Looking back, looking forward.

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Japan Law Year in Review 2015 and Year to Come 2016
January 2016
Amendment to the Civil Code: In March, a bill to reform part of the Civil Code relating to the rights and obligations of private individuals and corporates was submitted to the Diet following more than five years of discussions by the Legislative Council of the Ministry of Justice. The reform is the first major amendment to the Civil Code in 120 years. The main purpose of the reform is to update the law to reflect the current economic and social environment and the bill consists of approximately 200 items to be amended, including changes to the limitation period for certain classes of rights, the treatment of anti-transfer clauses relating to the transfer of rights, and the establishment of rules applicable to the terms and policies that are unilaterally set by a party to the contract. Although the bill did not pass the Diet this year, it is expected to be resubmitted again in 2016. It is likely to take approximately three years for the amendments to become effective after the bill is passed.

Amended Companies Act: In May, the amended Companies Act came into effect. The amendments contain a number of changes which will affect M&A practices in many respects. Among such changes, in share transfer transactions, a parent company selling shares in its subsidiary is now required to obtain approval at its shareholders’ meeting before such sale if (i) the book value of the shares exceeds 20% of the total assets of the parent company and (ii) the parent company will no longer be a majority shareholder as a result of the sale. The previous law did not require a parent company to obtain shareholder approval when selling shares in its subsidiary and therefore the change could affect the timetable of share sale deals.

More importantly, the Act introduces a cash-out system whereby a shareholder holding (directly or indirectly through wholly-owned subsidiaries) 90% or more of the voting rights of a company has the right to demand that the minority shareholders sell all shares, stock acquisition rights and bonds with stock acquisition rights held by such shareholders without passing a resolution at a shareholders’ meeting (the “Right to Demand for Sale”).

Before the amendment, using Z-shares (zenbu shutoku joukou tsuki shurui kabushiki) was the established practice to achieve a minority cash-out. However, this was a long process (e.g., waiting approximately eight weeks to hold an extraordinary shareholders’ meeting in the case of a listed company) and could not achieve a cash-out of stock acquisition rights and bonds with stock acquisition rights. The Right to Demand for Sale has been introduced to address these issues.

In addition, the Act introduces various forms of protection for shareholders who receive fractional shares as a result of a share consolidation (e.g., disclosure and the right to demand a share buyback by the company). Accordingly, it is expected that the share consolidation scheme will also be used for cashing out the minority shareholders.

In fact, following the date of enforcement, among the 11 companies that launched a tender offer bid aimed at acquiring 100% of the shares thus far (as of 10 November), six companies exercised the Right to Demand for Sale and three companies used the share consolidation scheme to squeeze out the minority shareholders. It will become common practice for the bidder to utilise the Right to Demand for Sale when 90% or more of the voting rights are secured whereas the share consolidation scheme will be used when a bidder acquires less than 90%.

Financial Instruments and Exchange Act: The Amendment to the Financial Instruments and Exchange Act (“FIEA”) in respect of the exemption for special business activities for Qualified Institutional Investors (the “Article 63 Exemption”) was enacted on 27 May 2015 (the “2015 Amendment”) and will come into force within one year after the date of promulgation (promulgated on 3 June 2015). Thereafter, the draft of the related amendments to the Cabinet Order and Cabinet Office Ordinance as well as the Comprehensive Guidelines for the Supervision of Financial Instruments Business Operators, etc. (“JFSA FIBO Guidelines”) have been disclosed for public comments over a one-month period from 20 November 2015.

The first key amendment is that the Financial Services Agency of Japan (“JFSA”) contemplates limiting the scope of non-Qualified Institutional Investors (“non-QIls”). After the 2015 Amendment, non-QIIs must be certain sophisticated investors such as the Government of Japan, Bank of Japan, a registered financial instruments business operator (“FIBO”), a fund investment management business operator in respect of the Article 63 Exemption (“Fund Manager”) or someone with a close relationship thereto (including officers, employees, parent companies, subsidiaries, entities entrusted with asset investment management by, or investment adviser of, the Fund Manager (“Closely Related Person”)), a stock company with a capital amount or net assets equivalent to over JPY 50 million, a foreign entity, employees’ pension funds
or corporate pension funds expected to hold investment assets of JPY 10 billion or more, and certain wealthy individuals who are expected to hold total financial assets of not less than JPY 100 million and who have maintained an account for securities and derivative trading for over a year (collectively referred to as “Eligible non-QIIs”). According to the JFSA FIBO Guidelines, the Fund Manager is required to take necessary measures to confirm its investor’s attributes (i.e., whether a QII or not) and the number of the non-QIIs.

Following severe criticism that new requirements for non-QIIs will make it difficult to establish new venture capital funds, the JFSA relaxes the above regulation for certain venture capital funds which satisfy the following requirements: (i) they continue to invest more than 80% of their total investment in stocks of non-listed companies, (ii) certain long-term borrowing as well as providing guarantees are prohibited; (iii) shares of the funds may not be redeemable during the existence of the funds; and (iv) they have an appropriate internal governance structure and an accounting audit by certified public accountants. Such venture capital funds may accept investments from not only Eligible non-QIIs, but also from certain designated investors including officers and employees of the listed company, the officers of the general partner of the partnership which is expected to hold investment assets of JPY 100 million or more, or persons who have expert knowledge and experience and play a significantly important role in newly-established business, M&A, IPO or other business for the relevant company.

