The pursuit of a company's interest over the life of a company

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A. Interest of equity holders

1. Start-up phase

In the start-up phase, an entrepreneur or third parties may wish to invest in a business idea as equity holders in a business association. In this context:

1.1 In your opinion, what is an entrepreneur's typical reasoning for setting up a specific business association? Attract investments by third parties? Avoidance of personal liability? Tax reasons? Protect IP rights and technology?

It depends on entrepreneur's interests: there are a lot of choices but they often choose to incorporate a legal entity to establish social guaranty, to remote legal liability of the business (although lenders often request an entrepreneur to guarantee the legal entity), license and approval purpose, or other various reasons. Considering the business will usually generate loss, but not sufficient profit at a start-up stage, to establish a corporate may not be favorable choice for tax purpose.

1.2 What kind of business association structures does your jurisdiction offer to equity holders (e.g., partnerships, corporation, LLC, etc.)?

A sole proprietorship is one typical structure to start a business venture If equity holders opt to use a business association structure, a corporation is commonly used. An LLC (assuming that this means a *godo kaisya* under the Companies Act in Japan) is also used when a founder intends a smaller business or less complex governance. This is because an LLC's incorporation costs are less than those of a corporation. A partnership is possible, but it is customarily used in fewer cases.

- **What are the most crucial differences between these business association structures from an equity holder's perspective?**

A corporation and an LLC are separate legal entities, and their legal liability is separate from equity holders (they risk losing the invested amount only); further, equity holders have voting rights in the entities and receive dividends. An LLC has a simpler governance structure than that of a corporation, although the Companies Act provides a corporation with multiple options for its governance structure. A partnership is not a separate legal entity. It can also distribute its profit.

- **If statistics on the use of business association structures are available in your jurisdiction: which are the most commonly used business association structures for start-ups? Do you see a particular reason for the dominance of one specific structure?**

We are not sure whether appropriate and reliable statistics are available, but for the start-up phase it appears that a sole proprietor and a corporation are mainly used. A corporation (i.e., a separate legal entity) may more easily enjoy social reliability in a Japanese business relationship. In terms of separate legal liability and loan availability from a bank in Japan, a corporation (or an LLC) might be more appropriate.

- **In case of a corporation or LLC (in the following we simply refer to the "company"): are there any equity instruments other than common shares that are typically used for equity investments? Non-voting shares? Other forms of participation rights?**

For a business venture, common shares and preferred shares (class shares) are often used. A preferred share in the context of a business venture means a class share that has a special right to be distributed residual assets (calculation of the structure of special distribution depends on the case). Please note that this special right is not expected at the liquidation stage, but it is expected at the exit stage (M&A). Furthermore, the preferred share has to be converted to a common share before listing. The preferred shares will be provided in the articles of incorporation/investment agreement. In addition, a deemed preferred share (which is a common share with a preferred share characteristic in the economic context under a shareholders agreement) has recently been proposed, although the tax treatment for that is still under discussion.

- **Can equity investors remain anonymous (for example by the use of bearer shares)? Anonymous towards the company, other investors, the public? In the event equity investors cannot remain anonymous when holding shares, is there any alternative scheme that can be implemented to participate on an anonymous basis (for example, silent partnership schemes)?**

When considering attendance or using a voting right at a shareholders meeting, it appears that anonymity toward a company is not expected, although a trustee may be used to retain a shareholder’s anonymity. A shareholders’ list is disclosed to shareholders and creditors under certain conditions, but not publicly disclosed. A silent partnership can be used from a financial perspective, but it is unlikely to be used from a business venture perspective.

1.3 Once the entrepreneur has set up a company:

- **What could be a typical focus of third party equity investors when they invest in a company in this phase?**

It depends on what type of start-up phase company is expected; however, if promising (with the sufficient possibility of success) a business venture, founders consider their own capital policy carefully. They often induce cash by equity from third-party investors—they do not expect a dividend, but expect a capital gain from a future M&A or IPO.

- **What could typically be the friends', family's and fools' ("FFF") focus? Helping the entrepreneur to get his / her business going?**

When considering the contrast with a professional investor, the FFF may focus on helping an entrepreneur/founder to get his business going. Considering the amount that an FFF can invest, finding other investors, such as individual investors, Angels or venture capitalists is much more important.

- **What could typically be the professional investor's focus?**

Typically, professional investors are interested in a capital gain from an IPO or at the M&A stage, but not a dividend at earlier growing stages. During the growing, beginning or intermediate stages, professional investors usually expect a venture company (and its founder) to use cash in the company to develop the business, and not to distribute dividends.

- **If there is a difference in focus among the various equity investors, how is this typically reflected in the legal relationship (be it corporate or contract law)? Are there legal instruments that are only used by certain investors (e.g., only by professional investors)?**

The Companies Act and other laws regarding contracts do not distinguish between family and outside investors. In equity investment practice, a shareholders agreement or investment agreement will often be made when considering a company's capital structure and each shareholder's interest.

