

Advisory
M&A Japan

An Overview of Tender Offers in Japan*

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Introduction

Takeover bids are becoming increasingly common in Japan, and are being used or considered by foreign buyers, both strategic and financial. Despite this, specific requirements remain often vague, especially to those unfamiliar with Japanese practice and requirements, and there is a noted lack of explanatory material of tender offers in the English language.

This document is intended to provide non-Japanese with initial guidance of the takeover process in Japan. It is not, however, intended to be an all inclusive reference around the subject, and further, it is emphasized that the area of tender offers is undergoing continual change. Readers should consult with their financial and legal advisors on each occasion, and we accept no responsibility for the completeness and continued accuracy of this document .

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Tender Offers in Japan-Overview (1/3)

- **The Financial Instruments and Exchange Law** (the FIEL) amending the Securities and Exchange Law of Japan in 2006, in principle, requires that any “off-market” acquisition of shares issued by a company which is either listed on a Japanese stock exchange or a continuously disclosing company (meaning that it is under an obligation to file securities reports in Japan) (“Offeree”) must be made by way of a tender offer. A tender offer (“Tender Offer”) is:
 - An offer made to a large number of unspecified persons to purchase securities, or
 - An invitation to such persons to make an offer to sell such securities
- The purpose of the Tender Offer system is to prevent specified stock transactions taking place without ordinary shareholders being afforded the opportunity to participate
- In principle, TOB regulations apply for the following transactions (see overleaf for the exceptions and refer to Article 27-2-1 of the FIEL for details).
 - More than 5% shareholding acquisition off market
 - More than 1/3 shareholding acquisition by specific transaction on market (e.g., Via ToSTNeT)
 - More than 1/3 shareholding acquisition by the combination of on and off market transaction within three months
- There is a need to appoint TOB agent (“Kokai-Kaitsuke-Dairinin”) (this would usually be a securities company)
- There is mandatory disclosure of TOB offeror (“Kokai-Kaitsuke-Todokeisho”)
- Company defense measures are becoming popular, but there are some limitations on use of excessive defensive measures (METI & MOJ Guidelines, TSE rules)
- Various discussions on overall revisions to the Takeover rules are still taking place– you need to recheck that you are up to date

Tender Offers in Japan-Overview (2/3)

- The following are some of the exceptions to the general TOB regulations for the off market transaction (as set out in Article 6 of the FIEL Enforcement Order):
 - Acquisition which results in a shareholding in the Offeree (including those held by related parties) not exceeding 5% of the Offeree's issued share capital; and
 - Acquisition from not more than 10 shareholders within any 60 days. However, if this acquisition off the market results in the acquirer's shareholding exceeding one third of the total issued share capital of the Offeree (including those held by related parties), the general TOB regulations will apply
 - Acquisition of the securities of a company of whose issued share capital the acquirer (included related parties) already owns more than 50% (only, however, when acquisition is from not more than 10 shareholders within any 60 days).
 - Transactions between affiliated companies

<i>When is a TOB be required</i>			
<i>Expected No. of shareholders to whom Tender Offer will be made</i>	<i>Ownership after TOB</i>		
	<i>Less than 5%</i>	<i>5% - 1/3</i>	<i>More than 1/3</i>
<i>A large number (>10) of unspecified shareholders</i>	<i>Not required</i>	<i>Required</i>	<i>Required</i>
<i>10 or less shareholders within 60 days</i>	<i>Not required</i>	<i>Not Required</i>	<i>Required</i>

Tender Offers in Japan-Overview (3/3)

- Documents required to be submitted:
 - a public notice: at least two (2) national newspaper or website (EDINET)
 - a registration statement (“kokai-kaitsuke-todokeidesho”) regarding take over bid (to the Prime Minister of Japan)
 - an explanatory booklet (“kokai-kaitsuke-setsumesho”) of the take over bid (to potential subscriber)
- Method
 - period of take over bid: 20 to 60 trading days
 - A bid can be conditional (i.e., specify minimum percentage required)
 - A bid can also specify the maximum %, however a mandatory offer for all stock is required if it is intended to acquire more than 2/3rds of outstanding shares.
 - Offerors are requested to buy equity from all offerees uniformly. (pro-rata if oversubscribed)
- It is not allowed for offerors to purchase target’s equity in stock market during take over bid period
- It is not allowed for offerors to change terms and conditions of take over bid which becomes unfavorable to offerees. for example, decrease of offer price, shorten take over bid period etc.

