

PANORAMIC NEXT

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Panoramic Next: M&A explores the most impactful recent developments in global mergers and acquisitions and how legal practitioners have responded to them. Through a series of interviews with seasoned experts in key jurisdictions, it offers useful insights across all stages of M&A transactions.

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ABOUT

Kochi Hashimoto is an associate at Oh-Ebashi specialising in M&A, having successfully facilitated a considerable number of transactions for clients. Her primary focus is M&A and startup support, including assisting startups in raising capital and preparing for IPOs. Her industry expertise is in healthcare and IT, and she has worked for a US medical device company. She is also actively involved in international transactions, having worked for one of Germany's leading law firms. She is a licensed Japanese attorney and speaks Japanese and English.

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Yuzo Ogata is an associate at Oh-Ebashi specialising in corporate governance, M&A, corporate crisis management and commercial litigation. He has extensive experience handling both domestic and cross-border M&A transactions, playing significant roles in many deals. His professional background includes experience at a renowned law firm in the United States. He is qualified in Japan and California and speaks Japanese and English. He is also the author of *Overview of Guidelines for Corporate Takeovers: Enhancing Corporate Value and Securing Shareholders' Interests*.

Q&A

WHAT TRENDS ARE YOU SEEING IN OVERALL ACTIVITY LEVELS FOR MERGERS AND ACQUISITIONS IN YOUR JURISDICTION DURING THE PAST YEAR OR SO?

The overall Japanese M&A market experienced a slight decline in activity levels in 2023 compared to 2022. According to RECOF DATA, which is one of the most reliable statistical data sources for M&A transactions in Japan, the number of announced deals completed by Japanese companies in 2023 was 4,015, marking a 6.7 per cent decrease from the previous year (2022), which saw a record 4,304 deals. This reduction represents the first decline in three years. The breakdown of these deals shows a decrease in both domestic transactions (IN-IN) and inbound transactions (OUT-IN), while outbound transactions (IN-OUT) returned to pre-pandemic levels.

However, in terms of deal value, the total amount paid by buyers in 2023 surged by 52.2 per cent compared to the previous year, reaching US\$124 billion. This marked the fourth-highest level on record, behind 2018, 2019, and 1999.

The increase in deal value is particularly noticeable in domestic and outbound deals, with Japanese buyers showing a stronger acquisition stance. The total amount paid by Japanese buyers in outbound deals increased by 134 per cent compared to the previous year, reaching US\$54.8 billion. This resurgence can be attributed to a return to

pre-pandemic activity levels and a focus on strategic acquisitions in key sectors such as steel and pharmaceuticals.

Inbound transactions in 2023 remained relatively small in size, with the total amount paid by foreign buyers reaching US\$14.2 billion, a notable decline compared to previous years. Even in this environment, private equity (PE) firms continued to play an important role.

Looking ahead, the M&A market in Japan continues to show strong signs of recovery. The number of deals declined sharply as stated above, especially in the first quarter of 2023, which may be attributed to a variety of factors contributing to the uncertain situation, including the ongoing crisis in Ukraine, tensions between the US and China, rising interest rates and rising inflation. In the first half of 2024, however, the number of M&A deals involving Japanese companies increased by 19.4 per cent year-on-year to 2,321, surpassing the previous record set in 2022. All market segments, including domestic, outbound and inbound deals, saw growth. The total deal value for the period reached US\$63.4 billion, an 11.3 per cent increase from the previous year. While domestic deal value decreased due to the previous year's large going private activity concerning Toshiba, outbound and inbound deals saw significant increases, with the latter nearly tripling in value. These trends suggest that stable M&A activity is expected to continue, driven by ongoing corporate restructuring and strategic acquisitions.

WHICH SECTORS HAVE BEEN PARTICULARLY ACTIVE OR STAGNANT? WHAT ARE THE UNDERLYING REASONS FOR THESE ACTIVITY LEVELS? WHAT SIZE ARE TYPICAL TRANSACTIONS?

