CLIFFORD CHANCE

AMENDMENT TO FOREIGN EXCHANGE AND FOREIGN TRADE ACT OF JAPAN: EXPANSION OF REGULATED SECTORS FOR FOREIGN DIRECT INVESTMENTS INTO JAPAN

Japan currently requires prior approval for foreign direct investments into a very limited number of sectors closely related to national security and public order. With effect from 1 August 2019, however, such regulated sectors will be expanded to include information processing equipment and software, and a wider range of telecommunications and IT services. Multinationals, acquirers and investors in such additional sectors must review existing plans and bear this amendment in mind, to allow time for such prior approval process and to resolve any uncertainty surrounding their transactions.

BACKGROUND

While foreign investments in Japan have been liberalised as a whole, the Foreign Exchange and Foreign Trade Act of Japan (FEFTA) and a limited number of specific statutes regulate investments in certain sectors relating to national security, public order, public health and safety, and the smooth operation of the national economy (Regulated Sectors). The Bank of Japan should be notified in advance of foreign direct investments in the Regulated Sectors. These investments are subject to a 30-day waiting period (normally shortened, however, to two weeks) until the transaction is approved.

The notified transaction could be suspended by the Minister of Finance or other ministers in charge of the relevant sector at their discretion, taking into account the effect such foreign investments may have on the Regulated Sectors.

AMENDMENT

The governmental notice setting out Regulated Sectors was amended on 27 May 2019 to include additional sectors, investments into which may have a significant impact on national security (the Additional Sectors). Such Additional Sectors include; (i) the production of equipment and components relating to information processing (such as integrated circuits, flash memory storage media, mobile telephones and computers (including those for personal

Key issues

- Investments in additional regulated industrial sectors will become subject to approval by the government, which requires a 1-month waiting period.
- Although rarely enforced, the possibility of being ordered to discontinue a deal must be kept in mind. This be dealt with in documentation by including an appropriate condition precedent.
- Professional advice needs to be sought and prior consultation with the Bank of Japan is recommended, given that the additional sectors are broadly defined.
- Even minority investments in a private company (or a 10% stake or more in a listed company), including capital increases by a foreign investor regarding its Japan subsidiaries, are subject to this regulation.

use)); (ii) the production of software relating to information processing (such as embedded software and packaged software) and; (iii) a wider range of telecommunications services (such as a wider scope of local/fixed telecommunication services, mobile telecommunications services and support services for the Internet).

TIMELINE

The amendment will take effect from 1 August 2019. However, actual regulations with respect to foreign direct investments in the Additional Sectors will only apply to investments which close on or after 31 August (meaning that investment in the Additional Sectors during the period from 1 August 2019 to 30 August 2019 will only be subject to the existing regulations (i.e. *ex-post facto* reporting)).

IMPACT ON YOUR BUSINESS

The prior notification requirement will no longer be an 'exception', as there will be more and more M&A transactions relating to the Additional Sectors due to increasing demand for investments in technology companies in every industry. This could be another major condition precedent which should always be ticked off before acquisitions of shares in Japanese companies.

Whilst it is clearly indicated in the governmental press release that the government is concerned about the Additional Sectors, it is not clear as to whether the authorities intend to more actively review, investigate and suspend investments in the Additional Sectors.

In fact, foreign direct investments are rarely suspended under current practice. There has been only one case where an order of discontinuance was issued (See TCI Transaction). Also, apart from the acquisition of Toshiba Memory, no transactions have recently been reported to be under intense investigation by the government since the TCI Transaction in 2008.

Nevertheless, the foreign direct investment regulation must be given serious consideration - it can be a deal breaker in the worst-case scenario, and if not complied with, constitutes a criminal offence.

OTHER PRACTICAL SUGGESTIONS

The Additional Sectors are broadly defined and a case-by-case analysis would be required to determine whether the business of a target company falls within the Additional Sectors. Professional advice needs to be sought and prior consultation with the Bank of Japan is recommended in the early stages of the transaction, given the timing implications (i.e. two to four-week waiting period) this regulation may have for the overall deal timeline.

Prior notification is required not only in a normal M&A transaction where a foreign investor acquires shares from a third party but also in a capital increase transaction where a foreign parent company acquires additional shares in its Japanese subsidiary. Thus, intra-group transactions may also need more time to be completed in cases of multinational companies operating in the Additional Sectors.

This expansion of regulated sectors by Japan is in line with the global trend towards broadening the range of sectors regulated under foreign direct investment regulations, for instance in the US, the EU and the UK, particularly in the technology sector. Therefore, as investments in the technology sector increase, companies are having to pay more attention to foreign direct investment regulations globally.

TCI Transaction

In 2008, the government issued an order of discontinuance for a proposed investment in The Electric Power Development Co., Ltd. (also known as J Power) by The Children's Investment Fund (TCI) on the grounds that such investment might jeopardise public order.

Toshiba Memory Transaction

As part of the rehabilitation of the Toshiba group, Toshiba Memory Corporation, which was the semiconductor business unit of Toshiba, was offered for sale in 2017. During the bidding process, it was widely reported that the government intended to investigate the case from the foreign direct investment perspective in order to prevent technology leakage. In the end, however, the deal was not blocked and it was successfully sold to a consortium led by Bain Capital in 2018.

"Concerning these specified types of businesses, the government of Japan, bearing in mind the recent enhanced importance of consolidated cybersecurity measures and placing eyes on the need for appropriate prevention of acts that may cause conditions leading to serious damage to Japan's security, e.g., leakage of technologies of significance in terms of domestic security and damage to domestic defense-related production or technological infrastructures, decided to take necessary measures to these ends"

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