

Foreign Investment Review 2021

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Foreign Investment Review 2021

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Oliver Borgers
McCarthy Tétrault LLP

Lexology Getting The Deal Through is delighted to publish the tenth edition of *Foreign Investment Review*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on the European Union, France, Italy, Pakistan, Spain, Sri Lanka and Uzbekistan.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Oliver Borgers of McCarthy Tétrault LLP, for his continued assistance with this volume.



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Contents

Australia	5	Laos	80
Deborah Johns Gilbert + Tobin		Dino Santaniello Tilleke & Gibbins	
Austria	12	Myanmar	86
Isabella Hartung and Julia Schönhuber Barnert Egermann Illigasch Rechtsanwälte		Nwe Oo and Ross Taylor Tilleke & Gibbins	
Cambodia	17	New Zealand	89
Jay Cohen and Nitikar Nith Tilleke & Gibbins		Ben Paterson and Lance Jones Russell McVeagh	
Canada	21	Pakistan	99
Oliver Borgers, Dominic Thérien, Jonathan Bitran and Erin Keogh McCarthy Tétrault LLP		Sarjeel Mowahid and Ahmed Reza Mirza ABS & Co	
China	33	South Korea	107
May Liu Global Law Office		Joo Hyoung Jang, Rieu Kim, Kyunghun Kim and Youjin Hwang Barun Law LLC	
European Union	39	Spain	112
Charles Pommiès, Dominic Long and Jonathan Benson Allen & Overy LLP		Juan Manuel de Remedios and Laura del Olmo White & Case LLP	
France	45	Sri Lanka	117
Orion Berg and Camille Grimaldi White & Case LLP		Nirosha Peiris Tiruchelvam Associates	
Germany	51	Switzerland	123
Roland M Stein and Leonard von Rummel BLOMSTEIN Partnerschaft von Rechtsanwälten mbB		Stephan Erni, Astrid Waser and Eric Olivier Meier Lenz & Staehelin	
India	58	Thailand	131
Hardeep Sachdeva and Priyamvada Shenoy AZB & Partners		Jirapong Sriwat and Apinya Sarntikasem Nishimura & Asahi	
Italy	68	United Arab Emirates	136
Francesco Salerno and Kathleen Lemmens Gianni & Origoni		Silvia Pretorius Afridi & Angell	
Japan	74	United Kingdom	142
Koki Yamada and Dai Iwasaki Tokyo International Law Office		Tim Cowen and Claire Barraclough Preiskel & Co LLP	

United States 148

Paul Marquardt, Chase Kaniecki, Nathanael Felix Kurcab,
Nora McCloskey and Elise Lane
Cleary Gottlieb Steen & Hamilton LLP

Uzbekistan 154

Mahdi Magdiev
Winfields

Vietnam 159

Phuong Thi Minh Tran and Nam Ngoc Trinh
Tilleke & Gibbins

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LAW AND POLICY

Policies and practices

1 | What, in general terms, are your government's policies and practices regarding oversight and review of foreign investment?

With a view toward enhancing the growth potential of the Japanese economy and to reinvigorate regions around the country, the Japanese government undertook measures to increase inward foreign direct investment (FDI). Accordingly, in 2013, the Japanese government announced its target of increasing FDI stock to ¥35 trillion by 2020, and FDI stocks have grown steadily since to ¥33.9 trillion by the end of 2019. In July 2020, the Japanese government announced that it would formulate the Medium and Long-term Strategy for Promoting Foreign Direct Investment in Japan 2021 by spring 2021, which may include the next FDI target. The Japanese government also announced that the new strategy should be responsive to: the current climate for inward FDI; the shrinking economies in local areas and growing difficulty in business succession with a falling birth rate and aging population; and the progress of the Fourth Industrial Revolution around the world and intensifying global competition.

The Japanese government actively opened its doors to foreign investors, in principle, for more than a decade after the Foreign Exchange and Foreign Trade Act (the Forex Act) was amended in 1998.

However, this trend seems to have shifted in recent years. Since 2018, the Japanese government started to gradually tighten the foreign investment regulations and has continued to do so in 2019 and 2020. This appears to be in line with global trends such as in the United States, which has recently taken aggressive measures to prevent technology leaks to foreign countries.

The Japanese government is promoting an open policy for foreign investors while scrutinising incoming investments over possible national security concerns. In August 2019, Japan added cybersecurity to the list of sectors to be protected under the Forex Act. Further, the 7 June 2020 revision to the Forex Act, which tightens regulations on inbound equity investments, came into full effect (the 2019 Amendment).