The IT and system development industries continue to lead in M&A activity, though there was a slight decline in the number of transactions. The number of deals where the targets were software or IT companies remained significant, reflecting ongoing interest in digital transformation efforts within Japan. For example, Fujitsu's acquisition of German SaaS provider GK Software highlights the strategic shift towards cloud and SaaS-based business models, emphasising the importance of digital technologies.

The semiconductor sector has also seen intensified activity aimed at enhancing international competitiveness. For example, JIC Capital, a wholly owned subsidiary of Japan Investment Corporation (JIC), has announced its intention to acquire Shinko Electric Industries, a major semiconductor packaging company and a subsidiary of Fujitsu, for US\$4.6 billion, in collaboration with Dainippon Printing and Mitsui Chemicals. JIC Capital has also acquired semiconductor materials company JSR for US\$6.2 billion. The companies aim to advance next-generation semiconductor businesses and enhance market competitiveness in next-generation products. In addition, MinebeaMitsumi has reportedly acquired Hitachi Power Devices, a semiconductor manufacturer and wholly owned subsidiary of Hitachi, for US\$270 million. This acquisition enables a vertically integrated business model for the development and production of power semiconductors.

WHAT WERE THE RECENT KEYNOTE DEALS? WHAT MADE THEM SO SIGNIFICANT?

Japan Industrial Partners' (JIP) US\$14 billion acquisition of Toshiba

One of the recent keynote deals in Japan was the acquisition of Toshiba by the Japanese PE firm, Japan Industrial Partners (JIP). The deal size was not the only factor that made the Toshiba deal so significant. It was also attracting attention because it was a major turning point in the recent restructuring history of Toshiba, which had been negatively impacted by an accounting scandal revealed in 2015 and the confusion in its governance that followed.

Nidec's US\$113 million tender offer proposal to TAKISAWA

This deal was proposed and announced by Nidec without the consent of TAKISAWA's management. Since the issuance of such an acquisitional proposal without the prior consent of the target's management was rare in Japan, the progress of the deal, including the communications between Nidec and TAKISAWA, garnered a lot of attention from stakeholders and M&A specialists alike. In addition, since the Ministry of Economy, Trade, and Industry (METI) published its new 'Guidelines for Corporate Takeovers' in August 2023, which discourage Japanese companies from rejecting buyout offers without reasonable cause, Nidec's proposal has been deemed a good case study to illustrate how the reasonableness of corporate takeovers in Japan would be assessed under the new guidelines. This deal may also have some impact on the corporate value of machine manufacturers evaluated under the Japanese M&A market, and accelerate the transactions they are involved in.

Dai-ichi Life HD's US\$ 20 billion counter tender offer proposal to Benefit One

In December 2023, Dai-ichi Life HD announced a tender offer to acquire Benefit One, a subsidiary of Pasona Group, following a prior tender offer initiated by M3, Inc., a healthcare information services provider, in November 2023. The Dai-ichi Life HD's counteroffer surpassed M3's bid, leading to a competitive takeover scenario. This counteroffer was ultimately accepted by Pasona Group as it was deemed more beneficial for enhancing Benefit One's corporate value. Like the Nidec-TAKISAWA deal, this unsolicited bid is still uncommon in Japan, yet its success signals a shift in the Japanese M&A landscape. With the successful execution of such deals, Japanese companies are expected to become less hesitant in making unsolicited acquisition proposals, which could lead to more competitive tender offers, expanding corporate management options, and further invigorating Japan's capital markets. The developments in this area warrant close attention.

IN YOUR EXPERIENCE, WHAT CONSIDERATION DO SHAREHOLDERS IN A TARGET TEND TO PREFER? ARE MERGERS AND ACQUISITIONS IN YOUR JURISDICTION PRIMARILY CASH OR SHARE TRANSACTIONS? ARE SHAREHOLDERS GENERALLY WILLING TO ACCEPT SHARES ISSUED BY A FOREIGN ACQUIRER?

In Japan, M&A transactions can be broadly classified as either (1) statutory corporate reorganisations, which are specified in the Companies Act of Japan, such as mergers and stock exchanges; or (2) other transactions such as share transfer deals and business transfer deals. While shares are generally used as consideration in the former cases (ie, item (1)), partly because there are tax benefits under such transactions, cash is more frequently used in the latter cases (ie, item (2)). Since the number of the latter transactions are greater than that of the former due to the simplicity of the process, cash deals are generally more common.

