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Restocking the Buyer's Private M&A Toolkit Post-Cigna

by Daniel Serota and Alex Shoaff
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As a result of the Delaware Court of Chancery's decision last year in *Cigna Health and Life Insurance Co. v. Audax Health Solutions, Inc.*,[1] potential buyers in private merger and acquisition transactions are facing a significant challenge in securing the protections once commonly available to them in private mergers in the absence of a separate agreement with the individual shareholders. *Cigna* disrupted the ability of buyers to obtain indemnification (other than pursuant to an escrow or holdback) and to require selling shareholders to be bound by the decisions of a stockholder's representative. It also called into question the validity of claim releases by the target company's shareholders. Further, a letter of transmittal or other agreement for which the stockholders do not receive additional consideration cannot be used to impose these requirements even if the requirements are explicitly included in the terms of the merger agreement.

While there have been many suggestions about how buyers should address the issues raised by *Cigna*, including use of joinder agreements as a closing condition or avoiding mergers for stock purchases, drag rights if available, larger escrows, or reductions in purchase price, these solutions are often impractical as they increase deal risk and holdup value, result in timing delays, offer insufficient protection, create moral hazards and/or have significant negative value impact on the selling shareholders. What is needed is an alternative approach that restores the economic risk allocation that was available pre-*Cigna* without imposing deal risk, timing delays or reducing value while respecting *Cigna's* conclusions regarding the statutory requirements for mergers under the Delaware General Corporation Law.

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A hybrid solution would require incentives under the merger agreement for shareholders to sign joinder agreements that would allow the buyer to enforce the bargained-for allocation of risk and other obligations, while not making the transaction less attractive to the company and its shareholders than a pre-*Cigna* structure. The solution lies in reframing the consideration (or the portion thereof equal to the highest indemnification cap and after a separate reduction for a customary and separate escrow fund or holdback) to be paid to each shareholder as a grant of non-transferable rights to receive payment from a separate escrow or holdback after some significant period (e.g., six years). Such separate escrow or holdback would be a way to secure the indemnification obligations set forth in the merger agreement (after any traditional holdback or escrow has been expended or is otherwise unavailable) and would allow individual shareholders to accelerate the cash payment or their pro rata portion of such separate escrow or holdback upon the execution of a joinder agreement by the applicable shareholder. This approach allows buyers and target companies to execute merger agreements without requiring that all shareholders become parties pre-closing, creates a significant incentive for shareholders to execute joinders giving the buyer the protections negotiated with the target company and does not impose on shareholders obligations or barriers to receiving their consideration that were not considered common before *Cigna.*

The Cigna Decision

In February 2014, Optum Services, Inc. ("**Optum**") and Audax Health Solutions, Inc. ("**Audax**") entered into a merger agreement under which Optum would acquire Audax via a reverse triangular merger. Over two-thirds of Audax's shareholders approved the merger in a non-unanimous written consent. The merger agreement contained provisions conditioning payment of each shareholder's portion of the merger consideration upon such shareholder executing a letter of transmittal and surrendering its shares. The letters of transmittal contained a general release of claims against Optum (the details of which were not contained in the merger agreement) and a provision agreeing to the appointment of the shareholders' representative. The merger agreement also required shareholders to indemnify Optum up to the full amount of their share of the merger consideration for certain breaches of the merger agreement.

At the time, Cigna Health and Life Insurance Co. ("**Cigna**") was a shareholder of Audax. Cigna did not consent to the merger, did not execute a support agreement, and did not execute its letter of transmittal. Optum in turn refused to pay Cigna its portion of the merger consideration in accordance with the terms of the merger agreement. Cigna brought suit, arguing that the letter of transmittal (including the general release and shareholders' representation appointment) was unenforceable for a lack of consideration. Cigna further argued that the shareholder indemnification provision in the merger agreement violated Section 251(b) of the Delaware General Corporation Law (the "**DGCL**"). Section 251(b) of the DGCL requires that a merger agreement clearly state "the cash, property, rights or securities of any other corporation or entity which the holders of such shares are to receive." Cigna argued that because certain of the indemnification obligations extended indefinitely and were capped only at each shareholder's share of the merger consideration, each shareholder could never definitely determine the consideration they received under the merger.