2. Growth phase

In the start-up phase a business idea comes into existence: the idea is put into a business plan, a company is set up, first steps relating to production, service, distribution, sales etc. are made. The growth phase allows potential new investors to better assess not only the viability of business idea, but also the commitment of the people involved. In this phase, the new investors are usually not FFF, but professional investors. As a result, the FFF who invested in the start-up phase are faced with more demanding and skilled potential new co-investors. Against this background:

2.1 In your opinion, does the focus of the equity holders (e.g., the FFF or professional investors) shift in the growth phase (as compared to the start-up phase)?

Assuming that the growth phase means the individual wealth/success investor ("Angel"), he or she is interested in an entrepreneur business's success and capital gain from the investment. The capital gain will be realized by the IPO or M&A of the entrepreneur's business. In contrast, Angels are not usually interested in annual dividends that will be smaller compared to the expected capital gain.

- ***If so, what could be a particular focus for equity holders in the growth phase? Protection from dilution?***

When a company seeks a more sophisticated investor at the maturity stage, it is expected that a company should refrain from relaxed or over-investment at this growth stage. This is because if a company increases its capital by inducing outside (Angel's) investment and their shareholding ratio increases too much, it will become much more difficult at the maturity stage to induce a more sufficient and sophisticated investment. The important issue is a balance of the capital ratio between a founder and outside investor including an Angel (i.e., to maintain a founder's ratio so that it is not too low; otherwise, it will be difficult to seek further bigger investment from venture capitalists at the maturity stage. Preferred shares (details omitted) can be one solution.

- ***In your experience, do the equity investors from the start-up phase participate in further capital rounds in the growth phase? Do they usually accept dilution? Do they usually cash out at this point in time?***

It is normal for new investors to join for further investment. Usually as equity investors from the start-up phase have already invested, they do not have sufficient amounts for additional investment. Although their share ratio will reduce as bigger investors join, they usually do not intend to be cashed out at this timing because their equity value will considerably increase due to future growth.

2.2 In your jurisdiction, does the company law provide existing equity holders protection from being diluted in further financing rounds in the growth phase? If so, how are they protected? Is there a need for equity holders to seek protection on a contractual basis?

Regarding the dilution of shareholders' equity ratio, in a company of which shares are restricted for sale without company approval (depending on its articles of incorporation, but mainly by a board of directors), shareholders can be provided a chance to invest in the company's newly issuing shares per the existing shareholders' equity ratio. However, it is common or for a venture company that seeks further growth to seek investment from an appropriate investor (i.e., business companies that may have a synergy effect, or individual investors).

2.3 When new potential investors offer to come on board during the growth phase, the existing equity holders may be reluctant to provide the information required to satisfy the potential new investor's need for valuation. The reason for the existing shareholders' reluctance may be, for example, that the required information contains (still) unprotected intellectual concepts, knowledge or ideas. In your experience, which legal instruments are used to find a balance between the potential new investor's need for information and the existing equity holders' wish to keep such

information confidential? Do existing equity holders have legal means to prevent management from disclosing such information?

Regarding the confidentiality of intellectual concepts, knowledge or ideas (I assume that this means 'know-how'), if they are key points of the business venture company, then that information is the most necessary information to value the company. I suppose that it will be difficult to persuade investors to invest in the company if the company keeps it confidential. Considering the possibility of a third competitive potential investor canceling its desire to invest after disclosing know-how information, often a non-disclosure agreement is made that prohibits using the information disclosed for any purpose other than investment in the business venture. Unfair competition prevention law, or patent and copyright might work in this context.

3. **Maturity**

During the various capital rounds in the growth phase, the circle of equity investors in a company typically becomes larger and the atmosphere may become less familiar. Also, in the maturity phase the management of the company may become more professional in the sense that there is a management in place which is not, or not significantly, invested in the company (i.e., intensification of the principal-agent-conflict). As a consequence, legal concepts that govern the relationship between equity holders (such as fiduciary duties of majority equity holders) as well as legal concepts that govern the relationship between management and equity holders (such as fiduciary duties of the board members / management, duty of loyalty, principle of equal treatment) may become more important. In other words, corporate governance may become more important. Against this background:

3.1 In your opinion, how does the equity holder base change between the start-up phase, the growth phase and the maturity phase? How does the focus of the equity holders change? Focus on fair distributions of earnings?

Assuming that the maturity stage means that a venture capitalist (professional/fund) starts to invest in the business, this is a big change to the shareholders' structure. Assuming that the founder is seeking an IPO in the near future (or within a few years), in order to induce a healthy outside investor, the founders' share ratio will be lowered by inducing venture capitalist investment. For instance, it will be less than half or considerably less. In addition, at this stage, as the company does not have redundant cash (if it has, it should use it for research & development or marketing), usually investors including Angels and venture capitalists do not expect distribution.

