

PUT AND CALL OPTION Q&A: JAPAN

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This Q&A provides country-specific commentary on *Standard document, Put and call option agreement: Cross-border* and forms part of our *Cross-border Private Company Acquisitions*.

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PUT AND CALL OPTION

In this article, “private company” means a joint stock company other than a “public company”. A public company is any joint stock company with articles of incorporation that do not require the approval of the joint stock company for the transfer of its shares (*Article 2.5 of the Company Act, No. 86 of July 26, 2005; the Company Act*).

1. ARE THERE ANY STATUTORY PROVISIONS IN YOUR JURISDICTION GRANTING PRE-EMPTION RIGHTS TO PRIVATE COMPANY SHAREHOLDERS THAT WOULD NEED TO BE WAIVED BEFORE AN OPTION IS GRANTED OR EXERCISED?

No. There are no statutory provisions granting pre-emption rights to shareholders of a private company before the granting of or the exercise of an option by a third party for the transfer of existing shares in the private company (share transfer option).

Further, there are no statutory provisions granting pre-emption rights to existing shareholders of a private company before the granting of or the exercise of a share option by a third party for the issue of shares by way of subscription in the private company (stock acquisition right (*Shin-kabu-yoyaku-ken*)).

However, a private company must obtain the approval of its shareholders for the grant by the company of a stock acquisition right to a third party. The approval must be obtained by a special resolution at a shareholders’ meeting, and requires a majority of two-thirds or more of the votes of the shareholders present at the meeting, where the quorum requires shareholders holding a majority of the votes of the shareholders entitled to exercise their votes at such shareholders meeting to be present (*Articles 238.2, 199.2, 108.1.5, 309.2, Company Act*).

The special resolution must set out various matters for consideration by the shareholders, including (most relevantly):

- The features and number of shares for subscription by exercise of the stock acquisition right.
- Where it is agreed that there is no requirement for monies to be paid in exchange for the shares, a statement to that effect.
- Where monies are to be paid in exchange for the shares, the amount of money to be paid in exchange for one share or the method for calculating that amount.
- The day on which the shares will be allotted.
- The date for the payment of monies in exchange for the shares (if applicable).

(*Articles 236 and 238(1), Company Act*.)

2. IS A FORM OF CONSIDERATION REQUIRED FOR THE GRANT OF A CALL OR PUT OPTION? CAN THIS CONSIDERATION BE A NOMINAL AMOUNT OR THE GRANT OF A CALL OPTION (WITH RESPECT TO A PUT) OR THE GRANT OF A PUT OPTION (WITH RESPECT TO A CALL)?

The grant of an option over existing shares in a company for no consideration, or for a nominal amount, is possible in Japan, for both a stock acquisition right and a share transfer option.

RESOURCE INFORMATION

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RESOURCE TYPE

Country Q&A

STATUS

Law stated as at 31-Mar-2017

JURISDICTION

International
Japan



It is not common for the consideration to be the grant of a call option (with respect to a put) or the grant of a put option (with respect to a call). The legal effect of such an arrangement would need to be assessed on a case-by-case basis as this arrangement is not contemplated under existing laws, and there is no judicial precedent providing guidance on the legality of this arrangement.

A company may grant a stock acquisition right for the subscription or allocation of shares to a third party without contribution (consideration) (*Articles 236.1.2, 277, Company Act*), provided that the grant is approved by a special resolution at a shareholders' meeting. The resolution is subject to further statutory requirements (see *Question 1*).

The special resolution must set out various matters for consideration by the shareholders, including (most relevantly):

- The features and number of shares for subscription by exercise of the option.
- Where it is agreed that there is no requirement for monies to be paid in exchange for the shares, a statement to that effect.
- Where monies are to be paid in exchange for the shares, the amount of money to be paid in exchange for one share or the method for calculating that amount.
- The day on which the shares will be allotted.
- The date for the payment of monies in exchange for the shares (if applicable).

(*Article 238(1), Company Act*.)