The court agreed with Cigna and held that the letter of transmittal was unenforceable for lack of consideration. Pointing to the language of Section 251 of the DGCL, the court found that Cigna's right to receive its share of the merger consideration vested at the effective time of the merger.[2] Because the letter of transmittal was to be executed after the effective time of the merger, the court held that the letter of transmittal was not supported by consideration (even though the merger agreement conditioned receipt of the merger consideration upon execution of the letter of transmittal).[3] As the letter of transmittal was not supported by consideration, Optum could not enforce its general release contained therein.[4]

The court further agreed with Cigna regarding its interpretation of Section 251(b) of the DGCL. The court reasoned that because Cigna could be required to pay back all or none of its share of the merger consideration at any time, its consideration was not reasonably ascertainable.[5] Therefore, the court held the indemnification obligations contained in the merger agreement unenforceable.[6] However, *Cigna* made clear that its holding did not concern escrow agreements and the court repeatedly distinguished a claw back indemnification right from an escrow arrangement.[7]

After *Cigna*, questions remain whether indemnification obligations which are not unlimited in duration or are capped at an amount less than the purchase price are still enforceable. Moreover, the court made clear that additional obligations contained in letters of transmittal to be signed post-closing are unenforceable due to the lack of consideration above and beyond the merger consideration to which shareholders are already entitled post-closing.[8] Because a letter of transmittal is often the only document a non-consenting shareholder signs, the court's holdings have made it more difficult for buyers to reduce their risks in private mergers by limiting their ability to utilize releases against non-consenting shareholders. Coupled with the questions the *Cigna* holding raises regarding the availability of long-term or uncapped shareholder indemnification the court's invalidation of the risk reducing provisions in the letter of transmittal may cause future merger to become a riskier endeavor.

Proposed Solutions and their Consequences

Four approaches have emerged as the first round of solutions proposed to resolve the issues raised by *Cigna*: (a) lower purchase prices, (b) increased holdbacks, (c) avoiding mergers altogether and (d) the use of closing conditions requiring all or certain shareholders to enter joinder agreements containing the desired protections.

Lower Purchase Prices. Lower purchase prices can compensate buyers for the increased risk they face in light of their inability to obtain indemnification and release of claims from non-consenting shareholders. While buyers save money upfront with a reduced purchase price, the risk is difficult to price and the target company and shareholders have an informational advantage and perverse incentive to prefer price reductions when likely indemnification claims would exceed the purchase price reduction. Lower purchase prices can also lead to moral hazard issues as a company whose shareholders have limited or no indemnification obligations may choose to take actions to maximize price or closing certainty but that breach the agreement or hurt the value of the company. Moreover, due to the difficulty in quantifying this increased risk, the amount of any purchase price reduction can be difficult to negotiate. Without adequate support for the lower numbers, target companies may view such prices as at best undesirable and at worst arbitrary and unfair. Lower purchase prices also have a negative effect on all shareholders, including those willing to provide indemnification and releases through joinder or other agreements. Without a method to separate out these low risk persons from the non-consenting shareholders, a smaller purchase price harms all shareholders equally.

Increased Holdbacks. Increased holdbacks or escrows are similarly undesirable. Buyers would again need to quantify the risks of shareholder litigation to justify the amount of the increased holdback (particularly the size of the holdback required to cover the highest indemnification cap). Again, without a means to reveal low risk persons from the other shareholders, the holdbacks would apply to all shareholders pro rata. Shareholders who would otherwise agree to indemnification and general releases, knowing that they are at a low risk of being sued for breach of the contract or wanting to sue the company outside of the contract, would receive no additional benefit to counterbalance the additional burden of the holdback.

Avoiding the Merger Structure. In practice, the merger structure is often utilized to avoid holdouts or when the number of stockholders makes a stock purchase agreement otherwise impractical or is undesirable for pre-signing confidentiality or other reasons. Thus, avoiding mergers altogether is at best a situational solution and will not work for every transaction. Instead, a solution is needed that does not eliminate the benefits of a merger structure.

