instead challenging the squeeze-out procedures themselves, in particular through appraisal proceedings.

ENFORCEMENT AND REGULATORS

A tender offeror who violates the tender offer regulations under the FIEA is subject to criminal penalties. Although the tender offeror may be subject to an administrative emergency injunction, this prior restraint action has never been

used against a tender offer, to date.

If an acquirer acquires shares by a process other than a tender offer in violation of a mandatory tender offer rule, or if a public notice of the commencement of a tender offer or a tender offer statement contains a misrepresentation of material facts, then the acquirer is subject to administrative surcharges.

If a tender offer statement contains a misrepresentation of material facts, or does not meet the statutory requirements, the tender offeror is subject to an order to amend the statement.

The above administrative enforcement actions are under the jurisdiction of the Financial Services Agency and its authorities are partially delegated to the inferior bureau, the Kanto Local Finance Bureau.