Additionally, where there is no requirement for monies to be paid in exchange for the shares, and this is "particularly favourable" to the proposed buyer, or where the amount to be paid in is "particularly favourable" to the proposed buyer, the directors of the company must explain the reasons for the need to solicit subscribers in this manner (that is, through the grant of an option for the relevant shares) at the shareholders' meeting and prior to voting on the relevant resolution (*Article 238.3, Company Act*).

A buyer who has subscribed for the stock acquisition right may be liable to the company if there has been some collusion between the buyer and the directors of the company that has resulted in the buyer being issued shares where either:

- The issue for no consideration is "extremely unfair" (*Article 285.1.1, Company Act*).

- The amount to be paid in is extremely unfair (*Article 285.1.2, Company Act*).

In each case, the buyer will be liable to pay to the company the difference between the amount paid in and the fair value of the shares, or the fair value of the stock acquisition right (if no consideration is paid).

3. IS THERE ANY MANDATORY PROVISION IN YOUR JURISDICTION THAT LIMITS THE FREEDOM OF THE PARTIES TO DECIDE HOW DIVIDENDS (OR OTHER DISTRIBUTIONS) RELATED TO SHARES SUBJECT TO AN OPTION SHOULD BE APPORTIONED (FOR EXAMPLE, THE SELLER'S RIGHT TO RETAIN THE BENEFIT OF THE DIVIDENDS UNTIL THE OPTION IS EXERCISED BY THE BUYER)?

Until the buyer exercises the option and becomes listed in the shareholder register as the holder of the shares, they are not considered a shareholder and are not entitled to receive any dividends in respect of the relevant shares. Until such time as the buyer is registered, the company must only treat the shareholder listed on the shareholder register as the shareholder entitled to receive distributions (*Article 130, Company Act*).

4. IF THE CONSIDERATION PAYABLE BY THE BUYER ON EXERCISE OF AN OPTION IS SHARES TO BE ISSUED BY THE BUYER, WHAT UNDERTAKINGS SHOULD THE SELLER CONSIDER OBTAINING FROM THE BUYER (FOR EXAMPLE, THE BUYER HAS PROPER AUTHORITY TO ISSUE THE RELEVANT SHARES AND/OR VALID AUTHORITY FOR THE DISAPPLICATION OF ANY APPLICABLE PRE-EMPTION RIGHTS)?

The issue of shares by the buyer as consideration for either a stock acquisition right or a share transfer option over shares in the seller is not a common structure in Japan. The legal effect of such arrangements would need to be assessed on a case-by-case basis as this arrangement is not contemplated under existing laws, and there is no judicial precedent providing guidance on the legality of this arrangement.

5. IF THE CONSIDERATION PAYABLE BY THE BUYER ON EXERCISE OF AN OPTION IS CASH, WHAT ARE THE MOST COMMON CALCULATION METHODS TO DETERMINE THE RELEVANT AMOUNT (FOR EXAMPLE, "FAIR MARKET VALUE")? IS THERE ANY STATUTORY PROVISION THAT APPLIES? DO THE PARTIES USUALLY SET OUT SPECIFIC VALUATION PROCEDURES IN PUT AND CALL OPTION

AGREEMENTS?

There are no statutory provisions that prescribe how to calculate the price for the exercise of a share transfer option over existing shares in a company. The parties to the option agreement will usually set out the process for calculating the consideration payable (if any) for the grant of the option or the exercise of the option.

The grant by a company of a stock acquisition right requires a special resolution of a shareholders' meeting (*Article 238.2, Company Act*), and the resolution must specify the strike price or the method for calculating the strike price. The resolution is subject to further statutory requirements (see *Question 1*).

The special resolution must set out various matters for consideration by the shareholders, including (most relevantly):

- The features and number of shares for subscription by exercise of the option.
- Where it is agreed that there is no requirement for monies to be paid in exchange for the shares, a statement to that effect.
- Where monies are to be paid in exchange for the shares, the amount of money to be paid in exchange for one share or the method for calculating that amount.
- The day on which the shares will be allotted.
- The date for the payment of monies in exchange for the shares (if applicable).

(*Article 238(1), Company Act*.)

There are no statutory provisions requiring the strike price to be calculated in any particular way.

