Employees: Cross-Border Private Acquisitions (Japan)

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A Practice Note discussing the key employment law issues to consider when acquiring a private company or a business in Japan. It discusses obligations and legal protections afforded to employees in Japan in the event of a share or asset purchase or company split. It also outlines employee termination costs and formalities, due diligence considerations, standard purchase agreement provisions, and visa requirements for foreign directors and officers.

Maintaining the continuity and productivity of the workforce of an acquired business is often considered a key component of a successful transaction. Identifying employee-related costs and liabilities triggered by the transfer of employees and allocating those costs and liabilities between a buyer and seller can also be a significant challenge and difficult point of negotiation.

In cross-border transactions, employee-related challenges and risks to the buyer can be greater, as the laws protecting employees can vary greatly among different jurisdictions. Counsel representing buyers in cross-border transactions should become familiar with the laws and requirements concerning employees in each jurisdiction where the target business operates.

This Note sets out the key employment law considerations when acquiring or disposing of a private company (share purchase) or a business (asset purchase or company split) in Japan, including:

- Any obligation to inform and consult, or other legal protections afforded to, employees in connection with the share or asset purchase or company split.
- The costs, formalities, and rights relating to the dismissal of employees impacted because of the share or asset purchase or company split.
- What to consider when undertaking due diligence regarding the employees and the common employment warranties and indemnities sought in share and asset purchases or company splits.
- Visa requirements for foreign nationals working or serving as directors or officers in Japan.

A share purchase is the most common way to acquire a private company in Japan. When acquiring a business or assets in whole or in part, two structures are available:

- Company split (*kaisha bunkatsu*), which is a corporate transaction in which transferred businesses are spun off.
- Business or asset purchase (*jigyo jyoto*), which is a contractual transfer of individual assets, contracts, and employees.

Under the Companies Act, a company split means that a company (a split company) transfers all or part of the assets, debts, labor contracts, and other rights and obligations pertaining to its business to another company or a newly established company (a successor company). A company split is functionally similar to a business or asset purchase because both are used for causing a business of a company to be transferred to another company. However, significant differences exist between a company split and a business or asset purchase. In a company split, each contract pertaining to the transferred business will be succeeded by the successor company without consent from the opposite party involved in each contract, while in a business or asset purchase, consent to the contract transfer is a must. Parties planning on a business transfer will usually consider the number of contracts to be succeeded when deciding whether to adopt a company split or an asset purchase.

For more information regarding different acquisition structures in Japan, see Practice Note, Acquisition Structures: Comparing Asset and Share Purchases (Japan).

- Unless otherwise stated, a reference in this Note to:
- APPI means the Act on the Protection of Personal Information (Act No. 57 of 2003 as amended in 2020).
- Companies Act means the Companies Act (Act No. 86 of 2005 as amended in 2019).
- Labor Contracts Succession Act means the Act on the Succession to Labor Contracts upon Company Split (Act No. 103 of 2000).
- Labor Union Act means the Labor Union Act (Act No. 174 of 1949 as amended in 2014).
- LCA means the Labor Contract Act. (Act No. 128 of 2007 as amended in 2018).
- LSA means the Labor Standards Act (Act No. 49 of 1947 as amended in 2020).

Official translations of Japanese law that are publicly available may not timely reflect all revisions of the law.

Employee Rights on a Share or Asset Purchase

Share Purchase

In a share purchase, there is no employee consent required or specific procedure to be followed in Japan by a selling company or a purchasing company regarding transferred employees. By its nature, a share purchase neither causes a change in working conditions nor a termination of employment contracts.

Asset Purchase

In a business or asset purchase, a selling company in Japan must obtain the consents of employees who are designated to be transferred in the asset purchase agreement. Those who do not agree to be transferred will remain with the selling company after the transaction.

Company Split

In a company split, an employee's consent to transfer is not necessarily required. Whether employees will be transferred from a split company to a successor company depends, in principle, on the type of employee and what the company split contract stipulates.