There are most likely multiple factors that make Japanese companies choose cash transactions in the latter cases (ie, item (2)). As one of these factors, it is often said that the sellers of target companies tend to steer clear of the downward risks associated with the buyers' shares. In addition, from the buyers' perspective, if they choose a share transaction, they must comply with the disclosure requirements under the securities regulations, which can be a significant burden for them. The burden of undergoing complex procedures to receive the other companies' shares, such as the opening of brokerage accounts, can also discourage sellers from choosing a share transaction. This burden will be greater if the shares in question are issued by foreign buyers, which might be one of the reasons why the shareholders of Japanese target companies tend to prefer cash deals in cross-border transactions.

Recently, the Companies Act of Japan was amended and a Japanese company is now able to acquire a part of the target company's shares by delivering its shares to the target company's shareholders in order to make such target company its subsidiary. This is another option for statutory corporate reorganisations (ie, cases under item (1) above), but this can only be used in transactions between Japanese companies.

HOW HAS THE LEGAL AND REGULATORY LANDSCAPE FOR MERGERS AND ACQUISITIONS CHANGED DURING THE PAST FEW YEARS IN YOUR JURISDICTION?

While the introduction of the new type of corporate reorganisations mentioned above was a big change, there was another and more significant change in 2020 that affects foreign investors in the context of economic security, which is described below.

Under the Foreign Exchange and Foreign Trade Act of Japan (FEFTA), if a foreign investor carries out a foreign direct investment (FDI) in a Japanese target company that is conducting certain businesses that may have an impact on the national security of Japan, the foreign investor must file a prior notification with the Japanese government via the Bank of Japan. The FDI will then be examined after the notification during a statutory waiting period of 30 days, which can be extended for up to five months if the FDI elicits strong national security concerns.

The FEFTA was amended in 2020 and the businesses that are subject to the prior notification requirement are classified into two categories, namely, 'core industries' and 'other industries' (ie, non-core industries). The conditions for exemption from the requirement of prior notification are stricter if the target company is involved in a core industry. Core industries include software industry, semiconductor manufacturers and certain cybersecurity service providers. An FDI in an unlisted Japanese company that is involved in a core industry will always require a prior notification with no exceptions. In addition, the appointment of directors in the target companies was added to the list of FDIs subject to notification; thus, foreign investors may need to continuously comply with the notification requirements even after the closing of the M&A transaction.

From a practical perspective, the 'software industry' has been included among the industries requiring prior notification under the FEFTA since 2019, even before the 2020 amendment. Businesses developing applications other than game software are broadly classified as part of the software industry, which may include modifying existing software. As a result, many startups engaged in the software industry are now subject to prior notification requirements. Additionally, when acquiring shares in unlisted companies, there

is no minimum threshold, meaning that even the purchase of just one share is subject to notification. Consequently, in cases where foreign investors become shareholders in startups, most investment deals are subject to these notification requirements.

DESCRIBE RECENT DEVELOPMENTS IN THE COMMERCIAL LANDSCAPE. ARE BUYERS FROM OUTSIDE YOUR JURISDICTION COMMON?

A significant trend in recent M&A activity in Japan is the focus on startups, which now account for around 40 per cent of all deals. M&A and investments in startups, particularly by corporations and corporate venture capital, have increased. Historically, IPOs were the main exit strategy for startups in Japan, but M&A exits have been gaining traction.

Investment fund activity has also grown. Although the number of M&A deals involving investment funds dropped by 14.5 per cent over the past year to 918, the total value reached a record around US\$36.78 billion. A notable feature of recent M&A activity has been large-scale acquisitions, such as the US\$14 billion acquisition of Toshiba by a consortium led by JIP and the US\$6.2 billion purchase of JSR Corporation by JIC. In the cross-border sector, the largest deal was the US\$2.2 billion management buyout of Outsourcing Inc, conducted in partnership with Bain Capital.