6. WHAT ARE THE WARRANTIES THAT THE SELLER USUALLY GIVES TO THE BUYER IN CALL AND PUT OPTION AGREEMENTS?

The seller (or transferor) of the option shares usually gives the buyer (or transferee) warranties in respect of:

- The seller's legal capacity.
- The seller's authority to grant the option.
- The completion of all necessary internal procedures for the grant of the option.
- The accuracy and legality of the seller's signature.
- The validity and enforceability of the agreement and the binding nature of any obligation(s) stipulated in the agreement.

Additionally, the seller will usually assure the buyer that there is no requirement for any additional procedure, licence or permit to effect the grant or transfer.

7. IS IT COMMON FOR THE PUT AND CALL OPTION AGREEMENT TO SET OUT THAT ANY DISPUTE REGARDING THE CONSIDERATION OR THE REORGANISATION OF THE COMPANY SHOULD BE REFERRED TO AN INDEPENDENT EXPERT? HOW IS THE INDEPENDENT EXPERT APPOINTED? WHAT IS USUALLY THE INDEPENDENT EXPERT'S REMIT?

Stock acquisition right

It is not common for the stock acquisition right to provide for the appointment of an expert to calculate the strike price in the event that the parties are unable to agree on the strike price or the method of its calculation. However, a dispute is unlikely because the strike price or the calculation method is always determined before the issuance of the stock acquisition right.

Share transfer option

In the case of, for example, a joint venture agreement containing a share transfer option right, it is possible for the option clause to provide for the appointment of an expert to calculate the strike price of the option in the event that the parties are unable to agree on the option price or the calculation in accordance with the pricing mechanism stipulated therein or the pricing mechanism to be used for its calculation. In the case of joint venture agreements, it is not uncommon for the parties to agree to appoint an expert.

In each case (stock acquisition right or share transfer option), the remit of the independent expert will generally be limited to applying the pricing mechanism in accordance with the contractual terms.

8. WHAT ARE THE ANTI-DILUTION MECHANISMS (IF ANY) THAT ARE COMMONLY SET OUT IN A PUT AND CALL OPTION AGREEMENT?

It is not common to include anti-dilution mechanisms in an option agreement. However, it is possible to provide an anti-dilution clause in the covenants clause of the option agreement.

9. IF THE PUT AND CALL OPTION AGREEMENT DOES NOT SPECIFY THE TIME WITHIN WHICH THE OPTION(S) MUST BE EXERCISED, IS THERE ANY MANDATORY PROVISION THAT WOULD SET OUT A SPECIFIC TIMEFRAME OR WILL THE OPTION(S) NEED TO BE EXERCISED WITHIN A REASONABLE TIME? IN THIS CASE, IS THERE ANY DEFINITION UNDER APPLICABLE LAW OR COURT INTERPRETATION OF "REASONABLE TIME"?

There are no mandatory provisions that prescribe the timeframe within which the option should be exercised.

10. IS IT COMMON FOR CALL AND PUT OPTION AGREEMENTS TO SET OUT ANY ACCELERATION EVENT (FOR EXAMPLE, A PROVISION ALLOWING THE CALL/PUT OPTION TO BE EXERCISED EARLIER IN THE EVENT THE COMPANY IS SUBJECT TO A THIRD PARTY OFFER)?

It is not common for an option agreement to set out any acceleration event. However, it is possible to include acceleration mechanisms in the option agreement.

11. HOW ARE THE SHARES TRANSFERRED ONCE AN OPTION HAS BEEN EXERCISED (FOR EXAMPLE, IS ANY REGISTRATION OF THE NEW HOLDER OF THE SHARES REQUIRED)?

Share certificate (in the case of the company issuing certificated shares)

When the stock acquisition right or the share transfer option is executed, the company issuing the stock acquisition right or the seller under the share transfer option must deliver the share certificate to the buyer.

Shareholder registry (both in the case of the company issuing certificated shares and uncertificated shares)

The shareholder registry must be updated for the perfection of the issuance of shares under the stock acquisition right and the transfer under a share transfer option.

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