Separately, in April 2020, the government announced that, effective from 15 July 2020, pharmaceuticals and medical equipment would be added to the list of the protected sectors (see below for the particular types of businesses that the Forex Act protects) to ensure a stable domestic supply of these medical products amid the covid-19 pandemic and in the event of potential future outbreaks. These include manufacturers of vaccines, heart and lung machines, ventilators and pharmaceuticals.

In general, foreign entities investing in Japan must submit an ex post facto report to the relevant ministries. The purpose of this requirement is to enable the government to make a statistical record of the number of ex post facto reviews and government investigations.

However, the Forex Act requires prior filing in certain limited investments involving particular types of businesses and particular geographic areas or countries. These are as follows:

- The business-related restrictions are imposed on, among others, investments in any business related to:
 - national security (eg, weapons, airplanes, nuclear power, space development, or information and communication technology);
 - public infrastructure (eg, electricity, gas, water, telecommunications or railways);
 - public safety (eg, medicine, medical equipment, vaccine manufacturing or private security service); and
 - protected-domestic industry (eg, agriculture).
- The area-related restrictions are imposed on, among others, investments concerning countries with which Japan has not executed an FDI treaty (eg, Iran) and certain activities involving the Iranian government, entities, individuals or groups.

If the investment falls into one of the above categories, the party who intends to make such an investment is required to submit prior notification of the intended investment to the relevant ministries. The relevant ministries will then review the filed report in principle within 30 days from filing. After the review, the relevant ministries may order a suspension or amendment of the filed investment, if they find the investment is likely to:

- threaten national security;
- disrupt public order;
- hamper the protection of public safety; or
- have a significant adverse effect on the smooth management of the Japanese economy.

To date, the Japanese government has rarely exercised its authority to issue an investment suspension order under the current Forex Act. There has been only one case where the ministries have actually issued a suspension order.

Since 1980, when the Forex Act was enacted, the first and only investment suspension order was issued in 2008. At that time, the Children's Investment Master Fund (TCI), a UK-based activist fund, intended to purchase up to a 20 per cent stake in J-Power, a Japanese electric utility owning core infrastructures including nuclear plants and power lines. The relevant ministers announced that, upon their review, including a series of interviews with TCI, the investment risked impairing J-Power's financial condition, reducing future capital expenditure or maintenance spending on fundamental infrastructures, and causing negative effects on the construction and maintenance of the Ohma nuclear fuel recycling plant. A Ministry of Finance official publicly described the Japanese government's position in this instance as exceptional given that all other foreign investments were approved since the Forex Act was enacted in 1980.

Main laws

2 | What are the main laws that directly or indirectly regulate acquisitions and investments by foreign nationals and investors on the basis of the national interest?

The Forex Act (along with supplemental regulations) is the main law.

Further, the following other laws regulate investments by foreign nationals or set the upper limit of holding ratios by foreign nationals in specific business sectors:

- the Broadcast Act;
- the Radio Act;
- the Civil Aeronautics Act;
- the Consigned Freight Forwarding Business Act;
- the Mining Act;
- the Ships Act; and
- the Act on Nippon Telegraph and Telephone Corporations.

Scope of application

3 | Outline the scope of application of these laws, including what kinds of investments or transactions are caught. Are minority interests caught? Are there specific sectors over which the authorities have a power to oversee and prevent foreign investment or sectors that are the subject of special scrutiny?

The Forex Act is applied to foreign investments conducted by foreign investors in the following situations, among others:

- the acquisition of 1 per cent or more of shares of listed companies;
- the acquisition of shares of unlisted companies from a domestic investor;
- the transfer of shares from a non-resident individual to a foreign investor (where a non-resident acquired these shares while a resident);
- when consent is sought for any material change to corporate objects, or to other matters having a material impact on the management of the target company or companies;
- the transfer of a business from a Japanese entity;
- the establishment of a branch, factory or other business office (excluding a representative office) in Japan or substantially changing the type or business objectives of such a branch, factory or other business office, excluding those with the business objectives of:
 - banking;
 - foreign insurance;
 - gas;
 - electricity;
 - certain types of securities;
 - investment management;
 - foreign trust; and
 - fund transfer;
- the extension of loans to Japanese corporations exceeding certain thresholds; and
- the acquisition of private placement bonds issued by a Japanese corporation exceeding certain thresholds.