3.2 In your jurisdiction, does the law provide for stricter corporate governance rules for large (privately-held) companies as compared to small companies? If so, what

exactly triggers the application of the stricter corporate governance rules? In which sense are the corporate governance rules different / stricter?

At start-up stage an LLC or a corporation that has simpler governance structure with restriction to sell shares can be within the Companies Act, but considering to go listing (i.e., Maturity stage in this questionnaire) a venture company incorporates a board of directors and statutory auditor under the Act. Some listing companies, pursuing reliability from capital market, changed their governance system to have committees such as board nomination.

3.3 In your jurisdiction, do (certain) equity holders (e.g., majority shareholders) have obligations towards (certain) other shareholders or the company (e.g., duty of loyalty)? Please explain such obligations.

Majority shareholders usually can vote at a shareholders meeting and choose directors at their discretion. However, a resolution of a shareholders meeting can be revoked if the resolution is related to the interest of the major shareholder himself who voted. A share issuance is usually determined by a board of directors, but a share issuance with an unfair price or purpose can be negated under the Act.

3.4 Does the company have any means to control the circle of its equity holders (i.e., can the articles of incorporation prevent competitors from holding shares in the company?) or have such restrictions to be agreed among the other equity holders (e.g., shareholders' agreement)?

It is possible to provide a competitor-restriction clause for a new investor in the articles of incorporation or shareholders or investment agreement, but this is an uncommon practice. Instead, it is more common for founders and existing shareholders to consider and determine on a project-basis when an outside investor offers to invest.

4. **IPO / Listed phase**

Following the IPO, a company enters into a new phase of being listed. The listing has potentially a great influence on the equity holder: the sale of their interest becomes easier. Against this background:

4.1 How does the focus of the shareholders change through the going public as compared to the maturity phase? Does the fact that a shareholder may at any time sell the residual value in its share (ideally) at a fair price in your opinion soften the focus on distribution of earnings? Does the focus shift from long term to short term?

Shareholders in the listed stage will focus more on maintaining share liquidity in the listing (i.e., flexibility to purchase and sell shares at their discretion). In addition, as an ordinary individual investor may join, fair disclosure also becomes more important. Assuming that the fair value of a share in a public market includes the future distribution of earnings, the focus on distribution of earnings may not be strong (in addition, traditionally many listed companies have continued stable annual distribution to increase long-term shareholders). The profit that the founder shareholder of a business venture/target company may enjoy differs depending on the exit scenarios. If M&A, he may enjoy larger values of shares by selling all shares, although if an IPO he will be restricted to selling all shares within a certain period. In addition, as with an IPO, a broad and considerable number of people/entities purchase the shares, and the founder shareholder may enjoy more profit per share than if it were an M&A, where one acquirer purchases the target company.

4.2 In your jurisdiction, are there publicly available records on the identity of (certain of) the shareholders in a listed company? If so, does this in your opinion influence the shareholders' focus?

The names of major shareholders, among others, under detailed conditions will be listed in the listing company's financial report, and a certain number or more percentage of shareholders under other conditions shall submit a report regarding certain increase or decrease of shares. Therefore, shareholder identity can be made publicly available via these reports.

4.3 An efficient allocation of resources requires a most accurate pricing of the shares.

- **In this regard, are companies that are listed in your jurisdiction under an obligation to publish price-relevant information (ad hoc publicity)? If so, please provide a short overview of the respective rules including the exemptions from such obligation.**

A listing company has an obligation to disclose certain information including decisions by a listed company, listed company earnings information, events occurring for a listed company, amendments, etc. to performance estimates or dividend estimates of the listed company, other information, and information regarding subsidiaries. The disclosure obligations are generally under the Financial Instruments and Exchange Act and stock exchange rules.

- **It can be assumed that no jurisdiction requires listed companies to publish all price sensitive information. If this is correct in your jurisdiction, how does the law protect the market and its participants (including, the equity holders in the company) from market abuse? Are there insider trading and market manipulation prohibitions? If so, please provide a short overview and, if you can, provide certain peculiarities about them?**

Market manipulation, the conditions for which are provided in applicable law and discussed in court precedents, is prohibited under the Financial Instruments and Exchange Act. If someone violates the Act, the punishment is 10 years or less imprisonment and/or 10 million yen or less in pecuniary fines. If the violation was committed to gain financial benefit and certain other conditions were met, the punishment is 10 years or less imprisonment and/or 30 million yen or less in pecuniary fines.

