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PRELIMINARY AGREEMENTS: JAPAN: INTERNATIONAL ACQUISITIONS

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This Q&A provides country-specific commentary on *Practice note, Preliminary agreements: International Acquisitions*, and forms part of our *international acquisitions transaction guide*.

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RESOURCE INFORMATION

RESOURCE ID
3-501-0276

RESOURCE TYPE
Practice note

STATUS
Law stated as at 27-May-2016

JURISDICTION
Japan

1. Are letters of intent commonly entered into on acquisitions? What issues are commonly covered?

Letters of intent are commonly entered into on acquisitions. The issues usually covered by letters of intent are:

- Key terms of transactions (parties, purchased shares or assets, structure, price and so on).
- Due diligence.
- Transaction schedule.
- Confidentiality.
- Costs and expenses.
- Whether the transaction is legally binding.
- Choice of law and jurisdiction.

If a party to the transaction is a listed company, normally it would opt not to stipulate detailed terms relating to the transaction in a letter of intent because the letter may trigger an obligation of disclosure under the rules of a stock exchange.

2. Can you ensure that a letter of intent is not legally binding?

A letter of intent is not legally binding if that is expressly stipulated in the letter. Otherwise, the letter can be legally binding, depending on the parties' intention and the surrounding circumstances.

Therefore, it is advisable and common for the letter to clearly stipulate the non-binding nature of clauses relating to the transaction, although confidentiality or certain other provisions may be expressed to be binding.

3. Are there any particular formalities required for a legally binding letter of intent?

No formalities are required for a legally binding letter because even oral agreements can be legally binding under the Japanese Civil Code. However, usually the letter is in writing, and an oral agreement is unlikely to be construed to be legally binding in this respect.

Agreements do not have to be supported by consideration under Japanese law.

4. Can a non-binding letter of intent give rise to a duty to negotiate in good faith? If so, what might constitute breach of this duty and what liability arises on breach?

No. In general a non-binding letter of intent does not give rise to a legal duty to negotiate in good faith.

There are some court precedents to the effect that a party breaking a negotiation before entering into a contract is liable to monetary damages incurred by the other party in certain circumstances. However, the risk can be minimised by stipulating in the letter of intent that it is not legally binding and that the parties will not be subject to any liability if a negotiation is broken.

5. Is it permitted to have a lock-out agreement where the seller agrees not to negotiate with or provide information to another prospective buyer for a period of time?

In general, it is permitted to have a lock-out agreement. There is an argument that certain lock-out agreements should not be permitted from the point of view of directors' fiduciary duties, but there are no court precedents or accepted opinions in this respect.

6. Is it permitted to have a lock-in agreement whereby the parties agree to continue negotiations for a set period of time? If so, how widely used are they?

It is permitted to have a lock-in agreement. A lock-in agreement is generally used when a purchaser obtains exclusivity in a transaction.

7. What remedies are available for breach of a lock-out agreement?

The party of a lock-out agreement who is not in breach is unlikely to be granted injunctive relief, but may be able to obtain a limited amount of monetary damages.

This issue was addressed in a well-known court precedent, *Sumitomo Trust & Banking v UFJ Holdings*. Based on a no-shop provision in a memorandum of understanding (MOU), Sumitomo Trust filed a suit against UFJ seeking to enjoin the negotiations between UFJ and Tokyo-Mitsubishi and payment of damages.

The Supreme Court held in the injunction case that the no-shop provision of an MOU is valid, but it declined to grant injunctive relief on the grounds of lack of necessity (*Supreme Court Decision; Aug. 30, 2004, 58 Minshu 6, 1763*). It argued that it was not impossible for Sumitomo Trust to recover monetary damages.

When Sumitomo Trust sought monetary damages against UFJ, the Tokyo District Court (the court of first instance) rejected Sumitomo Trust's claim for damages based on an expectation interest (*Tokyo DC Judgment; Feb. 13, 2006, H.J. 1928, 3*). Although criticised, the Tokyo District Court decision seems to indicate that monetary damages for breach can only consist of reimbursement of out-of-pocket expenses of the party not in breach, such as costs incurred for due diligence.