The Forex Act generally covers the acquisition of minority interests, except for the acquisition of less than 1 per cent of the shares of listed companies. As the 1 per cent threshold may impose an undue burden on a foreign investor, the recent 2019 Amendment introduced two exemptions.

Investment in certain sectors, such as in a weapons manufacturing, may fall into the categories in which prior notification is required. If required, the authorities will review the transaction to determine whether the investment is likely to threaten national security, disrupt

public order or hamper the protection of public safety. There are no rules or regulations requiring special scrutiny for any particular sectors in such reviews.

In addition to the above, the Forex Act requires prior notification when a foreign investor seeks to acquire the shares of an unlisted Japanese company from another foreign investor, if the company conducts certain business such that the acquisition is likely to threaten national security. For the avoidance of doubt, unlike unlisted companies there are no thresholds. These categories of businesses include:

- manufacturing weapons and certain related products;
- manufacturing satellites, rockets and certain related products;
- manufacturing nuclear plants and certain related products; and
- manufacturing semiconductor devices.

Definitions

4 | How is a foreign investor or foreign investment defined in the applicable law?

The Forex Act defines a 'foreign investor' as: (1) a non-resident individual; (2) a corporation, partnership, association or other entity established under a foreign jurisdiction or having its principal office in a foreign country; (3) a corporation established under Japanese law of which the ratio of the sum of the voting rights directly or indirectly held by those listed in item (1) or (2) is 50 per cent or more, including through entities of which the ratio of the voting rights held by those listed in item (1) or (2) is 50 per cent or more; and (4) a corporation, partnership, association or other entity in which the majority of either the officers (eg, directors) or the representative officers are non-resident individuals.

Further, the definition of foreign investor for certain types of limited partnership has been changed since the 2019 Amendment. Both general partners and limited partners of a partnership had been individually subject to the notification requirement, but under the 2019 Amendment, only the partnership itself (through its general partner) will be subject to the notification requirement.

Special rules for SOEs and SWFs

5 | Are there special rules for investments made by foreign state-owned enterprises (SOEs) and sovereign wealth funds (SWFs)? How is an SOE or SWF defined?

SOEs are not able to enjoy exemptions from prior notification.

However, SWFs that are deemed not to pose a risk of threatening national security are eligible for an exemption from prior notification of a listed company stock purchase if accredited by the Ministry of Finance.

For an SWF to obtain accreditation, the Ministry of Finance will enter a memorandum of understanding (MOU) with the SWF, if the Ministry believes both of the following conditions are satisfied:

- the SWF's investment activity is only for economic return; and
- the SWF's investment decision is made independently of their government.

The decision to enter an MOU and for accreditation are not made public.

Relevant authorities

6 | Which officials or bodies are the competent authorities to review mergers or acquisitions on national interest grounds?

The Minister of Finance and the minister with jurisdiction over the targeted business are the competent authorities to review mergers or acquisitions under the Forex Act. Though the decision-making authorities are such ministers, all of the applications, notifications or post-facto reports, which are required under the Forex Act, must be submitted through the Bank of Japan.

Examples of the jurisdictions of the ministers are follows:

- the Prime Minister: banks, trusts, security business, insurance businesses and investment advisers;
- the Minister of Finance: import and export of precious metals and import and export of alcohol;
- the Minister of Agriculture, Forestry and Fisheries: agriculture and fishery and the manufacture of food or beverages;
- the Minister of Health, Labour and Welfare: pharmaceutical matters and medical devices; and
- the Minister of Economy, Industry and Technology: manufacture, sales, import and export of aircraft, weapons and electricity.

7 | Notwithstanding the above-mentioned laws and policies, how much discretion do the authorities have to approve or reject transactions on national interest grounds?

For those transactions only requiring ex post facto reports, the authorities do not have any discretion to either approve or reject the transactions as the ex post facto reports are required mostly for the purpose of statistical analysis.

However, in reviewing the transactions subject to the prior notification requirement, the authorities (the Minister of Finance and the minister with jurisdiction over the targeted business) have, theoretically, relatively broad discretion under the Forex Act.

PROCEDURE

Jurisdictional thresholds

8 | What jurisdictional thresholds trigger a review or application of the law? Is filing mandatory?

The Foreign Exchange and Foreign Trade Act (the Forex Act) imposes prior notification requirements on investments into certain limited areas of businesses and investments involving certain geographical regions.