Minority Squeeze Outs

- A stepwise deal is often useful as a “soft-landing” to allay any concerns of target management
- Such a stepwise deal should consider the powers of shareholders
 - 33%+ ability to block special resolution (M&A, amendments to the articles of incorporation, etc)
 - 50%+ control of company (election, dismissal of board of directors, approval of financial statements, approval of dividend payments, etc)
 - 66%+ ability to pass special resolution
- If the initial TOB results in greater than 66%, the minority can be squeezed out by a corporate split and liquidation mechanism, or other similar schemes. If greater than 90% is obtained, minorities can now be cashed out

Ownership Thresholds and Key Shareholder Rights – a summary

Ownership percentage (voting rights)	Rights
1.0%	<ul style="list-style-type: none"> • Right to propose agenda at shareholders' meeting
3.0%	<ul style="list-style-type: none"> • Right to request the calling of a shareholders' meeting • Right request court to review majority decision not to remove a director for wrongdoing • Right to demand court-supervised inspection of company's operation and finances
5.0%	<ul style="list-style-type: none"> • If company is listed, disclosure of ownership above this level is required under substantial shareholder rules
10.0%	<ul style="list-style-type: none"> • Right to request court to review proposed dissolution of the company
> 33.3%	<ul style="list-style-type: none"> • Blocking minority. Negative control – ability to veto special resolutions
> 50.0%	<ul style="list-style-type: none"> • Majority control - ability to pass ordinary resolutions including in relation to appointment of directors and auditors
> 66.6%	<ul style="list-style-type: none"> • Full control - ability to pass special resolutions in relation to various issues including: <ul style="list-style-type: none"> - Removal of board members - Transfer of the company's business - Stock-for-stock (stock swap) - Stock transfer - Merger

Summary of Criteria for De-listing of Section 1 & 2 in TSE

Application	Application is made if any of the criteria listed below are met
No. of shares listed	Less than 4 thousand units ¹
No of shares held by the "special few" ²	If the number of shares held by the "special few" is either: (1) Over 75% of the number of shares listed as of the end of last 2 business years (2) Over 90% of the number of shares listed (without predetermined documents being submitted)
No. of shareholders holding at least 1 "unit" (excluding the "special few") as of the end of last 2 business years	Minimum shareholder level (by total number of listed share units) (1) Less than 10 thousand units Min. 400 shareholders (2) 10 thousand units or more but less than 20 thousand units Min. 600 shareholders (3) More than 20 thousand units Min. 1000³ shareholders Provided that, in the following cases: (1) The current share price per 1 unit is more than 100,000 yen but less than 500,000 yen and average monthly trading volume over the previous year is less than 1,000 units Half the number of shareholders required by the criteria above (although at least 400 shareholders) (2) The current share price per 1 unit is less than 100,000 yen Min. 400 shareholders

Note 1: A unit is the minimum amount of shares with 1 voting right

Note 2: The „special few“ are defined as the 10 largest shareholders, with the exception of some types of institutional shareholders, directors of the issuer and the issuer itself if it holds its own shares

Note 3: For each 10 thousand units in excess of the first 20 thousand units minimum increases by an additional 100 shareholders (up to 2,000 shareholders)

Source: TSE, August 2005

Summary of Criteria for De-listing of Section 1 & 2 in TSE

Average monthly trading volume	<p>(1) Over the past or previous year: less than 10 units; or</p> <p>(2) No trades during last 3 months</p>
Market capitalization	<p>Less than 1 billion yen (for a period of 9 months, or 3 months if documents are not submitted within the first 3 months)</p> <p>Or</p> <p>Less than twice the number of shares listed (for a period of 3 months)</p>
Excess liabilities False statements or unfair representation	<p>Excess liabilities have continued for the last 2 business years</p> <p>a) In a case where the listed company has made a “false statement” in the annual and interim securities reports and, in addition, the Exchange deems that it exerts significant influence</p> <p>b) A certified public accountant stated “an unfair representation” or words to the effect that “he or she does not represent an opinion” in the annual or interim Audit Report and, in addition, the Exchange deems that such statement exerts significant influence</p>
Other	<p>Suspension of bank account, bankruptcy proceedings, civil rehabilitation proceedings, corporate rehabilitation proceedings, or liquidation, suspension of business activity, inappropriate merger, violation of listing agreement, violation of written oath, entrustment to vicarious organizations for administration of stocks, restriction on transfer of shares, changeover to a wholly-owned subsidiary company, withdrawal of consent for handling at designated depository organization</p>