Carve-out transactions, where companies divest subsidiaries or business units, have also been increasing, particularly among large Japanese firms like Hitachi and Fujitsu. This trend is partly driven by the METI's 'Practical Guidelines for Business Restructuring' issued in July 2020. These guidelines have encouraged companies to optimise their business portfolios by divesting non-core operations and focusing on more profitable areas. The Toshiba acquisition by the JIP-led consortium highlights this ongoing trend, which reflects broader market pressures on Japanese conglomerates to streamline operations and improve profitability.

Business succession M&A has also seen a rise, with 467 deals recorded last year, a 45.5 per cent increase from the previous year. Foreign buyer interest in Japanese companies has been steadily growing, although it still accounts for less than 10 per cent of annual deals. In August 2024, for example, Seven & i Holdings, valued at nearly US\$34.48 billion, received a buyout proposal from Canada's Alimentation Couche-Tard. Japan's relatively low EV/EBITDA multiples make its companies attractive targets for foreign buyers, and this trend of cross-border M&A is expected to continue.

ARE SHAREHOLDER ACTIVISTS PART OF THE CORPORATE SCENE? HOW HAVE THEY INFLUENCED M&A?

In recent years, the presence and influence of shareholder activists have grown rapidly in Japan. These shareholder activists acquire shares in publicly traded Japanese companies and use their position as shareholders to advocate for changes in corporate strategy and governance. Generally, they would demand governance reforms through the exercise of their right to make shareholder proposals, but in recent years, their demands have become more aggressive, for example, by pushing for business reforms through takeover bids and other methods. In fact, there have been cases of public companies being sold off as a result of shareholder activist proposals.

Several factors have contributed to the surge in shareholder activism. Domestically, one major factor is considered to be the introduction of the Corporate Governance Code by the Tokyo Stock Exchange in 2015. This code was formulated against the backdrop that Return On Equity and stock prices of Japanese companies were low compared to international standards, so it aimed to improve these ratios and make Japanese companies more attractive to investors in Japan and abroad. Since the establishment of the Code, dialogue with shareholders of Japanese companies has become more active.

Increased investments in Japanese companies by foreign shareholder activist funds and the increased activity of activists worldwide have also contributed to this trend of shareholder activism in Japan. The low price-to-book value ratios and low total shareholder returns of Japanese companies compared to their US and European counterparts, as well as the small average market capitalisation of listed companies, have also created an environment conducive to investments by shareholder activists.

Traditionally, Japanese society has tended to dislike these activists, but in recent years, this view has gradually changed and there are more and more cases where the actions of activists are favourably received. The increase in the number of shareholder activists is expected to continue for some time, and this may bring about changes in the M&A activities of Japanese companies.

TAKE US THROUGH THE TYPICAL STAGES OF A TRANSACTION IN YOUR JURISDICTION.

The typical M&A process in Japan is as follows: first, when a decision to conduct a sale or acquisition is made, preliminary preparations are made as necessary, and a potential counterparty is selected. Generally, the potential counterparty is selected through an M&A broker (often an M&A specialist or the M&A department of a bank or securities company), but it is also possible for the CEO or management of the company to contact their acquaintances or business partners. If a brokerage firm is used, an agreement is made with the brokerage firm in the initial stage before the selection of the counterparty. Seller due diligence may also be conducted around the time of selecting the counterparty, but this is not necessarily common in Japanese practice.

Once a potential counterparty is selected, a meeting with the potential counterparty is held and a confidentiality agreement is concluded. Alternatively, once a counterparty company contacts the seller expressing interest in the M&A based on a no-name sheet and company profile, the next step is to have a meeting between the top management of the two companies. After the top management meeting, the general terms of the M&A are negotiated, and the terms of the sale, such as the sale price and scheduled sale date, are agreed. In Japan, it is common for M&A transactions to require board approval. However, since board meetings are often held infrequently, such as only once a month, and it is difficult to hold extraordinary meetings, especially for large companies, deal schedules must be aligned accordingly.