5. **Acquisition**

In its life cycle, the company may itself become the object of an acquisition and integration into the acquirer's structure. At this point, the life cycle of the company ends. For the purpose of the remainder of this questionnaire, we assume that the acquirer proceeds via a public tender offer. Against this background:

5.1 In case a listed company (target) is approached by another company (bidder), the board of the target will have to decide whether it supports the offer (friendly offer) or not (unfriendly offer). What are the interests that the board of directors needs to take into consideration for this decision? Shareholders' interests only (e.g., offer price only)? The interests of other stakeholders (employees, community etc.)?

Under the duty of care of a good manager and the duty of loyalty in applicable laws, the board of directors acts to maximize the interest of shareholders; however, other logic can be accepted considering corporate social responsibility.

5.2 In case of an acquisition of the listed company (target) by another company (bidder), the shareholders' are at a disadvantage as they cannot communicate efficiently or act in concert (for example, regarding the rejection of a low offer). A rational bidder should try to use this disadvantage of the shareholders to his benefit. In your jurisdiction, how does the law protect shareholders of the target in case of public tender offers? (for example, is there a specific process for public takeover offers which provides protection? Does the bidder need to treat target shareholders equally? Are there, for example, minimum price rules and/or best price rules?)

If a bidder seeks to purchase the shares of a company that has a continuous disclosure obligation (for instance, where it is listed) (there are certain detailed conditions to apply the TOB regulation; one typical situation, for instance, is where after the purchase the bidder owns more than two thirds of all shares), the bidder shall disclose certain information regarding the shares and provide a selling chance fairly and equally to all shareholders. The minimum price and/or best price rule might not be provided in Japan, but the TOB price can be raised depending on the applicable situation.

5.3 As mentioned above, a listing provides (ideally) liquidity for the company's shares and ensures a high level of information for a potential new investor. In fact, equity investors may invest in listed companies exactly for these reasons. In your jurisdiction, how is an equity investor protected from a delisting? Does the delisting require (qualified) shareholder consent? What are the deadlines for the delisting? Do

issuers need to provide for an off-exchange trading for a certain period following delisting?

If shares in a certain corporation might infringe the delisting standard, in order to have equity investors acknowledged, those shares are categorized as "supervised shares" by a stock exchange in Japan, from the date the stock exchange determined that the shares shall be supervised to the date the stock exchange concluded whether shares are to be delisted. The delisting may occur if (i) a number of shareholders or traded shares fall below certain standards, (ii) there is excess debt, suspension of bank transactions, bankruptcy, reorganization or rehabilitation proceedings, (iii) unfair listing, delay of or false information in a financial report, an opinion that concludes inappropriate by an accounting firm, or others. However the delisting does not require shareholder consent. The category of "supervised shares" means that, although equity shareholders have opportunities to conduct exchange trading, it is expected to be delisted within the period mentioned above.

B. Interest of debt holders

1. Start-up phase

In the start-up phase, the entrepreneur may ask the so called "FFF" (friends, family and fools) for a loan. In other words the entrepreneur asks them to invest in a business idea as debt holders. In this context:

1.1 In your experience, what could be the typical focus of the FFF in this phase? Helping the entrepreneur to get his / her business going? How is this focus reflected in the legal relationship? For example, will such debt holders be likely to refrain from asking for security? Is the agreed interest rate likely to correctly reflect the risks for the debt investor?

It is understood that the FFF also expects company growth. A convertible bond can be proposed, but it is not customarily used due to reasons including the issuing cost. The Japan Finance Corporation ("JFC"), a public corporation wholly owned by the Japanese government, provides an equity-nature loan. The equity-nature loan has equity characteristics although it is a debt, for instance, a long loan term (7 to 15 years), no installment payment (i.e., it will be paid once at the end of the term), a borrower company generates loss is considerably low, the equity-nature loan can be deemed capital for financial institution inspection purposes. A debt-equity-swap ("DES") can be used under Japanese law, but a DES is ordinarily used in a reorganization situation. Regarding whether the agreed interest rate is likely to correctly reflect the risk for the debt investor, as the interest rate is determined between the parties, it is usually considered a fair condition; nevertheless, it depends on how they determined the interest rate.

1.2 In your experience, is it common for professional investors to act as debt holders in this phase? If so, how is the different focus of professional investors typically

reflected in the legal relationship? What are the legal instruments commonly used in your jurisdiction to protect their interests? For example, is it common for the professional investors to request a personal security by the entrepreneur in case the company does not yet have (a lot of) assets to secure a loan?

It is more common for a start-up phase individual investor (Angel) or venture capitalist to provide finance as equity investment, but not by a loan. If a loan, the founder/entrepreneur might provide a personal security (guarantee).

2. Growth phase

2.1 In your experience, who provides debt in this phase and what could typically be their focus (e.g., high return on investment)?

