CLIFFORD CHANCE

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# Companies Act Reform: Organisation Restructuring/M&A (Cash-out, Capital Raising)

This briefing explains the new rules regarding cash-out and capital raising by a private placement of shares as set out in the amendment to the Companies Act, which was enacted on 20 June 2014 ("Amendment"). The Amendment is expected to come into effect on 1 April 2015.

The Amendment has introduced a new cash-out mechanism called a Demand for Sale of Shares. A cash-out (or squeeze out) is the compulsory acquisition of shares by majority shareholders from minority shareholders for consideration in cash and is often used to convert of a subsidiary into a wholly-owned subsidiary. Under the amended Companies Act, a Demand for Sale of Shares can be made by a shareholder holding no less than 90% of the voting rights in the target company. The amended Companies Act also provides for new minority shareholder protections for each of the existing mechanisms under current law for undertaking a cash-out: namely a "consolidation of shares" and a "class share scheme", the latter of which is by way of subjecting class shares ("Class Shares") to a class-wide call. In relation to capital raising, a shareholders' resolution will be required in certain types of share issuances that result in a person acquiring control of the company.

## Cash-out

### Background

A cash-out is commonly used in practice to convert a company to a wholly-owned subsidiary for the purpose of facilitating the decision-making process of the company, reducing administration costs in relation to shareholders as well as meeting certain conditions pursuant to a leveraged buy-out transaction.

Under the current Companies Act, a class share scheme is employed to effect a cash-out for tax reasons. However, conducting a cash-out by way of a class share scheme presents certain problems: aside from costs and the long duration needed for implementation, when used following a tender offer bid to privatise a company, the class share scheme has been criticised as placing minority shareholders under pressure to sell their shares during the preceding tender offer bid because, should the minority shareholders not accept the acquirer's offer during the tender offer bid, they would have to wait for a considerable length of time before finally receiving their cash consideration under a class share scheme.

Another issue is that share options cannot be transferred pursuant to a class share scheme. An acquirer would then have to acquire the share options as a separate process to the scheme or seek a waiver for the exercise of such share options from optionholders. Even then, there is a risk that should such optionholders refuse to waive their right to exercise, they may then exercise their options after the acquisition by the acquirer of all issued shares in the company.

### Demand for Sale of Shares

Through the Demand for Sale of Shares, a shareholder holding no less than 90% of the voting rights of a target company may acquire the remaining shares in the target company (not already held by such shareholder) without approval at a shareholders' meeting of the target company, subject only to approval by the board of directors. In the same Demand for Sale of Shares, such shareholder may require the sale of not only shares, but also share options.

### Protection of Minority Shareholders under Consolidation of Shares and the Class Share Scheme

Under the current Companies Act, there is a risk that a shareholders resolution approving a cash-out by way of a consolidation of shares was invalid, due to the lack of protection for minority shareholders during the consolidation of shares procedure. The amended Companies Act has now introduced minority shareholder protection measures: the company must disclose certain information relating to the consolidation of shares prior to and after the consolidation, and shareholders may seek various court orders to prevent the company from proceeding with the consolidation of shares and require the company to purchase any fraction shares held by them.

Similar minority shareholders' protections have also been provided under the Amendment for class share schemes: information disclosure by the company prior to and after the acquisition of Class Shares, and shareholders may seek various court orders to prevent the company from proceeding with the acquisition of Class Shares and request that the court adjudicate in the determination of the consideration price of the Class Shares.

### Practical Implications

Moving forward, it is expected that the Demand for Sale of Shares for a cash-out would be commonly-used by shareholders that hold no less than 90% of the voting rights, saving them time and streamlining the acquisition of shares and share options into a single process.

Should the Demand for Sale of Shares mechanism not be used, the consolidation of shares or the class share scheme mechanisms will continue to be available for cash-outs.

## Issuance of Shares Accompanying a Change of Control

### New Rules for Share Issuance

Under the existing Companies Act, public companies may issue shares to a particular person with the approval of the board of directors, unless such issuance is made at an advantageous price in which case approval by a special majority of shareholders at a shareholders' meeting is required. However, it had been argued, with a view to adequately protecting existing shareholders and investors, that approval at a shareholders' meeting should be required as well for issuances of shares that result in a change of control, and that the information regarding the subscriber should be disclosed to other shareholders who may want to apply for an injunction to the prevent the share issuance.

Under the amended Companies Act, share issuances by a public company to a particular person resulting in a change of control would require a disclosure by the company with respect to the information about the subscriber, and following such disclosure, should any shareholder holding 10% or more voting rights oppose such a share issuance, shareholders' approval would then be necessary in order to proceed.

The procedure in detail is as follows: the company must notify shareholders with respect to certain information pertaining to the subscriber at least two weeks before the payment is due to be effected for the subscription. If any shareholder holding 10% or more of the voting rights opposes the share issuance within two weeks of such notification, the company is required to seek shareholders' approval for the share issuance no later than the day preceding the payment date for the subscription. Shareholder approval however, would not be required if the company would otherwise face the risk of serious detriment to its financial condition or in an urgent situation requiring the issuance of shares to continue business.

## Practical Implications

The new rules for share issuances are not expected to have a major impact on companies listed on the Tokyo Stock Exchange. The listing rules of the Tokyo Stock Exchange already prescribe a similar regime – share issuances to a particular person that would result in a change of control, would require either shareholder approval or a third party opinion explaining the necessity and appropriateness of the share issuance, unless there is an urgent need for such share issuance.

Additionally, the Financial Instruments and Exchange Law of Japan requires the reporting company to explain the decision-making process concerning a share issuance to a particular person, which includes a third party opinion or shareholders' approval. Therefore, the new rules for share issuances pursuant to the amended Companies Act would mainly impact non-listed companies.

Companies undertaking share issuances that would be affected by the new rules are advised that preparation for the requisite shareholders' meeting requires time and advance planning (particularly in the case of listed companies) and hence should factored into the relevant timelines, especially if dissenting shareholders holding 10% or more of the voting rights are expected.

*Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.*

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