Tender Offer Process in Detail (1/4)

1) Public Notice

- The Offeror must place a public notice of the Tender Offer in two daily newspapers in Japan (under Article 27-3 of the FIEL and Article 9 of the Ordinance Concerning Tender Offers for Share Certificates etc. by Persons other than the Issuing Company (the “Tender Offers Ordinance”))

2) Registration Statement for the Tender Offer

- The Offeror must file a registration statement for the Tender Offer with the Prime Minister through EDINET (under Article 27-30 (2)(3) of the FIEL)

3) Attachments to the Registration Statement for the Tender Offer

- The FIEL refers to the registration statement for the Tender Offer together with the attachments to it as the “Tender Offer Registration Statement”. The following documents must be attached to the Tender Offer Registration Statement (in accordance with Article 27-3(2) of the FIEL and Article 13 of the Tender Offers Ordinance):
 - Articles of incorporation or other equivalent written document (if the Offeror is a legal entity)
 - Written document confirming establishment (if the Offeror is a legal entity which does not submit securities reports under the FIEL)
 - Abstract of Japanese residence documents or other equivalent document (if the Offeror is an individual)
 - Documentation giving broad power of attorney to act on behalf of the Offeror in relation to the filing of the Tender Offer Registration Statement (if the Offeror is not resident in Japan)
 - Copy of an executed contract with a securities company or bank relating to administration activities
 - Copy of an executed agency contract (if the Offeror appoints an agent for the Tender Offer)
 - Written evidence that the Offeror has sufficient funds to conduct the Tender Offer, together with the Offeror’s bank account balance
 - Details of directors of the Offerors, resumes, and third party references
 - Written evidence of the grant of all permissions, approvals, acknowledgements and other necessary permits issued by any administrative agency pursuant to laws relating to the acquisition of shares
 - Written document setting out the contents of the public notice made on commencing the Tender Offer

Tender Offer Process in Detail (2/4)

4) Tender Offer Agent

- A securities company is appointed as a tender offer agent when a Tender Offer is made and assumes an administrative role covering matters such as processing acceptances, maintaining safe custody of the tendered shares, settling accounts and making payments
- A Tender Offer Agent represents the Offeror and receives from shareholders their notice of intention to tender their shares. The FIEL does not require the appointment of a tender offer agent. It is, however, desirable to appoint such an agent for the convenience of the shareholders and to reduce the administrative work involved for the Offeror
- Even where a tender offer agent is not appointed, the FIEL requires the Offeror to appoint a financial institution to maintain safe custody of and payment for the tendered share certificates (Article 27-2(4) of the FIEL)
- The Tender Offer Agency Agreement must be attached to the Tender Offer Registration Statement

5) Funds for Tender Offer

- The Offeror's bank account balance and the nature of any loan agreements entered into by the Offeror in connection with the Tender Offer must be set out in the Tender Offer Registration Statement
- Written evidence of such funds, in the form of a certificate of the Offeror's bank account balance and loan agreements, must also be attached to the Tender Offer Registration Statement (Article 13 of the Tender Offers Ordinance)
- The certificate of the Offeror's bank account balance must be dated as at the day or at two days before filing of the Tender Offer Registration Statement
- The certificate of financing must be valid as at the settlement date and must have been issued recently

Tender Offer Process in Detail (3/4)

6) Pro Rata Method

- The Offeror may specify that the Tender Offer is conditional upon the acquisition of at least a certain number of shares or, alternatively, the Offeror may set the maximum number of shares to be acquired (Article 27-13 of the FIEL)
- If the total number of shares tendered by Offeree shareholders exceeds the maximum number of shares to be purchased set out in the filed Tender Offer Registration Statement (where the Offeror has set an upper limit on the number of shares to be acquired), the actual number of shares to be purchased from each shareholder tendering shares must be determined on a pro rata basis
- Formula for Pro rata Method
 - shares to be acquired from each shareholder tendering shares = total number of shares tendered from each shareholder