Closing Conditions. The use of closing conditions that require all shareholders to sign joinder agreements most closely approximates the protections thought available before Cigna. Buyers can negotiate a closing condition in the merger agreement that all or a certain number of shareholders enter into joinder agreements binding shareholders to indemnification provisions, appointment of the shareholder representative, general releases of claims and other provisions of the merger agreement applicable to shareholders. Because the holding in Cigna casts doubt on whether non-consenting shareholders can be bound to indemnification obligations contained in the merger agreement alone, including the desired indemnification and releases in both the merger agreement and joinder agreements is best practice. Incentivizing shareholders to enter into joinder agreements poses the key problem to this approach, the feasibility of which declines as the total number of shareholders rises. Buyers can condition the closing upon receipt of signed joinder agreements from all shareholders but shareholder inactivity and the opportunity for holdouts from shareholders looking to obtain additional concessions can bog down the closing process. Closing over the condition can remedy any holdout, but as the court in Cigna makes clear, obligations imposed for the first time post-closing cannot be enforced unless the buyer provides additional consideration beyond the merger consideration. As such, without additional consideration, the protections afforded in the joinder agreement and merger agreement may be found unenforceable against such shareholders. Furthermore, requiring all shareholders to sign joinders as a closing condition increases deal risk and delays closing, thus making the transaction less desirable to the target company and the buyer.

Incentivizing Shareholders to Sign Joinders through an Accelerable Escrow Payment Right

For the buyer, having shareholders enter into joinder agreements after the merger agreement is signed affords the buyer the same types of protections thought available prior to Cigna. However, because shareholders are statutorily entitled to their share of the merger consideration once the merger closes, additional agreements entered into post-closing between shareholders and the buyer must be supported by additional consideration. Moreover, shareholders willing to hold out in the pre-closing period can potentially gain a great deal of leverage over the deal. Therefore, each shareholder has little incentive to enter into a joinder agreement when it anticipates that the parties will consummate the merger even if such shareholder does not sign. Effectively incentivizing shareholders to enter into joinder agreements becomes the key to restoring the pre-Cigna landscape for buyers.

Incentivizing shareholders to enter into joinder agreements can be difficult when each is entitled to their share of the merger consideration upon closing whether they enter into a joinder or not. However, the utilization of a right allowing the stockholder to accelerate payments held in an escrow upon the completion of certain conditions can remedy the problem of shareholder incentives. Private merger agreements can be drafted such that the merger consideration itself takes the form of a non-transferable, non-certificated right that entitles shareholders to their pro-rata share of a separate escrow or holdback (in addition to any traditional escrows or holdbacks for the transaction) after a set number of years (the "**Accelerable Escrow Payment Right**"). However, each shareholder's Accelerable Escrow Payment Right would also separately grant each shareholder the right to receive their pro-rata share of the escrow or holdback within a small number of business days upon such shareholder executing a joinder agreement in a form agreed between buyer and the target company and attached to the merger agreement. By including the desired protections in the joinder, buyers are protected in much the same manner they were before *Cigna*.

Moreover, such an approach may lead to better results for most shareholders of the target company as well. This convertible interest contains a self-selecting means of separating shareholders who provide some risk to the company post-closing and those that do not. Those shareholders who know that they present little risk to the company post-closing would be willing to sign the joinder agreement and receive their money right away, while the consideration is effectively held back from those individuals unwilling to sign joinders (signaling that they may consider future litigation or breach of the agreement). The convertible interest also solves the problem of shareholder holdouts as consummation of the merger can occur before all joinder agreements have been executed. Based on the incentives imposed through the Accelerable Escrow Payment Right, a buyer can consider lesser or no closing conditions relating to joinder agreements, reducing deal risk and closing delays. Furthermore, unlike the situation in *Cigna*, any obligations newly imposed post-merger in the joinder agreements will not be held invalid for lack of consideration because in exchange for execution of the joinder agreements the shareholder receives within a few business days a payment that it might not otherwise receive for years.

Restoring the Balance: Protecting Buyers and not Imposing Undue Delays or Reductions on Selling Shareholders

The Delaware Court of Chancery's decision in *Cigna* shook up the private M&A practice of including individual shareholder obligations (such as indemnity obligations) in letters of transmittal executed post-closing. Due to the court's holding, practitioners have been charged with inventing a means of restoring the buyer's pre-*Cigna* private M&A toolkit. Use of the Accelerable Escrow Payment Right should be considered by buyers as a means of retaining the protections and flexibility previously available to them in private mergers while avoiding the deal risks, value reductions or delays created by many of the first generation of solutions for *Cigna*.

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[1] *Cigna Health and Life Insurance Company v. Audax Health Solutions, Inc., Audax Holdings Inc., Optum Services, Inc. and Shareholder Representative Services, LLC*, 107 A.3d 1082 (Del. Ch., C.A. 2014).
[2] *See id.* at 1090 –1091.
[3] *See id.* at 1091.
[4] *See id.*
[5] *See id.* at 1095.
[6] *See id.*
[7] *See id.* at 1099.
[8] *See id*.