In recent years, it appears that sellers are increasingly conducting M&A using a bidding format to improve the terms of the sale as much as possible. In the case of a bidding process, a process letter describing the bidding procedure is distributed to potential buyers, who have signed confidentiality agreements, along with an information memorandum containing basic information about the target company. From this group of bidders, one potential buyer is selected to proceed with the M&A transaction and negotiations.

When both the seller and the counterparty agree to proceed with the M&A after the top management interviews and negotiations are conducted, a basic agreement, such as a letter of intent, is signed. The letter of intent is not a final agreement, but rather a provisional agreement that confirms both parties' intentions regarding the M&A. The letter of intent is an instrument that is generally used to ensure the parties' compliance with the initial M&A agreement.

The letter of intent normally includes an outline or scheme of the transaction, the expected sale price, the expected sale date, the method of conducting the due diligence, the treatment of directors and officers, and whether exclusive negotiating rights will be granted.

Once this basic agreement is executed, due diligence is conducted, final terms are negotiated considering the results of the due diligence, and a definitive contract is signed before closing.

ARE THERE ANY LEGAL OR COMMERCIAL CHANGES ANTICIPATED IN THE NEAR FUTURE THAT WILL MATERIALLY AFFECT PRACTICE OR ACTIVITY IN YOUR JURISDICTION?

Amendments of Financial Instruments and Exchange Act

In May 2024, Japan's Financial Instruments and Exchange Act was amended (although not in force yet). Of particular interest is the revision of the public tender offer (TOB) and large shareholding reporting system.

Under the current public tender offer system in Japan, any acquisition resulting in ownership exceeding one-third of a company's shares requires a public tender offer — known as the 'one-third rule'. Market transactions are generally open to all participants, and are considered to ensure a certain level of transparency and fairness, and thus are not typically subject to public tender offer regulations.

However, recent practices have shown that some hostile takeovers have been initiated through market transactions to avoid these regulations. This has raised concerns that minority shareholders may not receive adequate information or time to make informed investment decisions. To address these issues, the revised law now includes market transactions (on-exchange transactions) within the scope of public tender offer regulations.

Additionally, the threshold for the public tender offer requirement has been lowered from one third to 30 per cent. This change primarily reflects two considerations: (1) many foreign public tender offer systems set a 30 per cent threshold for such offers; and (2) considering the proportion of voting rights in Japanese listed companies, holding 30 per cent of voting rights allows one to block special resolutions at most shareholder meetings.

The revision also abolishes the 'rapid acquisition' regulation, which previously required public tender offers for certain transactions where ownership exceeded one-third through a combination of market and off-market transactions.

Publication of Guidelines for corporate acquisitions

In August 2023, as mentioned above, METI published the 'Guidelines for Corporate Takeovers.' These guidelines outline the desirable behaviours and principles that

companies should follow when engaging in acquisitions of publicly listed firms, with the aim of promoting M&A, facilitating corporate restructuring and enhancing the competitiveness of Japanese companies. Notably, the guidelines have rephrased 'hostile takeovers' as 'non-consensual acquisitions'. This change from the traditionally negative term 'hostile' to 'non-consensual' is intended to promote acquisitions that enhance corporate value and safeguard shareholder interests. The guidelines are expected to foster a more constructive M&A environment that aligns with societal expectations for fairness and effectiveness in corporate restructuring.

Acquisition of a foreign company in exchange for its own shares

Stock transfers involve a method where a corporation acquires another company using its own shares as compensation. This method was introduced by the Companies Act amendment in 2019. Under the current law, this system cannot be used to make a foreign company a subsidiary. However, there are discussions to amend the Companies Act to allow for stock transfers in cases of acquiring foreign companies as subsidiaries.

WHAT DOES THE FUTURE HOLD? WHAT ACTIVITY LEVELS DO YOU EXPECT FOR THE NEXT YEAR? WHICH SECTORS WILL BE THE MOST ACTIVE? DO YOU FORESEE ANY PARTICULAR GEOPOLITICAL OR MACROECONOMIC DEVELOPMENTS THAT WILL AFFECT DEAL SIZES AND ACTIVITY?