Under the Labor Contracts Succession Act, there are four different cases in terms of transferring employees in a company split:

- The first case is where employees of a split company are primarily engaged in the business that is subject to a company split (Primary Engaged Employees), and their employment contracts are listed by the parties in the company split agreement as contracts to be succeeded to the successor company. In this case, those employees will be automatically transferred to the successor company regardless of their desire or consent.
- The second case is where the employment contracts of the Primary Engaged Employees are not listed by the parties in the company split agreement as contracts to be succeeded to the successor company. In this case, those employees will be granted a tag-along right to be automatically transferred to the successor company upon submitting their objection in writing to the split company by a certain time after receipt of notice.
- The third case is where employees of a split company are not primarily engaged in the business that is subject to a company split (Non-primary Engaged Employees), but their employment contracts are listed by the parties in the company split agreement as contracts to be succeeded to the successor company. In this case, those employees will be granted a right not to be transferred to the successor company upon submitting their objection in writing to the split company by a certain time after receipt of notice.
- The last case is where employment contracts of the Non-primary Engaged Employees are not listed by the parties in the company split agreement as contracts to be succeeded to the successor company. In this case, those employees will not be transferred to the successor company.

Governmental guidelines set out how to interpret whether an employee is primarily engaged in the target business, and the employees can dispute their designated employee category. For information on the consultation procedures between a split company and its employees regarding the employee designation and transfer, see Company Split Consultation Procedures.

Collective Agreements

Asset Purchase and Share Purchase

Unless otherwise agreed in an asset purchase or share purchase agreement, collective agreements (*rodo kyoyaku*) will not be succeeded to a purchasing company.

Company Split

Under the Labor Union Act, the contents of a collective agreement can be categorized into two parts:

- Normative parts stipulate the working conditions and other treatment of employees and have the function of nullifying any individual labor contracts that contravene the collective agreement.
- Obligatory parts are legally binding but do not have the same function as normative parts. For example, a provision allowing union members to utilize the company's facility for the purpose of union activities and a union shop clause will fall under an obligatory part. A union shop clause forces employers to hire only those belonging to a labor union and terminate their employment contracts once they are no longer a union member.

A normative part of a collective agreement is not transferable to a successor company even if a company split agreement indicates otherwise. However, if employees belonging to a labor union that has a collective agreement with a split company are transferred to a successor company, the successor company will be deemed to have executed a collective agreement (both the normative and obligatory parts) with the same details as the original collective agreement regardless of the contracting companies' intention.

With respect to an obligatory part, unlike a normative part, contracting companies may choose what contents are to be transferred by stipulating the details in a company split agreement. However, the transfer of the obligatory part will be effective only when the split company and the labor union agree.

Obligation to Inform or Consult Employees

Share Purchase

Because a share purchase neither causes a change in working conditions nor a termination of employment contracts, contracting parties are not obliged to inform or consult employees prior to a share purchase. In practice, the parties to a share purchase do not usually carry out any consultation procedures with the employees.

Asset Purchase

There is no legal obligation in Japan to inform or consult with employees in an asset purchase. However, a guideline published by the Ministry of Health, Labor and Welfare (*Kōrō-shō*) (MHLW) advises selling companies to consult with employees and provide them with ample information to help them consider whether to consent to the transfer, such as an overview of the purchasing company and working conditions the employees may expect.

The MHLW guideline is not legally binding and there are no penalties for violating it. However, since following the guideline may facilitate execution of an asset purchase and help contracting parties ensure the protection of employees, contracting parties usually implement the guideline's procedures.

Company Split Consultation Procedures

Because a company split could force employees to move to another company regardless of their wishes, the Labor Contracts Succession Act, related regulations, and MHLW guidelines comprehensively and exhaustively stipulate employee consultation procedures. To mitigate risks arising out of or in connection with a company split, the contracting companies should carefully follow these procedures:

- A split company must endeavor to obtain the understanding and cooperation of its employees, for example, through consultation with a labor union or an employee representing a majority of employees (if there is no such labor union). According to MHLW guidelines, the employer should discuss matters related to the background of the contemplated company split, how it determined which employees are to be transferred in accordance with the Labor Contracts Succession Act, and other details of the transaction. This consultation procedure should begin, at the latest, concurrently with the beginning of consultations with individual employees.
- A split company must consult with both the Primary Engaged Employees and employees who secondarily engage in the business that is subject to a company split, and the Non-primary Engaged Employees whose employment contracts are included in the company split agreement. In this consultation procedure, a split company must provide information to employees such as the prospect of fulfilling the obligations to be borne

by each of the contracting companies, and an overview of the successor company where such employees would work after the company split is effective.