- **Are the debt holders and their focus in the growth phase typically different from the ones in the start-up phase? Is it now mostly professional investors (and no FFF)?**
- **If there is a difference, how could this be reflected in the contractual relationship? For example, do the interest rates or the security for the debt change?**

2.2 What kind of security is commonly request by debt holders in this phase? For example, rather collateral (pledge, etc.) or personal guarantees by the entrepreneur? What is the reason for the preference of a specific kind of security?

Most assets and equity can be provided for security, although they might not be highly valued at this stage. The founder/entrepreneur may provide a personal security (guarantee).

2.3 During the growth phase, the burn rate of the company may be quite high and the company may continuously be at the verge of over-indebtedness. Will investors usually be willing to subordinate their debt? Usually only the entrepreneur / FFF from the start-up phase or also professional investors?

Preferred debt or subordinate debt can be provided depending on the case, but it appears that tailor-made finance has not been so actively used. Considering the future stage where more investors will look to invest, simple finance schemes are preferred.

2.4 Investors providing debt in this phase may wish to keep the possibility to participate in the potential valuation upside. How could this wish be accommodated in your jurisdiction? For example, are profit-participating loans or convertible loans commonly used instruments?

A convertible loan, when assuming a loan with a share acquisition right, is not usually used by a lender business operator in Japan because a business operator who finances others as its business is required to register with the competent authorities. In order to enjoy the potential upside, a convertible bond (bond with stock acquisition rights) can be used; however, this appears to be uncommon in practice. Although may have been also not become standard practice, a convertible note can be used. A convertible note in this context means a note that has stock acquisition rights subject to the following: (i) the timing of the exercise being limited (such as the next wave of finance); (ii) the investor having no right to convert; (iii) the conversion price being capable of change under the conditions of the next financing, and others. However, it is not so common for business venture finance to accumulate loans, bonds, and debt because it may hurt the business entity's balance sheet.

3. Maturity

After having reached maturity, the structure of debt holders may change fundamentally. Against this background:

3.1 In your jurisdiction, who is usually the debt holder in the maturity phase (e.g., banks)?

At this stage, banks can be a debt holder.

- **Are the debt holders and their focus in the maturity phase typically different from the ones in the start-up or growth phase?**

Their focus might not be different from the start-up or growth phases.

- **If there is a difference, how may this be reflected in the contractual relationship?**

3.2 Before providing debt to a company, the potential debt holder may require information about the company's financial status to assess the default risk. What financial information is publicly available for potential new investors who wish to invest in a privately-held company? Are financial statements available from public registers? Excerpt from the debt enforcement register? Tax returns? Do companies have means to influence the amount of publicly available financial information?

A company has an obligation to disclose its financial results (balance sheet and profit and loss statement), although not all non-public companies carry out that obligation in practice. Tax returns are not publicly disclosed. Even if a company discloses the financial results, as they are concise, usually a company discloses further detailed information to a potential loan provider if it requires it.

3.3 In your jurisdiction, is it common for privately-held companies to issue notes? Could you provide a short overview of the requirements and the procedure relating to the issuance of notes? Is the focus of note-holders any different from other debt holders?

It is not customary for privately-held companies to issue bonds (unless a company issues bonds for the shareholders' tax benefit; however, this tax structure is now ineffective due to the amendment of tax laws). In many companies, the board of directors determines whether to issue bonds, but detailed exceptions do exist. It is normal for privately-held companies to issue a promissory note. A promissory-note holder and bond holder are usually given a public trade market, although some other debt (including ordinary loans) can be sold as a market transaction.

4. IPO / Listed

4.1 Once a company is listed, the debt holders have a considerably higher level of information regarding the company's financial situation. One could expect that this reduces the risk for the debt holder. Thus, in your jurisdiction, do listed companies usually have to pay lower interests?

It depends on the company's situation; however, generally, it is easier to enjoy a lower interest rate if a listed company discloses its financial information appropriately.

4.2 In your jurisdiction, is it possible to list notes? Could you provide a short overview of the requirements and the procedure relating to the listing of notes? In your opinion, is the focus of holders of listed notes any different from the focus of other debt holders?

It is possible to list bonds if a company is listed, the bonds satisfy certain requirements of fluidity, among others, and an application to list the bond security is submitted. More fluidity can be expected from listed bonds than other debts.

5. Acquisition

5.1 In your jurisdiction, what is commonly the effect of a public tender offer on listed notes. Do they have to be redeemed? Can holders of listed notes interfere in the process of a public tender offer? If so, by which means?

Listed notes continue through a TOB process, and holders of listed notes do not interfere in the public tender offer process.

5.2 In your jurisdiction, what is the typical influence of a public tender offer on existing credit facilities?

Existing credit facilities continue through a TOB process. The amount of debt may influence the TOB price.