Delaware Chancery Court Appoints a Custodian to Sell Deadlocked Company

By Kenneth A. Gerasimovich and Jennifer Brady

In the last edition of the GT M&A Report, we explored some of the potential exit solutions for joint venture partners trapped in a soured business relationship. As we discussed, 50/50 joint ventures are particularly prone to deadlocks. However, management disputes can thwart any business at any time in its development. The case of *In re: Shawe & Elting LLC*[1] (*Shawe*) demonstrates that even an established and highly profitable company can be derailed by conflicts among management and owners. The case also helps to demonstrate that the best time to deal with deadlocks and conflicts is *before* they arise, by having agreed upon dispute resolution and exit strategies in place from the outset.

In *Shawe*, the Delaware Chancery Court appointed a custodian to sell Transperfect Global, Inc. (Transperfect), a profitable Delaware corporation. The Court relied on Section 226 of the Delaware General Corporation Law (DGCL), which authorizes the appointment of a custodian for a corporation when the stockholders are so divided that they are unable to elect new directors, or the directors are so divided that the business of the corporation is suffering or is threatened with irreparable injury, and the stockholders are unable to terminate the division.

Transperfect began in 1992, in a New York University dormitory room shared by business school students Elizabeth Elting and Philip Shawe.[2] Elting and Shawe were briefly engaged, but ended their relationship in 1997.[3] Despite their failed romance, Shawe and Elting managed to run the Transperfect business as equal directors and co-CEO's for 23 years, and to grow it into a global provider of translation, website localization, and litigation support services, with 92 offices and 3,500 employees.[4] In 2014, the company had annual revenues of approximately $471 million, net income of $79.8 million, and no debt.[5] However, after years of personal, professional and legal conflicts between Shawe and Elting, the management of the company had, according to the Court, devolved into a state of complete dysfunction.[6]

In June 2015, at the end of oral arguments in the case, Chancellor Bouchard urged the parties to settle their dispute, warning them that the Court's opinion was not "going to be pretty."[7] Unfortunately, there was no settlement and the Chancellor was true to his word. His opinion, delivered in August, includes a 60 page summary of the facts of the case, which delves, in painful detail, into the bitter relationship between Shawe and Elting. It describes a culture of "mutual hostaging," with Shawe and Elting withholding approval on the other's projects until a concession could be exacted on a different matter.[8] Even the pair's personal disputes are discussed in the opinion, with the Court highlighting a "bizarre" incident when Shawe crawled under Elting's hotel room bed and refused to leave while they were on a business trip in Buenos Aires,[9] and recounting a confrontation in Elting's office that resulted in a "Domestic Incident Report" against Elting over a scuffle to physically remove Shawe's foot from her office doorway.[10]

The facts, as conveyed by the Court, leave no doubt that Shawe and Elting were trapped in a bitter deadlock. The parties had several discussions at various points regarding a buy-out of Elting's interests, but failed to agree upon terms. This case seemed to present an ideal situation for a petition for dissolution under Section 273 of the DGCL, which provides for judicial dissolution of a 50/50 joint venture if the joint venture partners are unable to agree upon the desirability of discontinuing the joint venture and disposing of its assets. The Court noted, however, that while in substance the case involved the type of 50/50 deadlock that Section 273 was meant to address, technically Section 273 did not apply because Shawe's mother held a nominal 1 percent interest the company.[11]

The Court instead turned to Section 226(a) of the DGCL, finding that the requirements of Section 226(a)(1) had been satisfied because the parties stipulated that they were so divided they failed to fill a vacancy on the company's board, and also failed to elect successors to directors whose terms had expired.[12]

In addition, the Court found that conditions for appointing a custodian were also satisfied under Section 226(a)(2). This section requires a showing that the directors are so divided regarding the management of the affairs of the corporation that the required vote for action by the board cannot be obtained, and the stockholders are unable to terminate this division. The Court cited deadlocks between Shawe and Elting on several matters of critical importance to the company.[13] However, the existence of deadlocks alone is not sufficient under Section 226(a)(2); the business of the corporation must either be suffering or threatened with irreparable injury because of the deadlocks. The Court found this to be a closer question because the business had been highly profitable, but noted that its profitability was not dispositive.[14] The Court found that the company's irretrievably dysfunctional governance structure threatened the company with irreparable injury.[15] The third and final condition established in Section 226(a)(2) is whether the stockholders are unable to terminate the division between the directors, which the Court found "plainly exists" in this case.[16]