The second key amendment is that the 2015 Amendment and relevant regulations disqualify certain funds from relying on the Article 63 Exemption, namely in the case that (i) all QIIs which invest in the fund are investment limited partnerships as prescribed in Article 2, paragraph 2 of the Limited Partnership Act for Investment and its volume of contributions (excluding the amount of borrowings) do not exceed JPY 500 million, or (ii) the fund receives the amount of investment equivalent to more than 50% of the total investments from the individual or entity which qualifies as a Closely Related Person. In addition, the 2015 Amendment establishes provisions with regard to grounds for disqualification from the Article 63 Exemption, including (i) non-Japanese funds that do not have a representative in Japan, or (ii) where the relevant operator relying on the Article 63 Exemption (“Exempted Operator”) was subject to the order for the abolition of business or criminal punishment, etc within the previous five years. An entity which falls under any of the grounds for disqualification cannot rely on the Article 63 Exemption.

The third key amendment is that the 2015 Amendment strengthens the oversight and regulation of the Exempted Operator, which is now subject to disclosure requirements. The JFSA and the Exempted Operator must each make available to the public certain contents of the filed notification pursuant to the Article 63 Exemption. Furthermore, the 2015 Amendment introduces new annual reporting and recordkeeping requirements in relation to its business introduces certain conduct obligations for the Exempted Operator similar to those which have been already applicable to registered FIBO. For example, the Exempted Operator is required to comply with the duty of loyalty, duty of due care of a prudent manager, advertisement regulation, suitability requirements, obligations to deliver certain contractual documents, segregation of the fund assets, etc.

Finally, the 2015 Amendment extends regulators’ enforcement powers and criminal penalties. The enforcement powers include the ability to require the submission of reports; to conduct on-site inspections; and to issue orders to improve, suspend and abolish business operations (as necessary). According to Article 192 of the FIEA, the JFSA could file a petition to the court for an injunction to stop any act in violation of the provisions of the FIEA. When a court which receives the JFSA’s petition finds that there is an urgent necessity and that it is appropriate and necessary for the public interest and investor protection, the court may give an order to a person who has conducted or will conduct any marketing activities in violation of the FIEA to prohibit or suspend such act.

**Electronic Trading Platform:** In September, mandatory use of electronic trading platforms (ETP) was implemented by the Japanese FSA. Certain financial instruments business operators and registered financial institutions are now required to use ETPs when they enter into plain vanilla interest rate swap transactions referring to Japanese yen.
Looking forward.

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Year to Come – Japanese Law in 2016

FinTech: In April 2015, the Financial System Council, a board established by the Japanese FSA to advise the Prime Minister, published an interim report on further developments in the settlement system, reflecting the rapid innovation taking place in financial technology or “FinTech”. The report emphasised the importance of formulating a comprehensive action plan to facilitate business development by non-bank players and the business linkage between banks and these non-bank players. Treatment of the virtual currency “bitcoin” is also a hot topic as it does not clearly fit within the current legal regime in Japan. In addition to anti-money laundering regulations, the virtual currency will likely be subject to certain customer protection measures, as it is considered that the bankruptcy in 2014 of bitcoin exchange Mt. Gox was caused by fraudulent manipulation. The Working Group on Payments and Transaction Banking, a subgroup of the Financial System Council, has been holding discussions since July, and such discussions will continue in 2016.

Energy mix and Japan policy on coal: In May 2015, the Ministry of Economy, Trade and Industry (METI) published a report proposing the target energy mix for Japan by 2030. The proposal states that as a result of the high cost of renewable energy, Japan has no choice but to rely on nuclear power for 20-22% of its energy by 2030. This nuclear target is reduced from the weighted average of 27% of energy provided by nuclear power in Japan in the decade up to the 2011 Fukushima disaster. Japan’s nuclear power stations, closed following the disaster, began to reopen in August 2015, but even if all of the more than 40 nuclear reactors are reopened, additional investment in nuclear reactors will be required to achieve the METI target proportion.

In a climate of increasing domestic and international pressure to reduce support for inefficient coal-fired power, the METI report reduced the target amount of coal-fired power in Japan in 2030 as METI seeks to shift its focus to renewable energy sources and strike a balance between the benefits of clean energy and the high price of renewable energy. The METI report proposes a target of 22-24% renewable energy sources by 2030, a significant increase in the proportion of energy currently provided by renewable energy sources, and is expected to require the commission of additional renewable power plants as a result. Two coal-fired power projects were recently rejected by the Minister of the Environment (MOE) following failed environmental impact assessments, and, in response, METI is considering putting a cap on the number of new coal-fired power plants using clean coal technology.