In Japan, many companies, especially small and medium-sized enterprises, are suffering from a lack of successors and human resources. According to the Small and Medium Enterprise Agency's 'Current Status and Issues of M&A in Small and Medium Enterprises and Small Businesses', the number of business owners aged 70 or older is expected to reach 2.45 million by 2025, of which about half will have no successors. As a result of this, the number of business succession M&As has been increasing in recent years, and this trend is expected to continue.

As mentioned above, M&As involving startup companies have also been a trend in recent years. According to an announcement by the Japan Venture Capital Association, the amount of funding raised by start-ups was about ¥80 billion in 2013, but in 2021, it reached around ¥800 billion, a tenfold increase. It is expected that more and more start-ups that have received investments will choose M&A as their exit strategy, and they have already been making their presence felt in the area of M&A transactions as of last year as well as this year. In Japan, as in the US, it is expected that the number of start-ups choosing M&A for further growth will increase.

Another recent trend gaining attention is M&A activities that are promoting SDGs and ESG initiatives to achieve sustainability management. M&As undertaken for the purpose of sustainability management, such as carbon neutrality initiatives are becoming more and more popular, especially among large companies. The number of such M&As rapidly increased eightfold to 273 in 2021 compared to the previous year, and was 315 in 2022 and 343 in 2023, accounting for 8.5 per cent of the total number of M&As. Sustainability management is playing an increasing role and has driven close to 10 per cent of all M&As in Japan. This trend is especially prominent in the energy sector. For instance, NTT Anode Energy and JERA (a joint venture of Tokyo Electric Power Holdings and Chubu Electric Power) jointly acquired renewable energy company Green Power Investment (GPI) from

an American energy firm, in a deal worth US\$2.07 billion. Marubeni also invested in Serva Solutions, the largest battery recycling company in North America. Companies are expanding renewable energy operations and restructuring their asset portfolios to support decarbonisation efforts. The steel sector has also seen a significant increase in activity. Nippon Steel is advancing its acquisition of the US steel manufacturer US Steel and has invested US\$1.34 billion in Elk Valley Resources (EVR), a Canadian coal producer. These moves are considered part of a broader strategy focused on decarbonisation.

The Inside Track

WHAT FACTORS MAKE MERGERS AND ACQUISITIONS PRACTICE IN YOUR JURISDICTION UNIQUE?

If a buyer is intending to acquire a controlling stake in a public company in Japan, it will be required to commence a tender offer procedure that is peculiar to the Japanese legal system. Acquiring more than one third of the total voting rights of a listed company would be sufficient to trigger the tender offer requirement. However, the current tender offer system has been fundamentally amended as mentioned above. From a cultural perspective, a seller in Japan often strongly desires to maintain all of its current employees in the target company even after the sale. As such, in the definitive agreement, it is common for the seller to require as one of the buyer's post-closing covenants that, for several years after closing, the target company's workers should continue to be employed by the company and their working conditions should remain unchanged.

WHAT THREE THINGS SHOULD A CLIENT CONSIDER WHEN CHOOSING COUNSEL FOR A COMPLEX TRANSACTION IN YOUR JURISDICTION?

Since a complicated deal often requires expertise in various legal fields, it is advisable for a client to seek the assistance of a law firm that can provide a one-stop service covering all such various legal fields. Experience in these kinds of transactions is also desirable. To control costs, it is also a good idea to consider law firm options other than large or international law firms.

WHAT IS THE MOST INTERESTING OR UNUSUAL MATTER YOU HAVE RECENTLY WORKED ON, AND WHY?

In a diligence process of a family-owned business, a substantial amount of off-the-books inventory was found, for which the relevant tax risk turned out to be significant. In our jurisdiction, this kind of risk would usually be dealt with through special indemnity clauses in the definitive agreement. However, in this transaction, because of the magnitude of the risk, the parties agreed that the target company should file an amended tax return before the signing of the definitive agreement. Despite this, and even after the filing, another off-the-books inventory risk was discovered, so the buyer proposed a substantial discount on the purchase price. This eventually resulted in the seller abandoning the deal.

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