Shawe and Elting did not have a stockholders' agreement or any type of written voting or management agreement. In addition, their efforts to negotiate a buy-out agreement, after their business relationship had already deteriorated, drove them into further conflict. The dispute in *Shawe* shows the limitations of DGCL Section 273, which is not available to corporations with more than two stockholders, even if the board and stockholders are equally divided in deadlock. Although Section 226 of the DGCL provided an alternative avenue for a judicial resolution of the impasse in *Shawe*, the Court made clear it was a very unusual remedy that places the fate of the company in the hands of the Court, rather than the owners of the company. All of this could have been avoided if the parties had in place a stockholders' agreement, or similar agreement, with dispute resolution mechanisms and sale provisions, or other exit strategies before conflicts arose.

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[1] *In re Shawe & Elting LLC,* Del. Ch., C.A. Nos. 9661, 9686, 9700 and 10449, Bouchard, C. (Del. Ch. Aug. 13, 2015)(Mem. Op.).
[2] *Id.*, at 4.
[3] *Id.*, at 5.
[4] *Id.*, at 2.
[5] *Id.,* at 7.
[6] *Id.*, at 1.
[7] Matt Chiappardi, *TransPerfect Co-CEOs Warned To Make Peace Or Else*, Law 360.
[8] *In re Shawe & Elting LLC*, Del. Ch., C.A. Nos. 9661, 9686, 9700 and 10449, at 94.
[9] *Id.*, at n.2.
[10] *Id.*, at 54.
[11] *Id.*, at n. 312.
[12] *Id.*, at 67.
[13] *Id.*, at 68.
[14] *Id.*, at 73.
[15] *Id.*, at 77.
[16] *Id.*, at 78.

View from Amsterdam: Dutch Merger Code (SER) Amended

By Rob van Eldik

Under the SER Merger Code (*SER Fusiegedragregels*), a merger or acquisition in the Netherlands that involves an entity with 50 employees or more requires the parties to give notice of the merger to relevant trade unions. This notification should take place before any binding merger documents, like a SPA, are signed between parties. The main purpose of the SER Merger Code ("Merger Code") is to protect the interests of employees who work for companies that may be subject to a merger or acquisition. Pursuant to the rules of the Merger Code, parties are required to timely involve employee representatives in a proposed merger or acquisition, in order to allow those representatives to give their views on the proposed transaction and on the potential impact to the employees.

Recently, the Merger Code was amended with changes that are relevant for corporate and employment mergers and acquisitions practice. Firstly, the Merger Code's scope has been expanded. Secondly, it now introduces the option to challenge whether an actual change of control has occurred. Finally, the confidentiality obligations imposed on the involved trade unions have been strengthened.

Scope

The definition of "business sector" (*bedrijfsleven*) has been broadened. As of Oct. 1, 2015, a merger or acquisition involving (semi-) governmental bodies, not-for-profit organizations and professional service providers (*vrije beroep*), are now subject to the Merger Code's notification requirements, if they operate on the market and are professionally organized. As a result, formerly exempt companies that are active in the health care industry, or in education, may now be subject to the notification requirements pursuant to the Merger Code, in case of a merger.

For M&A practice, this means that the scope of proposed transactions that may be subject to the notification requirements is materially expanded.

Change of control

A change of control is assumed to take place where: (i) the right to appoint more than half of the members of the board of management, or supervisory board of the company (depending on whether a one-tier or two-tier board structure applies), is acquired; (ii) more than 50 percent of the voting rights in the general meeting of shareholders is acquired; or (iii) more than 50 percent of the share capital is acquired.

The Merger Code, as of Oct. 1, 2015, introduces the right to challenge this assumption. For example, in a case where the majority of share capital is acquired, but the shares do not have voting rights, or other shareholders hold increased voting rights, it can now be argued that no change of control is effectively taking place.

The same applies if a company being acquired is subject to the full large company regime (*volledig structuurregime*), where the members of the supervisory board are appointed by the supervisory board itself, instead of the shareholders. In this case, the assumption of a change of control can be refuted, and the notification requirements do not apply.

Confidentiality

Finally, the scope of the confidentiality obligations that apply to members of the trade unions has been expanded, putting stricter requirements on the disclosure of any information relating to a proposed merger or acquisition.