A split company must confer with each of the employees whether their employment contract is to be succeeded to a successor company (taking into account their wishes regarding the transfer of the employment) and the working conditions those employees may work under after the company split. Though the MHLW guidelines do not stipulate any specific timeline with respect to this consultation procedure, it advises split companies to devote enough time to communicate with each prospective employee about the transfer before the notification deadline for certain types of employees and labor unions.

- A split company must notify the Primary Engaged Employees, the Non-primary Engaged Employees whose employment contracts are included in a company split agreement, and any labor union which has entered into a collective agreement with a split company of certain matters, such as the overview of the business to be succeeded, the number of employees each contracting party plans to employ after the closing and the prospect of fulfilling the obligations to be borne by each of the contracting companies. The notification deadline specified in the Labor Contracts Succession Act is the day prior to the date that is two weeks prior to the date of the shareholders meeting scheduled to approve a split agreement.

Of these procedures, a split company should especially avoid failing to consult with each of the subject employees individually. If a split company does not hold any individual consultation procedures, or holds remarkably insufficiently consultation procedures, the Primary Engaged Employees may dispute the effectiveness of the succession of their labor contracts.

Labor Union Negotiations

Whether the transaction is an asset purchase, company split or share purchase, a labor union representing employees of the target company may request to bargain if executing the transaction could impact employees belonging to the union. The employer is advised to sincerely negotiate with the union according to the request. If the union's request concerns the employees' working conditions, refusing to bargain could be a violation of the Labor Union Act.

Unlawful Dismissal: Employee Rights and Protection

Whether in the context of an asset purchase, company split or share purchase, a court judges the effectiveness of ordinary dismissal or terminations for redundancy in the same way. A company that terminates an employment contract in Japan will be responsible for the dismissal or redundancy.

Under the LCA, if a terminated employee files a lawsuit after being dismissed, a Japanese court will overturn the dismissal if it finds that:

- There are no objectively reasonable grounds for the dismissal.
- The dismissal is not considered to be appropriate in general societal terms.

Accordingly, the employer must pay the unpaid salary to the employee as if the employee had continued working until the time of the court's decision.

Additionally, Japanese courts judge the effectiveness of terminations due to redundancy in a stricter manner compared to ordinary dismissal. When reviewing redundancy terminations, a court considers four factors, namely:

- The necessity of personnel cutbacks.
- Measures that the employer has or should have taken to avoid the personnel cutbacks.
- The reasonability of personnel selections.
- The appropriateness of the redundancy procedure.

In the case of an asset purchase or company split, if a selling company (or split company) terminates its employees only because they remain in the selling company (or split company) after the business they used to engage in has been transferred, the dismissal or redundancy may be overturned under the same criteria.

Employee Dismissals: Costs and Formalities

When dismissing employees, an employer must give at least 30 days advance notice or pay compensation in lieu of notice. The compensation payable is equivalent to the average wages for 30 days, and the employee's average wage is calculated by dividing the employee's total wages for the previous three months by the total number of calendar days of the previous three months.

If an employer has paid less than 30 days of the compensation, the number of days in which the advance notice should be given may be reduced by the number of days paid.

Under the LSA, when an employer gives advance notice of dismissal, the employee can request the employer to issue a certificate stating the reason for dismissal before the dismissal has taken effect. After the dismissal has taken effect, the employee can request the employer to issue a certificate stating:

- The period of employment.
- The type of work engaged in by the employee.
- The position held by the employee.
- The wages paid to the employee.
- The cause for the dismissal.

Even before a payday, the employer must pay wages and any other money and goods that the dismissed employee is entitled to earn (except for retirement allowance of which the payment is due on a specific date) within seven days upon the request of such employee.

Post-Transfer Changes to Terms and Conditions of Employment

There are three ways that a successor company (in case of company split) and purchasing company (in case of asset purchase) can change the terms and conditions of employment after the completion of the transaction:

- Modify the work rules.
- Enter a collective agreement with a labor union.
- Change terms and conditions by agreeing with each employee individually.

The work rules in Japan usually mean a set of comprehensive and exhaustive rules that the employer prepares, which uniformly apply to all employees. In practice, almost every working condition is thoroughly stipulated in the work rules instead of an individual employment contract. Employers do not necessarily need to obtain employees' consent when introducing or modifying the work rules. Therefore, modifying the work rules is a practical and common way for employers to change terms and conditions of employees.