Internationally, in November the OECD agreed to severely restrict export subsidies for coal-fired power stations, the first time that its financing rules have been changed for climate change reasons. The effect of the changes are that export credit agencies (ECAs) from OECD countries cannot support inefficient coal-fired power plants from 2017, but will permit support for (i) highly efficient “ultra-supercritical” power stations, and (ii) smaller power plants in countries where at least 10% of the population lacks access to electricity. The OECD agreement is reported to be an arrangement led by the U.S. and Japan consistent with the Japanese government/ECA strategy to support export of facilities using the most efficient “ultra-supercritical” technology.

U.S. issuers’ samurai bonds: Since 1 July 2014, withholding for U.S. source income under FATCA has been effective. As a result, a 30% FATCA withholding tax applies to payments of certain U.S. source income (including payments of interest on U.S. Samurai bonds issued on or after 1 July 2014) made to non-U.S. financial institutions (FFIs) that are non-compliant with FATCA.

Under the intergovernmental agreement between the U.S. and Japanese governments in relation to FATCA, Japanese financial institutions (including Japanese banks acting as paying agents and Japanese securities firms acting as account management institutions that open and hold accounts for bondholders) are generally not subject to withholding obligations under FATCA.

However, there still remains a possibility that withholding by a Japanese financial institution may be required if there is significant non-compliance with certain FATCA requirements. In order for a Japanese financial institution to withhold under FATCA, it would be necessary to enact new laws and regulations facilitating such withholding in Japan. Instead of this time-consuming approach, an alternative solution has been discussed among Samurai bond players and they came up with a solution that a withholding agent is to be appointed in the U.S. so that withholding can be made outside Japan.
Moreover, a U.S. issuer that pays interests on its bonds to a Japanese paying agent is required under FATCA to withhold on payments that are allocated to certain non-compliant Japanese financial institutions. In order for a U.S. issuer to determine its withholding obligation, a Japanese paying agent needs to provide the U.S. issuer (or its agent for withholding) for each interest payment with a withholding statement stating whether withholding is required or not, along with a withholding certificate (such as Form W-8IMY) that contains identification information on both account management institutions and their participants (i.e., bondholders). If a U.S. issuer (or its agent for withholding) does not receive this documentation, it may be required to treat an account management institution or a participant as a “recalcitrant account holder” that is subject to withholding. However, there was no established framework to pass such required documentation up the payment chain to the U.S. issuer (or its agent for withholding). These were main obstacles to U.S. Samurai bonds after the enforcement of FATCA.

After long discussion among Samurai bond players as well as U.S. IRS and Treasury over years, JASDEC, the Japanese clearing house operating a domestic book-entry transfer system, finally published new guidelines for U.S. Samurai bonds in July 2015. The guidelines provide a new framework enabling relevant parties to pass the required documentation mentioned above up the payment chain to U.S. issuers (or their agent for withholding) in order to avoid FATCA withholding.

While this new framework would resolve the FATCA-related issues, this further requires a Japanese paying agent and accounting management institution that intend to handle U.S. Samurai bond to become a Qualified Intermediary (“QI”) (within the meaning of the relevant U.S. tax rules) by entering into a QI agreement with the U.S. IRS. To provide them with sufficient time for becoming a QI and establishing their internal systems facilitating creation of required documentation, the new framework will come into effect on 1 January 2016. This means that U.S. Samurai bonds can be issued under the new framework on or after 1 January 2016.

**Act on the Protection of Personal Information**: In September, the bill to amend the Act on the Protection of Personal Information was approved by the Diet and will come into force within two years. The amendments, amongst other things, (i) clarify the definition of “personal information” and set rules for processing “sensitive personal information”, (ii) permit the transfer of “anonymous processed information” (so-called big data) to a third party without obtaining the prior consent of the data subject, (iii) establish an independent data protection authority and (iv) set certain restrictions for the transfer of data to countries where the level of data protection is insufficient.

**Margin Rules for non-centrally cleared derivatives transactions**: In September, a mandate to post a certain amount of margin when conducting non-centrally cleared derivatives transactions will be implemented. This regulation was originally intended to be implemented around December but postponed following BCBS/IOSCO’s revised implementation timetable. The new regulations will require banks to enter into or amend a Credit Support Annex with their counterparties.
Your contacts.

John Maxwell  
Managing Partner, Japan  
Tel: +81 3 6212 1227  
john.maxwell@linklaters.com

Peter Frost  
Partner, Tokyo  
Tel: +81 3 6212 1212  
peter.frost@linklaters.com

Motoyasu Fujita  
Partner, Tokyo  
Tel: +81 3 6212 1213  
motoyasu.fujita@linklaters.com

Eriko Sakata  
Partner, Tokyo  
Tel: +81 3 6212 1243  
eriko.sakata@linklaters.com

Kozo Sasaki  
Partner, Tokyo  
Tel: +81 3 6212 1241  
kozo.sasaki@linklaters.com

Hiroya Yamazaki  
Partner, Tokyo  
Tel: +81 3 6212 1435  
hiroya.yamazaki@linklaters.com

Zeny Onishi  
Counsel, Tokyo  
Tel: +81 3 6212 1438  
zenya.onishi@linklaters.com

Hirofumi Taba  
Counsel, Tokyo  
Tel: +81 3 6212 1245  
hirofumi.taba@linklaters.com

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