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View from London: Major Changes Introduced to Corporate Law by the Small Business, Enterprise and Employment Act 2015

By Adam Cain

The Small Business, Enterprise and Employment Act 2015 (the Act) received Royal Assent on Mar. 26, 2015, and marks the single biggest change to company law since the Companies Act in 2006 (CA). It will be phased in over the course of the next 12 months. Although the Act's title implies that it will only have an impact upon small businesses, it introduces significant changes which will affect all companies.

This article initially focuses on two key changes that took effect in May 2015: the abolition of bearer shares, and the application of the general duties of directors under the CA to shadow directors. The remainder of the article focuses on the changes to certain company filing matters.

Abolition of bearer shares

Bearer shares are unregistered shares that are owned by whoever physically holds the share warrant. As no one is entered in the company's register of members as the owner of such shares, they are easily transferable and held anonymously.

Holders of existing bearer shares have until Feb. 26, 2016, to surrender them to the company in exchange for registered shares. If the bearer shares are not surrendered or exchanged within that timeframe, they will be canceled, and the relevant monies will be paid to the court by the company.

If a company's articles of association contain provisions permitting the issuance of bearer shares, no amendment is required to remove such a provision; however, if a company does intend to remove them to ensure consistency with the Act, they will be able to do so by passing an ordinary resolution, rather than a special resolution (which would usually be required to amend articles).

Shadow directors

The second change is to widen the application of directors' duties to shadow directors. Previously, the general statutory duties that applied to directors under the CA had limited application to shadow directors. Shadow directors are defined in the CA as persons "in accordance with whose directions or instructions the directors of the company are accustomed to act."

Section 170(5) of the CA has been amended to provide that the general duties of directors apply to shadow directors, where and to the extent they are capable of applying and the Secretary of State has been given power to make regulations concerning the application of general duties to shadow directors.

Disputes relating to the appointment of directors and secretaries

The provisions introduced by the Act aim to reduce the number of disputes regarding the appointment of directors and secretaries, particularly where an individual finds that they have been appointed as a director or secretary of a company without his approval or knowledge.

Under prior legislation, when a director or secretary was appointed by a company, the company had 14 days to notify the UK registrar of companies (Companies House) of such appointment. The consent of the appointee was expressly required by Companies House. In practice, this meant that the relevant Companies House forms were required to be signed by the company director or company secretary that was being appointed. For companies that elected to use electronic/Web filings, the company was required to provide three out of seven pieces of information that had been requested about the appointee (e.g., parent's maiden name, eye color, etc.) to act as authentication of the electronic filing.

As of Oct. 10, 2015, it is no longer necessary for a newly appointed company director or company secretary to sign the form which is filed at Companies House to record their appointment, or if a company uses electronic/Web filings, it is no longer required to provide the relevant authentication information relating to the appointment of officers. Instead, the relevant form simply requires the company to confirm that the director or secretary has consented to their appointment, which is achieved by ticking the appropriate box on the relevant Companies House form.

In addition, the first directors and secretary of a new company are no longer required to sign the form of application for incorporation to confirm their consent to their appointment. Instead, the form will simply state that they have consented to act.

Consent to act as a director

The decision to dispense with the express requirement to obtain the consent of the appointee means that a person can now be recorded as a company director or company secretary on the public register at Companies House, even if they have not actually agreed to be appointed. In order to try and avoid this problem, Companies House will write to newly registered company directors, as soon as reasonably practicable, to inform them that it has received notice of their appointment. This will, however, only be done for newly registered directors, and not for a newly registered company secretary.

The Act will also provide an additional safeguard for persons who have not consented to act as a director or secretary of a company, as they will be able to apply to have the register corrected. It is currently expected that this further safeguard will be implemented in December 2015, although arguably it should have been in effect from Oct. 10, 2015, as well.

Removing the day of a director’s date of birth from the public register

Previously, a director’s full date of birth has been publicly available to view at Companies House. Due to concerns that this information is frequently used in identity theft cases, the Act has allowed the Registrar, as of Oct. 10, 2015, to omit the day of a director’s birth from the publicly available register, so that only the month and year will be visible to members of the public. Companies still, however, are required to send full details of dates of birth to the Registrar, and this information will continue to be available for inspection in the company’s own statutory books.

Striking companies off the register

Under the CA, the Registrar can strike off a company if he has reasonable cause to believe it is not carrying on business or is not in operation. The Registrar must give notice of this intention and advertise the notice of the proposed strike off in the Law Society Gazette. This process previously could take up to six months and provided the opportunity for creditors to object to the process.