8. Is it common to provide for either party to pay the other party a pre-determined sum if the deal does not complete because of the "fault" of the other party?

It is not common to provide for either party to pay the other party a pre-determined sum, although a lock-out agreement is not meaningful unless accompanied by this type of provision. However, a few public transactions have incorporated break-up fee structures.

9. Are confidentiality letters commonly used in private company acquisitions?

Yes, confidentiality letters and confidential agreements are commonly used.

10. Are there any formalities required for a binding confidentiality letter?

There are no formalities required for a binding confidentiality letter (see *Question 3*).

11. Are there any national law restrictions on the disclosure of certain types of information?

The Act on the Protection of Personal Information prohibits an entity that uses a personal information database for its business from providing personal information to any third party without obtaining consent from each individual included in the database. However, the provision of personal information upon a merger or other type of business transfer is recognised to be an exception to this rule.

Under the guidelines of the Ministry of Economy, Trade and Industry, such exception is also applicable to provision of the personal information to a potential successor of a business if that potential successor enters into a contract to ensure that the personal information is adequately protected. However, this exception does not apply to the case where the purchaser acquires only shares of the target company and does not therefore obtain the personal information as a direct effect of the transaction. This is because the rule generally prohibits any transfer of personal information between different entities, even between a parent company and its wholly-owned subsidiary. Since due diligence must generally be conducted confidentially before the transaction is announced and it is not realistic to obtain consents from each individual at the due diligence stage, personal information cannot be disclosed to a potential purchaser of shares that is conducting due diligence.

Under the Foreign Trade and Foreign Exchange Act, certain sensitive technologies, including those relating to the development of weapons and spatial technologies, cannot be provided to non-residents without governmental approval.

12. Is the target company usually made a party to the letter?

The target company is not often made a party to the confidentiality letter, especially when share purchases are contemplated. In this case, it is more likely that only the seller and the purchaser enter into the confidentiality letter. One of the reasons for this is that a seller does not normally want to inform the target company of the transaction at this early stage.

13. Are restrictive covenants in the letter subject to public policy restrictions? If so, what are they?

It is theoretically possible but very unlikely for restrictive covenants to be subject to public policy restrictions under the Civil Code. Although there is no rule, very unreasonable covenants (for example, an obligation of non-disclosure covering a very long period) may be in breach of public policy.

14. Are there any restrictions on the duration of a confidentiality letter?

No, there are no restrictions on duration. However, an unreasonably long duration could be subject to public policy restrictions.

15. What remedies are available for breach of a confidentiality letter?

The party who is not in breach can seek monetary damages against the party in breach. Injunctive relief can only be granted if it is proved to be impossible to recover damages through monetary remedies.

16. Can a confidentiality letter contain a penalty clause?

It is possible in theory but not common for a confidentiality letter to contain a pre-determined penalty clause. The disclosing party is likely to be willing to include this type of clause into the letter since it is not easy to prove the amount of damages owed by a party not in breach. However, it is not easy for parties to agree on the amount of damages beforehand.

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Professional qualifications.

Japan, 2000, New York, 2006

Areas of practice.

M&A, corporate transactions, securities regulation

Recent transactions

- Representing Mitsubishi Motors Corporation in its Strategic Alliance with Nissan Motor Co., Ltd. (2016-)
- Representing Japan Tobacco Inc. in its sale of Japan Beverage Holdings, JT A Star and beverage brands to Suntory Beverage and Food (2015)
- Representing Applied Materials, Inc. in its business combination with Tokyo Electron Limited. (2013-2015)
- Representing Micron Technology, Inc. in its acquisition of Elpida Memory, Inc. (2012-2013)
- Representing UNITIKA Ltd. in an issuance of preferred stock to Japan Industrial Solutions, Ltd. and certain banks (2014)
- Representing CYBERDYNE, Inc. in its initial public offering with dual-class stock structure (2014)

Languages.

Japanese, English

Professional associations/memberships.

Daini Tokyo Bar Association

Publications.

Doing business in Japan, Mori Hamada & Matsumoto, 2011; Triangular mergers: Magic triangles, IFLR, 2008; Cyberdine's dual-class IPO, IFLR, 2014