$x \frac{A}{B}$ (with fractions of half a share and over being rounded up to the nearest whole share), where

- A = maximum number of shares to be purchased set out in the Tender Offer Registration Statement
- B = total number of shares tendered

Note: If the total number of shares to be acquired from tendering shareholders calculated using the above formula differs from the maximum number of shares to be purchased set out in the Tender Offer Registration Statement, then the difference must be dealt with using a method provided in the Tender Offer Registration Statement

7) Explanatory Document (Tender Offer Circular)

- The Offeror must prepare an explanatory document (Tender Offer Circular) with respect to the terms of the Tender Offer and issue this to the Offeree shareholders at the same time or in advance of receiving tender of shares (Article 27-9 of the FIEL and Article 24 of the Tender Offers Ordinance)

Tender Offer Process in Detail (4/4)

8) Announcement of Offeree's Views

- The Offeree may give its views on the Tender Offer during the Tender Offer period. Any document containing these views of the Offeree must be filed with the Prime Minister and copies of the document must be forwarded to the Offeror and the relevant stock exchange (Article 27-10 of the FIEL)

9) File Documents

- Any documents filed with the Prime Minister must be kept for a period of 5 years from the date of filing, and must be made available to the public. Duplicates of the documents must also be stored in the headquarters of Offeror/Offeree or other major offices and must be made available to the public (Article 27-14 of the FIEL)

10) Other Expenses

The following list sets out the Tender Offer expenses which an Offeror will generally be incurred in connection with a Tender Offer in Japan:

- Fee for Tender Offer Agent
- Costs of giving public notice of the Tender Offer in newspapers
- Costs of printing Tender Offer Circular
- Costs of preparing and mailing letters to shareholders (*)
- Fee for attorneys

The following expenses may be incurred:

- Expenses for researching telephone numbers of each shareholder of the Offeree through shareholders' list (*)
- Costs of maintaining custody of tendered share certificates and costs of delivering such certificates
- Costs of exchanging "registration statement" to EDINET form
- Other expenses required to complete the Tender Offer

(*) These are not required under the law but can be done if a particularly proactive approach is needed

Points of Notes Regarding Tender Offers (1/4)

1) Changes to Tender Offer Conditions

- No change to the terms of the Tender Offer which is detrimental to the Offeree is permitted (e.g. where the purchase price is reduced, the number of shares to be purchased is reduced, the offer period is shortened or, where the minimum number of shares for the Tender Offer is stipulated, an increase of this number (Article 27-6 of the FIEL))
- The Offeror must place a public notice of any changes to the tender offer conditions in one daily newspaper in Japan (Article 27-6 of the FIEL)

2) Cancellation of the Tender Offer

- The tender offer cannot be cancelled after an issue of the public notice of the Tender Offer other than in accordance with Article 27-11 of the FIEL
- The situations where the Offeror is permitted to cancel the Tender Offer are limited to the situations such as the occurrence of a material change in the Offeree's business and/or assets and the occurrence of material events which interfere with the achievement of the purpose of the Tender Offer. Any such situations must be specifically disclosed at the outset in the public notice of the Tender Offer and in the Tender Offer Registration Statement
- Where a Tender Offer is cancelled, the Offeror must place a public notice stating this and the reason in one daily newspaper in Japan or website (Article 27-11 of the FIEL)

Points of Notes Regarding Tender Offers (2/4)

3) Types of consideration

- Japanese Law allows both cash and/or securities offers (Art. 8-2 of the FIEL Enforcement Order)
- However, most offers are made in cash as a non-cash offer requires to register and issue the securities prior to the TOB announcement

4) Limited scope for conditions to offer

- Very high degree of certainty is required -only statutorily-prescribed conditions allowed
- Financing conditions are not permitted – financing from announcement
- The offer may be subject to a minimum acceptance condition. However, if the condition is satisfied, the Offeror will be bound to purchase at least the number of shares specified in the offer