The changes introduced by the Act as of Oct. 10, 2015, have shortened the time period to strike a company off the register from six months to four months. An important change introduced by the Act is the reduction in the time period required for the Registrar to send communications to the company from one month to just 14 days. In addition, the changes introduced by the Act enable the Registrar to strike off a company two months after publication of the Gazette notice, rather than the current three months.

Similarly, the voluntary strike off process instigated by a company, will now take around two months rather than the previous three to four months. It is important to note that in each case, these changes only apply to procedures that commenced after Oct. 10, 2015.

We will provide further updates as additional parts of the Act come into force.

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View from Tokyo: First Major Amendment to Privacy Law May Affect Offshore Companies

By Ryo Takizawa

On Sept. 3, 2015, a bill to amend the Act on the Protection of Personal Information (APPI)[1], the main privacy law in Japan, was passed by the National Diet. This is the first major amendment to the APPI since the original version of the APPI took effect in 2005. The original APPI focused on regulating information processed on a paper basis, resulting in several gaps between what the APPI could enforce and what actually should be subject to privacy laws in light of changes in information technology. The bill to amend the APPI was introduced to the Diet to bridge the gaps in this borderless information world, where data is flying on an online basis, rather than a paper basis.

Application to Offshore Companies

The original APPI did not specify whether the act applied to offshore companies, and no Supreme Court case has established whether offshore companies are subject to the APPI. As a result, it was commonly thought that the original APPI did not apply to offshore companies. In other words, under the original APPI, technically speaking, offshore companies did not have to observe the APPI unless they had a branch office in Japan.

However, in order to enhance the protection of privacy rights in this borderless era, the amended APPI clearly sets out that it will now apply to offshore companies. Article 75 of the new APPI provides that it will apply to offshore companies "which obtain personal information in connection with provision of goods or services to a person in Japan and process such personal information." What "in connection with provision of goods or services" means has not yet been clearly defined. Therefore, if we take a broad interpretation, it could mean that any type of online services that people in Japan can access (e.g., any website, any online shopping website and any social networking service) falls under the category of "provision of services to a person in Japan." It should also be noted that "a person in Japan" is not limited to Japanese citizens.

Restriction on Data Transfer from Japan to Offshore

The amended APPI will provide new restrictions on data transfer from Japan to an offshore third party. In this regard, a group company is also considered a third party.

The original APPI did not provide an offshore restriction, which is separate from an onshore restriction, on data transfer to an offshore third party. This means that, under the original APPI, a data transfer company could send personal data to an offshore company without obtaining prior consent from data

[1] Under the APPI, "Personal Information" is information about a living individual which can identify the specific individual by name, date of birth or other description contained in such information. "Personal Information" includes information that enables one to identify a specific individual with easy reference to other information.

subjects, as long as the sending party satisfied the (a) outsourcing, (b) opt-out consent, or (c) the joint-use requirements, each of which exempt a company from obtaining prior consent from data subjects.

Under the amended APPI, for the purpose of data transfer to an offshore third party, the exemptions for (a) outsourcing, (b) opt-out consent and (c) joint-use are available only if:

(i) a third party receiving personal information is located in a jurisdiction that the Privacy Committee[2] designates as having the same level of protections as Japan in terms of protection of personal information; or

(ii) a third party receiving personal information has established appropriate systems to secure personal information, as designated by the Privacy Committee.

In other words, if neither (i) nor (ii) is satisfied by a receiving offshore party, a data sending party must obtain consent from data subjects to the offshore data transfer, and cannot rely on any of the exemptions.

The Privacy Committee is expected to prepare: (i) a list of the designated jurisdictions, and (ii) standards to specify "appropriate systems to secure personal information," promptly after its establishment on Jan. 1, 2016.

Effective Date

The effective date of the amendment to the APPI's application to offshore companies and restrictions on offshore data transfer will be a date set within two years of Sept. 9, 2015. This effective date has not yet been determined by the government. During this grace period, offshore companies should confirm whether the amended APPI will be applicable to their business. Also, from an M&A perspective, buyers should carefully consider whether it will apply to a target company's business and its compliance obligations.

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[2] Under the original APPI, there was no central authority to enforce the law and each ministry enforced the law against companies under its jurisdiction. One of the main purposes of the amendment is to establish the Privacy Committee to play the role of the single central authority.

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