As long as the intended investment falls into one of these categories, the filing is mandatory and there are no numerical threshold-based exemptions such as turnovers or asset size. Even in cases where the business triggering the prior notification is small relative to the size of the overall business, the filing requirement could be triggered. For instance, if an electric manufacturer's batteries are used in satellites, then prior notification might be required. As the waiting period for prior notification could delay the entire transaction, a careful review of the targeted company is highly recommended, especially when it conducts a wide range of business activities such as electronics manufacturers.

National interest clearance

9 | What is the procedure for obtaining national interest clearance of transactions and other investments? Are there any filing fees? Is filing mandatory?

The prior notification application must be submitted to the Minister of Finance and the minister with jurisdiction over the targeted businesses via the Bank of Japan. Application forms are available at the Bank of Japan's website. There are no filing fees.

The relevant ministers will review the applications, and may require hearings, written responses to inquiries and the submission of additional documents.

If the investment does not fall into the categories requiring a mandatory filing, the authorities do not have power to intervene in the transaction.

10 | Which party is responsible for securing approval?

A foreign investor is responsible for securing government approval. Therefore, if the investment falls into the category triggering the need for prior notification, in Japanese business practice it is strongly recommended to include a conditions precedent clause to the consummation of the transaction so that the parties are not obliged to make the investment during the waiting period.

Review process

11 | How long does the review process take? What factors determine the timelines for clearance? Are there any exemptions, or any expedited or 'fast-track' options?

Under the Forex Act, if prior notification is required, the investor must wait to close the investment for 30 days after the Bank of Japan's acceptance of the application. However, such a waiting period normally will be shortened to two weeks from the acceptance in accordance with the relevant ordinance. Moreover, with an aim to facilitate more inward foreign direct investment, the Ministry of Finance and other relevant ministries have implemented expedited fast-track options for greenfield investment (ie, certain investments involving a wholly owned Japanese subsidiary), rollover investments (ie, certain investments, the same type of which were previously filed within six months by the same investor) and passive investments (ie, certain investments that the investor undertook so as not to proactively participate in the management or to take control of the company). If the fast-track option applies, the waiting period will be further reduced to five business days.

However, if the authority finds that there needs to be a review procedure on whether the investment is likely to threaten national security, disrupt public order or compromise public safety, the waiting period can be extended up to five months. Given the recent trend to encourage foreign investment, the Ministry of Finance and other relevant ministries may give the foreign investor an opportunity for prior consultation or may request *sua sponte* more details about the potential investment before the prior notification is submitted. Therefore, a foreign investor should be mindful that the timeline for submission of a prior notification may be extended, especially if the foreign investor seeks to invest in one of secured categories of business.

12 | Must the review be completed before the parties can close the transaction? What are the penalties or other consequences if the parties implement the transaction before clearance is obtained?

An investor may not close the transaction for which prior notification is required for the relevant waiting period. If the investor closes the transaction in violation of this time restriction, the investor will be subject to criminal penalties, including imprisonment of up to three years or a fine, or both. The fine will be up to three times the amount of the investment or ¥1 million, whichever is higher.

Involvement of authorities

13 | Can formal or informal guidance from the authorities be obtained prior to a filing being made? Do the authorities expect pre-filing dialogue or meetings?

The Bank of Japan accepts general enquiries about Forex Act filing procedures via the telephone.

The Ministry of Finance and other relevant ministries are generally open to pre-filing consultation if there are any substantive enquiries. Although such a pre-filing consultation is voluntary, it is recommended for an investor to conduct pre-filing consultations, especially if there is

any ambiguity in terms of the application of relevant laws and regulations. Recently, the Ministry of Finance and other relevant ministries may also *sua sponte* request a pre-filing consultation.

14 | When are government relations, public affairs, lobbying or other specialists made use of to support the review of a transaction by the authorities? Are there any other lawful informal procedures to facilitate or expedite clearance?

The Ministry of Finance and the minister with jurisdiction over the targeted businesses will review the application. As there has only ever been one case where a suspension order was issued, investors typically do not utilise government relations, public affairs lobbyists or other specialists to support the review of the transaction. Other than cooperating fully with the review process, such as providing necessary information that is requested or promptly providing answers to enquiries, there are no other informal procedures to facilitate or expedite clearance.

The waiting period will be expedited as a default rule set by the relevant ordinance.

15 | What post-closing or retroactive powers do the authorities have to review, challenge or unwind a transaction that was not otherwise subject to pre-merger review?