However, if changing terms and conditions by modifying the work rules is unfavorable to employees, the modification should meet certain criteria for the change to be legally effective, including:

- Whether the change is appropriate considering the extent of the disadvantage to employees.
- The necessity for changing the terms and conditions.
- The appropriateness of the contents of the changed work rules.
- The status of negotiations with a labor union.
- Any other circumstances pertaining to the change to the work rules.

Changing terms and conditions in a way that is unfavorable to employees by amending a collective agreement is, unlike the work rules, widely accepted, as a collective agreement is produced through negotiation between a union and an employer.

Share Option Schemes: Employee Participation

It is common for employees, especially employees of listed companies, to participate in share option schemes in Japan.

Share Options: Tax Benefits

Tax benefits for employees are vested under specific conditions. There are two types of share option plans in Japan:

- Non-qualified share option plans (*Zeisei-Hitekikaku Stock Option*).
- Qualified share option plans (*Zeisei-Tekikaku Stock Option*).

In the case of qualified share option plans, there are tax benefits when an employee exercises the share option.

Group Companies

If group companies have a share option scheme for employees, stock options can be granted to employees in Japan of group companies. While not mandatory, a share option scheme which is applicable to an entire group of related companies is common in Japan, especially among listed companies.

Transferability

If an employee that participates in a share option scheme is transferred as part of a business, the transferee is not under an obligation to provide an equivalent scheme. The transferred employee can exercise his/her share option

according to the conditions that are agreed in the original agreement with the transferor. However, the transferor and transferee can stipulate regarding such share options in their agreement.

The Companies Act provides that if the outstanding share option of a split company grants the option holder the right to acquire share options of a successor company in the case of a company split, the option holder may demand that the split company purchase the share option at a fair price if either:

- The contents of the share option to be granted by the successor company in accordance with the split agreement are different from those of the split company.
- The contracting parties do not agree on granting the successor company's share option.

Due Diligence and Warranties: Employees

A buyer in its due diligence exercise prior to an acquisition would usually request the following information concerning employees in Japan:

- A list of employees that the target company prepares in accordance with the LSA.
- A wage ledger that the target company prepares in accordance with the LSA.
- Templates of employment agreements.
- Any rules applicable to all or a part of the employees such as the work rules and a revision history for past few years.
- Collective agreements entered with a labor union.
- Documents related to disciplinary actions taken by the target company.
- Documents related to dismissals conducted by the target company.
- Documents related to an employee stock ownership plan and any other incentive plans of the target company.
- Notifications regarding labor insurance and social insurance submitted by the target company.
- Notifications, instructions, and any other communications with authorities such as the Labor Standards Inspection Office, and the target company's responses thereto.
- Documents related to any conflict with employees which arose or may arise.

The target company commonly provides all the requested information. However, it will sometimes take some measures for the purpose of protecting personal data such as masking or anonymizing so that the data recipient will not be able to identify the data subject.

For additional information on due diligence in Japan, see Practice Note, Due Diligence for Private Acquisitions in Japan.

Data Protection Considerations

A data protection or privacy issue that often arises over the course of a due diligence exercise concerns the consent of the data subject for transfer of personal information. According to the APPI, an individual or entity that uses a personal information database for its business must not, in principle, transfer personal data to third parties without obtaining a consent from the specific individual identified by the personal information (the "Principal").

Under the APPI, personal data means personal information contained in a database, and includes personal information about a living individual that can identify a specific person by name, date of birth or any other description that consists of such information. Therefore, the provision of the list of employees and the wage ledger during due diligence could be subject to the APPI.

As for the schemes in which the succession of business occurs such as an asset purchase and a company split, the APPI and related guidelines stipulate that the provision of personal data while undertaking due diligence does not fall under the third-party provision that the APPI prohibits, and accordingly the consents from the Principals are not required.

On the other hand, since a share purchase is not inherently related to the succession of business, the transfer of data to third parties over the course of due diligence for the share purchase is subject to the Principal's consent. In order to avoid the risk in relation to the provision of personal data, the target company, when requested to disclose data containing personal information, should provide the data in a way that the data recipient will not be able to identify the Principal by, for example, masking a part of the data such as the Principal's name, or anonymizing the data.

Additionally, contracting parties usually enter a non-disclosure agreement (NDA) that typically stipulates how the recipient can use the personal data, protective measures in case the provided data is divulged, and how to handle the data when it is no longer required for use by the recipient. The APPI guidelines state, in the context of the third-party provision, that contracting parties should conclude an NDA that includes these provisions.

