

Japan's Trends in Dealing with Open Markets

A presentation at the TerraLex APRM Session

“Globalization and Anti-Takeover Mechanisms: Current Trends and Strategies”

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by

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I. Introduction

It is a privilege to be able to make a presentation on company law aspects of new types of merger arrangements in Japan. I thank the organizers of the Session for providing this opportunity.

After sketching the recent amendment of the *Company Act* in Japan, I briefly explain the "triangular merger" and some anti-takeover mechanisms.

II. Enactment of *Company Act*

The basic statute covering merger in Japan is the *Company Act* (Law No. 86 of 2005). In Japan, there were no statutes with the title “Company Law.” Laws regarding the company were essentially sections in the *Commercial Code*, the *Private Company Law* and the *Law for Special Exceptions concerning Audit, etc. of Kabushiki-Kaisha*.¹

The *Company Act* is a new law enacted by amending the parts of the old law governing companies that were contained in the *Commercial Code*.

The *Company Act* has amended the law in major ways. For example, a company can now be set up with a capital amount of just one yen. Before, the minimum capital amount for setting up a *kabushiki kaisha* (joint stock company) was 10 million yen. In the case of a *yugen kaisha*, it was 3 million yen. So, it has become easier to set up a company. In the case of a *kabushiki kaisha*, at least three directors must be appointed. However, under the new system, only one director is necessary. Also, the law now

¹ In Japanese, these are, respectively, the *Sho ho*, the *Yugen kaisha ho*, and the *Kabushikigaisha no kansatou nikansuru shoho notokurei ni kansuru horitsu*.

permits greater flexibility with regard to consideration in reorganization.. This is where “triangular mergers” come in. This new flexibility in compensation allows “triangular mergers” to be carried out.

III. Triangular Mergers

Most provisions of the *Company Act* entered into force on May 1, 2006, but the provision on flexibility with regard to consideration was given a 1-year grace period² and will come into force on May 1, 2007. “Flexibility with regard to consideration” means that assets delivered to a company (or its shareholders) as consideration for reorganization may be as broadly defined as “money or other assets.” The prior rule generally required shares of the surviving company as such consideration.³

Under the previous system, if Company A (a Japanese company) merged into Company B (a Japanese Company) and Company B was a surviving company, shareholders of Company A would receive shares of Company B. A merger of a Japanese company and an overseas (non-Japanese) company was prohibited.

Under the *Company Act* the situation is changed. For example, if a 100% subsidiary of a *kabushiki kaisha* merges into itself another company, in consideration for the merger the subsidiary may provide the shareholders of the absorbed and extinguished company with shares of its parent company instead of its own (i.e. the absorbing company’s) shares. A triangular merger results, in which the parent company may expand its business through this merger while continuing to hold all the shares of its subsidiary.

Once such flexibility is permitted, the exchange of shares of an overseas parent in exchange for shares of its 100% Japanese subsidiary will become legally possible by triangular merger through the Japanese subsidiary as an absorbing and surviving company. Under the old *Commercial Code*, courts had treated this as impossible.

Now, preparation of disclosure rules regarding the triangular merger is in progress.

In principle, there is no restriction on foreign direct investment in Japan, although it is required to file either a subsequent report, or prior notification, depending on the

² (Article 4 of the Supplementary Provisions of the *Company Act*)

³ See Art. 749, Par. 1, Sec. 2, and Art. 751, Par. 1, Sec. 3 of the *Company Act*, on amalgamation; Art. 758, Par. 4, and Art. 760, Par. 5, on absorption and division; Art. 768, Par. 1, Sec. 2 and Art. 770, Par. 1, Sec. 3, on exchange of shares.

industry. However, there are some business categories related to national security or national interests. These include nuclear fuel, aircraft, ordnance manufacturing, agricultural, forestry and fishery business, petroleum, leather and leather products manufactures. Such industries are subject to the requirement of prior notification. When a notification is made, the MOF and other competent ministers may recommend or order change in, or suspension of, the proposed transaction.

IV. Anti-take over defenses

Lastly, I will explain some anti-take over defenses.

Poison Pills

By so providing in the Articles of Incorporation of a company, the company may issue the class of shares all of which the company can compulsorily obtain by a special decision of the shareholders' meeting. The company can also issue a share warrants (*shinkabu yoyaku ken.*) Please note that there are two important court cases.

Livedoor v. Nippon Broadcasting System, Inc.

(Tokyo High Court Decision of March 23, 2005, *Hanji* 1899-56)

The NIRECO case

1. (Tokyo District Court Decision of June 1, 2005, *Kinyu-shoji Hanrei* 1218-8).

Golden Shares (*ogonkabu*)

This is a defense in which shares with refusal rights are used. It is legally possible to issue these shares, but stock exchanges have asked the companies to refrain from issuing golden shares.

Japanese companies are preparing for triangular mergers and many of them are trying to maintain a system of "stable shareholders" (*antei kabunushi*) under which companies own shares in each other.

The new *Company Act* is a useful tool for foreign companies to merge with Japanese companies, but practically it is important to analyze the situation of the target company including various circumstances surrounding the merger.