The competent authorities have the power to issue an order requiring the foreign investor who failed to make prior notification to divest all or a part of the shares that were acquired or to take such other measures, if necessary, upon seeking an opinion from the Ministry of Finance's Council on Customs, Tariff, Foreign Exchange and other Transactions.

SUBSTANTIVE ASSESSMENT

Substantive test

16 | What is the substantive test for clearance and on whom is the onus for showing the transaction does or does not satisfy the test?

The authorities will review an investment subject to prior notification to assess whether it is likely to threaten national security, disrupt public order, compromise public safety or have a significant adverse effect on the smooth management of the Japanese economy. For example, the Ministry of Finance and the Ministry of Economy, Trade and Information issued an order to suspend the Children's Investment Master Fund's proposed investment in a Japanese power company as there was a likelihood that the investment might compromise public safety.

The investor has the burden of proof to show that the transaction does not fall into any of the above-mentioned categories.

17 | To what extent will the authorities consult or cooperate with officials in other countries during the substantive assessment?

The Japanese authorities have continually stressed that the Foreign Exchange and Foreign Trade Act (the Forex Act) restrictions are consistent with international standard rules such as the Organisation for Economic Co-operation and Development Codes of Liberalisation of Capital Movements and of Current Invisible Operations. The 7 June 2020 revision to the Forex Act authorises the Japanese government to exchange information with foreign governments for the purpose of regulatory enforcement by foreign governments or authorities.

Other relevant parties

18 | What other parties may become involved in the review process? What rights and standing do complainants have?

Before issuing an order to suspend or change the content of an investment, the relevant ministers are required to receive input from the Ministry of Finance's Council on Customs, Tariff, Foreign Exchange and other Transactions (the Council). The Council comprises academic experts nominated by the Minister of Finance. There are no procedures for allowing the complainant to participate in the review process. Therefore, the complainants have no rights or standing.

Prohibition and objections to transaction

19 | What powers do the authorities have to prohibit or otherwise interfere with a transaction?

The Minister of Finance and the minister with jurisdiction over the targeted businesses have the power to order an investor to suspend or change the content of the investment, but only upon the investor's refusal to implement the recommendation from the relevant ministers.

20 | Is it possible to remedy or avoid the authorities' objections to a transaction, for example, by giving undertakings or agreeing to other mitigation arrangements?

Other than regular advocacy activities, there is no remedy or way to avoid the authorities' recommendations or objections to an investment subject to the Forex Act. However, the authorities' decision can be formally challenged.

Challenge and appeal

21 | Can a negative decision be challenged or appealed?

A negative decision can be appealed. A foreign investor can file an appeal with the relevant ministry challenging an order to suspend or change the content of an investment. The ministry receiving the appeal is required to hold a public hearing after giving reasonable advance notice.

A party that is dissatisfied with the relevant ministry's decision in the appeal procedure may then bring an action in court.

Confidential information

22 | What safeguards are in place to protect confidential information from being disseminated and what are the consequences if confidentiality is breached?

Under the National Public Service Act, government officials owe a duty of confidentiality for any confidential information of which the officials become aware in the course of their duties. As such, any confidential information provided to government officials in the foreign investment review process will be subject to such an obligation. If an official were to breach his or her confidentiality obligation, he or she can incur a criminal penalty of imprisonment for up to one year or a fine of up to ¥500,000. The party may make a claim for damages against the Japanese government, as a result of the dissemination of confidential information, if the required elements under the State Redress Act, for example, an intentional act or an act owing to the negligence of an official, can be established.

RECENT CASES

Relevant recent case law

- 23 | Discuss in detail up to three recent cases that reflect how the foregoing laws and policies were applied and the outcome, including, where possible, examples of rejections.

Since the enactment of the Foreign Exchange and Foreign Trade Act in 1980, there has been only one instance where the order to suspend the investment was actually issued (the order issued to suspend the Children's Investment Master Fund's proposed investment in J-Power in 2008), despite the fact that hundreds of prior notification applications have been filed each year.

UPDATES AND TRENDS

Key developments of the past year

- 24 | Are there any developments, emerging trends or hot topics in foreign investment review regulation in your jurisdiction? Are there any current proposed changes in the law or policy that will have an impact on foreign investment and national interest review?