Employment Provisions in the Acquisition Agreement: Warranties and, Indemnities

Warranties

The target company in Japan commonly warrants the following matters:

- **The target company is not owing or may not owe anything with respect to employment other than as disclosed.** This warranty is for a purchasing or successor company to hedge the risk in case the target company owes debt in relation to unpaid wages or its misconduct against employees which are not detected through due diligence.
- **The target company is not a party of any agreement entered into with a labor union other than as disclosed.** It is possible that the target company has concluded several agreements with a labor union which are not detected through due diligence. Among them, there may be some agreements which affect the purchasing or successor company's interest in relation to the target company, such as a mandatory consultation procedure that the board of the target company will be required to take before making important business decisions. Therefore, this warranty could be also a feasible hedge.
- **No key employees of the target company are expected to resign after the closing of transaction.** When a purchasing or successor company expects the target company will continue its business with the same personnel as before, this warranty is usually included.

Indemnities
A common indemnity clause regarding employment agreed by the contracting parties arises when unpaid salary has been detected through due diligence, but the parties have decided to proceed with the transaction without reducing the purchase price. In this case, even if the target company has represented that unpaid salary does not exist, a normal indemnity used when the target company breaches warranties might not be triggered because the purchasing or successor company was aware, at the time of concluding the transaction agreement, that there was unpaid salary. This special indemnity is usually designed to function when the target company has suffered a loss corresponding to the unpaid salary because of the employees' demands, regardless of the purchasing or successor company's awareness of the fact.

Directors

A Japanese company can choose whether it has a board of directors or not. The Companies Act does not have many restrictions on the composition of the board of directors or supervisory board of a private company in Japan, but most private companies have a board of directors rather than a supervisory board.

If a company has a board of directors, there must be three or more directors and one or more company auditors. If a company does not have a board of directors, there is no limit to the number of directors, and it is not necessary to select a company auditor.

Requirements as to Nationality or Domicile of Directors/Management and Foreign Directors

There are no nationality or residency requirements for directors or management personnel in Japan. The previous requirement that at least one representative director of a Japanese company have an address in Japan has been abolished. Therefore, even if all representative directors live abroad and are not Japanese nationals, the application for the registration of incorporation of a Japanese company will be accepted.

There are also no restrictions on the authority of foreign directors or management for companies in Japan. However, signature certification or notarization by competent authorities of the home country may at times be required for foreign directors or management depending on the type of procedure.

Directors' Personal Liability for Acts of the Company

Directors in Japan owe a general duty of care of a good manager and a fiduciary duty to the company under the Companies Act. These duties are not as distinguishable as those under the laws of some other countries.

Directors who do not comply with their duties are liable to the company for the resulting damages. Where directors are grossly negligent or knowingly fail in complying with their duties, such directors are also liable to third parties or shareholders for the resulting damages.

A director can be liable for the damage suffered by the company resulting from various actions, such as:

- Violating applicable laws or the company's articles of incorporation, which includes a breach of the duty of care under the Companies Act.

- Distributing dividends unlawfully, meaning the distribution exceeds the legally distributable amount.

As for parent company directors, they can be liable for the damage suffered by the subsidiaries in certain situations, for example, when parent company directors order the subsidiary in contradiction to applicable laws or their duties of care.

Visa and Work Permit Requirements

If foreign nationals (other than permanent or long-term residents) live and work in Japan for the purpose of a long-term stay, they are required to obtain a relevant working visa in advance. Before applying for a working visa, a certificate of eligibility (COE) should be requested at the nearest Regional Immigration Bureau. To obtain a COE, a sponsor in Japan (usually an employer) must contact the immigration office on behalf of the applicant.

The difficulty of obtaining these permits depends on the facts of the case. In Japan, there are various types of working visas, such as a highly skilled professional visa and working visas for:

- Business manager.
- Journalist.
- Legal or accounting services.
- Medical services.
- Researcher.
- Engineer.
- Intra-company transferee.

It generally takes one to three months to obtain a visa. The visa application is nearly cost free unless an applicant outsources submitting and drafting the documents to an outside agency.

A business manager visa is usually selected in association with private acquisitions and can relate to managing international trade or other activities related to business management (excluding management or administrative activities which require legal and accounting service qualifications). Examples include managing a corporation, working as a supervisor, and so on.

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