C. Interest of management / employees

1. Start-up phase

In the start-up phase, it is essential that the key management is committed towards the development of the business idea or project. In this context:

1.1 Which are the most commonly used means to ensure that the management / key employees will not leave the company until the company reaches the growth or maturity phase? Are warrants or similar incentives granted during this stage?

Often founders/entrepreneurs hold shares, and a company issues stock options to employees.

1.2 It is likely that at this stage, there are not sufficient funds for remuneration of management / key employees. Is it common to grant warrant or stock incentive schemes in your jurisdiction? Is there any other scheme to liaise with this issue?

It is common for a company to issue stock options to employees.

2. Growth phase

The management plays a crucial role so that the company succeeds in going from the start-up phase to the growth phase; furthermore, it tends to assume considerable risk by devoting itself to such a project. Therefore, it would seem reasonable to protect the management in further financing rounds during the growth phase.

2.1 In case new investors come on board in the growth phase and such investors request replacement of the current management: in such replacement, does the current management usually lose rights granted under an incentive plan? How broad are "bad leaver" provisions usually formulated?

It depends on what conditions are provided in a stock option allotment agreement, but it can be provided that a stock option holder may lose the stock options or that his stock options shall be purchased according to a previously determined calculation.

2.2 Upon implementation of an incentive plan, the rights related to the shares that the management will be entitled to receive are usually subject to vesting. Is there any specific vesting period that is applied in your jurisdiction or is the vesting period usually linked to a liquidation event (such as an IPO)?

A certain type of stock option can enjoy favorable tax treatment (i.e., tax deferral when the option is exercised; and the sold amount (minus the acquisition amount) can be treated as a capital gain (i.e., a lower rate of income tax than salary payment). In order to enjoy the tax treatment, the stock option has several restrictions. For instance, the exercise period begins 2 years to 10 years after the grant date, and the exercise amount does not exceed 12 million yen a year. In order to provide more favorable benefit to employees, other types of stock option such as a paid-stock option or a paid-stock option trust have been developed.

2.3 In certain jurisdictions the management may fall out of a labor relationship since it is developing executive duties for the company and/or may hold certain stock of the company (it might fall in a special labor relationship or corporate relationship). Is this the case in your jurisdiction? If so, is the loss of labor rights compensated by special laws or by contractual means?

In general, the management falls out of the labor relationship, but it depends on the facts and circumstances.

3. Maturity

After having reached maturity, the business activity and the relationship between the shareholders and the management / key employees tend to become more complex (in particular, intensification of the principal-agent-conflict). The increasing complexity triggers certain hindrances or deterrents for the ongoing activity of the company. In this context:

3.1 In your jurisdiction, do the various corporate bodies (e.g., board of directors, directors, management) have

- **an obligation to "act in the best interest of the company"? If so, how is the "interest of the company" defined? Is it the interest of all stakeholders (including the interests of all equity holders (e.g., holder of non-voting shares), debt holders, management, employees and public) or just the shareholders? Are only long term interests taken into account or also short term interests?**

The directors have a duty of care of a good manager and a duty of loyalty. “Interest of the company” usually means shareholders’ interest (i.e., it includes shareholders that have non-voting rights and short-period shareholders). However, others claims that “interest of the company” means to consider broad stakeholders surrounding the company.

- **"fiduciary duties" or a duty to treat equity holders equally? How are these defined?**

Directors have a duty of care of a good manager and a duty of loyalty in Japan.

3.2 In your jurisdiction, how are conflicts of interest addressed by the law? Are the rules on conflicts of interests for listed companies applied to non-listed companies? Have the rules on conflicts of interests become more rigid in recent years?

The Companies Act provides that a certain type of transaction between directors and company (including indirect transaction) shall be approved by the company. Other types of transaction can be restricted by agreement between director and a company.

3.3 In your jurisdiction, is it common to put in place incentive plans for key management and employees or are they only entitled to receive a cash bonus (usually based on individual and overall performance)? Do incentive plans provide tax advantage for the company?

A cash bonus as an incentive plan can be established, although a non-cash rich company prefers stock options. Regarding such an incentive, a company can treat the payment as cost for tax purposes (i.e., it is acceptable for a company). Both the management and employees enjoy the benefit of receiving cash, but it will be taxed as salary income regarding which the tax rate is usually high (around 50% or more in total).

4. IPO/ Listed phase

Reaching an IPO is often the pinnacle of private companies that have reached certain growth and have an attractive equity interest. Obviously, the management and employees play a significant role in the IPO/listing process. In this context:

4.1 It is our understanding that when a company goes from a private to a public setting it implies considerable changes for management and employees. In your experience and within this framework, what is the most significant change for management and employees? Does going public usually increase the total amount of the compensation and/or does it usually change the structure of the compensation (cash, shares, warrants, etc.)?