The 7 June 2020 revisions to the Foreign Exchange and Foreign Trade Act (the Forex Act) is a recent hot topic as it: introduces an exemption scheme from the need for prior notification for a listed company's share purchase (PN-SP) to further promote foreign direct investment (FDI) conducive to sound economic growth; and lowers the threshold for PN-SP from 10 per cent to 1 per cent. A foreign investor is generally required to file a prior notification if it acquires 1 per cent or more shares in a listed company, which is included in the list of protected sectors under the Forex Act (designated business sectors). However, two exemptions are available depending on the nature or structure of a foreign investor if three criteria are satisfied: a foreign investor or its closely related person will not become a board member of the target company; a foreign investor will not propose to the general shareholders' meeting a transfer or disposition of important business activities of the target company; and a foreign investor will not have access to non-public information about the target's technologies that may impact Japanese national security or public welfare.

Exemption for a foreign financial institution: blanket exemption

This exemption is available for the following financial institutions that are licensed or registered under financial regulatory laws in Japan and other jurisdictions: securities firms, banks, insurance companies, asset management companies, trust companies (excluding those solely engaged in custody businesses), registered investment companies (including mutual funds and exchange-traded funds) and high-frequency traders (only those registered in Japan). However, it is not applicable for SOEs.

This blanket exemption provides a comprehensive exemption from filing a PN-SP. A post facto report will be required when the investor's total shareholding reaches 10 per cent or more for each transaction.

Exemption for a regular foreign investor (including certain SWFs but not SOEs): regular exemption

This exemption is generally applicable for foreign investors as well as SWFs and public pension funds accredited by the authority, but not for an investor with a record of sanctions for a Forex Act violation and SOEs. The scope of the regular exemption depends on whether a target engages in business in 'core sectors', which means certain business sectors that would pose a significant risk to national security as listed under the Forex Act (eg, weapons, aircrafts, nuclear facilities and dual-use technologies that are able to divert to military use).



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If a target does not conduct business in any of the core sectors, a foreign investor will be exempted from filing a PN-SP provided that a post facto report for a listed company's share purchase will be required when the investor's total shareholding reaches: 1 per cent for the first time; 3 per cent for the first time; and 10 per cent or more for each transaction. A post facto report will not be required at the second and subsequent transactions reaching 1 per cent or 3 per cent.

If a target conducts business in any of the core sectors, a foreign investor will be exempted from filing a PN-SP only if a shareholding ratio is under 10 per cent and the following two additional requirements are satisfied: the foreign investor will not attend and will not have their designated persons attend the target's board or committee meetings that make important decisions for its business in the core sector; and the foreign investor will not make proposals in writing to the board or individual members of the board requiring responses or actions within a specific deadline. The post facto report regulation stated above will apply to cases where a target does not conduct business in any of the core sectors.

List of classifications of listed companies regarding the prior-notification requirements on FDI under the Forex Act

To facilitate an understanding about PN-SP, the Japanese government has published a list of all listed companies categorising: companies not conducting business in designated business sectors; companies conducting business in designated business sectors but not core sectors; and companies conducting business in core sectors. The list of companies operating in designated business sectors or core sectors is available at the Ministry of Finance's website.

Coronavirus

- 25 | What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

The nationwide state of emergency declaration, which had been in effect since early April 2020, has been lifted. However, the Japanese government continues to carefully review the situation and is implementing a

set of measures to prevent the spread of covid-19 infections and restore socio-economic activities.

Government measures that have been undertaken include tax measures (eg, payment deferrals and rate reductions), employment-related measures (eg, subsidy for leave allowance for small and medium-sized enterprises and large enterprises), economic stimulus measures (eg, business loans with low interest rates) and customs measures (eg, giving certain priority to import and export customs clearance of supplies and goods related to addressing covid-19 and securing lifelines). In addition, given the covid-19 pandemic, the need for digital transformation has become imperative in all aspects of Japanese society, especially in the government and business sectors. Accordingly, in the first half of 2020, the Japanese government established a digital transformation policy in response to the pandemic concerning, for example, civil court proceedings, the traditional carve seals custom for internal and external documents and contracts, and the submission of administrative documents to government agencies .

As the covid-19 situation changes daily, our clients have been faced with uncertainty and difficulty in forecasting their business operations in the short-term. Nevertheless, we generally advise them to prepare for the mid- to long-term implications and remediate the short-term shock. In the near-term, the situation, and thus the strategy, varies depending on the business sector and company's size, but protecting the well-being of their employees, customers and other related persons is the most important first step. The next step is to rethink their current cash position and reassess cash flow projections. For the mid- to- long term, thinking about their supply chain, manufacturing, distribution and their global business communication lines are the most important topics to be considered.

Other titles available in this series

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