5) Due diligence

- Usually is high level, however depends on case by case
- Timing and process generally depend on nature of takeover and size of target
- Key concerns regarding due diligence are the same as in Europe (e.g. limited withdrawal by bidder after formal announcement, limited information available in hostile offers, secrecy concerns)
- No requirement to disclose the information passed between Offeror and Offeree (including to rival bidders)
- Generally, no restriction on Offeree Board's ability to disclose information to potential bidders
- Price sensitive information
- Disclosure obligations may be triggered, if material impact on Offeree's share price (Inside information regulation)
- Criminal sanctions can be applied for insider dealing / market manipulation

Points of Notes Regarding Tender Offers (3/4)

6) Employee consultation

- On a merger, the employees of the target (Offeree) are deemed to be employed by the acquirer (Offeror)
- No legal obligation to consult with employees in TOBs, Offeree's employees generally do not have rights of challenge. However:
 - Consultation is mandatory, if the structure involves statutory demerger
 - Where there is a significant difference between the employment conditions of the Offeror and Offeree and the Offeror proposes to adopt conditions less favourable to either its own employees or the employees of the Offeree, the consent of the employees so disadvantaged may be required
- The Offeror is required to give details in offer document of intentions after acquiring control

7) Minority squeeze-out

- Two new takeover schemes enable a form of squeeze-out:
 - "stock swap" (kabushikikokan) scheme – allows a joint stock company to acquire all of the shares of another joint stock company with the approval of only two-thirds of shareholders
 - "stock transfer" (kabushikiiten) scheme – allows the shareholders of an existing joint stock company to establish a new holding company for purposes of acquiring all of the shares of the existing company by means of a stock swap
- The article of 27-13-4 of the FIEL requires a Offeror to make an offer to buy all shares when ratio of shareholdings by the bidder becomes beyond a certain threshold of shareholding such as 2/3 to protect small shareholders from the risk of delisting of his/her shares.

8) Third party consents

- Share acquisitions usually do not require the consent or approval of third parties. However, depending on the terms of agreements to which the Offeree is party, if there is a change of control, the acquisition may trigger notice requirements or even termination of certain contracts
- In mergers, the rights and obligations of the target company transfer automatically to the surviving entity. However, it may be necessary for the surviving company to "perfect" its rights under certain contracts (e.g. third party notice). Also, a merger may also trigger "change of control" type of provisions in the company's third party contracts

Points of Notes Regarding Tender Offers (4/4)

9) Deal protection

- Stakebuilding in the context of a mandatory bid and obtaining oral commitments from key shareholders and stakeholders (e.g. main bank, group companies, management, employee shareholding scheme) are main methods of deal protection
- Bidders will need to take into account consequences of stakebuilding activity and disclosure requirements
- Break fees –however, doubts as to validity and potentially raising fiduciary duty issues
- Exclusivity arrangements –not very common but do exist
- Irrevocable undertakings –possibly ineffective as statute provides that shareholders are entitled to withdraw acceptances during the offer

10) Merger control

- An Offeror is required to file with the Fair Trade Commission (“FTC”) a report of its shareholdings in the Offeree each time the shareholding level crosses 10, 25 and 50%, in each case within 30 days of crossing the relevant levels and if the Offeree is a Japanese company with total assets of more than ¥1bn
- In case of a share acquisition, the Offeror must file a notification with FTC within 30 days after closing
- A company is prohibited from acquiring or holding shares with voting rights in any other company where such an acquisition or holding will substantially reduce competition in a market
- The FTC will examine whether a transaction will result in control if:
 - The Offeror’s ownership of shares with voting rights in the Offeree exceeds 50%; or
 - The Offeror’s ownership of shares with voting rights in the Offeree exceeds 25%, and the Offeror is the leading shareholder
 - Minority interests may also be caught
- An acquisition is unlikely to be deemed to have an anti-competitive effect where the combined market share of the parties to the transaction:
 - Is no more than 10% of the relevant market; or
 - Is more than 25% of the relevant market and is not the largest market share, provided that the relevant market is not oligopolistic but is open to new entrants including imports
- Failure to file a notifiable transaction may lead to fines and/or annulment of the transaction. In practice, it is common that offerors have discussion with FTC prior to the TOB announcement.