Under the strict disclosure obligation and prohibition of unfair trading such as insider trading, it can be customarily considered that a public company is socially reliable; further, a public company may be advantageous from a human resources aspect to source good employees. It is not certain that the total compensation amount will change or that the compensation structure will change before and after the listing.

4.2 Following the IPO the management is constantly assessed by the performance of the share price. Also the management's pay may to large extent depend on the share price performance. One could expect that management may abstain from taking any steps that are likely to weaken the share price – even if such steps are beneficial to the company in long term. In your jurisdiction, are there any measures that are

commonly taken to address this conflict (i.e., incentives for long term strategies)? Is, for example, by law or by agreement a part of the pay paid in mid- to long term options?

Under the strict disclosure rules, even disadvantageous information shall be disclosed. It depends on the company, but some may provide long-term incentives to management, for instance stock options or cash payment, under the Companies Act or agreement.

4.3 Is the management and/or employees bound by a mandatory lock up period upon the IPO? In the event the lock up period is not mandatory, please explain the common standards in your jurisdiction towards implementing a lock up period.

The lock-up period for management and major shareholders is usually six months.

5. Acquisition

In the scenario of the acquisition, it is frequent that the management is essential towards the subsequent development of the company. In this context:

5.1 The focus of the board of directors of a listed company may be set to a large extent on the share price performance. Usually, this should be in line with the corporate interest. However, in case a listed company is being approached by a potential bidder, the board of directors and the management of the potential target may face a conflict of interest: an acquisition that may be beneficial to the shareholders of the potential target, may at the same time require replacement or adjustment of the target's board of directors and management. In your jurisdiction, how is this conflict of interest addressed? For example, are there limits to the defense measures that the board of directors of the target may take?

Regarding the issue that the board of directors and the management of the potential target may face a conflict of interest, where an acquisition may be beneficial to the shareholders of the potential target, this may simultaneously require replacement or adjustment of the target's board of directors and management, where the TOB management provides its opinion to the ongoing TOB. If M&A, there is no explicit procedure; however, an acquirer explains to managers who the acquirer wishes to remain in the company and asks them to stay on certain periods.

5.2 Which are the common alternatives in order to keep management / key employees focused and keen to continue in the company?

It depends on the situation; however, in general, not only financial incentives but also the company's business not getting worse and their posts being maintained are important.

5.3 In parallel, is it common to reinforce non-competition and confidentiality undertakings of the management / key employees upon acquisition? Is it common to regulate a non-solicitation by the Seller and that it is enforceable (for which period)?

TOB is a procedure to purchase a listed company's share, so it is not common to reinforce non-competition and confidentiality of the management and key employees. If it is necessary, it can be amended after the TOB. If M&A (share purchase or asset deal), often the seller is restricted from soliciting or conducting a competing business, for instance for 1 to 2 years.

D. Interest of advisors / lawyers

1. Startup

During the startup phase, it is one of the most difficult stages to advice companies and/or projects since the company does not have the resources (funds) to implement an appropriate legal scheme and the management/equity holders tend to think in the short term rather than the long term.

1.1 Which are the common difficulties you liaise with during this stage? How do you tend to structure your fees (for example, do you go below your standard rates and agree to have this difference compensated at a later stage when the company has become more successful)?

As a company during the start-up phase does not have enough cash for administrative issues, it is often lawyers who also accept discount rates. However, business venture support is not easy because, in general, the start-up phase includes many legal issues, and no internal rules and regulations have been drafted, and only a few people belong to the legal department. A long-term agreement (i.e., being paid later) is possible, but it may not work because a company may suspend its agreement with professionals.

1.2 In case you accept warrants / rights to shares as compensation for professional services rendered: how do you set the amount or the value of such warrants and rights? Do you rely on valuations of the company? If so, whose valuations? Is it common for an advisor in this situation to request that the company has previously successfully completed a minimum viable product ("MVP") stage which reduces the risk of failure (i.e., as part of the lean startup methodology it is advisable to diminish uncertainty for the project by means of developing an MVP to validate the project)?

To receive stock options instead of cash as a legal fee is possible, but it is still not ordinary practice. It is not practicable to take the valuations of outside professionals for attorney payment purposes.

2. Growth

Commonly, it is important to provide appropriate legal advice when the company intends to achieve going from the start-up phase to a growth phase. The role of lawyers and advisors would likely enhance the possibilities to effectively reach a solid growth phase. In this context:

2.1 How do you tend to structure your fees during this stage (in particular, is there a difference in the fee structure as compared to the start-up phase)?

It is uncertain whether the structure changes, but it is possible if the company succeeded in being financed by an Angel or venture capitalist.

2.2 Is it common for advisors (in particular, lawyers) to take board positions during this phase? If so, how is such board member compensated? In cash? Or with exclusivity for providing legal services to the company?

Regarding lawyers, it is not common for legal counsel to assume a board position at the same time due to legal and ethical regulation in Japan.

2.3 As the lawyer you may be asked by the entrepreneur to render advice on the division of equity (in particular to FFF)? What is the basis for your advice regarding the division of equity?

If this means compensation by shares as a legal fee, it is not ordinary practice but it is possible. Nevertheless, considering insider trading regulation, it may be difficult to monetize equity at the receiving lawyer's discretionary timing.

2.4 In certain jurisdictions corporate law is rigid and does not allow to regulate certain rights of the shareholders in the by-laws of the company (such as, preferential preemptive rights, drag along or tag along rights). Please explain (succinctly) which is corporate legal scheme that applies in your jurisdiction. Is the shareholders agreement enforceable against third parties in your jurisdiction or is only binding between the relevant shareholders?

Generally, a shareholders agreement provides for shares, governance, and other matters. The agreement is effective between parties to the agreement and binds them only.

3. Maturity

After having reached maturity, the business activity is much more complex and the interests of the company become more intricate. In this context:

3.1 How do you tend to structure your fees during this stage (in particular, is there a difference in the fee structure as compared to the start-up or growth phase)?

It depends on the situation. It can change to an ordinary hourly-rate charging system.

3.2 Are you able to become member of the board of directors of the companies? Do you tend to render more unique advice to companies (while the corporate counsel provides the typical ongoing corporate advice)?

Usually, corporate counsel does not become a director of the same company.

3.3 From a lawyers' perspective, how is the conflict of interest of the management liaised with (are there any mandatory provisions that apply in your jurisdiction)?

Usually, corporate counsel does not become a director of the same company.

3.4 Does the anti-money laundering provisions in your jurisdiction have changed the form your render advice?

Client identification shall be confirmed under applicable laws and regulations.

4. IPO/ Listed phase

Reaching an IPO is often the pinnacle of private companies which have reached certain growth and have an attractive equity interest. It is unlikely that the process of becoming a listed company will be successful without the proper advice. In this context:

4.1 How do you structure your fees for an IPO?

It depends on the case, but a fixed-amount payment with an additional extra-charge system is often used.

4.2 From a lawyers' perspective, which are the main regulatory aspects of offering equity to the public? Is it common that companies reach this stage (in certain jurisdictions becoming a listed company is less rigid)?

Some companies decrease their share prices immediately after listing, and they are not raised thereafter. Some companies have disclosed price-decreasing information or committed disclosure violation immediately after the listing. (Except for the last example) they may conduct the remainder under the laws and regulations, but such examples may infringe public investors' reliability on the public market. Lastly, it is not common for a company to reach the IPO stage.

4.3 Is there any specific secondary market in your jurisdiction that allows early startup companies to become listed with the aim of obtaining more equity (given the complexity of becoming a public company in certain jurisdictions a startup company can become listed in a specific market which is less rigid and allow it to obtain other sources of financing, among others)?

There are several markets for listing companies; however, the secondary or third market might not meet the requirement in this question.

4.4 Does the fact of becoming a listed company imply that the lawyers and/or advisors adjust rates their rates accordingly?

The lawyers' fee rates can be raised accordingly, but this often happens when a company changes and hires more sophisticated lawyers.

5. Acquisition

In the scenario of the acquisition, it is frequent that lawyers and advisors are highly involved. In this context:

5.1 Which is most frequent scheme of implementing an acquisition (asset deal vs share purchase deal)?

It depends on the facts and circumstances in each case. A share purchase deal will be a much simpler transaction than an asset deal, but the acquirer may assume the target company's potential liability or risk. An asset deal may (at least logically) carve out unexpected potential liability because transaction parties may choose which rights and obligations are to be transferred, although it may take a long time to analyze each asset and follow a transfer procedure for each of them.

5.2 From a lawyers' perspective, which are the main differences within the process of acquiring a stake in listed companies versus private companies?

If acquiring shares in listed companies, you should take careful note of the timely disclosure obligation and insider trading issues.

5.3 From a lawyers' perspective, which are the main steps in your jurisdiction in order that a public entity becomes a private entity as a consequence of an acquisition?

A listed company bears a strict timely disclosure obligation, and it is sometimes difficult to change a company's business drastically—including a change of focus and closing main stores—because a listed company has many, relatively small share ratios, and multiple types of shareholders. A delisting scheme is sometimes used to conduct a drastic change of business where a single fund owns the major shares of the company. A company may be delisted if it satisfies list revocation conditions or a company applies to delist.

5.4 How do you tend to structure your fees during this stage (in particular, is there a difference in the fee structure as compared to other phases)?

It depends on the case. Both the hourly-rate basis and a fixed fee with additional charge when billable hours exceed a certain threshold are used.